

such as where you live and the amount of your other income. Janney suggests that you discuss any tax issues with your Janney Financial Consultant as well as with your own tax adviser.

Bond Pricing

When compared to equities, investors will find it is frequently more difficult to obtain good pricing information on many bonds. Municipal bonds are particularly challenging since there are more than 1 million individual municipal bond issues outstanding, many of which rarely trade. In a like manner, mortgage-backed securities, with a variety of complicated structures, are also difficult securities for which to find good price information.

Large strides have been made towards achieving what is called "price transparency." Investors can visit the website at www.investinginbonds.com to access recent trade prices for most municipal and corporate issues. Prices for U.S. Treasury issues and many U.S. agency issues can be found in newspapers, while price information for other fixed income securities may be more illusive.

At Janney, we are committed to offering our clients fair pricing on both purchases and sales. Likewise we strongly support industry efforts to improve price transparency. Our traders constantly monitor markets, news, trade information and a variety of other information sources to insure fair prices on all transactions.

Bond transactions are typically executed on a principal basis. This means that Janney executes the transaction for our proprietary account. By contrast, Janney executes most equity transactions on an agency basis, where the buyer and seller are matched up at the same price and a commission is added to a purchase or subtracted from a sale. Unless executed in a "fee based" account*, bond trades include a mark-up (client purchase) or mark-down (client sale), which is similar to the commission on an agency trade.

Consider the following example for a Janney client who is purchasing a bond. Janney traders first ascertain the "street" or wholesale market of the bond. Based on the offering side of this market (the price for which bond dealers will sell the bond), Janney adds a mark-up. We will assume that the offering side of the market for 10 bonds (\$10,000 of par value) is \$9,900. The mark-up might be \$10 per bond or \$100 for the transaction to make the total amount the investor pays (not including accrued interest) \$10,000. The amount of the mark-up will vary depending on a variety of factors, including total size of the transaction, the liquidity of the bond, difficulty or time involved in executing the trade and specific features of the bond. Janney may sell the bond from its inventory, or purchase the bond from another broker-dealer for resale to our client.

If you have any questions about this process, contact your Janney Financial Consultant.

Statement Pricing

As noted, accurate bond price information is sometimes difficult to obtain. The bond prices Janney clients receive on their monthly statements are derived from several pricing services including FT Interactive Data and Standard and Poor's, J J Kenney. If you have any questions about these prices, we would be glad to provide you with market bid prices upon request.

Other Important Information

Certificates of Deposit (CDs) - The type of CDs offered by Janney are known as brokered CDs. They are insured by the Federal Deposit Insurance Corporation up to \$100,000 in combined principal and interest per investor. CDs are subject to price changes as interest rates fluctuate, and if sold before maturity, the price received may be less than the purchase price. CDs may also include redemption features.

Survivor's Option - Certain securities, including

most CDs, some U. S. Agency offerings and certain corporate note programs, offer a feature known as a Survivor's Option or Death Put. If the owner of a security with such a feature dies, the estate or survivor will receive the par amount of the security. There are limitations on this feature, including limitations on the total amount of securities covered by this option. Contact your Janney Financial Consultant for more information.

CONCLUSION

Bond investments can be an important part of an investor's asset allocation strategy. However, before making such an investment, it is important to understand the features of the bond as well as the risks and opportunities each investment offers. The explanation above covers many of the important points to be considered when investing in fixed income securities, but there may be other factors associated with specific bonds that also need to be considered. If you have any questions or comments about this topic, contact your Janney Financial Consultant. You can also:

Email to: disclosure@jmsonline.com

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* Contact your Janney Financial Consultant for a copy of our disclosure brochure, *Choosing the Way You Pay for Services and Products Offered by Janney*.



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Investment Disclosure Communication

Understanding
your fixed income
investments



Janney Montgomery Scott LLC

Janney Montgomery Scott LLC (“Janney”) believes it is important for our clients to have access to the information they need to make informed investment decisions. This brochure, which is one of a series of disclosure documents providing important investment information to our clients, focuses on fixed income securities.

Fixed income securities are generally known as bonds and specifically include U.S. Treasury securities, U.S. Agency securities, municipal bonds, corporate bonds, certificates of deposit, preferred securities, commercial paper, and mortgage-backed securities. As with all investments, Janney wants you to understand and consider the benefits and risks involved when making investment decisions. In addition, some securities have special features that are important to be recognized and understood.

Credit Risk

In broad terms, "credit risk" refers to the probability that a bond issuer will pay all required interest and principal payments over the life of the issue. U.S. Treasury issues are widely considered to be the securities with the lowest potential for default and, therefore, usually have lower yields associated with lower risk to the investor. At the other end of the credit spectrum are high yield bonds, often called "junk bonds," usually issued by corporations, although some municipal securities fall into this category. These lower quality bonds normally carry higher yields, reflecting higher risk to the investor.

Most bonds are rated by one or more rating agencies. This means that the agency evaluates the creditworthiness of the bond issuer and assigns a rating as an indication of its opinion of the credit quality. The three primary rating agencies are Moody's, Standard and Poor's (S&P) and Fitch. The rating systems used by these agencies are slightly different for each agency. A complete description of rating systems is available upon request.

The highest rating, indicating the lowest level of credit risk, is AAA (Moody's notation is Aaa). AAA along with AA, A and BBB comprise the investment grade ratings. Each agency has gradient indicators within a category. For example, S&P's second highest rung includes AA+, AA and AA-. The lowest ratings within the investment grade designations are BBB- from S&P and Fitch and Baa3 from Moody's. Ratings indicating creditworthiness below investment grade are the BB, B, C and D ratings. These ratings reflect credit issues ranging from "ongoing uncertainties" (S&P BB) to "vulnerable to nonpayment" (S&P CCC) to "payment default" (S&P D).

The investment grade designation is in some respects a definitive threshold. Many institutional portfolios have investment criteria which prohibit investments that are rated below investment grade. If a bond is downgraded from BBB to BB, the institution is required to sell it. On the other hand, although they are both investment grade, there is a large difference in creditworthiness between AAA and BBB, and investors must consider their tolerance for the added risk a lower quality bond carries. It is also important to note that a bond's rating can fall if the issuer's financial stability deteriorates. The tradeoff between yield and quality is an important part of the investment decision process. You should discuss these issues, including your risk tolerance, with your Janney Financial Consultant when considering such an investment.

Bonds rated below investment grade are called high yield or junk bonds. Although junk bonds are frequently issued by well known companies, they carry a level of risk that may be unacceptable to many investors. Investors must carefully consider whether the inherent risk of a junk bond is justified by the higher yield it may offer.

Although many junk municipal bonds are rated, others carry no rating at all, making it more difficult to evaluate their credit quality. Investors should be particularly cautious when evaluating the credit quality of bonds with no rating.

Rating agencies do a good job reviewing bonds and the companies that issue them; but they are not guarantors. Just because a rating agency puts an investment grade rating on a bond does not mean that they have guaranteed it.

Interest Rate Risk

A significant consideration with fixed income products is the potential for a change in the market value of the bond as interest rates change. Generally, as interest rates rise, the value of a bond will decline. If a bond is purchased with a yield of 3% and subsequently the yield for similar bonds rises to 4%, the 3% bond will decline in value, even if it has an excellent credit rating.

Longer maturities change in value more than short maturities for a given change in interest rates. For example, if the market interest rate for a 2-year Treasury issue rises 2% (or 200 basis points) from 1.5% to 3.5%, the value of that bond will decline by about 3.7%. The same change in interest rate for a 10-year Treasury bond will lower the value by about 14.6%. This risk may be partially offset by the fact that, typically, longer maturities offer a higher yield. This tradeoff is important to discuss with your Janney Financial Consultant.

Of course, when interest rates fall, the value of a bond can rise, but the amount of price increase can be limited by any redemption feature as discussed below.

Redemption/Reinvestment Risk

Many bonds, especially those with longer maturities, include a provision whereby the issuer can redeem or "call" the bond before it matures. Redemption provisions come into play in much the same way that home mortgages work. When interest rates decline, home owners and issuers alike may take advantage by refinancing to lower their interest expense. Many bonds also contain sinking fund redemption features, extraordinary call provisions and other provisions whereby part or all of the bonds

can be redeemed before maturity.

A bond with a redemption or call provision has a limitation on its upside price potential. The shorter the call date, the more limited the price appreciation. A bond with a 30-year maturity, which can be redeemed at the option of the issuer in 5 years, has the significant downside price volatility of a 30-year bond but the limited upside of a 5-year bond, given the 5-year redemption feature.

Consider another way to view the impact of a redemption feature, using as an example a bond with a 5% yield, a 30-year maturity, and a 5-year call feature. If rates for similar bonds stay at 5% or move higher during the lifetime of the bond, the investor will receive 5% until the bond matures. On the other hand, if interest rates fall and the issuer is able to refinance by redeeming the bond after 5 years, the investor will be faced with the challenge of reinvesting the proceeds in a lower interest rate environment.

Mortgage-backed securities offer a particular challenge, since most of these issues are partially paid off or "factored" down as principal on the underlying mortgages is received. Although certain structures may narrow or minimize this risk, these bonds generally pay off more quickly as rates fall (leaving the investor to reinvest at lower rates) or pay off more slowly as rates go up. Your Janney Financial Consultant can help you determine if these bonds fit your investment objectives, and if so, which structures work best for you.

Taxes

Many investors purchase municipal securities or other fixed income securities because they may offer tax advantages over other investments. Interest on most municipal bonds is free from federal income tax, but in certain cases the interest may be subject to the Alternative Minimum Tax (AMT). Tax advantages depend on the specifics of a bond as well as on your individual circumstances,