

AN IN-DEPTH LOOK AT DEFINED-MATURITY ETFs

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This information is intended to be general in nature and should neither be construed as investment advice nor a recommendation of any specific security or strategy.

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I. A WHOLE NEW RANGE OF OPPORTUNITIES FOR INVESTORS

As the ETF market has evolved, so too has the breadth and depth of available products.

Defined-maturity exchange traded funds (ETFs), a recent structural innovation in the rapidly growing ETF market, have created a wide range of new opportunities for fixed-income investors. Today, these ETFs provide sector-specific exposure to fixed-income markets, including segments of the market previously only accessible to institutional investors.

Investors seeking diversified bond exposure were once limited to purchasing shares of bond mutual funds or purchasing several different individual bonds. While both of these options offer certain benefits, they can also present challenges for investors, including limited trading flexibility and transparency of holdings as well as potentially higher costs.

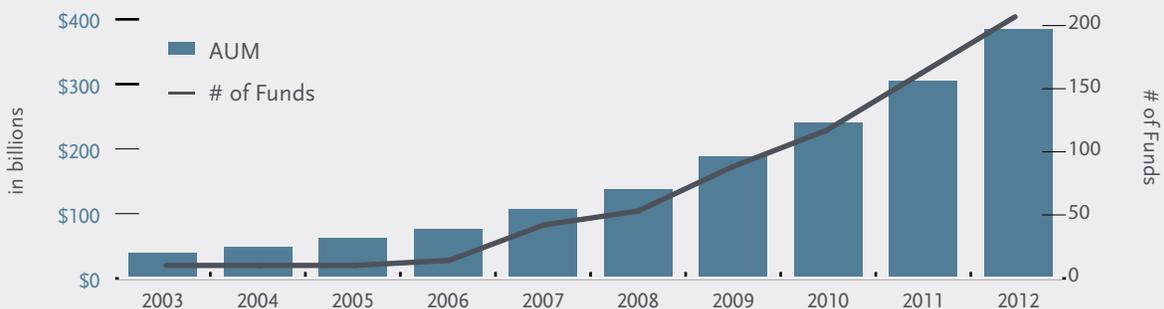
Fixed-income ETFs offer a welcome alternative because, like mutual funds, the ETFs may also offer diversified

exposure to a basket of bonds in a single transaction, but unlike mutual funds, ETFs trade on major stock exchanges, affording the added benefits of intra-day pricing and trading flexibility. They also offer greater transparency of holdings, potential tax efficiencies and generally lower expenses than both mutual funds and individual bonds.

For these reasons, fixed-income ETFs have become the investment vehicle of choice for many investors. While fixed-income ETFs have been heralded as a convenient, low-cost alternative to both bond mutual funds and individual bonds, certain investment strategies such as building a laddered bond portfolio or obtaining targeted exposure to particular points on the yield curve were still only attainable through a direct investment in bonds. That is, until the introduction of defined-maturity ETFs—a recent structural innovation that has opened the door to new opportunities for bond investors.

EXHIBIT 1: ASSET GROWTH OF U.S. LISTED FIXED-INCOME ETFs

As of 12.31.2012



SOURCE: Morningstar.

II. A New Era in Fixed-Income Investing

Defined-maturity ETFs, introduced in early 2010, possess all of the features of traditional fixed-income ETFs with one distinct difference: a specified maturity date. Each fund is structured to track an index comprised of bonds that all mature in a particular year. During that year, the index—and the ETF—terminate and the fund's net assets are distributed to shareholders.

In other words, defined-maturity ETFs have an investment and cash-flow profile similar to bonds while offering all the advantages inherent in an ETF. Adding to their appeal is the fact that the funds offer a level of liquidity, price transparency and trading flexibility typically not available in the over-the-counter (OTC) market in which bonds trade. As such, defined-maturity ETFs offer a compelling combination of diversification and targeted bond investing—a potential substitute for individual bonds and enabling investors to implement strategies they may not otherwise be able to. They may be a compelling alternative to other fixed-income products as well.

Following are the key features of defined-maturity ETFs, the benefits they may afford investors, and some factors to consider when evaluating investment alternatives.

Pre-Defined-Maturity Date – Defined-maturity ETFs provide exposure to a particular year of maturity—just as individual bonds do—when proceeds* are distributed to shareholders. Thus, defined-maturity ETFs enable investors to create customized portfolios that address projected cash flow needs and precisely manage interest rate exposure. By contrast, perpetual-life funds (e.g., mutual funds) offer limited flexibility to match interest rate exposure and future cash flow needs.

Diversification – Defined-maturity ETFs typically offer exposure to a basket of 30 to 100 individual bonds from multiple issuers, reducing issuer concentration risk and potentially lowering portfolio volatility. While most traditional bond funds offer similar exposure, replicating this level of diversification in the OTC bond market is considerably more difficult and costly, as the minimum investment required to purchase a single bond is often \$10,000.

Exchange Traded Liquidity and Transparency – ETFs offer daily holdings disclosure as well as the real-time pricing, intra-day trading and liquidity that come with exchange listing. By contrast, mutual fund shares are priced once daily and holdings are usually disclosed quarterly. In addition, defined-maturity ETFs generally have tight bid/ask spreads, especially in comparison to those of the OTC bond market—whereas the OTC bond market can be non-transparent and thinly traded.

Lower Costs – Expense ratios for defined-maturity ETFs are comparable to other fixed-income ETFs and are generally lower than those of mutual funds. Transaction costs for defined-maturity ETFs are minimized because the bonds in the portfolios are held until maturity (unless called or defaulted). Additionally, because of the way ETFs are structured and their unique in-kind share creation/redemption process (which we explore in the next section), the funds generally do not incur the trading costs associated with cash inflows/outflows from shareholders, as is the case with mutual funds.

*These ETFs do not seek to return any predetermined amount at maturity, and the amount an investor receives may be worth more or less than their original investment. In contrast, when an individual bond matures, an investor typically receives the bond's par (or face) value.

Tax Efficiencies – Defined-maturity ETFs are generally more tax efficient than bond mutual funds. Mutual funds often have to sell bonds in order to meet redemptions, particularly in a declining market. And as bonds in a mutual fund portfolio approach maturity—falling below the fund’s target threshold—those bonds have to be sold and new bonds purchased. These pressures may increase turnover in a mutual fund portfolio, creating tax consequences for those who continue to hold shares of the fund. Defined-maturity ETFs, on the other hand, do not sell securities to meet redemptions and unless the bonds in the fund’s portfolio are called, the securities are generally held until they mature. As a result, the funds typically generate comparably fewer taxable events. It should be noted, however, that a defined-maturity ETF’s final distribution is considered a sale for tax purposes and therefore, depending upon the purchase price and holding period, investors may incur a capital gain or loss.

Monthly Income – Defined-maturity ETFs seek to pay a monthly income distribution, as do mutual funds, whereas bonds pay semiannually. An ETF’s more frequent distributions, if any, may be an attractive feature for investors looking to supplement their income.

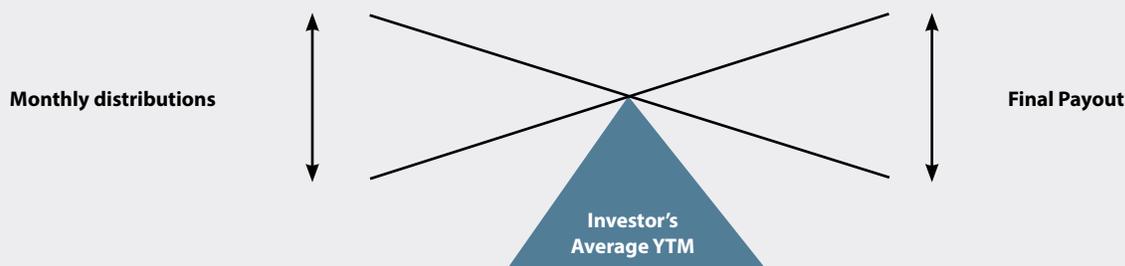
The first fixed-income ETFs were introduced in 2002, roughly 10 years after the advent of the ETF market itself with the launch of the Standard and Poor’s Depository Receipt (“SP DR”) ETF. Although equity ETFs still represent a comparatively larger percentage of the total ETF market, fixed-income ETFs are rapidly gaining market share. In the last four years alone, the total amount of assets in U.S. listed fixed-income ETFs nearly tripled from approximately \$138 billion on December 31, 2008, to more than \$384 billion as of December 31, 2012. Today there are approximately 207 fixed-income ETFs listed in the U.S. offering exposure to virtually every sector of the market. The vast majority of these funds are index-based in that they seek to replicate the performance of a particular benchmark index (before fund fees and expenses).

III. UNDERSTANDING FUND DISTRIBUTIONS

Defined-maturity ETFs are designed to provide a yield-to-maturity (YTM) comparable to what an investor would realize if they were to invest in the fund's underlying bond portfolio. It's important to note that unlike bonds, which have a fixed coupon payment and return par (or face) value at maturity, the fund's monthly distributions and final payout may fluctuate. Nonetheless, investors can still determine with a fair amount of accuracy what their

YTM may be because these fluctuations occur in opposite directions such that any increase/decrease in income distributions a shareholder may experience is generally offset by a corresponding decrease/increase in the final payout they receive at fund maturity. This is due to the way in which ETFs are structured and the unique share creation and redemption process.

EXHIBIT 2: THE DYNAMICS OF DEFINED-MATURITY ETF DISTRIBUTIONS



THE IN-KIND SHARE CREATION/REDEMPTION PROCESS

ETFs continuously offer and redeem shares through an in-kind share creation/redemption process: Shares of an ETF are created when an Authorized Participant or "AP" (typically a large investment firm) delivers to the ETF a basket of securities representative of the underlying portfolio, and the AP receives ETF shares in return. When redeeming shares, the opposite occurs: the AP delivers ETF shares and receives a basket of underlying securities in return, which are then sold on the open market at prevailing prices. (APs are the only entities that can transact directly with the fund.)

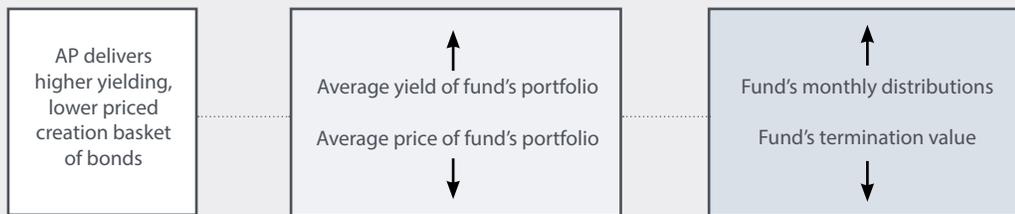
The AP creates and redeems shares as necessary to meet the supply and demand needs of the marketplace as investors buy and sell shares on public exchanges, which in turn, helps to keep an ETF's market price relatively in line with its NAV. The creation/redemption process also serves to minimize transaction costs incurred by the fund and to reduce the potential for capital gains transactions that result from cash inflows and outflows. (For more detailed information on the ETF share creation/redemption process, see our publication *Have You Explored ETFs?*)

THE ROLE OF MARKET INTEREST RATES IN DEFINED-MATURITY ETFs

Share creation and redemption, coupled with changing market interest rates, may cause an ETF's income accrual rate to fluctuate because as market rates rise and fall, the prices and yields of bonds delivered into and out of the portfolio will change, causing the fund's distributions to fluctuate. For example, if market yields rise, an AP creating shares of the ETF typically delivers higher yielding

bonds into the fund's portfolio, which serves to increase the portfolio's yield and therefore, its distributions to shareholders. However, because of the inverse relationship between bond prices and yields, the higher yielding bonds delivered into the fund's portfolio will have declined in price, reducing the average price of the fund's portfolio and therefore, its termination value.

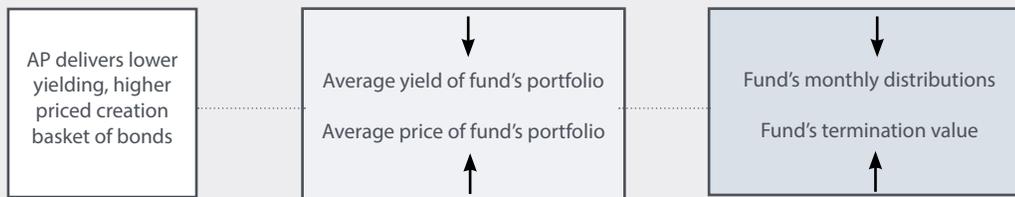
EXHIBIT 3: SHARE CREATION IN A RISING-RATE ENVIRONMENT



The opposite is true in a falling-rate environment: APs typically deliver lower-yielding/higher priced bonds into the

fund's portfolio, reducing the portfolio's average yield but increasing its termination value.

EXHIBIT 4: SHARE CREATION IN A FALLING-RATE ENVIRONMENT



In other words, the ETF's distributions and final payout dynamically adjust in accordance with changing market yields--generally they offset each other such that an investor's anticipated YTM will remain relatively constant. Fund distributions will also likely change as the fund approaches its termination date: as the fund

nears its termination and bonds in the portfolio mature, the proceeds are generally reinvested in cash or cash equivalent securities earning prevailing short-term rates until the fund terminates and the proceeds are distributed to shareholders.

IV. PORTFOLIO APPLICATIONS

Defined-maturity ETFs can be a powerful tool for implementing a variety of strategies previously only afforded through buying individual bonds. ETFs may be particularly attractive for liability-based investing because they enable investors to time maturities to meet anticipated expenses, while also reducing interest rate risk as future liabilities approach. Following are some of the ways in which investors may use the funds to create customized investment solutions.

Targeted Yield-Curve Exposure: For investors seeking to capture perceived opportunities at particular points on the yield curve, defined-maturity ETFs offer an effective means of obtaining precise, targeted exposure. Investors can also easily barbell their yield-curve exposure by simultaneously overweighting and underweighting particular maturity years, while gaining an added element of diversification.

Manage Future Cash Flow Needs: In addition to providing supplemental monthly income, defined-maturity ETFs may provide a source of cash that can be allocated to large future expenses as the funds allow investors to match maturities with expected liabilities. For example, an investor facing future college expenses can select funds whose terminations align with the years those expenses will be incurred. As each fund terminates, the final cash distribution can be applied toward that year's tuition payment.

Build and Manage Laddered Portfolios: ETFs can play many roles in an investor's toolkit—from replacing gaps created by maturing or called bonds, to managing cash flow needs, to customizing a portfolio's duration profile. But in today's uncertain market, target defined-maturity ETFs' most compelling application may be laddering, as ETFs offer new choices to financial advisors and their clients. Laddering with defined-maturity ETFs provides a level of efficiency, cost effectiveness and flexibility that was largely unavailable through wrappers and individual bonds.

To help manage interest rate risk, fixed-income investors frequently construct laddered bond portfolios—i.e., portfolios of individual bonds that have varying terms to maturity. As shorter-dated bonds mature, the proceeds are rolled over and invested into bonds with longer-dated maturities. Investing across a range of maturities allows investors to remain in the market—without getting locked into making a call on the yield curve. There is no need to make a call on when to sell or redeem, because it happens automatically in conjunction with the maturity of the portfolio. And data for annual returns going all the way back to 1900 show that simple bond ladders focused on maturities of 10 years or less delivered consistent positive performance. (See Exhibit 5.)

EXHIBIT 5: BOND LADDERS: LONG-TERM HISTORY

1900–2012	Bond Ladders: Long-Term History				
	5-Year	7-Year	10-Year	15-Year	20-Year
Average Return	4.6%	4.7%	4.8%	4.9%	5.0%
Minimum Return	0.4%	0.3%	0.2%	-1.5%	-2.1%
Maximum Return	15.5%	15.7%	16.2%	19.3%	21.0%

SOURCE: Crestmont Research.

Yet, creating ladders with individual bonds can present a number of challenges including limited bond availability, liquidity and cost constraints, concentrated bond exposure, and credit research on individual companies and securities. The availability of individual bonds with the investor's target maturities can be lacking. There may be liquidity constraints and limited trading flexibility with individual bonds. Finally, cost can be an issue as individual bonds may have high minimum purchases of \$10,000 or more.

Defined-maturity ETFs offer a convenient and cost-effective approach to building laddered portfolios, or filling gaps in an existing laddered portfolio resulting from matured, called or defaulted bonds. Laddered ETF portfolios can be used as an inflation protection strategy as well as meeting

a wide variety of income and lifestyle needs (e.g., funding college tuition at specific due dates or reaching a certain retirement date). Defined-maturity ETFs enable also investors to create customized duration strategies adapted to their changing needs.

And over time, laddering gives investors the potential to benefit from "rolling down the yield curve" and taking advantage of both income and price changes. This is a preferred strategy when the yield curve is upward sloping or steep. An investor purchases a bond at the top of the steepest part of the yield curve and holds the bond long enough until it reaches a lower yielding part of the curve. The objective is to benefit from built-in appreciation that occurs as a normally higher interest rate bond becomes a valuable shorter-term bond.

V. DEFINED-MATURITY ETFs: A VERSATILE, INNOVATIVE FIXED-INCOME SOLUTION

For fixed-income investors, defined-maturity ETFs offer a range of potential benefits, including flexibility, transparency, diversification, and liquidity. More important, these innovative vehicles allow investors and their advisors to implement a range of fixed-income portfolio strategies that until now may have been too complex and costly. Whether investors are seeking to generate current income, reduce interest rate risk, manage cash flow needs, or a range of other objectives, defined-maturity fixed-income ETFs may offer a high-quality, low-cost solution—they represent some of the best and latest thinking in fixed-income investing.

As with any ETF, defined-maturity ETFs may be sold prior to their maturity date at the then-current market price (less any brokerage and transactional fees that

may apply) and the amount an investor receives at the time of sale or maturity may be more or less than their original investment. If the amount an investor receives as liquidation proceeds upon the ETF's termination is higher or lower than their cost basis, they may incur a gain or loss for tax purposes. Defined-maturity ETFs, like any fixed-income investment, entail interest rate risk and depending upon the fund's underlying investments, may entail credit risk as well. In addition, because the distributions generated by the funds are less predictable than those of bonds, the funds may not be appropriate for investors requiring a fixed stream of income. Investors should consult with their financial advisor to help determine whether defined-maturity ETFs are appropriate for their portfolio.

About Guggenheim Investments ETFs

Guggenheim Investments offers investors a broad range of ETFs—domestic and international equity, fixed-income and currency—to provide the core building blocks for portfolios, access to hard-to-reach market segments, as well as targeted investment choices. As the eighth-largest U.S. ETF provider with approximately \$11 billion in assets³, Guggenheim Investments seeks to be a go-to source for strong, actionable ideas to the marketplace. With a history of purposeful innovation, including many industry “firsts”, Guggenheim Investments delivers what we believe are distinct and relevant strategies for institutional investors, private wealth advisors and the clients they serve. Our clients value our commitment to the intelligent pursuit of wealth and our traditions of independence, thought leadership and nimbleness.

For more information, visit guggenheiminvestments.com.

To learn more about Defined-Maturity ETFs and how they may help optimize your portfolio’s performance, talk with your advisor or visit guggenheiminvestments.com/ETF.

³SOURCES: BlackRock 12.31.2012.

RISK CONSIDERATIONS Investors should consider the following risk factors and special considerations associated with investing, which may cause you to lose money, including the entire principal amount that you invest. **Interest Rate Risk:** As interest rates rise, the value of fixed-income securities held by funds is likely to decrease. Securities with longer durations tend to be more sensitive to interest rate changes, making them more volatile than securities with shorter durations. **Credit/Default Risk:** The risk that issuers or guarantors of debt instruments or the counterparty to a derivatives contract, repurchase agreement or loan of portfolio securities is unable or unwilling to make timely interest and/or principal payments or otherwise honor its obligations. Debt instruments are subject to varying degrees of credit risk, which may be reflected in credit ratings. Securities issued by the U.S. government have limited credit risk. Credit rating downgrades and defaults (failure to make interest or principal payment) may potentially reduce the funds' income and share prices. **Asset Class Risk:** The bonds in a fund portfolio may underperform the returns of other bonds or indexes that track other industries, markets, asset classes or sectors. **Call Risk/Prepayment Risk:** During periods of falling interest rates, an issuer of a callable bond may exercise its right to pay principal on an obligation earlier than expected. This may result in the funds having to reinvest proceeds at lower interest rates, resulting in a decline in a fund's income. **Extension Risk:** The risk that an issuer will exercise its right to pay principal on an obligation later than expected. This may happen when there is a rise in interest rates. Under these circumstances, the value of the obligation will decrease and the funds' performance may suffer from its inability to invest in higher yielding securities. **Income Risk:** The risk that falling interest rates will cause a fund's income to decline. **Liquidity Risk:** If a fund invests in illiquid securities or securities that become illiquid, fund returns may be reduced because the fund may be unable to sell the illiquid securities at an advantageous time

or price. **Declining Yield Risk:** During the final year of the funds' operations, as the bonds held by the funds mature and the funds' portfolio transitions to cash and cash equivalents, the funds' yield will generally tend to move toward the yield of cash and cash equivalents and thus may be lower than the yields of the bonds previously held by the funds and/or prevailing yields for bonds in the market. **Fluctuation of Yield and Liquidation Amount Risk:** The funds, unlike a direct investment in a bond that has a level coupon payment and a fixed payment at maturity, will make distributions of income that vary over time. Unlike a direct investment in bonds, the breakdown of returns between fund distributions and liquidation proceeds are not predictable at the time of your investment. For example, at times during the funds' existence, it may make distributions at a greater (or lesser) rate than the coupon payments received on the funds' portfolio, which will result in the funds returning a lesser (or greater) amount on liquidation than would otherwise be the case. The rate of fund distribution payments may adversely affect the tax characterization of your returns from an investment in the funds relative to a direct investment in corporate bonds. If the amount you receive as liquidation proceeds upon the funds' termination is higher or lower than your cost basis, you may experience a gain or loss for tax purposes.

High-Yield Securities Risk: Bonds that are rated below investment-grade are considered to be "junk" securities. While these securities generally offer a higher current yield than that available from higher grade issues, they typically involve greater risk. The ability of issuers of high-yield securities to make timely payments of interest and principal may be adversely impacted by adverse changes in general economic conditions, changes in the financial condition of the issuers and price fluctuations in response to changes in interest rates. High-yield securities are less liquid than investment-grade securities and may be difficult to price or sell, particularly in times of negative sentiment toward high-yield securities.

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