

CLARITY



TRANSLATING THE JARGON

TERM	DEFINITION
Active management	Active decisions made on the selection of stocks, managers, funds, asset classes, etc with the aim of outperforming the market/benchmark.
Alpha (excess return)	The measure of the amount of return that is being driven by a manager's active decisions (stock selection or fund/asset allocation). It is determined by comparing the fund's return to an appropriate benchmark.
Benchmark performance	<p>This indicates how the benchmark of the investment performed. When compared to the gross return performance it shows whether decisions made by the portfolio manager have added value.</p> <p>For an asset class sector fund, the benchmark generally represents the performance that an investor could have achieved had they invested in a market index that is consistent with the asset class.</p> <p>For diversified investment options the benchmark is usually a composite of the underlying asset class sector funds.</p>
Beta	<p>Beta is the sensitivity of an asset's movement versus its benchmark.</p> <ul style="list-style-type: none">• Beta of 1 means the asset's volatility is the same as its benchmark• Beta of more than 1 means the asset is more volatile than its benchmark• Beta of less than 1 means the asset is less volatile than its benchmark
Correlation	Measure of strength of a relationship between two variables. Positively correlated assets move in the same direction while negatively correlated assets move in opposite directions.
Credit risk	The risk of default on a debt that arises when a borrower fails to make payments.
Currency carry	The tendency of higher interest rate currencies to earn higher returns than lower interest rate currencies as a compensation for higher risk.
Currency risk	The risk associated with the fluctuation of foreign exchange rates; also called foreign exchange risk.
Derivatives	Contracts (agreements to do something in the future) that derive their value from the performance of an underlying asset, event or outcome.
Diversification	The practice of combining assets and types of assets with less than perfect correlation in a portfolio to reduce overall risk.

Duration (interest rate risk)	The sensitivity of a bond's price to a change in interest rates.
Dynamic asset allocation (also called tactical asset allocation)	Decision to deliberately deviate from the strategic asset allocation in an attempt to add value or mitigate risks based on forecasts of the near-term relative performance of asset classes.
Factors	Factors are specific, single attributes of investable securities, such as the security's size, quality or valuation.
'Growth' style or factor	Seeks companies whose earnings are projected to be superior to the market average.
Index	A portfolio of securities (such as bonds or shares) that represent the market or a specific portion of it.
Inflation	Percentage increase in the general price level from one period to the next; a sustained rise in overall level of prices for goods and services. In Australia, we use Consumer Price Index (CPI).
Information ratio	The measure of an investment manager's skill. It is the magnitude of excess returns over the benchmark relative to the variability of these excess returns, measured as the ratio of excess return to tracking error. High information ratio is usually indicative of the manager having more skill.
Interest rate (Duration) risk	The risk associated with interest rate changes and their impact on bond prices and other financial instruments.
Investment styles	Fund managers focus on particular 'styles' (market segments or specific market factors, similar to the above under 'factors') in their investment processes based on their investment philosophy or belief set.
Liquidity	The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Assets that can be easily bought or sold are known as liquid assets.
'Momentum' style or factor	Focus on identifying those securities that have demonstrated strong performance (absolute or relative) over the past (typically 12) months, and are likely to continue that performance trend.
'Quality' style or factor	Focus on identifying companies that appear to have a greater ability to deliver sustainable returns to shareholders. These companies are typically characterised by high profitability, low leverage and low earnings volatility.
Passive management	A style of investment management that aims to achieve investment returns in line with those of a specified market or index. May also refer to a style of investment management that focuses on holding investments for an extended period rather than trading to maximise gains.
Rebalancing	The process of adjusting weights of the constituent securities in an index or the weights of assets in a portfolio, to realign the index/portfolio back to the original weights.
Sharpe ratio	Measure of risk-adjusted return (reward to variability), calculated as ratio of excess return (relative to the risk-free rate) to standard deviation (volatility).
Smart beta	Transparent, rules-based strategies designed to provide focussed exposure to specific factors, market segments or indices.
Standard deviation (commonly referred to as volatility)	An indication of how much actual returns vary from the average return. Asset classes with higher expected returns typically have higher standard deviation (volatility of returns), i.e. more uncertainty/fluctuations.
Strategic asset allocation	Long term mix of assets that is expected to achieve an investor's long-term objectives (and within constraints). It is typically reviewed annually for tracking against objectives and triennially in more depth.

Time horizon	Length of time over which an investment is held; it can vary depending on an investor's goals and constraints as well as on the nature of the investment. Shorter term horizons usually indicate that less volatile assets should be used.
Tracking error	Measures the standard deviation of the fund's excess return relative to benchmark. Tracking error is a useful tool to determine how much variability in fund returns is due to the active decisions of an investment manager.
'Value' style or factor	Seeks to invest in assets that are underpriced on the expectation prices will increase. With shares, the key ratio to judge whether stocks are underpriced or not is their relative price/earnings ratio.
Volatility (or standard deviation)	An indication of how much actual returns vary from the average return. Asset classes with higher expected returns typically have greater volatility.
'Volatility' style or factor	Focus on identifying companies that have more stable return patterns and avoiding the most volatile securities

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