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The Long and Short of Fixed Income Investing

Fixed income investing through bonds or bond funds serves an important role in structuring a diversified portfolio. While stocks may offer investors capital appreciation over the long term, bonds may provide a stabilizing influence on a portfolio overall while offering income potential. This booklet helps explain some of the key terms and concepts that you'll hear about when exploring fixed income investing.

TYPES OF BONDS

Bonds, like stocks, come in a variety of types with varying levels of quality and risk. The major bond sectors include:

- **Treasury:** Issued by the U.S. Treasury and used to fund government activities and pay off national debt
- **Municipal:** Issued by states, cities, counties, and towns and used for public works or other activities
- **Corporate:** Issued by companies and used to fund expansion, modernization, expenses, or other activities
- **Asset-backed:** Broad class of securities backed by a wide range of collateral including residential and commercial mortgages and consumer debt
- **High-Yield (also called Below-Investment Grade):** Issued by companies and often used for mergers, acquisitions, and leveraged buyouts
- **Money Market:** Short-term investments such as government securities, certificates of deposits, commercial paper, and other highly liquid securities

BOND FUNDS

Bond funds are constructed using combinations of bonds with a variety of characteristics, such as: fixed or floating rate; eligible for early redemption or paid in full at maturity; government-guaranteed or not government-guaranteed; liquid or illiquid; and dollar- or non-dollar denominated.

The types and timing of bond funds selected for an investor's portfolio will be determined by the investor's goals, risk tolerance, and other investments. The investor needs to balance the credit risk and the interest rate risk against the desired rate of return. A greater degree of credit risk may provide a higher return along with potentially greater volatility.



SHORT-TERM FUNDS

Generally have average maturities of less than five years. Typically, short-term funds have a lower level of interest-rate risk than longer-term funds.

INTERMEDIATE-TERM FUNDS

Usually have average maturities from three and a half to seven years. Generally provide moderate levels of interest-rate risk, return, and volatility.

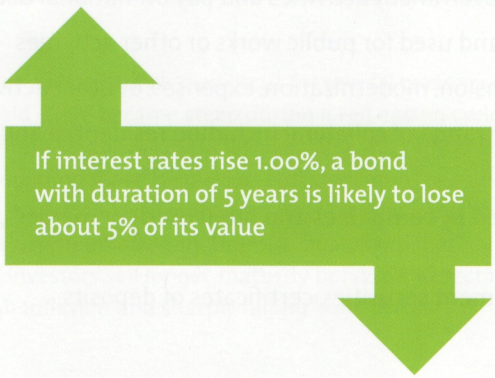
LONG-TERM FUNDS

Typically have average maturities of more than seven years. Because the investment is locked in for a longer period of time, these funds will usually provide the highest level of income. However, they will also usually have a higher degree of interest-rate risk and volatility than shorter-term bond funds.

Definitions of Key Fixed Income Terms and Concepts

THE IMPORTANCE OF TIME

- **Maturity:** Is the date by which the principal amount of the bond must be repaid. Most bond funds maintain a dollar-weighted average maturity, which is the average of all the current maturities of the individual bonds in the fund.
- **Duration:** Is the time-weighted average maturity of a bond expressed in years. Duration may be easily transformed into a measure of a bond's interest-rate sensitivity. Duration estimates how much a bond's price will rise or fall given a change in market interest rates; the longer the duration, the greater the price change relative to interest-rate movements. In general, if interest rates rise, bond prices fall; and if interest rates fall, bond prices tend to increase.



A MATTER OF INTEREST

- **Coupon:** The periodic interest rate the bond issuer has agreed to pay. It may be fixed or it may adjust over time.
- **Yield:** A term that describes the income return expected from an investment in a bond. A bond's yield can be measured in many different ways. Here are some common methods:
  - **Current Yield:** the bond's interest rate divided by its current price
  - **Yield to Maturity:** an estimate of what an investor will receive if the bond is held to its maturity date
  - **Tax-equivalent:** for non-taxable bonds, the return adjusted for the investor's tax bracket
- **Total Return:** A measure of return on investment in a bond that takes into account the coupon-based income and any change in the price of the bond in the market. The timeframe used to measure total return is the holding period. Total return equals the coupon income earned over the holding period plus the change in the price of the bond at the end of the holding period. A more complete total return measure also takes into account any income earned on reinvestment of coupon income.

THE IMPACT OF INFLATION

Inflation can pose a pervasive threat to fixed income portfolios because it eats away at real savings and investment returns. For example, a bond that earns 2% before inflation in an environment where inflation is 3% will actually provide the investor with a negative rate of return of -1%. This situation can severely impact a stream of coupon payments that a bond holder was counting on to pay expenses or for reinvestment. It also reduces the value of the principal of a fixed income investment.

Inflation can negatively affect fixed income investments in another way. As inflation rises, interest rates also tend to rise, which may lead to a decrease in total returns for bond funds.

*For more information on any Calvert fund, please contact Calvert at **800.368.2748** for a free prospectus. An investor should consider the investment objectives, risks, charges, and expenses of an investment carefully before investing. The prospectus contains this and other information. Read it carefully before you invest or send money.*

Investment in mutual funds involves risk, including possible loss of principal invested. You could lose money on your investment in a Calvert Fund or the Fund could underperform because of the following risks: the stock or bond market may decline; the individual stocks or bonds in the Fund may not perform as well as expected; and/or the Fund's portfolio management practices may not work to achieve their desired result. Bond funds are subject to interest rate and credit risk. As interest rates rise, bond prices generally decrease.

MEASURES AND TYPES OF RISK

You can evaluate risk in two ways: **relative risk** and **absolute risk**. Relative risk is a comparison between different risk levels, such as the risk of a specific bond fund versus its benchmark. Absolute risk is simply the probability of something happening (such as a decline in value) without comparison to any other type of risk.

RELATIVE RISK:

- **Alpha:** Is a measure of risk-adjusted return. It takes into consideration an investment's volatility and performance versus a benchmark. The excess return of an investment relative to its benchmark is its alpha. Positive absolute alpha suggests that, after taking into account the amount of risk taken, the portfolio manager may be providing added value over the benchmark return.

- **Sharpe Ratio:** Is a measure of risk-adjusted performance. It measures an investment's rate of return above or below the risk-free rate (typically that of the one-year Treasury note) per unit of risk taken. This calculation allows investors to compare the performance of funds with different risk levels. The higher the Sharpe Ratio, the better the fund's historical risk-adjusted performance.

ABSOLUTE RISK:

- **Interest Rate Risk:** Interest rates and price are closely linked in the fixed income world. In general, this is an inverse relationship: as rates rise, bond prices generally fall. Typically, the longer the bond's maturity, the greater the impact interest rates can have on its price. The risk is that if a bond is not held until maturity, the investor may realize a gain or a loss at the time of sale depending on the current interest rates.

- **Credit Risk:** This is a measure of the credit-worthiness of a bond's issuer (the likelihood of a bond issuer defaulting on principal payment or becoming bankrupt). Bonds are evaluated for credit quality by firms such as Moody's and Standard & Poor's.

FOR EXAMPLE:

If a particular bond fund holds a smaller percentage of corporate bonds than its benchmark and instead invests more in government bonds, the fund may have a higher relative risk than its benchmark because it doesn't conform exactly to the benchmark. At the same time, the fund's absolute risk may be lower because Treasury bonds are a less risky asset class than corporate debt.

CREDIT QUALITY:
What bond ratings mean...

S&P	MOODY'S	MEANING
AAA	Aaa	The highest grade.
AA	Aa	Very high grade. Excellent.
A	A	Good.
BBB	Bbb	Medium quality (the lowest rating for what are called "investment grade" bonds).
BB/B/CCC	BA/B/Caa	Junk bonds (below-investment grade). Increasingly risky.

May Lose Value. Not FDIC Insured. Not a Deposit. No Bank Guarantee. Not NCUA/NCUSIF Insured. No Credit Union Guarantee.

Calvert mutual funds are underwritten and distributed by Calvert Distributors, Inc., member FINRA, a subsidiary of Calvert Group, Ltd.

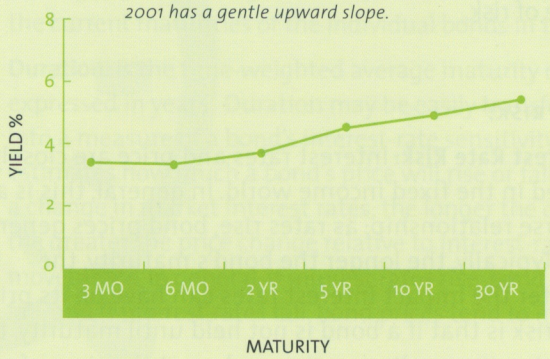
YIELD CURVES REFLECT THE RELATIONSHIP BETWEEN SHORT-TERM AND LONG-TERM BONDS

The yield curve shows the relationship between interest rates at various points along the maturity spectrum. For U.S. Treasuries, the yield curve can span any period from a one-month to a 30-year maturity. The yield curve can be a useful predictor of economic growth, and it is included in most measures of leading economic indicators.

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SAMPLE U.S. TREASURY YIELD CURVES

A normal curve like this one from August 2001 has a gentle upward slope.



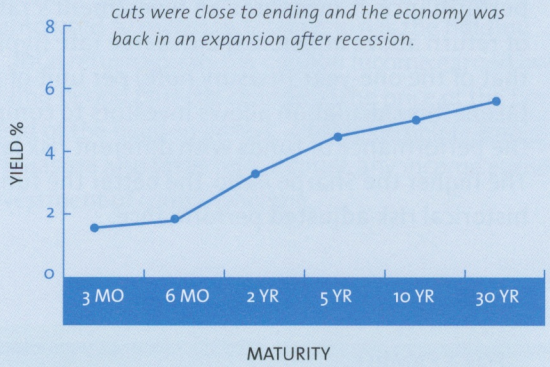
A NORMAL YIELD CURVE slopes upward and indicates that the relationship between short- and long-term bonds is "normal" — that is, short-term bonds provide lower yields than long-term bonds. This typically signals that investors expect the economy to move along with normal rates of growth and without significant changes in inflation.

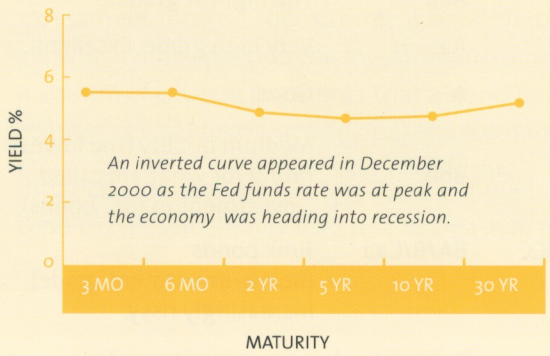
In this environment, higher yields must be offered on longer maturity bonds as they have more price volatility and investors must be compensated for that risk. In the non-government-guaranteed sectors, investors must be compensated for the longer exposure to the issuer's position in the marketplace, so those curves are normally more upward sloping than the benchmark curve for Treasuries.

A STEEP YIELD CURVE may occur for several reasons. In recent decades, the yield curve became steep during a Fed easing cycle and reached maximum steepness in between easing and tightening cycles. This type of steepening move is called a "bull steepener" because it occurs during a bull market in bonds when interest rates fall and prices on outstanding bonds rise. In inflationary times, a "bear steepener" curve may appear when investors sell longer-maturity bonds on expectation of rising and/or high inflation and sharply falling bond prices.

Fed easing cycle: the cost to borrow money is going down
Fed tightening cycle: the cost to borrow money is going up

Steep curve appeared in March 2002 as the Fed cuts were close to ending and the economy was back in an expansion after recession.





AN INVERTED YIELD CURVE occurs when long-term yields fall below short-term yields. It appears when investors believe that inflation and long-term rates will drop in the future and they are anxious to "lock in" high yields while rates are low. Inverted curves may occur when the Federal Reserve raises short-term interest rates and are usually followed by an economic slowdown. In rare cases, the yield curve may be inverted when there is a supply/demand imbalance in the market and investment regulations favor longer-term bonds.

A FLAT YIELD CURVE is experienced most often during a transitional phase in monetary policy expectations and usually does not persist for any significant period of time.

Source material for yield curve data included: Federal Reserve web sites, CNNmoney.com, and Stockharts.com.

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