AC Alternatives®
From American Century Investments

ALTERNATIVES

WHAT YOU NEED TO KNOW ABOUT RISK

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We've outlined some of the advanced techniques associated with alternative investing. In addition to this information, each specific fund you may consider will have its own set of risks. It's also important for you to fully understand what those fund risks are. They can be found in the fund's prospectus.

OVERVIEW

HOW CAN ALTERNATIVE INVESTMENTS BE USED IN A PORTFOLIO?

Alternatives have the potential to:

- Manage volatility
- Lessen impacts of market swings
- Improve diversification

Institutions have used alternative investments for decades to aim for enhanced risk-adjusted returns over time.

We recommend working with a financial advisor to help you understand and use alternatives.

OVERVIEW continued

THE BALANCE OF RISK AND REWARD

ALTERNATIVES are investment choices outside of traditional long-only stocks and bonds and may react differently than traditional asset classes to market swings.

All investments have benefits and risks. Inside we explore a few of the more common risk terms to understand when considering alternatives for your portfolio.

You can find information about a specific fund's investment strategies and risks in the fund's prospectus.

SHORT SELLING

DEFINITION

A trading strategy intended to **capitalize on falling prices**.

EXAMPLE

A portfolio manager effectively **borrows and then sells** a stock or bond they anticipate will decline in price.

- The manager does not own the stock or bond but instead will **buy back the shares** in the future to return them to the original owner.

- The **profit or loss** is the difference between the amount the manager originally sold the stock or bond for and the amount paid to buy it back.

SHORT SELLING continued

KEY POINTS

- Investors take action on a belief that a **security might be overvalued** (striving to benefit if the value decreases).
- Short selling can be effective during market corrections or rising interest rate periods, but **may limit gains** during up markets.
- A **"short squeeze"** occurs when there are no shares available to buy back for the original owner.

PURPOSE

Profit from falling prices

Short selling is the **opposite of buying low/selling high**. It means you buy a security and expect the price to decline.

Hedge

Investors seek to **reduce risk in the long term** with offsetting short positions. You might short sell to help guard against a sharp decline in a specific security or the market as a whole.

WHAT CAN GO WRONG?

If the price of the borrowed stock goes up instead of down, an investor **faces losses on the amount that it appreciates**—which in theory could be unlimited since there is no price ceiling. With bonds, short losses are limited to the face value of the bond.

DERIVATIVES

DEFINITION

Contracts where the value is based on the **performance of other assets, interest rates or indices**. Two common types of derivatives are **options** and **futures**.

EXAMPLE 1 - **OPTIONS** (Two basic types of options contracts)

- **Call Options** - A buyer can, but is not required to, buy an asset like stock in the future for a set price. The seller is required to sell at that set price if the buyer exercises this option.
- **Put Options** - A seller can, but is not required to, sell an asset like stock in the future for a set price. The buyer is required to buy at that set price if the seller exercises this option.

A portfolio manager holds a stock she believes has risen to its fair value and will not likely appreciate further any time soon.

Scenario 1

She can sell the stock, creating a **taxable gain** and losing the upside potential if the stock continues to appreciate. But, this **may free up capital to buy other assets**.

Scenario 2

She can sell call options on the stock. This means she keeps the stock in hopes of **further gains if the value keeps rising**. At the set price, the options may be exercised.

DERIVATIVES continued

EXAMPLE 2 - **FUTURES**

A contract where the **buyer and seller are both required to buy or sell an asset**, like a stock, bond or index, at a future date at a set price.

A portfolio manager is expecting a large new investment in cash in a month and he expects the market to rise in this time period.

Scenario 1

He can wait for the money to arrive in a month and then invest it in the market despite the fact that the market may have already risen.

Scenario 2

He can buy a futures contract now on an index with an obligation to settle at a future date at a set price. Even without the new money yet, he won't miss a short-term market rise. But, he is obligated to settle at the pre-determined price even if the market declines.

DERIVATIVES continued

KEY POINTS

- Derivatives are typically bought for much less than the asset's price, but **move up and down with the asset's price**.
- Investors often use them as a **hedge for risk management** purposes.
- **Derivatives are risky** when used in excess or inappropriately; can cause portfolio **instability and/or large losses**.

PURPOSE

- Derivatives are used to **hedge against changes** in interest rates and price movements, and **can be a cost effective way to help gain access** to otherwise hard-to-trade assets or markets.
- The value reflects several factors, like the **asset's future price compared to the set price, the time until it expires and how volatile the asset price is**.

WHAT CAN GO WRONG?

Derivatives allow investors to earn large returns from small movements in the underlying asset's price. However, investors **could lose large amounts** if the price of the underlying asset moves against them significantly. Counterparty risk is inherently involved in most derivative transactions and means that contract holders may default on their obligations, which could lead to a loss.

LEVERAGE

DEFINITION

Using borrowed money for an investment and **expecting the profits to be greater than the interest owed**.

EXAMPLE

Leverage can **help investors finance additional investments**. Mutual funds regulations limit the amount of explicit leveraging, when money or assets are contractually borrowed for a fee.

An investor uses **$100,000 cash** on hand and **borrows $30,000** to **buy $130,000 of XYZ** stock at $10 per share.

If the stock price increases to $15, the **investor could profit $65,000** minus the interest on borrowing (vs. $50,000 if they had only bought shares with the cash on hand).

Calculation

$5 price increase
x 13,000 shares
$65,000 minus interest

vs.

$5 price increase
x 10,000 shares
$50,000

LEVERAGE continued

KEY POINTS

- Leverage may **augment returns** or **ability to hedge** risks.
- Mistimed or excessive leverage can lead to **large losses**.

PURPOSE

- Investors generally use leverage to **help increase the magnitude of profits** by gaining additional shares, assets or market exposure through borrowing.
- This greater purchasing power can be obtained through certain derivatives to **help increase profits**.
- Leverage **magnifies both gains and losses**.

WHAT CAN GO WRONG?

Losses can be amplified when borrowing because there would be a loss if the investment decreases in value, and there's also **typically interest due on the borrowed money**.

LIQUIDITY

DEFINITION

Measure of how readily a security can be bought or sold on demand. A **liquid security** can be easily bought or sold with little or no impact on price. A **liquid market** is when the spread between the selling and buying price is close together. The spread will increase as markets become less liquid.

EXAMPLE

A stock may have **fewer shares available** in the marketplace and **less daily trading value**.

- An investor has bought **microcap stocks**, which are stock in public companies whose total value of outstanding shares is considered small ($50 million to $300 million).

- This kind of asset will generally take a bit **more effort or time before it can be bought, sold or realized as cash** and is considered to have low liquidity.

LIQUIDITY continued

KEY POINTS

- Alternative investing strategies may involve **less liquid or harder-to-sell securities**.
- By regulation, mutual funds must **limit investments** in less-liquid securities (called illiquid securities) to **less than 15% of assets**.

PURPOSE

- Less-liquid investments **may be attractive for investors willing to trade off the ability to sell quickly** for longer-term return potential.
- Liquidity is an **important factor in the price of a security**. When many investors may want to sell illiquid assets at the same time, there may be less buyers for those securities, which may negatively impact price.

WHAT CAN GO WRONG?

During periods when markets decline suddenly and sharply, liquidity is an important consideration because **investors may become risk-averse** and there are **typically many more sellers than buyers**. This is true for even the most liquid of securities (e.g. blue chip stocks), but the impact will be magnified for investments that are harder to sell.

PERFORMANCE EXPECTATIONS

QUESTION

What should investors expect from **alternative investments**?

ANSWER

Investors might perceive all alternatives as high risk with the potential for high returns. But, like any investment, investors need to determine what makes the most sense for their personal goals, time horizon and risk tolerance.

Considerations

- Alternatives **historically have underperformed equities over the long term** and in periods of rapid rises in the stock market.
- Alternatives have **tended to have lower volatility than equities**, but generally higher volatility than many fixed-income asset classes.
- Alternatives are often referred to as **"absolute return,"** which are potential returns independent of prevailing market conditions or benchmarks.

It is important for you to understand the role that alternatives may play in your portfolio as well as the benefits and risks associated with the strategy and of the specific products you may be considering.

Work with your financial professional to determine if alternatives might have a place in your portfolio.

Source: American Century Investments®

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You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. The fund's prospectus or summary prospectus, which can be obtained by visiting americancentury.com, contains this and other information about the fund, and should be read carefully before investing.

Alternative mutual funds that hold a variety of non-traditional investments often employ more complex trading strategies than traditional mutual funds. Each of these different alternative asset classes and investment strategies have unique risks. Advisors should fully understand the asset classes and investment strategies and the risks of any alternative mutual fund they are considering for their clients.

Investment return and principal value of security investments will fluctuate. The value at the time of redemption may be more or less than the original cost. Past performance is no guarantee of future results.

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