absolute return—appreciation or depreciation in the value of an investment (usually a stock or mutual fund) over a certain period of time expressed as a percentage. See also relative return.

absolute return strategy—approach to investing that seeks a positive return using unconventional assets and nontraditional techniques such as futures contracts, options, derivatives, arbitrage and leverage. In contrast, “traditional” managers are concerned with relative return—how the return on assets compares with similar assets or the market as a whole. See also absolute return, short selling, option, derivative, arbitrage and leverage.

active management—style of investing that tries to outperform an investment benchmark. When compared with passive managers, active managers tend to buy and sell frequently in an effort to exploit short-term investment trends. See also passive management.

alpha—risk-adjusted performance measure for a stock, mutual fund, index or other investment that is compared with the risk-adjusted performance of a benchmark. A positive alpha of 1.0 means the security has outperformed its benchmark by 1%. A similar negative alpha would indicate an underperformance of 1%.

alternative investment—financial product that is not one of the three traditional asset types (i.e., stocks, bonds and cash) or the mutual funds and managed accounts that invest in these assets. Art, commodities, derivatives, hedge funds, limited partnerships, precious metals, private equity, real estate and venture capital are all examples of alternative investments. Because the returns on these investments have a low correlation with those of traditional asset classes, many large institutional funds allocate a small portion of their portfolios to these products. Socially responsible investments are another example of an alternative investment.

annualize—to express a rate of return for a period greater than one year or less than one year in terms of 12 months.

annuity—when referring to defined benefit pension plans, periodic payments (usually monthly) provided for the lifetime of an individual (the annuitant). The payments may be fixed or a varying amount and may continue for a period after the annuitant’s death. —insurance contract purchased with a lump sum of money or a series of premium payments in which an insurance company agrees to provide a series of payments at regular intervals over a period of more than one full year to an individual (the annuitant).

appraisal—estimate of quantity, quality or value by an expert typically for taxation purposes or to determine the market value of the property being assessed.
**arbitrage**—technique employed to take advantage of price differences of identical or similar securities in separate markets. Arbitrage is accomplished by purchasing in one market for immediate sale in another at a better price.

**asset allocation**—investment strategy that apportions a portfolio’s assets according to an investor’s goals, risk tolerance and investment horizon. Allocation typically involves selecting assets representing different asset classes. The assets in each class have different levels of risk and return and may behave differently over time.

**asset-backed security (ABS)**—bond or other financial obligation backed by a pool of loans, leases, credit card debt, company receivables, royalties or other securities with the exception of real estate and mortgage-backed securities. Investor returns are periodic payments that pass through from the securities in the pool. For investors, asset-backed securities are an alternative to investing in corporate debt. See also **mortgage-backed security**.

**asset-liability matching**—investment strategy that attempts to time future asset sales and income streams to correspond with future expenses. Pension fund managers use this technique in an effort to minimize a portfolio’s liquidation risk by trying to match asset sales, interest and dividend payments with expected benefit payments to plan beneficiaries. Also known as liability matching and liability-driven investing (LDI).

**asset mix**—see **asset allocation**.

**bankers acceptance (BA)**—order to a bank to pay a sum of money at a future date, typically within one to six months. When the bank endorses the order as “accepted,” it assumes responsibility for ultimate payment to the holder of the acceptance. An acceptance may be traded in secondary markets much like any other claim on a bank. BAs are often used for imports and exports, where the creditworthiness of one trader is unknown to the other trader. BAs are also used as a money market investment.

**bankruptcy**—judgment by a court that an individual or business is unable to repay debts in full because liabilities exceed assets.

**basis point (BP)**—one-hundredth of a percent. Basis points are used to measure very small changes or differences between yields on fixed income securities. A change of 0.01% in a bond’s yield is 1 basis point. If the yield on a bond increases from 4% to 4.5%, it has increased by 50 basis points. Investment fees are also typically expressed in reference to basis points.

**benchmark**—standard by which something can be measured or judged. A company may benchmark its compensation or benefit package to determine how it compares with others in an industry or geographic locale. Investors benchmark the performance of their investments with major market indices such as the S&P 500 to quantify how far they are from investment goals.

**beta**—measure of how an investment’s price moves in relation to a financial market as a whole. Beta is the average change in the value of a security corresponding to a 1% change in the market. For example, a beta of 0.5 means the security is only half as volatile as the average security, while a beta of 2.0 means the security is twice as risky. An asset with a beta of zero means that its price is independent of the market. The higher the beta, the higher the return required and vice versa.

Whether the beta is positive or negative is also important. A positive beta means the value of the asset generally follows the market, while a negative beta indicates the value of the asset is inversely related to the market (the value of the asset generally decreases when the value of the market goes up and vice versa).

**balance sheet**—condensed financial statement showing the nature and amount of an entity’s assets and liabilities on a given date.
bond
— certificate of debt similar to an IOU issued by a company or government entity. An investor lends money to the issuer and, in exchange, the issuer promises to repay the loan at a future date, known as the bond’s maturity date. Depending on the type of bond, the issuers may be required to make periodic interest payments to the bondholder (owner) between the date of issuance and maturity. Bonds issued by a corporation are referred to as corporate bonds. When comparing the return on bonds, an investor uses one of these yields, depending on the type of bond and its maturity date: coupon yield, current yield, tax-equivalent yield or yield to maturity.
— obligation of an insurer to protect the insured against financial loss caused by the acts of another.

book value—dollar amount at which an asset is carried on a balance sheet. Book value may be more or less than market value. The value of a capital asset is its cost plus any additions, minus depreciation. A corporation’s book value is its assets minus liabilities.

broker
— person or business that buys or sells for another in exchange for a commission. Insurance brokers bring together clients who are seeking insurance coverage and insurance companies. The broker represents the buyer rather than the company even though he or she receives a commission from the company.
— those who handle orders to buy and sell securities, commodities and other property are also referred to as brokers. How the commission is paid in these transactions varies depending on what is being sold, who the buyer and seller are, and the amount of the transaction.

cash equivalent—short-term and, typically, very safe savings place such as a savings account, money market account and certificate of deposit (CD). Offered by banks, credit unions and other financial organizations, cash equivalents tend to have no maturity date or mature in a very short period of time. They are called cash equivalents since they are easy to buy and sell.

certificate of deposit (CD)—money deposited in an interest-bearing account at a bank or trust company. The financial institution offers a written certification that the dollar amount has been deposited for a certain period of time at a fixed rate of interest. The length of time may be anywhere from a week to several years. Upon maturity, the account holder receives the principal and interest as agreed upon when the account was established. Early withdrawal of the money in a CD is penalized.

closed-end fund—legally known as a closed-end company, a closed-end fund generally does not continuously offer shares for sale. Rather, a fixed number of shares are sold to the public at an initial public offering (IPO), after which the shares trade via a secondary market such as a stock exchange. The price of the shares after the IPO is determined by market demand; shares may sell above or below their net asset value.

Closed-end funds are not required to redeem shares from investors, though some do offer to repurchase their shares at specified intervals. The investment portfolios of closed-end funds tend to invest in more illiquid securities than mutual funds. Also referred to as a publicly traded fund. See also open-end fund.

commercial paper (CP)—short-term unsecured debt issued by large banks and companies to get funds for short-term needs. Since it is not backed by collateral, only those with excellent credit ratings are able to sell CP at a reasonable price. Commercial paper usually has a face value of $100,000 or more, sells at a discount and has a repayment period ranging from two days to nine months, which is shorter than the repayment period for bonds. Interest rates fluctuate with the market but are usually better than what is available from banks. Commercial paper is a major constituent of many money market mutual funds.

commingled fund—investment vehicle similar to a mutual fund that pools assets from several investors into one portfolio that is managed under a particular strategy. Investors benefit from professional money management, reduced management expenses and diversification. The primary disadvantage is that capital gains are spread evenly among investors. Small pension funds unable to meet the requirements for a separately managed account find a commingled fund, also known as a pooled fund, attractive.
compound interest—interest calculated on both the principal and the accrued interest in a savings account. Interest may be compounded daily, monthly, quarterly, semiannually or annually. As an example, a $100 savings account earning 5% interest compounded annually will earn $5 and be worth $105 ($100 + $5) at the end of the first year. At the end of the second year, $5.25 (5% × $105) will be earned, increasing the account balance to $110.25 ($105 + $5.25). In year three, the account earns $5.51 (5% × $110.25), which increases the balance to $115.76 ($110.25 + $5.51).

consumer price index (CPI)—measure of price changes for a basket of goods and services purchased by households. A CPI makes it possible to compare the relative cost of living over time.

convexity—measure of the curvature in the relationship between bond prices and bond yields. Convexity is a risk management tool that helps measure and manage the amount of market risk to which a bond portfolio is exposed. As convexity increases, the systemic risk to which a portfolio is exposed increases. As convexity decreases, the exposure to market interest rates decreases and the portfolio can be considered hedged. In general, the higher the coupon rate, the lower the convexity (or market risk).

correlation—extent to which two economic or statistical variables move together, normalized so that its values range from -1 to +1. If two variables move in the same direction, there is positive correlation; if they move in opposite directions, there is negative correlation. Investors can combine investments that have low correlations or high negative correlations to reduce risk.

coupon stripping—separating the coupons from coupon bonds to create zero-coupon bonds. The bond principal and coupon amounts can then be traded separately.

credit rating—assessment by a credit bureau or agency of a person’s or organization’s ability to fulfill financial obligations. Among the factors that are usually taken into consideration as part of the assessment are current assets, income, debt and payment history.

credit spread—difference in yield between two bonds of similar maturity but different credit quality. For example, a 10-year Treasury note is trading at a yield of 6% while a 10-year corporate bond is trading at a yield of 8%. Corporations must offer a higher return on their bonds because their credit is worse than the government’s. The corporate bond is said to offer a 200-basis-point spread over the Treasury. See also basis point (BP).

difference in the value of two options on the same security when the value of the option sold exceeds the value of the one bought. For example, an investor buys a stock option for $2 and sells one for $5. The net amount received (credit) is $3. The investor will profit if the spread narrows. Also called a credit spread option.

custodial arrangement—warehousing of securities by a bank, trust company or other entity for safekeeping. See also custodian.

custodian—individual or organization entrusted with the care of someone or something. Banks, brokerage firms and mutual fund companies function as custodians when they hold the cash and securities of a retirement plan; they may also collect income and do simple reporting on the value of the assets.

defined benefit (DB) plan—employee retirement plan established and maintained by an employer that uses a predetermined formula to calculate the amount of an employee’s retirement benefit. Factors such as earnings and years of service are often part of the formula. Employer contributions to DB plans are determined actuarially. No individual accounts are maintained, as is done for money purchase plans.

defined contribution (DC) plan—see money purchase plan.
**de-risking**—activity or series of activities taken to lower risk. Managers of defined benefit retirement plans may select certain investments in an attempt to de-risk (reduce the volatility of) the plan's funded ratio.

**derivative**—financial contract with a value derived from the value of an underlying asset (e.g., bonds, commodities, stocks, residential mortgages, commercial real estate, loans), an index (e.g., interest rates, exchange rates, stock market index, price index) or other item (e.g., weather conditions) to pay or receive money in the future based on the performance of the underlying asset.

Derivatives are used to reduce the chance of loss from changes in the value of the underlying element—a strategy called hedging. Alternatively, derivatives can be used to increase profit if the value of the underlying element moves in the direction they expect. This strategy is referred to as speculation. The main types of derivatives are futures, options and swaps. See also option and swap.

**directed commissions**—fees charged by a broker for executing security transactions placed by an investment manager that result from instructions received from the manager's client.

**diversification**—strategy of mixing a wide variety of securities in a portfolio to reduce investment risk. Diversification may involve different types of securities (i.e., stocks, bonds and mutual funds), issuers, maturity dates, geographic regions, etc. The investor hopes the positive performance of some securities will neutralize the negative performance of others. Individuals with small portfolios use mutual funds as an inexpensive way to diversify.

**dollar-weighted rate of return**—also called the internal rate of return, the interest rate that makes the present value of cash flows into a portfolio plus the ending market value of the portfolio equal to the initial market value of the portfolio. This dollar-weighted measure is useful in comparing investment alternatives and managers; the higher the rate of return, the better the choice is. It can be misleading, however, because it is influenced by the timing and magnitude of cash flows in and out that are beyond the control of a portfolio manager. An alternative measure of performance is the time-weighted rate of return, which controls for cash flows. See also time-weighted rate of return.

**duration**—weighted average time until all of a bond's cash flows are to be received.

—measure of the sensitivity of a bond's price to a change in interest rates. Calculation of duration is relatively complicated, involving present value, yield, coupon, maturity and call features. This indicator of interest rate risk is part of the standard information provided on bonds and bond mutual funds. Duration is expressed as a number of years. The bigger the duration number, the greater the interest rate risk or potential reward.

**economically targeted investment (ETI)**—selection of securities for the economic benefits they create apart from investment return. For example, investments that create jobs, improve the stock of affordable housing or improve the infrastructure in a particular state or other geographic region might be given preference over other investments. See also socially responsible investing.

**efficient frontier**—curved line that graphically represents the maximum expected investment return for different amounts of risk. Investment portfolios below the efficient frontier curve are not “efficient” because investors can achieve greater return for the same risk. Portfolios that cluster to the right of the efficient frontier are also suboptimal, because they have a higher level of risk for the defined rate of return. No investment portfolios exist above the curve.

**equity**—investment by an owner or owners in a property or business. Equity (or equity shares) is often used to refer to stockholder shares in a corporation. More specifically, equity equals assets minus liabilities.

**excess earnings**—return from investments in excess of an assumed or expected rate of return.
**face value**—see par value.

**fixed income**—money earned that remains constant and does not fluctuate, such as income derived from bonds, annuities and preferred stock.

**Foreign Property Rule**—limit imposed on pension fund investment in foreign assets set by Canada’s Income Tax Act. The limit is 30% of total plan assets.

**fund earnings**—income (e.g., interest, dividends, capital gains) received on assets in a fund portfolio.

**funded ratio**—pension plan assets relative to its liabilities.

**Generally Accepted Accounting Principles (GAAP)**—collection of rules and procedures established by the Financial Accounting Standards Board to ensure external financial statements are fair representations of the economic circumstances of a company.

**going long**—buying a security such as a stock, commodity or currency with the expectation that the asset will rise in value. Going long is the opposite of selling short. See also short selling.

**group annuity**—contract in which an insurance company agrees to provide periodic income (usually monthly) to a group of people. A group annuity has the same characteristics as an individual annuity, except it is underwritten on a group basis.

**growth investing**—an investing style that looks for stocks that will deliver returns via share price increases (capital appreciation).

**guaranteed annuity**—precisely what is guaranteed varies from one annuity contract to another. Fixed annuities that promise a specific monthly payment are sometimes referred to as guaranteed annuities. A participating annuity may be labeled guaranteed because it promises a certain return on investments or protection of principle. An annuity may also guarantee payment for a specified number of years to a beneficiary or an estate if the beneficiary dies before the specified period has passed. Given the huge variations in the meaning of this term, a purchaser is advised to read an annuity contract carefully for how it is defined by the insurer.

**guaranteed investment contract (GIC)**—similar to certificates of deposit that can be purchased at banks, GICs are sold by insurance companies. The value of a GIC remains stable with a fixed rate of return. The rate of return, not the principal, is guaranteed. There is a penalty for early withdrawal.

**hedge fund**—aggressively managed investment portfolio that uses advanced investment strategies such as leveraged, long, short and derivative positions in an effort to generate high returns. Hedge funds are most often set up as private partnerships, open to a limited number of investors with very large initial minimum investments. Investors generally must keep their money in the fund for at least one year. Unlike mutual funds, hedge funds are largely unregulated. Early in their history, hedge funds took short positions to hedge against risk. Today, hedge funds make speculative investments that carry more risk than the market in general.

**high yield bond**—see junk bond.

**immediate annuity**—insurance contract purchased with a lump sum of money in which an insurance company agrees to begin making income payments within a short period (e.g., one month, one year) after the purchase.

**income trust**—a trust designed to produce investment returns.
**index fund**—mutual fund composed of securities selected to mirror a designated market index. Because the fund is passively managed to match a predetermined index, management expenses tend to be less than with an actively managed fund. Historically, passively managed index funds have also outperformed the majority of actively managed funds. See also *active management* and *passive management*.

**indexing**—periodically adjusting a benefit amount such as pension payments to recognize a change in price or wage levels. The Consumer Price Index is frequently used for this purpose.

**inflation**—rise in the general level of prices for goods and services in an economy over a period of time. Essentially, inflation is a decline in the real value of money. Rising prices discourage investment and saving. In cases of extreme inflation, consumers begin hoarding goods in an effort to buy items before prices go even higher. The primary measure of inflation is the Consumer Price Index.

**infrastructure**—basic physical and organizational structures and facilities (e.g., buildings, roads and power supplies) needed for the operation of a society or enterprise.

**institutional investor**—organization such as a bank, investment company, insurance company, pension fund or endowment fund with substantial professionally managed securities. Frequently, the dollar amounts of these entities are such that they qualify for lower commissions and other preferential treatment.

**investment consultant**—individual or firm that provides investment assistance for a fixed fee, a fee based upon a percentage of assets or a fee derived from brokerage commission. Such assistance may include analyzing portfolio constraints, setting performance objectives, advice on asset allocation, performance measurement, educating fiduciaries and selecting/monitoring investment managers. Consultants typically work for brokerage firms or independent advisory firms. Their clients are most often institutional investors such as pension plans, but may include individuals with substantial sums to invest. On occasion, investment consultant is also used as a generic term to describe a money manager or a financial planner.

**investment earnings**—return on assets including interest, dividends, rent and capital gains.

**investment policy**—commonly used to describe how contributions to an employee benefit plan are to be utilized from the time they are received until benefits are paid.

**investment return**—see *return* and *yield*.

**j**

**junk bond**—debt security with a low credit rating—typically a rating below “BBB” from S&P and below “Baa” from Moody’s. Because of their higher risk of default, these bonds pay a higher interest rate than that paid on investment grade bonds. Junk bonds are also referred to as high-yield bonds or speculative bonds.

**L**

**large cap**—short for large market capitalization, a company with a market capitalization of over $10 billion. Large caps are bigger than mid caps and smaller than mega caps. Cap classifications are only approximations that change over time. The exact definitions of these terms can also vary among brokerage houses. See also mega cap, micro cap, mid cap, nano cap and small cap.

**leverage**—strategy that uses borrowed money to purchase financial assets with the objective of increasing returns. Leverage can be created through options, futures, margins and other financial instruments. For example, instead of investing $1,000 in ten shares of stock, an investor might decide to invest the same money in options contracts that would make it possible to control 500 shares. Companies also use leverage to increase equity. A business may borrow money to invest in business operations and create more opportunity to increase value for shareholders. Leveraging has the potential to magnify a positive investment outcome, but there is also the risk of magnifying a negative outcome. See also *option*.

**liability-driven investing**—see *asset-liability matching*. 
life annuity—promise under an insurance contract or defined benefit pension plan to make periodic payments (usually monthly) for the lifetime of an individual (the annuitant). Payments stop upon the death of the annuitant.

lifestyle fund—see target-risk fund.

liquidity—ease with which an asset can be converted into cash with no significant loss in value. Assets vary greatly in their level of liquidity. Cash and money market funds are examples of liquid assets. At the other extreme are illiquid assets such as real estate and collectibles.

long—see going long.

market price—also called market value, the dollar amount for which a seller is willing to sell and a buyer is willing (and able) to purchase a good or service in the marketplace.

market value—see market price.

master trust—pooling of assets or trusts for multiple plans under one trust agreement.

mean—average of a set of numbers that is calculated by dividing the sum of the numbers by how many numbers were in the set. A mean is a measure of central tendency; it is always between the extreme values in the set of numbers. See also median.

median—measure of central tendency; the middle value in an ordered set of values. The median divides the distribution of numbers in half. See also mean.

mega cap—short for a company with capitalization over $200 billion. Mega caps are the very largest companies, such as General Electric, Microsoft and Wal-Mart. Cap classifications are only approximations that change over time. The exact definitions of these terms can also vary among brokerage houses. See also large cap, micro cap, mid cap, nano cap and small cap.

micro cap—short for a company with market capitalization between $50 million and $300 million. A micro cap is larger than a nano cap but smaller than a small cap. Cap classifications are only approximations, changing over time. The exact definitions of these terms can vary among brokerage houses. See also large cap, mega cap, mid cap, nano cap and small cap.

mid cap—short for a company with market capitalization of $2 billion to $10 billion. As the name suggests, a mid cap is in between a small cap and a large cap. Cap classifications are only approximations, changing over time. The exact definitions of these terms can vary among brokerage houses. See also large cap, mega cap, micro cap, nano cap and small cap.

Modigliani Risk-Adjusted Performance (M2, M2 or RAP)—measure of how well the return on an investment portfolio rewards an investor for the amount of risk taken, relative to a market index (or other benchmark) and the risk-free rate of return. Derived from the Sharpe ratio, M2 is easier to interpret. If two investment portfolios have M2 values of 4.3% and 4.8%, the portfolio with the M2 of 4.8% provides 0.5 percentage points more return per year for the same risk. See also Sharpe ratio.

money market—where debt securities with a maturity of one year or less are bought and sold.

money purchase plan—also known as a defined contribution plan, a retirement savings vehicle that defines payments to be made by an employer and possibly employees but not the benefit formula. Accumulated contributions and interest determine the retirement benefit amount that can be provided or purchased as an annuity for the member upon retirement.

mortgage—loan by which a borrower (mortgagor) gives a lender (mortgagee) a lien on property (typically real property) as security for the payment of the debt obligation. The borrower continues to use the property while loan payments are being made. When the loan has been paid in full, the lien on the property is removed. Mortgage loans are used in connection with the purchase of single-family structures, condominiums, multifamily structures, office buildings, large commercial centers, industrial plants and even undeveloped land.
mortgage-backed security (MBS)—bond or other financial obligation backed by a pool of mortgage loans. Investor returns are periodic payments that pass through as interest and principal from the underlying mortgages.

nano cap—short for a company with market capitalization under $50 million. Nano cap is the smallest of the cap classifications, and investment in these companies is generally considered high risk. Cap classifications are only approximations, changing over time. The exact definitions of these terms can also vary among brokerage houses. See also large cap, mega cap, micro cap, mid cap and small cap.

net income (NI)—total money received minus taxes and expenses. Also called net earnings.

open-end fund—type of mutual fund that places no restrictions on the amount of shares that can be issued. Shares are continuously bought and sold directly from the mutual fund company and/or a brokerage house. The price of a share in an open-end fund fluctuates daily depending on the performance of the securities held by the fund.

Open-end funds offer investment choice, liquidity and convenience but charge fees and often require a minimum investment. If a fund’s investment manager determines total assets have become too large to execute effectively a stated objective, the fund may be closed to new investors. In an extreme situation, the fund may be closed to new investment by existing fund investors. See also closed-end fund.

option—standardized contract between a party and one of the exchanges, or a custom contract between two parties, that gives the buyer the right (not the obligation) to exercise an option to buy or sell at a preset price on a specified date. A call option gives the holder the right to buy the underlying asset by a certain date at a certain price. A put option gives the holder the right to sell the underlying asset by a certain date at a certain price.

par value—dollar amount assigned to a security by an issuer. For a bond, par value is the amount stated on the face of the bond and repaid to the investor when the bond matures.

passive management—style of investing that attempts to match the average return and risk of a market or index by attempting to mirror its makeup. Adjustments are longer term and automatic versus the shorter-term approach dependent on personal judgment used in active management. Index (mutual) funds are passively managed. Since the fund manager’s strategy is to make as few portfolio transactions as possible, transaction costs and capital gains taxes tend to be lower than with actively managed funds. In addition, passively managed funds have historically outperformed most actively managed funds. Passive management is also referred to as passive strategy, passive investing and index investing. See also active management and index fund.

pension plan—plan organized and administered to provide a regular income for the lifetime of retired members; other benefits that may be provided include payments on permanent disability, death, etc. See also defined benefit plan and money purchase plan.

performance-based fee—amount paid to providers such as investment managers or third-party administrators based, at least in part, on investment results or achievement of goals. Also known as an incentive fee.

pooled fund—see commingled fund.

portable alpha—investment strategy in which an investment manager separates two aspects of portfolio return—the alpha and the beta. The beta is the extent to which an investment moves with the overall market and can be said to be the result of an increase resulting from the overall market increase. Alpha is the measure of a manager’s ability to pick investments that outperform the market in a given period. If an investment manager is able to improve alpha by investing in securities that are not correlated with the beta of the existing portfolio, the manager has created a portable alpha. See also alpha and beta.
preferred stock—fractional ownership in a public corporation represented by a certificate or book entry. Preferred stockholders have preferential rights over common stockholders with regard to the payment of dividends and the distribution of assets if the company is liquidated. Preferred dividends are normally fixed, whereas common stock dividends may fluctuate depending on company earnings. Claims of both common and preferred stockholders are secondary to claims of bondholders and other creditors of the company. Preferred stock usually does not carry voting rights.

present value—given a specific interest rate, the amount of money needed today to provide (1) a sum of money at a specific future date or (2) a series of payments over a set period.

price/earnings (P/E) ratio—current share price of a stock divided by its current or estimated future earnings per share (EPS). The EPS used in this calculation may be the last four quarters (trailing P/E), but sometimes it is taken from the estimates of earnings expected in the next four quarters (projected or forward P/E). A third variation uses the sum of the last two quarters and the estimates of the next two quarters.

A high P/E ratio generally suggests that investors are expecting higher earnings growth in the future compared with companies with a low P/E ratio. The ratio is most useful when comparing one company with others in the same industry, with the market in general or against the company’s own historical P/E ratio. Also known as the price or earnings multiple.

private equity—money invested in companies that are not publicly traded on a stock exchange. Private equity is highly illiquid because sellers of private securities must locate willing buyers. Investors in private equity are generally compensated when a firm (1) goes public, (2) is sold or merges with another firm or (3) is recapitalized.

proxy—person authorized to act for another; for example, a person empowered by a shareholder to vote on his or her behalf at a shareholder meeting. Proxy also refers to the written document a shareholder uses to authorize another person to vote on his or her behalf at the meeting.

prudent person rule—a substantive rule of law, composed of several basic duties and principles, that requires plan administrators and trustees to exercise the care, diligence and skill in the administration and investment of a pension fund that a person of “ordinary prudence” would exercise in dealing with the property of another person. It includes a duty to act prudently and with due diligence when managing fund assets, a duty of loyalty to the fund and its members, a duty to be even-handed when dealing with competing interests and a duty to adequately diversify assets to avoid unwarranted risks.

quartile—measurement used to divide a population into four equal parts. The first quartile represents the lowest fourth of the data (1-25%), the second represents 26% to 50%, the third represents 51% to 75% and the fourth quartile is 76% to 100%.

real estate investment trust (REIT)—corporation or trust that uses pooled funds to purchase and manage real estate assets and/or mortgage loans. Usually publicly traded, REITs are required to distribute (or pass through) 95% of their income to shareholders to qualify for special tax treatment.

real return bond (RRB)—debt security issued by the Canadian government that offers protection against inflation. RRBs pay interest semiannually based on an inflation-adjusted principal; and, at maturity, they repay the principal in inflation-adjusted dollars. RRBs must be purchased, transferred or sold—directly or indirectly—through a participant of the Debt Clearing Service. They are available only in integral multiples of $1,000.
Registered Pension Plan (RPP)—employer-sponsored defined benefit (DB), money purchase or hybrid plan that provides retirement benefits to Canadian employees upon retirement. The latter includes target benefit, industry-wide, cash balance and combination plans, etc. RPPs must be registered with the Canada Revenue Agency and meet criteria under the nation’s Income Tax Act.

Employer contributions are required for a DB plan—the amount is whatever is necessary to provide the benefits promised members. With a money purchase plan, an employer must contribute a minimum of 1% of a worker’s income. For plans that are not a DB plan, the plan’s design determines whether an employee may contribute and whether an employee is required to contribute. Contributions and gains are tax-deferred. Funds are taxed when they are withdrawn from the plan.

While employed by the employer sponsoring their RPP, members cannot withdraw required contributions—funds must remain in the RPP until the member’s termination of employment, death or retirement. Members may, however, withdraw amounts accumulated through voluntary contributions. At termination of employment, a member is entitled to his or her own contributions and plan sponsor vested contributions unless the assets are locked-in. Members also have the option to transfer accumulated amounts to another RPP or a locked-in RRSP.

Generally, funds in a locked-in plan cannot be withdrawn, but there are some exceptions such as small entitlements and a member’s shortened life expectancy. Members can also apply to the minimum standards regulator to withdraw funds on hardship grounds.

Registered Retirement Savings Plan (RRSP)—voluntary money purchase plan that an individual or a group of individuals who do not have a registered pension plan (RPP) can use to accumulate money for retirement. Set up at a financial institution such as a bank, credit union, trust company, mutual fund company, insurance company or investment dealer or brokerage firm, the plan may be a regular RRSP or a self-directed one. A self-directed RRSP allows the plan participant to build and manage his or her own investment portfolio. The RRSP must be registered with the Canada Revenue Agency and is subject to Section 146(1)(j) of the Income Tax Act.

Plan rules determine whether the RRSP is voluntary or compulsory for members. Contributions are tax-deductible and investment income is tax-free until withdrawn, when it is treated as income for tax purposes. Upon retirement, the holder of the RRSP may purchase a prescribed form of annuity or transfer plan assets to a Registered Retirement Income Fund (RRIF).

Although contributions are not locked-in, an employer may place limits on withdrawals from an RRSP as long as an employee remains employed. Employers cannot, however, restrict employee access once a worker retires or a worker’s employment is terminated.

relative return—difference in the money gained or lost on an investment over a period of time compared with another investment (usually a stock or mutual fund). Because relative return compares the return on one investment with another, it is more helpful than absolute return—especially when reviewing the performance of an investment manager who is expected to achieve a return higher than a benchmark investment. See also absolute return.

return—money gained or lost (both realized and unrealized) on an investment. The return may be interest, dividends, rent, an increase in the value of the investment or a decrease in the investment’s value. Also referred to as total return, it is typically calculated for a year.

revenue—income, usually from the sale of a company’s products and services, before any costs or expenses are subtracted.
**risk**
—hazard or chance of loss. For example, health risk is the likelihood a person will become sick, injured or die. Various lifestyle and physical factors can be used to determine the chance that one of these events will occur.

—when investing, there are many risk factors that may result in an investment not achieving a desired return.

**risk budgeting**—process focused on how risk is distributed throughout an investment portfolio. The goal is to identify, quantify and spend investment risk in the most efficient manner possible. An investor calculates how much different assets in a portfolio contribute to the total risk of a portfolio. If the investor is uncomfortable with the amount of risk an asset represents, some of the money invested in the asset is moved to another investment option. The risk exposure of a portfolio can come from various factors including inflation, economic growth, steepness of the yield curve and changes in short-term interest rates.

**Sharpe ratio**—risk-adjusted measure of an investment’s performance. In other words, whether the return on a portfolio is the result of smart investment decisions or excess risk. The greater the Sharpe ratio, the better the return for the same risk. A negative ratio indicates a portfolio with less risk will perform better than the one analyzed. Also referred to as the Sharpe index, Sharpe measure and reward-to-variability ratio. See also Modigliani Risk-Adjusted Performance (M², M² or RAP).

**short selling**—selling a security that the seller has borrowed. Short sellers assume they will be able to buy the stock at a lower amount than the price at which they sold short. See also going long.

**small cap**—short for a company with market capitalization of $300 million to $2 billion. A small cap is larger than a micro cap but smaller than a mid cap. Cap classifications are only approximations that change over time. The exact definitions of these terms can also vary among brokerage houses. See also large cap, mega cap, micro cap, mid cap and nano cap.

**socially responsible investing**—also known as sustainable investing, an investment approach that takes into consideration social, economic, environmental and/or ethical issues as well as financial gain when selecting securities. In general, socially responsible investors favor stock in corporations that promote environmental stewardship, consumer protection, human rights and diversity. Some (but not all) avoid corporations involved in alcohol, tobacco, gambling, weapons, and/or the military. See also economically targeted investment (ETI).

**soft dollars**—arrangement in which an investment manager directs the commission generated by a financial transaction with a client toward a third party (or in-house party) in exchange for services that are for the benefit of the client but are not client-directed. In contrast to hard dollars (actual cash), soft dollars are incorporated into other brokerage fees and expenses and not reported directly. Soft dollars may also refer to a situation in which payment is made in kind or by passing business to another party versus hard cash.
**solvent**—capacity of a benefit fund, corporation or other entity to meet its present and future financial obligations as they become due.

**specified multi-employer pension plan (SMEPP)**—pension plan that has collectively bargained contributions, covers employees of two or more employers and has been designated in writing as a SMEPP by the applicable regulatory authority (where permitted).

**split funding**—when applied to retirement plans, the use of two or more funding sources. For example, a portion of a plan may be funded by a life insurance company while the remainder is invested in stocks through a corporate trustee.

**stock**—ownership share in a public corporation. Stock is a means of raising the capital a company needs to cover start-up costs and expansion. Ownership is usually indicated via a stock certificate or book entry. Depending on the type of stock owned, the holder may be given the right to vote on major corporate issues and may benefit from stock dividends, capital gains and—if the corporation is dissolved—a claim upon assets remaining after all creditors have been paid. Stocks are also referred to as equity securities and equities.

**strip**—see coupon stripping.

**subordinated debt**—loan (or security) that ranks below other loans (or securities) with regard to claims on assets or earnings. If a default occurs, creditors with subordinated debt do not get paid until senior debtholders are paid in full. Hence, subordinated debt is more risky than un-subordinated debt.

**surplus**—more than what is needed; for example, plan assets exceed liabilities.

**swap**—exchange of one security for another. An investor may use a swap to change the maturity of bonds, to acquire a different quality of stocks or bonds, or because investment objectives have changed. Recently, swaps have grown to include currency swaps and interest rate swaps.

—in the context of mergers and acquisitions, an exchange of an acquiring company’s stock for the stock of the company being acquired at a predetermined rate. Typically, only a portion of a merger is completed with a stock-for-stock transaction, with the rest of the expenses being covered with cash or another method of payment.

**target benefit plan (TBP)**—retirement plan similar to a defined benefit (DB) plan in that there is a pooling of funds. Employer contributions are based on the amount needed to accumulate sufficient funds (at an assumed interest rate) to pay a projected future benefit—the target benefit—to plan members upon retirement.

Unlike a DB plan, however, a TBP does not guarantee the benefit amount to be paid. The obligation of the plan is only to pay whatever benefit can be provided given plan funding.

Depending on the financial status of the plan and plan policies, actions can be taken to:

- Increase or decrease contributions
- Decrease benefits for all members
- Grant indexing for all members
- Expand other base or ancillary enhancements.

While the potential for such actions introduces a degree of uncertainty for plan members, it is not near the level of uncertainty that exists with a money purchase arrangement, and it provides a steady stream of income like a DB plan. Because members share the risks associated with the plan through the possible reduction of their benefits, TBPs are also referred to as shared-risk plans (SRPs).
**target-date fund**—hybrid mutual fund investing in a mix of assets (i.e., stocks, bonds and cash) that is automatically reset as a specific date (usually a retirement date) approaches. Over time, the mix typically becomes less risky so that shareholders have more stable values and returns when they are ready to begin withdrawals. While proponents cite the convenience of using these funds to put retirement investing on autopilot critics are wary of the one-size fits-all approach and express concern as to whether the risk associated with the mix of assets is appropriate. Target-date funds are also known as target-retirement-date funds and age-based funds.

**target-risk fund**—mutual fund that invests in an asset mix determined by the level of risk and return that is appropriate for investors. Factors that determine the appropriate mix include the investor’s age, risk aversion, investment purpose and time until the principal will be withdrawn. A target-risk fund can have conservative, moderate or aggressive growth strategies. Aggressive growth funds are targeted to young investors, while conservative growth funds are targeted to investors nearing retirement and the withdrawal of their funds.

Target-risk funds are designed to be the main investment in a person’s portfolio. The purpose of the fund may be defeated if other funds are chosen at the same time, because the asset allocation mix may be distorted. Also known as a lifestyle fund.

**time-weighted rate of return**—measure of the compound rate of growth in a portfolio used to compare different investment alternatives and managers. Unlike dollar-weighted rate of return, this approach eliminates the distortions created by cash inflows and outflows. The method assumes a single investment at the beginning of a period and measures the growth or loss of market value to the end of that period. The portfolio is evaluated each time there is a cash transaction (i.e., new purchases and sales, dividend and income payments, deposits and withdrawals). The performances of periods between cash flows are linked together to reflect a return for the whole period. See also *dollar-weighted rate of return*.

**Treasury bill**—short-term debt (bond) issued by a government. Treasury bills issued by the government of Canada are available in multiples of $1,000. They must be purchased, transferred or sold—directly or indirectly—through a participant of the Debt Clearing Service. Periodically, Canada also issues *cash management bills (CMBs)* with maturities of less than three months; they may have a maturity as short as one day. CMB auctions take place on any business day.

**trust**—see *trust fund*.

**trust fund**—assets managed by an individual, a group of individuals or an organization for the benefit of another party or parties. Trusts are established for a wide range of purposes. For example, a trust may be set up for a child and managed by an adult until the child reaches a specified age. In relation to benefits, trusts are set up to provide pension and health and welfare benefits to employees and retirees. A trust agreement in combination with state and federal laws may restrict what trustees may do with assets.

**unfunded actuarial accrued liability (UAAL)**—actuarial accrued liability that exceeds the actuarial value of fund assets. If the value is negative, it is referred to as a negative unfunded actuarial accrued liability, or a funding excess. Also referred to as an unfunded actuarial liability.

**universe bond index**—collection of debt securities that provides a broad measure of a fixed income market.

**value investing**—looking for securities that are selling for less than what the investor believes they are worth, for example, stocks with low price/earnings (P/E) ratios.
yield—income earned (i.e., interest or dividends) or projected on an investment expressed as a percentage of an investment’s cost, current value or face value. There are various ways to calculate yield depending on whether the security is a bond, stock or mutual fund. With the exception of a bond’s yield to maturity, yield generally takes into account only interest earned on an investment and not changes in value. For investments with stable values such as certificates of deposit and money market funds, yield and return may be used interchangeably. Such is not the case for stocks, bonds and mutual funds, which may have capital gains and losses. Unlike yield, return takes into consideration the changes in value.

—bonds have four yields: coupon yield, current yield, yield to maturity and tax-equivalent yield. The yield for comparisons depends on the type of bond and its maturity date. See also bond.

—yield on a mutual fund is a fund’s income (interest and dividends minus fund expenses) as a percentage of its net asset value.

—for stocks, yield is calculated by dividing the total of the annual dividends by the current market price.

yield curve—interest rates available for each maturity from one day out to 30 years. The curve is positive when long-term debt instruments have higher yields than short-term debt instruments. This is the usual condition and happens because investors demand a higher return for taking on the additional risk of the longer-term investment. Also called normal yield curve.