



## **Morningstar Institutional Categories**

(for portfolios available for sale in the United States)

Morningstar Methodology Paper

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# Contents

Category List	3
Introduction	8
Domestic Equity	9
Alternative Strategies	15
Sector Specific	17
International Equity	20
Balanced	24
Target Date	26
Taxable Bond	31
Municipal Bond	35
Money Market	41

# Category List

Broad Category Group	Category Name	
Domestic Equity	Giant Growth	9
Domestic Equity	Giant Core	9
Domestic Equity	Giant Value	9
Domestic Equity	Large High Growth	10
Domestic Equity	Large Core Growth	10
Domestic Equity	Large Valuation-Sensitive Growth	10
Domestic Equity	Large Core	10
Domestic Equity	Large Relative Value	10
Domestic Equity	Large Core Value	11
Domestic Equity	Large Income-Oriented Value	11
Domestic Equity	S&P 500 Tracking	11
Domestic Equity	Mid High Growth	11
Domestic Equity	Mid Core Growth	11
Domestic Equity	Mid Valuation-Sensitive Growth	11
Domestic Equity	Mid Core	12
Domestic Equity	Mid Relative Value	12
Domestic Equity	Mid Core Value	12
Domestic Equity	Mid Income-Oriented Value	12
Domestic Equity	Small High Growth	12
Domestic Equity	Small Core Growth	12
Domestic Equity	Small Valuation-Sensitive Growth	13
Domestic Equity	Small Core	13
Domestic Equity	Small Relative Value	13
Domestic Equity	Small Core Value	13
Domestic Equity	Small Deep Value	13
Domestic Equity	Micro Cap	14
Domestic Equity	All-Cap Growth	14
Domestic Equity	All-Cap Core	14
Domestic Equity	All-Cap Value	14
Alternative Strategies	Bear Market	15
Alternative Strategies	Market Neutral	15
Alternative Strategies	Long-Short	15
Alternative Strategies	Leveraged	15
Alternative Strategies	Leveraged Net Long	16

Alternative Strategies	Precious Metals	16
Alternative Strategies	Currency	16
Sector Specific	Domestic Energy	17
Sector Specific	World Energy	17
Sector Specific	Domestic Health	17
Sector Specific	World Health	17
Sector Specific	Technology	18
Sector Specific	Communications	18
Sector Specific	Utilities	18
Sector Specific	Domestic Financial	18
Sector Specific	World Financial	18
Sector Specific	Domestic Real Estate	18
Sector Specific	World Real Estate	19
Sector Specific	Foreign Real Estate	19
Sector Specific	Consumer Staples	19
Sector Specific	Consumer Discretionary	19
Sector Specific	Industrials	19
Sector Specific	Materials	19
International Equity	Foreign Giant	20
International Equity	Foreign Large Growth	20
International Equity	Foreign Large Core	20
International Equity	Foreign Large Value	20
International Equity	Foreign Small/Mid Growth	21
International Equity	Foreign Small/Mid Core	21
International Equity	Foreign Small/Mid Value	21
International Equity	Foreign All-Cap	21
International Equity	World Large Growth	21
International Equity	World Large Core	21
International Equity	World Large Value	22
International Equity	World Mid Cap	22
International Equity	World Small Cap	22
International Equity	World All-Cap	22
International Equity	Europe	22
International Equity	Emerging Europe	22
International Equity	Japan	23
International Equity	Pacific/Asia ex-Japan	23
International Equity	China	23
International Equity	Latin America	23
International Equity	India	23
International Equity	Diversified Emerging Markets	23

Balanced	Moderate Allocation	24
Balanced	Conservative Allocation	24
Balanced	Foreign Allocation	24
Balanced	Aggressive Allocation	24
Balanced	Moderate Allocation	24
Balanced	Conservative Allocation	24
Balanced	Foreign Allocation	24
Balanced	Global Allocation	24
Balanced	Flexible Allocation	25
Balanced	Global Flexible Allocation	25
Balanced	Convertibles	25
<hr/>		
Target Date	Target Date 2000-2010 Aggressive	26
Target Date	Target Date 2000-2010 Moderate	26
Target Date	Target Date 2000-2010 Conservative	26
Target Date	Target Date 2011-2015 Aggressive	26
Target Date	Target Date 2011-2015 Moderate	27
Target Date	Target Date 2011-2015 Conservative	27
Target Date	Target Date 2016-2020 Aggressive	27
Target Date	Target Date 2016-2020 Moderate	27
Target Date	Target Date 2016-2020 Conservative	27
Target Date	Target Date 2021-2025 Aggressive	27
Target Date	Target Date 2021-2025 Moderate	27
Target Date	Target Date 2021-2025 Conservative	28
Target Date	Target Date 2026-2030 Aggressive	28
Target Date	Target Date 2026-2030 Moderate	28
Target Date	Target Date 2026-2030 Conservative	28
Target Date	Target Date 2031-2035 Aggressive	28
Target Date	Target Date 2031-2035 Moderate	28
Target Date	Target Date 2031-2035 Conservative	28
Target Date	Target Date 2036-2040 Aggressive	29
Target Date	Target Date 2036-2040 Moderate	29
Target Date	Target Date 2036-2040 Conservative	29
Target Date	Target Date 2041-2045 Aggressive	29
Target Date	Target Date 2041-2045 Moderate	29
Target Date	Target Date 2041-2045 Conservative	29
Target Date	Target Date 2050+ Aggressive	30
Target Date	Target Date 2050+ Moderate	30
Target Date	Target Date 2050+ Conservative	30
Target Date	Retirement Income Aggressive	30
Target Date	Retirement Income Moderate	30
Target Date	Retirement Income Conservative	30
<hr/>		
Taxable Bond	Ultrashort Investment Grade	31
Taxable Bond	Short Government	31

Taxable Bond	Short Investment Grade	31
Taxable Bond	Short/Intermediate Government (2.5-4)	31
Taxable Bond	Short/Intermediate Investment Grade	32
Taxable Bond	Intermediate Government (4-6)	32
Taxable Bond	Intermediate Investment Grade (4-6)	32
Taxable Bond	Long Government (>6)	32
Taxable Bond	Long Investment Grade (>6)	32
Taxable Bond	GNMA	32
Taxable Bond	Mortgage-Backed	33
Taxable Bond	A-Rated	33
Taxable Bond	BBB-Rated	33
Taxable Bond	Multisector Bond	33
Taxable Bond	High Yield Bond	33
Taxable Bond	Bank Loan	33
Taxable Bond	World Bond	34
Taxable Bond	Foreign Bond	34
Taxable Bond	Emerging Markets Bond	34
Taxable Bond	Inflation-Protected Bond	34
<hr/>		
Municipal Bond	Muni National Long (>6)	35
Municipal Bond	Muni National Intermediate (4-6)	35
Municipal Bond	Muni National Short/Intermediate (2.5-	35
Municipal Bond	Muni National Short (<2.5)	35
Municipal Bond	High Yield Muni	35
Municipal Bond	Muni Insured	36
Municipal Bond	Muni Single State Insured	36
Municipal Bond	Muni California Insured	36
Municipal Bond	Muni Arizona	36
Municipal Bond	Muni California Long (>6)	36
Municipal Bond	Muni California Intermediate (4-6)	36
Municipal Bond	Muni California Short-Intermediate (<4)	37
Municipal Bond	Muni Colorado	37
Municipal Bond	Muni Connecticut	37
Municipal Bond	Muni Florida	37
Municipal Bond	Muni Georgia	37
Municipal Bond	Muni Maryland	37
Municipal Bond	Muni Massachusetts Long (>6)	37
Municipal Bond	Muni Massachusetts Short &	38
Municipal Bond	Muni Michigan	38
Municipal Bond	Muni Minnesota	38
Municipal Bond	Muni Missouri	38
Municipal Bond	Muni New Jersey	38
Municipal Bond	Muni New York Long (>6)	38
Municipal Bond	Muni New York Short & Intermediate	39

Municipal Bond	Muni North Carolina	39
Municipal Bond	Muni Ohio	39
Municipal Bond	Muni Pennsylvania	39
Municipal Bond	Muni Virginia	39
Municipal Bond	Muni Single State Long (>6)	39
Municipal Bond	Muni Single State Intermediate (4-6)	40
Municipal Bond	Muni Single State Short-Intermediate	40
<hr/>		
Money Market	Taxable Money Market	41
Money Market	Tax-Free Money Market	41

# Introduction

The Morningstar Institutional Categories were launched in May 2009 in response to feedback from Morningstar's institutional clients. These clients felt that the existing Morningstar Categories were too broad to support their business processes, such as manager compensation discussions and expense peer grouping. The Morningstar Institutional Categories were developed to address those needs by using more granular definitions to assign portfolios to peer groups. The result is a system with substantially more categories. These categories more thoroughly identify distinct investment strategies.

The Morningstar Institutional Categories allocate portfolios into peer groups using the same holdings-based methodology already employed by the Morningstar Categories, which were introduced in 1996. The two structures are parallel in that one category is assigned to each portfolio in Morningstar's managed funds database. The key difference is that the Institutional Categories have narrower parameters, allowing for more sophisticated and detailed peer group comparisons. This new system is intended to help institutional investors identify true peers, build more thoroughly diversified portfolios, and gain more insight into an individual portfolio's strategy.

Morningstar assigns Institutional Categories to various types of portfolios, including mutual funds and exchange-traded funds. In contrast to Morningstar Categories, funds from each universe are ranked collectively. Portfolios are placed in a given category based primarily on their average holdings statistics over the past three years. If the portfolio is new and has no history, Morningstar assigns the best Institutional Category possible given the investment objectives stated in the prospectus, then reevaluates as portfolio holdings become available. Morningstar will periodically review Institutional Category assignments and may make changes as necessary.

The driving principles behind the Institutional Categories system are consistent with Morningstar's existing methodologies:

- Individual portfolios within an Institutional Category invest in similar types of securities and therefore share the same risk factors
- Individual portfolios within an Institutional Category can, in general, be expected to behave more similarly to one another than to portfolios outside the category
- The aggregate performance of different categories differs materially over time
- Institutional Categories have enough constituents to form the basis for reasonable peer group comparisons
- The distinctions between the Institutional Categories are meaningful to institutional investors and assist in their investment-related business processes

# Domestic Equity

Domestic equity portfolios are defined as maintaining at least 85% exposure to equity and investing at least 70% of assets in US-domiciled securities. Particular style and market cap focuses are identified via Morningstar's Style Box methodology in which equity securities are given a style and size score, based on their style and market capitalization characteristics, respectively. Each fund is then assigned a style and size score, based on an asset-weighted average of the scores assigned to each stock within the portfolio.

Value is generally defined by slow growth (low growth rates for earnings, sales, book value and cash flow) and low valuations (low price ratios and high dividend yield). Conversely, growth is described by fast growth (high growth rates for earnings, sales, book value and cash flow) and high valuations (high price ratios and low dividend yields).

Giant cap stocks comprise the top 40% of total US market capitalization. Large cap stocks make up the next 30%. Mid-cap stocks are defined as being part of the next 20% while small and micro-cap stocks comprise the smallest 10% of the total US market. The absolute breakpoints are updated periodically to ensure the definitions of each capitalization range fluctuate appropriately with the market. Generally though, market cap breakpoints will be as follows:

- ▶ Giant: >\$40 billion
- ▶ Large: \$8 billion-\$40 billion
- ▶ Mid: \$1 billion-\$8 billion
- ▶ Small: \$500 million-\$1 billion
- ▶ Micro: <\$500 million

## **Giant Growth**

Giant growth portfolios have the highest style and size scores of all funds focused on the US equity market. These funds seek returns through capital appreciation by focusing on stocks that continue to reinvest in the business and grow operations.

## **Giant Core**

Giant core portfolios have value-growth scores in the mid range because neither growth nor value characteristics dominate the portfolio.

## Domestic Equity (continued)

### **Giant Value**

Portfolios from this group combine the largest size scores with lower style scores. These portfolios generally offer a sizeable amount of current income because many of the giant cap stocks they hold are well-established firms with consistent dividend histories.

### **Large High Growth**

Large high growth portfolios have lower size scores than giant cap-focused portfolios but maintain the highest style scores of funds in the large capitalization range. These portfolios tend to maintain exposure to the most rapidly growing industries as they seek opportunities for capital appreciation regardless of the price.

### **Large Core Growth**

Large core growth portfolios typically exhibit classic growth characteristics. These funds favor returns through capital appreciation and tend to focus on proven industries that still have opportunities for expansion. Their style scores are somewhat lower than those of their high growth counterparts.

### **Large Valuation Sensitive Growth**

Large valuation sensitive growth portfolios typically exhibit both growth and value characteristics, as managers in this group are generally interested in growing companies but are also sensitive to valuations. Stocks in these portfolios may have somewhat lower projected growth ratios than high growth stocks but come with lower price valuations. As a result, the style scores for these funds are lower than both high growth and core growth funds.

### **Large Core**

Value-growth scores for funds in the large core space are exactly in the mid-range for large cap funds. This can be the result of a strategy that looks for stocks with growth expectations and price characteristics roughly equivalent to the average for large cap stocks. Alternatively, these portfolios may hold a broad representation of stocks from across the style spectrum. Returns for these funds tend to be highly correlated with market returns as these portfolios are generally representative of the total US market.

### **Large Relative Value**

Large relative value portfolios hold stocks that exhibit attractive price multiples but also have some sort of growth catalyst. These funds may seek returns through dividend income as well as through capital appreciation. Style scores for this group are a step lower than funds with a blended style, reflecting the additional emphasis on low valuation.

## Domestic Equity (continued)

### **Large Core Value**

Large core value portfolios exhibit classic value characteristics. As a result, their style scores generally end up directly in the middle of the value-oriented range. These managers generally seek capital appreciation at low prices but also favor a notable amount of dividend income.

### **Large Income-Oriented Value**

Large-income oriented value portfolios favor stocks that promise high current income through reliable dividends. These portfolios may also choose some stocks considered to be in distress or out of favor. Style scores for this group are the lowest of funds in the large cap range.

### **S&P 500 Tracking**

S&P 500 Tracking portfolios are passively managed and provide broad exposure to the US equity market by directly mirroring the S&P 500 Index. These funds may hold each of the 500 stocks in direct proportion to the index and may also gain exposure through futures contracts.

### **Mid High Growth**

The size scores for mid high growth funds occupy the mid-range of all funds. These portfolios likely favor stocks from this capitalization range but could also seek exposure to stocks from a variety of cap ranges, leading to a mid-range size score. Style scores from this group are the highest for the mid-cap range, reflecting a focus on firms actively pursuing rapid expansion with above-average valuations.

### **Mid Core Growth**

Mid core growth portfolios exemplify classic growth characteristics. Their style scores are directly in the middle of the growth spectrum as these managers seek solid opportunities for capital appreciation with valuations that are somewhat lower than high growth members. Most likely, these portfolios are exposed primarily to mid-cap firms though they could invest in stocks from a variety of cap ranges.

### **Mid Valuation-Sensitive Growth**

Mid valuation-sensitive portfolios typically exhibit both value and growth characteristics as these managers seek stocks with solid growth expectations but lower valuation multiples than high or core growth stocks. As a result, these funds exhibit style scores a step below their core growth counterparts.

## Domestic Equity (continued)

### **Mid Core**

Mid core portfolios provide middle-of-the-road exposure to the US equity market. These portfolios may hold mid-cap stocks specifically or a wider array of large to small stocks, leading to a mid-range size score. Similarly, the style scores of funds in this group are roughly equal to the average for funds in the mid-cap range, either because they seek stocks offering both growth potential and low valuations or because they choose stocks from a variety of style ranges.

### **Mid Relative Value**

Mid-cap relative value portfolios hold stocks available at attractive prices relative to some measure of actual value that still maintain healthy growth rates. This is reflected by style scores that are higher than other funds in the value spectrum.

### **Mid Core Value**

These portfolios pursue a classic value-style approach as reflected by their style scores, which generally land in the middle of the value range. They may choose some stocks that are currently out of favor in the market, though management sees the potential for a turnaround. Alternatively, they may focus on achieving returns through consistent income.

### **Mid Income-Oriented Value**

Mid-cap income-oriented value portfolios focus on stocks in the mid-range of US market capitalization that provide the opportunity for high current income through reliable dividends. These portfolios may also choose some stocks considered to be in distress or out of favor.

### **Small High Growth**

Small high growth portfolios are defined as having style scores at the very top of funds in the small cap range. Funds in this group tend to focus on young firms or companies from emerging industries. The nature of these companies combined with market expectations of high growth generally contributes to relatively volatile returns.

### **Small Core Growth**

Small core growth portfolios are also subject to relatively higher volatility as they may also favor young firms or firms from growing industries that have not yet established a consistent revenue stream; however, core growth portfolios prefer stocks that offer solid growth potential without the extreme price tag. Funds in this group will have low size scores.

## Domestic Equity (continued)

### **Small Valuation Sensitive Growth**

Small valuation sensitive growth funds seek those firms that are expected to grow steadily in the future but have reasonable price valuations, potentially because the market has not yet established certainty about the firm's prospects or because the relevant industry is somewhat mature. This combination of growth at a reasonable price is depicted by style scores a step higher than those of blended strategies.

### **Small Core**

Funds in the small core group typically pursue one of two strategies. These funds either seek exposure to firms with a wide range of value and growth characteristics or they choose companies with growth and valuation characteristics roughly equivalent to the average for US small cap stocks. As a result, their style scores fall directly in the center of the score distribution for small cap funds.

### **Small Relative Value**

Small relative value portfolios maintain a somewhat middle-of-the-road approach with a distinct value tilt. They seek promising stocks available at a discount to some measure of their intrinsic value. This slight preference for value is borne out by the style score, which is just lower than the average for small cap funds.

### **Small Core Value**

Small core value portfolios typify the value investing principle of seeking stocks with the potential for capital gains available at prices that reflect a discount to book value, or some other measure of actual value. As a result, their style scores tend to be in the middle of the value-oriented range.

### **Small Deep Value**

Small deep value portfolios seek stocks that are trading at a deep discount relative to their book value. These companies are most likely in some distress but fund management sees potential for turnaround. Small deep value funds have both low size and style scores.

## Domestic Equity (continued)

### **Micro Cap**

Funds in this group focus primarily on the very smallest stocks in the US market and may seek either value or growth opportunities. Micro cap companies are typically very young or in extremely new industries and due to this, they may have unproven revenue streams. As a result, these funds may be subject to high return volatility. Micro cap funds may have a wide range of style scores but have the lowest size scores possible.

### **All-Cap Growth**

All-cap growth funds seek to maintain balanced exposure to stocks of all sizes, preferring those with strong prospects for growth and capital appreciation. These portfolios will invest at least 20% of assets in each of the large, mid and small market capitalization ranges. Funds in this group have a style score reflective of either valuation-sensitive, core or high growth characteristics.

### **All-Cap Core**

All-cap core funds exhibit a profile broadly representative of the entire US market. They maintain at least 20% exposure to each of the large, mid and small market capitalization groups and they select stocks with a variety of growth and price characteristics. Style scores in this group will be roughly equivalent to the overall average.

### **All-Cap Value**

All-cap value portfolios seek opportunities for reasonably priced returns, either through capital appreciation or current income, across the US market capitalization spectrum. These portfolios invest at least 20% of assets in the each of the three broad cap ranges: large, mid and small. The style scores will range from relative value to income-oriented value.

# Alternative Strategies

Alternative strategies funds employ a unique investment approach designed to offer returns different than those of the US stock market. These funds are not defined by their region, sector or market cap exposure but rather by their long or short exposure to the market at large. Typically, the asset allocation attained by these “hedge-fund like” strategies is the result of substantial exposure to derivative instruments.

## **Bear Market**

Bear market portfolios invest in short positions and derivatives in order to profit from stocks that drop in price. Because these portfolios often have extensive holdings in shorts or puts, their returns generally move in the opposite direction of the benchmark index.

## **Market Neutral**

Market neutral portfolios seek income while maintaining low correlation to fluctuations in market conditions. Market neutral portfolios typically hold 50% of net assets in long positions and 50% of net assets in short positions in order to deliver positive returns regardless of the direction of the market.

## **Long-Short**

Long-short portfolios hold sizable stakes in both long and short positions. These funds may vary their long and short exposure to markets, depending on management’s macroeconomic outlook or particular opportunities.

## **Leveraged**

Leveraged portfolios seek to achieve overall exposure to the market consistently larger than the sum of fund assets. This is achieved through borrowed cash invested in securities that can provide income or capital appreciation in excess of the borrowing costs. This allows management to achieve returns through stocks held on a long-term basis as well as through short-term opportunities. These portfolios are defined by greater than 110% net equity exposure.

## Alternative Strategies (continued)

### **Leveraged Net Long**

Leveraged net long funds are typically referred to as “130/30” funds. These portfolios seek to maintain long equity exposure in excess of total fund assets (130% long, for example) which are offset by short positions that bring the net equity exposure to roughly 100% of net assets. The result is that these funds achieve positive returns in line with the overall market but also benefit from a few opportunistic stock declines.

### **Precious Metals**

Most precious metals funds invest primarily in mining-related stocks though some do invest directly in gold bullion. Funds in this group may focus specifically on gold or they may be exposed to a variety of precious- or base-metal mining stocks.

### **Currency**

Currency portfolios seek exposure directly to US and foreign currencies via money market instruments and derivative securities. Examples of these include forward currency contracts and index options.

# Sector Specific

Sector-specific funds are usually equity funds, in that they maintain at least 85% exposure to equity. Occasionally though, these funds may also gain the given sector exposure through bonds or derivative instruments with bond-like exposure.

The sector designations are based on the GICS (Global Industry Classification Standard) classification system. Membership in one of the following categories is defined by having at least 70% exposure to the indicated sector.

## **Domestic Energy**

Domestic energy portfolios invest at least 70% of assets in US securities that provide exposure to the GICS Energy sector. Companies in this sector will be involved in the exploration, production, marketing and transportation of oil, gas and coal products. They may also provide energy-related services or equipment.

## **World Energy**

World energy funds seek companies from the US and throughout the world that engage in energy exploration, production, refinement, transportation and sales. These funds may focus on oil, gas, coal or other consumable fuel-based products.

## **Domestic Health**

Funds in this group maintain at least 70% exposure to US companies in the GICS Health Care sector. Domestic health portfolios may select a wide variety of firms, including those that manufacture health care equipment and supplies, provide health-related services or engage in research and development of pharmaceuticals.

## **World Health**

World health funds maintain at least 30% exposure to the US but otherwise seek global exposure to health care-related industries. Some funds in this group focus on a specific industry segment, such as biotechnology production, while others spread exposure across the sector at large.

## Sector Specific (continued)

### **Technology**

Technology-focused portfolios look for returns from the broad Information Technology sector, which is comprised of companies involved in the development, production and marketing of hardware or software products and services. Technology funds may invest in domestic or international stocks, focusing specifically on Internet-related firms or may choose exposure to a combination of industries such as database management, electronics equipment or semiconductor firms.

### **Communications**

Communications portfolios invest domestically or globally in firms that provide communications services through fixed-line, cellular, wireless or fiber optic cable networks. These firms belong to the GICS Telecommunications sector.

### **Utilities**

Portfolios from this group focus on stocks from the GICS Utilities sector. These are generally mature and stable firms that operate as electric, gas and water utilities in either US or international markets.

### **Domestic Financial**

Domestic financial portfolios focus at least 70% of assets on US stocks of companies that engage in banking, finance, asset management and insurance services. These companies comprise the GICS Financial sector, less the REITs segment.

### **World Financial**

Global financial funds hold stocks of US and international firms that comprise the GICS Financial sector, less the REITs segment. These companies engage in banking, finance, asset management and insurance services. Global portfolios maintain at least 30% exposure to domestic firms.

### **Domestic Real Estate**

Domestic real estate portfolios primarily invest in real-estate investment trusts (REITs), of which there are various types. Some focus on apartment, hotel, industrial or shopping-center properties. These portfolios maintain at least 70% exposure to US stocks.

## Sector Specific (continued)

### **World Real Estate**

These portfolios seek capital appreciation through investing primarily in REITs, though some do invest directly in real-estate operating companies. Global portfolios commit 30-70% of assets to the US.

### **Foreign Real Estate**

Foreign real estate portfolios seek favorable real estate investment opportunities outside of the US market. Primarily, these investments are non-US REITs but may also include real-estate operating companies.

### **Consumer Staples**

Consumer staples portfolios invest domestically or internationally in companies that produce non-durable household goods and other products that are generally less sensitive to market cycles. These funds could focus on a wide variety of products and services, from food and beverage manufacturers to operators of large retail centers.

### **Consumer Discretionary**

Consumer discretionary firms are those involved in manufacturing of durable household goods, textiles and automobiles. Firms in service industries like travel and leisure, apparel retail and media production are also included. Funds that focus on these types of stocks can be vulnerable to market fluctuations as these goods and services are sensitive to economic cycles. Funds in this group can invest in both US and international stocks.

### **Industrials**

Funds that focus on stocks from the Industrials sector may provide exposure to companies active in a broad range of industry segments, from aerospace and defense manufacturing to the provision of transportation and employment services. They may invest domestically and internationally. Some may specialize in a particular segment, such as transportation, while others may seek to reduce risk via diversification across the spectrum.

### **Materials**

Materials-focused portfolios can be described as commodity funds as this sector is comprised of firms involved in the manufacture of paper and forest products, construction materials and steel products. Funds in this group may provide exposure to US or foreign markets.

# International Equity

International equity portfolios expand their focus to include stocks domiciled in countries outside the United States though most invest primarily in developed markets. World or global funds keep 30-70% of assets in domestic securities but typically invest the remaining assets in foreign stocks. In contrast, foreign funds devote no less than 70% of assets to international markets. Market cap or style specialties are identified via the same Morningstar Style Box methodology that applies to domestic equities though breakpoints are adjusted to account for market differences.

Individual region or country focuses are defined by at least 70% exposure to the indicated markets, as presented through portfolio holdings.

## **Foreign Giant**

Foreign giant-capitalization portfolios invest in stocks from the very largest international companies. These portfolios provide exposure to a wide range of prices and growth expectations, as well as a variety of developed markets. Size scores for these funds are the highest possible while style scores may span the spectrum.

## **Foreign Large Growth**

Portfolios from this group choose stocks that offer solid potential for capital appreciation. These funds have the highest style scores of funds in this capitalization range, which reflect their appetite for growth and relatively higher prices.

## **Foreign Large Core**

Foreign large core managers seek exposure to well-established, sizeable firms that represent broad exposure to foreign markets. These portfolios may closely follow the MSCI EAFE index or may actively seek firms with a combination of growth and valuation characteristics. Style scores are in the middle of the range for large-cap funds.

## **Foreign Large Value**

Foreign large value portfolios exhibit classic value attributes. They may provide exposure to dividend-paying stocks or firms considered out of favor by the market. These funds have lower style scores, as the valuation ratios and projected growth of their favored stocks are lower.

## International Equity (continued)

### **Foreign Sm/Mid Growth**

Portfolios from this group invest in smaller firms with ambitious expectations for growth. These funds generate returns primarily through capital appreciation since the firms they hold reinvest excess cash in other growth opportunities. High style scores reflect fast growth and high price multiples while small to mid size scores reflect the preference for stocks in the lowest 30% of each economically integrated market (such as Europe or Asia ex-Japan).

### **Foreign Sm/Mid Core**

Foreign sm/mid core portfolios choose stocks from the smallest 30% of international market capitalization. Style scores for funds in this category span from value to growth.

### **Foreign Sm/Mid Value**

Foreign sm/mid value funds look for smaller international companies that offer returns at attractive prices. These portfolios may choose value stocks because they offer high dividend yields or turnaround potential at cheap prices. Both style and size scores for these funds will be low relative to most international equity portfolios.

### **Foreign All-Cap**

Foreign all-cap portfolios invest at least 20% of assets in each of the three main market capitalization ranges: large, mid and small. Style scores will vary widely for these funds as they may favor a variety of growth opportunities and price multiples.

### **World Large Growth**

World large growth portfolios seek classic growth opportunities among international and domestic firms. The preference for fast growth is borne out by the highest style scores of large-cap portfolios with global exposure.

### **World Large Core**

These funds exhibit style scores roughly equal to the average for funds in the global large-cap range, either because they seek stocks offering both growth potential and low valuations or because they choose stocks from a variety of style ranges. Stocks found in these portfolios will typically come from the largest 70% of world market capitalization.

# International Equity (continued)

## **World Large Value**

Portfolios in this group pursue a classic value approach as reflected by their style scores, which are typically in the low-end of the large cap range. World large value managers seek to generate returns through either dividends or discounted growth from firms in the largest 70% of market capitalization.

## **World Mid Cap**

World mid-cap portfolios may hold global mid-cap stocks specifically or a wider array of large to small stocks, resulting in a mid-range size score. Funds in this category span the style spectrum.

## **World Small Cap**

World small-cap portfolios invest primarily in stocks that comprise the smallest 30% of global markets. These firms may be young or from emerging industries worldwide. Style scores in this group may vary greatly.

## **World All-Cap**

World all-cap portfolios favor a broad sampling of global stocks, which is achieved by investing at least 20% of assets in each of the large, mid and small market cap ranges. These funds may pursue either value or growth strategies, leading to a broad range of style scores.

## **Europe**

Europe funds typically invest in large, economically developed European countries, including Germany, France, the Netherlands and Britain. Some may also provide limited exposure to the emerging areas of Eastern Europe.

## **Emerging Europe**

These portfolios invest the majority of fund assets in the emerging markets of Europe, which are typically thought of as the Eastern European nations, but can include western countries such as Portugal and Greece. The Russian market is a popular focus for these funds.

## International Equity (continued)

### **Japan**

Japan-focused funds invest primarily in the large and highly developed Japanese market. Reflecting Japan's economic maturity, these funds may vary their investment focus between large or small cap and growth or value stocks.

### **Pacific Asia ex-Japan**

These portfolios may focus on a variety of Asian financial markets, excluding Japan. Most invest primarily in Hong Kong, Singapore, Taiwan and Korea. Due to the export-oriented nature of these markets, many of the stocks found in these portfolios will be from manufacturing industries.

### **China**

China funds seek focused exposure to the diverse Chinese market. These funds may choose from a wide variety of market capitalizations and industry segments, though many emphasize the financial and telecom sectors.

### **Latin America**

These funds typically focus on the largest economies in Latin America such as Brazil, Mexico and Argentina. The smaller, less well-developed markets, such as Peru and Colombia, tend to be largely unrepresented in these portfolios.

### **India**

These funds invest the majority of assets in firms based in India. Portfolios from this group may provide focused exposure to India's information technology and industrial materials sectors.

### **Diversified Emerging Markets**

Diversified emerging markets portfolios invest at least 70% of assets in emerging markets from around the world. Though these portfolios typically invest in 20 or more countries, they tend to put more emphasis on companies based in Latin America or Asia. Firms from the Middle East or Africa are generally less well represented.

# Balanced

Balanced portfolios employ diverse asset allocation strategies to divide investable assets into an optimal mix of exposure to equity, fixed income and cash or cash-like securities. Domestic allocation funds invest at least 70% of total assets in domestic securities while global portfolios limit US exposure to 30-70%. Foreign balanced funds invest 70% or more in international markets. The proportion of equity exposure to fixed income exposure determines a portfolio's relative placement.

## **Aggressive Allocation**

Aggressive allocation portfolios invest between 70% and 85% of total assets in equity securities; remaining assets are allocated among bonds or cash. Portfolios in this group may focus on a wide range of market capitalization and valuation characteristics, though under normal market conditions they tend to maintain a fairly static asset allocation.

## **Moderate Allocation**

Moderate allocation portfolios distribute assets among all three major asset classes: equity, bonds and cash. These portfolios take a balanced approach, investing 50-70% of assets in domestic equity securities and 30-50% in fixed income. Typically, exposure to each asset class remains within specified ranges.

## **Conservative Allocation**

Conservative allocation funds pursue exposure to each major asset class, with a preference for fixed income. These portfolios typically invest 20-50% of assets in equities, with the remainder focused on bonds and some cash. Relative exposure to each asset type typically falls within specified ranges.

## **Foreign Allocation**

These funds typically invest in a mix of international stocks, bonds or cash. The asset allocation of these portfolios is likely to remain somewhat fixed over time, especially given normal market conditions. Foreign allocation funds may be either aggressive or conservative with respect to equity exposure.

## **Global Allocation**

Global allocation portfolios provide exposure to stocks, bonds and cash globally. These funds generally specify a preferred asset allocation mix and adhere to that over time, though funds in this group may be more heavily-weighted in either stocks or bonds.

## Balanced (continued)

### **Flexible Allocation**

Funds in this group allocate among stocks, bonds and cash. The relative proportion of assets devoted to each asset class varies over time as these funds do not adhere to a pre-defined target mix.

### **Global Flexible Allocation**

Portfolios from this group offer exposure to all of the major asset classes globally, but do not have a specific target asset allocation, thus they may invest in variable proportions of stocks, bonds or cash.

### **Convertibles**

Convertible bond portfolios have a stated focus on convertible bonds and convertible preferred stocks. These securities tend to behave like both stocks and bonds. They can be converted to shares of stock under optimal conditions, providing the upside exposure of stocks; however, they generally provide a stream of consistent income, which also gives them some fixed-income characteristics.

# Target Date

Target date portfolios are generally intended to provide a comprehensive solution to an investor's retirement savings needs. These portfolios apply a customized asset allocation strategy to optimally allocate investments between equity, bond and cash. Over time, the relative proportion in the riskier asset, equity, is reduced as the investor draws nearer to retirement. Within this asset allocation glide path framework, managers vary widely in regards to their appetite for risk, as do investors.

Morningstar's target date categories classify the universe of funds with similar target dates based on their relative risk profile using the Morningstar Lifetime Allocation Indexes. Ibbotson Associates developed the asset allocation framework for these indexes where the highest equity stakes are considered aggressive while funds with the lowest equity exposure are conservative. Moderate funds lie in the mid-range. The equity allocation ranges that define the risk profiles within each target date category will be refreshed annually, corresponding to the year-end index rebalance.

## **Target Date 2000-2010 Aggressive**

These portfolios are generally intended for investors whose retirement date has recently passed or is in the very near future. These funds typically invest heavily in bonds, though aggressive portfolios have a higher equity allocation than their conservative or moderate counterparts.

## **Target Date 2000-2010 Moderate**

Funds in this group are best for investors with a recent or near-term retirement date. To meet the need for safety and income necessary at this stage of the investment horizon, these portfolios invest primarily in bonds. The moderate classification indicates equity exposure in the mid-range of funds in this target retirement date range.

## **Target Date 2000-2010 Conservative**

Target Date 2000-2010 portfolios are largely invested in bonds so as to provide safety and consistent income to shareholders at or very near retirement. Funds in this group are the most conservative with respect to risk appetite.

## **Target Date 2011-2015 Aggressive**

Target Date 2011-2015 portfolios are intended for investors who have a specific date in mind (in this case, 2011 through 2015) for retirement or another goal. Aggressive funds have the highest proportion of assets invested in equities.

## Target Date (continued)

### **Target Date 2011-2015 Moderate**

Target Date 2011-2015 portfolios are intended for investors who have a specific date in mind (in this case, 2011 through 2015) for retirement or another goal. Moderate portfolios in this group may allocate assets fairly evenly between equity and fixed income securities.

### **Target Date 2011-2015 Conservative**

Target Date 2011-2015 portfolios are intended for investors who have a specific date in mind (in this case, 2011 through 2015) for retirement or another goal. Conservative portfolios will focus more heavily on bonds, providing more safety and dividend income than aggressive or moderate portfolios.

### **Target Date 2016-2020 Aggressive**

Target Date 2016-2020 portfolios are intended for investors who have a specific date in mind (in this case, 2016 through 2020) for retirement or another goal. Aggressive portfolios may experience higher return volatility as they are the most heavily invested in stocks.

### **Target Date 2016-2020 Moderate**

Target Date 2016-2020 portfolios are intended for investors who have a specific date in mind (in this case, 2016 through 2020) for retirement or another goal. Moderate portfolios are designed for investors at this stage with a roughly average level of risk aversion.

### **Target Date 2016-2020 Conservative**

Target Date 2016-2020 portfolios are intended for investors who have a specific date in mind (in this case, 2016 through 2020) for retirement or another goal. Conservative portfolios are more heavily weighted in bonds or cash than their aggressive or moderate counterparts.

### **Target Date 2021-2025 Aggressive**

Target Date 2021-2025 portfolios are intended for investors who have a specific date in mind (in this case, 2021 through 2025) for retirement or another goal. Aggressive portfolios have the highest allocation to equities in this target date range, but also have notable exposure to bonds.

### **Target Date 2021-2025 Moderate**

Target Date 2021-2025 portfolios are intended for investors who have a specific date in mind (in this case, 2021 through 2025) for retirement or another goal. The moderate classification indicates equity exposure in the mid-range of funds in this target retirement date range.

## Target Date (continued)

### **Target Date 2021-2025 Conservative**

Target Date 2021-2025 portfolios are intended for investors who have a specific date in mind (in this case, 2021 through 2025) for retirement or another goal. Funds in this category have the highest allocation to fixed-income securities.

### **Target Date 2026-2030 Aggressive**

Target Date 2026-2030 portfolios are intended for investors who have a specific date in mind (in this case, 2026 through 2030) for retirement or another goal. Aggressive portfolios in this group have the highest allocation to equities.

### **Target Date 2026-2030 Moderate**

Target Date 2026-2030 portfolios are intended for investors who have a specific date in mind (in this case, 2026 through 2030) for retirement or another goal. Moderate portfolios maintain exposure to equity based on a roughly average level of risk acceptance.

### **Target Date 2026-2030 Conservative**

Target Date 2026-2030 portfolios are intended for investors who have a specific date in mind (in this case, 2026 through 2030) for retirement or another goal. Conservative funds are more heavily weighted in bonds or cash than their aggressive or moderate counterparts.

### **Target Date 2031-2035 Aggressive**

Target Date 2031-2035 portfolios are intended for investors who have a specific date in mind (in this case, 2031 through 2035) for retirement or another goal. Aggressive portfolios allocate the majority of their investments to equity securities.

### **Target Date 2031-2035 Moderate**

Target Date 2031-2035 portfolios are intended for investors who have a specific date in mind (in this case, 2031 through 2035) for retirement or another goal. Moderate portfolios will primarily invest in equities but will allocate more to bonds than aggressive funds in this target date range.

### **Target Date 2031-2035 Conservative**

Target Date 2031-2035 portfolios are intended for investors who have a specific date in mind (in this case, 2031 through 2035) for retirement or another goal. The conservative classification covers funds with the lowest amount of equity exposure in this target date range.

## Target Date (continued)

### **Target Date 2036-2040 Aggressive**

Target Date 2036-2040 portfolios are intended for investors who have a specific date in mind (in this case, 2036 through 2040) for retirement or another goal. Aggressive portfolios have a higher allocation to equities than their moderate or conservative peers.

### **Target Date 2036-2040 Moderate**

Target Date 2036-2040 portfolios are intended for investors who have a specific date in mind (in this case, 2036 through 2040) for retirement or another goal. Moderate funds have an equity allocation that's higher than their conservative peers, but lower than their aggressive peers.

### **Target Date 2036-2040 Conservative**

Target Date 2036-2040 portfolios are intended for investors who have a specific date in mind (in this case, 2036 through 2040) for retirement or another goal. Conservative portfolios invest a notable portion of assets in bonds or cash.

### **Target Date 2041-2045 Aggressive**

Target Date 2041-2045 portfolios are intended for investors who have a specific date in mind (in this case, 2041 through 2045) for retirement or another goal. Given the long time horizon, funds at this early stage of the glide path invest primarily in equity, as investors at this stage can afford to assume a relatively high amount of risk. Aggressive portfolios are at the high end of the range of equity exposure.

### **Target Date 2041-2045 Moderate**

Target Date 2041-2045 portfolios are intended for investors who have a specific date in mind (in this case, 2041 through 2045) for retirement or another goal. For funds at this stage of the glide path, variations in equity exposure are relatively minimal since most investors are primarily concerned with wealth accumulation. Moderate funds, however, consistently provide equity exposure in the mid-range for funds with this target date range.

### **Target Date 2041-2045 Conservative**

Target Date 2041-2045 portfolios are intended for investors who have a specific date in mind (in this case, 2041 through 2045) for retirement or another goal. While portfolios designed for investors with a long investment horizon are primarily exposed to equity, conservative portfolios invest more assets in bonds than aggressive or moderate funds in this group.

## Target Date (continued)

### **Target Date 2050+ Aggressive**

Target Date 2050+ portfolios are designed for investors just beginning to save for retirement. As a result, most funds invest the majority of assets in equity, so asset allocation variation among risk profiles is minimal. Aggressive funds, however, have more equity exposure than most other funds in this target date range.

### **Target Date 2050+ Moderate**

Target Date 2050+ portfolios are designed for investors just beginning to save for retirement. Funds from this group allocate the majority of assets to equity securities, but they also provide a bit more exposure to bonds than aggressive funds.

### **Target Date 2050+ Conservative**

Target Date 2050+ portfolios are designed for investors just beginning to save for retirement. While portfolios designed for investors with a long investment horizon are primarily exposed to equity, conservative portfolios invest more assets in bonds than aggressive or moderate funds.

### **Retirement Income Aggressive**

Retirement income portfolios are designed for investors already in retirement who are actively drawing down accumulated assets. Aggressive portfolios invest a substantial portion of net assets in equity securities.

### **Retirement Income Moderate**

Retirement income portfolios are designed for investors already in retirement who are actively drawing down accumulated assets. Moderate portfolios have less equity exposure than aggressive portfolios.

### **Retirement Income Conservative**

Retirement income portfolios are designed for investors already in retirement who are actively drawing down accumulated assets. Conservative portfolios invest the majority of assets in fixed-income securities.

# Taxable Bond

Taxable bond portfolios invest at least 80% of assets in securities that provide bond or cash exposure. Duration and credit quality placement are determined using Morningstar's Fixed Income Style Box methodology. A fund's fixed-income style box placement is calculated using average effective duration and credit quality distribution data provided by the fund's management. Average effective duration classifications typically are as follows:

- ▶ Long: >6 years
- ▶ Intermediate: 4-6 years
- ▶ Short-Intermediate: 2.5-4
- ▶ Short: 1-2.5
- ▶ Ultrashort: <1

Taxable bond portfolios are also differentiated by focus on a specific sector. A sector focus is defined by consistent investment of at least 70% of assets in the given sector.

## **Ultrashort Investment Grade**

Ultrashort investment grade portfolios focus on AAA- or AA-rated securities that mature in less than one year. These securities may include corporate or government issues.

## **Short Government**

Short government portfolios invest the majority of assets in securities backed by the US government or government agencies. These portfolios offer low risk potential and limited total return potential.

## **Short Investment Grade**

Short investment grade portfolios may provide exposure to both high quality corporate bonds and government issues. Both types of securities offer low risk of default while the short-term focus of these portfolios leads to low interest rate risk.

## **Short/Intermediate Government**

Portfolios in this group prefer bonds issued either by the US government or by government-linked agencies. As a result, these portfolios have minimal credit risk. Given their short to intermediate duration focus, interest rate risk is also muted.

## Taxable Bond (continued)

### **Short/Intermediate Investment Grade**

Short/intermediate investment grade portfolios invest primarily in corporate bonds with an AAA or AA credit rating or government-guaranteed bonds. Total risk and return potential for funds in this group is marginally higher than funds with a strict focus on government securities.

### **Intermediate Government**

Intermediate government portfolios focus on bonds issued by the US government or government-linked agencies. While these portfolios are not subject to high default risk because of the government's backing, they are subject to interest rate risk. Total risk and return potential for these funds will naturally fall between that of short- and long-government-focused portfolios.

### **Intermediate Investment Grade**

Portfolios from this group focus on bond issues rated AA or higher. Typically, these funds will have exposure to both corporate and government securities. Because high-quality bonds are usually more creditworthy, the primary investment risk comes from interest-rate sensitivity.

### **Long Government**

Long government portfolios invest heavily in long-term bonds backed by the US government or its agencies. While default risk of these securities is considered very low, these portfolios will experience higher returns and volatility than other government portfolios because interest rate fluctuations will have a bigger impact on their longer-duration bonds.

### **Long Investment Grade**

Long investment grade portfolios buy long-term bonds from issuers rated AA or higher. These can include corporate or government issues. Funds from this group may have higher returns and volatility than most other bond funds as they are generally subject to more default and duration risk.

### **GNMA**

These portfolios have a stated focus on securities issued by the Government National Mortgage Association (Ginnie Mae or GNMA). GNMA mortgage-backed securities carry an explicit government guarantee, making them the safest mortgage-backed investments. These portfolios typically have high average credit quality.

## Taxable Bond (continued)

### **Mortgage-Backed**

Mortgage-backed portfolios invest the majority of assets in mortgage-backed securities from a wide variety of issuers and with a wide range of maturities. These funds are exposed to both credit quality and interest rate risk, leading to both high risk and high return potential.

### **A-Rated**

These portfolios maintain average credit quality exposure equivalent to A-rated securities either through a specific focus on those securities or through balanced exposure to securities rated in the range between high and low quality. Typically, these portfolios will be primarily invested in corporate bonds.

### **BBB-Rated**

BBB-rated portfolios maintain exposure to securities rated in the middle ground between high and low quality. These portfolios are typically invested heavily in corporate bonds of various maturities.

### **Multisector Bond**

Multisector bond portfolios invest in mortgages, foreign bonds, and high-yield debt. These funds tend to hold 35-65% of assets in unrated or high yield bonds.

### **High Yield Bond**

Portfolios in this group seek returns via significant exposure to low quality bonds, those that are either unrated or rated by a major agency as BB or lower. These securities offer higher yields because they have a higher probability of default and are generally more vulnerable to economic fluctuations. These funds tend to have higher total return and risk potential than investment-grade bond portfolios.

### **Bank Loan**

Bank loan funds focus on floating-rate bank loans instead of bonds. These securities carry credit risk but also have a relatively high, adjustable current income based on a common short-term benchmark whose interest rate adjusts periodically, such as the LIBOR.

## Taxable Bond (continued)

### **World Bond**

World bond portfolios invest 30-70% of assets in fixed income securities issued by non-US entities. These funds may focus primarily on developed markets or provide some exposure to emerging market issuers.

### **Foreign Bond**

Foreign bond funds invest at least 70% of assets in international fixed-income securities. Most likely these portfolios are primarily exposed to developed markets and high-quality bonds; however, they may also invest in low-quality issues or emerging markets. As a result, these portfolios may be exposed to several sources of risk, including credit quality, interest rate, and currency.

### **Emerging Markets Bond**

Emerging markets bond funds focus on fixed-income securities from emerging markets around the world. These portfolios will most likely include exposure to Latin America and Eastern Europe.

### **Inflation-Protected Bond**

Funds in this group invest the majority of assets in securities whose principal values are adjusted with inflation rates in order to mitigate inflation risk. While any entity could issue such securities, the United States Treasury is currently the primary source of inflation-hedged bonds.

# Municipal Bond

Municipal bond strategies are generally defined by state or national focus and duration exposure. A fund is considered state-specific if at least 70% of its assets are invested in municipal securities issued by the various government entities of a single state. Average effective duration and credit-quality distribution are calculated and provided by fund management. These figures lead to duration- and credit-quality-based category assignments via Morningstar's Fixed Income Style Box methodology. The duration classifications that apply to taxable bond portfolios also apply to municipal bond portfolios.

## **Muni National Long**

These portfolios focus on long-term bonds issued by states and municipalities from across the country. The income earned through these portfolios is generally federal tax-exempt. While these portfolios do not experience substantial credit risk, their long-duration focus gives them interest rate sensitivity.

## **Muni National Intermediate**

Muni national intermediate portfolios invest the majority of assets in municipal bonds issued by various state and local governments. The advantage of these portfolios is that the income earned is exempt from federal taxes.

## **Muni National Short/Intermediate**

Muni national short/intermediate portfolios invest in bonds issued by various states and municipalities to fund public projects. Income garnered by bondholders is generally free from federal taxes.

## **Muni National Short**

Muni national short portfolios invest in short-term bonds issued by state and local governments from across the country. The revenue from these bonds is used to fund public projects and the income provided to bondholders is typically exempt from federal taxes.

## **High Yield Muni**

High yield municipal portfolios maintain substantial exposure to low quality municipal bonds, which include those that are not rated or are rated BBB or lower by a major rating agency such as Standard & Poor's or Moody's. These portfolios offer higher total return and risk than most other municipal portfolios.

## Municipal Bond (continued)

### **Muni Insured**

These portfolios invest primarily in municipal securities that are insured, either by the issuer or the underwriter of the bond, to guarantee timely payment of principal and interest. Funds from this group invest in securities issued by various state and local governments.

### **Muni Single State Insured**

Muni single state insured portfolios focus on insured municipal securities issued by the state or local governments of a single state. Insured securities carry a guarantee, made by either the bond issuer or underwriter, to make timely principal and interest payments.

### **Muni California Insured**

Muni California insured portfolios invest the majority of assets in insured municipal securities issued by the state of California or individual city and county governments. Insured securities carry a guarantee, made by either the bond issuer or underwriter, to make timely principal and interest payments. The income earned by these portfolios is typically free from California state tax.

### **Muni Arizona**

Muni Arizona portfolios invest in Arizona municipal debt. Income earned from these portfolios is typically free from both federal and Arizona state taxes.

### **Muni California Long**

Muni California long portfolios invest primarily in California municipal debt and have an average effective duration greater than six years. These portfolios have increased interest rate sensitivity relative to short or intermediate portfolios. The income earned by these portfolios is free from federal and California state taxes.

### **Muni California Intermediate**

Muni California portfolios invest in bonds issued by the state and local governments of California, and have an average effective duration between four and six years. The income earned by these portfolios is free from federal and California state taxes.

## Municipal Bond (continued)

### **Muni California Short-Intermediate**

These portfolios invest primarily in California municipal debt and have an average effective duration less than four years. The income earned by these portfolios is free from federal and California state taxes.

### **Muni Colorado**

Muni Colorado portfolios invest specifically in Colorado municipal debt. This group includes funds spread across the duration spectrum. The primary advantage of these portfolios is that income earned is typically exempt from both federal and Colorado state taxes.

### **Muni Connecticut**

Muni Connecticut funds purchase securities issued by the state of Connecticut or its various local governments. The income earned through these portfolios is free from federal and Colorado state taxes. These portfolios may focus on long, intermediate or short-term bonds.

### **Muni Florida**

Muni Florida portfolios invest primarily in Florida municipal debt, the income from which is exempt from both federal and Florida state taxes. This group may include funds with a focus on short, intermediate, or long-term bonds.

### **Muni Georgia**

Muni Georgia portfolios invest in bonds issued by the state of Georgia or any of its local governments to fund public projects. The income paid to bondholders is generally free from federal and Georgia state taxes. This group may include long, intermediate or short-term portfolios.

### **Muni Maryland**

These portfolios invest heavily in Maryland municipal debt and offer exposure across the duration spectrum. The income earned through these portfolios is free from both federal and Maryland state taxes.

### **Muni Massachusetts Long**

These portfolios focus on Massachusetts municipal debt, and have an average effective duration greater than six years. Because of the additional interest-rate sensitivity associated with longer duration bonds these funds may have greater total return potential than their short or intermediate counterparts. The income earned by these portfolios is free from federal and Massachusetts state taxes.

## Municipal Bond (continued)

### **Muni Massachusetts Short & Intermediate**

Muni Massachusetts short & intermediate funds invest the majority of assets in Massachusetts municipal debt. In particular, funds in this group have an average effective duration less than six years. The income earned by these portfolios is free from federal and Massachusetts state taxes.

### **Muni Michigan**

Muni Michigan portfolios invest primarily in Michigan municipal debt, issued to raise funding for public projects. These portfolios may have exposure across the duration spectrum or focus specifically on long, intermediate or short-term bonds. Income earned by these portfolios is free from federal and Michigan state taxes.

### **Muni Minnesota**

Muni Minnesota portfolios primarily invest in bonds issued by the state of Minnesota or its local governments to fund public projects. The income earned by these securities is exempt from federal and Minnesota state taxes. Portfolios from this group may focus on long, intermediate or short-term bonds.

### **Muni Missouri**

These portfolios buy bonds issued by the state of Missouri or its local governments. The primary benefit of these portfolios, as compared to more diversified bond funds, is that the income earned is tax-exempt at both the federal and state level. Funds from this group may provide a wide range of duration exposure.

### **Muni New Jersey**

Muni New Jersey portfolios invest primarily in New Jersey municipal debt. These funds may have a preference for long, intermediate or short-term bonds. Income earned through these portfolios is generally exempt from federal and New Jersey state taxes.

### **Muni New York Long**

These portfolios buy bonds issued by the state of New York or its local governments issued in order to raise funds for public projects. These portfolios have an average effective duration greater than six years, leading to somewhat higher risk and return potential than a short or intermediate portfolio. Income earned through these portfolios is generally exempt from federal and New York state taxes.

## Municipal Bond (continued)

### **Muni New York Short & Intermediate**

These portfolios invest heavily in New York municipal debt, and have an average effective duration less than six years. Income earned through these portfolios is generally exempt from federal and New York state taxes.

### **Muni North Carolina**

Muni North Carolina portfolios invest the majority of assets in North Carolina municipal debt. These portfolios may be focused on any duration range and the income earned by shareholders is generally exempt from federal and North Carolina state taxes.

### **Muni Ohio**

Muni Ohio portfolios invest primarily in Ohio municipal debt, issued to raise funding for public projects. These portfolios may offer exposure across the duration spectrum or focus specifically on long, intermediate or short-term bonds. Income earned by these portfolios is free from federal and Ohio state taxes.

### **Muni Pennsylvania**

Muni Pennsylvania portfolios invest in Pennsylvania municipal debt. Income earned from these portfolios is typically free from both federal and Pennsylvania state taxes.

### **Muni Virginia**

Muni Virginia funds purchase securities issued by the state of Virginia or its various local governments. The income earned through these portfolios is free from federal and Virginia state taxes. These portfolios may focus on long, intermediate or short-term bonds.

### **Muni Single State Long**

These portfolios invest primarily in municipal debt issued by a single state or its local governments. Income earned from these portfolios will be free from federal taxes state level taxes, making them attractive investments for residents of the target state. Funds in this group will maintain average effective duration greater than six years.

## Municipal Bond (continued)

### **Muni Single State Intermediate**

Muni single state intermediate funds have an average effective duration between four and six years. Municipal securities are typically exempt from federal taxes. These funds also take advantage of state-tax benefits by focusing on bonds from a single state.

### **Muni Single State Short-Intermediate**

These portfolios invest primarily in municipal debt issued by a single state or its local governments. Income earned from these portfolios will be free from federal taxes and state taxes, making them attractive investments for residents of the target state. Funds in this group will maintain an average effective duration of less than four years.

# Money Market

Money market portfolios are generally described as those that invest in short-term securities that mature in less than one year, and are low risk enough to be considered cash equivalents. Examples of qualifying securities include US T-bills, high quality commercial paper and short-term CDs. These portfolios are differentiated by preference for taxable or tax-free securities.

## **Money Market Taxable**

These portfolios invest in highly liquid, ultra-short securities. The goal is to provide a level of current income that is consistent with the preservation of capital.

## **Money Market Tax-Free**

Tax-free money market portfolios invest primarily in ultra-short and highly liquid municipal securities that are typically exempt from some federal and state taxes. The primary goal of these portfolios is to provide current income consistent with capital preservation.