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Mutual Funds & Subaccounts

Understanding Variable Subaccounts

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An investment in knowledge pays the best interest.

- Benjamin Franklin

To understand subaccounts, it helps to understand mutual funds

A Mutual Fund is…

- **An investment vehicle** that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets.
- **Mutual funds are operated** by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors.
- **A mutual fund's portfolio** is structured and maintained to match the investment objectives stated in its prospectus.

PRO TIP

The SEC refers to a mutual fund as a "company" and the fund's holdings as a "portfolio." This differentiation is significant and can be a source of confusion for novice investors.

Whew.
That was a mouthful.
Consider this…

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A Mutual Fund is Like a Team

Instead of players**, the fund has various investments** combining their strengths to try and produce gains for investors, all led by a portfolio manager acting as the coach for the fund.

Investment types:

- Bonds/fixed income
- Equities
- Cash
- Alternatives

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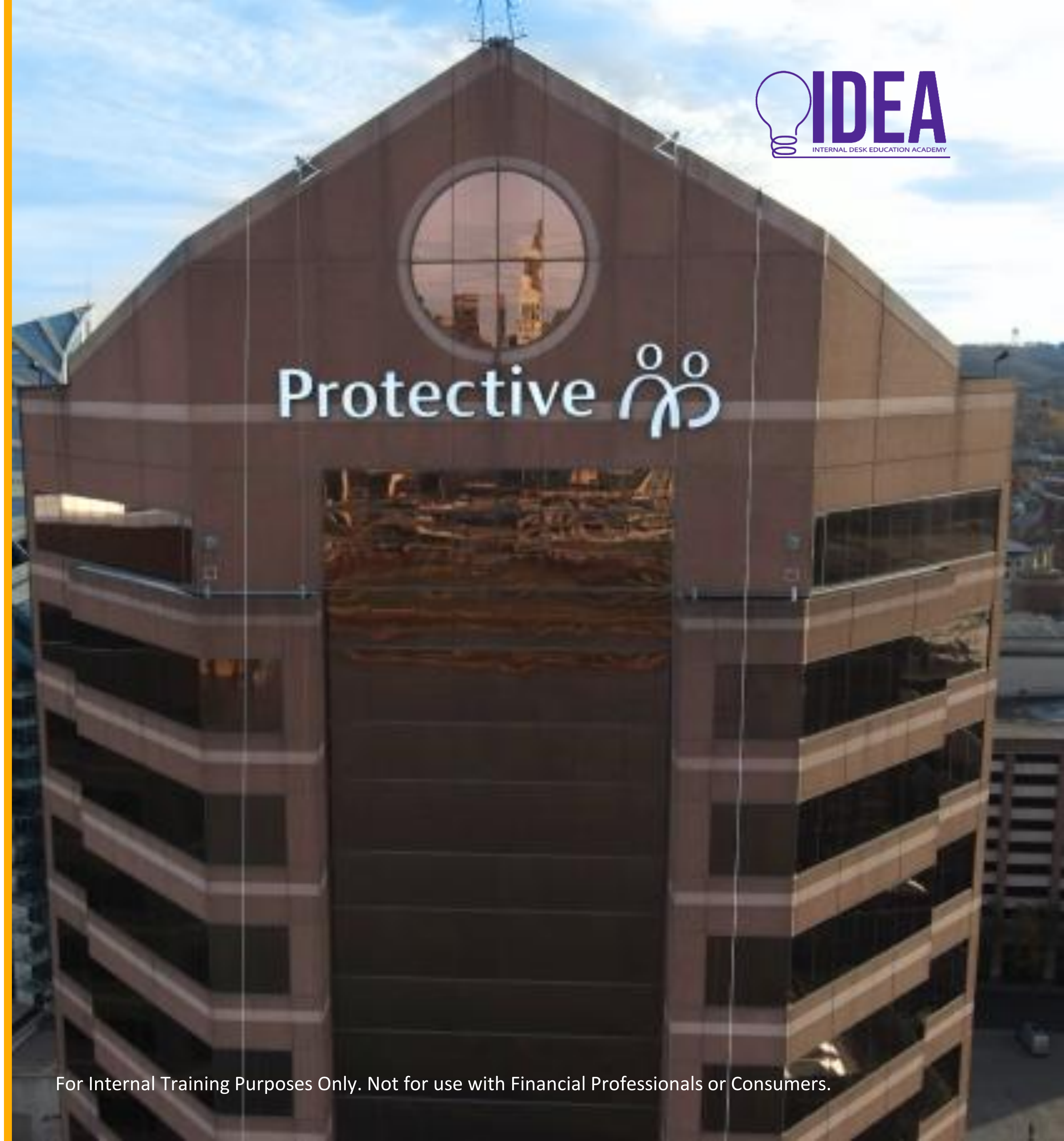
Meet Lauren!

She used to work in the **call center** at **Fifth Third Bank** in Downtown Cincinnati.

Internal Wholesaler

Lauren just got a sweet **new job** as an **Internal Wholesaler** working here on the 16th floor!



Human Resources dropped a **401k form** off at **Lauren's desk.**

- ☐ ClearBridge Aggressive Growth Fund ___%
- ☐ ClearBridge All Cap Value Fund ___%
- ☐ ClearBridge Appreciation Fund ___%
- ☐ ClearBridge Equity Fund ___%
- ☐ Legg Mason BW Absolute Return Opportunities Fund ___%
- ☐ Royce Low-Priced Stock Fund ___%
- ☐ Western Asset Core Bond Fund ___%
- ☐ Western Asset Intermediate Maturity New York Municipals Fund ___%
- ☐ Western Asset Institutional Tax Free Reserves ___%
- ☐ Legg Mason Lifestyle Allocation 85% ___%


I wonder if **Protective** provides a 401k match...
What's the deal with all of these fund things? This would be a lot easier if I could buy individual stocks.

Stock Market

Diversification

Property

Instant Access

Expertise

Lauren technically can buy stocks but remember why **mutual funds are beneficial…**

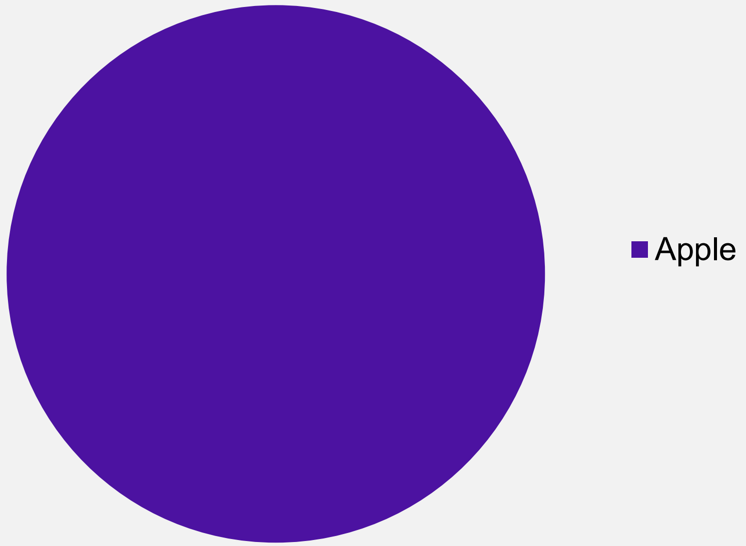
Without Diversification

Lauren's money will fluctuate with that stock; she would get 100% of the **upside** but would also get 100% of the **downside**.

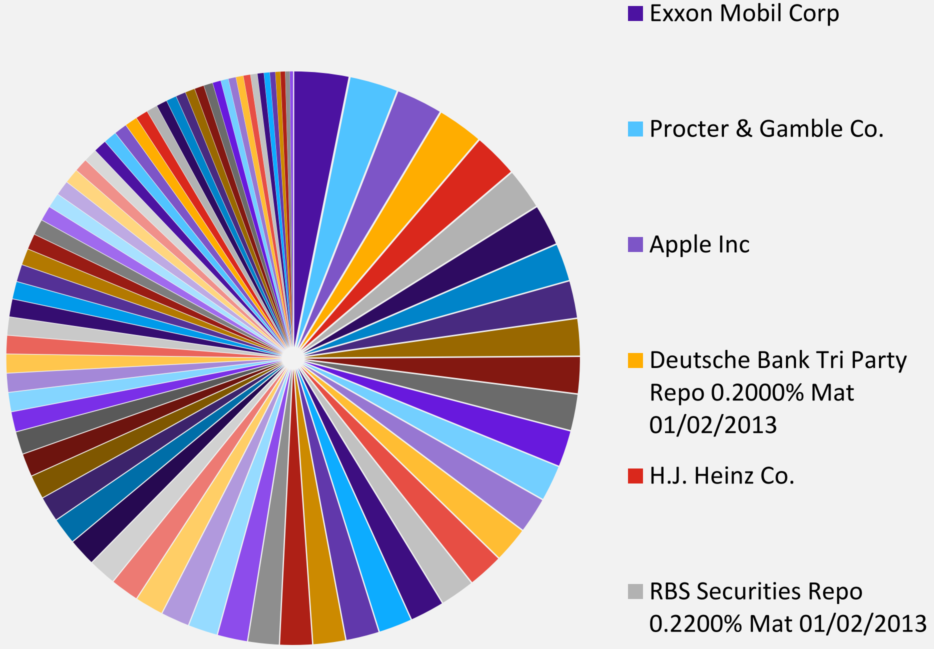
With Diversification

Lauren goes from **this** to **this**!

Stocks



ClearBridge Equity Income Fund



Asset Classes & Styles

A Basic Explanation

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Asset Class:
What you own

+

Style:
How it's managed

=

Both impact:
- Risk
- Return
- Behavior

(Behavior under varying market conditions)

Core Asset Classes

Equities (Stocks)

Objective:

- Growth (capital appreciation)

Subcategories:

- Domestic vs international
- Sector funds (tech, healthcare, etc)

Fixed Income (Bonds)

Objective:

- Income and capital preservation

Subcategories:

- Government vs corporate
- Investment grade vs high yield
- Duration (short, intermediate, long-term)

Cash & Cash Equivalents

Objective:

- Liquidity and capital preservation

Subcategories:

- Money market funds, short-term instruments

Investment Style Categories

Growth

- Focus on companies expected to grow earnings faster than average
- Higher valuations, more volatility

Value

- Focus on under-valued companies
- Often more income and dividend-oriented

Blend

- Mix of growth and value

Stock Investment

‘Size” Style Categories

	Large Cap	Mid Cap	Small Cap
Market Rank	Top 100	101–250	251 and beyond
Risk Level	Lower	Moderate	Higher
Growth Potential	Steady	Moderate to high	High
Stability	High	Medium	Low
Volatility	Lower	Moderate	Higher
Investment Horizon	Suitable for long-term stability	Suitable for balanced growth	Suitable for long-term high growth

Fixed Income (Bond) Styles

Measurement	Style	Impact
Credit Quality	High Quality (Treasuries, AAA)	Lower risk, lower yield
	Investment Grade	Moderate risk
	High Yield (Junk)	Higher income, higher default risk
Duration / Rate Sensitivity	Short Duration	Less sensitive to interest rates
	Long Duration	More sensitive, more price volatility

Evaluating Investment Choices

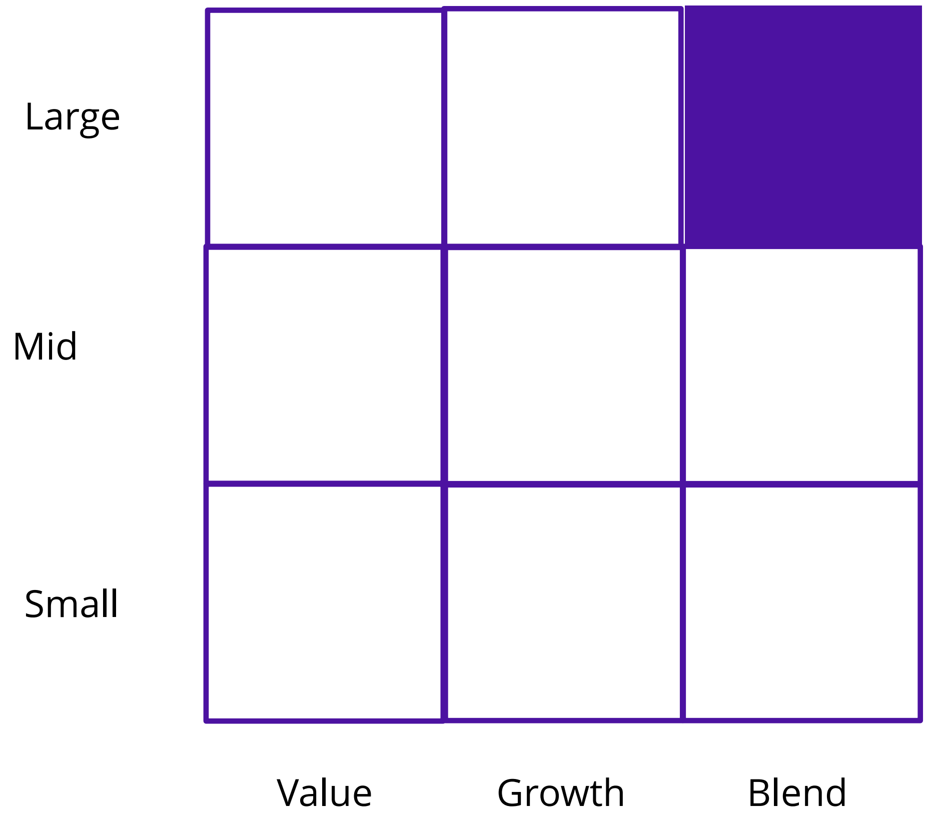
The Morningstar Style Box

It's a nine-square grid with:

Three stock investment size styles:
- Large
- Mid
- Small

Three investment style categories:
- Value
- Growth
- Blend

The darkened square details where the portfolio's 'center of gravity' is, in terms of its style and market cap characteristics



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Why This Matters?

Understanding the difference between small cap, mid cap, and large cap helps investors align their choices with their financial goals more effectively.

Influences how mutual funds and subaccounts are structured, how portfolios are diversified, and how risk is managed.

For instance:

- **Large** cap funds focus on stability
- **Mid** cap funds aim for growth
- **Small** cap funds look for high potential opportunities

How Do You Choose What's Best

There isn't a single suitable choice.

- It usually depends on what the investor is aiming for.

When based on risk profile:

- Conservative investors often lean towards large caps
- Moderate risk-takers may consider mid caps
- Aggressive investors may explore small caps

When based on portfolio balance:

- Many portfolios include a mix of all three.
- This helps spread risk while still capturing growth opportunities.

Not Just Mutual Funds

Also Applies to Subaccounts

Each Subaccount Has:

- An asset class
- A style profile

Allocation Decisions Drive:

- Growth potential
- Income
- Volatility of contract value

Subaccounts are mutual fund-like investment options ***inside a variable product***

Questions to Ask Advisor

- **What** role does this fund play? (Growth, income, stability)
- **What** style exposure does the client already have?
- **Are they** overconcentrated in any one style?

Assignment
For the Next Session