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Unit Investment Trusts

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What is it?

A unit investment trust (UIT) is a distant cousin of the mutual fund. Like mutual funds, UITs buy pools of securities, usually stocks or bonds, and then sell interests in them to investors (sometimes referred to as unitholders). However, unlike mutual funds, which never expire, may buy and sell securities frequently, and often are actively managed, UITs buy securities only when the trust is first created and then hold them for a specified period of time, usually one to five years. There is no buying or selling of assets by the UIT during the life of the trust, except in limited circumstances, nor is there any active management. However, the market value of the trust fluctuates with market conditions and the value of the underlying securities. As a result, shares of the trust may be worth more or less than their original value when sold.

Because the securities held by UITs remain unchanged for a fixed period of time, investors generally are able to determine the income that will be generated. Investors receive income monthly, quarterly, or semiannually; if they hold the UIT through its termination date, they also receive a proportionate share of the trust's principal when it is liquidated. That amount will depend not only on the size of an investor's holdings but on the market value of the securities in the trust.

UITs represent many types of investments, such as the Dow Top 10, corporate bonds, international bonds, state or municipal bonds, U.S. government securities, mortgage-backed securities, and equities. Some UITs concentrate on specific sectors, such as global funds, utility funds, industry sector funds, or a particular investment strategy. Some exchange-traded funds are structured as UITs.

UITs offer a variety of features that include exchange options, dividend reinvestment programs, and deferred sales charges. In addition, income is tax free if the UIT invests only in municipal bonds. A UIT's prospectus has information about its investment objectives, risks, charges and expenses, and you should read it carefully before investing.

Why do investors buy UITs?

UITs offer diversification

A UIT gives investors the ability to purchase a limited number of specific securities with a lower initial minimum investment than might be needed to buy the same securities individually.

UITs can help provide a stable income

UITs offer fixed payments at periodic intervals that can be used to provide a steady stream of income.

Caution: The long-term return of a bond UIT may be affected if it holds callable bonds that are redeemed early.

UITs can be tax efficient

Because a UIT holds a fixed number of securities and does not actively trade, any annual taxable capital gains distributions are minimal. Also, some of its distributions are considered return of principal. However, you may have a taxable capital gain if your units have increased in value when you redeem them or when the trust is terminated.

UITs incur no trading costs

A UIT's returns are not affected by the costs of buying and selling securities. However, investors should remember that UITs do have an upfront fee (up to 4.5 percent) and some annual fees.

UITs can help implement specific stock investing strategies

Many investors use UITs to implement a strategy known as the "Dogs of the Dow." This strategy entails buying the 10 highest yielding stocks in the Dow Jones Industrial Average, holding them for a year, and then repeating the process. UITs let investors play this strategy without having to buy individual stocks and trade them at the end of each year.

Evaluating a UIT

Among the questions you'll want to ask about a UIT are:

- On what date does the UIT terminate? For a bond UIT, that date is usually the date on which the portfolio matures.
- Can I roll the proceeds of the trust over to another UIT?
- How often does the UIT make any interest payments?
- Can I reinvest any distributions in a mutual fund or another UIT?
- Is the UIT insured? If a bond UIT is insured against failure to pay both interest and principal, it will typically offer a somewhat lower yield in exchange for the extra protection.



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