Glossary Of Common Investment Terms

Absolute Return An approach to investing designed to deliver positive investment performance regardless of the investment environment. This differs from peer group or market index relative investing.

Active Managers Refers to investment managers who aim to outperform a particular benchmark/index by making decisions about the type of investment to buy or which stocks to buy.

Alpha Alpha is a measure of the managers stock picking skill, as it quantifies the value added (or taken away) by the decisions of the manager. It represents the difference between the return expected from the fund compared to that actually produced.

A positive alpha indicates that the fund has performed better than expected given its beta and a negative alpha indicates that the performance is below expectation.

The effectiveness of alpha as a means of performance evaluation is dependent upon the correct benchmark being used.

Asset Allocation The act of deciding which categories of assets and in what proportions the "investment" should be allocated to, at any given time, to yield the most attractive risk adjusted returns. This is one of the most important roles of an investment manager.

Base Rate Commonly regarded as the minimum rate that banks use to work out lending rates to their customers. The UK interest rate is set by the Monetary Policy Committee of the Bank of England.

Beta Beta is a measure of the volatility of a fund compared to its benchmark. A fund with a Beta of 1 is expected to move up and down in line with the market. A fund with a Beta above 1 has been more volatile than the market and a fund with a Beta less than 1 and more than 0 is less volatile than the market.

The validity of a funds Beta is dependent upon the correlation to the Benchmark. A manager with a Beta below the benchmark who matches or beats the benchmark return illustrates considerable skill as the returns are not solely reliant on movements in the broader market.

Benchmark Benchmarks have different uses in the investment community. One use of a benchmark is to act as a measure of performance, so you can see how the value of a security has changed over time relative to the rest of the market. A second use is to act as a guide or objective for performance of an investment fund.

Bonds An alternative name for a fixed-income investment. Bonds are a form of debt investment, where the investor lends funds to the bond issuer. In return the lender expects to receive back the principal and interest (known as coupons). Governments, states, local authorities or companies generally issue bonds.

Commodities Commodities are raw goods such as oil, grains, metals and foods which can either be bought directly or traded on a commodities exchange.

CPI (Consumer Price Index) A measure of the rate of change in the prices of goods and services, including food, gas and electricity. The CPI is a key measure of inflation used by the Bank of England when considering interest rate decisions.

Defensive Defensive companies are those which are less volatile than the market as a whole because their business remains relatively stable in good times and bad.

Derivative A security, such as an option or futures contract, where the value is derived from the performance of an underlying security.

Emerging Markets These are small stock markets in which investments can be made in newly industrialised countries (NICs) or developing countries.

Equities Ordinary shares in a company, which normally give their holders voting rights.

Financial Conduct Authority (FCA) The FCA and the Prudential Regulation Authority (PRA) are the bodies that regulate the financial services industry in the UK. These organisations superseded the Financial Services Authority on 1 April 2013.

Fiscal Policy Government policy which uses tax and public spending to change major factors in the economy, such as inflation, unemployment, overall demand and the balance of trade.

FTSE 100 Index A share of the 100 largest companies listed on the London Stock Exchange in terms of market capitalisation.

Hedging Trading activity undertaken to reduce risk in a portfolio, which can still generate a return.

Inflation A measure of how fast prices are rising in the economy.

Information Ratio Information Ratio measures the active return of the fund divided by the amount of risk taken relative to the benchmark. The higher the information ratio, the higher the active return of the portfolio given the amount of risk taken.

Investment Grade Investment grade is a term given to bonds/securities which are regarded as investable and unlikely to carry a high risk of default. Formally, bonds with ratings falling between AAA to BBB- are regarded as being investment grade by leading credit rating agency Standard & Poor’s.

AAA-rated securities are the most highly rated by Standard & Poor's. They are classed as having an extremely strong capacity to meet financial commitments such as the paying of interest and the repaying of capital.

The rating is then followed by AA-rated, which are securities considered to have a very strong capacity to meet financial commitments, and A-rated securities, which are regarded as having a strong capacity to meet financial commitments but are somewhat susceptible to adverse economic conditions and changes in circumstances.

A company with a BBB-rating is regarded by Standard & Poor's as having an adequate capacity to meet financial commitments, but are more subject to adverse economic conditions. A BBB- (minus) rating is the lowest rating before sub-investment grade.

Investment Trusts

A company quoted on the stock-exchange which invests in other companies and in securities. The value of these investments gives the basic value of the shares of the investment trust. The actual trade price depends on supply and demand.

Liquidity

The amount of cash or investments that can be readily converted into cash in a portfolio. Can also be used to refer to how easy it is to buy or sell securities in a market without moving the price.

OEIC

Short for Open Ended Investment Company. This is a type of unit trust where the price and offer price are the same.

Option

A financial contract which gives the right (but not the obligation) to buy or sell a stock at a particular price and within a particular time period.

Quantitative Easing

A monetary policy tool whereby a central bank actively increases the money supply in an economy in a bid to stimulate economic growth. This is typically implemented through large-scale purchases of financial assets such as government bonds. Quantitative easing was used by countries such as the UK and United States in the wake of the 2008 credit crisis.

Sharpe Ratio

The Sharpe ratio is a measure of the risk adjusted return of an investment. It measures the excess return for every unit of risk that is taken in order to achieve the return.

In general, the higher Sharpe ratio, the better the returns on a fund are due to the decisions of the manager

For the purpose of the calculation, the Risk Free rate is 3% and the level of risk is measured by the standard deviation of the returns.

Using the Sharpe ratio as a means of comparison is most effective when used with funds that have similar objectives over the same time period. The analysis is focused on comparisons within individual sectors and is compared against the fund's relevant benchmark, where available within Financial Express.

The effectiveness is reduced if the fund is contained in the incorrect sector, or the benchmark used is incorrect. Where necessary we have overridden certain elements of the data feeds or sector constraints to allow fairer comparison.

Sortino Ratio The Sortino ratio is a variation of the Sharpe ratio that recognises that large positive deviations should not be penalised in the same way as large negative performance returns. The calculation therefore takes into account downside deviations only, rather than the standard deviation which doesn't recognise the difference between positive and negative returns.

A higher ratio indicates that the risk of a large loss is lower.

Sovereign Bond A fixed income security issued by a government in support of national spending and denominated in a foreign currency. Sovereign bonds are generally regarded as riskier than government bonds as they are subject to movements in exchange rates.

Total Return The complete return generated by the investment, including income and capital growth.

Undervalued A security priced below what is considered fair value.

Unit Trust A pooled investment vehicle created under trust laws. Investors buy and sell units in the fund, based on the bid and offer prices set by the investment management firm.

Volatility The amount by which a security's price can vary over a given period.

Yield Income divided by price. It is often referred to in percentage terms.

Yield Curve A graph showing the relationship between yield and maturity of bonds with the same risk profile