

# Glossary

of Key Investment Terms





## Absolute Return

The percentage change in value of an asset or portfolio over a given period of time. The portfolio's or asset's absolute return can be compared with that of a benchmark to derive "relative return." (See Benchmark, Relative Return and Total Return.)

## Absolute-Return Strategy

An investment strategy that seeks to generate the highest possible absolute return within specified, often multiple, asset classes without the construction limitations imposed when managing against a specific benchmark. By separating itself from a benchmark, an absolute-return strategy seeks to generate a positive return regardless of the positive or negative performance of relevant markets.

## Active Return

The performance difference between a portfolio and a benchmark that is attributable to an investment manager's decisions to construct a portfolio of securities that differs from the benchmark's construction. For example, if a portfolio of securities selected by an investment manager returned 5% while the benchmark returned 3%, the portfolio's "active return" is 2%. Active return is only possible when a manager takes on active risk. (See Active Risk.)

## Active Risk

The risk that the performance of a portfolio will differ from a benchmark and the risk that is attributable to an investment manager's decisions to construct a portfolio of securities that differs from the benchmark's construction. Active risk is typically

measured as the standard deviation of active returns and is often referred to as tracking error. Investment managers must take on active risk in order to seek active return. (See Active Return.)

## Alpha

Alpha is a beta-adjusted measure of return. Positive alpha indicates that an investment portfolio has earned, on average, a premium above what is expected for the level of market variability (beta). A negative alpha indicates that the investment portfolio has received, on average, a premium lower than that expected for the level of market variability. (See Beta.)

## Arbitrage

A trade that exploits price differences between two or more markets involving similar financial instruments—the profit being the price spread between the prices in the different markets. Arbitrage is common in the currency, stock and bond markets. For instance, an investor may identify an exchange-rate disparity for a given currency in two countries. The investor may sell a given currency in the US where the exchange rate is higher and then repurchase the same currency in the UK where the exchange rate is lower, pocketing the difference.

## Ask Price (Offer Price)

Typically the lowest price that a seller is willing to accept for a security—the counterpart of the bid price, which is the highest price that the buyer is willing to pay. The difference between the ask price and bid price is known as the bid-ask spread. (See Bid-Ask Spread and Bid Price.)

## Bankruptcy

A judicial, regulatory or administrative proceeding or filing that is triggered when a company is unable to meet its debt obligations. Bankruptcies typically end either with reorganization and debt relief or with liquidation of the company.

## Basis Point

One hundredth of one percentage point (0.01%).

## Benchmark

A standard barometer against which investments can be measured in terms of performance, characteristics, construction and similar criteria. Sometimes widely recognized instruments (e.g., US Treasuries) or interest rates (e.g., the US fed funds rate or LIBOR) serve as benchmarks. More commonly, a benchmark is composed of an unmanaged group of securities with the same general characteristics as the portfolio being measured against it. Stock indices such as the S&P 500, the FTSE 100 and the Nikkei 225 are commonly used for equities, while indices such as the Lehman Aggregate or the Nomura Bond Performance Index are commonly used in fixed income. (See Market Weight, Overweight and Underweight.)

## Beta

A measure of the expected change of a security's or portfolio's return relative to that of the market. By definition, the beta of a benchmark index is 1.00. A security with a beta of more than 1.00 tends to rise or fall more than the market; a security with a beta of less than 1.00 tends to rise or fall less.

## Bid-Ask (Bid-Offer) Spread

The difference between the selling and purchasing price of an asset. (See Ask Price, Bid Price and Spread.)

## Bid Price

The purchase price that a buyer is willing to pay for an asset. (See Ask Price and Bid-Ask Spread.)

## Bond

A security that pays interest. The issuer agrees to pay the bondholder a regular set sum based on the amount borrowed and the bond's coupon, and to repay the principal amount of the loan at a future date. Many variations exist on this basic format, including bonds with no coupon and with variable coupons; bonds may also contain call or put provisions. The price of a bond is quoted assuming a par value of 100; thus, if a bond price is quoted as £90 and the principal value of the actual holding is £1,000, that holding is valued at £900. A bond selling above 100 is said to be trading at a premium; at 100, at par; and below 100, at a discount. The price varies over the life of the bond as interest rates, perceived credit quality and other factors fluctuate, and as the bond approaches its maturity date. A bond's price is inversely related to its yield: It rises when the bond's yield falls and declines when the yield rises.

Bonds belong to the fixed-income asset class. (See Call Provision, Coupon, Maturity, Par or Face Value and Put Provision; also, see The Major Fixed-Income Sectors, page 15.)

## Book Value

An accounting term that defines the net value of an asset as it appears on a company's balance sheet; a company's book value is equal to its total assets minus its total liabilities.

## Call Option

A contract that gives an investor the right to buy a specified asset at a predetermined price and date prior to the security's stated maturity, if any (common stock doesn't have a maturity), or the date that the issuer makes the final payment to the security holder. (See Put Option.)

## Call Provision

A bond feature that allows the issuer to retire the debt, in full or in part, prior to the bond's stated maturity date. Such a feature is favorable to the borrower, who can retire the bond and replace it with a lower-coupon issue if market rates fall. Conversely, such a feature is detrimental to the investor, who risks losing the higher-coupon bond when rates fall. Because of this disadvantage to the investor, callable bonds typically yield more than otherwise comparable bonds without a call provision. (See Put Provision.)

## Cap-Weighted Index

An index weighted by the market capitalization of each security in the index. Larger-cap companies thus account for a greater portion of the index. For example, if a company's market capitalization is \$1 billion and the market capitalization of all securities in the index is \$100 billion, the company would be 1% of the index. An index may also be fixed weighted, with each security, sector or country having a

specified weight; fixed-weight indices are often equal weighted. (See Equal-Weighted Index.)

## Cash Earnings

Net earnings, excluding intangibles such as goodwill. The higher the proportion of cash earnings to reported earnings, the higher a company's earnings quality is deemed to be. (See Earnings per Share.)

## Compressed Valuations

When the difference between the highest- and lowest-priced segment of a stock market is much smaller than usual. This limits an investor's opportunity to buy value stocks trading at deep discounts but increases the ability to buy faster-growing stocks at a lower-than-usual premium to the market. (See Growth Stock and Value Stock.)

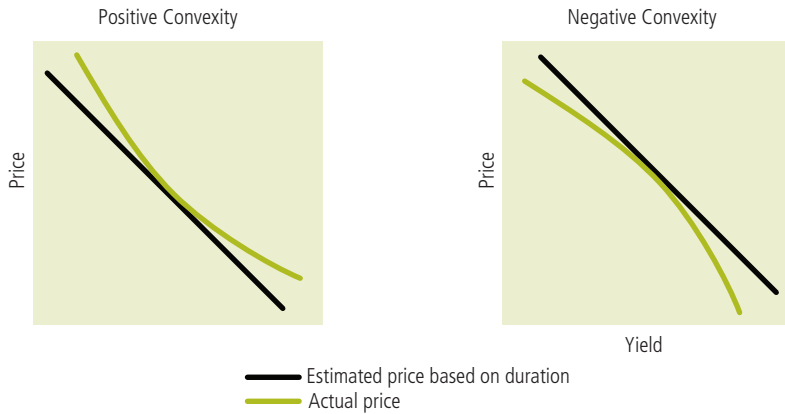
## Convertible Bond

A bond that, at the option of the issuer or the investor, can be exchanged for common stock of the issuing company, at a predetermined conversion ratio and at predetermined dates. Some convertible bonds are convertible throughout their lives. Although a convertible bond is chiefly a fixed-income instrument, its price tends to be highly influenced by the stock price.

## Convexity

A measure of a bond's price volatility that, in conjunction with duration, describes its sensitivity to changes in interest rates, particularly when the change in rates is sizable. Duration describes a linear relationship between yield and price that holds true only for small shifts in rates. As rate shifts increase in magnitude, a bond's dura-

## Positive and Negative Convexity



tion changes, causing it to become more or less sensitive to the change in rates than would be expected based on a static duration measure. Convexity aims to describe that changing relationship. Bond convexity falls into two camps: positive convexity and negative convexity. The durations of bonds with positive convexity—most option-free bonds—lengthen when rates fall and shorten when rates rise. This is a beneficial effect, as it means that their prices rise faster and fall more slowly than in a one-to-one, linear relationship with incremental changes in yield. The durations of bonds with negative convexity experience the opposite effect: They lengthen when rates rise and shorten when rates fall, causing their prices to fall faster and rise less rapidly than in a linear relationship with yield. Mortgages, which have implicit call options (the homeowner may prepay at any time), and corporate bonds that have embedded call provisions exhibit negative convexity. (See Duration.)

### Coupon

The rate at which a bond pays interest, expressed in percentage terms. A bond with a 4% coupon and a principal value of £1,000 would pay £40 annually to the bondholder. Coupon payments are typically made either annually or semiannually, according to the terms of the bond's covenant. The coupon may be fixed or variable.

### Credit Rating

A measure of credit quality. Bond-rating agencies such as Moody's Investors Service, Standard & Poor's and Fitch Ratings publish issuer ratings that, in their view, reflect the likelihood that the issuer will default on interest and principal payments. Rating systems vary from agency to agency; generally, however, bonds rated triple A (AAA or Aaa) are of the highest quality, while those rated below triple B (BBB or Baa) are of the lowest quality and are considered speculative or non-investment grade.

## Credit Risk

The risk that a bond issuer may default on its debt obligations or that a counterparty will default on a payment in the sale or purchase of a negotiable instrument. (See Default.)

## Currency Forward

A contract that obligates participants to buy or sell a specified quantity of a currency at a specified price on a specified future date. Investors often use these contracts to lock in the current value of a foreign currency that the investor expects to lose value against his or her home market.

## Current Coupon

The prevailing coupon rate in the new-issue market for securities that are priced at or close to par. (See Discount Coupon and Premium Coupon.)

## Cyclical Stock

Equity in a company that makes products or provides services that tend to be in demand during periods of strong economic growth and out of favor when the economy is weak. Examples include commodities and durable goods, both of which are in greater demand during economic booms. (See Defensive Stock.)

## Cyclical Trend

Recurring movements in prices or interest rates, usually linked to different stages in a business cycle. (See Secular Trend.)

## Debt-to-Equity Ratio

A company's debt (borrowings) divided by the market value of its shareholder equity.

## Default

An event triggered when a debt obligor fails to pay the interest or principal of its obligations and a specified grace period has expired.

## Defensive Stock

Refers to a company that tends to produce goods or services that are in demand irrespective of economic cycles, such as health-care companies or utilities.

## Derivative

A tradable financial instrument that derives its value from underlying assets—such as stocks, bonds, market indices, commodities and livestock. It is typically a contract based on the buyer's/seller's assumptions regarding the future price of the underlying assets. Given the uncertainty of future prices, participants often hedge their bets by entering into a contract for a future sale or purchase at a specified price. This contract, or financial instrument, is the derivative. (See Future, Hedging and Option.)

## Discount Coupon

A rate below current coupon. Bonds with discount coupons are typically priced below par. (See Current Coupon.)

## Discount to Fair Value

A measure of the valuation difference between the lowest-valued segment of a stock market, such as the cheapest 20%, relative to the overall market. It indicates whether the value opportunity is strong or muted at any given time relative to long-term history. (See Fair Value.)

## Duration

A measure of a bond's price sensitivity to changes in interest rates, expressed in years. Duration approximates how much a bond's price will change if interest rates change by a given amount. For each year of duration, a bond's price will fall (or rise) roughly one percentage point for each one-percentage-point increase (or decrease) in yield. Thus, a bond with a longer duration will perform worse when rates rise than a bond with a shorter duration; conversely, it will perform better when rates fall. Technically, duration is the weighted average term to maturity of the bond's cash flows. Thus, it is shorter than maturity for coupon-bearing bonds, which make annual or semiannual payments throughout the life of the bond. Duration is an excellent approximation of price sensitivity when interest-rate changes are small, but it becomes less accurate when rate changes are large. (See Convexity.)

## Dynamic Gap

The difference between our analysts' estimates of a company's growth potential and the market's, as measured by consensus forecasts of earnings, revenues or other barometers. Alliance Growth Equities research shows that "upside surprise"—growth above what the market was expecting—is more closely associated with outperformance than the absolute level of growth. The Alliance investment process favors companies with dynamic gaps that are positive and widening over those whose gaps are narrowing or negative.

## Earnings per Share (EPS)

A company's net profit divided by the number of common shares outstanding.

## EBITDA

(Earnings Before Interest, Taxes, Depreciation and Amortization)

A measure of a company's cash flow, excluding the impact of its financial structure or tax position, both of which could be altered.

## Equal-Weighted Index

An index in which all the securities are given equal weight. As soon as the price of one security changes, it is no longer equal weighted. Therefore, such indices are rebalanced on a quarterly, semiannual or annual basis.

## Equity

Ownership of a company in the form of shares that represent a claim on the corporation's earnings and assets. Common stockholders have the right to vote on directors and other key matters. While preferred stockholders lack voting rights, they have priority in dividend payments. A corporation can authorize additional classes of stock, each with its own set of contractual rights.

## Equity Risk Premium

A forward-looking estimate of how much equities are likely to outperform bonds. Equity investors typically demand a higher return due to their greater risk of not receiving cash flows for their investment.

## Excess Return

Difference between returns, which may be applied to managers or sectors. When referring to a manager or portfolio, the excess return is typically the same as the active return—the difference between



the manager's/portfolio's return and the benchmark's. A fixed-income sector's excess return is the difference between its return and that of a comparable-duration government bond: If short-term corporate debt returns 6% and a short-term government security returns 4%, the excess return is 2%. (See Risk-Free Rate.)

### Exchange-Traded Fund (ETF)

An instrument that provides exposure to an index and is traded on a stock exchange. The price of these units depends on the prevailing market prices of the underlying index components. ETFs offer investors a low-cost, liquid means to invest in indices; they are essentially an alternative to an index portfolio.

### Factor Risk

A common trait that causes many securities to trade together. Equity factor risks include industry or sector, home country, currency, valuation, earnings variability, growth rate and market capitalization; fixed-income factor risks include sector, industry, rating and currency. (See Idiosyncratic Risk and Systemic Risk.)

### Fair Value

A price deemed to accurately reflect the value of a company, asset or financial instrument and thought to be equitable for both buyer and seller. Fair value is generally calculated based on measurable financial performance and potential. In the futures market, fair value refers to the relationship between the futures contract on a market index and the actual value of the index. When futures are above fair value, traders are betting that the market index will go higher. The converse is true when

futures fall below fair value. (See Discount to Fair Value.)

### Fundamental Success

When a company is well positioned to outperform over the long term due to the growth or stability of earnings or cash flow and balance-sheet strength. Longer-term investors tend to focus more on such fundamental strengths than on bouts of underperformance due, for instance, to market volatility, technical factors or short-term difficulties. (See Debt-to-Equity Ratio.)

### Future

A forward contract that is traded on an exchange, requiring the future delivery of a commodity, bond, stock index or currency at a specified price and date.

### Government-Sponsored Enterprise (GSE)

A private corporation created by the US Congress to reduce the cost of capital for certain sectors of the economy. GSEs include the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae) and the Student Loan Marketing Association (Sallie Mae). GSE securities carry the implicit backing of the US government but are not the government's direct obligations.

### Growth Factor Risk

A benchmark-relative measure of a portfolio's exposure to characteristics typically associated with the growth investment style. A positive reading indicates that the portfolio is more leveraged to the growth style and, thus, should outperform when growth stocks are

in favor; the higher the reading, the higher this leverage. For example, a growth factor risk of 0.2 typically means that a portfolio is 20% more leveraged to the growth style than the index. Conversely, a negative reading would indicate that the portfolio is less exposed than its benchmark to growth and will likely underperform when growth is in favor, and outperform when growth is out of favor.

### Growth Stock

A company that is expected to generate above-average revenue and earnings growth relative to its industry or the overall market. Such companies usually pay little or no dividend, preferring to use excess cash to finance expansion. However, because of the company's rapid earnings growth, investors typically expect the stock's price appreciation over time to more than compensate for the lack of short-term dividends. (See Defensive Stock.)

### Hedging

A trading practice aimed at limiting financial loss in an asset due to unexpected price changes. For example, cross-border securities investors need to exchange their home currencies for the local currencies of the markets in which they're investing in order to make the purchases. Through hedging instruments such as forwards or futures contracts, they can arrange to re-exchange the currencies at fixed prices at specified points in the future. This arrangement allows an investor to gain exposure to price changes in the underlying security without having to risk depreciation of the home currency relative to the local currency, which would lower the total value of the

transaction when the proceeds are brought back home. There are many forms of hedging, which, in effect, seeks to neutralize a specific risk. (See Future.)

### Hybrid Security

A security that combines characteristics of two or more financial instruments, generally debt and equity. The most common type of hybrid is a so-called convertible bond, which is a fixed-income security that can be exchanged for common stock. Another popular type of hybrid is a Basket D. Basket Ds, which are issued by banks and insurance companies, are considered 75% equity and 25% debt. Hybrid securities are typically lower in the capital structure than senior corporate bonds, so recovery rates in times of corporate financial stress tend to be lower; however, debt-equity hybrids usually rank ahead of common stock. (See Convertible Bond.)

### Idiosyncratic Risk

Risk that is isolated to a limited number of assets, such as an individual company or a small group of securities, and that can be reduced through diversification. Errors in management strategy are one kind of idiosyncratic risk. (See Factor Risk and Systemic Risk.)

### Information Ratio

The ratio of a portfolio's excess return, or premium, to its tracking error, or the standard deviation of the premium over the period being measured. It is designed to measure how much excess return a manager delivers for each unit of risk. A higher number indicates a more favorable balance of reward to risk than a lower number. A

positive number indicates that the portfolio outperformed, and a negative number indicates underperformance. (See Excess Return and Tracking Error.)

## iShares

Index funds traded like shares on stock markets. Each share represents a proportion of ownership in the collection of stocks that make up an index. This investment vehicle enables smaller investors to diversify their holdings by giving them exposure to a potentially large number of companies without the necessity of buying each stock.

## Leverage

In a financial context, the degree to which a business or asset is financed by borrowing. High financial leverage is generally regarded as a negative for a company, since it increases the risk of bankruptcy in the event of a financial squeeze and can make future borrowing more difficult and/or expensive. However, leverage to finance highly profitable new ventures, for example, can result in higher returns to shareholders. “Leveraged investing” is when investors borrow money to purchase more securities or other assets than they could with cash. This allows an investor to capture more of the upside if a security appreciates, but increases the loss if the security depreciates.

## Liability

A legal obligation to pay a specific amount within a defined time frame. For businesses, this typically includes debt payments, accounts payable, taxes, wages and similar pending expenses recorded on a

company’s balance sheet. Short-term liabilities are those payable within the next year, and long-term liabilities are those payable over a longer time frame.

## LIBOR

### (London InterBank Offered Rate)

The interest rate that banks charge one another in the short-term international interbank market. It applies to loans borrowed anywhere from one day to five years. LIBOR is officially fixed each day by a handful of large London banks, although the actual rate changes throughout the day. It is also used as a benchmark to set other short-term interest rates, which are sometimes set as specific increments relative to LIBOR (e.g., LIBOR plus 2%).

## Liquidity

The ease with which an asset can be bought or sold quickly. High liquidity means that an asset can very easily be exchanged for currency, and low liquidity means that supply and demand are somewhat constrained. Highly liquid assets tend to have more narrow bid-ask spreads; illiquid assets tend to have wide bid-ask spreads.

## Long-Duration Assets

Securities or other assets whose cash flows to investors tend to be further out in the future. In equity markets, these are typically companies that pay little or no dividends, often because they are reinvesting most of their earnings. The term is most typically used in conjunction with growth stocks but may also apply to emerging-market stocks and other assets.

## Market Capitalization

Also referred to as market cap, it reflects the total equity of a company. A company's market capitalization is determined by multiplying the number of shares outstanding by the current stock price. Stock markets are frequently subdivided in terms of capitalization, with typical groups often including large-cap (those with the largest capitalizations), mid-cap (medium-size companies) and small-cap (the smallest publicly traded companies). Each group has distinct attributes and performance patterns, and spreading investments across the various groups tends to diversify risk.

## Market Value

The current price of a security in the market, as reflected by the last reported price on an exchange, or the current bid-ask price if the security is traded over the counter. (See Bid-Ask Spread, Market Capitalization and Over the Counter.)

## Market Weight

When a portfolio allocates the same percentage of assets to a specific security or group of securities as its benchmark. Also known as a "neutral weight."

## Mark to Market

To record the value of open positions in a security, a portfolio or an account based on current prices, not the purchase price or "cost basis." This technique allows any interim gain or loss to be recognized for tax or accounting purposes even though the positions have not yet been closed out.

## Maturity

The date when, or the remaining time until, an issuer is obligated to deliver the

final coupon and principal payments owed to a bondholder. Bonds with a remaining term to maturity of one to five years are generally considered short-term; those maturing between six and 12 years out are considered intermediate-term; and those with maturities beyond 12 years are considered long-term. Bonds maturing in less than one year are categorized as cash equivalents.

## Net Asset Value (NAV)

The dollar value of a mutual-fund share, calculated by dividing the fund's total net assets (assets minus liabilities) by the total number of shares outstanding. NAV, which is typically calculated at the end of each day, can change constantly to reflect changes in the value of a fund's holdings.

## Option

A contract that provides the right to buy or sell a specific asset such as a stock, a commodity or a currency at a particular price during a defined period of time. The right to buy is referred to as a "call option," while the right to sell is known as a "put option." Although option holders have the right to buy or sell, they are not obligated to do so.

## Option-Adjusted Spread (OAS)

A measure of a bond's yield spread relative to another instrument (typically a government bond or swap) that adjusts for the yield effect of a bond's explicit or implicit call or put options. Using OAS rather than nominal spread allows for direct comparison between option-free bonds and those with put or call features. (See Spread.)

## Over the Counter (OTC)

Securities not listed on an established exchange such as the London Stock Exchange, Tokyo Stock Exchange or New York Stock Exchange, but rather traded by broker-dealers who negotiate directly with one another over computer networks and by telephone. Stocks traded over the counter may be more speculative, since these companies often have not yet met the size or stability requirements for listing on an established exchange and have less accurate pricing data and other information readily available. Still, these trades tend to fall under the oversight of relevant regulatory bodies. Many bonds trade over the counter rather than on an exchange. Also known as “unlisted securities.”

## Overweight

When a portfolio allocates a larger percentage of assets to a specific security or group of securities than its benchmark does. (See Benchmark.)

## Par or Face Value

The amount of principal that the issuer must pay the bondholder at maturity. Although an individual bond typically has a par value of \$1,000, the term “par” is often used interchangeably with 100 in the context of a bond’s price. (See Bond.)

## Premium Coupon

A rate above current coupon. Bonds with premium coupons are typically priced above par. (See Current Coupon and Discount Coupon.)

## Price-to-Book Ratio (P/B)

A comparison of a stock’s market value with its book value, calculated by dividing

the current closing price of the stock by the latest quarter’s book value per share.

## Price-to-Earnings Ratio (P/E)

The most common measure of a stock’s value, calculated by dividing the market value per share by after-tax earnings per share. The higher the P/E ratio, the more the market is willing to pay for each unit of earnings.

## Price-to-Growth Ratio (PEG)

A ratio used to determine a stock’s current value per unit of earnings growth. It is calculated by dividing the price/earnings ratio by the annual earnings-per-share growth and indicates a stock’s potential value. A lower PEG means that the company’s growth is priced more attractively than its peers.

## Put Option

A financial contract that gives the holder the right, but not the obligation, to sell an asset at a predetermined price on or before a particular date. (See Call Option.)

## Put Provision

A bond feature that allows the investor to redeem the bond at par value before the bond’s stated maturity date. A put provision is typically valid only for predetermined dates and would only be attractive to the investor if the bond’s market value declined below par. Such a feature is favorable to the investor and detrimental to the issuer. Because of their potential advantage to the investor, puttable bonds typically yield less than otherwise comparable bonds without a put provision. (See Call Provision.)

## Relative Return

An asset's or a portfolio's return over a period of time relative to that of a chosen benchmark. It is calculated as the difference between the asset's absolute return and the benchmark's performance. (See Absolute Return and Benchmark.)

## Return on Equity (ROE)

A measure of how much profit a company is able to generate with the capital provided by shareholders. Calculated by dividing after-tax income for a specified time period (e.g., trailing 12 months, trailing five years, forward 12 months) by the book value. ROE is expressed as a percentage.

## Risk

In common parlance, the chance of loss or of something bad occurring. In financial parlance, it usually means the uncertainty of outcomes due to one or many causes; it can be positive as well as negative. Return is usually measured by the standard deviation of returns—in other words, the extent to which returns may vary from the norm. Volatile assets tend to have a wider range of possible returns and thus are said to be higher-risk.

## Risk-Free Rate

An investment with a predictable rate of return. An example is a short-term government bond. A short-term government bond has the explicit backing of a government, and the time period before the bond matures is short enough to minimize the risks of inflation and market interest-rate changes. Its yield is therefore considered risk-free. (See Credit Risk.)

## Risk Premium

The expected return above the risk-free rate that investors demand to compensate for the volatility of returns or the possibility of default of risky assets. (See Risk-Free Rate.)

## Secular Trend

A long-term change attributable to an important fundamental shift in the economy or business environment that is not related to seasonal or cyclical factors. Industrialization and globalization are examples of secular trends. (See Cyclical Trend.)

## Securitization

The process of creating a tradable financial instrument from a pool of underlying assets, such as loans or mortgages, which generate an income stream for the issuers. Securitization allows issuers to remove assets from their balance sheets, thereby freeing up capital for other uses. It also allows investors to better diversify risk.

## Share Buyback

A company's repurchase of its own shares. It typically increases the market price of the remaining shares because each of the remaining shares represents a larger claim on earnings and assets.

## Spread

The difference between two variables, such as a security's bid and ask prices (bid-ask spread). In the bond market, the "yield spread" is the difference in yield between bonds, most often between the yield of a bond and a benchmark such as a government bond, swap or LIBOR.

Valuation spreads measure the difference between expensive and cheap segments of the market.

### Standard Deviation

A statistical measure of risk that shows how aligned or at variance the returns of an asset, industry or fund are relative to their historical performance.

### Style Drift

The tendency of a portfolio manager to stray from its investment philosophy and process to boost short-term returns.

### Swap

A contract between two parties to exchange future cash flows based on a set principal amount. An interest-rate swap normally involves swapping fixed-rate and floating-rate payments in the same currency. Other common types include currency swaps and credit default swaps.

### Systemic Risk

A risk or event that affects an entire financial market or system, such as a stock market crash or a banking-system failure. Systemic risks cannot be avoided through diversification. (See Factor Risk and Idiosyncratic Risk.)

### Total Return

The return on an investment, including price appreciation and depreciation, as well as income from dividends or interest.

### Tracking Error

The variance of a portfolio's investment returns relative to those of its benchmark or index. (See Active Risk, Information Ratio and Standard Deviation.)

### Tranche

When a bond's cash flows are repackaged as a collateralized debt obligation (CDO) or a portfolio of mortgage securities is repackaged as a collateralized mortgage obligation (CMO), the various securities constituting the CDO or CMO are called tranches. Each tranche within a deal has a different risk/return profile, and the tranches trade separately from one another.

### Transaction Costs

The costs incurred when buying or selling an asset security, such as commission, fees and any indirect taxes.

### Underweight

When a portfolio allocates a smaller percentage of assets to a specific security or group of securities than its benchmark does. (See Benchmark.)

### Valuation

The worth of an asset or a company using various techniques or the value of an investment portfolio's holdings at a specific date.

### Value Risk Premium

The anticipated return premium of value stocks versus the broader market. (See Value Stock.)

### Value Stock

A stock that is underpriced by the market relative to its long-term fundamentals, such as dividends, earnings and sales. Such stocks tend to have a high dividend yield, low price-to-book ratio and/or low price-to-earnings ratio.

## Volatility

The extent to which the price of a financial asset or market fluctuates, measured by the standard deviation of its returns. Volatility is a commonly cited risk measure. (See Standard Deviation.)

## Warrant

A certificate entitling the holder to buy or sell a certain quantity of an underlying instrument at a predetermined price. The right to buy the underlying instrument is referred to as a call warrant; the right to sell it is known as a put warrant. In this respect, a warrant is similar to an option. Warrants typically have much longer time available to exercise than options. (See Option.)

## Yield

A component of the return on an investment. In the equity market, a share's dividend yield is its annual dividend payment as a percentage of the share's market price. In the fixed-income market, a bond's yield is its annual interest payment as a percentage of the bond's market price. Various measures of yield exist: most notably, current yield, which considers only coupon interest; and yield to maturity, which is

the rate that will make the present value of the bond's expected cash flows equal to the bond's market price.

## Yield Curve

A line connecting the yields of bonds from one end of the maturity spectrum to the other. Because yields typically rise sharply at the short end of the maturity spectrum and rise more gradually at longer maturities, the plotted line usually forms a curve. However, depending on a host of factors, yield curves may be steeply upward-sloping, flat, inverted, straight, bowed or even kinked.

## Yield Curve

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## The Major Fixed-Income Sectors

### Adjustable-Rate Mortgage (ARM)

A mortgage loan whose interest rate is raised or lowered periodically in accordance with a stated reference rate. ARM refers both to the original homeowner loan and to a securitized pool of such loans. (See Securitization.)

### Agency

A bond issued by a government agency or quasi-government agency to finance that entity. Securities repackaged by an agency, as with mortgage-backed securities, are not considered agency debt. Unlike debt issued directly by the federal government or its agencies, quasi-government agency debt is not backed by the full faith and credit of the federal government but is nevertheless very highly rated. (See Government-Sponsored Enterprise.)

### Asset-Backed Security (ABS)

A fixed-income security created by pooling together loans of a similar type, such as home-equity loans, car loans or credit-card receivables. In the US, which has a very large mortgage-backed securities market, mortgages are not considered a type of ABS; however, mortgages are considered a subset of the ABS market in many other countries, including the UK. (See Securitization.)

### Collateralized Debt Obligation (CDO)

A fixed-income security created by pooling together bonds or loans of a similar type, such as corporate bonds (collateralized

bond obligation) or mortgage-backed securities (collateralized mortgage obligation). A CDO repackages the cash flows of the pool of assets into tranches with different maturities, cash flows and risks. (See Collateralized Mortgage Obligation and Tranche.)

### Collateralized Mortgage Obligation (CMO)

A fixed-income security created by pooling together mortgage-backed securities. A CMO parses expected and unexpected cash flows from the underlying assets into multiple tranches according to a set of rules specified in the CMO's prospectus. Thus, the various tranches are subject to different amounts of risk and are suitable for different types of investors or investment purposes. (See Collateralized Debt Obligation and Tranche.)

### Commercial Mortgage-Backed Security (CMBS)

A mortgage-backed security collateralized by commercial rather than residential mortgage loans. Unlike residential mortgage-backed securities, CMBSs are not usually subject to prepayment risk, as most underlying loans do not permit prepayment without substantial penalties. (See Mortgage-Backed Security.)

### Corporate Bond

Debt issued by a corporation. As creditors, corporate bondholders have a prior legal claim over common and preferred stockholders.

### Credit Default Swap (CDS)

An instrument that transfers the credit risk of a specific entity (usually a corporation, financial institution or sovereign) from a protection buyer to a protection seller in exchange for a regular payment until the contract expires or a credit event occurs. (See Swap.)

### Emerging-Market Debt

Debt issued by governments of and corporations within developing economies. A country may issue such securities in its own currency or, commonly, in US dollars or the currency of another major economy. Many emerging-market issuers are rated below investment grade.

### Government Bond

Debt issued directly by a country's government in its own currency. Government bonds of the major developed countries are often, though not always, considered free of credit risk.

Country	Common Name for Government Debt
Australia	Treasuries
Canada	Canadas
France	OATs (Obligations Assimilables du Trésor)
Germany	Bunds
Italy	BTPs (Buoni del Tesoro Poliennali)
Japan	JGBs (Japanese Government Bonds)
UK	Gilts
US	Treasuries

### High-Yield Bond

A fixed-income security with a rating of BB or lower and thus considered non-investment, or speculative, grade. These instruments tend to offer substantially higher yields than investment-grade credits due to their greater likelihood of default.

### Inflation-Linked Security

A bond indexed to and intended to protect the investor against inflation. A number of governments and some corporations issue such debt.

### Mortgage-Backed Security (MBS)

A fixed-income security, especially a mortgage "pass-through," created by pooling together home mortgage loans with similar interest rates and other characteristics. The pool of mortgages forms the collateral behind the mortgage-backed security. Bondholders receive cash flows based on the pooled mortgages' collective interest and principal payments, including prepayments of principal, less a fee reserved for the originator of the MBS. Originators are predominantly government or quasi-government agencies. (See Securitization.)

### Sovereign Bond

Debt issued directly by a country's government in a currency other than its own.

## About AllianceBernstein

AllianceBernstein L.P. is a leading investment manager. Our worldwide presence, breadth of services and depth of research allow us to offer a full array of investment solutions to meet our clients' diverse needs.

**Research Excellence.** We believe that research excellence is the ultimate source of enhanced investment outcomes. To this end, we have built one of the largest research organizations in our business, with more than 200 buy-side analysts operating in every meaningful capital market around the world. We integrate fundamental and quantitative analysis of securities with economic, currency and other specialized research in pursuit of unique investment insight.

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