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**BASIC INFORMATION  
IN TRADING ON FINANCIAL INSTRUMENTS**

## BASIC INFORMATION IN TRADING ON FINANCIAL INSTRUMENTS

### Part I - Risks related to financial instruments

#### 1. Introduction

Before investing or using the services of Banco Bradesco Europa S.A. (the "Bank" or "BBE"), we strongly recommend you to read this document, carefully:

It is of major importance that you clearly understand all risks associated to the financial instruments you are trading when analysing and deciding on an investment.

The most efficient manner of benefiting from the relationship with the Bank is to create your investor profile, which includes your knowledge and experience, investment objectives, financial situation, your capacity to bear losses and aversion to risk.

Past performance is not a guarantee of future returns, by any means.

Fixed income investments are those made in instruments with fixed compensation. As a consequence of the oscillations of the market, the fixed income investment may suffer changes, if redeemed prior to the due date of the investment made. Moreover, as a consequence of the credit risk, there may incur losses of the capital invested in fixed income investments.

Equity investments are deemed to be those where the profitability is not linked to terms and rates determined beforehand, and which volatility depends on the market behavior. Investments in equities may cause the loss of the capital invested.

Derivatives are the financial instruments deriving or depending on the value of another asset. They may be used as hedge instruments (to avoid or exchange the risk) or as leverage instrument (to increase the profitability, however upon a higher risk). Such instruments, among others, are: forward agreements, swaps, options and future.

The use of derivatives, depending on the instrument used and of the market behavior, may cause even a negative net worth, and/or margin call.

The Bank has the obligation to inform clients thoroughly about the risks attached to investments and requires the classification of certain instruments according to their risk contents.

#### 2. Classification of the various risk types

This classification serves as additional information for both the investment consultant and the investor and is independent of the individual analyst's assessment. Standard denominations of some risks are:

- **Business risk**  
Risk of doing business in a specific sector, and of cyclical up and downs in that sector. Some sectors are more subject to cycles than others. This risk will mostly affect the value of shares issued by companies active in the considered sector.
- **Credit Risk**  
Credit Risk is the risk of losses associated with non-fulfillment by the borrower or counterparty of its respective financial obligations under the agreed terms, the devaluation of credit contracts owing to deterioration in the borrower's credit rating, a reduction in profits or return, advantages conceded in negotiations and recovery costs.
- **Country Risk**  
Expropriation risk: consists of the possibility of a foreign government taking control of a significant share of a company's assets against a very small payment or without any payment at all. An example is the risk of forced nationalization of one of the principal creditors of a bank.  
  
Repatriation risk: occurs when assets are held abroad and may not easily be brought into the country. This could occur as a result of government restrictions on the repatriation of direct foreign investments, owing to devaluation or through the imposition of currency controls.  
  
War, Civil Commotion, Revolution risk: All of these factors cause uncertainties and potentially threaten the value of a bank's cash flows in a country.
- **Exchange Rate and Parity Risk**  
Risk of loss associated with fluctuations in the exchange rate and/or parities between foreign currencies.
- **Inflation Risk**  
Risk of decline in value of securities cash flow due to inflation.
- **Interest-rate Risk**  
Risk of loss associated with adverse changes in interest rates and gaps between applications and borrowing and the types of interest rates agreed or the related terms.
- **Liquidity Risk**  
Risk of imbalance between negotiable assets and current liabilities – discrepancies between payments and receipts which could affect the institution's ability to make payments, considering the different currencies and liquidation terms and its rights and obligations.

- **Market Risk**

Risk of losses resulting from fluctuations in the market values of positions held, in addition to the financial margin, including risks of operations subject to changes in exchange rates and interest rates, as well as securities and commodity prices.

- **Reinvestment risk**

Risk that future coupons from a bond will not be reinvested at the prevailing interest rate from when the bond was initially purchased.

- **Value risk**

Risk of loss of part or all of an investment.

However, money market securities trade in very high denominations, giving the average investor limited access to them. The easiest way for retail investors to gain access is through money market mutual funds or a money market bank account. These accounts and funds pool together the assets of thousands of investors to buy money market securities.

Some investors also purchase Treasury bills (T-bills) and other money market instruments directly from Federal Reserve Banks or through other large financial institutions with direct access to these markets.

#### Main Types

There are several different instruments in the money market: certificates of deposit, T-bills, commercial paper, banker's acceptances and more.

The emergence of money market mutual funds has allowed individual investors to take part in the money market's rates of return (please refer to section 2.5).

#### Risks

Money Market Instruments aim to have a value equal to the nominal. As a consequence, their price is not influenced by market movements. Because they are typically considered as a generally low-risk investment, money market funds are widely used defensive investments.

Although securities purchased on the money market carry less risk than long-term debt, they are still not entirely risk free. Money-market instruments are debt-based instruments, and under similar risks as bonds, mainly currency risk and inflation risk.

## Part II - Financial instruments

We refer to Part I for a description of the "Risks" aspects linked to each type of financial instrument.

### 1. Definition: What is a 'financial instrument'?

A financial instrument is a physical or virtual document representing a legal agreement involving some sort of monetary value.

In today's financial marketplace, financial instruments can be classified generally as equity based, representing ownership of the asset, or debt based, representing a loan made by an investor to the owner of the asset. Foreign exchange instruments comprise a third, unique type of instrument. Different subcategories of each instrument type exist, such as preferred share equity and common share equity, for example.

Financial instruments can be thought of as trade-able packages of capital, each having their own unique characteristics and structure. The wide array of financial instruments in today's marketplace allows for the efficient flow of capital amongst the world's investors.

The following document only introduces major characteristics and the most common inherent risks of financial instruments. Ask your account officer for additional information that may not be included in this booklet.

## 2. Description of financial instruments

### 2.1 Money Market instruments

#### Description and Main Features

The money market instruments invest in fixed-income securities, not unlike the bond market. The major difference is that the money market instruments invest in short-term debt and monetary instruments. In other words, money market instruments are forms of debt that mature in less than one year and are generally very liquid.

### 2.2 Bonds

#### Description and Main Features

Similar to a mortgage with a bank, bonds are issued by a borrower to a lender. When you buy a corporate bond, you are lending your money to a corporation for a predetermined period of time (known as the maturity). The face value of the bond is the amount the lender will repay once the bond matures.

The borrower may also pay you a premium, known as a "coupon", at a predetermined interest rate in exchange for using your money. For most bonds, these interest payments are made periodically (e.g. yearly or every 6 months) until maturity is reached.

When a bond is traded on any day, which is not the entitlement date for the interest payment of the bond, accrued interest will be paid. The accrued interest is the interest paid or received by an investor purchasing or selling bonds and represents the value of interest which is not yet paid by the issuer to the holder of the bond. Depending on the bond type and rate, there are different methods for calculating this interest accruing during the financial year.

There are three important factors you need to consider before buying a bond:

- 1 The entity issuing the bond.
- 2 The interest rate (or coupon) you will receive.
- 3 The maturity date, the day when the borrower must pay back the principal to the lender.

### 2.2.1 Corporate bonds

Corporate bonds typically carry a higher credit risk than government bonds.

The risks associated with corporate bonds depend entirely on the issuing company. Purchasing bonds from well-established and profitable companies is much less risky than purchasing bonds from firms in financial trouble. Bonds from extremely unstable companies typically have high issuer risk. They are commonly referred to as "junk bonds".

#### Risks

As with any free-market economy, corporate bonds prices are affected by supply and demand. Bonds are generally issued initially par value with some exceptions. In the secondary market, a corporate bond's price can fluctuate. The most influential factors that affect a bond's price are yield, prevailing interest rates and the bond's rating. If there is an increase of risk in the market, the bond price will decrease. If the issuer is considered high quality, the bond price would go up. The main risks related to bonds are:

- **Inflation risk:** Corporate bonds offer little protection against inflation because the interest payments are usually a fixed amount until maturity.
- **Currency risk:** Investments made in foreign currency are subject to exchange rate fluctuations. For some bonds, the nominal and the interest may be paid in different currencies.
- **Credit risk:** Corporate bonds have the chance that the corporate issuer will default on its debt obligations.
- **Liquidity risk:** risk that an investor might not be able to sell his or her corporate bonds quickly due to a thin market with few buyers and sellers for the bond. Interest rate risk: the value invested in bonds can change due to a change in the absolute level of interest rates.
- **Reinvestment risk:** risk that future coupons from a bond will not be reinvested at the prevailing interest rate from when the bond was initially purchased.

### 2.2.2 Government bonds

Government bonds are a debt obligation of a national government. Because they are backed by the credit and taxation power of a country, they are generally regarded as having little or no risk of default.

Examples of such instruments are US Treasury Bills. Treasuries include short-term Treasury bills (T-bills), medium-term Treasury notes and long-term Treasury bonds (T-bonds):

- **Treasury Bills:** are U.S. government debt securities with a maturity of less than one year. T-bills do not pay a fixed interest rate. They are issued through a competitive bidding process at a discount from par.
- **Treasury Notes:** are marketable, fixed-interest rate U.S. government debt securities with a maturity between one and 10 years.
- **Treasury Bonds:** are marketable, fixed-interest U.S. government debt securities with a maturity of more than 10 years. Treasury bonds are usually issued with a minimum denomination of \$1,000.

Government bonds are considered as a safe market by investors. These debt instruments offer very little risk of default, so the interest rate investors receive is relatively low. In general, the price of treasuries rise as interest rates fall, and the opposite is true when interest rates rise.

#### Risks

Government bonds prices are affected by interest rates, inflation and economic growth.

- **Inflation risk:** Treasuries offer little protection against inflation because the interest payments are usually a fixed amount until maturity.
- **Currency risk:** Investments made in foreign currency are subject to exchange rate fluctuations.
- **Interest rate risk:** the value invested in bonds can change due to a change in the absolute level of interest rates.
- **Liquidity risk:** risk that an investor might not be able to sell his government bonds quickly due to a thin market with few buyers and sellers for the bond. Interest rate risk: the value invested in bonds can change due to a change in the absolute level of interest rates.
- **Reinvestment risk:** risk that future coupons from a bond will not be reinvested at the prevailing interest rate from when the bond was initially purchased.

### 2.3 Stocks

#### Description and Main Features

Also known as "shares" or "equity", stock is a type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings.

A holder of stock (a shareholder) has a claim to a part of the corporation's assets and earnings. In other words, a shareholder is an owner of a company. Ownership is determined by the number of shares a person owns relative to the number of outstanding shares. For example, if a company has 1,000 shares of stock outstanding and one person owns 100 shares, that person would own and have a theoretical claim to 10% of the company's assets and any future dividends paid by the issuer.

### Main Types

There are two main types of stock: common and preferred.

- Common stock usually entitles the owner to vote at shareholder's meetings and to receive dividends.
- Preferred stock generally does not have voting rights, but has a higher claim on assets and earnings than the common shares. For example, owners of preferred stock receive dividends before common shareholders.

### 2.3.1 Common Stock

Holders of common stock exercise control by electing a board of directors and voting on corporate policy. Common stockholders are at the bottom of the priority ladder for recovering their investment. In the event of liquidation, common shareholders have rights to a company's assets only after bondholders, preferred shareholders and other debt-holders have been paid in full. In the U.K., these are called "ordinary shares".

If the company goes bankrupt, the common stockholders will not receive their money until the creditors and preferred shareholders have received their respective share of the leftover assets. This makes common stock riskier than debt or preferred shares.

### Risks

The price of a stock is affected by supply and demand: the higher the demand, the higher the price, the reputation and the country of the company and the interest rates. The main risk of a stock are:

- **Value risk:** stock prices depend on the development of corporate profits and the markets. Your original investment is therefore not guaranteed: there is always the risk that the stock you invest in will decline in value, and you may lose your entire principal.
- **Business risk:** your stock is only as good as the company in which you invest - a poor company means poor stock performance.
- **Currency risk:** Investments made in foreign currency are subject to exchange rate fluctuations, which may significantly impact the final realization price of the stock.
- **Country risk:** For some companies located in unstable countries, specific risks arise from factors such as lack of currency or transfer limitation, nationalization of companies, political, economic and social instability, etc.

### 2.3.2 Preferred Stock

Also known as "preferred shares", preferred stock is a class of ownership in a corporation that has a higher claim on the assets and earnings than common stock.

Preferred stock generally:

- has a dividend that must be paid out before dividends to common stockholders.
- does not have voting rights.

The precise details as to the structure of preferred stock are specific to each corporation. However, the best way to think of preferred stock is as a financial instrument that has characteristics of both debt (fixed dividends) and equity (potential appreciation).

There are certainly pros and cons when looking at preferred shares:

- Preferred shareholders have priority over common stockholders on earnings and assets in the event of liquidation and they have a fixed dividend (paid before common stockholders).
- Investors must weigh these positives against the negatives, including giving up their voting rights and less potential for appreciation.
- Rates of return on preferred stock are lower than those on common stocks, and very close to those for corporate bonds, where corporate bonds are considered less risky.

### Risks

Preferred stock are mainly subject to the same risks as common stocks.

### 2.3.3 American Depository Receipt

An American Depository Receipt (ADR) is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on U.S. stock markets just like regular stocks and are issued/sponsored in the U.S. by a bank or brokerage.

ADRs were introduced in response to the difficulty of buying shares from other countries that trade at different prices and currency values. U.S. banks purchase a large lot of shares from a foreign company, bundle the shares into groups and reissue them on either the NYSE, AMEX or Nasdaq. The depository bank sets the ratio of U.S. ADRs per home country share. This ratio can be anything less than or greater than 1. For example, a ratio of 4:1 means that one ADR share represents four shares in the foreign company.

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## Risks

- **Country risk:** is the government in the home country of the ADR stable?
- **Currency risk:** is the currency of the home country stable? ADRs track the shares in the home country; therefore, if its currency is devalued, it trickles down to your ADR and can result in a loss.
- **Inflation risk:** this is an extension of the exchange rate risk. Inflation is a big blow to business, and the currency of a country with high inflation becomes less and less valuable each day.
- Everything related to stock.

## 2.4 Convertible Security

### Description and Main Features

A convertible, sometimes called a "CV", is either a convertible bond or a preferred convertible stock. A convertible bond is a bond that can be converted into the company's common stock. You can exercise the convertible bond and exchange the bond into a predetermined amount of shares in the company. The conversion ratio can vary from bond to bond.

Convertibles typically offer a lower yield than regular bonds because there is the option to convert the shares into stock and collect the capital gain. However, should the company go bankrupt, convertibles are ranked the same as regular bonds.

Most Convertible Securities are callable, in other words, the company can force convertible bondholders to convert the bonds to common stock by calling the bonds. This is called "forced conversion" or "Reverse Convertible Security".

### Risks

Convertible securities are subject to similar risks as their underlying (Credit risk, inflation risk, currency risk, interest rate risk, liquidity risk, reinvestment risk), but with a lower value risk.

## 2.5 Investment funds and ETFs

### Description and Main Features

An investment fund is comprised of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market securities, private equity, real estate and similar assets. Investment 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. An investment fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

- **Open-end funds** (more commonly known as mutual funds) continuously offer their shares to investors and prospective investors and stand ready to redeem their shares at all times. Transactions in shares of mutual funds are based on their net asset value (NAV), determined at the close of each business day.
- **Closed-end funds** have a fixed number of shares outstanding. Following an initial public offering, their shares are traded on an exchange between investors. The invested capital in a closed-end fund is fixed and will change only at the direction of management. The major difference to open-end funds is that investors are not offered the possibility to redeem their shares at the end of each business day.

Exchange Traded Funds are investment funds which track an index, but can be traded like a stock. Because ETFs are traded on stock exchanges, they can be bought and sold at any time during the day (unlike most mutual funds). Their price will fluctuate from moment to moment, just like any other stock's price, and an investor will need a broker in order to purchase them, which means that he/she will have to pay a commission.

### Risks

The risks related to Investment Funds and ETFs are the same as the ones related to stocks (business risk, country risk, currency risk, inflation risk, market risk, value risk).

## 2.6 Options

### Description and Main Features

Options are a privilege sold by one party to another that offers the buyer the right to buy (call) or sell (put) a security at an agreed-upon price during a certain period of time or on a specific date.

There are two basic types of options: calls and puts.

A call gives the holder the right to buy an asset (usually stocks) at a certain price within a specific period of time. Buyers of calls hope that the stock will increase substantially before the option expires, so they can then buy and quickly resell the amount of stock specified in the contract, or merely be paid the difference in the stock price when they go to exercise the option.

A put gives the holder the right to sell an asset (usually stocks) at a certain price within a specific period of time. Puts are very similar to having a short position on a stock. Buyers of puts are betting that the price of the stock will fall before the option expires, thus enabling them to sell it at a price higher than its current market value and reap an instant profit.

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The exercise or strike price of the option is what the stock price must pass (for calls) or go below (for puts) before options can be exercised for a profit. All of this must occur before the maturity date, also known as the expiration date. It should be noted that an option gives the holder the right, not the obligation, to do something. The holder is not required to exercise if he/she does not want to or if the terms are not favourable.

The objectives of options are up to the holder. Two types of people use options: speculators and hedgers. Speculators simply buy an option because they think the stock will go either up or down over the next little while. Hedgers use options strategies, such as the "covered call", which allows them to reduce their risk and essentially lock-in the current market price of a security.

Options (and futures) are popular with institutional investors because they allow institutions to control the amount of risk they are exposed to.

Options require more than just a basic knowledge of the stock market. You have the potential to lose a lot of money if you take various positions - for e.g. if you are the writer of an option. Options are highly complex and highly leveraged. If you are using options to speculate, you need to keep a close watch on them and to have a high tolerance for risk.

#### Risks

Options are subject to Market Risk and to the same risks as the ones of the stocks, with an exponential impact due to the leverage.

## 2.7 Futures contracts

### Description and Main Features

As the name implies, futures are contracts on commodities, currencies, and stock market indexes that attempt to predict the value of these securities at some date in the future.

The primary purpose of futures markets is to provide an efficient and effective mechanism for the management of price risks. Futures traders accept price risks from producers and users with the idea of making substantial profits.

A futures contract on a commodity is a commitment to deliver or receive a specific quantity and quality of a commodity during a designated month at a price determined by the futures market. For example, someone buying an April Canola contract at \$5 a pound is obligated to accept delivery of 100 pounds of canola during the month of April at \$5 per pound. Selling a futures contract means you are obligated to deliver these goods. The same concept applies to buying a futures contract on any other asset. It is important to know that a very high portion of futures contracts trades never lead to delivery of the underlying asset; most contracts are "closed out" before the delivery date.

There are two reasons to use commodity futures contracts: to hedge a price risk or to speculate. The gain (or loss) on the futures contract will equal the gain (or loss) on the market price at harvest time - this is called a perfect hedge. A mutual fund manager would use this same strategy, but with index futures. He or she would short futures contracts on a stock index, therefore reducing any downside risk for a certain period of time.

The risks associated with futures contracts apply mainly to speculators. Speculators take positions on their expectations of future price movement, often with no intention of either making or taking delivery of the commodity. They buy when they anticipate rising prices and sell when they anticipate declining prices.

The reason why futures are so risky is because they are usually bought on margin, and each futures contract represents a large amount of the underlying asset.

#### Risks

Futures are subject to the same risks as the ones of the stocks, with an exponential impact due to the leverage.

## 2.8 Forex (FX)

### Description and Main Features

The foreign exchange (also known as "forex" or "FX") market is the place where currencies are traded. The overall forex market is the largest in terms of the total cash value traded. Any person, firm, or country may participate in this market.

The forex market is open 24 hours a day, five days a week, with currencies being traded worldwide among the major financial centres of London, New York, Tokyo, Zürich, Frankfurt, Hong Kong, Singapore, Paris and Sydney – spanning most time zones.

#### Risks

- Currency Risk
- Inflation Risk
- Interest Rate Risk