

Term	Explanation
A.B.S.	Asset backed security. A term describing certain finance structures where the underlying obligation and the source of interest and capital repayment is generated from the cash flow from a particular financial asset or pool of assets or from the predetermined proceeds from the disposal of the asset.
A.I.S.	Alternative Investment Strategy see Alternative Investments
ADR Arbitrage	This strategy involves trading the shares of non-US companies against their equivalent American Depository Receipts (ADR). An ADR is simply a non-US company whose shares are listed on the US exchange and traded in US Dollars.
Alpha	This term has been slightly misused and has become an industry 'buzzword' meaning the difference between a portfolio's risk-adjusted return and the return for an appropriate benchmark portfolio, i.e. the added value. Most active investors are trying to maximise alpha. Statistically, alpha is the Y-intercept of the regression line.
Alternative Investments	An investment that is perceived to be an alternative to traditional investments and strategies such as mutual funds, equities and bonds. Alternative investments include hedge funds, private equity funds, real estate investment trusts (REIT), and CTAs.
Asset swap	The term used for interest rate swap or cross-currency swap transactions for hedging interest rate and foreign exchange risk in fixed income securities. Convertible arbitrage managers often 'swap out' of the debt portion of the convertible leaving only the equity derivative. This effectively removes the interest-rate risk and credit risk.
Beta	A measure of the sensitivity of an asset to changes in the market, i.e. its market risk. An asset with a beta of 0.5 means that if the market were to go up 1% then the asset would go up 0.5%. Statistically, beta is the slope of the regression line.
C.F.T.C	Commodity Futures Trading Commission. US regulator of the futures markets.
C.T.A	Commodity Trading Adviser. A dated term originating from the time when futures were predominately based on physical commodities. Today, CTAs trade all types of futures: financial, energy, softs, precious and non-precious metals, etc. See also Managed Futures .
Calmar Ratio	A return/risk ratio where the numerator of the ratio is the compound annualized rate of return over the last three years. The denominator, the risk element, is the maximum drawdown over the last three years. If

three years of data is not available then available data is used.

Convertible Bond	Convertible bonds are corporate debt instruments with an option or warrant component attached allowing the holder to either hold the bond to maturity or convert the bond into a predetermined amount of equity in the company. Historically, convertible bond strategies have been negatively correlated with both equities and bonds. Convertible arbitrage strategies profit from a number of factors that affect the prices of convertible bonds. Changes in volatility of particular stocks cause significant changes in the values of their convertible bonds, as can changes in a company's overall creditworthiness or the structure of its liabilities. Occasionally, supply and demand imbalances for the convertibles present opportunities with respect to where the stock's volatility is actually trading.
Dispersion Volatility	This strategy involves trading the listed options on various equities against the options on the index to which those equities belong. Profits can be generated by price anomalies that may exist in the mathematically derived relationship of prices of the index options and of the individual equity options.
Distressed Securities	This strategy involves investment in the equity or debt of companies that are in 'distress'. Often the securities or derivatives of companies verging on bankruptcy or indeed already in bankruptcy can be acquired below their intrinsic value. Substantial profits can be made from the investments in these securities as a result of recovery, restructuring or liquidation.
Downside Deviation	See Sortino Ratio
Emerging Markets	This strategy involves equity or fixed income investing in emerging markets around the world. Conventionally, the emerging markets referred to Latin America, Eastern Europe, Africa, India, and certain countries in Southeast Asia.
Event Driven	A broad classification of strategies that attempt to profit from certain events that affect the price of a particular security. These events can include mergers, takeovers, bankruptcy, etc. Conventionally, event driven strategies include risk arbitrage (merger arbitrage), distressed securities and special situations.
F.S.A	Financial Services Authority. UK regulator created under the Financial Services and Markets Act 2000. Prior to the 2000 Act there were principally three regulators regulating all investment activity other than banking SFA (Securities and Futures Authority), IMRO (Investment Management Regulatory Organisation), and the PIA (Personal Investment Authority). The 2000 Act effectively merged all prior regulators into the FSA.
Fixed Income Arbitrage	Fixed income arbitrage involves a wide spectrum of strategies across all types of interest-rate related securities ranging from corporate and government debt to swaps and futures. Two typical strategies are 'basis'

trading and yield curve trading.

Fund of funds	A fund of funds is a fund that invests in other hedge funds or mutual funds. Funds of funds can be strategically diversified or focused on a particular strategy, geographic region, or currency.
Global Macro	A strategy falling under the conventional classification of opportunistic whereby the fund manager attempts to identify opportunities anywhere in the world deriving from many factors: macro-economic, currency devaluations, debt defaults, etc.
Hedge Fund	Hedge funds are investment partnerships or investment companies that attempt to produce superior returns compared to traditional investments. Hedge fund managers are often remunerated by management fees and performance fees.
High Water Mark	An arrangement whereby the fund manager will only take a performance fee when the net asset value (NAV) of the fund exceeds any prior highest NAV ('net new highs'). The arrangement ensures that if a fund has lost value, the manager does not get paid a performance fee until the loss is recouped, and only gets paid a performance fee on any incremental gain in value above the point from where the loss was made.
High Yield	High Yield securities are non-investment grade bonds or preferred stocks with high yields. Some of these securities are issued with low credit ratings (junk bonds) and some become low rated due to a number of reasons (currency instability, bankruptcy, political instability, etc.) Sometimes opportunities arise between various securities' market prices and related credit spreads.
Hurdle Rate	The return above which a fund manager becomes eligible to earn a performance fee. For example, if a fund has a hurdle rate of 5%, and the fund returns 25% for the year, the fund will only take performance fees on the 20% return above the hurdle rate. Typically, hurdle rates are set at the risk-free rate or a multiple of the risk-free rate.
Incentive Fee	see Performance Fee.
Index Arbitrage	This strategy involves the purchase or sale of a basket of equities that replicates or closely tracks the listed index futures contract for those particular equities. The simultaneous purchase or sale of the futures contract offsets the directional risk of the position. Profits are generated by capturing any discount or premium in the price of the futures contract relative to its underlying basket of equities. The basket is dynamically adjusted for changes in the weightings of the constituent stocks. Within this strategy there can be additional opportunities. "Add/deletes" involve trading the stocks that are periodically deleted from the index against new stocks that are added to the index.
Jensen Alpha	Developed by Michael Jensen, the formula measures the added value of an investment with respect to a benchmark. The formula is the investment's excess return (annual return minus the risk-free rate) minus

the Beta times the excess return of the benchmark.

Leverage	Sometimes referred to as gearing, is the borrowing of funds whose value exceeds 100% of the collateral. The use of leverage can exponentially increase return on capital ratios (and losses).
Long/Short	This strategy involves holding both long and short positions in equities simultaneously. The manager seeks to identify opportunities in the relative value of a basket of securities. The aim is not to be market neutral and the overall portfolio will have either a long or short bias.
Long-only	A strategy where the manager attempts to add value by stock picking - the 'buy-and-hold' strategy.
M.A.R	Minimal Acceptable Rate. Used in calculating the <u>Sortino Ratio</u> , it is normally set at the risk-free rate. See <u>Risk-Free Rate</u> .
Managed Futures	Simply a fund that uses only futures in its strategy. All types of futures can be traded and the strategies are either fundamental or technical.
Market Timing	The manager attempts to 'time the market' by switching between long equity positions and cash or fixed income. This strategy should not be confused with 'Mutual Fund Timing,' where the manager attempts to profit from 'stale pricing' of mutual funds whose underlying assets or securities trade in a different time zone.
Market-Neutral	Market neutral managers take offsetting long and short positions in related or similar securities that they believe are mispriced with respect to each other. The identification and calculation of these mispricings is based on both quantitative and qualitative analysis. Unlike <u>Long/Short</u> managers, the market neutral managers attempt to minimise at all times their exposure to systematic risk (minimize <u>Beta</u> and currency risk).
Master-Feeder Fund	A typical structure for a hedge fund that has both US investors and non-US investors. An offshore 'master' fund is owned by two 'feeder' funds: one is a US limited partnership (LP) and the other is an offshore fund. As the investors will have different tax treatments, US investors invest into the US feeder fund and non-US investors invest into the offshore feeder fund. All the investment funds are then pooled at the master level and managed by the fund manager.
Merger Arbitrage	see <u>Risk Arbitrage</u>
Mortgage-Backed	Mortgage-backed securities are debt instruments backed by physical assets, of which there are many different types, and often include a borrower's option to prepay which in practice is exercised in a less than completely efficient manner. Mortgage derivatives strip cash flows from these underlying securities in ways that create complex valuation dependencies on both the path of interest rates and the borrower's prepayment behaviour. Differences in the prices of these similar securities can present trading opportunities.

Net Exposure	The net exposure of the fund (long or short) calculated by subtracting the gross short exposure from the gross long exposure (including leverage).
Opportunistic	A general term describing any fund that is 'opportunistic' in nature. These types of funds are usually aggressive and seek opportunities around the world as they arise.
Relative Value	A category of strategies that attempt to profit from changes in the relative value of two similar or securities or their derivatives.
Risk Arbitrage	The strategy involves the offsetting purchase and sale of the shares of two companies that are merging. The arbitrage is in the fact that once the merger or acquisition has taken place there is no position left. The risk is if the merger or acquisition collapses – hence, the name risk arbitrage.
Risk-Free Rate	From the Capital Asset Pricing Model (CAPM), the rate at which capital would grow if it were not placed "at risk" (invested) – i.e. the bank deposit rate.
S.E.C	Securities and Exchange Commission. US regulatory authority.
Sharpe Ratio	Proposed by William Sharpe in order to measure the quality of return with respect to its risk, the ratio is calculated by dividing the excess return, or the return on capital minus the risk-free rate, by the standard deviation, or volatility of the return. A return with a higher volatility, i.e. higher risk, will have a lower Sharpe Ratio than a return with a lower volatility – therefore, the higher the Sharpe Ratio, the better quality of return. For a more detailed description of this ratio please go the Performance section on this site.
Short Bias	A strategy where the net market exposure of the portfolio is always short. This is managed by short selling or by use of derivatives or a combination of both.
Sortino Ratio	Similar to the Sharpe ratio as a measure of the quality of a return with respect to its risk, the Sortino Ratio uses <u>Downside Deviation</u> (DD) rather than standard deviation as the denominator of the ratio. DD is used in order to differentiate between 'good' and 'bad' volatility – bad volatility meaning volatility on the downside and good volatility meaning volatility on the upside. The idea is that if a fund is volatile on the upside (a favourable situation) then it would still have a low Sharpe Ratio. The ratio is calculated by dividing the fund's excess return by the DD. The excess return is defined as the return less the Minimal Acceptable Rate (usually the risk-free rate) – the higher the Sortino Ratio, the better quality of return.
Special Situations	This strategy profits from special situations that may arise from time to time. For example, a company may issue a special class of share or warrant. As a result an opportunity may arise from the relationship between the new issue and the ordinary shares. Alternatively, sometimes opportunities exist in the relationship between a holding company's share price and the price of its holding. Occasionally, there are opportunities in the relationship between a non-US share price and the share price of its

equivalent ADR (American Depository Receipt).

Standard Deviation	The measurement of volatility calculated by examining the dispersion of a distribution of returns around a mean. It is sometimes referred to as Sigma.
Statistical Arbitrage	A strategy that attempts to profit from deviations in the price of securities from historical relationships or patterns that are quantified by statistical methods. This strategy is based on the premise that historical price relationships or patterns among correlated assets are likely to hold in the future.
Sterling Ratio	A return/risk ratio where the numerator is the compound annualized rate of return over the last three years. The denominator, the risk element, is the average annual maximum drawdown over the last three years less an arbitrary 10%. If three years of data is not available, then the available data is used.
Treynor Ratio	Developed by Jack Treynor, this ratio is another return/risk ratio. The numerator of the ratio is the annual return less the risk-free rate as in the <u>Sharpe Ratio</u> . The denominator, or the risk, is the <u>Beta</u> of the return relative to a benchmark.
Volatility Arbitrage	This strategy involves the purchase and sale of option premium in two statistically correlated securities. Profits are made by temporary market anomalies in related instruments due to 'market noise' and short-term departures from equilibrium in supply and demand in the options.