VANDERBILT Ave.
ASSET MANAGEMENT

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GLOSSARY

Active management: A money-management approach that seeks to outperform the market through the application of informed, independent investment judgment. The opposite of passive management, or "indexing," which seeks to replicate market performance through the construction of a portfolio mirroring the composition of the market. Also, in bonds, as opposed to buying and holding to maturity.

Asset allocation: The mix of stocks, bonds, cash equivalents and other assets in which your capital is invested.

Barbelled portfolio: A bond portfolio emphasizing securities with both short and long maturities, avoiding the intermediate range. Other commonly employed configurations are *ladders*, portfolios where maturities are evenly spaced along a continuum, and *concentrated* portfolios, with securities clustered around one maturity. Different maturity strategies work best in different bond markets.

Call: The right that some bond issuers have to redeem a bond at stated times prior to maturity for a stated price, typically exercised when interest rates fall. Call represents a risk for bondholders, compensated by extra yield, which may or may not be *adequate* compensation. With the opposite of a call, a *put*, the *bondholder* has the option to sell the bond back to the issuer at a stated price, and so putable bonds usually yield less than the prevailing market rate.

Capital gain (or loss): Increase (or decrease) in the market value of a stock, bond or other investment asset. A part of total return, along with interest or dividend payments.

Capital markets: The universe of publicly traded securities, including stocks, bonds and money-market instruments worldwide.

Cash equivalents: Very short-term investments, coming due in a year or less—the maturity range of money-market funds and Treasury bills. Similar to cash in liquidity and safety from market volatility.

Correlation: The degree to which two assets behave alike under differing market conditions. The more they behave alike, the greater their positive correlation; the more they behave in opposite ways, the greater their negative correlation. The less positively correlated two assets are, the more one will diversify the other—and, the more the combination will lower an investor's overall risk.

Derivatives: Securities whose values are linked to, or derived from, other securities. These include well-established instruments like futures and options, as well as newer, more complex vehicles, many related to mortgage-backed bonds. Taken as a whole, derivatives encompass a broad array of securities that span a gamut in risk from safer than most bonds to highly speculative.

Developed markets: The capital markets of countries where economies are mature, such as the U.S., Canada, most of western Europe and Japan; the term is also used to refer to the countries themselves. The most commonly used index of the developed foreign markets, the "EAFE" index of Europe, Australia and the Far East, comprises 21 countries (*contrast with "Emerging markets"*).

Discount bonds: Bonds selling below face value because their interest payments are lower than prevailing interest rates.

Diversification: Investing in more than one asset at the same time for the purpose of lowering risk. A stock portfolio is diversified the more stocks it contains; an investor's overall portfolio is diversified the more different asset classes it contains (domestic and foreign stocks, taxable bonds, municipal bonds, money-market instruments, etc.). The greater the diversification, all else equal, the lower the investor's risk.

Duration: A measure of interest-rate sensitivity related to maturity and other factors, and expressed in years. Duration indicates how much a bond's price can be expected to fall if interest rates rise by a certain percentage, or how much the bond's price will rise if interest rates fall. For each year of duration, a bond's price will drop (or rise) roughly 1% for every percentage-point rise (or drop) in rates.

Emerging markets: Countries where economies are in the developmental stage, such as Brazil, India, Thailand and Turkey.

Equities (stocks): Securities representing shares of ownership in the issuing enterprise, as distinct from fixed-income investments (bonds), which represent loans to the issuer.

Expected return: A measure of the value of an investment, taking account of its current price and the estimated future cash flow to the investor. The higher the current price in relation to future estimated cash flow, the lower the expected return; the *lower* the price in relation to future cash flow, the *higher* the expected return.

Fixed-Income securities (bonds, notes, bills, etc.): Securities representing loans to governments, agencies, corporations or banks for a stated period at a fixed interest rate—as opposed to equities (stocks), which represent shares of ownership.

"Growth" stocks: Stocks of companies prized for fast sales and earnings growth; often selling at high prices in relation to current company characteristics (the kind of stocks favored by "growth investors").

Hedging (currencies): Eliminating some or all of one's exposure to a foreign currency by trading that currency for U.S. dollars.

Income: Interest payments for bonds, dividends for stocks. The most reliable portion of investment return.

Market timing: Switching out of, or into, stocks or bonds according to one's prognostication of how the markets will do in the short run.

Money-market investments: See "Cash equivalents."

Mortgage-backed securities: Bonds backed by pools of mortgages. Interest and principal payments on the mortgages are used to pay the bondholders.

Par bonds: Bonds selling at face value.

Premium bonds: Bonds selling above face value because their interest payments are higher than prevailing interest rates.

Prerefunded bonds: Bonds whose principal and interest payments are backed by Treasury bonds or other obligations issued or guaranteed by the federal government, which are held in escrow. Generally municipal bonds.

Price/book value: The ratio of a stock's current price to its earnings per share, either actual or forecast. A lower P/E ratio than that of the average stock is often associated with superior investment value, and vice versa.

Risk/reward tradeoff: The amount of return (or expected return) for the risk incurred, or the amount of return sacrificed to lower risk.

T-bills: Treasury bills (see "Cash equivalents").

Total return: All the return an investor receives on a specific investment over a stated period, including realized or unrealized capital gain or loss, and dividends or interest; expressed as a percentage of the investment's value at the beginning of the period. Total return is the true measure of investment results, as distinct from either income, yield or price appreciation alone, since total return measures the total change in value of an investment over a given period (aside from the investor's own withdrawals or additions).

"Value" stocks: Stocks selling at low prices in relation to company assets, sales and earnings power (the kind of stocks favored by "value investors").

Volatility: Variability, fluctuation. In investing, the range of outcomes for a given investment over a period of time. The smaller the range of an investment's returns, the lower the investment's volatility, and vice versa. One of the most common measures of investment risk.

Yield: One component of investment return: a high yield is often an indication of superior investment value. In fixed-income investments current yield, one type of yield calculation, represents the interest payments of a security expressed as a percentage of its current market price. Yield to maturity, another widely quoted measure, uses a more complex formula that also factors in the difference between a security's current price and its par value at maturity. Regardless, yield and total return often differ because of changes in interest rates, changes in credit quality and other events that cause capital gain or loss in bonds.

In stocks, yield means the current annual dividend expressed as a percentage of the current price of the stock. Here, too, yield and total return differ, since return also includes price appreciation/deprication. High yield in a stock means dividends are high in relation to current price.

Yield curve: The line connecting the yields of bonds from one end of the maturity spectrum to the other. Called a "curve" because yields typically rise sharply as maturity lengthens at the short end of the spectrum, and rise more gradually at longer maturities, so that if you draw a line connecting all the yields, it will generally be curved rather than a straight diagonal.

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