Investec
Wealth & Investment

Jargon Busting

Portfolio Management

This is the continuous process of making and effecting decisions about the investment of a portfolio to achieve a target return objective within a given risk profile. These cover the full range of choices from how much to have in each asset class to which individual shares to hold. It is both an art and a science and involves assessing the likely strengths, weaknesses, opportunities and threats of all of the potential investments to create a blend that is suitable for the client’s needs and requirements.

Types of Investment

Equities

Equities are shares in companies and entitle each holder to a “share” in the company’s fortunes. These shares are usually listed on a stock market to enable buyers and sellers to trade. Shares are bought in anticipation of income from dividends and capital gain as the value of the share rises if these fortunes are positive but they can also be negative with the possibility of loss.

Bonds/Fixed Interest Stock

Bonds are an investment purchased for their, usually, fixed income stream – in the form of interest. They are issued by companies (or governments) as a form of borrowing with a fixed interest rate, the “coupon”, and a repayment date known as “redemption”. Generally, because of the stability of the fixed income stream, less price movement is expected from bonds than from equities. They are traded to enable investors to buy and sell and the price is usually determined by the perception of the borrowers’ ability to repay at redemption.

Gilts

Gilts are bonds issued by the UK government. Originally they were issued with gold leaf on the edges and were known as “gilt-edged stock” but now this has been shortened to “gilts”.

Collective

A vehicle for pooled investment where investors combine their resources to buy investments together. Such vehicles can be unit trusts, open-ended investment companies (OEICs) or investment trusts. The benefit is the ability to spread limited resources over a wider range of investments, thus improving diversification and reducing risk. These are known as mutual funds in the US.

Unit Trust

A form of collective investment scheme. Investors buy units in a unit trust, which then uses the money raised to invest in a range of specified investment areas. The unit price is calculated according to the value of the underlying investments rather than demand for or supply of the units. If investors wish to redeem their units, they do so by selling them back to the manager of the unit trust. As a result, the unit trust will have to sell some investments to generate the cash required to repurchase the units. The reverse is true for purchases. This gives rise to the description of unit trusts as “open-ended”.

Investment Trust

A form of collective investment scheme. An investment trust is a public limited company that issues shares to investors and then invests the funds on their behalf. Often the investment trust has a specified area of investment such as US or Emerging Markets. The shares are listed on the stock market to offer the opportunity to buy and sell, the price being determined by demand and supply in the normal way. When investors wish to realise their investment, they have to sell the shares to other investors. Occasionally the investment trust has an agreed “wind up” date. This feature gives the investment trust the description of being “closed-ended”. Once the issue of shares has taken place, the size of the investment trust in terms of number of shares will not be changed.

OEIC (Open-ended investment company)

A form of collective investment scheme that is designed to incorporate favourable aspects of both investment trusts and unit trusts. It is, legally speaking, a company that issues shares, like an investment trust. However, whereas an investor in an investment trust who wishes to realise their investment has to sell their shares in the market, investors in an OEIC can sell the shares back to the company, as if it were a unit trust.

Alternative investments
Refers to investments in something other than bonds and shares. These are usually collective vehicles, and can include hedge funds, structured products, infrastructure funds, commercial property funds and commodity funds. Alternative investments are generally added to portfolios to provide diversification away from the more traditional types of investment such as equities and bonds but can incorporate intricate underlying strategies and can carry very high charges.

Hedge Fund
A type of investment fund where the managers are allowed to use complex trading techniques to try to gain either a higher or more predictable return on investment. For example, hedge funds are allowed to use short selling, which other funds are unable to do. Whilst some hedge funds are listed on a market, liquidity can be very tight and it can take a long time to exit an investment. Charges are high and the underlying holdings are often opaque.

Structured Product
Structured products are investment instruments specially created to meet the needs that cannot be met from the traditional financial instruments available in the markets. They have a redemption date and are fairly illiquid between the point of issue and redemption. Structured products can be used: as an alternative to a direct investment; as part of the asset allocation process to reduce risk exposure of a portfolio; or to utilize the current market trend. They can protect capital in a falling market but often do not capture the full gain of a rising market. They rarely pay any income.

Infrastructure Fund
Infrastructure vehicles offer a number of similar characteristics to commercial property trusts. The phrase infrastructure covers a wide range of commercial assets, such as hospitals, schools, police facilities etc. In effect, the Government buys assets on a long-term hire purchase contract from the fund with an annual return to investors of around 8.5%. These funds have a high initial yield, good visibility of future income from top quality sources, and some prospect of income growth over time.

REIT (Real estate investment trust)
A REIT is a tax efficient property vehicle. UK property companies were allowed to convert into REITs in January 2007. This allows them to pay out higher dividends to investors.

Investment terms

Capital return
The return on the amount invested ignoring dividend and interest income generated, i.e. how much the capital value has moved. This is expressed as a percentage of the sum invested.

Yield or Income return
The percentage return paid on a bond or share in the form of interest or dividend relative to the price. The yield of something will change if the income payment changes or the price changes.

Total return
The capital return plus any income return.

Redemption/maturity
Bonds/gilts usually have a set date when the borrower will repay the loan. This is known as the redemption date. The length of time a particular bond/gilt has until it is redeemed is known as its maturity.

Volatility
The rate at which the price of a share moves up and down. If the price of a stock moves up and down rapidly over short time periods, it is described as having high volatility. If the price rarely changes significantly, it is said to be a low volatility stock. Investors generally prefer lower volatility. Volatility also measures the variability of the total return of the portfolio.

Earnings per share (EPS)
This is the amount of a company's total profit attributable to each share. It is calculated by dividing the company's total profit by the number of shares in issue. Companies that show steady, consistent earnings growth, year after year, will often outperform companies with variable earnings over time.

P/E ratio
The price to earnings ratio is worked out by dividing the share price (p) by the company's earnings per share (e) and is expressed as a multiple. It can be "historic" or "prospective" depending on whether one uses past earnings or forecast earnings. The higher the p/e ratio is, the higher the value the market is placing on the shares.

Discounts and Premiums
Investment trust share prices are determined by supply/demand from investors and they can therefore trade independently from the value of the underlying assets. If the share price is below the asset value, it is said to be trading at a discount and vice versa, a premium.

Market Capitalisation
This is the market value of a company’s outstanding shares, the share price multiplied by the shares in issue.

Beta
A measure of the volatility, or systematic risk, of a share or a portfolio in comparison to the market as a whole. A beta of less than 1 means that the security has shown less volatility than the market, and greater than 1 means it has been more volatile than the market.

Security
A US term, a security is a tradeable financial asset of any kind. Securities are broadly categorised into debt securities (e.g. banknotes, bonds and debentures) and equity securities, (e.g. shares).

Price to earnings ratio to growth ratio (PEG)
This is calculated by dividing the P/E ratio by the company’s projected growth in earnings (P/E divided by % of next year growth). The PEG tells you how a share is being priced relative to its growth rate. The lower the number, the less you have to pay to get in on the company’s expected future earnings growth.

Cyclical Stock
This is a share highly correlated to general economic activity and thus likely to be more volatile than the average over the economic cycle. When the economy is in a recession the profits of a cyclical company tend to drop as does its share price. Conversely, when the economy is in an expansion phase the share price tends to go up with the profit growth. Shares which do not display this cyclical volatility are referred to as defensives.

Benchmark
A yardstick against which the performance of a portfolio can be measured. This is usually the index which is commonly used for each asset class. At the total fund level portfolios can have “customised” benchmarks comprising fixed percentages in a basket of indices, to reflect the strategic allocation of the portfolio.

Strategy and tactics
Strategy relates to the way in which the long term objectives of the client are met. It involves agreeing a blend of assets with the client which is often also used to form the benchmark for performance measurement purposes. Tactics relate to short term positions that the fund manager may take from time to time to invest above or below the agreed long term strategic positions with the aim of producing enhanced returns over time.

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IWI890 v3 10/15