UBS Global Asset Management

For Professional Clients only

Glossary
An A to Z of investment terms

Italic type indicates a cross-reference within this glossary

130:30

A particular type of *long/short* fund.

A...

ADRs

American Depository Receipts. *Certificates* issued by a bank stating that a specific number of a company's *shares* have been deposited with them. These certificates are denominated in dollars and traded on the American exchanges as if they were American *securities*. However, they normally represent stock in companies outside America.

Absolute return

Any investment strategy that aims to achieve a given level of long-term return, rather than a return relative to a specific *benchmark, index* or *inflation* measure.

Accrued interest

Interest earned on a *bond* since the last interest payment date. If the *bond* is sold, the accrued interest is paid (gross of tax) to the seller at the time of the transaction in addition to the *clean price* of the *bond*.

Accumulation units

Units in a *collective investment scheme* where income is rolled up or automatically reinvested to increase the unit value.

Active management

A style of investment management where the fund manager aims to outperform a *benchmark* by superior *asset allocation*, market timing or *stock selection* (or a combination of these). Compare with *passive management*.

Active risk

A measure of estimated *volatility* of fund performance against the *benchmark*. Also known as forecast *tracking error* or *relative risk*. In technical terms, it is defined as the forecast standard deviation of annual *returns* versus the *benchmark*. Active risk is usually quoted *ex-ante*, the *ex-post* measure of *volatility* of actual returns more usually being referred to as realised *tracking error*.

Activity

A measure of the percentage of the fund switched within a market or sector over a specified time period. To be precise, it is defined as the lesser of purchases and sales divided by the mean value of the fund's holdings in that sector or market. Compare with *turnover*.

Actuarial valuation

A review of the assets and *liabilities* of a *pension fund* to determine the *surplus* or *deficit*, and the future rate of contributions required.

Advisory client

A client who takes their own investment decisions, based on a *broker* or fund manager's investment recommendations. Compare with *discretionary client*.

Allotment letter

Allocation of *shares* from a *new issue* is made by means of an allotment letter. This entitles the recipient to a certain number of *shares*, subject to payment. When demand for a *new issue* exceeds the *shares* available, allotment is either made on a random (see *ballot*) or proportional basis.

Allotment price

Price at which stock is allotted to successful applicants in a *new issue* or other offer.

Alpha

Often loosely used to describe the amount of investment *return* an *active manager* adds from their management of the fund. The formal definition of alpha is the outperformance of a stock or fund in excess of the *return* that can be attributed to the market in general. The *return* attributable to the market will be determined by the actual market *return* and the stock or fund's *beta*. For example, if a fund returns 14%, the market returns 10% and the *beta* of the fund is 1.2, the alpha of the portfolio is 14% – (10%x1.2) = 2%. If a fund has a consistently high alpha this can indicate skilful management. Compare with *beta*.

Alternative investments

Investments other than mainstream *equities* and *bonds*. New capabilities sometimes referred to as “alternatives” include *hedge funds*, *private equity*, *infrastructure*, *gold* and *commodities*. *Real estate* is also sometimes described as an alternative. Alternatives may be *asset classes* in their own right (e.g. *gold*) or may be new strategies for investing in established *asset classes* (e.g. *hedge funds*).

Annualised return

The rate of *return* for any given period expressed as the equivalent average return per year. Note that this is not a simple arithmetic calculation.

Annuity

A financial product which you purchase with a lump sum payment that pays out a guaranteed income stream until the death of the member (or in some cases until the death of their dependants). Annuities are a key component used in *buyouts* and are offered by many financial institutions, in particular insurance companies.

Arbitrage

Price anomalies can arise between different markets for similar instruments. Arbitrage aims to exploit these differences. Modern arbitrage frequently involves *derivatives*.

Asset allocation

The apportionment of a fund's assets between *asset classes*. See *strategic asset allocation* and *tactical asset allocation.*

Asset class

A collective term for investments of a similar type with a unique combination of investment characteristics. The main asset classes are *equities (shares), bonds*, cash and *real estate*.

Asset/liability modelling

A technique that gauges the suitability of various investment strategies by making projections of the future investment *returns* and *liabilities* of a fund.

Asset-backed securities

Securities, usually *bonds*, where the cashflow to make the *coupon* payments comes from underlying assets. For example, mortgage-backed bonds where the cashflow comes from mortgage payments made by borrowers.

Asset stripping

A process by which a controlling shareholder sells off the assets of a company and pays the proceeds to the shareholders (often himself). Alternatively, the cash proceeds are retained within the remaining 'shell' of the original company to be used for a variety of purposes.

Attribution analysis

Analysing the *return* achieved by a fund manager into its constituent parts (eg. *asset allocation* and *stock selection*) to show where value is being added.

Auction

Sale of new stock at which successful competitive bidders pay the price they bid. Non-competitive bidders pay the weighted average price of successful competitive bids.

Authorised share capital

The amount of *share capital* that a limited company is authorised to issue. This does not provide any indication of the worth of the company which is related to its *issued capital* and reserves, its *Net Asset Value* (NAV) and its profitability.

Authorised fund

A *pooled fund* that is subject to certain *FSA* regulations so that it can be marketed to the general public. Compare with *unauthorised fund*.

B...

Balanced management

A particular type of *multi-asset management* where a manager is responsible for all *asset classes*, with the possible exception of *real estate*. A fund using this style is called a balanced fund. Compare with *specialist management* and *multi-asset management*.

Ballot

When a *new issue* is over-subscribed some or all of the applications are "put into a hat" and applications withdrawn at random to be granted part or all of the *shares* applied for. Applications not selected are unsuccessful and are returned.

Barbell portfolio

A portfolio of *bonds* which is concentrated in short and long-dated *bonds* with little or no exposure to intermediate *maturity* bonds. Contrast with a *bullet portfolio*.

BARRA

A popular *risk management* system for the investment industry supplied by MSCI Barra.

Base rate

The minimum reference rate at which commercial banks will lend money to their customers. Most loans are expressed in terms of a percentage over base rate. The greater the perceived *credit risk* of the borrower, the greater the number of percentage points over base rate that will be charged. In the UK, the Bank of England's *Monetary Policy Committee* (MPC) sets the *repo rate*.

Basis point

One hundredth of 1% (i.e. 0.01%). Also referred to as bps.

Bear market

A market where prices decline against a background of widespread pessimism. Compare with *bull market*.

Bearer security

A *bond* or *share* where the ownership is not recorded on a register. Possession of a bearer security proves ownership.

Benchmark

A yardstick against which the investment policy or performance of a fund manager can be compared.

Beneficial owner

The person or persons who have ultimate rights to the value of an investment or property, as distinct from the registered owner who may be a *nominee*.

Best execution

The duty of an investment firm to take all reasonable steps to obtain, when executing orders on behalf of clients or decisions to deal, the best possible result for those clients taking into account factors such as price, costs, speed, likelihood of execution and settlement, size, nature and any other consideration relevant to the execution of the order.

Beta

A measure of the expected movement in price of a stock or fund, given a movement in its *benchmark*. For example, suppose a stock has a beta of 1.2. If the market appreciates by 10%, the expected corresponding increase in stock price would be 12%. Compare with *alpha*.

Bid-offer spread

The difference between the price at which financial securities and units in a *pooled fund* can be sold (bid price) and bought (offer price). Compare with *single price*.

Blue chip

The name used to describe companies that are perceived to be high quality.

Bond

A *certificate* of debt issued by a company, government, or other institution. A bond holder is a creditor of the issuer and receives interest at a rate stated at the time of issue.

Bonus issue

When a company issues extra *shares* free of charge to existing shareholders on a pro rata basis. Compare with *rights issue*.

Book cost

The historic cost of the assets when purchased.

Bottom-up

An approach to investment which is based on the selection of individual stocks. Thus, the sector or country weightings are a by-product of the particular stocks chosen. Compare with *top-down*.

Bourse

The French equivalent of the *London Stock Exchange*. The term is also sometimes used for other European exchanges.

Broker

A firm that provides investment *research* and *execution* services.

Bull market

A market where prices increase against a background of widespread optimism. Compare with *bear market*.

Bullet portfolio

A portfolio of *bonds* with *maturities* highly concentrated around one point on the *yield curve*. Contrast to a *barbell portfolio.*

Buyout

Sponsors of pension schemes have a legal obligation to ensure that all the *liabilities* of the pension scheme are met (the *liabilities* of the pension scheme are the pensions that the scheme needs to pay to all of its members). A buyout is where this legal obligation to meet all the *liabilities* of the pension scheme is transferred from the sponsor to another financial institution, usually an insurance company. This institution takes on full responsibility for guaranteeing the pensions in return for a one-off payment. Once this one-off payment is made, the financial institution will issue individual *annuities* to each member of the scheme and, from that point on, the member will receive a regular guaranteed sum of money (usually equal to what they would have received from the pension scheme) from the financial institution. This transfer of legal obligation can be implemented immediately (known as an immediate buyout). Alternatively, this can be implemented using a phased approach where the pension scheme membership is divided into groups and the risks related to each group is transferred to the financial institution at different points in time (known as phased, progressive or partial buyouts).

C...

CAPS

See *Mellon.*

CDO

Collateralised Debt Obligation. A type of *asset-backed security* where the underlying assets are various kinds of debt obligations, including other *asset-backed securities*.

CFA

Chartered Financial Analyst. The CFA Institute awards this industry qualification, which requires three years of industry experience and three exams.

CGT

Capital Gains Tax introduced in 1965 as a tax on the net appreciation in the value of an *asset*. This is charged on gains above an annual limit. *Pension funds* and charities are exempt from CGT.

CPI

Consumer Price Index. An inflationary indicator that measures the change in cost for a fixed "basket" of goods and services. Internationally referred to as *HICP*. Similar to *RPI* although there are differences in coverage and methodology.

CSAs

Commission Sharing Arrangements; these are mechanisms that enable investment management firms to ensure that *commissions* paid are allocated more accurately to *brokers* according to the quality of their *execution* or their *research*. At the start of 2006 the *FSA* sanctioned the use of CSAs.

Call

A payment on a specified date on a partly paid stock, to be paid by the holder of the *allotment letter*.

Call money

Deposits placed in the *money market* which are available at *call*, i.e. with no advance notice.

Call option

An *option* that gives the buyer the right (but not the obligation) to buy a specified quantity of the underlying instrument at a fixed price, on or before a specified date. Compare with *put option*.

Capital preservation fund

A fund that is managed with the aim of outperforming a cash *benchmark* while operating within investment guidelines designed to protect the original capital sum.

Capitalisation issue

An issue creating additional *share capital* either by the issue of new *shares* for old as with a *scrip issue* or by share rationalisation.

Catch-up

A type of *performance* fee typical of *infrastructure funds*. For example, the investor is paid distributions from the fund until they receive an 8% preferred *return* on their investment. Then, the manager is paid 80% of subsequent distributions until it has received the equivalent of 20% of *returns* (this is where the manager "catches up" with the investors). Thereafter, the investors receive 80% of the *returns* and the manager 20%.

Certificate

The document evidencing ownership of stocks, *shares* or *unit trusts* confirming relevant registration details. See also *Crest.*

Certificate of deposit

Abbreviated to CD; issued by banks and building societies. CDs have a secondary market, the holder of a CD is able to sell it to a third party in order to realise cash before the *maturity date* of the CD.

Chartism

The study of historical market data to determine trends and to try to predict future movements.

Chinese walls

Controls over communications put in place in financial institutions that offer a wide range of services which could lead to conflicts of interest.

Churning

Excessive dealing in *securities* leading to abnormally high turnover of the portfolio. This is considered undesirable for *pension funds* and could lead to a loss of tax-exempt status.

Class action

A class action arises when a group of investors initiates a legal action against a company or its directors in respect of alleged negligence or illegal behaviour. The majority of class actions are initiated in the US. The case usually involves a claim for compensation in respect of *share* price losses in a specified period.

Clean fees

Fund management fees that are all inclusive, to which there will be no extra charges added. Compare with *dirty fees.*

Clean price

The price of a *bond* excluding any *accrued interest*.

Closed-end fund

A *pooled fund* with a limited number of units available. Compare with *open-ended fund*.

Collateral

Assets put up as a security that a future financial obligation will be met.

Collective investment scheme

A fund in which several investors hold units. The assets are not held directly by each client, but as part of a "pool". *Unit trusts* and *OEICs* are types of *pooled fund*. Compare with *segregated fund*.

Combined Code

A code of *corporate governance* principles for UK companies. So called because it combines the recommendations of several key reports on corporate governance issues including those of the committees chaired by Cadbury, Greenbury, Hampel and Higgs.

Commercial paper

Short-dated, unsecured *bonds* issued by companies.

Commission

Amounts paid to *brokers* for undertaking transactions.

Commission recapture

A commission recapture agreement is where *brokers*, who have received *directed commissions* from a client, agree to give back some of their *commission* to the client. Such an agreement would usually be facilitated by a third party (such as a *custodian*) who would take a share of the revenue.

Commodity

A tradeable item that can be further processed and sold. Industrial (metals), agricultural (wool, wheat, sugar) and bulk commodities (coal, iron ore) are examples. It is possible to invest in physical commodities or in *derivatives* based on commodity prices.

Common investment fund

An arrangement whereby the assets of two or more entities, normally with common control and/or objectives, are pooled for investment.

Concentrated portfolio

A portfolio that holds fewer stocks than normal, with the aim of achieving a higher performance target but with a commensurate increase in *risk*.

Consolidated Alternatives

Pension funds are increasingly looking to invest in alternatives in one single, consolidated solution. Consolidated *alternative investments* are often *pooled funds*, investing in a range of alternative assets such as *hedge* funds, *private equity* funds, *infrastructure* funds and *real estate* funds.

Consolidation

Where a company increases the *nominal value* of its *shares* and reduces the number of *shares* in issue by consolidating holdings. For example, five 5p *shares* might be consolidated into one 25p *share*.

Contract note

Written confirmation of the purchase or sale of an investment.

Contra-cyclical manager

A fund manager who goes against the general trend in investment cycles, or against the "herd", by buying stocks that are out of favour in the belief that they will recover. Also known as a contrarian manager.

Conventional bond

A *bond* where the *coupon* and *principal* payments are fixed at the time of issue. Compare with *index-linked bond*.

Convertible stock

Stock (often *fixed interest*) which gives the holder the right, but not the obligation, to convert all or part of the holding into *ordinary shares* on specified dates and on specified terms.

Convexity

A measure of the sensitivity of a *bond's* price to changes in *yield*, over and above that explained by modified *duration*.

Core portfolio

A portfolio normally invested in a controlled manner to provide stable returns (possibly by *indexation*). The core portfolio generally represents the bulk of a fund's assets. The remainder of the fund's assets (often called the satellite portfolio) can then be managed in a more aggressive way, in search of higher returns. This arrangement is called a core/satellite approach.

Corporate bond

Strictly speaking, corporate bonds are those issued by companies. Generally, however, the term is used to cover all *bonds* other than those issued by governments in their own currencies. Therefore the 'credit' sector, as it is often known, includes issues by companies, supranational organisations and government agencies. The key feature that distinguishes corporate bonds from government bonds is the risk of *default* – see *credit risk*.

Corporate governance

Issues relating to the way in which a company ensures that it is attaching maximum importance to the interests of its shareholders and how shareholders can influence management. Governance issues include executive pay levels and how institutional investors use their votes.

Counterparty

The other party with whom a transaction is made.

Coupon

The regular interest payment due on a *bond*. Expressed as a percentage of the nominal value of the stock.

Credit default swap (CDS)

A form of *swap* whereby one party pays a fixed periodic *coupon* for the life of the agreement. The other party makes no payments unless a credit event (defaults in a pre-agreed manner) relating to a predetermined asset occurs.

Credit rating

Each *bond* issue is given a credit rating according to how much investment *risk* is associated with the *bonds* – i.e. how likely it is that the issuer will be able to meet interest (*coupon*) and capital (*principal*) repayment obligations. The higher credit ratings (such as AAA) mean that the issuer is highly likely to be able to meet these obligations and thus can offer *bonds* with lower interest rates and still attract investors. *Bonds* with higher ratings are referred to as *investment grade*, those with lower ratings as non-investment grade (i.e. D to BB+). See also *default risk*.

Credit risk

The *risk* that a *bond* issuer will default on their obligations, or the risk of default of *counterparties* to OTC contracts such as *swaps*. A function of the credit quality of the issuer. *Credit ratings* are provided by agencies including Moody's and Standard & Poor's.

Crest

A service which enables the *securities* of UK registered companies to be held and transferred between members of Crest without the need for paper-based *certificates* and transfer forms.

Cum dividend

Cum is the Latin prefix meaning 'with'. A *share* quoted cum dividend carries the right to receive a recently declared dividend. Cum scrip and cum rights have similar meanings. Compare with *ex dividend*.

Cumulative

Usually used in connection with *preference shares*, where the share carries the right to receive *dividend* arrears before any other *dividends* are paid on lower ranking stocks such as *ordinary shares*.

Currency hedging

Currency risk can be mitigated by *hedging* using *derivatives*.

Currency overlay

An investment strategy in which the currency exposure of a portfolio is altered using *derivatives* (usually *forward* contracts).

Currency risk

Investing in any securities not denominated in the investor's own base currency introduces currency risk due to the *volatility* of foreign exchange rates.

Current yield

See *yield*.

Custody/Custodian

Custody is the administration of *securities* by a financial institution; known as the custodian. The custodian is the primary record keeper of a client's investments and collects income, processes tax reclaims and provides other services, according to client instructions.

Customised benchmark

A *benchmark* specifically constructed by a client rather than using an industry standard.

Cyclical Stock

A stock exhibiting price movements that are relatively sensitive to changes in the general economic climate. Examples include *shares* in retailing companies. Compare with *defensive stock*.

D...

DAX

Short for Deutsche Aktienindex which is an arithmetic index of the share price of 30 blue chip German companies weighted by capitalisation.

DMO

The UK Debt Management Office (DMO) carries out the government's debt management policy to minimise the government's borrowing costs over the longer term.

DTCC

Depository Trust and Clearing Corporation. Provides clearing and *settlement* services in the US.

DVP

Delivery versus payment. Refers to any trade *settlement* where the *securities* and cash move simultaneously and in opposite directions between *settlement* parties.

Dawn raid

When an investor buys a substantial number of a company's *shares* before the market becomes aware of their intentions. The buyer's objective is usually to build a strategic stake in the target company.

Decile

See *percentile*.

Deep discount bond

A *bond* launched at a large discount to its face value, typically with a *coupon* well below current market levels. Specific tax rules apply to these *bonds*.

Default risk

The risk that an issuer of *bonds,* whether government or corporate, will fail to make payments either of regular *coupon* payments or final *principal*. *Credit rating* agencies grade company and government issues to show the likelihood of this event. An investor can diversify away much of this risk by holding a variety of issues to mitigate the impact of the default of any one issuer.

Defensive stock

A stock exhibiting price movements that are relatively insensitive to changes in the general economic climate. Examples include *shares* in utility companies. Compare with *cyclical stock.*

Deficit

In the context of pensions, a scheme is in deficit when the assets are assessed to be insufficient to meet the value of the *liabilities*. Compare with *surplus*.

Defined benefit scheme

A type of pension scheme where the pension that will ultimately be paid to the employee is fixed, usually as a percentage of final salary. It is the responsibility of the sponsoring organisation to ensure that sufficient assets are set aside to meet the pension promised. Often abbreviated to DB. Compare with *defined contribution scheme*.

Defined contribution scheme

A type of pension scheme where employees' and the employer's contributions are fixed but the pension ultimately paid to the employee depends on the investment *returns* achieved by the contributions and *annuity* rates at retirement. Often abbreviated to DC. Compare with *defined benefit scheme*.

Dematerialization

The elimination of physical documents proving ownership of securities. Instead, the ownership of securities is recorded as electronic data. This type of environment is sometimes referred to as 'paperless'. See *Crest*.

Derivatives

Financial instruments that are based on the movements of underlying assets. They allow exposures to markets and individual assets to be adjusted, thereby adjusting the *risk* characteristics of a fund. Common types of derivative include *forward* contracts, *futures*, *options*, and *swaps*. Derivatives may be traded on an exchange, or *OTC*. See also *credit default swap* and *inflation swap*.

Directed commission

A process whereby a client directs a manager to route trading through a selected panel of *brokers*. These *brokers* may then give back some of the *commission* to the client via a *commission recapture* agreement.

Dirty fees

Fund management fees to which extra charges are added, for example for overseas transactions. Compare with *clean fees.*

Discounted cashflow (DCF)

Discounting is a mathematical technique for expressing the value today of cashflows due to be received in the future. The result is called the present value. One way of assessing an investment is to establish what the likely cashflows will be, discount them to their present value, and compare the result with the current market price of the investment. If the present value of the cashflows is more than the current market price, the investment may be undervalued and worth further consideration.

Discretionary client

A client who gives an investment manager total authority to manage the assets against a specified *benchmark*. The manager has discretion to make decisions as if he was the *beneficial owner*. Compare with *advisory client*.

Diversification

The spreading of investment funds among different types of assets, markets and geographical areas in order to reduce *risk*.

Dividend

The part of a company's after tax earnings which is distributed to the shareholders in the form of cash or *shares*. The directors of the company decide how much dividend is to be paid and when. The dividend is neither automatic nor guaranteed for *ordinary shareholders*.

Dividend cover

The extent to which the *dividends* distributed by a company are backed by the distributable earnings of the company.

Dividend reinvestment

The reinvestment of the cash *dividend* to buy additional *shares*, usually at a price lower than the current market price.

Dividend yield

The *return* that the annual *dividend* of a share represents in relation to the current *share* price. Calculated by dividing the annual *dividend* per *share* by the current market price.

Domestic bond

A *bond* issued in the country and currency in which the borrower is domiciled.

Double taxation relief

Companies or individuals with profits or income arising abroad may suffer withholding tax on amounts remitted to the UK. The profits or income may also be subject to UK tax. A double taxation agreement aims to prevent or give relief for double taxation. It provides that income will be taxed in one country only or, if taxed in both, that one country will allow credit for tax paid in the other.

Dow Jones Industrial Average

This is an *index* of the New York Stock Exchange and is a basket of thirty *shares*, chosen to represent the economy, that provides an indication of the general movement of prices in the market.

Draw down

When investing in certain types of funds, notably *venture capital* funds, the investor commits to invest a certain sum of money but does not give it all to the fund manager at the outset. As the fund manager makes investments, money is drawn down, ie. requested from the investors.

Duration

The duration of a *bond* is the sum of the present value of the future income and *redemption* payments, weighted by the number of years until receipt. Modified duration is a measure of the sensitivity of the price of a *bond* to changes in its *redemption yield*.

Dynamic alpha

A term used to describe an investment strategy that uses the concept of *portable alpha.*

E...

EMU

Economic and Monetary Union. One stage of this was the introduction of the *euro*.

ERISA

Employee Retirement Income Security Act (1974). US pension legislation, now sometimes used as a generic term to cover the whole US pension market.

ETF

Exchange traded fund – a relatively new technique evolved from *passive* investment. Instead of buying a unit in a *tracker fund*, investors can "buy" an *index* in the form of units which are actively traded on a stock exchange. The price of these units depends on the prevailing market price.

EV/EBITDA

A method of valuing *equities* calculated by dividing a company’s enterprise value (market value of *equity* plus net debt of the company) by its earnings before interest, tax, depreciation and amortisation. This measure calculates the company’s short-term cash flow generation in relation to its market valuation.

Earnings per share

A common way of expressing company profits – dividing the profits after tax by the number of *shares* in issue. Earnings per share is the basis for the calculation of the *PE ratio* (price/earnings *ratio*).

Earnings yield

See *yield*.

Enhanced indexation

An investment strategy by which managers aim to add incremental performance to an *index return*. Techniques range from trading strategies, whereby managers seek to add performance in managing index constituent changes, to *arbitrage* between similar stocks and low risk *active* fund management based upon a combination of quantitative and *fundamental analysis*.

Equalisation

As income from a *pooled fund* accrues between *dividend* distributions, it is added to the unit price. An investor purchasing units will thus be paying for some of the next *dividend* payment in the unit price; effectively turning capital into income (which is taxable). Fund managers can state an equalisation factor with each distribution to indicate the proportion of the total distribution that is not subject to income tax.

Equity

The capital of a company belonging to the *ordinary shareholders* who have *voting rights* allowing them to influence the management of the company.

Euro

The name of the single European currency introduced on 1 January 1999, initially in the form of bank money only. On 1 January 2002, euro notes and coins were issued in participating countries and became the sole legal tender. Participating countries are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Slovenia, Malta, Cyprus and Greece (at August 2008). See also *EMU*.

Eurobond

A *bond* issued in a currency or market other than that of the country of origin of the issuer. The name derives from the first issuers of such *bonds* – American companies issuing *bonds* in European currencies.

Euronext.liffe

Market for trading in *derivatives* (formally known as Liffe).

European Central Bank (ECB)

Has sole responsibility for defining monetary policy and controlling *interest rates* for those countries participating in *EMU*. Has responsibility for issuing notes in *euros*.

Eurozone

A collective term for the countries participating in the *euro*.

Ex-ante

Literally means ‘before the event’. A forward-looking measure or estimate. Compare with *ex-post*.

Ex-post

Literally means ‘after the event’. A backward-looking measure using historical data. Compare with *ex-ante*.

Ex dividend

To clarify who receives the *dividend* on a share that is sold around the time the *dividend* is due, a date is fixed when a *share* goes ex-dividend. Anyone buying after this date will not receive the *dividend*. A *share price* will normally fall by the amount of the *dividend* on the day that it goes ex-dividend. Compare with *cum dividend*.

Execution

The buying or selling of an investment.

Execution-only

A *broker* who simply executes his clients' orders, without giving any advice. This is the cheapest form of stockbroking and is often done by telephone. Known in the US as discount brokerage.

Exempt unit trust

A *unit trust* that is only available to tax-exempt investors such as charities and *pension funds*.

Exercise price

The price at which an *option* holder has the right to buy or sell the underlying asset. Also known as *strike price*.

Expiry date

The last date on which an *option* can be exercised. Also known as *maturity date*.

External management

Where a scheme hires firms of investment managers to manage assets on its behalf. Compare with *internal management*.

F...

FRAG 21

Financial Reporting and Auditing Group guide on the issuance of reports to third parties on the internal controls of investment managers and *custodians*. The group is part of the Institute of Chartered Accountant in England and Wales (ICAEW). The ICAEW has issued new guidance "Assurance Reports on internal controls of service organisations made available to third parties" AAF 01/06 which supersedes FRAG 21/94. *SAS70* is an alternative to the AAF 01 report.

FRN

Floating Rate Note. A type of *bond* where the *interest rate* is reset in line with *money market* rates at regular, pre-determined dates.

FRS 17

A UK accounting standard which requires companies to incorporate their *pension funds* into their balance sheets and specifically that all *pension fund liabilities* should be valued using an AA *corporate bond* yield. Any mismatch between assets and *liabilities* is effectively brought on to the company's balance sheet, and can potentially increase the *volatility* of a company's *share price*. See also *IAS19*.

FSA

The Financial Services Authority, the sole statutory regulator of financial services in the UK.

FTSE All-Share Index

An arithmetically weighted index of leading UK *shares* (by market capitalisation) listed on the *London Stock Exchange*. Consists of around 900 companies and updated daily. The FTSE 100 Index (or "Footsie") covers only the largest 100 companies.

Federal Reserve Board

The Federal Reserve Systems' Board of Governors that oversees Federal Reserve Banks and establishes monetary policy in the US.

Fixed deposit

A cash deposit which is made for a fixed period of time at a fixed rate of interest.

Fixed interest

An income stream which remains constant during the life of the asset, such as income derived from *bonds*, *annuities* and *preference shares*.

Flat yield

See *yield*.

Flotation

The first issue of *shares* to the public in a company new to the stock market. See also *IPO*.

Forward contract

A transaction in which two parties agree to the purchase and sale of a *commodity* or asset at some future time under such conditions as the two agree.

Fully paid

Shares on which the full nominal value has been subscribed. Compare with *nil paid*, *partly paid*.

Fundamental analysis

An analysis of a company taking into account all the factors that affect its cashflow, profits, business, the industry it operates in and the economy in general.

Fund of hedge funds

See *hedge funds*.

Futures contract

An obligation to make or take delivery of a specified quantity of an underlying asset at a particular time in the future and at a price agreed upon when the contract was made. Exchange-traded futures contracts have standard terms, and are subject to daily *margining*.

G...

GIPS

Global Investment Performance Standards set out a voluntary code which aims to achieve fair representation and full disclosure of performance records. This code provides a number of key ethical principles when quoting figures.

GTAA

Global Tactical Asset Allocation. New techniques for *TAA* have been developed and become more commonly known as GTAA. Standalone GTAA funds can be used to overlay TAA views onto existing portfolios, regardless of their *benchmarks* through the use of *derivatives*.

Gearing

A measure of how much a company has borrowed (usually related to its total assets). Gearing may also be used when referring to a fund's borrowing.

Gilts

Gilt-edged securities; the familiar name given to sterling-denominated marketable *bonds* issued by the British government.

Gilt repos

Selling *gilts* and simultaneously entering into an agreement to repurchase them at a fixed time and price. A technique used to fund temporary cash shortfalls, to fund long gilt positions, or to gear portfolios by borrowing against gilts. Buying gilts with a resale agreement is called reverse repo and is a means of lending cash on a *collateralised* basis.

Gilt strips

Investors can buy separately either the individual *coupons* or the ultimate *principal* repayment due on a specific *gilt*. These separate elements are referred to as principal or coupon strips and are identified by the payment date. The separation process is achieved by "stripping" the gilt. A key benefit is that the duration of a strip is equal to its term, thus making it easier for *pension funds* to find *securities* to match fixed *liabilities*.

Gold

Gold is potentially attractive as an investment due to its high liquidity, its status as an *asset* held by central banks, and because it is seen as a good source of *diversification* for funds and an *inflation hedge.*

Government bonds

Bonds issued by governments or quasi-government institutions.

Grey market

The familiar name given to the unofficial market for a new security before its formal offering. Also known as "when-issued trading".

Gross redemption yield

See *yield*.

Group money purchase scheme

See *occupational defined contribution*.

Group personal pension scheme

A *defined contribution* arrangement which is made up of individual personal contracts or policies with employees. Once a group scheme is set up, the employer's only obligation is to make the contributions.

Growth manager

A fund manager who aims to select stocks that he believes will achieve above-average profits growth. Compare with *value manager* and *momentum manager*.

H...

HICP

Harmonised Indices of Consumer Prices. Published by Eurostat, to measure price changes on a comparable basis across EU member states and the *EMU* area as a whole. It is the measure monitored by the *European Central Bank* (ECB) in setting monetary policy. See also *CPI* and *RPI*.

Hang Seng Index

An index of the share price of largest securities listed on the Hong Kong Stock Exchange.

Hedge Funds

A hedge fund is a capital pool that has the ability to use *leverage* and to take both *long* and *short* positions with the aim of achieving an *absolute return*. A large variety of hedge fund strategies exists and the level of *risk* taken will vary. Investors looking for a diversified exposure to hedge funds will normally opt for a fund of hedge funds – a fund with underlying investments in several hedge funds covering different strategies and geographical areas.

Hedging

A strategy that aims to reduce *risk*. For example, a *forward* currency transaction might be executed when investing in overseas *shares* or *bonds* to avoid volatility of returns due to exchange rate movements.

High alpha bond fund

A new type of *bond* product which has a higher *performance* target compared to more traditional bond funds. This is sought through taking a wider range of interest rate, credit and currency views, utilising the new *UCITS III* rules which allow the use of *derivatives*.

High watermark mechanism

This is a term related to some *performance fees*. It is a mechanism where *performance fees* are charged on positive performance only, and whereby if the fund performance deteriorates a fee will not be charged until the fund moves beyond its previous highest value. For example, a fund value could start at 100 and move up to 120, for which a *performance fee* would be charged. However if it falls to say 110 a fee will not be charged until it goes above 120.

High yield bond

A speculative *bond* with a *credit rating* below *investment grade.*

I...

IAS19

International Accounting Standard 19 – the standard applicable when reporting pension benefits. Introduced on 1 January 2005 and replaces *FRS 17* (the equivalent UK accounting standard) for UK companies listed on an EU stock exchange. Non-listed companies are permitted to use the international standard but are not required to do so.

IMA

The Investment Management Association is the industry body for the investment industry. Formed from previous industry bodies IFMA and AUTIF, the IMA's role is to make representations to the UK government, publicise the use of investment funds and promote training and knowledge throughout the industry. IMA is also an acronym for *Investment Management Agreement*.

IMA Disclosure Code

In May 2002, the *IMA* published a Code of Practice on the disclosure of costs and charges incurred in the management and custody of pension scheme assets. The Code was drawn up by a Joint Working Party of Members of the *IMA* and the *NAPF*, and is endorsed by the NAPF Investment Council. A second edition of the Code was published in March 2005. Level One requires a statement of house policies and processes to explain how the fund manager operates. Client-specific information must be supplied to fulfil the Level Two requirements.

IPO

Initial public offering. A public offer to buy some or all of the stock of a company on *flotation*.

ISIN

International Securities Identification Numbering system. The ISIN code is a unique code given to a *security* and is used worldwide.

Illiquid

Illiquid assets are those assets that cannot be easily sold or converted into cash. It may often be impossible to convert the asset to cash until the end of the life of the asset.

Immunisation

A strategy in which the *duration* of a *bond* portfolio is matched to the *duration* of its projected *liabilities*, in order to protect against *interest rate risk*.

Income distribution

The distribution of income to unit holders of *pooled funds* in strict proportion to the number of units held at the *ex-dividend* date.

Index

A calculation of the average price of *shares, bonds,* or other assets in a specified market to provide an indication of the average performance and general trends in the market.

Indexation

A style of fund management that aims to construct a portfolio to provide the same return as that of a chosen market *index*. This can be achieved on a full replication or sampling basis. Full replication involves buying all the stocks in the index in the same proportions in which they make up the index. Sampling means using statistical methods to choose an appropriate portfolio to best match index performance. Indexation is also known as *passive management*. See also *tracker fund* and compare with *active management*.

Index-linked bonds

Both the interest payments (*coupons*) and the value of the eventual capital repayment for index-linked *bonds* are adjusted in line with the change in *inflation*, as measured by a pre-determined inflation measure. Investors are thus protected against the value of their investment being eroded by inflation.

Inflation

A measure of the increase in prices of goods and services over time. See also *RPI*, *CPI* and *HICP*.

Inflation swap

An inflation swap is a contract between two parties, typically where a *pension fund* wants to receive the rate of *inflation* from the time the contract commences until *maturity*. In order to receive *inflation* over the life of the swap the *pension fund* has to pay away a fixed rate of interest.

Information ratio

The information ratio is a measurement of *risk* adjusted performance. It measures performance added per unit of *risk* taken. Formally, it is the *return* of a fund in excess of its *benchmark* divided by the realised *tracking error*.

Infrastructure

Infrastructure *assets* are the permanent assets that a society requires to facilitate the orderly operations of its economy. Examples of infrastructure include: transportation assets such as toll roads and airports; utility and energy assets such as water and electricity; communications and social infrastructure such as transmission towers and education. In broad terms, infrastructure assets generally have high upfront capital costs but have relatively long operational lives, high operating margins and offer reliable, long-term cash flows.

Initial margin

This is the returnable *collateral* that must be deposited by a *futures* market participant when initiating an *open position*. It is also required of writers of *options*. See also *variation margin*.

In-specie transfer

A direct transfer of a parcel of stocks from one manager to another. Avoids the need to make sales and purchases and thus saves *transaction* costs.

Interest rate

An Interest rate is a fee paid on capital borrowed. It indicates the price at which you can borrow. For example, when you get a bank loan, the interest rate is the rate you pay and will often depend on how much you want loaned to you.

Interest rate risk

The *risk* of a fall in the value of a security, especially a *bond*, resulting from a rise in *interest rates*.

Intermediate customer

A professional or experienced investor as defined by the Financial Services and Markets Act. Under *MIFID*, the broadly equivalent client classification from 1 November 2007 has become Professional Client. Compare with *private customer*.

Internal management

Where a scheme employs its own staff to manage the assets of all or part of the scheme. Compare with *external management*.

In-the-money

A term usually used when referring to traded *options*. With *call options* it is where the *exercise price* is below the current price of the underlying *security*. With *put options* it is the reverse. Compare with *out-of-the-money*.

Investment grade

See *credit ratings*.

Investment Management Agreement (IMA)

A document setting out the investment management contract between the fund manager and the client. Contains appropriate legal details and details of investment objectives and *benchmarks* agreed.

Investment trust

A public limited company that holds *shares* in other public and private companies as its main business.

Issued share capital

The portion of a company's *authorised capital* that has been issued by the company.

Issuing house

This is the name given to financial institutions, often merchant banks, that act as intermediaries between companies seeking capital and the investors prepared to supply it.

L...

Large cap

Short for large capitalisation, meaning those stocks with a relatively high *market capitalisation.*

Leverage

Taking on debt in order to make an investment. See *gearing*.

LIBID

London Inter-Bank Bid Rate. *Interest rate* at which prime banks will offer to take funds on deposit from other banks in the London Inter-Bank market.

LIBOR

London Inter-Bank Offer Rate. *Interest rate* at which prime banks will offer to lend money in the London Inter-Bank market.

Liability

A financial obligation or cash outlay that must be made at a specific time to satisfy the contractual terms of such an obligation. In the case of a *pension fund*, liabilities are linked to the age structure of scheme members, and are often dependent on uncertain future factors such as inflation and mortality. See also *longevity*.

Liability driven investing (LDI)

Any investment strategy that has as its *benchmark* something that is in some way specific to the *liabilities* of the pension scheme. The aim is that changes in value of the investments will be closely related to changes in the value of the *liabilities*.

Liability matching

The ultimate expression of *liability driven investing*. In practice it is not possible for *pension funds* to achieve an exact match, the closest matching can be achieved using *bonds*.

Lien

Legal term denoting the existence of a legal charge over assets. Gives the right to claim possession of another party's assets in the event of a default on a debt.

Life (assurance) company

An insurance company that transacts long-term business such as life assurance and pensions. Life companies often offer *pooled funds* for pension investment. Refer to *life company fund*.

Life company fund

A *pooled fund* operated by a *life company*.

Lifestyle investment

A process used in *defined contribution schemes* whereby a member's investments are adjusted depending on their age or term to retirement. Typically, assets are switched from *equities* to *bonds* and cash as retirement approaches.

Liquidity

The capability of a market to accommodate supply and demand without unreasonable price changes. Liquidity is a vital requirement for healthy capital markets. See also *illiquid*.

Listing

The *FSA* has responsibility for the listing of companies to the "official list". Inclusion in this list represents an endorsement from the *FSA* that the company has met minimum standards. It is the responsibility of the *London Stock Exchange (LSE)* to admit a company's securities to trading on the exchange. Being "listed on the LSE" is therefore not the same as being "officially listed".

Listing particulars

Detailed information that must be published by a company applying to be listed.

Listing rules

Rule book for listed companies. Commonly known as the *Yellow Book*.

London Stock Exchange (LSE)

The UK's main exchange for trading in *shares.*

Longevity

Relates to the number of years an individual is expected to live. This future life expectancy is an important component of a pension scheme's *liability* calculation as an assumption is required to assess how long the scheme will have to pay pensions for in the future. Due to improvements in medical treatment and changes in life style, we have seen significant reductions in the number of people dying. This trend is expected to continue and future life expectancy estimates have been increased. This has resulted in pension schemes being expected to pay pensions for a longer time period which in turn increases the expected costs/*liabilities* of the scheme.

Long position

A long position means that the investor actually holds the security or derivative. Compare with *short position*.

Long/short fund

Traditional *equity* funds hold only *long positions*. Long/short funds can also take *short positions*. A typical long/short fund might hold 130% of its value in long positions and 30% in short – hence such funds being called *130/30* funds. The aim of such a fund is to enhance *performance* by allowing managers to express negative as well as positive views.

M...

Macro economics

A study of issues relating to the broader economy whether national or global e.g. national economic policy or the effect of inflation on house prices. Compare with *micro economics*.

Managed fund

Has a variety of meanings, but most commonly refers to a *multi-asset pooled fund* or an investment contract under which an insurance company offers participation in one or more *pooled funds.*

Mandate

The agreement between a client and investment manager laying down how the fund is to be managed. May include performance targets by reference to a *benchmark*.

Margin

Money that must be deposited by participants in *options* and *futures* markets as security that they will be able to meet their commitments at the due date. See also *initial margin* and *variation margin*.

Market abuse

The Financial Services and Markets Act 2000 introduced a regime to tackle market abuse. Broadly speaking market abuse is defined within this act as the misuse of information, the giving of false or misleading impressions and market distortion. This sits alongside the insider dealing legislation in the Criminal Justice Act 1993.

Market capitalisation

The total value of a company, as determined by the market price per share multiplied by the number of *shares* in issue.

Market impact

Market impact is a measure of each *trade's* average *execution* price versus the volume-weighted average price of the stock for that trading day. It is thus a measure of how the size of the order affects the price at which it is executed.

Market maker

Someone who offers to buy and sell *securities* acting as a principal. This contrasts with the operations of a *broker* who acts as an agent for the investor.

Market neutral

An investment strategy which takes advantage of *long* and *short positions* in order to create a portfolio that is not affected by general market movements.

Market risk

The *risk* that the investments in a *portfolio* do not provide the *returns* expected of them due to underperformance of the chosen assets and markets. Also known as *systematic risk*.

Mark-to-market

Valuing stocks or other financial instruments held against the current market price to determine the paper profit or loss to date.

Mature scheme

A pension scheme with a high proportion of pensioners and deferred members, and a low proportion of current members.

Maturity

End of the life of a *fixed interest* security at which point it is repaid. Also known as *redemption*. Maturity can also mean the end of the life of a *future* or *option*.

Median

The median is the value of the middle item in a population. It is a measure of central tendency that is unaffected by extreme values at either end of the population. See also *percentile*.

Mellon

One of the two leading performance measurers. Recently renamed again, and is still sometimes referred to by its former names, MAS and *CAPS*. See also *WM*.

Micro economics

A study of issues affecting a subset of the economy, such as an individual company or household. Compare with *macro economics*.

Mid-cap

Used to describe collectively those companies of medium-sized *market capitalisation*. See also *small-cap* and *large cap*.

MiFID

Markets in Financial Instruments Directive. MiFID is a new EU Directive that came into force on 1 November 2007 across the European Economic Area (EEA). It aims to harmonise financial markets across the EU to create a consistent approach to the regulation of financial markets. MiFID brought about changes in scope, details and evidential requirements. Some of the key changes MiFID brought in are in the areas of client classification, *best execution*, suitability, inducements and conflicts of interest.

Migration risk

The risk that a *bond* will be downgraded to a lower *credit rating* by one of the independent ratings agencies, reflecting its likelihood of *default*. As a *bond* migrates its price usually falls.

Minimum Funding Requirement (MFR)

A requirement introduced in the Pensions Act 1995 in an attempt to ensure that pension schemes had sufficient assets to meet their *liabilities*. It was modified in 2002 and replaced with a new scheme-specific funding requirement under the Pensions Act 2004.

Modified duration

See *duration*.

Momentum manager

A fund manager who buys *shares* that have recently performed well, in the expectation that they will continue to do so. Compare with *growth manager* and *value manager*.

Monetary Policy Committee (MPC)

The Monetary Policy Committee (MPC) of the Bank of England sets the UK *repo rate* with the objective of achieving a stated *inflation* target.

Money market

A general term for the banks and other institutions that accept cash deposits.

Money-weighted rate of return

See *time-weighted rate of return*.

Mortgage-backed securities

See *asset-backed* securities.

Multi-asset management

Where a manager is responsible for most *asset classes* and is measured against a peer group *benchmark* or *customised benchmark* which specifies a fixed *asset allocation* (the manager may or may not have discretion to vary the allocation around this *benchmark*). Compare with *specialist management*.

Mutual fund

See *unit trust*.

Myners Report

Paul Myners published a review of issues affecting the *pension fund* industry on behalf of the government in 2001. His report and subsequent documents have undergone consultation and the Myners' Principles established.

N...

NAPF

National Association of Pension Funds. The UK industry body for *pension funds*.

New issue

New *shares* issued by companies to raise additional cash. The new *shares* are offered to existing shareholders, through a *rights issue* or to a wider audience through a *placing*.

Nil paid

Shares whose *nominal value* has not been paid up and where there is therefore a *call* due on the balance. Government stocks are sometimes issued in this way, with one or more *calls* at specified dates.

Nominal rate of return

A rate of *return* expressed only in monetary terms, i.e. not adjusted for *inflation*. Compare with *real rate of return*.

Nominal value

Sometimes known as par value, this is the face value of a security as opposed to its market value. In the case of a *bond* it represents the principal sum due on *redemption*.

Nominee

Shares or investments need not be registered in the name of their *beneficial owner*. They may be registered under the name of a nominee, a practice often used to ease the administration of holding, buying and selling *shares* on behalf of clients.

Non-systematic risk

This is the *risk* attributable to an individual company, as opposed to the sector or broader market. This risk can be reduced by the *diversification* of a portfolio. Also known as specific risk. Compare with *systematic risk*.

O...

OEIC

Open Ended Investment Company. A *collective investment scheme* structured as a limited company in which investors can buy and sell *shares* on an ongoing basis. Compare with *unit trust*.

OTC

An over the counter (OTC) financial contract is one that is not traded on an exchange but is "tailor-made" for a client by a financial institution.

Occupational defined contribution scheme

A type of *defined contribution* scheme where, although individual members "pots" of assets are separately identified, the scheme itself is a single legal entity. The employer is responsible for appointing the trustees. Also known as group money purchase (GMP), contracted-out money purchase (COMP) and contracted-in money purchase (CIMP).

Off market

Transactions in *unquoted securities*, or transactions involving listed *shares* which are not executed on a stock exchange or within a regulated market.

Offer price

See *bid-offer spread*.

Open-ended fund

A *pooled fund* where new units can be issued according to investor demand. Compare with *closed-ended fund*.

Operational risk

The *risk* of loss from errors, fraud, legal problems, and generally everything not included in *credit risk* or *market risk*.

Open position

Normally used in the context of exchange-traded *futures* and *options*. It denotes a position that is exposed to movements in the price of the *futures* or *options*.

Options

The right to buy (*call option*) or sell (*put option*) a specific security at a specified price (exercise or *strike price*), at or within a specified time (the expiry date). This right can be exercised whatever happens to the security's market price. This right is obtained by payment of an amount (known as the premium) to the writer of the option. Options can also be purchased on stock indices, in which case they are usually cash settled at *maturity*.

Ordinary shares

Securities which represent an ownership interest in a company. If the company has also issued *preference shares*, both have ownership rights.

Out-of-the-money

An *option* which it would not be worthwhile to exercise immediately e.g. a *call option* with an *exercise price* above the current underlying share price; or a put *option* with an *exercise price* below the current underlying share price. Compare with *in-the-money*.

Overlay

An investment strategy using *derivatives* to alter the *risk/return* profile of an underlying portfolio in some desired way. See for example *tactical asset allocation.*

Over-subscription

Shares are said to be oversubscribed when more applications are received than there are shares for offer. In this event, applications are usually scaled down pro rata. (See *allotment letter* and *ballot*).

Overweight

To hold more of a stock or sector than the *index* or *benchmark* against which the portfolio is measured. Opposite of *underweight*.

P...

PE ratio

Price/earnings ratio. A ratio used to value a company's *shares*. It is calculated by dividing the current market price by the *earnings per share*.

PPF

The Pension Protection Fund was launched on 6 April 2005. It is a statutory fund established under the provisions of the Pensions Act 2004. The PPF was established to pay (subject to various limits) the pension entitlements of members of eligible defined benefit pension schemes, should the sponsoring employer become insolvent, where there are insufficient assets in the pension scheme. The PPF is funded by a levy on all eligible schemes.

PRAG

Pensions Research Accountants Group – responsible for issuing recognised Statements of Recommended Practice (SORPs) for pension schemes.

Par value

See *nominal value*.

Partly paid

Shares or *bonds* may be issued partly paid, meaning that the full value of the investment will be paid in two or more instalments or *calls*. Only the first instalment is paid on issue.

Passive management

A style of investment management that seeks to attain performance equal to market or index *returns*. See also *indexation* and *tracker fund*. Compare with *active management*.

Pension fund

A collective term for the assets set aside today to pay a retirement income in the future. Assets are set aside in this way to benefit from long-term investment *returns* and from the tax incentives offered by the government to encourage saving for retirement. A pension fund may be established by an employer (occupational pension fund) or by an individual (personal pension or *stakeholder* pension).

Pensions Commission

The Pensions Commission was set up in 2002 to review the UK private pension system and long-term savings. Their First Report was published in October 2004, setting out a detailed and comprehensive analysis of the UK pensions system. The Second Report, published in November 2005, presented their conclusions on the likely evolution of the UK pension system if policy remained unchanged, and the Commission's recommendations for a new policy direction. A final statement was published in April 2006 detailing its response to specific issues raised since the Second Report. The Pensions Commission, having concluded its review, has been disbanded. Meanwhile, many of its recommendations have been taken up the Pension's Act 2007 and Pension's Bill 2007-8. See also *Personal Accounts*.

Percentile

A measure of a 100th part of a population. For example, to make comparisons between *pension funds* easy, performance measurers rank funds into percentiles. The top 1% of funds will be in the first percentile, while the bottom 1% will be in the 100th percentile. Other similar measures are deciles (one tenth parts of the population) and quartiles (one quarter parts). See also *median* (the 50th percentile).

Performance fee

A fee structure that is in some way related to the investment performance delivered by the manager.

Personal Accounts

The *Pensions Commission's* Final Report in 2006 included detailed recommendations for pension reform in the UK. These recommendations have been largely taken up by the government in the Pensions Act 2007 and Pensions Bill 2007-08. A key element of this is the creation of Personal Accounts – from 2012 employees will be auto-enrolled into a qualifying workplace pension scheme. The aim of this is to improve occupational pension provision for low and moderate earners. This compulsory pension savings scheme was previously referred to as the National Pension Savings Scheme (NPSS), but has evolved to now become known as 'Personal Accounts'.

Placing

The placing of a company's *securities* made by a sponsor or stockbroker with their own clients and with the market.

Plan sponsor

The company or organisation that is the employer of a pension scheme's members.

Policy

See *asset allocation*.

Pooled fund

See *collective investment scheme*.

Portable alpha

The fundamental technique behind *targeted return* and similar strategies. Generally, by using *derivatives* the ability to outperform a *benchmark* or "create *alpha*" can be transferred from one *asset class* to another. For example, if you have a portfolio that can outperform the Japanese equity market, you can create a portfolio that outperforms the US equity market by selling Japanese equity *futures* against your Japanese equity portfolio and buying US equity *futures*. Portable alpha techniques often feature in *liability driven investment* solutions.

Pound cost averaging

Buying (or selling) *shares* in order to maintain relative sector or market weightings. For example, a fund manager wants to maintain a holding of 50% of total assets in UK equities. If the UK equity market falls in value relative to other assets held, the percentage of total fund by value that is in UK equities goes down. To get back to 50% in UK equities, he would "pound cost average".

Preference share

Preference *shares* rank before *ordinary shares* in respect of *dividend* payments and, usually, capital repayment. *Dividends* on preference *shares* are at a fixed rate and the shares do not normally carry *voting rights* unless the *dividend* is in arrears.

Principal

The amount that is borrowed and the value at which a *bond* is redeemed. This is also called *nominal value* or par value.

Private customer

This term defines an investor who is assumed to have less capital to invest and/or less investment knowledge than a professional or experienced investor (categorised as an *intermediate customer*). This definition was created under the Financial Services and Markets Act. The private customer is granted greater legal protection, and companies dealing with this category of investor are required to explain and disclose with greater clarity than to the non-private customer. Under *MIFID*, the broadly equivalent client classification from 1 November 2007 has become *Retail Customer*.

Private equity

Funds put up by investors to finance new and growing businesses. Also known as venture capital.

Professional Client

See *intermediate customer*.

Programme trade
Purchase and/or sale of a bundle of *securities*. Increasingly used as an efficient way of re-organising a portfolio.

Property unit trusts (PUTs)
Pooled investment vehicles that enable investors to hold a stake in a diversified portfolio of properties.

Prospectus
A legal document setting out the terms of issue of a new stock. See *new issue*.

Proxy
A written authorisation given by a *shareholder* to someone else to vote on his behalf at a company's annual general meeting (AGM) or special meeting (EGM).

Put option
An *option* that gives the buyer the right (but not the obligation) to sell a specified quantity of the underlying instrument at a fixed price, on or before a specified date. The writer (seller) of the *option* has the obligation to take delivery of the underlying instrument if the option is exercised by the buyer. Compare with *call option*.

Q...

Quantitative management
A statistical approach to fund management. The most common form of quantitative management is *indexation*.

Quartile
See *percentile*.

R...

REIT
Real Estate Investment Trust. An efficient, fully-tradable tax-transparent vehicle for property investment. Originated in the US but now used in other countries. In the UK, since 1 January 2007, listed (but not private or AIM listed) property companies are allowed to adopt the REIT status, provide they meet certain requirements and accept certain restrictions.

RPI
Retail Prices Index; the headline index used in the UK to measure inflation (the change in the value of a basket of goods). This is the index used for *index-linked gilts.* There are several variants of RPI: RPI-X is the rate of inflation in the UK, excluding mortgage interest rates. RPI-Y is as RPI-X, but excluding changes in indirect taxation such as VAT. See also *HICP* and *CPI*.

Real asset
An asset with underlying real value that should protect the holder against *inflation* in the long term. Examples are *ordinary shares*, *real estate* and *index-linked gilts*. Contrasts with monetary assets such as fixed interest *bonds* or cash.

Real estate
Real estate, also referred to as property, is an investible *asset class* which typically comprises land and anything fixed to the land, for example, buildings.

Real rate of return
The *return* over and above *inflation*.

Real yield
The *yield* on an investment, after allowing for inflation.

Reconventioning
A change in the conventions of a security such as the accrued interest calculation method and daycount convention (the way in which the number of days between the last interest payment and a transaction date is calculated). Those countries participating in *EMU* reconventioned their *bonds* to a harmonised standard.

Redemption
The repayment of the *principal* sum outstanding on a *bond*. The date on which this occurs is the redemption date.

Redemption yield
See *yield*.

Redenomination
In those countries participating in *EMU*, the nominal currency of securities changed from the national currency to the *euro*. An official conversion rate and formula was used by each country.

Refi rate
The *European Central Bank* (ECB) equivalent of the *repo rate*.

Registrar

A bank or other organisation that administers company *share* registers. Where the stock is *settled* through *Crest*, the registrar confirms the transfer of stock electronically to *Crest* within a strict time frame.

Relative risk

Risk relative to a *benchmark*. Also known as *active risk*.

Repo rate

Short for "sale and repurchase agreement". The Bank of England implements monetary policy by lending to the banking system at the official repo rate chosen by the *Monetary Policy Committee* (MPC). This is commonly known as the *base rate*. Banks sell assets to the Bank of England with an agreement to buy them back in about a fortnight's time, and the repo rate is the rate of interest implied by the difference between the sale and repurchase price in these transactions.

Research

The process of gathering information about economies, markets and individual investments to support investment decisions. Investment managers use some combination of their own internal *research* and that provided by *brokers*.

Retail Client

See *private customer*.

Return

The value received (income plus capital) annually from an investment, usually expressed as a percentage. See also *total return*.

Return on equity

A method of valuation of company accounts which can determine how a company is spending its money, calculated by dividing a company's net income by its stockholder equity.

Rights issue

When existing *shareholders* are given rights to purchase the new *shares* in proportion to their existing holding. Compare with *bonus issue*.

Risk

In a financial context, the possibility of financial loss, or of *returns* less than those expected. Such losses could come from market movements *(market risk)*, *counterparty* or *bond* issuer default *(credit risk)*, or errors, legal problems or fraud *(operational risk)*. Generally investors deliberately take market risk through investments in risky assets such as *equities* and *bonds*. In return for the risk, investors expect higher returns than they would get from a riskless investment such as *treasury bills* in their home currency. See also *risk management* and *active risk*.

Risk appetite

A qualitative assessment of the amount of *risk* that an investor is willing to take.

Risk budget

A mathematical assessment of the total amount of *risk* that an investor is prepared to take and the allocation of that risk between the various possible *asset classes*.

Risk-free asset/rate

An investment with no chance of default, and a known or certain rate of *return*.

Risk management

Identifying and quantifying *risk,* then taking appropriate action to make sure *risk* remains within acceptable levels. Sophisticated systems and statistical models are required to measure and manage *risk*, and appropriate expertise to interpret and use the results. With good risk management, an effective balance between *risk* and *returns* can be achieved.

Risk premium

The extra *yield* over the *risk-free rate* demanded by investors to compensate them for bearing *risk*.

Running yield

See *yield*.

S...

SAS70

US Statement on Auditing Standards No. 70. The SAS70 is an auditor’s report on controls and processes placed in operation within core Operations and Fund services. This is one of the options available to replace *FRAG 21*.

SDLT
Stamp Duty Land Tax. SDLT was introduced by the Finance Act 2003. SDLT applies to any land transaction, with the rate charged dependent on the value of the land. The rates are tiered but most commercial property transactions will be charged at 4%.

SDRT
Stamp Duty Reserve Tax. SDRT was introduced by the government in 1986, primarily to capture paperless share transactions not covered by *stamp duty* legislation. SDRT now accounts for most of the taxation collected through the UK's exchanges (including the *London Stock Exchange*), as well as other chargeable events such as dealing in *unit trusts* and *OEICS*. SDRT is levied at an ad valorem rate of 0.5%.

SEC
The Securities & Exchange Commission. An independent regulatory agency in the US with responsibility for administering the federal securities laws. The SEC also regulates firms involved in the purchase or sale of *securities*, people who provide investment advice, and investment companies.

SORP
Statements of Recommended Practice issued by the accountancy profession. One SORP sets out recommendations on the form and content of the financial statements of pension schemes.

SRI
Socially responsible investment. Investment policies or restrictions that take account of the social, environmental and other impacts that a company's activities can have on its employees, consumers and the environment. Legislation requires *pension funds* to disclose the extent to which they take these factors into account in their investment activities.

Satellite portfolio
See *core portfolio*.

Scrip issue
A *share* issue which raises no new money for a company, but simply gives extra shares to existing holders. Also known as a *bonus issue*. Compare with *rights issue*.

Securitisation
The process of taking a set of underlying assets and re-packaging them as a new *security*. See *asset-backed securities*.

Security
A generic term for a financial asset such as a *bond* or *equity* (share).

Segregated fund
Where the assets of a particular fund are managed independently of those of other funds under the fund manager's control. Compare with *pooled fund*.

Self investment
Investment in the *shares* of the company sponsoring the pension scheme (or a close associate). Also covers investment in assets used by the sponsoring company such as *real estate*.

Self tender
A *share buy-back* via a *tender offer*. It can be triggered by a hostile bid or be part of a corporate programme to reduce the capital base.

Settlement
The completion of a purchase or sale of *bonds* or *shares*. The moment when the cash is delivered to the seller and the stock is delivered to the buyer. Settlement in the UK equity markets takes place 3 working days after the date of the original bargain or trade.

Settlement date
The date on which *settlement* takes place. Compare with *trade date*.

Share
A stake in a company which confers ownership rights on the holder. Shares are also know as *equities*.

Share buy-back
When a company buys some of its own *shares* in the market to reduce its *issued share capital*, and thus change the proportion of debt to equity that it holds on its balance sheet.

Share capital
The funding for a company that is raised through the issue of *shares*. See also *authorised share capital* and *issued share capital*.

Sharpe ratio
A measure of *return* over and above the *risk free rate* per unit of *risk* taken. It is a suitable measure for funds with an *absolute return* target, or for an investor's full range of investments.

Short position

A short position exists when an investor has sold stock that they do not own in anticipation of being able to buy it later at a lower price. In order to do this, the investor first borrows, for a fee, the stock from another investor who does own it. "Going short" means to take a short position. Compare with *long position.*

Single price

Where units in a *pooled fund* may be bought and sold at the same price a single price is quoted. Compare with *bid-offer spread*.

Small-cap

Used to describe collectively those companies of small *market capitalisation*. See also *mid-cap*.

Soft commission

An arrangement whereby a *broker* offered to pay some of a *pension fund* or a fund manager's costs (e.g. subscriptions to information services) if a certain amount of business was directed to the *broker*. The *Myners Review* identified such arrangements as a potential conflict of interest, largely because they are not sufficiently transparent. From June 2006, an *FSA* directive banned the use of soft commission arrangements.

Sortino Ratio

The sortino ratio is a variation of the *Sharpe* ratio, which differentiates downside *risk* from general volatility to help measure the *return* relative to "harmful" volatility. The ratio is calculated as the relevant annualised *return* less the risk free rate divided by the loss deviation. The loss deviation focuses on negative values in a distribution and is calculated as the annualised *standard deviation* of negative *returns*.

Specialist management

A fund management arrangement where there are separate accounts with one or a variety of managers for specific *asset classes*. A specialist fund manager is concerned primarily with *stock selection* within the specialist *asset class*. *Asset allocation* decisions are taken by the trustees, their consultant or a specialist *tactical asset allocation* manager. Compare with *multi-asset management*.

Spot price

The present physical market price of the relevant *commodity*, currency, or investment instrument.

Spread

The difference in *yield* between different types of *bonds*, for example between *government bonds* and *corporate bonds*. Also referred to as *yield spread*.

Stakeholder pension

A type of personal pension with capped charges, originally designed for lower paid individuals to encourage them to save for their retirement. Anyone whether employed, self employed or unemployed is eligible for this scheme. All companies are required by law to provide at least a stakeholder scheme if they have five or more employees.

Stamp duty

An ad valorem duty, currently 0.5%, on purchases and certain transfers of UK shares. Levied by the government and payable by the buyer only. See also *SDRT* and *SDLT*.

Standard deviation

Standard deviation is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. The greater the degree of dispersion the greater the risk.

Statement of Investment Principles (SIP)

Trustees of *pension funds* are required under the Pensions Act 1995 to prepare and keep up to date this written statement of how their scheme's assets are invested. Essentially, it provides evidence that the trustees have thought through the suitability of their scheme's investment policy and how that policy is implemented.

Stock Exchange Daily Official List (Sedol)

Prepared daily by the *London Stock Exchange*, this is a record of all *securities* listed on the Exchange. It also provides details of *dividend* dates, *rights issues*, prices and other pertinent information.

Stocklending

The lending of a *security* by the registered owner, to an authorised third party, for a fixed or open period of time, for an agreed consideration secured by *collateral*. The demand to borrow *securities* comes mainly from *market makers* and *hedge funds* to cover *short positions* or take *arbitrage* opportunities.

Stock selection

The process of deciding which stocks to buy within an *asset class*.

Strategic asset allocation

The long-term *benchmark asset allocation*, designed to meet the fund's *risk* and *return* objectives. See also *tactical asset allocation*.

Strike price

See *exercise price*.

Style

The philosophy behind the way in which a manager manages the fund. For example, see *value manager* and *growth manager*.

Subordinated debt

Used to describe debt instruments that rank below secured debt, or other more senior debt instruments of the same company, in the event of the liquidation of the issuer.

Sub-prime

There is no exact industry definition of sub-prime. However, the term is typically applied to borrowers who have demonstrated their inability to repay debt in a timely manner as required by contractual obligations (e.g. history of late payments or missed payments on personal debt). In the US, mortgage borrowers are assigned a FICO score, a type of credit score. Market convention typically characterises borrowers with a FICO score below 620 as sub-prime.

Sub-underwriting

The sponsor (or *underwriter*) of a *new issue* will usually spread its financial risk by sub-underwriting a proportion of its total commitment with other financial institutions.

Supranational institution

A financial institution that spans a number of countries and has no single domicile. For example, the World Bank and the European Investment Bank.

Surplus

In the context of pensions, a scheme is in surplus when the assets are assessed to be more than enough to meet the value of the *liabilities*. There are a number of ways in which *liabilities* can be calculated and a surplus should always be looked at in the context of the method used. Compare with *deficit*.

Swap

A swap is a type of *derivative* where two parties agree to exchange assets or cashflows over an agreed period. Swaps can be based on *equity* indices, *bonds* of different *maturities*, baskets of *securities*, individual securities, or *interest rates*. As with other *derivatives*, swaps can be used to gain a desired exposure without trading in the underlying assets. Swap-based strategies are offered by some investment banks as potential solutions for reducing pension schemes' *risk* relative to their *liabilities*.

Switching costs

The costs of buying and selling investments in order to implement a change in investment strategy.

Systematic risk

Systematic risk is the *risk* attributable to the market which cannot be diversified away by investing in a wide variety of different sectors. Also known as *market risk*. Compare with *non-systematic risk*.

T...

TIPS

The US equivalents of UK *index-linked gilts*. Their strictly correct name is Treasury Inflation-Indexed Securities (or TIIS). Both the *coupon* and *redemption* payments are adjusted in line with the non-seasonally adjusted *CPI*.

Tactical asset allocation (TAA)

Day-to-day decisions to deviate from the long-term *strategic asset allocation* of the portfolio to reflect the fund manager's market views. TAA is traditionally undertaken by buying and selling physical assets. See also *GTAA*.

Take-over bid

An offer made to the shareholders of a company by an individual or organisation intending to gain control of that company.

Targeted return

A particular *dynamic alpha* strategy that aims to diversify and manage sources of *risk* in order to achieve a consistent given *return* in the long-term. The given return can be absolute or relative to an index or inflation measure. It makes use of *portable alpha* techniques.

Tender

A method of issuing *securities* whereby investors are invited to bid, subject to a minimum price. The allocation of the *securities* is made according to the prices bid.

Tender offer

A public offer to buy some or all of the existing stock of a company within a specified period.

Time-weighted rate of return

The time-weighted *return* is the rate at which the fund would have grown without any new money, but holding the same underlying assets as the actual fund. It can be calculated accurately by compounding the growth rates of the fund for the periods between the flows of new money. Time-weighted returns are used in preference to money-weighted returns since the former are independent of the timing of the cash flows into the fund, a factor which is normally beyond the control of the investment manager.

Top-down
The opposite to *bottom-up*, where emphasis is placed primarily upon sector or country selection, with stock selection taking place subsequently.

Total return
Essentially, a combination of capital return and income return. To be precise, the aggregate increase (or decrease) in the value of the portfolio resulting from the net appreciation (or depreciation) of the principal of the fund, plus the net income during the period. This is expressed as a percentage of the value of the fund at the start of the period.

Tracker fund
A fund which aims to match the investment performance of a particular market *index*. See also *indexation* and *passive management*.

Tracking error
A measure of *volatility* of fund *performance* against the *benchmark*. Typically tracking error is used as an *ex-post* measure, where it is the *standard deviation* of fund *returns* relative to the *benchmark*. This might be calculated, for example, using 3 years of monthly *returns*. It can also be used in the *ex-ante* sense, where it would be called forecast tracking error or *active risk*.

Trade
A binding agreement to buy or sell *securities*. Also known as a deal or a bargain.

Trade date
The date on which a *trade* takes place. Compare with *settlement date*.

Transaction costs
Those costs associated with trading on a portfolio, notably stamp duty and commissions. The *IMA Disclosure Code* sets out how investment managers should report details of these costs to their clients.

Transition
The transfer of assets from one fund manager to another which may involve buying and selling assets.

Treasury bill
Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a *return* to the investor by virtue of being issued at a discount to their final *redemption* value.

Treynor ratio
A measure of *return*, over and above the *risk-free rate*, per unit of *beta*. It is a suitable measure for funds with a return target relative to a *benchmark* or for evaluating an individual fund that is only part of an investor's overall range of diversified investments.

Turnover
A measure of the percentage of a fund switched within and into or out of a market sector. To be precise it is defined as the sum of purchases and sales divided by the mean value of the sector or market. Compare with *activity*.

U…

UCITS
Undertakings for Collective Investments in Transferable Securities. A UCITS fund is an *authorised fund* that may be sold across all countries in the EU. UCITS III is the latest version of the UCITS regulations which enable funds to invest in a wider range of financial instruments, including *derivatives*. All UCITS funds converted to UCITS III by 13 February 2007. Most, but not all, UK authorised funds are UCITS.

Unauthorised fund
A *pooled fund* that is suited to the needs of institutional investors, but cannot be marketed to the general public. Compare with *authorised fund*.

Unbundling
The division of *transaction costs* into the elements attributable to the provision of research and trade *execution*. This is an important part of the *IMA Disclosure Code*.

Unconstrained benchmark
Any strategy where the manager is given complete freedom to choose the investments most likely to achieve the client's goal. The investments made may be completely different from the *benchmark,* if one is specified. Typically, the manager is measured over a long period of time.

Underlying security
The *shares*, other *securities*, or index, on which a *derivative* instrument is based.

Underweight
To hold less of a stock or sector than the *index* or *benchmark* against which the portfolio is measured. Opposite of *overweight*.

Underwriter

An institutional investor who "insures" a *new issue* (or *rights issue)* by agreeing to buy all *shares* which are not sold. The underwriter earns a fee.

Unit trust

A *pooled fund* established under trust in which investors can buy and sell units on an ongoing basis. Known as *mutual funds* in the US and some other countries. Compare with *OEIC*.

Unquoted securities

Shares which are dealt in the market but which are not subject to any listing requirements and are given no official status.

Upper quartile

See *percentile*.

V...

Valuation

A summary of an investment portfolio showing the holdings and their value as at a certain date.

Value manager

A fund manager who aims to select stocks that he believes to have potential that is not reflected in the current price. Compare with *growth manager* and *momentum manager.*

Variation margin

Daily payment/receipt of cash in response to a loss/profit on an open *futures* position. See also *initial margin*.

Venture capital

See *private equity*.

Vintage fund

Some investments in alternatives can be in *illiquid* assets over a longer period of time and are made via a vintage fund. This structure offers investors a limited time window (for example one year) to allocate capital, after which the fund is closed to new investments, thus avoiding dilution of returns from these *illiquid* assets.

Volatility

A measure of the frequency and magnitude of price changes of an asset.

Voting rights

Ordinary shares usually have associated voting rights that enable the holder to influence the management of the company. See also *corporate governance*.

W...

WM

The WM Company. One of the two leading performance measurers. See also *Mellon*.

Warrants

A *certificate* giving the holder the right to purchase *shares* or stock at a stipulated price within a specified time span, or in some cases, forever.

Weighted average return

A rate of *return* that is weighted to take into account the relative sizes of the funds which make up the sample.

Weighting

The holding of a stock or sector in a portfolio or *benchmark*/index relative to the total holding. See also *overweight* and *underweight*

White Paper

The government published the Pensions White Paper in June 2006, based on the work of the *Pensions Commission*. This proposed, among other things, a form of compulsory savings scheme (now become known as *Personal Accounts*) and an increase in the retirement age.

Withholding tax

Tax deducted from overseas investment income. The tax can often be claimed back, either at source or via a reclaim process. See also *double taxation relief*.

With profits

A type of investment offered by insurance companies whereby an investor receives a guaranteed *return* supplemented by regular bonuses and, perhaps, a final or terminal bonus on *maturity*.

Y...

Yield

A measure of the income *return* earned on an investment. In the case of a *share* the yield expresses the annual *dividend* payment as a percentage of the market price of the share. For property, it is the rental income as a percentage of the capital value. For *bonds* the running yield (or flat or current yield) is the annual interest payable as a percentage of the current market price. The *redemption yield* (or yield to maturity) allows for any gain or loss of capital which will be realised at the *maturity* date.

Yield curve

A graphical representation of the relationship between the *yields* of *bonds* of different *maturity,* for a set of similar *bonds*.

Yield spread

The difference in *yield* between different types of *bonds*, for example between *government bonds* and *corporate bonds*.

Yellow book

See *listing rules*.

Z...

Zero coupon bond

Bond which pays no income. The only payment the investor receives is the repayment of the *principal* on *maturity*. These *bonds* are issued at a discount to their face value.

UBS Global Asset Management

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