Investment Glossary – A Guide to Common Investment Terms

Abenomics — The economic policies advocated by Japanese Prime Minister Shinzō Abe, based upon the "three arrows" of fiscal stimulus, monetary easing and structural reforms.

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

Alpha — A measure of a manager's stock picking skill, as it quantifies the value added (or taken away) by their decisions. 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.

Balance of Payments — The record of all economic transactions between the residents of one country and the rest of the world in a particular period. These transactions are made by individuals, firms and government bodies. The balance of payments provides detailed information concerning a country's trade with other nations and also the demand and supply of its currency.

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.**

Beta — 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 return illustrates considerable skill as the returns are not solely reliant on movements in the broader market.

Benchmark — There are different uses of benchmarks in the investment community. One use 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.

BoJ — **Bank of Japan,** the Japanese central bank responsible for monetary policy

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 and companies generally issue bonds.

CAPE — **See Shiller P/E**

CAPEX — Also known as Capital Expenditure. Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. It is often used to undertake new projects or investments by the firm.

Capital Account — One of two primary components of a nations balance of payments, the other being the **current account.** The capital account reflects net change in ownership of national assets. A surplus in the capital account means money is flowing into the country. A deficit in the capital account means money is flowing out of the country i.e. the nation is increasing its ownership of foreign assets.

Capital Controls — Any measure taken by a government, central bank or other regulatory body which limits the flow of foreign capital in and out of the domestic economy. Measures include taxes, tariffs, outright legislation and volume restrictions, as well as market based forces.

Carry Trade — A strategy in which an investor borrows money at a low interest rate in order to invest in an asset that is likely to provide a higher return or interest rate.

Central Bank — a national bank that provides financial and banking services for its country's government and commercial banking system, as well as implementing the government's **monetary policy** and issuing currency.

Commodities — Raw goods such as oil, grains, metals and food which can either be bought directly or traded on a commodities exchange. “Hard” commodities are those extracted or mined from the ground whereas “soft” commodities are those farmed or grown on land.

Credit Risk — The risk of loss of principal or interest stemming from a borrower’s failure to repay a loan or interest on that loan. Investors in fixed interest investments (bonds) are compensated for assuming credit risk by way of interest payments from the bond issuer. The yields on bonds correlate strongly to their perceived credit risk.

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.

Current Account — One of the components of a country’s balance of payments. The current account measures net cash transfers (broadly money in and money out) that have taken place over a given period of time. If an economy is running a current account deficit, it is absorbing more than it is producing. This can only happen if some other economies are lending to it or the economy is running down its foreign assets such as official foreign currency reserve. If an economy is running a current account surplus, it is saving and accumulating reserves of foreign assets.

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.
Derivatives	A security with a price that is dependent upon or derived from one or more underlying assets. The value of the derivative is determined by fluctuations in the underlying asset.
Emerging Markets	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.
European Exchange Rate Mechanism (ERM)	A mechanism created to reduce exchange rate variability and achieve monetary stability in Europe in preparation for Economic and Monetary Union. Currency fluctuations had to be contained within a set margin relative to a basket of the participating currencies. The UK left the ERM in 1992 after 2 years leading to the crash known as "Black Wednesday".
Federal Reserve	Also known as "**the Fed"** – is a central banking system of the United States which is responsible for the management of monetary policy. It sets interest rates through the decisions of the **Federal Open Market Committee (FOMC).** It is a quasi-independent government entity, with its leadership appointed by the President which derives its authority from an Act of Congress. It conducts monetary policy independently of the fiscal, political authorities of the government and has a dual mandate to combat inflation and maximise employment throughout the business cycle.
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 1st April 2013.
Fiscal Multiplier	A ratio used to measure the effect of government spending on the subsequent income level of that country.
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.
FOMC (Federal Open Market Committee)	A committee within the Federal Reserve system which oversees the nations open market operations. The committee makes key decisions about interest rates and the growth of the US monetary supply.
FTSE 100 Index	A share of the 100 largest companies, listed on the London Stock Exchange, in terms of market capitalisation.
GDP	**Gross Domestic Product** is the broadest measure of a nation's total economic activity. GDP represents the monetary value of all goods and services produced within a nation's geographic borders over a specified period of time
GILTS	Otherwise known as Gilt Edged Securities – are bonds issued by some national governments. Reference to **GILTS** usually means UK gilts, unless otherwise specified.
Growth Investing	a style of investment strategy focused on capital appreciation. Growth investors, invest in companies that exhibit signs of above-average growth, even if the

share price might appear expensive in terms of certain metrics such as price-to-earnings or price-to-book ratios.

Hedging	Trading activity undertaken to reduce risk in a portfolio which can still generate a return.
High Yield	A high-yield bond is a high interest paying bond with a lower credit rating than investment-grade corporate bonds. Sometimes known as a junk bond.
Hyperinflation	When a country experiences very high and usually accelerating rates of inflation, rapidly eroding the real value of the local currency until it becomes worthless. A recent example is Zimbabwe until 2009 when it stopped using its own currency. Further back, the most famous example is a three-year period in the Weimar Republic (modern day Germany) following the First World War. In January 1923 a loaf of bread cost 250 marks, and by November, 200,000 million marks.
Inflation	A measure of how fast prices are rising in the economy measured in the UK by **RPI** or **CPI.**
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	A term given to bonds/securities which are regarded as investable and unlikely to carry a high risk of default. 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 and are classed as having an extremely strong capacity to meet financial commitments - paying interest and repaying capital. AA rated securities are considered to have a very strong capacity to meet financial commitments. A rated securities are regarded as having a strong capacity to meet financial commitments but are more susceptible to adverse economic conditions and changes in circumstances. BBB rated securities are said to have 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 or **High Yield** Bonds.
Investment Trusts	A company quoted on the stock exchange which invests in other companies and securities. The value of these investments give the basic value of the shares of the investment trust. The actual trade price depends on supply and demand.
JGB	or **Japanese Government Bond debt** issued by the government of Japan. Similar to **Gilts** in the UK, the Japanese government pays interest on the bond until the maturity date. At the maturity date, the full price of the bond is returned to the bondholder.
Liquidity	refers to how easy it is to buy or sell securities in a market without moving the price. Liquidity positively impacts the stock market. When stock prices rise, it is often connected to high levels of liquidity on household and business balance sheets which drives a demand for equity investments. For an individual investor, it is the amount of cash or investments that can be readily converted into cash in a portfolio.

Monetary Policy the actions of a central bank, that determine the size and rate of growth of the money supply, which in turn affects interest rates. Monetary policy is maintained through actions such as modifying the interest rate, buying or selling government bonds, and changing the amount of money banks are required to keep in reserves.

MPC (Monetary Policy Committee) A committee of the Bank of England which is responsible for formulating the United Kingdom's monetary policy, mainly through setting of the rate interest at it which it lends to banks – the Bank of England Base Rate. Its decisions are made with a primary aim of price stability as defined by the government's inflation target (2% per year on the Consumer Price Index as of 2016).that enable the inflation target to be met.

Monetary Stimulus Government policy of lowering interest rates and quantitative easing used to make the economy grow faster.

Money Supply the entire stock of currency and other liquid instruments circulating in a country's economy at a particular time. It is made up of cash, coins, and balances held in current and savings accounts that businesses and individuals can use to make payments or hold as short-term investments.

OEIC An open-ended investment company is a type of open-ended collective investment formed as a corporation in the United Kingdom. OEICs are the preferred legal form of new open-ended investment over the older unit trust. The manager must create shares when money is invested and redeem shares as requested by shareholders.

Opportunity Cost A benefit that a person could have received but gave up to take another course of action.

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.

PBoC The People's Bank of China is the central bank of the People's Republic of China controlling monetary policy and regulating financial institutions in mainland China.

P/E Ratio The price-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings. The price-earnings ratio is also sometimes known as the price multiple or the earnings multiple. It is a widely used measure of the relative value of a share or market index. A high P/E ratio being broadly expensive and a low P/E ratio being cheap. P/E ratios can be measured using historic or forward earnings over a variety of different time periods. See also **Shiller P/E.**

Price Return The return on an investment or index not including any income paid. In contrast to the **Total Return,** which includes re-invested income.

Price to Book (P/B) A ratio used to compare a stock's market value to its book value (a company's assets minus its liabilities). It is calculated by dividing the c closing price of the stock by the book value per share. A lower P/B ratio might indicate the stock is undervalued.

Quality Investing An investment strategy based on a set of clearly defined fundamental criteria that seeks to identify companies with outstanding quality characteristics. The quality assessment is made based on soft (such as management credibility) and hard criteria (balance sheet stability, consistency of earnings or good returns on capital investment in the company).

Quantitative Easing or **QE.** 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.

Retail Price Index **RPI** is a measure of inflation measuring the change in the cost of a representative sample of retail goods and services and is published monthly by the Office for National Statistics.

S&P 500 Index The Standard & Poor's 500, often abbreviated as the S&P 500, or just "the S&P", is an American stock market index based on the market capitalizations of the 500 large companies having common stock listed on the major US stock exchanges.

Sharpe Ratio 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.

Shiller P/E Is a cyclically adjusted price-to-earnings ratio, also commonly known as **CAPE** or P/E 10 ratio. It is a valuation measure usually applied to the US **S&P 500** equity market. representing the market price divided by the average of ten years of earnings (moving average), adjusted for inflation. It attempts to provide a long-term view of the valuation of the S&P 500 using average earnings over the last decade to smooth out the impact of business cycles and other events.

Sortino Ratio 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 takes into account downside deviations only, whereas standard deviation doesn’t recognise the difference between positive and negative return. 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 foreign currency. Sovereign bonds are generally regarded as riskier than government bonds as they are subject to movements in exchange rates.

Stagflation Stagnant growth and rising inflation. Not a good recipe for a country’s economic health.

TARGET2 The interbank payment system for the implementation of the Eurosystem’s monetary policy and the functioning of the euro money market. By smoothing large transfers across national boundaries it aids the integration and stability of the euro area money market. It is also the mechanism whereby financing is provided to countries within the EU such as Portugal, Ireland, Greece and Spain (PIGS) which runs a current account deficit. Balancing liability risk is held by current account surplus countries such as Germany. In the event of default by any of the PIGS, Germany would have a significant liability to the ECB.

Tight Monetary Policy or to **Tighten** is a course of action undertaken by a Central Bank to reduce spending in an economy that is growing too quickly or to curb inflation by raising interest rates to increase the cost of borrowing and reduces its attractiveness**.**

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.
US Treasury	The department of the US government responsible for executing fiscal policy as established by Congress and the President. The Treasury pays the country's bills, collects revenue through the Internal Revenue Service, and borrows money through the issuance of Treasury securities when Congress fails to appropriate enough revenue to meet the country's spending obligations.
Value Investing	A strategy that identifies and invests in stocks believed to be undervalued by the market. The strategy is based on a thesis that the market overreacts to good and bad news, resulting in stock price movements that do not correspond with a company's long-term fundamentals, giving an opportunity to profit when the price is deflated.
VIX	or **CBOE Volatility Index** is an index of expected future price volatility implied by options contract prices on the US S&P 500 index. It is often called a fear index because its value rises when investors are concerned about future volatility. High values of the index do not imply that the market will fall - they merely indicate that investors expect that prices will move up or down substantially in the future.
Volatility	The amount by which a securities price can vary over a given period.
Yield	The income return on an investment, calculated by dividing income 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. The shape of the yield curve informs regarding future interest rate changes and economic activity. There are three main types. A normal yield curve is where longer maturity bonds have a higher yield compared to shorter-term bonds due to the risks associated with time. An inverted yield curve is where the shorter-term yields are higher than the longer-term yields, which can predict recession. A flat (or humped) yield curve is where the shorter- and longer-term yields are very close to each other, sometimes a predictor of economic transition.

If you would like any further explanation as to any of the topics or definitions covered in this document, please do not hesitate to contact us.