GLOSSARY OF TERMS

SOURCE: GETALTS.COM BY RYDEX/SGI (HTTP://WWW.GETALTS.COM/WHAT/GLOSSARY-OF-TERMS)

40 Act

This is a generic term that usually refers to the Investment Company Act of 1940, which regulates investment companies such as mutual funds, exchange traded funds and closed end funds. The Act requires that funds meet certain rules and requirements in order to be eligible for sale to the public.

Absolute Return

This term can have several meanings. In its broadest sense, it is the measure of the gain or loss in the value of an asset. In the sense of alternative strategies, an "absolute return" strategy seeks to provide positive returns regardless of the overall return of the market. "Absolute return" can also sometimes refer to the entire universe of hedge funds that subscribe to such strategies.

Accredited Investors

This term, used by the SEC, refers to financially sophisticated investors. Because these people have much higher-then-average wealth, they are assumed to understand more about finance and investments, and thus have a reduced need for certain regulatory protections. Qualifying as an "accredited investor" requires meeting one of the following criteria:

- Earn an individual income of more than $200,000 per year, or a joint income of $300,000, in each of the last two years and expect to reasonably maintain the same level of income.
- Have a net worth exceeding $1 million, either individually or jointly with his or her spouse.
- Be a general partner, executive officer, director or a related combination thereof for the issuer of a security being offered.

Asset Allocation

The process of apportioning portfolio holdings among different types of assets (e.g., stocks, bonds, industry sectors, individual securities, alternative investments). The asset allocation process generally aims to balance risk and reward, according to an individual's goals, risk tolerance and investment time horizon.

Alternative Asset

Alternative "assets" are those that typically fall outside the equity and bond markets, for example: real estate, private equity, and commodities. Sometimes alternative assets are also called "hard assets" or "real assets," as they are often tangible items that hold inherent value-that is, their value is not derived from other sources.

Alternative Investments

Generally an investment that is not one of the tree traditional asset types (stocks, bonds, and cash). It is important when considering alternatives to know whether the investment in question is an alternative "asset" or alternative "strategy," or a combination of both.

Alternative strategies

Alternative strategies have more flexibility in the way they use assets in the portfolio, including such tactics as shorting, leverage, and using derivatives, such as futures, forward contracts, options and swaps. Within the portfolio, alternative "strategies" can use both traditional assets (like equities and bonds) and/or alternative assets like commodities and private equity.

Arbitrage

This is the practice of exploiting price differentials in two or more markets - i.e., buying an asset in one market and selling it in another market where the price is higher. By pairing two or more transactions, the manager can essentially profit from the price spread between markets.

Bear market

Generally considered a broad market condition in which the prices of securities are falling. Most bear markets coincide with periods of economic difficulty and widespread pessimism. In some cases, negative sentiment can lead to self-sustaining declines in economic activity and market performance.

Bond

A debt instrument issued by an entity (e.g., a corporation or government institution), which has borrowed money from investors at a fixed interest rate for a defined period of time. The "bond" instrument defines all the relevant terms of the of the loan - e.g., time period, rate of interest, restrictions (e.g., pre-payment penalties).

Bull market

Generally considered a broad market condition in which the prices of securities are rising and expected to continue to rise. Most bull markets coincide with a period of economic expansion, or with the prospect of a near-term positive trend (i.e., the end of a recession). In some cases positive sentiment can lead to self-sustaining advances in asset prices and economic activity.

Chicago Board of Exchange (CBOT)

The world's oldest futures and options exchange, which was established in 1846. CBOT is part of the publicly held CME Group, which also operates the NYMEX and COMEX exchanges. **www.cmegroup.com**

Commodity

A "hard asset" that is a basic good used in commerce. Examples of different commodities include: agricultural commodities (e.g., corn, soybeans, pork bellies); metals (e.g., gold, silver); energy (e.g., oil, natural gas); and other natural resources (e.g., timber).

Convertible arbitrage

This is a market-neutral strategy that seeks to profit from the difference between the value of a company's common stock and the value of preferred securities that are convertible to common stock. Sometimes the value of the stock versus the value of convertible securities is out of synch, which may allow a manager to make a profit by buying the convertible shares while selling short the common shares at the same time. The short sale against the long position in the convertible security, the investor essentially isolates the embedded option in the convertible security. The investor then benefits from any increase in volatility, which would cause the option to increase in value.

Convertible securities

These can be either convertible shares (equity) or convertible bonds (debt). Convertible equity is commonly known as "preferred shares," which pay a dividend like a bond and often have convertibility into common stock under certain conditions; preferred shares generally do not have voting rights. A convertible bond is similar in that it has a convertibility feature, but the instrument itself is a debenture - i.e., a debt - and as such has debt-like features (e.g., callable). Convertible securities generally have an embedded "option" that gives the holder the right to exchange the security for common shares under

certain conditions and at a certain prices. It is this option feature that arbitrageurs ("arbs") seek to exploit in convertible arbitrage strategies.

Correlation

This is a measurement of how closely the performance of two assets match each other - the measure of correlation ranges from positive one (1) to negative one (-1). For example:

- If the value of two assets always moves in the same direction, they are said to be "highly correlated," and they have a correlation of positive one (1).
- If their values always move in opposite directions, they are said to have a "negative correlation" or "inverse correlation," and have a correlation of negative one (-1).
- If there is no consistent mathematical relationship between the value of the two assets, then the correlation coefficient is 0.

Counterparty

In broad terms this is a party to a contract. It can be a person or an entity. In alternatives, a counterparty is usually an institution that is buying or selling an investment contract.

Counterparty Risk

This is the risk that a counterparty will not have the means to satisfy its obligations under a contract. In alternatives, counterparty risk usually applies to derivatives contracts - i.e., that the buyer will have not sufficient capital to complete a purchase or a seller will not be able to deliver the promised security or payment upon settlement of the contract.

Dedicated Short-Bias

A hedge fund strategy with which the fund manager takes more short positions than long positions.

Derivatives

A security whose price is dependent upon, or derived from, one or more underlying assets. For example, a "future" is a contract in which the contract buyer agrees to purchase a specific asset, at a specific time, at a specific price from the contract seller (the counterparty). An "oil future" would obligate the buyer to purchase oil at a certain price, at a certain time, from the contract seller. Such contracts are considered securities and are called "derivatives," and they have market value. Derivatives of all kinds can be bought, sold or traded on open exchanges, such as the CBOT.

Discretionary

These strategies rely primarily on manager insight and judgment in security selection and portfolio positioning. Managers may use mathematical models and other analytical techniques to supplement their decision making, but the primary driver of decision making is the manager's judgment. (see also "Systematic")

Diversification

This is an investment strategy in which the investor makes allocations across a wide number of assets within a single portfolio, with the goal of smoothing out extreme fluctuations in the portfolio's value (i.e. "volatility"). The objective is for positive performance in some investments to neutralize negative performance in others, keeping the portfolios overall performance (return and volatility) within a narrow target range. According to Modern Portfolio Theory, the larger the number of assets across which the portfolio is diversified, the lower the portfolio's volatility should be, and the higher the probability of meeting the return objective.

Efficient Frontier

A line created on a risk-reward graph, where risk is on the vertical axis and return is on the horizontal axis. For any given combination of assets, investors can plot the portfolio allocations that are the most efficient, defined as providing the highest expected return possible for a given amount of risk. The line on the graph that connects all these "efficient" portfolios is called the "efficient frontier."

Equity

In investing, is typically considered to be ownership interest in a corporation in the form of common stock or preferred stock.

Event Driven

These are hedge fund strategies in which the manager seeks to profit from price inefficiencies caused by company-specific news or events - e.g., merger announcements, bankruptcies, restructurings, spin-offs, distressed credit or equity situations, asset sales.

Exchange Traded Fund (ETF)

These are investment vehicles traded on stock exchanges, much like stocks. An ETF holds assets such as stocks or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day.

Exposure

This is the amount an investor has "at risk" in the chosen investment - i.e., the amount he/she can lose.

Fixed income arbitrage

This type of hedge fund strategy seeks steady returns with low volatility, by exploiting inefficiencies in fixed income markets. Managers can use interest rate swaps and other strategies, and exploit mis-pricings of both public- and private-sector debt.

Futures

These are a type of derivative. A "future" is a financial contract that obligates the buyer to purchase an asset, such as a physical commodity or a financial instrument, at a predetermined future date and price. "Futures" are traded on exchanges such as the CBOT, NYMEX, or COMEX.

Global Macro

These are hedge fund strategies that use derivatives to capture potential returns in global markets. The manager may invest in a wide range of instruments and asset classes based on a view about how systemic influences (e.g., interest rates, governmental policies, fund flows) may affect given markets or asset prices around the world.

Hedge

This is a strategy by which the investor makes tries to reduce the risk of adverse price movements. Hedge strategies are often implemented using derivatives such as futures, swaps and options.

Hedge Funds

An investment portfolio that can use advanced strategies such as leveraged, long, short and derivative positions with the goal of generating consistent returns (either in an absolute sense or over a specified market benchmark). There are several key types of hedge funds, and individual funds can vary widely in structure, investment approach and objective.

Institutional Investors

These can be ultra-wealthy individuals, incorporated entities (including for-profit, not-for-profit organizations) or public agencies that trade securities. Institutional investors are large enough, and their trading volume is large enough, to qualify them for preferential treatment and lower commissions. They are also generally considered more expert in finance and investment, and thus qualify as "accredited investors." The most common types of institutional investors are public and private pension funds, endowments, and foundations.

Leverage

This is a strategy in which the investor seeks to increase potential return of an investment through the use of borrowed capital.

Limited Partnership

This is a legal structure that is established by two or more partners to conduct a business jointly. In this structure one or more of the partners is liable only to the extent of the amount of money that partner has invested - the partners are not personally liable for the obligations of the Partnership.

Liquidity

There are different types of liquidity:

- "Market liquidity" is the degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Highly liquid assets and securities can be easily bought and sold; "illiquid" assets are those that are generally considered difficult to buy or sell, either because of a lack of demand, a lack of supply, or because of contractual restrictions on their purchase/sale.

- "Fund liquidity" is generally considered the degree to which a fund has sufficient cash on hand to satisfy investor withdrawals; or the ease with which the fund could raise sufficient cash if required to.

Liquidity Risk

This risk is usually discussed in terms of investment funds or managers. It is the risk that the fund or manager will not have access to sufficient capital to meet cash demands - to meet investor withdrawals, operating expenses, or other requirements.

Long/Short

This is a hedge fund strategy that combines two equity investment strategies: a) buying a stock the manager likes and holding it until the manager decides to sell (buying "long"); and b) borrowing a stock the manager does not like and selling it, with the goal of buying it back later at a lower price and returning it to the lender (selling "short"). In a short sale, the difference between the sale price and re-purchase price is the profit on the trade.

Long Only

These are portfolios in which the manager holds only "long" positions - i.e., assets bought at market value and held until the manager decides to sell, hoping to capture any increase in value.

Managed Futures

This strategy involves building a portfolio of futures contracts - with the freedom to take both "long" and "short" positions. Managed futures portfolios can buy and sell futures in a number of areas, such as commodities and financials, including interest rates and currencies.

Market Exposure

This term refers to the types and levels of investment a manager may have in specific markets or sectors. Market exposure can be discussed in different ways. For example, any portfolio that contains stocks has "exposure" to equity markets. A portfolio that contains 10% non-U.S. stocks is said to have a 10% "international exposure." In alternatives, market neutral strategies are said to have "no market exposure" if they can achieve zero correlation to equity market indexes - that is, their performance is not affected by whether the broader market goes up or down.

Market Maker

This refers to an individual or entity that both buys and sells securities or commodities. In finance, market makers are generally institutions that hold securities or commodities in inventory, buying and selling with a goal of making a profit from the spread between those prices.

Market Neutral

In this strategy, a manger does not take a position on whether the market will go up or down, and indeed seeks to avoid "market exposure" altogether. The overall portfolio is not "long" the market - i.e., positioned to profit if the market goes up. The portfolio is also not "short" the market - i.e., positioned to profit if the market goes down. Generally, market neutral strategies seek to capture increasing values in specific assets or groups of assets while maintaining a neutral position to the market overall - i.e., a zero correlation between the portfolio and the market.

Momentum

Momentum refers to the rate of acceleration of a security's price or volume. It can also refer to "momentum strategies" in which the investor uses price momentum as the primary criteria for selecting securities for the portfolio.

Multi-strategy

These are hedge funds that can use many alternative strategies all within a single portfolio - e.g., strategies like short-bias; global macro; event driven. The manager's goal is to diversify across strategies in order to help smooth portfolio returns, the same way traditional a manager may diversify across assets.

Options

These are derivative securities. An "option" is a contract sold by one party (option writer) to another party (option holder), in which the option holder has the right to purchase an asset at a given price for a specified period of time. The option holder may execute the deal according to the contract terms, but is not obligated to do so. (Unlike a futures contract in which both parties are obligated to make the purchase/sale according to the contract terms on the specified date.)

Private Equity Firms

In private equity, the investor or fund makes a direct investment into a private company, or conducts a buyout of a public company by purchasing all outstanding shares and "taking it private," which results in a delisting of that company's stock.

Qualified Clients

- As defined by the SEC these are investors who meet one of the following criteria:
- A person or company with at least $750,000 under the management of the investment adviser at the time of entering into a contract with the adviser
- A person who or company that the investment adviser (and any person acting on his behalf) reasonably believes, immediately prior to entering into the contract, either:

- Has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than $ 1,500,000 at the time the contract is entered into; or
- Is a qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 at the time the contract is entered into; or
- A natural person who immediately prior to entering into the contract is:
- An executive officer, director, trustee, general partner, or person serving in a similar capacity, of the investment adviser; or
- An employee of the investment adviser (other than an employee performing solely clerical, secretarial or administrative functions with regard to the investment adviser) who, in connection with his or her regular functions or duties, participates in the investment activities of such investment adviser, provided that such employee has been performing such functions and duties for or on behalf of the investment adviser, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

Real Estate Investment Trusts (REITs)

This is a tax designation designed to provide real estate investors with a similar legal structure that mutual funds provide for stock and bond investors. REITs can be publicly or privately held; the shares of public REITs trade on major exchanges like other securities. REITs invest in real estate, either by buying properties directly or by financing mortgages.

Rebalancing

This is the process by which an investor realigns the weightings of assets in a portfolio. The process involves periodically buying or selling assets to maintain desired levels of asset allocation.

Risk

This is the chance that an investment's actual return will be different than expected. There are many different metrics for portfolio risk. The most common proxy for risk is portfolio volatility. Though newer metrics focus on other measures such as Value at Risk.

Short Position

This refers to an investor's holding of a borrowed equity when a short selling transaction is undertaken.

Short Selling

In short selling, the investor seeks to profit from the decline in the price of a security. To implement a "short" strategy, the investor borrows the target security and sells it at the market price. The investor's goal it to buy it back later once the market price has dropped, and return the security to the lender. The investor's profit on the transaction is: the income from the original asset sale, minus the money spent to re-purchase it, as well as any borrowing cost.

Spot transaction

This is a short-term contract in which two parties agree to a sale/purchase of a specific currency at a specific price on the same day or within one or two days.

Standard Deviation

In general, this is a statistical measure of how much the performance of a given variable fluctuates from its mean performance. In finance, it is used as a measure of historical volatility, either in the price of an asset or security, or in the return performance of an investment (e.g., a fund or portfolio). The higher the standard deviation, the more frequent the expected fluctuations from the mean. Thus, a higher standard deviation (a higher "volatility") is associated with a higher risk that the investment will not perform as desired.

Swap Agreements

Traditionally, this is the contractual exchange of one security for another. The swap may be based on features such as the security's maturity (bonds) or quality (stocks or bonds). Recently, the use of these instruments has grown to include other types of securities (e.g., currencies) as well as interest rate swaps.

Systematic

These strategies rely primarily on mathematical models for security selection and portfolio positioning. Generally, the manager creates an algorithm that models quantitative features of market performance (e.g., trading volume, price momentum, earnings, reversion patterns, historical trading patterns). Based on its interpretation of market conditions, the model will recommend optimal portfolio positioning relative to established patterns. The manager retains discretion over final portfolio implementation, but the output of the quantitative analysis is generally given primary consideration. (see also "Discretionary")

Transparency

The extent to which investors have ready access to financial information. Transparency can apply to companies, funds, or a manager's investment process, and it applies to multiple issues such as price levels, market depth and audited financial reports.

Value at Risk (VaR)

This is a probability risk measure, meaning that it indicates the probability of losing a specific amount, on a specific asset or portfolio, over a specific time horizon. For example, a portfolio that has an annual 2% VaR of $1 million dollars means that this particular portfolio has a 2% chance of losing $1 million in any given year. There are multiple varieties of VaR in use for both risk management and risk measurement. VaR came to prominence as a risk measure after the market crash of 1987, as a complement to other statistical models and a systematic method of estimating the impact of extreme but improbable events.

Venture Capital

An investment strategy that involves private investors taking private equity stakes in startup and small- and medium-size enterprises with strong growth potential. Private investors and institutions can make direct venture capital investments, or they can invest through "venture funds" managed by professional venture capitalist investors.

Volatility

A statistical measure of the dispersion of returns for a given security or market index. Volatility can measured in different ways: a) measured as standard deviation (or variance) from the mean returns for that same security or portfolio; or b) measured as standard deviation from a market index or portfolio other benchmark. Commonly, the higher the volatility, the riskier the security.