GLOSSARY OF TERMS --- SECURITIES

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Security:- normally refers to an investment which you buy on the stockmarket e.g. Question: "What securities do you hold?" Answer: "I hold 10 BP shares, 55 Microsoft shares and £100 nominal of Treasury 9% Stock".(see also stock).

Book value:- the cost of the security at the time of purchase.

Bearer security:- a security where the person in physical possession of the security document/certificate is entitled to the cash flows from the security (contrast with a **registered security**).A pound note is a bearer security since if you lose it the person finding it can spend it!.

Registered security:- where the person recorded in the company's register (usually a secure computer database) as the owner receives the cash flows from the security. The piece of paper/certificate for the security does not entitle you to legal ownership of the security.

Stock:- normally in UK refers to the **fixed interest securities** which you buy on the stockmarket e.g. Question: "How much **British Government Stock** do you hold?" Answer: "I hold £100 **nominal** of Treasury 9% Stock".(see also **security**). Stocks issued by the British Government are also called **Gilt-edged Stocks** or **Gilts** for short. You will find the daily prices of these listed in the Financial Times. The Americans refer to securities issued by the US Government as **US Treasury Bonds** or **US Treasury Notes.** You will find the prices of these listed in the Wall Street Journal.
The word can also refer to ordinary shares particularly in America, as for example "What stocks do you hold?". Reply "I hold Microsoft, Intel and IBM".

Fixed Interest Securities:- Those where the interest payments (also called **coupons**) are fixed and known at the date of purchase. Contrast with **variable interest securities** like **ordinary shares** where you are not sure what the size of the dividends will be in future years.

British Government Stock/Securities:- Stocks/securities issued to investors by the British Government. The monies which are paid to the Government by the investors as the purchase price of these stocks/securities are borrowings by the Government which have to be paid back at the redemption date of the stock/security.

Variable interest securities:- where the amount of dividends/interest to be payable in future is not fixed and known in advance e.g. **ordinary shares** like BP, Glaxo, Microsoft etc.

Ordinary shares or **Equities**:- investments in companies like BP, Shell etc. where the shareholder is entitled to share in the profits of the company but where the future dividends depend on the future success of the company and there is no fixed rate of interest or fixed payment of capital on a specified redemption date.

Capital:- money lent or money invested in a project or a security. In the case of a company it may borrow money (called raising capital) from investors and either offer investors a fixed payment of interest each year and a fixed repayment of the capital (this is called raising loan capital) at the end of a certain term or offer investors a share of the company profits (this is called share capital or equity capital).The company only needs to repay the loan capital at the repayment date. An investor is not able to ask for repayment of his capital from the company at any time (only at the redemption date). If however the investor wants out of his investment he can sell it for cash to another investor through the medium of a Stock Exchange (i.e. a place where stocks and shares are exchanged) but this transaction does not involve the company.

Nominal amount (N) : the amount in name only that you hold of the stock/security and which has to be converted into the actual cash you will receive back at the **redemption date** of the security.

Redemption date: the date when the stock/security is redeemed or paid out in cash to the investor.

Optional redemption date:- where the stock/security may not be paid back on a fixed date but where there may be a choice of possible **redemption dates**. The issuer of the stock (e.g. the British Government in the case of **British Government Stocks**) will choose the **redemption date** on which to repay.

Dividend:- the payments made (normally once or twice a year) to shareholders of **variable interest securities** (e.g. ordinary shares) when the company concerned distributes some of its profits to shareholders.

Dividend yield:- normally refers to ordinary shares/equities and is the level of dividend currently paid per share in a year divided by the price of one share. If the company currently pays 6p in **dividend** (for each share) and the price of one share is 100p then the dividend yield is 6% pa..

Par: redeemable at par means £1 **nominal** of the stock/security is paid out as £1 cash. Issued at par means that £1 nominal of stock/security costs £1 to purchase when the stock/security is first issued.

Redemption price (R) or Redeemable at (100+k)% : means that £N **nominal** of the stock/security is paid back as a cash amount £C equal to £N*R or equivalently £N*(100+k)/100. A **stock** redeemable at 105% means you get back £1.05 for every £1 of nominal. In that case R=1.05 and k=5.

Redemption yield:- the **internal rate of return** or, equivalently, the **money weighted rate of return** to an investor buying the stock..

Flat or running yield :- defined as the interest (coupons) payable in a year on the fixed interest stock/security divided by the current price of the stock/security e.g. if £6 is the fixed interest (coupons) payable in a year on £100 nominal of the stock/security and the current price is £95 per £100 nominal then the flat or running yield is 6/95=.06316 or 100*6/95=6.316% in percentage terms. Contrast with the redemption yield.

Cash redemption (C) : means the cash actually paid at the redemption date i.e. £N*R or equivalently £N*(100+k)/100.

Coupon :- interest payments on a fixed-interest security (bond).

Coupon rate (D):-the amount per unit nominal which when multiplied by the **nominal** amount of stock/security gives the interest/coupon payments per annum and it will specify how often the amount is paid e.g. if the nominal amount of stock/security is £100 and the coupon rate is 6% (D=.06) payable half-yearly, then the fixed interest payments are £3 every 6 months (**coupons**). The

coupon dates are the dates on the year when the interest/coupons are paid e.g. if the coupon dates were 1 January and 1 July then £3 would be paid on each of these dates.

Issue price:- When the security/stock first becomes available (i.e. is issued), e.g. by the British Government, it may not cost exactly £100 to buy £100 nominal of stock/security. If it, say, costs £95 to buy £100 nominal of stock, the stock is said to be issued below par, at 95% and if it costs say £105 to buy £100 nominal of stock, the stock is said to be issued above par, at 105%.

Price per £1 nominal (P):- the price paid per £1 nominal to buy/purchase the stock/security. If the coupon is payable m times a year then (ignoring income tax and capital gains tax):-

$P.N=D.N.\ a_{\overline{n}|}^{(m)} + R.N.v^n$ calculated at a rate of interest equal to the redemption yield.

Hence $P=D.\ a_{\overline{n}|}^{(m)} + R.v^n$ N.B. $R=(100+k)/100$

Income tax:- a tax payable to the Inland Revenue and which is taken from coupons/interest/dividends.

Capital Gains Tax:- a tax payable to the Inland Revenue and which is taken from the capital gain made on the investment.

xd:- stands for **ex-dividend** (i.e. without dividend) and means that the investor who buys the stock **xd** will not receive the coupon/dividend which is due to be paid in a few days time on the next coupon date as this coupon will go to the seller. British Government Stocks normally go **xd** 7 days before the next coupon date (i.e. the **xd** date is 7 days before the coupon date). In respect of ordinary shares/equities it means the investor who buys the stock **xd** will not receive the dividend due to be paid in a few days time as it will go to the seller. Shares normally go **xd** some days before the date when the next dividend is to be paid. If the buyer is entitled to the dividend payable in a few days time then the stock has not yet gone **xd** and is still **cum dividend** (i.e. with dividend).

Cum dividend :- see **ex-dividend**.

Accrued interest: applies to the situation of a **fixed interest security** when you are between **coupon dates**. It represents the interest accrued, but not yet paid, since the last coupon date. If, at today's date, the last coupon date was 56 days ago and the number of days between the last coupon date and the next is 180 days and on the next coupon date a coupon of £3 will be paid then the accrued interest to-day will be £3*56/180=£0.9333. If the stock has gone **xd** then the accrued interest is negative and is equal to the **negative** of the interest that will accrue between to-day's date and the next coupon date so that if there are 4 days to go from to-day to the next coupon date and 180 days between coupon dates the accrued interest is -3*4/180 or -£.0667

Debenture:- a fixed interest stock/security issued by a commercial organisation normally on a secured basis which means that when it comes to the redemption date and suppose that the commercial company has not got enough money to repay the stock then the debenture holders will have the legal right to sell certain pre-specified assets of the company (e.g. a building) in order to get enough money to repay the stock. These assets are described as the assets over which the debenture is secured.

Secured Loan Stock:- same as **debenture**.

Unsecured Loan Stock (referred to as **Corporate Bonds** in the USA**)**:- a fixed interest security but, unlike a **debenture**, it is not secured against pre-specified assets of the company. In the event the company is unable to repay the **unsecured loan stock** at the redemption date, the holders of the stock have to take their chance with the other creditors of the company as to whether there will be enough assets to sell in order to repay the loan stock after the company is would up.

Dirty price :- the price derived from an actuarial present value of future payments. The dirty price is <u>discontinuous</u> across **xd** dates. You pay the **dirty price** when you buy the stock.

Clean price :-the **dirty price** less the **accrued interest** . The clean price is <u>continuous</u> across **xd** dates. The prices quoted in the Financial Times are **clean prices** and you have to add on the **accrued interest** to get the price you actually pay.

Zero coupon bond (Gilt strip):- a bond that repays a fixed amount (the nominal amount) on one certain date. There are no coupons paid on the bond.

Further Definitions

Bear market :- a time of weak confidence among investors who are inclined to sell shares and prices decline.

Bull market :- a time of high confidence among investors when they are keen to buy shares and prices rise.

Index-linked gilt :- a bond issued by the British Government for which the interest payments (coupons) and the final redemption proceeds are linked to movements in the RPI.

Arbitrage :- the simultaneous buying and selling of two economically equivalent but differently priced portfolios so as to make risk-free profits at no net cost – a *'free lunch'*.

Forward contract :- an obligation in the form of a contract to buy (or sell) a specified asset on a specified date, at a specified price. No money changes hands until the specified date.

Futures contract :- like a forward contract, this is a contract to buy (or sell) an asset on an agreed basis in the future. However, futures contracts are standardised contracts traded on a recognised exchange like LIFFE. The profit or loss from the futures contract is calculated every day and the change in this value is paid by one party to the other – this is called 'marking to market'.

Forward interest rate *f*(t,,T,S):- at time t (measured from the origin at t=0), the average force of interest (i.e. the interest rate compounding continuously), operating over the future period from time T(measured from the origin) to time S (measured from the origin) i.e.:-

$$f(t,T,S) = -\frac{1}{(S-T)}\ln\frac{P(t,S)}{P(t,T)}$$

Bond strip :- a bond strip is a tradable security consisting of one of the payments constituting either a coupon of a coupon-bond or a redemption payment of a coupon-bond. In effect a **strip** is a zero coupon bond (ZCB).

Derivative instrument :- a financial instrument with a value dependent on the value of some other, underlying asset.

Macaulay (or Mean) Duration- First MD or FMD- (also known as the discounted mean term or effective mean term) **:-** the mean (average) duration of a series of cash flows after discounting these cash flows, where the cash flows are assumed positive (i.e. where the cash flows are either all 'in' or 'out' and each cash flow is weighted by its present value). (Named after the American F.R. Macaulay, son of T.B. Macaulay, FIA, Actuary of Sun Life of Canada).

If the cash flows at durations $(t_1, t_2, t_3..., t_n)$ are $(c_1, c_2, c_3...., c_n)$ and the spot interest rates are $(\delta_1, \delta_2, \delta_3....\delta_n)$, then $FMD = \frac{\sum_{i=1}^{i=n} t_i c_i e^{-\delta_i t_i}}{PV}$ where PV=Present Value=$\sum_{i=1}^{i=n} c_i e^{-\delta_i t_i}$

The FMD is the first moment of the duration where the 'notional' probability of duration t_i is $p_i = \frac{c_i e^{-\delta_i t_i}}{PV}$.

Macaulay (or Mean) Duration- Second MD or SMD- :- the mean of the square of the durations of a series of discounted cash flows (i.e. where the cash flows are either all 'in' or 'out' and each cash flow is weighted by its present value). The SMD is a measure of the convexity of the cash flows.

$$SMD = \frac{\sum_{i=1}^{i=n} t_i^2 c_i e^{-\delta_i t_i}}{PV}$$

The SMD is the second moment of the duration where the 'notional' probability of duration t_i is $p_i = \frac{c_i e^{-\delta_i t_i}}{PV}$.(also known as the **convexity** of the cash flows).

Gilt :- short for 'gilt-edged security', a debt security issued by the British Government that pays regular coupons.

Long (position) :- a long position in an asset means having an economic exposure to the asset. In futures and forward dealing the long party is the one who has contracted to take delivery of the asset in the future.

Short (position) :- a short position in an asset means having a negative economic exposure to the asset. In futures and forward dealing the short party is the one who has contracted to deliver the asset in the future.

Hedging :- action taken to protect the value of a portfolio against a change in market prices. Hedging involves holding offsetting long and short positions in the assets. The values of the long and short positions are expected to respond identically to market changes.

Yield curve :- a plot of yield against term to redemption. Usually the yield plotted is the gross redemption yield on coupon paying bonds but other yields can be used.

Zero coupon yield curve :- a plot of redemption yields against term to redemption for (usually hypothetical) zero coupon bonds (ZCBs).

Certificate of deposit :- a certificate issued by a bank showing that a stated sum of money has been deposited for a specified time at a specified rate of interest.

Convertible security :- a security which can be converted into something on specified terms (usually a fixed interest security that can be converted into a specified number of shares on specified dates).

Ground rent:- rent paid to the owner of land by a developer in respect of a ground lease granted to a developer who has the right to develop the land.

Tracker fund :- a fund that invests in such a way that its price performance tracks that of a specified index.

Market risk :- the risk arising from changes in the value of a portfolio due to movements in stock-market values (i.e. risk due to volatility of share prices).

Certificate of deposit :- a certificate issued by a bank showing that a stated sum of money has been deposited for a specified time at a specified rate of interest. Certificates of deposit can be traded (ie sold) by the original depositor.

Commercial paper :- a generic term for short term debt issued by companies. (The terms 'paper' or 'notes' are often used when referring to short term debt.) Commercial paper is a single name form of short-term borrowing used by large companies. It comes in the form of bearer documents for large denominations which are issued at a discount and redeemed at par.

Convertible security :- a security which may be converted into something else (usually into shares in the same company) on specified terms.

Credit rating :- a rating given to a company's debt by a credit-rating company as an indication of the likelihood of default. Top rating is usually AAA. Credit ratings are much used, and are generally highly reliable.

Credit risk :- the risk that the counter-party to an agreement will be unable or unwilling to make the payments required under the agreement.

Debenture :- A loan made to a company which is secured against the assets of the company. Debentures usually have a floating charge over the assets of the company so that debenture holders rank above other creditors should the company be wound up. Debentures with fixed charges are called mortgage debentures.

Dividend cover :- the number of times that the dividend payments are covered by earnings for the relevant period. Defined as the earnings per share divided by the dividend per share. It is the inverse of the payout ratio. Care needs to be taken that the tax treatment of the earnings and dividend figures are consistent.

Dividend yield :- the running yield (dividend divided by share price) on an equity.

Index tracking :- an index tracking fund (or an 'index fund') is an investment fund with the specific objective of tracking a particular index. The fund manager can either hold all the stocks in the index in the appropriate proportions (known as 'full replication') or use some mathematical model to choose a smaller sample of stocks which will perform as closely as possible to the index.

Junk bond :- a bond which does not meet the usual requirements of income cover and capital cover for institutional investors.

Unit trust :- an open ended investment vehicle whereby investors can buy 'units' in an underlying pool of assets from the trust manager. If there is demand for units, the managers can create more units for sale to investors. If there are redemptions (sales by investors), the managers will buy in units offered to them. Unit trusts are trusts in the legal sense.

American option :- an option that can be exercised on any day before its expiry.

European option :- an option that can only be exercised at expiry.

Call option:- the right, but not the obligation, to buy a specified asset on a specified date, at a specified price.

Put option:- the right, but not the obligation, to sell a specified asset on a specified date, at a specified price.

Intrinsic value :- for a **call option**, the difference between the asset price and the exercise price (if positive, otherwise no intrinsic value) . For a **put option** the difference between the exercise price and the asset price (if positive, otherwise no intrinsic value).

In-the-money option :- an option (call or put) which has **intrinsic value**.

Out-of–the–money option:- an option (call or put) which has no **intrinsic value**.

Option writer :- the person who sells the option to the buyer.

Stamp duty :- a Government tax paid on purchase of certain assets (e.g. shares, houses).

Swap :- a contract between two parties in which they exchange a series of payment according to a pre-agreed formula.

More definitions where the terms defined relate to securities

American depositary receipts (ADRs) :- depositary receipts held by the overseas branch of an American bank.

Anomaly switch :- a technique used in the active management of a bond portfolio. Anomaly switching involves moving between stocks with similar volatility, thereby taking advantage of temporary anomalies in price.

Arithmetic index :- an index constructed as the (weighted) arithmetic average of the prices of the constituent investments. The prices are often weighted and the average is usually multiplied by a factor chosen to give a convenient starting value for the index. The factor is periodically altered so as to maintain a continuous index value when it is necessary to alter the constituents or the weights.

Basis :- in futures markets, the **basis** is the cash price of the underlying security minus the futures price.

Basis trading/ Cash and carry trade :-an arbitrage position typically comprising a long cash position together with a short position in its respective futures contract, whereby the cash price plus the cost of carry of the underlying position is lower than the futures price. By convention, buying the basis is to buy cash bonds and sell futures, and selling the basis is to sell cash bonds and buy futures.

Bear spread - use for vertical spread :- an option strategy combining the purchase and sale of two puts (bear put spread) or two calls (bear call spread) with different strikes on the same underlying security.

Beta value :- a measure of a stock's volatility relative to movements in the whole market. Usually defined as the covariance of the return on the stock with the return on the market, divided by the variance of the market return.

Bid price :- the price at which a market maker offers to buy a security.

Bill of exchange :- a bill of exchange is an invoice which is endorsed by a merchant bank and which can be sold to a discount house to raise short term finance. Where the endorser is an ‘eligible’ bank the bill is known as an ‘eligible bill of exchange’. In the case of an ‘eligible bill’ the bill of exchange is a very secure investment.

Book value /Adjusted book value (of assets) :- The book value of a life insurance company's assets is the value at which it purchased them. In practice, companies may modify the value so as to take into account part - but usually not all - of subsequent changes in capital values. In this case, it is better called adjusted book value.

Bulldog :- a sterling denominated foreign bond issued by an overseas borrower in the traditional UK bond market.

Butterfly :- an option strategy involving the purchase of one put (or call), the sale of two puts (or calls) at a higher exercise price, and purchasing one put (or call) at an equally higher price.

Call deposit :- a bank deposit where the lender has immediate access to the money deposited. Interest rates can usually vary daily.

Call option :- the right, but not the obligation, to buy a specified asset on a set date in the future for a specified price.

Calendar spread :- a calendar spread is created by selling a call option with a certain exercise price and buying a longer maturity call option with the same exercise price. Alternatively a put option can be sold while simultaneously buying a longer maturity put with the same exercise price.

Cap :- an upper limit. For example, on a benefit, a contribution, benefit growth or a funding level.

Capital cover :-a calculation made for loans issued by companies. The capital cover is the number of times that the assets of the company (excluding intangibles and after notionally paying current Liabilities) cover the amount of the loan (including prior ranking loans).

Collar :- a lower limit. For example on a benefit, a contribution, benefit growth or a funding level

Convexity :- the convexity of a bond is defined as the Second Macaulay Duration of the bond. where P is the dirty price of the bond and i is the gross redemption yield on the bond.

Covenant :- an agreement with a legal binding on the parties involved. The expression is often used in association with corporate debt, because the borrower is bound to the terms of the agreement. The expression is also used in property investment because the tenant or lessee is bound to the terms of the lease agreement. In fact the meaning of covenant has been extended in the context of property investment so that it usually refers to the quality of the tenant, e.g. a tenant with a good covenant is a good quality tenant who is unlikely to break the terms of the agreement.

Custodian :- an organisation which undertakes the role of holding and accounting for assets in a portfolio on behalf of an investment manager or trustees.

Depositary receipt :- a negotiable certificate which gives evidence of the ownership of a company's shares. Often used as a medium by international investors, particularly for investments in emerging markets, as they may be more marketable than the shares they represent.

Diagonal spread :- a diagonal spread involves buying on option and selling another (both calls or both puts) where both the maturity and the exercise prices are different.

Efficient frontier :- an efficient portfolio is one for which it is not possible to increase the expected return without accepting more risk and not possible to reduce the risk without accepting a lower return. The efficient frontier is the line joining all efficient portfolios in risk-return space. In portfolio theory risk is defined as variance or standard deviation of return.

Emerging market :- a stock market in a developing country such as China, Mexico, Singapore etc. They offer high expected returns due to rapid industrialisation. They are also very risky markets.

Eurobond :- an international bond issued by a company or government, often in a currency other than the currency of the borrower. The bonds are traded internationally through banks, and not in the traditional bond markets.

European option :- an option that can only be exercised at expiry.

Exercise price/Strike price :- the price at which an underlying security can be sold to (for a put) or purchased from (for a call) the writer or issuer of an option (or option feature on a security).

Financial gearing :- The expression ‘gearing’ or ‘financial gearing’ is often used to refer to the impact on the profits for a company caused by fixed interest borrowing. For a financially highly geared company a small change in the total profits might have a very large proportionate impact on the profits for shareholders. A company with lots of fixed interest borrowing is "highly geared".

Fixed charge :- the assignment of specified assets of a company or an individual as security for a debt.

Floating charge :- the assignment of all the assets of a company or an individual as security for a debt.

Floating rate note (FRN) :-a Eurobond with a variable rate of interest. FRNs are usually medium term with interest paid quarterly based on a spread over 3-month Libor.

Floor :- see Collar

Foreign bond :- a bond issued in one country's domestic bond market by an overseas borrower.

Freehold :- the freeholder of land is in practice the absolute owner of it in perpetuity.

Fundamental analysis :- the analysis of a company's share value and potential for future profit and dividends, based on accounting and economic information.

Geometric index :- a geometric index is based on the geometric mean of the ratio of the share prices.

Global depositary receipt (GDRs) :- see Depositary receipt

Ground rent :- rent paid to the owner of land in respect of a ground lease granted to a developer who has the right to develop the land.

In-the-money :- an option with a positive intrinsic value is in-the-money.

Income cover :-a calculation made for loans issued by companies. The income cover is the number of times that the profit of the company (before interest payable and tax) covers the interest on the loan (including the interest on prior ranking loans).

Inflation risk premium :- the difference between the yield on a fixed income bond and the sum of the guaranteed real yield and the expected inflation rate on a similar index-linked bond. It is required as compensation for the uncertainty in the real return on the bond by investors with index-linked liabilities. Under the inflation risk premium theory the yield curve will tend to slope upwards because investors need a higher yield to compensate them for holding longer dated stocks which are more vulnerable to inflation risk than shorter dated stocks.

Intrinsic value :- for a call option, the greater of zero and the amount by which the market price of the underlying asset exceeds the exercise price. For a put option, the greater of zero and the amount by which the exercise price exceeds the market price of the underlying asset.

Introduction :- a method of obtaining a listing for an unquoted company which already has a large number of investors owning its shares. No new capital is raised by this means. It can also happen when a share is listed on a different stock exchange, or when a merger of two existing companies occurs and a new holding company is formed

Investment trust :- investment trusts are public companies whose function is to manage shares and investments. They have a capital structure in the same way as other public companies and can raise both loan and equity capital. Most have quoted shares allowing small investors to gain exposure to the portfolio held by the investment trust.

Leasehold :- a lease is an agreement which allows one of the parties (the leaseholder) the use of a specified portion of a building for a specified period in return for some payment.

Letter of credit :- a financial guaranty issued by a bank that permits the party to which it is issued to draw funds from the bank in the event of a valid unpaid claim against another party

Liquidity preference :- the liquidity preference theory is based on the generally accepted belief that investors prefer liquid assets to illiquid ones. Investors require a greater return to encourage them to commit funds for a longer period. Long dated stocks are less liquid than short dated stocks, so yields should be higher for long dated stocks.

Local authority bills :- short dated debt securities issued by UK local authorities. The investment characteristics are similar to Treasury Bills but yields are slightly higher due to the lower marketability and marginally higher risk of default

LIFFE, the London International Future and Options Exchange :- the derivative counter-part to the London Stock Exchange. It trades in futures and options where the underlying are shares or interest rates etc.

Managed fund :- (1) an investment contract by means of which an insurance company offers participation in one or more pooled funds. (2) an arrangement where the assets are invested on similar lines to unit trusts by an external investment manager.

Market maker :- an organisation which buys and sells securities on its own account. Market makers quote buying and selling prices for those shares in which they are prepared to deal.

Market risk :- market risk is the risk relating to changes in the value of a portfolio due to movements in the market value of the assets held.

Market segmentation :- market segmentation theory says that yields at each term to redemption are determined by supply and demand from investors with liabilities of that term.

Market value (of assets) :- the market value of a life insurance company's assets represents what they are worth in the open market, given a willing buyer and a willing seller.

Matching :- arranging assets and liabilities so that the cash flows generated by the assets can be expected to meet the liability payouts, either because the assets generate income of the right amount at the right time or because the market values of the assets are linked to the market values of the liabilities appropriately.

Matching :- this refers to the relationship - by size and incidence - between the cash-flows from the assets and those from the liabilities. The assets and liabilities of a life insurance company are said to be (absolutely) matched if the two cash flows cancel out. Otherwise, the company is said to be mismatched. In practice, absolute matching is almost impossible to attain, except in very special circumstances, and some degree of mismatching is therefore inevitable.

Mortgage debenture :- a mortgage debenture is a long term corporate debt security normally secured by a fixed charge on specified properties and ranks ahead of ordinary debentures offering the highest degree of security among corporate bonds.

Net Asset Value(NAV)/Net assets value per share :- the book value of the shareholders' interests in a company, usually excluding intangibles such as goodwill (NAV per share is NAV divided by the number of shares in issue).

Normal Market Size (NMS) :- the smallest block of shares in a particular company for which market makers can quote a price. It is approximately equal to the average number of the company's shares traded in a day.

Offer for sale :- a method of issuing shares of a previously unquoted company. The issuing house, often a merchant bank or specialised department of a stockbroker or clearing bank, underwrites the whole issue of the shares at a fixed price and offers them on to the public at a slightly higher price. An offer for sale may be made by tender. A minimum price is set and the public is invited to subscribe at this or a higher price. All shares are then issued at a common price - the striking price - which just satisfies the number of shares on offer. Any subscriber offering below the striking price will not receive any shares

Offer for subscription :- a method of issuing shares of a previously unquoted company. The shares in the company are offered directly to the public. There is no underwriting. This method could be used in conjunction with a tender offer instead of a fixed price.

Offer price :- the price at which a market maker is prepared to sell a particular security.

Open-ended Investment Company (OEIC) :- an investment vehicle very similar to an investment trust but with the open ended characteristics of a unit trust.

Operational gearing :- companies with high fixed costs and low marginal costs are said to have high ‘operational’ gearing. A small change in sales gives a big change in profits for such companies

Operational risk :- operational risk is the risk of loss due to fraud or mismanagement within the fund management organisation itself.

Option premium :- the price paid for an option. Received by the writer of the option.

Option writer :- the seller of an option.

Ordinary share :- a share in the equity capital of a company. Ordinary shareholders have the right to receive all distributable profits of the company after debt holders and preference shareholders have been paid. They also have the right to attend and vote at general meetings of the company.

OTC :- see Over-The-Counter

Out-of-the-money :- an option with no intrinsic value is described as being out-of-the-money.

Over-the-Counter (OTC) :- describes security dealings outside a recognised stock exchange for example the purchase of a derivative from a bank

Par yield curve :- a plot of coupon value on the y-axis against term to redemption on the x-axis. For each term, the coupon that would be required for a fixed interest bond of that term to be issued at par is plotted.

Payout ratio :- dividends divided by earnings per share. The inverse of dividend cover.

Placing/Selective marketing :- a new issue method where shares are placed with institutional clients of the issuing house rather than being offered to the public. Costs are low, as no underwriting is needed.

Policy switch :- a technique used in the active management of a bond portfolio. Making a policy switch entails taking a view on future changes in shape or level of the yield curve and moving into gilts with quite different terms to maturity and/or coupon.

Preference share :- a particular class of shares which generally rank ahead of ordinary shares. Preference shareholders are normally entitled to a specified rate of dividend, and, unlike ordinary shareholders, are not entitled to residual profits. Although part of a company's share capital, from an investment perspective preference shares are much more like fixed interest bonds.

Price earnings ratio :- the ratio of a share's price to its net earnings. The earnings per share used can be historic or prospective.

Prime Property:- property that is most attractive to investors. Prime property would score highly on all of the following factors: location, age and condition, quality of tenant, the number of comparable properties available, lease structure and size. to determine the rent at rent review and for valuation purposes.

Put option:- the right, but not the obligation, to sell a specified asset at a specified price at specified times.

Quantitative (quant) analysis :- modern mathematical techniques used to aid stock and sector selection.

Rack rent :- rent that would be received from a building if it were subject to an immediate open-market rental review. This may be different from the rent actually being received.

Real yield :- the yield on an investment after inflation has been allowed for. Often approximated as the difference between the yield realised and the rate of inflation over the corresponding period.

Redemption :- the return to an investor of the capital value of a bond or other security. Redemption may take place on a fixed date or on one of a series of specified dates. The bond may include an option for the borrower to choose the date or for the lender to choose. The capital amount repaid may be fixed or index-linked.

Redemption yield/Gross redemption yield :- the gross redemption yield (the word gross is often omitted), or yield to maturity, is the rate of return at which the discounted value of all future payments of interest and capital is equal to the "dirty" price of the bond. The net redemption yield allows for taxation of the amounts received by the investor.

Relative strength analysis :- a form of technical analysis where the performance of a share price is assessed relative to the market as a whole or a suitable market sector.

Repo market :- a market in which a holder of gilts or other securities can sell them to another party with an agreement to buy them back at a specified date for an agreed price. It can thus be used by market participants for secured lending.

Reverse yield gap :- the long-dated gilt yield minus the equity yield.

Reversion interest :- the interest of a freeholder or long term leaseholder, to whom the property will revert on expiry of a lease.

Rights issue :- a rights issue is where a company issues further shares, at a given price, to existing shareholders in proportion to their existing shareholdings. For example, a 1-for-5 rights issue allows each shareholder to buy one new share for each five currently held. The purpose is for the issuing company to raise more money.

Running yield :- the annual income on an investment divided by its current market value. Important examples are the flat yield on gilts, the gross dividend yield on equities and the rental yield on property.

Samurai bond :- a foreign bond issued in yen in the Tokyo bond market.

Scrip issue/capitalisation bonus issue :- a scrip issue is a further issue of new shares to existing equity shareholders. They receive free a number of shares in proportion to their holdings.

Settlement price :- the market price of a future at the end of each trading day.

Share split :- in a share split existing shares are split into two shares of half the original nominal value. No new money is raised and no reserves are capitalised.

Specific risk/alpha risk :- the risk of holding a share which is unique to the industry or company and can be eliminated by having a suitably diversified portfolio of shares of differing types of companies. This is sometimes also referred to as unsystematic risk.

Split capital investment trust :- an investment trust where the ordinary share capital consists of income shares and capital shares. Holders of income shares receive all (or most) of the distributed income while holders of capital shares receive little or no income but receive the residual value of the assets after income shares have been redeemed at a fixed value when the trust is wound up.

Spot interest rate :- the n year spot interest rate is the geometrical average of the interest rates that are expected to apply over the next n years. It is the redemption yield on an n year zero coupon bond.

Spread trade :- the purchase of one futures contract and the simultaneous sale of another in order to take advantage of relative price changes. Examples include buying one futures contract and selling another futures contract of the same underlying asset but different delivery month; buying a given delivery month of one futures contract and selling the same delivery month of a different, but related, futures contract.

Stamp duty :- the tax paid by the purchaser on the transfer of various types of asset, including UK shares.

Stock lending :- the lending of stock from one institutional investor to another (usually a market maker) often to allow the borrower to go short. The lender continues to be entitled to income generated by the stock and receives an additional consideration. Many institutional investors, such as pension funds, forbid their fund managers to undertake stock lending.

Straddle :- an option strategy involving one call and one put with the same strike and same expiry date.

Strangle :- an option strategy involving one call and one put with different strike levels but with the same expiry date.

Strap :- a strap consists of a long position in two calls and one put with the same exercise price and expiry date

Strip :- a combination of two puts and a call with the same exercise price.

Subordinated debt :- debt that ranks behind another class (senior debt) for repayment.

Swap :- a contract between two parties under which they agree to exchange a series of payments according to a pre-arranged formula.

Systematic risk :- the risk of the individual share relative to the overall market which cannot be eliminated by diversification. It is measured by the beta factor. A share with a beta greater than 1 is said to be aggressive, i.e. the price of the share is expected to do better than the market when prices rise. Conversely, a share with a beta less than 1 is a defensive stock, i.e. its price will be expected to fall by less than the market when prices fall.

Technical analysis :- estimation of future share prices based on the use of past share prices and/or trading volumes. Chartism is a form of technical analysis.

Term deposit :- a bank deposit for a fixed term. The interest rate may be fixed for the whole term or may vary at specified intervals.

Tick size :- the size of the minimum movement in a quoted price (eg 1/32nd for gilts).

Tick value :- the change in the value of a futures contract when the price changes by one tick.

Time value/Option value :- The excess of an option's value (or a security with an option feature) over its intrinsic value. Also known as "option value".

Touch :- the narrowest spread amongst the market makers between buying and selling prices. A narrow touch indicates good marketability.

Treasury bill :- a Government bill. Usually issued with a term of 91 or 182 days.

Underwriting :- in investment, underwriting is where an institution gives a guarantee to a company issuing new shares or bonds that it will buy any remaining shares or bonds that are not bought by other investors.

Vertical spread :- see bear spread

Volatility/Modified duration :- the sensitivity of the market price of an investment. A highly volatile investment is one which has a very unstable price. For fixed interest bonds, volatility is specifically defined as the rate of change in the dirty price (P) of the bond for a change in the gross redemption yield (y).

Warrant :- an option issued by a company. The holder has the right to purchase shares at a specified price at specified times in the future.

Yankee bond :- a foreign bond issued in dollars on the New York bond market by an overseas borrower.

Years purchase :- the present value of unit annual rental income from a property. Years purchase factors can be in respect of rent received in perpetuity (in which case they are the reciprocal of the yield), or they can be for a specified term (equivalent to an annuity certain).