

# Viewpoint



INVESTMENT CONCEPTS WHITE PAPER

## THE CASE FOR INVESTING IN HIGH YIELD FUNDS

Walter Donovan SENIOR VICE PRESIDENT, FIDELITY MANAGEMENT & RESEARCH COMPANY

Barry Fennell, CFA SENIOR PORTFOLIO ANALYST, FIDELITY MANAGEMENT & RESEARCH COMPANY

Eric Kaplan PORTFOLIO ANALYST, FIDELITY MANAGEMENT & RESEARCH COMPANY

### TABLE OF CONTENTS

Part 1:	
Defining and describing the high yield market . . . . .	2
Part 2:	
Assessing the benefits and risks of high yield investing . . . . .	6
Part 3:	
Putting high yield to work in a portfolio . . . . .	12

### INTRODUCTION

Common stocks and Treasury bonds have been around for generations, but high yield corporate bonds were not really recognized as a separate and viable asset class until the mid-1980s. Although the category now has an operating history of more than 20 years, some of the misapprehensions that first greeted high yield bonds remain in evidence today. Yet investing in high yield bonds – especially through mutual funds – can offer the potential for solid risk-adjusted returns, plus the ability to moderate portfolio volatility, to long-term investors who are prepared to accept the risks. The purpose of this paper is to review the evolution of the high yield corporate bond market and to discuss what this market means to today's investor.

## Part I

# DEFINING AND DESCRIBING THE HIGH YIELD MARKET

## A TWO-PRONGED MARKETPLACE

High yield bonds are assigned bond ratings below investment grade by the major rating agencies – below BBB by Standard & Poor’s or below Baa3 by Moody’s Investor Services<sup>1</sup> (see Exhibit 1). High yield bonds also exist in the municipal market, but our focus in this paper is on bonds issued by corporations. In some cases, they may be bonds with no rating at all, but considered by investment professionals to be equivalent in terms of credit quality.

The high yield marketplace includes two main types of companies. The first group consists of capital-intensive or early-stage growth companies that lack the operating history or balance sheet strength to merit investment-grade status. The second group, commonly known as “fallen angels,” consists of companies that once were investment grade but lost that standing because of doubt by the rating agencies about their ability to pay interest or repay principal in a timely manner due to potential operating and/or financial difficulties. The term “leveraged” is sometimes applied to companies whose bonds are rated below investment grade, as well as to their stocks and their loans.

## HOW THE CORPORATE HIGH YIELD MARKET EVOLVED

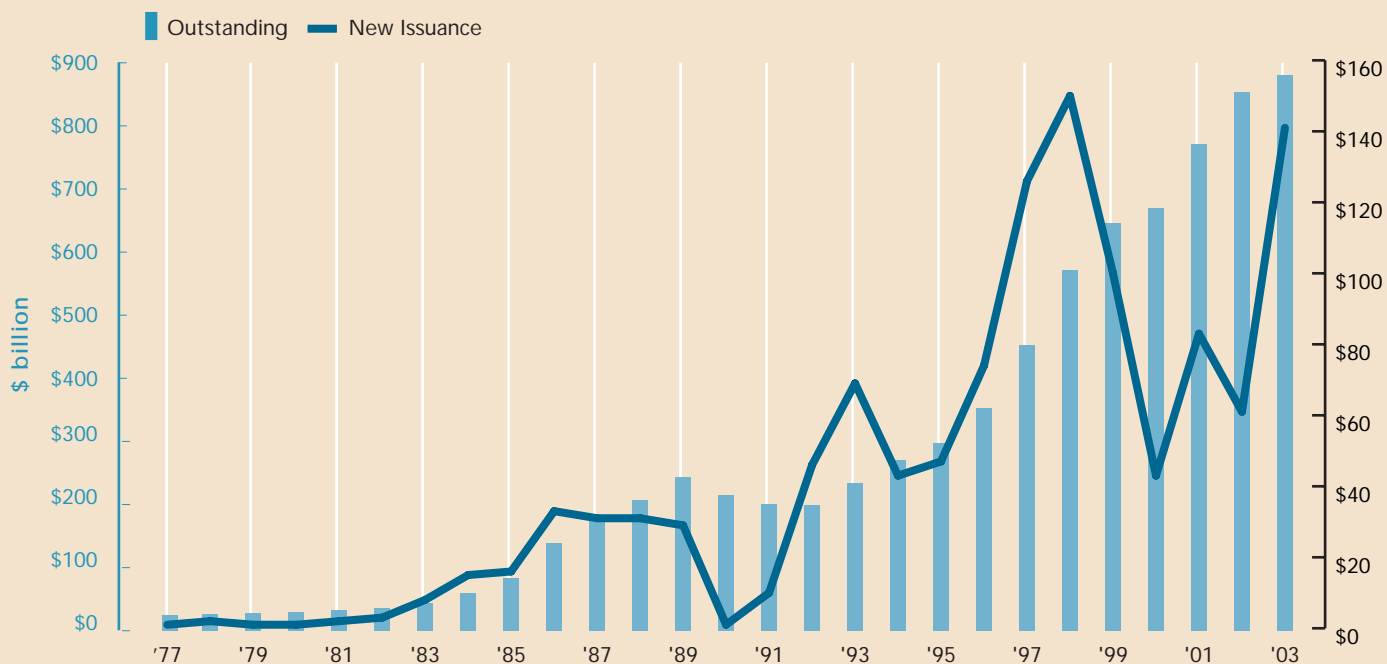
As Exhibit 2 illustrates, the high yield market has enjoyed extraordinary growth since its inception in the late 1970s. In those early years, fallen angels accounted for approximately 75% of the market, but the nature of new high yield issues would soon change. Buoyed by a powerful bull market that began in 1982, the investment community became willing to lend to secondary, speculative companies at rates well above those paid by more creditworthy enterprises. Meanwhile, merger and acquisition activity rose to unprecedented levels. More and more companies tapped the high yield market – then derisively referred to as the “junk” bond market – to finance increasingly large corporate restructurings.

Exhibit 1 Bond Ratings

	Moody's	Standard & Poor's	
Highest Quality	Aaa	AAA	Investment Grade
High Quality	Aa	AA	
Upper Medium	A-1, A	A	
Medium	Baa-1, Baa	BBB	
Speculative	Ba	BB	Not Investment Grade
Highly Speculative	B, Caa	B, CCC, CC	
Default	Ca, C	D	

Source: Fidelity.com

## Exhibit 2 Growth in Total Outstanding High Yield Bond Debt



Source: Credit Suisse First Boston

This upward trajectory in outstanding volume reversed itself abruptly in 1990, as the Gulf War loomed and the economy slipped into recession. At the same time, Congress was responding to scandal and disarray in the savings & loan industry by imposing new restrictions and by issuing new guidelines on appropriate investments for insurance companies. The combination of these factors hit the high yield category especially hard, and new issuance fell dramatically over a two-year period.

Yet the high yield sector managed to survive – and then some. New issuance rebounded tenfold as the economy began to recover in 1991, and outstanding volume continued to grow strongly through the 1990s as interest rates declined and the economy entered an historic expansion. A favorable economic backdrop enabled many high yield issuers to improve their operating and financial results, and also allowed many new companies to access the capital markets.

## FAVORABLE PERFORMANCE ATTRACTS INVESTORS

Just as important, the strong performance of the high yield market in the 1990s attracted a larger, more diverse group of investors. These favorable trends greatly enhanced the market's stability and breadth. By the end of the decade, more than 90% of the high yield market consisted of securities that were originally issued with below-investment-grade ratings, while less than 10% consisted of fallen angels – a complete reversal from the market's original composition.

By this time the “junk bond” label had virtually disappeared from the investment lexicon, but the sector was hardly immune to downturns. New high yield issuance peaked during the high-tech boom of the late 1990s, and by year-end 2000 approximately 20% of the Merrill Lynch® U.S. High Yield Master II Index<sup>2</sup> consisted of telecommunications companies, giving the market a high concentration of bonds in the lower, single-B credit quality tier. When the technology bubble burst, the market suffered yet another meaningful decline in performance as it absorbed a new generation of fallen angels.

## HIGH YIELD REBOUND

In the next section, we will review some of the performance details of the technology boom-and-bust sequence. For now, it is important to note that when high yield performance began to bounce back late in 2002, the market's fundamentals were much improved. In the months since that rebound began, through at least June 2004, the quality of new high yield corporate bonds issued has moved higher and industry representation has broadened.

As Exhibit 3 illustrates, the top four issuers included in the Merrill Lynch U.S. High Yield Master II Index represented four different industries as of June 30, 2004: telecommunications (Qwest), energy (El Paso Corporation), cable television (Charter Communications), and electric utilities (Calpine Corporation). Sector concentration has also decreased.

The high yield market's overall exposure to the telecom sector, as illustrated in Exhibit 4, declined from approximately 20% at year-end 2000 to about 8% by mid-2004. Together, telecommunications, energy, cable, and electric utilities accounted for only about 33% of the overall market at that point, compared to about 41% at year-end 2000. Today, the high yield sector includes a wide range of companies with familiar names, such as Xerox, Qwest Communications, Georgia-Pacific, JC Penney, Hilton Hotels, Lucent Technologies, and American Airlines – companies that entered the market due to credit-rating downgrades. It includes recognizable emerging growth companies, such as Nextel and Echostar Communications. Also on the high yield roster are well-known capital-intensive businesses that have used debt to expand and reposition their businesses, such as Charter Communications, Cablevision Systems, Iron Mountain, and MGM Mirage.

### Exhibit 3 Largest Issuers of Corporate High Yield Debt included in Merrill Lynch U.S. High Yield Master II Index

as of 6/30/04 by Par Value

Rank	Issuer	% of Index	Cumulative %
1	Owest Communications	2.3	2.3
2	El Paso	2.1	4.4
3	Charter Communications	1.9	6.3
4	Calpine	1.3	7.6
5	Williams Cos	1.4	9.0
6	HCA (Healthcare)	1.3	10.2
7	Georgia-Pacific	1.3	11.5
8	Allied Waste	1.1	12.6
9	Delta Air Lines	0.7	13.3
10	AES Corp	1.0	14.4

Source: Merrill Lynch U.S. High Yield Master II Index<sup>2</sup>

### Exhibit 4 Industry Weighting of Corporate High Yield Debt included in Merrill Lynch U.S. High Yield Master II Index (%)

	12/31/94	12/31/98	12/31/02	12/31/03	6/30/04
Telecom	1.4	14.1	9.2	8.1	7.9
Cable TV	6.2	11.6	4.8	5.3	5.2
Electric Utilities	6.1	6.4	7.7	10.3	10.4
Healthcare	3.2	6.8	6.1	5.6	5.7
Gaming	4.0	4.1	5.6	4.2	4.3
Energy	8.9	7.5	9.8	9.3	9.4
Technology	3.3	3.0	3.5	3.9	3.9
Super Retail	2.2	2.3	3.7	3.0	3.2
<b>Total</b>	<b>35.3</b>	<b>55.8</b>	<b>50.4</b>	<b>49.7</b>	<b>50.0</b>

Source: Merrill Lynch U.S. High Yield Master II Index<sup>2</sup>

## ASSESSING THE BENEFITS AND RISKS OF HIGH YIELD INVESTING

### FAVORABLE LONG-TERM PERFORMANCE

The key attraction of the high yield market is captured in its name: investors expect that the yields offered by bonds rated below investment grade should be higher than those of investment-grade bonds, in order potentially to compensate them for assuming the significantly higher risks inherent in lower-quality instruments. These risks include volatility in net asset value and returns, the untimely payment of principal and interest, and, in the most extreme cases, default (the issuer's inability to make income or principal payments). Lower-quality debt securities involve greater risk of default or price changes than investment-grade debt, due to potential changes in the credit quality of the issuer. Although bonds generally present less short-term risk and

volatility than stocks, bonds do entail interest rate risk (as interest rates rise, bond prices usually fall, and vice versa). Additionally, bonds and short-term investments experience greater inflation risk than stocks (the risk that the return of an investment will not keep up with increases in the prices of goods and services). High yield bond funds may invest in securities that are in default, and securities of foreign as well as domestic issuers. Investments in foreign securities involve risks in addition to those of U.S. investments, including increased political and economic risks as well as exposure to currency fluctuations.

Although all these risks are very real, the historical record on high yield bonds shows that long-term investors have been rewarded for assuming them. The performance of high yield bonds is commonly tracked by the Merrill Lynch U.S. High Yield Master II Index, which debuted on September 30, 1986. Between that inception date and June 30, 2004, the index posted an average annual return of 8.93%. By comparison, investment-grade bonds, as represented by the Lehman Brothers® Aggregate Bond Index,<sup>3</sup> posted an average annual return of 7.86% during the same period, while the S&P 500<sup>®4</sup> averaged a gain of 12.07%. Exhibit 5 provides additional comparison between these same asset classes using one-, three-, five-, and ten-year periods ending June 30, 2004.

## HYBRID CHARACTERISTICS

It's not surprising that the long-term performance of high yield corporate bonds lies somewhere between that of stocks and investment-grade bonds, because high yield bonds display characteristics of both fixed-income and equity securities. High yield bonds are, on average, less sensitive to interest-rate movements than investment-grade bonds, and more sensitive to the variables that influence equity prices, such as a company's earnings outlook, industry fundamentals, and the state of the economy.

**Exhibit 5 Annualized Performance (%) as of June 30, 2004**

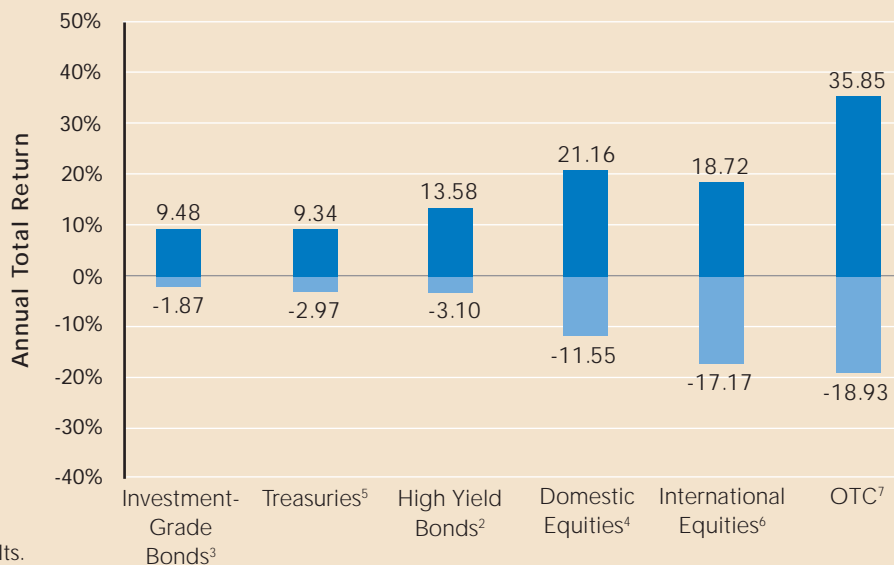
	1-Yr	3-Yr	5-Yr	10-Yr	Since 9/30/86
Merrill Lynch U.S. High Yield Master II Index <sup>2</sup>	10.19	8.80	4.79	7.50	8.93
Lehman Brothers Aggregate Bond Index <sup>3</sup>	0.32	6.36	6.95	7.39	7.86
S&P 500 <sup>4</sup>	19.11	-0.69	-2.20	11.83	12.07

Past performance is no guarantee of future results. You cannot invest directly in an index.

Yet, high yield bonds tend to be less volatile than equities, because the income component of their total return is considerably higher. From 1986 through 2003, the largest calendar-year loss in the high yield bond market was only -5.12% (2000), compared to lows of -8.30% for 10-year Treasuries (1994) and -22.10% for the S&P 500 (2002).

## Exhibit 6 Average Total Returns, 1987–2003

Altogether, the high yield market has had only four years of negative performance since 1986, and eight years of positive double-digit returns, the highest of which was +39.17% in 1991. The chart to the right depicts the average positive and average negative returns for various asset classes over the calendar years 1987–2003. Note that the high yield category occupies the middle position between fixed-income and equities, as might be expected from this hybrid asset category.



Source: FMR Co.

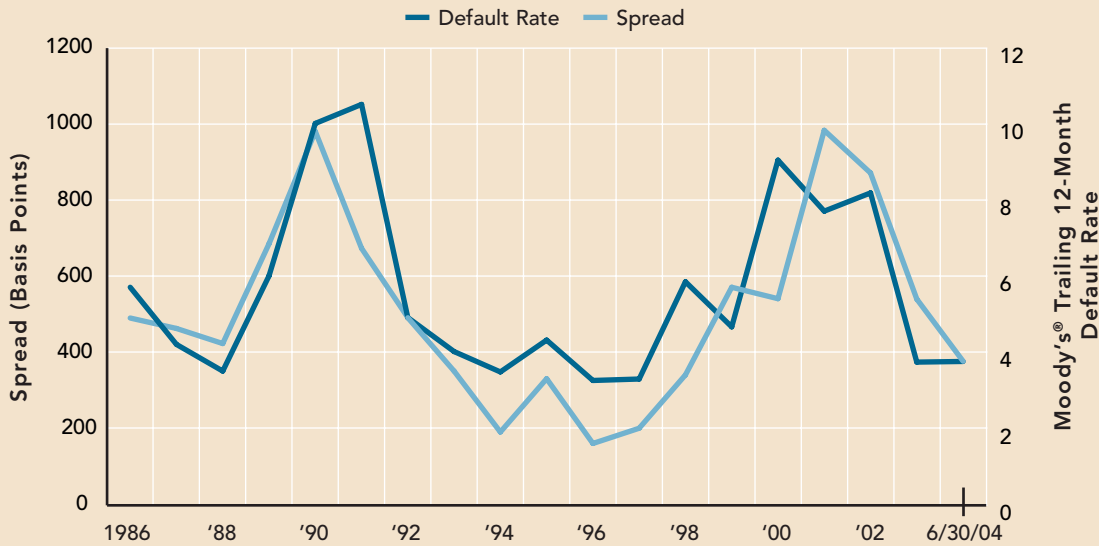
Past performance is no guarantee of future results.

## YIELD ADVANTAGE FLUCTUATES IN HIGH YIELD MARKET – FROM WIDE TO NARROW

So, what constitutes a “significant” yield advantage? The recent history of the high yield market provides some important answers. Between 1986 and 2003, the difference in yields between high yield bonds and 10-year Treasury bonds – known as the “yield spread” – averaged 5.24 percentage points. When the spread rises above average, it means that investors perceive the risks of owning high yield bonds are higher than average, and are demanding a higher premium to own them. This was demonstrated during the bear market that began in 2000 – the yield spread rose to more than eight percentage points in 2001, the highest level since the bear market of 1990.

When the economy began to recover in 2003, investors began to believe that the worst was over for the economy, the nation, and the financial markets. The high yield spread by year-end 2003 had dropped to 3.76 percentage points, and by June 2004 amounted to 3.78 percentage points.

**Exhibit 7 High Yield Average Annual Default Rate and Spread over 10-Year Treasury Bond**



Sources: Merrill Lynch, Moody's Investors Services.

Within the fixed-income market in particular, many investors in 2003 were attracted to the high yield sector because yields for alternative, investment-grade instruments had dropped to historically low levels, especially in money market instruments. The average yield for money markets during 2003 was 1.01% based on the Lehman Brothers® 3-month Treasury Bill Index,<sup>8</sup> vs. 4.10% for investment-grade bonds according to the Lehman Brothers Aggregate Bond Index,<sup>3</sup> vs. 9.58% for high yield bonds based on the Merrill

Lynch U.S. High Yield Master II Index.<sup>2</sup> High yield bonds became one of the few options available to investors targeting specific income levels. As of June 30, 2004, using the same benchmarks, comparable annualized yields have been 0.99% for money markets, 4.68% for investment-grade bonds, and 8.09% for high yield bonds.

## YIELD MOVEMENT ANTICIPATES CORPORATE DEFAULTS

In general, changes in yield spread levels are closely linked to changes in corporate default rates. As Exhibit 7 illustrates, during the past 18 years, the credit cycle has witnessed the default rate exceeding 10% just twice, and on both occasions the peaks were foreshadowed by sharply wider yield spreads. Similarly, when the market anticipates that defaults will lessen, lower yield spreads are the result.

## PERFORMANCE CAN VARY WIDELY BETWEEN CREDIT TIERS

When analyzing the performance of the high yield market, it is important to remember that the credit quality of the market is far from homogeneous. While a BB rating may not be considered investment grade, a BB-rated security is more creditworthy than a B or CCC-rated issue. Anything below CCC is considered “substantial risk,” while securities rated C and below by Moody’s may in fact be in default. These distinctions are important because the performance of different credit quality tiers can vary widely over time. In fact, the past few years have provided stunning examples of such variations.

**Exhibit 8 Average Annual Total Returns by Credit-Quality Tier**

	2000	2003
10-Year Treasury Bonds	+14.86%	+1.32%
Merrill Lynch U.S. High Yield Master II Index	-5.12%	+28.15%
BB	+2.22%	+19.45%
B	-7.71%	+26.01%
CCC	-17.41%	+60.99%

Sources: FMR Co., Lehman Brothers;<sup>5</sup> Merrill Lynch U.S. High Yield Master II Index.<sup>2</sup> Past performance is no guarantee of future results.

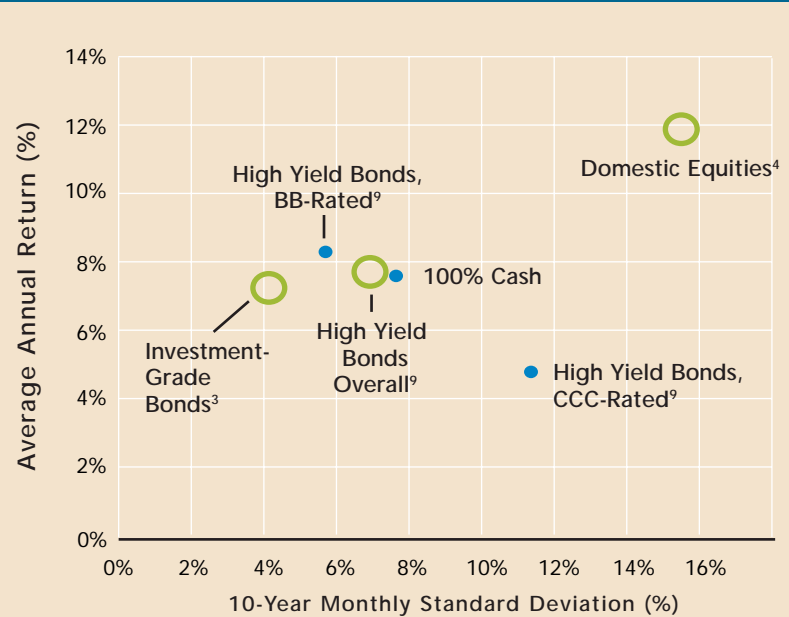
Exhibit 8 shows, for example, that in 2000, when performance in the equity market began its steep decline, BB-rated bonds within the Merrill Lynch U.S. High Yield Master II Index returned +2.22%, whereas CCC-rated bonds, which would soon bear the brunt of a spike in the default rate, returned -17.41%. In other words, not only did high yield bonds underperform Treasury bonds, there were also different strata of performance within the high yield sector, and returns were positively correlated to credit quality. By contrast, when economic conditions improved in 2003 and the default rate came down sharply, lower-quality bonds benefited most dramatically. For the full year, CCC-rated issues were up 60.99%, well above the 19.45% return from BB bonds.

## THE RISKS OF MARKET TIMING

It would be nice to be able to anticipate these seismic shifts within the high yield market and invest accordingly. However, history has shown most investors are not able to predict the markets – in particular, volatile markets – and are better off over the long term maintaining a diversified portfolio. As Exhibit 9 illustrates, over the ten years ending June 2004, the higher-rated tiers of high yield bonds have cumulatively outperformed the lower-rated tiers – but leadership has shifted from tier to tier most years within that period. It is not practical for an investor to try and predict when leadership will shift from one tier to another. A diversified strategy for an investor willing to accept the risks of high yield would include exposure to all the high yield credit tiers.

For example, the CCC-rated sector strongly outperformed the other high yield credit tiers in 2003. However, not only have BB-rated high yield bonds outperformed on a cumulative basis over the 10 years ending June 2004, Exhibit 9 demonstrates that they have done so while exhibiting less volatility, as measured by the annualized standard deviations of their returns. (Standard deviation is a statistical measure of how much a return varies over an extended period of time. The more variable the returns, the larger the standard deviation. Investors may examine historical standard deviation in conjunction with historical returns to decide whether an investment's volatility would have been acceptable given the returns it would have produced. Standard deviation does not indicate how an investment actually performed, but it does indicate the volatility of its returns over time.) The tech meltdown of the late 1990s so severely punished the lowest-rated bonds that their greater volatility throughout the 10-year period was, atypically, not accompanied by higher returns – despite their remarkable performance during 2003.

Exhibit 9 Average Performance and Volatility, 6/94–6/04



Sources: FMR Co., Lehman Brothers,<sup>3</sup> Merrill Lynch,<sup>9</sup> Standard & Poor's.<sup>4</sup>  
You cannot invest directly in an index. Past performance is no guarantee of future results.

## RISK CONSIDERATIONS

Investors with short-term time horizons are ill-advised to take on the risks of the high yield sector – risks that include macroeconomic conditions, geopolitical uncertainty, lackluster investor demand, corporate malfeasance, an oversupply of new issues, and a rapid downgrade of a large volume of bonds in the sector. While the impact of these risks upon performance has historically tended to be relatively short-lived, as demonstrated by the sector's attractive long-term performance record, they can be significant. Performance fluctuations, such as those that occurred between 2000 and 2002, reinforce the need for investors to maintain a long-term investment horizon and to be prepared to accept significant price volatility and varying levels of income distribution.

## Part 3

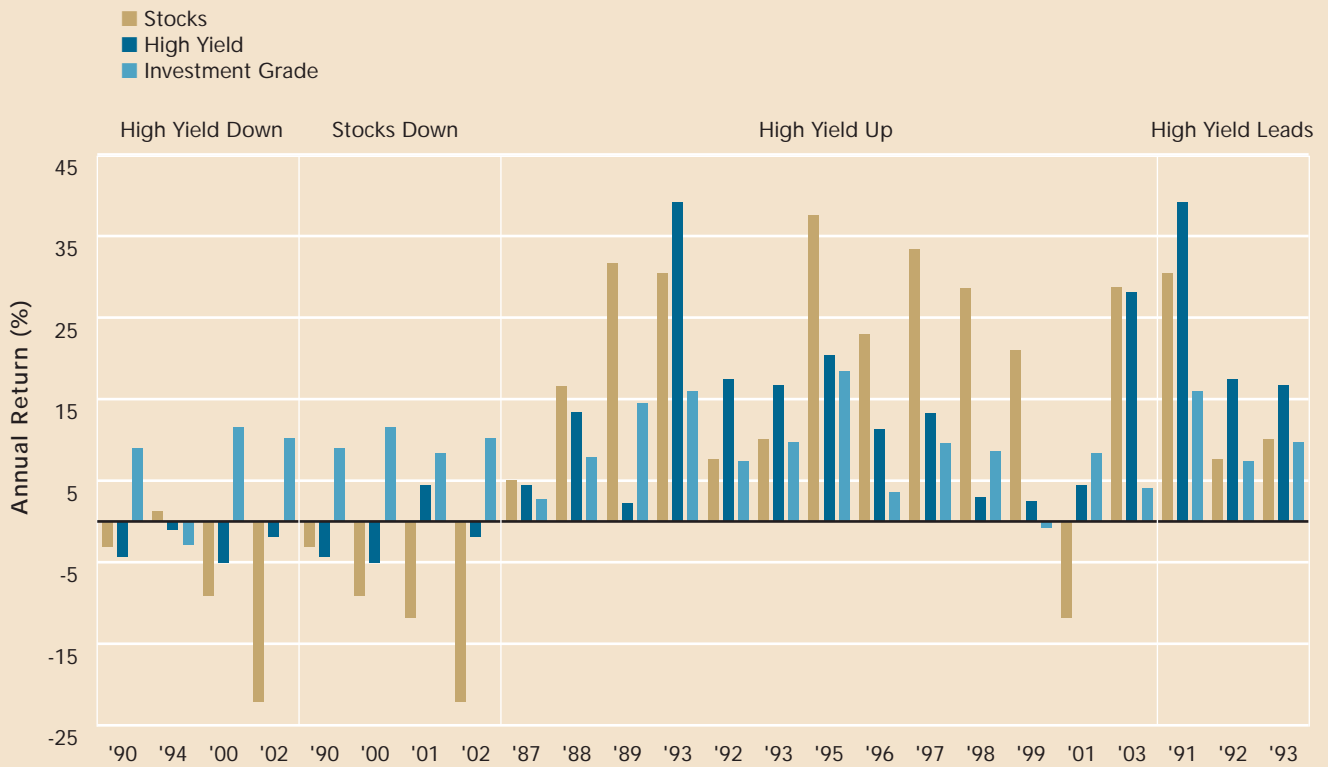
# PUTTING HIGH YIELD TO WORK IN A PORTFOLIO

While it is important to understand the risks associated with high yield securities as an asset class, it is also essential to understand the diversification value that high yield bonds can bring to a portfolio of stocks and Treasury or other investment-grade bonds. Adding high yield bonds to a portfolio tends to bring overall volatility down without sacrificing the potential for superior returns. The reason? Although high yield bonds share certain attributes with investment-grade bonds and share other characteristics with stocks, their risk and return characteristics are quite different from those of each group. Because high yield bonds are more sensitive than investment-grade bonds to the economic prospects of individual companies, they tend to perform well during periods of economic recovery and strength. As a result, they may potentially be less sensitive to the interest-rate fluctuations that drive the prices of Treasury bonds and most investment-grade bonds. In fact, during periods of inflation and rising interest rates, high yield bonds have historically tended to outperform most other types of bonds. The lower the rating, the less sensitive high yield bonds tend to be to interest rate fluctuations, and the more dependent they are on company-specific performance.

In particular, during periods of economic recovery, which are often accompanied by inflation and rising interest rates, high yield bonds have historically tended to outperform most other types of bonds. For example, between February 1988 and May 1989, when the Federal Reserve raised rates by 3.3 percentage points, high yield bonds outperformed investment-grade bonds by 2.14% according to Lehman Brothers and Merrill Lynch. This pattern repeated itself between January 1994 and May 1995, when the Fed raised rates by three percentage points. Again, the same sources report high yield bonds outperformed investment-grade bonds, this time by 2.68%. As always, it is important to remember that past performance is no guarantee of future results.

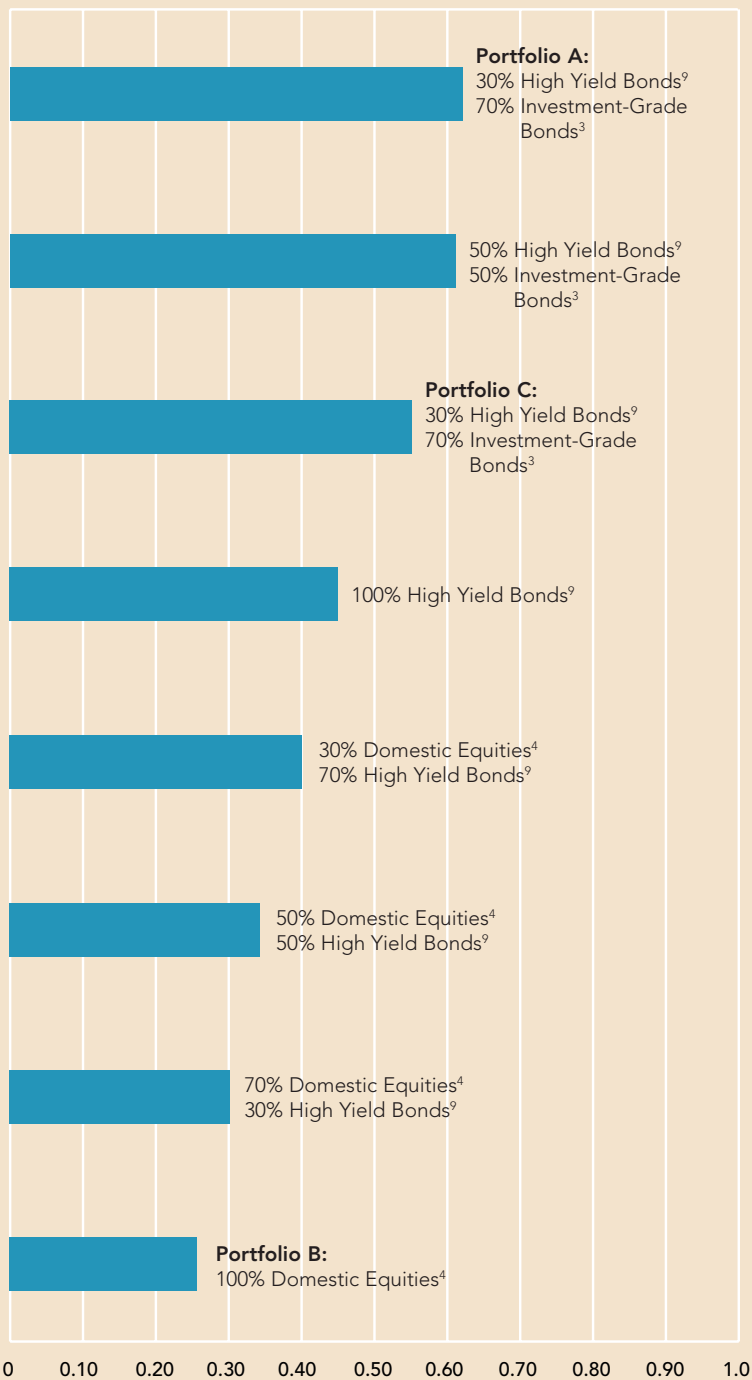
The performance differentials between high yield bonds and other types of assets during different time periods can actually be used to an investor's advantage. Exhibit 10 demonstrates that returns from the high yield sector have differed significantly from those of stocks and investment-grade bonds during many years since Merrill Lynch initiated its U.S. High Yield Master II Index. This means that high yield bonds in an investor's portfolio can complement investment-grade bonds and will also help complement stocks. Historically, when one has performed weakly or only moderately well, the other has oftentimes performed better. This divergence in performance among asset classes tends to diminish the overall volatility of an investor's portfolio while also helping to bolster performance over the long term.

Exhibit 10 High Yield vs. Stocks and Investment-Grade Bonds, 1987–2003



Sources: Stocks: S&P 500, High Yield: ML US HY Master II, Investment Grade: LB Aggregate

Exhibit 11 Sharpe Ratio of Various Portfolios, 1/85–6/04



Sources: FMR Co., Lehman Brothers,<sup>3</sup> Merrill Lynch,<sup>9</sup> Standard & Poor's.<sup>4</sup>

You cannot invest directly in an index. Past performance is no guarantee of future results.

In addition to adding diversification to a portfolio, high yield bonds have historically delivered attractive risk-adjusted returns. In the academic world, risk-adjusted returns are quantified using a measure called the Sharpe ratio. The Sharpe ratio is a measure of historical adjusted performance calculated by dividing the fund's excess returns over a risk-free investment, such as the 3-Month T-Bill, by the standard deviation of those returns. A high Sharpe ratio is attractive because it means that above-market returns have been generated with a minimum of volatility – the higher the ratio, the better the fund's return per unit of risk. Academics who have studied the fixed-income markets have discovered, as Exhibit 11 reveals, that Portfolio A, consisting of 30% High Yield (as represented by the Merrill Lynch U.S. High Yield Cash Pay Index<sup>9</sup>) and 70% investment-grade bonds (as represented by the Lehman Brothers Aggregate Index<sup>3</sup>), has over the period January 1985 (when the Merrill Lynch high yield index began) through 6/30/04 produced a higher Sharpe ratio than Portfolio B, all-stock (represented by the S&P 500 Index<sup>4</sup>), or Portfolio C, all investment-grade bonds.

## MUTUAL FUND BENEFITS

Many high yield bonds require a steep minimum investment, which makes it a challenge for an individual to build a diversified portfolio from scratch. Consequently, those who purchase only a few high yield bonds may end up overexposed to specific company risk and underexposed to the long-term benefits of high yield ownership. For these reasons, the majority of investors elect to own high yield through mutual funds.

The minimum investment for a mutual fund is usually on the order of a few thousand dollars, far below the threshold of many individual high yield bonds. And the expense structure of most mutual funds is extremely low relative to the transaction costs that would be incurred by an individual trying to assemble a portfolio containing dozens of high yield bonds.

Perhaps the most important benefit offered to high yield bond investors by an actively managed mutual fund is the team of credit analysts and portfolio managers who monitor the markets and the companies, their collateral, and their business plans on a daily basis. Individual investors do not always have the time and analytic support to stay on top of the risks and opportunities in the high yield universe.

Although diversification does not ensure a profit or guarantee against a loss, mutual funds generally can

spread risk better than the average individual investor by holding the securities of hundreds of companies. The ability to evaluate combinations of sectors, companies, and security types is another service provided by the research staff of actively managed mutual funds.

Mutual fund investors should watch for the use of leverage in the management of the fund itself. Some mutual fund managers – particularly those managing closed-end and hedge funds – add even more debt at the fund level, on top of the debt employed by the companies issuing the securities in which the fund invests. This type of fund may be attempting to bolster its returns by borrowing money in the capital markets, using the fund's assets as collateral, in expectation of earning a higher return overall. But if the vehicle in which the fund invests the borrowed money fails to achieve a return higher than the cost of the borrowed money, then the fund may have to sell other holdings in order to repay the borrowed funds.

For income-sensitive investors, a mutual fund holding many individual bonds can potentially achieve a fairly steady stream of current income. A true open-end mutual fund also provides investors with “daily liquidity” – the opportunity to buy and sell shares at will (although extra short-term trading fees may apply).

**Atlantic Financial, Inc.**  
**167 Washington Street, Norwell, MA 02061**  
**Toll Free 800-559-2900 Telephone 781-319-0110 Fax 781-319-0116**  
**www.AtlanticFinancial.com**

Securities offered through Cantella & Co., Inc. Member NASD/SIPC.

All indices are unmanaged, and performance of the indices includes reinvestment of dividends and interest income, unless otherwise noted. Indices referenced are not illustrative of any particular investment. An investment cannot be made in any index.

1. Analytic services provided by Standard & Poor's Ratings Services are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

No warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of any such rating or other opinion or information is given or made by Moody's in any form or manner whatsoever.

2. The Merrill Lynch U.S. High Yield Master II Index is an unmanaged market-capitalization-weighted index of all domestic and Yankee high yield bonds, including deferred interest bonds and payment-in-kind securities, and is not an investment vehicle. Issues included in the index have maturities of at least one year and have a credit rating lower than BBB-Baa3, but are not in default.
3. The Lehman Brothers® Aggregate Bond Index is a market-value-weighted performance benchmark for investment-grade fixed-rate debt issues, including government, corporate, asset-backed, and mortgage-backed securities, with maturities of at least one year.
4. The S&P 500 Index is an unmanaged market-capitalization-weighted index of common stocks. S&P 500 is a registered service mark of the McGraw-Hill Companies, Inc., and has been licensed for use by Fidelity Distributors Corporation and its affiliates.
5. The Lehman Brothers® Ten Year Treasury Bond Index is an unmanaged, market-value-weighted performance benchmark that tracks the performance of outstanding U.S. Treasuries with maturities of ten years.
6. The Morgan Stanley® Capital International Europe, Australasia and Far East (MSCI EAFE) Index is an unmanaged market-capitalization-weighted index of equity securities of companies domiciled in various countries. The Index is designed to represent the performance of developed stock markets outside the United States and Canada and excludes certain market segments unavailable to U.S.-based investors.
7. The NASDAQ Index is an unmanaged, market-value-weighted index of all common stocks listed on NASDAQ.
8. The Lehman Brothers® 3-Month Treasury Bill Index is an unmanaged, market-value-weighted performance benchmark that tracks the performance of outstanding U.S. Treasuries with maturities of three months.
9. The Merrill Lynch® U.S. High Yield Cash Pay Index is an unmanaged market-value-weighted index of domestic and Yankee high yield bonds. Qualifying bonds must have a minimum amount outstanding of \$100 million and a fixed coupon schedule. Issues included in the index have maturities of at least one year and have a credit rating lower than BBB-Baa3, but are not in default.
10. The Merrill Lynch® Mortgage-Backed Master Index is an unmanaged market-capitalization-weighted index that tracks the performance of US dollar-denominated 30-year, 15-year and balloon pass-through mortgage securities having at least \$150 million outstanding.

Investment decisions should be based on an individual's own goals, time horizon, and tolerance of risk. Relatively volatile instruments may not be suitable for investments intended to be left in place less than several years.

Mentions of specific securities or companies should not be construed as a recommendation.

All indices are unmanaged, and performance of the indices includes reinvestment of dividends and interest income, unless otherwise noted. Indices referenced are not illustrative of any particular investment. An investment cannot be made in any index.

Third-party trademarks and service marks are the property of their respective owners.

Fidelity Investments & Pyramid Design is a registered service mark of FMR Corp.



**Please carefully consider any funds' investment objectives, risks, charges, and expenses before investing. For this and other information, call your investment professional or visit [advisor.fidelity.com](http://advisor.fidelity.com) for a free prospectus.**

**Read it carefully before you invest or send money.**

Fidelity Brokerage Services LLC, Member NYSE, SIPC, 100 Summer Street, Boston, Massachusetts 02109  
Fidelity Investments Institutional Services Co., Inc., 82 Devonshire Street, Boston, Massachusetts 02109

Copyright 2005 FMR Corp. All rights reserved.