Jargon buster

Investor education

The world of finance can sometimes seem like a scary place. Large and somewhat alien words are often thrown around when speaking about investment, which can be intimidating for those who have not had a chance to learn what they mean. Furthermore, asking for help can be a little bit awkward when everyone else appears to know what they mean.

At Russell Investments, we've put together a list of terms and meanings that can sometimes cause confusion.

Active management

A fund management style which attempts to exceed the returns of a benchmark index by using manager expertise to select and invest in securities that are expected to outperform the index.

Alpha

returns a security or fund has generated above the benchmark. Benchmarks are often indices, and sometimes theoretical factor models, which measure how much investors should have received in compensation for the risk they took. Sometimes called excess or abnormal returns.

Asset allocation

A representation of how a portfolio is invested among various available asset classes. For example, a fund may have an asset allocation of 5% domestic shares, 50% international shares, 10% property, 15% domestic fixed interest, 15% international fixed interest and 5% cash.

Basis point

one basis point is 0.01%, or 0.0001. There are 100 basis points to one percent. For example, if a fund manager charges a fee of 40 basis points per annum of assets under management, this is equal to 0.4%. For a fund size of $100m, 40 basis points would equal $400,000. Basis points are often abbreviated as bp.

Bear market

A market going through a downward trend dominated by pessimism. The opposite of a bull market.

Behavioural bias

decision making imperfections that cause investors and other agents to make suboptimal decisions.

Beta

a measure of a security's market risk. Market risk is a type of rewarded systematic risk. Shares with a higher beta are more risky and are usually expected to generate higher returns.

Bond

Bonds promise to pay fixed sums of money (coupons and face value) at pre-determined dates in the future. Also known as fixed interest or fixed income securities. Bonds are generally issued by governments, banks and companies looking to borrow money. Buying bonds makes you a lender to the organisation selling them.

Bull market

A market going through a upward trend dominated by optimism. The opposite of a bear market.

Cash

Normally used to describe money, cash can also be used to describe a financial product which usually comprises low-risk, low-return, short-term debt.

Cash flows

The distribution of tangible cash. Dividends, coupons and rent are examples of cash inflows to investors, while reinvestments are examples of cash outflows.

CCFs

Collateralised commodity futures. Futures contracts on commodity products, which require a margin up-front.

Commodities

A tangible, basic good used for production or consumption. Ownership of commodities is traded on exchanges.

Commodities are also often used as investments. Examples include gold, cotton, coffee, oil, or wine.

Correlation

A measure of linear relationship specifically, how well one variable can be used to linearly estimate another. Often used in the context of security returns and diversification.

Coupon

The regular interest payment associated with a bond or similar debt security. The total interest payment is given by the coupon rate multiplied by the face/par value of the bond.

Custodian

The entity which technically holds assets on behalf of investors. It keeps custody of securities and other assets of a mutual fund for purposes of safekeeping. The custodian may collect income and do some simple reporting on the value of the assets.

Diversifiable risk

The portion of total risk that can be reduced by diversification in the portfolio. Diversifiable risk is generally assumed to be unrewarded because it is easily removed.

Diversification

the process of adding securities to your portfolio to reduce total risk. Because securities often don't move perfectly with each other, combing multiple, imperfectly-correlated securities means that the total volatility of your investments has reduced.

Dividend

A payment to shareholders, which can come from a company's after-tax earnings or reserves. A dividend normally represents a portion of a company's profit paid to shareholders.

Dividend yield

Dividend payment divided by share price. For example, a stock selling for $2 per share that has paid an annual dividend of $0.10 per share has a 5% dividend yield.

Duration

An umbrella term that may refer to a range of horizon-based bond characteristics. Commonly used to either refer to the maturity of bonds, or cash flow measures such as Macaulay, modified or effective duration. The latter terms estimate the sensitivity of a fixed income product to interest rate changes.

Efficient market

a market in which all publicly-available information is incorporated into security prices. An efficient market suggests that the only driver of higher expected returns is higher risk.

ETF

Exchange traded fund. Shares that represent part ownership of a fund that has invested in a portfolio of securities and are traded on a public stock exchange.

Because of how ETFs are priced, the value of an ETF share is usually proportionally equal to the individual securities into which the fund has invested.

Expected returns

The returns an investor assumes their investment will generate. In an efficient market this is equal to required returns, but if securities are improperly priced it may be more or less.

Futures contract

An agreement to trade certain securities or commodities at a given future date, for a given price.

Government bonds

Bonds issued by a government. Also known as government stock, treasury bonds and sovereign bonds.

Growth assets

A term given to securities that often include shares and property. Growth assets are expected to provide strong investment returns over the long term compared to income assets. They are termed 'growth' assets as the majority of their return is expected to come from capital gains rather than dividends.

Hedge funds

Funds that employ strategies to earn abnormal returns. Traditionally hedge funds were market neutral such that their portfolios were 'hedged' against market movements, hence their name. Hedge funds often employ more complicated investment strategies than mutual funds, and subsequently charge higher fees. Hedge funds are also less regulated.

Hedging

The process of eliminating any upside or downside risk of an investment. Usually done through financial contracts such as options and futures.

Imputation credits

Tax credits that represent tax paid by companies that are passed onto shareholders.

Income assets

A term given to securities that often include bonds and cash products. Income assets are expected to provide reliable cash flows and returns to investors but lower long-term returns compared to growth assets. They are termed 'income' assets as the majority of their return is expected to come from coupon payments rather than capital gains.

Index

A basket of securities which is created based on a set of rules. These rules are often put in place to allow the index to represent a particular market or sector. Indices allow for investors to quickly determine how a market as a whole has performed.

Inflation

A measure of the average increase in domestic price levels, and a corresponding fall in the value of domestic currency. Often measured as the change in price of a basket of goods and services consumed in the country.

Information ratio

portfolio returns minus benchmark returns divided by tracking error. The information ratio measures active management efficiency. A higher information ratio suggests that the fund manager is able to generate greater alpha per unit of benchmark relative risk.

Multi-asset fund

A type of managed fund that invests in more than one asset class. For example, a mutual fund that offers a product with weightings in both global equities and global bonds is an example of a multi-asset product.

Mutual funds

Funds that pools money from many investors to invest in a portfolio of securities. Investors buy shares or units in these funds.

Options

The right, but not the obligation, to trade certain securities or commodities at a given future date, for a given price called the strike price. Call options give the holder the right to buy at that strike price, while put options give the holder the right to sell.

Passive management

Management style where the fund manager aims to match closely the returns achieved by a particular index.

Portfolio

The aggregate of an investor's ownership of financial securities (and asset classes). Portfolios can be compared by the securities or assets classes in them, along with the weights given to each.

Private equity

Investment in the shares of companies which are not publicly traded (i.e., not listed on a stock exchange).

Required returns

The returns an investor needs to compensate them for the risk being taken.

Return

The total change in the value of an investment portfolio, usually expressed as a percentage. Return can comprise of income and/or capital gains.

Risk

The variability (or volatility) of returns. Generally speaking, the higher the level of risk an investor is required to bear, the higher the required return.

Risk-free rate

The return that is required for investing in an asset which has no risk. However, the risk-free rate is a theoretical concept only since technically all investments carry some form of risk. In practice, a common proxy for the risk-free rate is the interest paid on three-month US government Treasury bills.

Risk premium

The additional return required on top of the risk-free rate as compensation for investing in a risky security. The riskier a security, the greater the risk premium.

Shares

An investment that represents part ownership of a company. Also known as stock or equity. Investing in ordinary shares makes you a shareholder of the company and provides a claim to a proportion of the assets of the company along with any distribution of future profits, known as dividends.

Sharpe ratio

Expected returns minus the risk free rate divided by volatility. Sharpe ratio is a measure of portfolio efficiency calculated as expected returns per unit of risk. A higher Sharpe ratio indicates greater portfolio efficiency.

Systematic risk

The portion of total risk that cannot be reduced by portfolio diversification. Also referred to as market risk or beta risk. The greater the systematic risk of a security (or asset class), the higher the return required by investors.

Tracking error

The difference in returns of a portfolio or fund, and the index it was designed to track (or in the case of active managers, outperform). Tracking error is a measure of how closely the benchmark index is followed.

Venture capital

A type of private equity that generally focus on providing funding to start-up companies and small businesses.

Volatility

A popular measure of the risk of an investment. Calculated as the standard deviation of returns around their average.

Yield

Equal to a bond's coupon payment divided by the current market price of the bond. Also known as current yield.

Yield to maturity

The expected compound return of a bond if the issuer does not default. Yields have a negative relationship with bond prices, as yields fall, prices rise and vice versa.

Important information

The information contained in this publication was prepared by Russell Investment Group Limited. It has been compiled from sources considered to be reliable but is not guaranteed. This publication provides general information only and should not be relied upon in making an investment decision. Before making an investment decision, you need to consider whether this information is appropriate to your objectives, financial situation and needs. All investments are subject to risks. Past performance is not a reliable indicator of future performance.

Copyright © 2020 Russell Investments. All rights reserved. This information contained on this website is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments.