investor's guide

MUNICIPAL BONDS




THE GMS GROUP

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WHAT ARE MUNICIPAL BONDS?

Municipal bonds are debt obligations issued by states, cities, counties and other governmental entities, which use the money to build schools, highways, hospitals, sewer systems and many other projects for the public good.

When you purchase a municipal bond, you are lending money to a state or local government entity, which in turn promises to pay you a specified amount of interest (usually paid semiannually) and return the principal to you on a specific maturity date.

Not all municipal bonds offer income exempt from both federal and state taxes. There is an entirely separate market of municipal issues that are taxable at the federal level, but still offer a state — and often local — tax exemption on interest paid to residents of the state of issuance.

Most of this booklet refers to municipal bonds that are exempt from federal taxes. See page 8 for more about taxable municipal bonds.

AN INVESTMENT FOR TODAY'S TAX-CONSCIOUS INVESTOR

Tax-exempt municipal bonds are among the most popular types of investments available today - and with good reason. They offer a wide range of benefits, including:

- attractive current income free from federal and, in some cases, state and local taxes;
- a high degree of safety with regard to payment of interest and repayment of principal;
- a predictable stream of income;

- a wide range of choices to meet your investment objectives regarding investment quality, maturity, choice of issuer, type of bond and geographical location; and
- marketability in the event you must sell before maturity.

HOW SAFE ARE MUNICIPAL BONDS?

When you invest in a municipal bond, your primary concern should be the issuer's ability to meet its financial obligations. Issuers of municipal bonds have a record of meeting interest and principal payments in a timely manner. Issuers disclose details of their financial condition through "official statements" or "offering circulars," which are available through the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) portal at http://emma.msrb.org. They may also be obtained from your bank, brokerage firm, or on the Internet. Issuers also provide continuing disclosure about their financial condition. You may also contact the issuer or visit the issuer's web site for updated or current information.

Another way to evaluate an issuer is to examine its credit rating. Many bonds are graded by ratings agencies such as Moody's Investors Service, Standard & Poor's and Fitch Ratings. A number of banks and brokerage firms have their own municipal bond research departments. Bond ratings are important benchmarks because they reflect a professional assessment of the issuer's ability to repay the bond's face value at maturity.

Generally, bonds rated BBB (Standard & Poor's and Fitch) or Baa (Moody's) or better are considered "Investment Grade," suitable for preservation of investment capital.

CREDIT RATINGS

		MOODY'S	STANDARD & POOR'S	FITCH
INVESTMENT GRADE	Strongest	Aaa	AAA	AAA
	↓	Aa	AA	AA
		A	A	A
		Baa	BBB	BBB
NON-INVESTMENT GRADE		Ba	BB	BB
		B	B	B
		Caa	CCC	CCC
	↑	Ca	CC	CC
		C	C	C
	Weakest	C	D	D

Credit ratings, however, should not be the sole basis for any investment decision. Before purchasing bonds, talk with your investment advisor to make sure they're suitable for you.

Tax-exempt municipal bonds offer you the chance to maximize your after-tax return consistent with the amount of risk you're willing to accept. In general, as with any fixed-income investment, the higher the yield, the higher the risk.

THE ADVANTAGES OF TAX EXEMPTION

Under present federal income tax law, the interest income you receive from investing in municipal bonds is not subject to federal income taxes.* In most states, interest income received from securities issued by governmental units within that state is also exempt from state and local taxes. In addition, interest income from bonds issued by U.S. territories and possessions is exempt from federal, state and local income taxes in all 50 states.

* *If you are subject to the Alternative Minimum Tax (AMT), you may have to include interest income from certain municipal securities in calculating your income tax.*

One of the best ways to appreciate the tax-exempt advantage of a municipal bond is to compare it to a taxable investment. For example, assume you are in the 33% federal tax bracket, file a joint return and with your spouse, claim $230,000 in taxable income.

Now assume you have $30,000 to invest and you are considering two alternative investments: a tax-exempt municipal bond yielding 3.0% and a taxable corporate bond yielding 4.0%. Which investment will prove most advantageous in terms of after-tax income?

If you invest your money in the municipal bond, you would earn $900 in interest (a 3.0% yield) and not pay any federal income taxes. As noted in the table below, the taxable bond investment, however, would provide you only $804 in income after federal income taxes had been deducted (a 2.7% yield).

EFFECT OF FEDERAL INCOME TAXES ON YIELDS OF TAX-EXEMPT AND TAXABLE INSTRUMENTS

	3.0% TAX-EXEMPT BOND	4.0% TAXABLE BOND
CASH INVESTMENT	$ 30,000	$ 30,000
INTEREST	$ 900	$ 1,200
FEDERAL INCOME TAX IN THE 33% MARGINAL TAX BRACKET	$ 0	$ 396
NET RETURN	$ 900	$ 804
YIELD ON INVESTMENT AFTER TAXES	3.0%	2.7%

As you can see, the municipal bond would provide the better yield after taxes are taken into account. The tax-exempt bond yield advantage would be an even better investment if you accounted for state and local income taxes when calculating returns on the taxable bond investment.

To determine the yield you would need to earn from a taxable investment to equal the yield on a tax-exempt security, refer to the chart on pages 12 and 13.

UNDERSTANDING YIELDS

Basically, there are two types of bond yields: current yield and yield to maturity. Current yield is the annual return on the dollar amount paid for a bond. Yield to maturity is the rate of return you receive by holding a bond until it matures. It equals the interest you receive from the time you purchase the bond until maturity, plus any gain or loss depending on whether the bond's value has increased or decreased.

Tax-exempt yields are usually stated in terms of yield to maturity, with yield expressed at an annual rate. If you purchase a bond with a 6.0% coupon at par, its yield to maturity is 6.0%. If you pay more than par, the yield to maturity will be lower than the coupon rate. If purchased below par, the bond will have a yield to maturity higher than the coupon rate. When the price of a tax-exempt bond increases above its par value, it is said to be selling at a premium. When the security sells below par value, it is said to be selling at a discount.

UNDERSTANDING MARKET RISK

Whether a bond pays the investor a fixed interest rate (also known as the coupon rate), which cannot be changed during the life of a bond, or a variable interest rate, the market price of a municipal bond will vary as market conditions change. If you sell your municipal bonds prior to maturity, you will receive the current market price, which may be more or less than the original price depending on prevailing interest rates at the time of sale. So, for example, a municipal bond issued with a 5.0% coupon will sell at a premium if interest rates at the time of sale are below 5.0%. Consequently, it is important to understand that municipal bond prices fluctuate in response to changing interest rates: prices increase when interest rates decline, and prices decline when interest rates rise.

It's easy to understand the reasons:

- when interest rates fall, new issues come to market with lower yields than older securities, making the older securities worth more, hence the increase in price; and
- when interest rates rise, new issues come to market with higher yields than older securities, making the older ones worth less; hence the decline in price.

UNDERSTANDING CALLS

Many bonds allow the issuer to call — or retire— all or a portion of the bonds at a premium, or at par, before maturity. When buying bonds, be sure to ask your investment advisor about call provisions, and the difference between the yield to call and the yield to maturity.

GAINS AND LOSSES

If you sell a municipal bond for a profit before it matures, you may generate capital gains. Long-term capital gains (which require a 12-month holding period) resulting from the sale of tax-exempt municipal bonds are currently taxed at a maximum rate of 20%. Of course, if you sell your security for less than your original purchase price, you may incur a capital loss. Under current law, up to $3,000 of net capital losses can be used annually to reduce ordinary income. Capital losses can be used without limit to reduce capital gains. A municipal bond purchased at a premium or a discount and called or sold before maturity is subject to special rules. Since tax laws frequently change, consult with your tax lawyer or accountant for up-to-date advice.

TYPES OF TAX-EXEMPT MUNICIPAL BONDS

Municipal securities consist of both short-term issues (often called notes, which typically mature in one year or less) and long-term issues (commonly known as bonds, which mature in more than one year). Short-term notes are used by an issuer to raise money for a variety of reasons: in anticipation of future revenues such as taxes, state or federal aid payments, and future bond issuances; to cover irregular cash flows; meet unanticipated deficits; and raise immediate capital for projects until long-term financing can be arranged. Bonds are usually sold to finance capital projects over the longer term.

The two basic types of municipal bonds are:

General obligation bonds. Principal and interest are secured by the full faith and credit of the issuer and usually supported by either the issuer's unlimited or limited taxing power. In many cases, general obligation bonds are voter-approved.

Revenue bonds. Principal and interest are secured by revenues derived from tolls, charges or rents from the facility built with the proceeds of the bond issue. Public projects financed by revenue bonds include toll roads, bridges, airports, water and sewage treatment facilities, hospitals and subsidized housing. Many of these bonds are issued by special authorities created for that particular purpose.

BONDS WITH SPECIAL INVESTMENT FEATURES

Variable rate bonds. The interest rate of these bonds is calculated periodically, and is typically based upon a percentage of prevailing rates for Treasury bills and other interest rates.

Put bonds. Some bonds have a "put" feature which allows you to sell the bond at par value on a specified date before its maturity date and recoup the principal and accrued interest.

Zero-coupon, compound-interest and multiplier bonds. These are issued at a deep discount to the maturity value and do not make periodic interest payments. At maturity, an investor will receive one lump sum payment equal to principal invested, plus interest compounded semiannually at the original interest rate. Because they do not pay interest until maturity, the prices of these bonds tend to be volatile. These bonds may be attractive if you seek to accumulate capital for a long-term financial goal such as retirement planning or college costs.

Insured municipal bonds. Some municipal bonds are backed by municipal bond insurance specifically designed to reduce investment risk. In the unlikely event of payment default by the issuer, an insurance company, which guarantees payment, will send you both interest and principal when they are due.

TAXABLE MUNICIPAL BONDS

There are situations in which a governmental issuer will sell taxable municipal bonds because the federal government will not subsidize the financing of certain activities that do not provide a significant benefit to the general public. Investor-led housing, local sports facilities, refunding of a refunded issue and borrowing to replenish a municipality's underfunded pension plan are just four examples of bond issues that are federally taxable. Taxable municipals offer yields that are more comparable to those of other taxable sectors, such as corporate bonds or bonds issued by U.S. governmental agencies, than to those of tax-exempt municipals. The growth of the taxable municipal market in recent years has been astounding. In the last four years alone, over $321.5 billion in taxable municipals have been issued.

OTHER BASIC FACTS

Interest payments. Usually, interest on a long-term bond is paid semiannually, while interest on short-term notes is paid at maturity.

Form of issuance. Municipal bonds are issued in registered form only, which means that the investor's name is registered on the issuer's, or its agents', books. Virtually all municipal bonds today are issued in "book-entry" form, in which an investor's ownership is recorded through data entry at a central clearinghouse. In addition, the bank or investment firm will provide the investor with a confirmation that is a written record of the transaction. With book-entry securities, physical transfer of certificates is not necessary. Registered and book-entry bonds offer a number of protections and conveniences to bondholders, including protection from loss or theft, automatic payment of interest, notification of calls and ease of transfer. Before July 1983, municipal securities, for the most part, were issued in certificate form with coupons attached. Some of these so-called "bearer bonds" are still available in the marketplace. The issuer has no record of who owns these bonds. The owner clips the coupons and collects the interest from the issuer's paying agent. Transferring bearer bonds requires physical delivery and payment.

Minimum investment. Most municipal notes and bonds are issued in minimum denominations of $5,000 or multiples of $5,000.

Payment terms. Dealers are required by the Securities and Exchange Commission to receive payment for a securities purchase and to make payment for a securities sale no later than the third business day following the date of the trade.

Where to find listed prices. The Electronic Municipal Market Access (EMMA) system (http://emma.msrb.org) and investinginbonds.com provide real-time and historical trade data for municipal bonds. Additionally, you can find information on the internet through various individual investor web sites. Because the prices are typically based on $1 million lots and reflect a volume discount, prices on purchases and sales of smaller amounts may differ according to the size of the order. You can also receive price quotes from a municipal securities broker-dealer.

Marketability. Holders of municipal securities can sell their notes or bonds through one of the many banks and securities dealer firms that are registered to buy and sell municipal securities.

Reporting requirements. All tax-exempt interest must be reported on tax returns. This is simply a reporting requirement and does not affect the tax-exempt status of the security.

What are the costs of investing in municipal bonds? Municipal securities are bought and sold between dealers and investors much like other debt instruments. The price an investor pays for a municipal security includes a dealer's own spread, or profit, on the transaction.

THE TAX-EXEMPT MUNICIPAL BOND MARKET— HOW BIG AND WHO BUYS?

Outstanding state and local debt obligations totaled $3.71 trillion as of December 31, 2012*. The largest owners of tax-exempt securities are individuals, mutual and money market funds, property and casualty insurance companies and commercial banks.

TAX-EXEMPT/TAXABLE YIELD EQUIVALENTS

The table on the following page will help you determine the amount of income you require from a taxable investment to equal the yield on a tax-exempt bond. The table is for illustrative purposes only and is not intended to be representative of any specific security. To use the table most effectively, follow the directions in italics at the left side of the chart.

*Source: Thomson Reuters.

TAX-EXEMPT/TAXABLE 2013

HOW TO USE THIS CHART

1. Find the appropriate return (single or joint).

2. Determine your tax bracket by locating the taxable income category that you fall into. Taxable income is income after appropriate exemptions and deductions are taken. (The table does not account for special provisions affecting federal tax rates, such as the Alternative Minimum Tax.)

3. The numbers in the column under your tax bracket give you the approximate taxable yield equivalent for each of the tax-exempt yields in the near left column.

Example: If you are single and have a taxable income of $90,000 ($150,000 if married), you would fall into the 28% tax bracket. According to the table, you would need to earn 6.94% on a taxable security to match a 5% yield from a tax-exempt security.

SINGLE RETURN	$0-$8,925	$8,926–$36,250
JOINT RETURN	$0-$17,850	$17,851–$72,500
TAX BRACKET	10%	15%
TAX-EXEMPT YIELDS (%)		
1.0%	1.11%	1.18%
1.5	1.67	1.76
2.0	2.22	2.35
2.5	2.78	2.94
3.0	3.33	3.53
3.5	3.89	4.12
4.0	4.44	4.71
4.5	5.00	5.29
5.0	5.56	5.88
5.5	6.11	6.47
6.0	6.67	7.06
6.5	7.22	7.65
7.0	7.78	8.24
7.5	8.33	8.82

* The income brackets to which the tax rates apply are adjusted annually for inflation. Those listed above are for 2013.

YIELD EQUIVALENTS
TAX YEAR

TAXABLE INCOME*					
$36,251– $87,850	$87,851– $183,250	$183,251– $398,350	$398,351– $400,000	$400,001 & OVER	Effective Tax Rate for
$72,501– $146,400	$146,401– $223,050	$223,051– $398,350	$398351– $450,000	$450,001 & OVER	High Income Taxpayers
25%	28%	33%	35%	39.6%	40.6%**
TAXABLE YIELD EQUIVALENTS (%)					
1.33%	1.39%	1.49%	1.54%	1.66%	1.68%
2.00	2.08	2.24	2.31	2.48%	2.53%
2.67	2.78	2.99	3.08	3.31%	3.37%
3.33	3.47	3.73	3.85	4.14%	4.21%
4.00	4.17	4.48	4.62	4.97%	5.05%
4.67	4.86	5.22	5.38	5.79%	5.89%
5.33	5.56	5.97	6.15	6.62%	6.73%
6.00	6.25	6.72	6.92	7.45%	7.58%
6.67	6.94	7.46	7.69	8.28%	8.42%
7.33	7.64	8.21	8.46	9.11%	9.26%
8.00	8.33	8.96	9.23	9.93%	10.10%
8.67	9.03	9.70	10.00	10.76%	10.94%
9.33	9.72	10.45	10.77	11.59%	11.78%
10.00	10.42	11.19	11.54	12.42%	12.63%

** The Internal Revenue Code phases out a portion of the personal exemption deduction, and reduces certain itemized deductions, for taxpayers with adjusted gross income in excess of $300,000 (married, filing jointly) and $250,000 (single). In general, the limit on itemized deductions will increase the effective marginal tax rate by 0.33% and the personal exemption phaseout will increase the effective marginal tax rate by 0.3% for each exemption claimed.

STATE TAXATION OF MUNICIPAL BONDS FOR INDIVIDUALS

STATE	STATE'S OWN BONDS	OTHER STATES' BONDS
Alabama		X
Alaska (no tax)		
Arizona		X
Arkansas		X
California Income		X
Colorado		X
Connecticut		X
Delaware		X
District of Columbia		
Florida		
Georgia		X
Hawaii		X
Idaho		X
Illinois	X(2)	X(2)
Indiana		X (4)
Iowa	X(2)	X
Kansas		X
Kentucky		X
Louisiana		X
Maine		X
Maryland		X
Massachusetts		X
Michigan		X
Minnesota		X
Mississippi		X
Missouri		X
Montana		X
Nebraska	X	X
Nevada (no tax)		
New Hampshire		X
New Jersey		X
New Mexico		X
New York		X
North Carolina		X
North Dakota		X(3)
Ohio		X
Oklahoma	X(2)	X(2)
Oregon		X
Pennsylvania		X
Rhode Island		X
South Carolina		X
South Dakota (no tax)		
Tennessee		X
Texas (no tax)		
Utah	X(2)	X(1)(2)
Vermont		X
Virginia		X
Washington (no tax)		
West Virginia		X
Wisconsin	X(2)	X(2)
Wyoming (no tax)		

Bonds are designated "X" if taxable. All others are exempt or excluded from tax, or no income taxes are levied by those states. In certain cases, these designations pertain only to general obligation bonds, or to bonds in general. For example, a state may not generally exempt bonds, but some bonds may be specifically exempted by the laws authorizing their issuance.

(1) Income earned from a bond issued by another state is taxable only if such other state imposes a tax on Utah bonds.
(2) Interest from some obligations is exempt from tax.
(3) Taxable only if long form is used.
(4) Only for bonds acquired after 12/31/11.

STATE TAXATION OF MUNICIPAL BONDS FOR CORPORATIONS

STATE	STATE'S OWN BONDS	OTHER STATES' BONDS
Alabama		X
Alaska (no tax)		
Arizona		X
Arkansas		X
California Income		X
Colorado		X
Connecticut	X	X
Delaware		X
District of Columbia		X
Florida	X	X
Georgia		X
Hawaii		X
Idaho		X
Illinois	X(6)	X(6)
Indiana		X(7)
Iowa	X(6)	X
Kansas		X
Kentucky		X
Louisiana		
Maine		X
Maryland		X
Massachusetts	X	X
Michigan		X
Minnesota	X	X
Mississippi		X
Missouri		X
Montana	X(6)	X
Nebraska		X
Nevada (no tax)		
New Hampshire		
New Jersey	X	X
New Mexico		X
New York (8)	X	X
North Carolina		X
North Dakota		X
Ohio		
Oklahoma	X(6)	X
Oregon		X
Pennsylvania		
Rhode Island		X
South Carolina		X
South Dakota		
Tennessee	X	X
Texas		
Utah	X	X
Vermont		X
Virginia		X
Washington (no tax)		
West Virginia	X(5)	X
Wisconsin	X(6)	X
Wyoming (no tax)		

(5) Pro-rata adjustment is allowed.
(6) Interest on some obligations is exempt by law.
(7) Only for bonds acquired after 12/31/11.
(8) Interest on U.S. obligations and obligations of all states would not be taxable if the investment allocation percentage is zero. Otherwise, the interest is taxable at the investment allocation percentage.
Source: The information shown above is derived from the *State Tax Guide*, published and copyrighted by Commerce Clearing House, Inc., 4025 W. Peterson Ave., Chicago, Illinois 60646. Reflects law through May, 2013.

Glossary

Advance refunding. A financing structure under which new bonds are issued to repay an outstanding bond issue prior to its first call date. Generally, the proceeds of the new issue are invested in government securities, which are placed in escrow. The interest and principal repayments on these securities are then used to repay the old issue, usually on the first call date.

Bid. The price at which a buyer offers to purchase a security.

Bearer security. A security that is not registered in the name of an owner. As a result, it is presumed to be owned by the bearer or the person who holds it. Bearer securities are freely and easily negotiable, since ownership can be quickly transferred from seller to buyer.

Bond funds. Registered investment companies whose assets are invested in diversified portfolios of bonds.

Bond swap. The sale of a block of bonds and the purchase of another block of similar market value. Swaps may be made to achieve many goals, including establishing a tax loss, upgrading credit quality, extending or shortening maturity, etc.

Callable bonds. Bonds that are redeemable by the issuer prior to the specified maturity date at a specified price at or above par.

Call premium. The dollar amount over par that an issuer pays to an investor when a bond is called for redemption prior to maturity. Usually stated as a percentage of the principal amount called.

Coupon. This is the amount of interest due and the date on which payment is to be made. In the case of registered coupons (see **"Registered bond"**), the interest payment is mailed directly to the registered holder. Bearer coupons are presented to the issuer's designated paying agent or deposited in a commercial bank for collection. Coupons are generally payable semiannually.

Current refunding. A financing structure under which old bonds are called or mature within 90 days of the issuance of new refunding bonds.

Current yield. The ratio of interest to the actual market price of the bond stated as a percentage. For example, a $1,000 bond that pays $80 per year in interest would have a current yield of 8%.

CUSIP. The Committee on Uniform Security Identification Procedures, which was established under the auspices of the American Bankers Association to develop a uniform method of identifying municipal, U.S. government, and corporate securities. When issued, each bond is assigned a unique CUSIP number consisting of nine alphanumeric characters.

Dated date (or issue date). The date of a bond issue from which the bondholder is entitled to receive interest, even though the bonds may actually be delivered at some other date.

Default. Failure to pay principal or interest when due.

Discount. The amount by which the purchase price of a bond is less than the principal amount or par value.

Double exemption. Bonds that are exempt from both state and federal income taxes.

Extraordinary redemption. This redemption is different from optional redemption or mandatory redemption in that it occurs under an unusual circumstance such as destruction of the facility financed.

Face amount. The par value (i.e., principal or maturity value) of a security appearing on the face of the instrument.

Fixed-rate bond. A long-term bond with an interest rate fixed to maturity.

Interest. Compensation paid or to be paid to borrow money, generally expressed as an annual percentage rate.

Issuer. A state, political subdivision, agency or authority that borrows money through the sale of bonds or notes.

Legal opinion. A letter from a law firm concerning the validity of a municipal bond with respect to statutory authority, constitutionality, procedural conformity and usually the exemption of interest from federal income taxes. The legal opinion is usually rendered by a law firm recognized as specializing in public borrowings, often referred to as "bond counsel."

Limited tax bond. A bond secured by a pledge of a tax or category of taxes limited as to rate or amount.

Marketability. A measure of the ease with which a security can be sold.

Maturity. The date when the principal amount of a security becomes due and payable.

Moral obligation bond. A revenue bond which, in addition to its primary source of security, possesses a structure whereby an issuer pledges to make up shortfalls in a debt service reserve fund, subject to legislative appropriation. While the issuer does not have a legal obligation to make such a payment, the failure of the issuer to honor the moral pledge would have negative consequences for its creditworthiness.

Non-callable bond. A bond that cannot be called either for redemption by the issuer before its specified maturity date.

Notes. Short-term bonds to pay specified amounts of money, secured by specified sources of future revenues, such as taxes, federal and state aid payments and bond proceeds.

Offering price. The price at which members of an underwriting syndicate for a new issue will offer securities to investors.

Official statement. The disclosure document prepared by the issuer that gives in detail security and financial information about the issuer and the bonds or notes.

Optional redemption. A right of the issuer, at its option, to retire all or part of an issue prior to the stated maturity during a specified period of years, often at a premium.

Original issue discount. A bond, issued at a dollar price less than par which qualifies for special treatment under federal tax law. Under that law, the difference between the issue price and par is treated as tax-exempt income rather than a capital gain, if the bonds are held to maturity.

Par value. The principal amount of a bond or note due at maturity.

Paying agent. Place where principal and interest are payable. Usually a designated bank or the office of the treasurer of the issuer.

Premium. The amount by which the price of a security exceeds its principal amount.

Principal. The face amount of a bond, exclusive of accrued interest and payable at maturity.

Ratings. Designations used by rating services designed to give relative indications of credit quality.

Registered bond. A bond whose owner is registered with the issuer or its agent either as to both principal and interest or as to principal only. Transfer of ownership can only be accomplished when the securities are properly endorsed by the registered owner.

Special tax bond. A bond secured by a special tax, such as a gasoline tax.

Trade date. The date when a bond transaction is executed.

Trustee. A bank designated by the issuer as the custodian of funds and official representative of bondholders. Trustees are appointed to ensure compliance with the trust indenture and represent bondholders to enforce their contract with the issuers.

Unlimited tax bond. A bond secured by the pledge of taxes that are not limited by rate or amount.

Variable rate bond. A long-term bond the interest rate of which is adjusted periodically, typically based upon specific market indicators.

Yield to call. A yield on a security calculated by assuming that interest payments will be paid until the call date, when the security will be redeemed at the call price.

Yield to maturity. A number that gives the investor the average annual yield on a security. It is based on the assumption that the security is held to maturity and that all interest received over the life of the security can be reinvested at the yield to maturity.

Zero-coupon bond. A bond for which no periodic interest payments are made. The investor receives one payment at maturity. The maturity value an investor receives is equal to the principal invested plus interest earned compounded semiannually at the original interest rate to maturity.

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