Investment Terms

Glossary of Investment Terms

Absolute Return Fund: see Hedge Fund.

Active Management: a form of investment management that involves buying and selling financial assets with the objective of earning returns greater than a specified benchmark.

Active Management Return: the difference between a portfolio's return and the benchmark's return.

Active Management Risk: the risk taken by an active portfolio manager to earn active management returns by taking positions different from the benchmark; typically measured by the standard deviation of active management returns.

Actuary: a person or firm that specializes in estimating the liabilities associated with a benefit plan or an insurance trust.

Agency Conflict: the potential for conflict of interest between an agent and the person or organization for which the agent is acting.

Alternative Investment: a term used to categorize assets other than traditional publicly traded stocks and bonds, including but not limited to private equity, real estate, hedge funds, commodities, timber, and infrastructure.

Asset Allocation: the process of determining the desired division of an investor's portfolio among available asset classes.
Asset Class: a broadly defined generic group of financial assets, such as stocks or bonds.

Benchmark: a portfolio with which the investment performance of an investor can be compared for the purpose of determining investment skill. A benchmark portfolio represents a relevant and investable alternative to the investor's actual portfolio and, in particular, is similar in terms of risk exposure.

Benefits: periodic payments promised or expected to be made to the designated beneficiaries of a pool of assets.

Benefit Security Ratio: see Funded Ratio.

Bond (also Fixed-Income Security): a type of investment in which the holder lends money to another entity and is then entitled to periodic payments of interest and a return of the capital at a specified time in the future.

Buyout: a form of private equity in which a partnership buys all the shares of a public company, usually taking on a large debt, to operate the company privately with the intention of eventually making a profit by taking the company public again or selling part or all of it to another business.

Commingled Fund: an investment vehicle that sells units of ownership in itself to one or more investors and uses the proceeds to purchase financial assets for the benefit of the investors. The investors have a pro rata claim on the assets of the fund proportional to their unit ownership.

Common Stock (also Equity; Stock): legal representations of an ownership position in a corporation.

Commodity: a physical (real) asset used as an input to a production process. Many commodities are traded in cash (spot) markets or on organized exchanges in the form of futures contracts.

Conflict of Interest: a situation in which a person who has a duty to one party acts in such a way as to benefit the person (or a related party) at the expense of the party to whom the duty is owed.

Contributions: money added to a pool of assets for the purpose of investment and, eventually, payment of benefits.

Correlation: a statistical measure of the co-variation of two random variables (i.e., how much two variables change together).

Custodian Bank: a type of bank that provides safekeeping of financial securities for an investor, including the related accounting and reporting services.

Defined-Benefit Plan: a retirement plan in which the participants are promised a fixed benefit. The sponsoring organization takes the risk that its investments will be sufficient to provide these benefits.

Defined-Contribution Plan: a retirement plan in which a participant (and perhaps a sponsoring organization) makes fixed contributions and the participant bears the risk that the assets will be sufficient to provide adequate benefits upon retirement.

Diversification: the process of investing in more than one type of asset to reduce the risk of the entire portfolio.

Endowment: a gift, usually to an educational institution, whose purpose is to provide funding for a particular mission in perpetuity. Collectively, an aggregate of such gifts being managed in a single strategy.

Equity: see Common Stock.

Expected Return: the return on a security (or portfolio) that an investor anticipates receiving over a given time horizon.

Fiduciary: a person or entity that assumes responsibility to manage or oversee a pool of assets on behalf of some other person or entity, such as a pension fund or endowment. The fiduciary has a duty to act solely for the benefit of that entity (not himself/herself or some other entity).

Fiduciary Duty: a legal or ethical relationship of confidence or trust between two or more parties.

Financial Asset (also Security): a legal representation of the right to receive prospective future benefits under stated conditions.

Fixed-Income Security: see Bond.

Foundation: an entity that has some public mission (e.g., to cure a given disease) and provides grants to other entities to further that mission (e.g., by conducting scientific research to find a cure). It owns a pool of assets that are invested to provide income to fund that mission.

Funded Ratio (also Benefit Security Ratio): the ratio of the value of a fund's assets to the value of the fund's liabilities.

General Partner: an individual or firm that sources and obtains financing for the purchase of an asset and then manages that asset on behalf of other providers of capital (the limited partners).

Governance Structure: the set of processes by which a fund is managed for the benefit of some group of beneficiaries.

Growth Stocks: a segment of an equity market characterized by the stocks of companies that have experienced or are expected to experience earnings per share growth higher than the market as a whole. They also tend to display high price-to-earnings ratios relative to the market. Also called "glamour stocks."

Hedge Fund: a form of active management distinguished by a lack of traditional guidelines or benchmarks; a hedge fund typically uses derivatives, leverage, and/or short selling. The term is often synonymous with absolute return fund.

Indexing: see Passive Management.

Information Ratio: a risk-adjusted measure of portfolio active management performance. Mathematically, over an evaluation period, it is the annualized ratio of active management return to active management risk, where risk is measured by the standard deviation of the portfolio's active management returns.

Investable Universe: the aggregate of securities that is appropriate and available for selection under a particular investment mandate.

Investment Committee: a group of individuals who are responsible for determining the investment policy of a fund.

Investment Consultant: a professional (usually associated with a firm) who offers advisory services to a fund, most often in the areas of asset allocation, investment policy and manager selection.

Investment Manager: a person or entity that creates and manages portfolios of securities for clients with money to invest.

Investment Policy: a component of the investment process that involves determining a fund's mission, objectives, and attitude toward the trade-off between expected return and risk.

Investment Policy Statement: a formal written document describing a fund's investment policy.

Investment Return: the percentage change in the value of an investment in a financial asset (or portfolio of financial assets) over a specified time period.

Investment Risk: the potential for loss accepted by an investor in the pursuit of investment return; alternatively, the uncertainty associated with the end-of-period value of an investment.

Investment Skill: the ability of an active manager to select portfolios that consistently have average returns greater than a given performance benchmark.

Liability: the present value of the accrued benefits promised to the beneficiaries of a fund.

Limited Partner: an individual or entity that provides equity financing to a general partner for the purchase of an investment but does not participate in the ongoing management of the investment.

Liquidity: property of a security that allows investors to convert the security to cash at a price similar to the price of the previous trade in the security (assuming that no significant new information has arrived since the previous trade).

Mandate: the strategy or performance benchmark used by an investment manager on behalf of and at the direction of a client.

Market Capitalization: the aggregate market value of a security, equal to the market price per unit of the security multiplied by the total number of outstanding units of the security.

Market Cycle: a period of time over which a particular security market moves from one peak to another or one trough to another.

Market Index: a collection of securities whose values are averaged to reflect the overall investment performance of a particular market for financial assets.

Money-Weighted Rate of Return: the rate of return on a portfolio over a particular period of time. It is the discount rate that makes the present value of cash flows into and out of the portfolio, as well as the portfolio's ending value, equal to the portfolio's beginning value.

Mutual Fund: a managed investment company, with an unlimited life, that stands ready at all times to purchase its shares from its owners and usually will continuously offer new shares to the public.

Overfunded: the status of a fund whose assets are greater in value than the associated plan's liabilities.

Passive Management (also Indexing): the process of buying and holding a well-diversified portfolio designed to produce substantially the same returns as a specified market index.

Peer Group: a set of investors (funds or managers) whose returns are used for a comparison with those of a given fund to determine how the given fund ranks among similar funds.

Performance Appraisal: the part of the performance evaluation process that attempts to determine whether the investment returns over an evaluation period have been achieved by skill or luck.

Performance Attribution: the part of the performance evaluation process that identifies sources of returns for a portfolio relative to a designated benchmark over an evaluation period.

Performance Evaluation: a component of the investment process involving periodic analysis of how a portfolio performed in terms of both returns earned and risks incurred.

Performance Measurement: the part of the performance evaluation process that calculates a portfolio's rate of return over an evaluation period.

Plan Participant: a member of a defined-benefit or defined-contribution plan to whom benefits are promised or are being paid.

Policy Asset Mix: a set of asset classes and desired percentage allocations to each such that the total portfolio displays the investor's desired risk and expected return profile; also referred to as the "policy portfolio," "policy benchmark," "policy asset allocation," or "strategic asset allocation."

Private Equity: a broad asset class generally involving buyouts, venture capital, and distressed debt converted to equity.

Real Estate: an investment in land and physical structures intended to provide a stream of rental or lease income and possibly capital appreciation.

Rebalancing: the process of buying and selling assets to restore a fund to its policy asset mix after market movements or net cash flows have changed the actual market weights of the various asset classes.

Relative Performance: the difference between a portfolio's return and the benchmark's return.

Risk Budgeting: a risk management technique in which assets are allocated efficiently so that the expected return of each asset is proportional to its contribution to portfolio risk.

Risk Management: a part of the investment process in which the risks of a portfolio are identified and quantified; then, strategies are developed to control those risks.

Risk Tolerance: the trade-off between risk and expected return demanded by a particular investor.

Scenario Analysis: a process whereby, for the purpose of designing appropriate investment strategies, an investor considers a number of possible future economic investment environments and the likelihood of those environments occurring.

Security: see Financial Asset.

Separately Managed Account: an investment vehicle that takes in funds from a single investor and uses the proceeds to purchase financial assets for the sole benefit of that investor. The investor directly owns all assets held in the account. Also called "separate account."

Sharpe Ratio: a risk-adjusted measure of portfolio performance in which risk is measured by the standard deviation of the portfolio's returns. Mathematically, over an evaluation period, it is the annualized ratio of excess return (actual return less the risk-free return) of the portfolio divided by the portfolio's standard deviation.

Staff: the professionals who, on a day-to-day basis, administer the investment program of a fund.

Standard Deviation: a statistical measure of the variability (range of potential outcomes) of investment returns.

Stock: see Common Stock.

Stress Test: a form of analysis in which one estimates the impact of various adverse situations on the returns of a portfolio.

Taft–Hartley fund: a multi-employer defined-benefit plan whose beneficiaries are members of a labor union with members working for multiple employers.

Time-Weighted Rate of Return: the rate of return on a portfolio over a particular period of time. Effectively, it is the return on $1.00 invested in the portfolio at the beginning of the measurement period.

Trustee: a person who has fiduciary responsibility for a pool of assets.

Uncertainty: the state of incomplete knowledge about the present and future with respect to an investment.

Uncorrelated: condition in which the returns of two or more assets do not go in the same direction at the same time.

Underfunded: the status of a fund whose assets are less in value than the liabilities for which those assets exist.

Value Stocks: a segment of an equity market characterized by the stocks of companies that have experienced poor past price performance or whose issuing companies have experienced relatively poor past earnings compared with the market as a whole. They tend to display low price-to-earnings ratios relative to the market. Also called "distressed stocks."

Venture Capital: a form of private equity involving non-publicly traded equity investments in which a general partner provides capital to an entrepreneur to begin or grow an enterprise with the intention of eventually making a profit by taking the company public or selling it to another business.

Volatility: the characteristic that financial asset returns vary over time in unpredictable ways or amounts. This term is often used interchangeably with the standard deviation of the asset's returns.