Glossary

The vast majority of the definitions provided in the glossary were taken (with permission) from Campbell R. Harvey's Hypertextual Finance Glossary, the largest financial glossary on the Internet. His complete glossary can be accessed via his home page http://www.duke.edu/~charvey.

A

Accounting formula, basic: Total assets equal Total Liabilities + Total stockholders' Equity

Analyzer: Employee of a brokerage or fund management house who studies companies and makes buy-and-sell recommendations on their stocks. Most specialize in a specific industry.

Annual percentage rate (APR): The periodic rate times the number of periods in a year. For example, a 5% quarterly return has an APR of 20%.

Annual percentage yield (APY): The effective, or true, annual rate of return. The APY is the rate actually earned or paid in one year, taking into account the effect of compounding. The APY is calculated by taking one plus the periodic rate and raising it to the number of periods in a year. For example, a 1% per month rate has an APY of 12.68% (1.01^12).

Annualized gain: The percentage gain in a period times the number of periods in a year. If a stock appreciates 2% in one month, the annualized gain is 24%.

Arithmetic mean (average) return: An average of the subperiod returns, calculated by summing the subperiod returns and dividing by the number of subperiods.

Articles of incorporation: Legal document establishing a corporation and its structure and purpose.

Asset: Any item of economic value owned by an entity and measured in monetary terms.

Authorized shares: Number of shares authorized for issuance by a firm's corporate charter.

B

Average: An arithmetic mean of selected stocks intended to represent the behavior of the market or some component of it. One good example is the widely quoted Dow Jones Industrial Average, which adds the current prices of the 30 DJIA's stocks, and divides the results by a predetermined number, the divisor.

Balance sheet: Also called the statement of financial condition or position statement it is a summary of assets, liabilities, and owners' equity.

Basis: It is the price an investor pays for a security plus any out-of-pocket expenses. It is used to determine capital gains or losses for tax purposes when the stock is sold.

Bear market: A bear market is a prolonged period of falling stock prices, usually by 20% or more. Generally speaking, the term is applied to any market in which prices are in a declining trend.

Benchmark index: The performance of a predetermined set of securities, for comparison purposes. The Dow Jones, S&P 500 and NASDAQ are benchmark indexes.

Best-efforts sale: A method of securities distribution/underwriting in which the securities firm agrees to sell as much of the offering as possible and return any unsold shares to the issuer. As opposed to a guaranteed or fixed price sale, where the underwriter agrees to sell a specific number of shares (with the securities firm holding any unsold shares in its own account if necessary).

Blow-off top: A steep and rapid increase in price followed by a steep and rapid drop. This is an indicator seen in charts and used in technical analysis of stock price and market trends.

Bond: Bonds are debt and are issued for a period of more than one year. When an investor buys bonds, he or she is lending money. The sell-
er of the bond agrees to repay the principal amount of the loan at a specified time. Interest-bearing bonds pay interest periodically.

**Book value:** A company's book value is its total assets minus intangible assets and liabilities, such as debt.

**Book value per share:** The ratio of stockholder equity to the average number of common shares.

**Broker:** An individual who is paid a commission for executing customer orders.

**Bull market:** Any market in which prices are in an upward trend.

**Bullish, bearish:** Words used to describe investor attitudes. Bullish refers to an optimistic outlook while bearish means a pessimistic outlook.

**Buy:** To purchase an asset; taking a long position.

**Buy-and-hold strategy:** A passive investment strategy with no active buying and selling of stocks from the time the portfolio is created until the end of the investment horizon.

**Buy-side analyst:** A financial analyst employed by a non-brokerage firm, typically one of the larger money management firms that purchase securities on their own accounts.

**Calendar effect:** The tendency of stocks to perform differently at different times.

**Call option:** An option contract that gives its holder the right (but not the obligation) to purchase a specified number of shares of the underlying stock at the given strike price, on or before the expiration date of the contract.

**Capital:** Money invested in a firm.

**Capital gain:** When a stock is sold for a profit, it's the difference between the net sales price of securities and their net cost, or original basis.

**Capital loss:** When a security is sold for a loss, it is the difference between the net sales price of securities and their net cost, or original basis.

**Capital surplus:** Amounts of directly contributed equity capital in excess of the par value.

**Capitalization:** The debt and/or equity mix that funds a firm's assets.

**Cash dividend:** A dividend paid in cash to a company's shareholders. The amount is normally based on profitability and is taxable as income. A cash distribution may include capital gains and return of capital in addition to the dividend.

**Chinese wall:** Communication barrier between financiers (investment bankers) and traders. This barrier is erected to prevent the sharing of inside information that bankers are likely to have.

**Churning:** Excessive trading of a client's account in order to increase the broker's commissions.

**Clear a position:** To eliminate a long or short position, leaving no ownership or obligation.

**Collective wisdom:** The combination of all of the individual opinions about a stock's or security's value.

**Commission:** The fee paid to a broker to execute a trade, based on number of shares, bonds, options, and/or their dollar value. In 1975, deregulation led to the creation of discount brokers, who charge lower commissions than full service brokers. Full service brokers offer advice and usually have a full staff of analysts who follow specific industries. Discount brokers simply execute a client's order -- and usually do not offer an opinion on a stock.

**Common stock:** These are securities that represent equity ownership in a company. Common Shares let an investor vote on such matters as the election of directors. They also give the holder a share in a company's profits via dividend payments and the capital appreciation of the security.

**Competence:** Sufficient ability or fitness for ones needs. Possessing the necessary abilities to be qualified
to achieve a certain goal or complete a project.

**Compound Interest:** Interest paid on previously earned interest as well as on the principal.

**Compounded Annualized gain:** The percentage gain in a period raised exponentially by the number of periods in a year. If a stock appreciates 2% in one month, the compounded annualized gain is 26.824% \(2.02^{12} = 26.824\%\).

**Compounding:** The process of accumulating the time value of money forward in time. For example, interest earned in one period earns additional interest during each subsequent time period.

**Comprehensive due diligence investigation:** The investigation of a firm’s business in conjunction with a security offering to determine whether the firm’s business and financial situation and its prospects are adequately disclosed in the prospectus for the offering.

**Consumer Price Index:** The CPI, as it is called, measures the prices of consumer goods and services and is a measure of the pace of U.S. inflation. The U.S. Department of Labor publishes the CPI very month.

**Corner A Market:** To purchase enough of the available supply of a commodity or stock in order to manipulate its price.

**Corporate charter:** A legal document creating a corporation.

**Corporation:** A legal "person" that is separate and distinct from its owners. A corporation is allowed to own assets, incur liabilities, and sell securities, among other things.

**Credit risk:** The risk that an issuer of debt securities or a borrower may default on his obligations, or that the payment may not be made on a negotiable instrument.

**Current assets:** Value of cash, accounts receivable, inventories, marketable securities and other assets that could be converted to cash in less than 1 year.

**Current liabilities:** Amount owed for salaries, interest, accounts payable and other debts due within 1 year.

**Current yield:** For bonds or notes, the coupon rate divided by the market price of the bond.

**Dead cat bounce:** A small upmove in a bear market.

**Debt:** Money borrowed.

**Debt securities:** IOUs created through loan-type transactions - commercial paper, bank CDs, bills, bonds, and other instruments.

**Debt service:** Interest payment plus repayments of principal to creditors, that is, retirement of debt.

**Default risk:** Also referred to as credit risk, the risk that an issuer of a bond may be unable to make timely principal and interest payments.

**Dow Jones Industrial average:** This is the best known U.S. index of stocks. It contains 30 stocks that trade on the New York Stock Exchange. The Dow, as it is called, is a barometer of how shares of the largest U.S. companies are performing.

**Downgrade:** A classic negative change in ratings for a stock, or other rated security.

**Earnings:** Net Income for the company during the period.

**Earnings per share (EPS):** A company’s profit divided by its number of outstanding shares.

**Effective annual interest rate:** An annual measure of the time value of money that fully reflects the effects of compounding.

**Effective annual yield:** Annualized interest rate on a security computed using compound interest techniques.

**EPS:** Earnings per share

**Equity:** Represents ownership interest in a firm. Equity market

**Equity multiplier:** Total assets divided by total common stockholder’s equity.
Equity options/Stock Options: Securities that give the holder the right to buy or sell a specified number of shares of stock, at a specified price for a certain (limited) time period. Typically one option equals 100 shares of stock.

Ethics: Standards of conduct or moral judgement.

Expiration: The time when the option contract ceases to exist (expires).

Financial analysts: Also called securities analysts and investment analysts, professionals who analyze financial statements, interview corporate executives, and attend trade shows, in order to write reports recommending either purchasing, selling, or holding various stocks.

Financial risk: The risk that the cash flow of an issuer will not be adequate to meet its financial obligations.

Fundamental analysis: Security analysis that seeks to detect improperly valued securities by an analysis of the firm’s business prospects. Research analysis often focuses on earnings, dividend prospects, expectations for future interest rates, and risk evaluation of the firm.

Generally Accepted Accounting Principals (GAAP): A technical accounting term that encompasses the conventions, rules, and procedures necessary to define accepted accounting practices at a particular time.

Greater Fool Theory: The idea that when you have overpaid for something, someone else will be willing to pay even more to buy it from you.

Greed: is that force that makes it practically impossible for you to sell stock while it is still moving up.

Holding period: Length of time that an individual holds a security.

Individual investors: Persons who invest solely for themselves in their own accounts. Non-institutional investors.

Inflation: The rate at which the general level of prices for goods and services is rising.

Inflation risk: Also called purchasing power risk, the risk that changes in the real return the investor will realize after adjusting for inflation will be negative.

Initial public offering (IPO): A company’s first sale of stock to the public.

Institutional investors: Organizations that invest, including insurance companies, depository institutions, pension funds, investment companies, mutual funds, and endowment funds.

Interest: The price paid for borrowing money. It is expressed as a percentage rate over a period of time.

Interest on interest: Compound interest. Interest earned on reinvestment of each interest payment on money invested.

Interest rate risk: The risk that a security’s value changes due to a change in interest rates.

Internal rate of return: Dollar weighted rate of return. Discount rate at which net present value (NPV) investment is zero. The rate at which a bond’s future cash flows, discounted back to today, equals its price.

Investment bank: Financial intermediaries who perform a variety of services, including aiding in the sale of securities, facilitating mergers and other corporate reorganizations, acting as brokers to both individual and institutional clients, and trading for their own accounts. Underwriters.

Investment manager: Also called a portfolio manager and money manager, the individual who manages a portfolio of investments.

Investor: The owner of a financial asset.

Lead underwriter: The head of a syndicate of financial firms that are sponsoring an initial public offering of securities or a secondary offering of securities. Could also apply to bond issues.
Liability: A financial obligation, or the cash outlay that must be made at a specific time to satisfy the contractual terms of such an obligation.

Limited liability: Limitation of possible loss to what has already been invested.

Limited partner: A partner who has limited legal liability for the obligations of the partnership.

Limited partnership: A partnership that includes one or more partners who have limited liability.

Liquidity: A market or an investment is liquid when it has a high level of trading activity, allowing buying and selling with minimum price disturbance. Also a market characterized by the ability to buy and sell with relative ease.

Liquidity risk: The risk that arises from the difficulty of selling an asset. It can be thought of as the difference between the "true value" of the asset and the likely price, less commissions.

Long: One who has established a market position and who has not yet closed out this position through an offsetting sale; the opposite of short.

Magical thinking: is that force that keeps you from selling a stock once it starts to move down. It's a belief that somehow (magically) the stock will go back up just so you can get the price that you feel you should.

Marginal tax rate: The tax rate that would have to be paid on any additional dollars of taxable income earned.

Market capitalization: The total dollar value of all outstanding shares. Computed as shares times current market price. It is a measure of corporate size.

Market prices: The amount of money that a willing buyer pays to acquire something from a willing seller, when a buyer and seller are independent and when such an exchange is motivated by only commercial consideration.

Marketability: A negotiable security is said to have good marketability if there is an active secondary market in which it can easily be resold.

Multiple: another name for price/earnings ratio.

Net income: The company's total earnings, reflecting revenues adjusted for costs of doing business, depreciation, interest, taxes and other expenses.

Net worth: Common stockholders' equity which consists of common stock, surplus, and retained earnings.

Offering memorandum: A document that outlines the terms of securities to be offered in a private placement.

Offset: Elimination of a long or short position by making an opposite transaction.

Option: Gives the buyer the right, but not the obligation, to buy or sell an asset at a set price on or before a given date. Investors, not companies, issue options. Investors who purchase call options bet the stock will be worth more than the price set by the option (the strike price), plus the price they paid for the option itself. Buyers of put options bet the stock's price will go down below the price set by the option. An option is part of a class of securities called derivatives, so named because these securities derive their value from the worth of an underlying investment.

Outstanding shares: Shares that are currently owned by investors.

Oversubscribed issue: Investors are not able to buy all of the shares or bonds they want, so underwriters must allocate the shares or bonds among investors. This occurs when a new issue is under-priced or in great demand.

Paper gain (loss): Unrealized capital gain (loss) on securities held in portfolio, based on a comparison of current market price to original cost.
Par value: For stocks, it is the nominal dollar value assigned to a stock when it is first issued. The dollar value has no relation to the market price of the stock. For bonds, also called the maturity value or face value, the amount that the issuer agrees to pay at the maturity date.

P/B (ratio): See Price/book ratio

P/E (ratio): See Price/Earnings ratio.

Performance measurement: The calculation of the return realized by a money manager over some time interval.

Portfolio manager: Investment manager

Price/book ratio: Compares a stock's market value to the value of total assets less total liabilities (book value). Determined by dividing current stock price by common stockholders equity per share (book value), adjusted for stock splits. Market price of a share divided by book value per share. Also called Market-to-Book.

Price/Earnings ratio: The current market price of a share of stock (adjusted for stock splits) divided by its (trailing or projected) annual earnings per share. Also known as the P/E ratio, the P/E, the stock's multiple, or simply the multiple. Assume XYZ Co. sells for $25.50 per share and has earned $2.55 per share this year; XYZ stock sells for 10 times earnings. $25.50/$2.55 = 10

Primary market: The first buyer of a newly issued security buys that security in the primary market. All subsequent trading of those securities is done in the secondary market.

Primary offering: A firm selling some of its own newly issued shares to investors.

Principal/Principal amount: The face amount of debt; the amount borrowed or lent.

Private placement: The sale of a bond or other security directly to a limited number of investors.

Pro forma statement: A financial statement showing the forecast or projected operating results and balance sheet, as in pro forma income statements, balance sheets, and statements of cash flows.

Prospectus: Formal written document to sell securities that describes the plan for a proposed business enterprise, or the facts concerning an existing one, that an investor needs to make an informed decision. Prospectuses describe the objectives, risks and other essential information of the securities that will be sold.

Public offering: The sale of registered securities by the issuer (or the underwriters acting in the interests of the issuer) in the public market. Also called public issue.

Purchase: To buy, to be long, to have an ownership position.

Purchase and sale: A method of securities distribution in which the securities firm purchases the securities from the issuer for its own account at a stated price and then resells them, as contrasted with a best efforts sale.

Purchasing power risk: Also called inflation risk, the risk that changes in the real return the investor will realize after adjusting for inflation will be negative.

Put option: This security gives investors the right to sell (or put) a fixed number of shares at a fixed price within a given time frame.

Retail investors/individual investors: Small investors who commit capital for their personal account. Non-institutional investors.

Retained earnings: Accounting earnings that are retained by the firm for reinvestment in its operations; earnings that are not paid out as dividends.

Return on assets (ROA): Indicator of profitability. Determined by dividing
net income for the past 12 months by total average assets. Result is shown as a percentage.

Return on equity (ROE): Indicator of profitability. Determined by dividing net income for the past 12 months by common stockholder equity (adjusted for stock splits). Result is shown as a percentage.

SEC: The Securities and Exchange Commission, the primary federal regulatory agency of the securities industry.

Secondary issue: (1) Procedure for selling blocks of seasoned issues of stocks. (2) More generally, sale of already issued stock.

Secondary market: The market where securities are traded after they are initially offered in the primary market. Most trading is done in the secondary market.

Securities & Exchange Commission: The SEC is a federal agency that regulates the U.S. financial markets.

Securities analysts: financial analysts

Security: Piece of paper that proves ownership of stocks, bonds and other investments.

Selling short: If an investor thinks the price of a stock is going down, the investor could borrow the stock from a broker and sell it. Eventually, the investor must buy the stock back on the open market. For instance, you borrow 1000 shares of XYZ on July 1 and sell it for $8 per share. Then, on Aug 1, you purchase 1000 shares of XYZ at $7 per share. You’ve made $1000 (less commissions and other fees) by selling short.

Sell-side analyst: Also called a Wall Street analyst, a financial analyst who works for a brokerage firm and whose recommendations are passed on to the brokerage firm’s customers.

Shareholders’ equity: This is a company’s total assets minus total liabilities. A company’s net worth is the same thing.

Shares: Certificates or book entries representing ownership in a corporation or similar entity.

Short sale: Selling a security that the seller does not own but is committed to repurchasing eventually. It is used to capitalize on an expected decline in the security’s price.

Simple compound growth method: A method of calculating the growth rate by relating the terminal value to the initial value and assuming a constant percentage annual rate of growth between these two values.

Simple interest: Interest calculated only on the initial investment.

Stated annual interest rate: The interest rate expressed as a per annum percentage, by which interest payment is determined.

Stock: Ownership of a corporation which is represented by shares which represent a piece of the corporation’s assets and earnings.

Stockholder equity: Balance sheet item that includes the book value of ownership in the corporation. It includes capital stock, paid in surplus and retained earnings.

Stock market: Also called the equity market, the market for trading equities.

Stockholder: Holder of equity shares in a firm.

Stockholder’s equity: The residual claims that stockholders have against a firm’s assets, calculated by subtracting total liabilities from total assets.

Street: Brokers, dealers, underwriters, and other knowledgeable members of the financial community; from Wall Street financial community.

Technical analysis: Security analysis that seeks to detect and interpret patterns in past security prices.

Technical analysts: Also called chartists or technicians, analysts who use mechanical rules to detect changes in the supply of and demand for a stock and capitalize on the expected change.
Total return: In performance measurement, the actual rate of return realized over some evaluation. Considers all sources of return (dividends, interest, interest on interest, and any capital gain/loss) over some investment horizon.

Trade: A verbal (or electronic) transaction involving one party buying a security from another party. Once a trade is consummated, it is considered "done" or final. Settlement occurs 1-5 business days later.

Treasury bills: Debt obligations of the U.S. Treasury that have maturities of one year or less. Maturities for T-bills are usually 91 days, 182 days, or 52 weeks.

Treasury bonds: Debt obligations of the U.S. Treasury that have maturities of 10 years or more.

Treasury notes: Debt obligations of the U.S. Treasury that have maturities of more than 1 year but less than 10 years.

Treasury securities: Securities issued by the U.S. Department of the Treasury.

Underwrite: To guarantee, as to guarantee the issuer of securities a specified price by entering into a purchase and sale agreement. To bring securities to market.

Underwriter: A party that guarantees the proceeds to the firm from a security sale, thereby in effect taking ownership of the securities. Or, stated differently, a firm, usually an investment bank, that buys an issue of securities from a company and resells it to investors.

Underwriting: Acting as the underwriter in a purchase and sale.

Underwriting fee: The portion of the gross underwriting spread that compensates the securities firms that underwrite a public offering for their underwriting risk.

Underwriting syndicate: A group of investment banks that work together to sell new security offerings to investors. The lead underwriter leads the underwriting syndicate. Also: lead underwriter.

Unrealized capital gain/loss: An increase/decrease in the value of a security that is not "real" because the security has not been sold, or in the case of a short sale has not been purchased.

U.S. Treasury bill: U.S. government debt with a maturity of less than a year.

U.S. Treasury bond: U.S. government debt with a maturity of more than 10 years.

U.S. Treasury note: U.S. government debt with a maturity of 1 to 10 years.

Wall Street: Generic term for firms that buy, sell, and underwrite securities.

Wall Street analyst: Sell-side analyst.

Wash: Gains equal losses.

Winner's curse: Problem faced by uninformed bidders. For example, in an initial public offering uninformed participants are likely to receive larger allotments of issues that informed participants know are overpriced.

Zero-sum game: A type of game wherein one player can gain only at the expense of another player.