COMMON INVESTMENT TERMS EXPLAINED

AN INTRODUCTION TO REAL ESTATE, MUTUAL FUNDS, RETIREMENT PLANNING, STOCKS, AND BONDS

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Life is About Choices...What's Yours?

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INTRDOCUTION

Financial terms can be intimidating. The financial industry can even seem to have its own language designed to keep the average person confused. But if you understand the terminology, you'll gain the confidence you need to make good, informed decisions.

In this small report, you'll find some of the most common financial terms and acronyms used in the world of banking, mutual funds, stocks, and real estate transactions.

Although you may need to allow a little time to make sense of all the new terms, they're really not difficult if you dive right in.

Keep this guide handy as you explore the world of investing!

MUTUAL FUND TERMS

Closed-End Fund: A type of fund which issues a finite number of shares that trade throughout the day on stock exchanges at market-determined prices. Investors in a closed-end fund can buy or sell shares through a broker or online.

- Using this kind of fund is no different than buying and selling stock shares of any publicly traded company.

Diversification: Investing broadly across a number of different securities, industries, or asset classes to reduce risk. This is a principal advantage of investing in mutual funds.

Dollar-Cost Averaging: The practice of investing a fixed amount of money on a regular basis. This strategy results in buying more shares of a mutual fund when the price is lower and buying fewer shares when the price is higher, which lowers the average price paid for the fund shares.

- Also, this popular investment strategy promotes regular and consistent investing.

Expense Ratio: The total of a fund's expenses, shown as a percentage of its assets. These expenses include operating expenses, salaries, and more, and amount to most of the cost of owning shares of that fund.

Front-End Load: A fee that some funds impose at the time of purchase, in addition to the ongoing management expenses.

Hedge Fund: A private investment pool for qualified investors. Hedge funds are exempt from SEC registration. Among the various qualifications is a significant amount of wealth; the minimum investment is typically $1 million or more.

- Hedge funds don't have the same limitations as placed upon mutual funds. The risk and rewards can both be very high for hedge funds.

Hybrid Fund: A mutual fund that invests in both stocks and bonds.

Index Fund: A fund intended to mimic the performance of a market index. In essence, it's like owning a share of the entire market within that stock index.

Initial Public Offering (IPO): A closed-end fund's first offering of shares in that fund. Remember that closed-end funds are similar to stocks in many ways. Initial stock offerings from public companies are also referred to as IPOs.

Liquidity: When an investment can be quickly converted to cash, it is said to have a high amount of liquidity. Mutual funds are quite liquid because the shares can be sold back to the fund the next business day.

Money Market Fund: A mutual fund which invests in short-term securities. Money market funds are very safe, since the investments they make are quite low risk. Many people use these in lieu of a savings account. Money market funds are also a common place to hold money between investments.

Mutual Fund: An investment company that buys a portfolio of securities and is managed by a professional investment adviser.

- Mutual funds can be actively managed, where the manager creates a mix of investments to meet the fund's stated objective. They can also be passively managed, in which case the manager would just be attempting to track the performance of a particular index.

Net Asset Value (NAV): The per-share value of a mutual fund. This is determined by subtracting the fund's liabilities from its assets and holdings and then dividing by the number of shares outstanding.

No-Load Fund: A mutual fund that is sold without a sales commission and doesn't have a 12b-1 charge of more than 0.25% per year. (See below for definition of 12b-1 fees).

Open-end Fund: A mutual fund that sells shares directly to investors. The fund also buys back shares when investors decide to sell. The price of the shares is always the Net Asset Value (NAV).

Payroll Deduction Plan: Some employers provide employees the option of deducting a specific amount from their pay check at regular intervals; those monies are then used to purchase mutual fund shares.

Portfolio: The collection of securities (stocks, bonds, and other financial instruments) held by the mutual fund. The sum of your investment holdings would be your own personal portfolio.

Prospectus: Mutual funds have to provide an official document that describes the mutual fund to prospective investors. The information is required by the SEC and contains such attributes as policies, fees, and risks.

Stock Fund: A mutual find that primarily invests in stocks.

Total Net Assets: This is simply the total amount of assets a fund possesses minus its liabilities.

Total Return: A measure of a fund's performance that considers all aspects of return: capital gains distributions, dividends, and changes in net asset value. The total return is assessed over a specific period of time, and assumes that all dividends and capital gains distributions are reinvested.

Yield: A measure of income (dividends and interest) earned by the securities in a fund's portfolio minus the fund's expenses during a specified period. A fund's yield is expressed as a percentage of the maximum offering price per share on a specified date.

12b-1 Fee: A mutual fund fee, named for the SEC rule that permits it, used to pay distribution costs. One example of these expenses is compensation to financial advisers for initial and ongoing assistance. If a fund has a 12b-1 fee, it will be disclosed in the fee table of a fund's prospectus.

RETIREMENT

Retirement and education terms have been lumped together because these types of investments share many similarities. For both investments, it is frequently possible to make pre-tax contributions and/or take tax-free distributions.

Individual Retirement Account (IRA): An account by an individual to maintain and invest funds for retirement. Depending on the type of the account, either the contributions to the account are tax-deductible or the earnings are tax-free.

Keogh: This is a plan very similar to a 401k, only it is for self-employed individuals, partners, and owners of unincorporated businesses. It is sometimes referred to as an H.R. 10 plan.

Qualified retirement plan: These are plans that are acknowledged and authorized by the IRS and required to follow specific rules and regulations. Participants may accumulate money in these accounts on a tax-deferred basis. IRAs and 401(k)s are examples of qualified retirement plans.

Required Minimum Distribution: In general, holders of traditional IRAs must begin withdrawing money from the account by April 1 of the year after turning 70½. The amount required is a minimum distribution determined by your age and life expectancy. The IRS has tables available to determine the required withdrawal.

- If required withdrawals are not made on time, the IRS will collect an excise tax.
- Roth IRAs aren't subject to minimum distribution requirements until after the Roth owner dies.

Rollover: Under certain circumstances, when changing jobs, for instance, an investor may transfer funds from one qualified retirement account to another. This may be done without a tax penalty.

Roth IRA: Roth IRAs were first available in 1998. This IRA only allows after-tax contributions, but the earnings aren't taxed. Provided the guidelines are followed, all distributions are not taxable.

Traditional IRA: Traditional IRAs were first available in 1974. Typically, contributions to a traditional IRA are tax-deductible, provided that certain income thresholds are not exceeded.

401(k) Plan: A retirement plan sponsored by employers. A 401(k) allows employees to make tax-deferred contributions directly from their salaries to the plan. Employers may match a certain percentage of the employee's contributions.

403(b) Plan: This is very similar to a 401(k) plan, only it applies to employees of public schools, universities, and non-profit organizations.

457 Plan: Again, similar to a 401(k), but only applies to employees of state and local governments.

529 Plan: An investment program that is supported by state governments to help pay future qualified higher education expenses. There are two types of plans:

- Pre-Paid 529 Plan: These allow the purchase of academic credits at the present-day cost for future use. The school must be specified when opening the account.
- College Savings Plans: These allow contributions to an investment account for application to higher education costs. The school does not have to be specified.

STOCK MARKET TERMS

Annual Report: All companies are required by the SEC to produce an annual report. The report is sent to all shareholders and provides the financial results for the previous fiscal year. Accredited accounting firms review and verify the results.

Balance Sheet: This is a full accounting of a company's assets, liabilities, equity, and net worth at a certain point in time. A balance sheet is included as part of the annual report, and effectively tells you what the company is worth.

Bear Market: A bear market is one where there are considerable and long-term declines in the value of the market, typically for two or more quarters. There is not a precise or agreed-upon definition for this common term.

Blue Chip: The most stable and prestigious stocks on the stock market. Companies like General Electric and IBM are frequently considered to be Blue Chip stocks.

Bull market: The opposite of a bear market is a bull market. Two quarters of significant stock market growth and a positive outlook are characteristics of a bull market. This also usually means that there are more buyers than sellers, which drives up prices.

Capital Gain: Assets that are held for less than one year and sold for a profit are subject to ordinary income tax. This is also called a short-term capital gain. An asset that is held for more than one year and sold for a profit is considered a long-term capital gain and the tax rate is 20%.

Common stock: The basic unit of ownership in a corporation. Holders of common stock have certain rights, including voting on major issues concerning the corporation. When you buy stock, you are usually buying common stock.

Dividends: Profits paid to shareholders of the company. The board of directors authorizes the payment, usually quarterly. Commonly, dividends are in the form of cash, but may instead be additional shares of stock. Dividends are taxable.

- Companies with good opportunities for growth will usually elect to spend the money on expansion rather than giving it back to the shareholders in dividends, theoretically resulting in higher prices for the stock, which means greater gains for shareholders when they sell their stock.

EPS or Earnings per Share: This is calculated by dividing a company's net revenue by the number of outstanding shares. This number is commonly used to compare different companies on a per share basis.

The Fed or Federal Reserve Board: This organization ultimately controls the nation's interest rates. Consequently, The Fed has a tremendous influence on the stock market.

Fundamental analysis: This method for analyzing a stock looks at basic key ratios and attempts to understand the underlying business. This is normally undertaken to determine if additional analysis is worthwhile.

Growth Stocks: These stocks usually don't pay a dividend, but instead choose to put profits back into the company to finance additional growth. Investors buy growth stock for its potential price appreciation as the company grows.

Income Statements: Financial documents listing the income and expenses of a company.

Inflation: This occurs when the money supply is too great. It is a rise in price of a specific “bucket” of consumer goods. The percent increase from the last measurement is called the inflation rate. Interest rates will tend to rise overall, and this will slow market growth.

IPO or Initial Public Offering: The initial offering of a company's stock. Also used in mutual funds terminology, an IPO is a closed-end fund's first offering of shares in that fund.

Margin: A method to finance stock purchases. The stock that you already own is used as collateral for loan. The loan is then used to purchase additional stock.

Margin Call: If the stock you're using as collateral loses too much value, you must correct the situation by either depositing more money or selling other securities.

Market Capitalization or Market Cap: A way of measuring the size of a company. A market capitalization is simply the current stock price multiplied by the number of outstanding shares. A stock trading at $75 with 100,000,000 outstanding shares would have a market cap of $7.5 billion.

Market Order: An order to buy or sell a stock at the best available current price. A limit order specifies an exact price at which to buy or sell. A limit order may or may not be executed; a market order is executed immediately.

Mid Cap: This type of stock is any company with a market capitalization between $1 billion $8 billion.

NASDAQ: This is a stock exchange of primarily technological companies. It is similar to the NYSE.

The New York Stock Exchange or NYSE: The most prestigious and oldest of all stock exchanges in the United States.

Options: These give the owner the option to purchase or sell a specific number of shares of a stock at a specific price. Options are bought and sold on the open market.

Penny Stocks: Low priced stocks, usually around $1/share. They are not found on the major stock exchanges and usually carry high risk.

Preferred Stock: Similar to common stock, but the owners have additional rights not given to owners of common stock. Among these rights is a first call on dividends.

Price/Earnings Ratio (P/E): This shows how a company's earnings relate to the stock price. The P/E is the current price of the stock divided by the annual earnings per share. The higher the P/E, the more earnings growth investors will expect.

Recession: An economic condition defined by a declining standard of living and rising prices. Technically, a recession is defined by a decline in the nation's gross national product for two consecutive quarters.

ROI or Return on Investment: A measure of how good the investment is or was. ROI is calculated by subtracting the cost of the investment from the gain of the investment. That total is then divided by the cost of the investment.

- For example, if you bought a house for $100,000 and sold it for $120,000, the ROI would be ($120,000 - $100,000) / $100,000 = 20%.
- Is 20% a good ROI? That really depends on how long it took to make that 20%.

Securities and Exchange Commission (SEC): This is the chief regulatory body over the stock markets and publicly traded companies.

Short Selling: This is where an investor believes a stock is going to fall in price. The investor is able to borrow the stock from another client and then sell it. If the investor is correct, they would then buy the stock at the lower price, keep the difference, and then give the stock back to the person from whom they borrowed it.

Small Cap Stock: This type of stock is any company with a market capitalization of $1 billion or less.

Technical Analysis: A form of stock evaluation that relies on stock data to predict future price trends. Technical analysis does not consider the business itself, but focuses strictly on the numbers, using quantitative data to drive decisions.

Value Stocks: These stocks are underpriced by the market for reasons that have nothing to do with the business itself and are considered to be bargains.

Yield: The annual return of a stock, bond, or any investment expressed as a percentage of its cost.

BOND TERMS

Coupon: The interest rate the bond pays. This interest rate is usually fixed over the life of the bond. However, there are also bonds with variable interest rates that are tied to an external index.

Current Yield: The yield based on the current market price of that bond.

Face Value / Par Value: Also called the face or principal value of the bond. The owner of the bond is given the face value upon the maturity of the bond.

Maturity: Refers to the length of time until the face value is received. This period of time may be a few months or as long as 50 years.

Yield to Maturity: This calculation uses the current market price, interest rate, and time to maturity, and assumes that the interest payments received are reinvested at the bond's coupon rate. Also referred to as a bond's "yield."

- Yield to maturity calculations are extremely valuable because they include all the pertinent information and thus allow comparisons to be made between bond investments.

Zero Coupon Bonds: These don't provide periodic interest payments. Instead, they are sold at a discount. The only payment the investor receives is the face value at the end of maturity.

REAL ESTATE TERMS

Acceleration Clause: This is a clause in your mortgage that allows the lender to call the remaining principal of the loan due under certain circumstances. The most common reason for this occurring is if the borrower defaults on the loan.

Adjustable-Rate Mortgage (ARM): A mortgage in which the interest changes periodically. The interest rate is tied to a specified index.

Amortization: Your mortgage payment is applied to two things: the interest and the principal. As the loan is paid down, the interest portion of the payment decreases and the portion used toward the principle increases.

Annual Percentage Rate (APR): This is the true cost of your mortgage and takes into account all expenses. The APR includes fees and points, as well as the interest rate of your mortgage.

- Your APR is always higher than the interest rate of your mortgage. Also, it will tell you what your effective interest rate is, allowing easy comparison to other loan options.

Assumable Mortgage: A mortgage that can be assumed by the buyer when then home is sold. There is usually a qualification process for the new owner before he or she can assume the mortgage.

Balloon Mortgage: A mortgage that has a large final payment due at some point. For example, a loan may be amortized over a thirty-year period, but at ten years, the remaining principle must be paid in full.

Closing: This will mean different things in different states. In many states, a real estate transaction is not “closed” until the documents are recorded at the recorder's office. In others, the “closing” is the meeting at which the documents are signed and funds are exchanged.

Closing Costs: These are separated into either non-recurring closing costs or prepaid items. Non-recurring closing costs are items that are incurred only once as a result of buying the property or obtaining a loan. Prepaid items are those that recur over time, like homeowner's insurance and property taxes.

- To the best of the lender's ability, these non-recurring closing costs and prepaid items are shown on the good faith estimate (GFE) that they're required to provide to the borrower within three days of receiving the mortgage application.

Deed: The legal document that conveys title to a property.

Equal Credit Opportunity Act (ECOA): A federal law that requires lenders and other creditors to make credit equally available without discrimination based on race, color, religion, national origin, age, sex, marital status, or receipt of income from public assistance programs.

Equity: The difference between the fair market value of the property and the amount owed on the mortgage and other liens. To the owner, it is essentially the amount of net worth in the home.

First Mortgage: The mortgage that is in the preferential position among all the loans recorded against that property. This is the loan that would get paid first if the house were foreclosed and auctioned off. Normally, this is the loan that is recorded first, which is why it is commonly referred to as a first mortgage.

Fixed-rate Mortgage: A mortgage in which the interest rate is fixed throughout the life of the loan.

Good Faith Estimate (GFE): This estimate is required by law to be provided to a potential mortgage customer within three days of applying for a loan. The GFE must include an itemized list of all fees and costs associated with that particular loan. These fees include things like inspections, title insurance and taxes.

Home Equity Loan: A loan secured against a property that allows the borrower to obtain money drawn against home's equity. Usually such a loan is in second position (after the first mortgage).

Loan-to-Value Ratio (LTV): The amount of the loan divided by either the appraised value or sales price (whichever is lower). This value is one of the factors used to determine if a loan would be approved.

Note: Any legal document which obligates a borrower to repay a mortgage loan at a specified interest rate over a specified period of time.

PITI (Principal, Interest, Taxes and Insurance): Your mortgage payment may include all of these, depending on the terms of the loan. Taxes are frequently placed into an escrow account, and the lender applies the funds towards property taxes.

Points: Points are essentially fees that the borrower must pay to receive a home loan. One point would equal one percent of the loan amount. By paying more points upfront, a lower interest rate can usually be obtained.

Prime Rate: The short-term interest rate used by banks. The prime rate serves as the index in some adjustable rate mortgages and home equity lines of credit. You'll see the prime rate mentioned in the newspaper and on TV all the time.

- This number is invaluable; when the prime rate is rising, you can expect mortgage rates will eventually rise as well.

- Variables that influence the prime rate will usually affect the interest rates of new fixed mortgages. The prime rate is usually The Fed's funds target rate + 3%. Many interest rates used by the bank are a function of the prime rate.

Principal: The amount of money borrowed or the amount that remains unpaid. When you get a home loan for $100,000, the principal is $100,000. The principal can also refer to that portion of a loan payment that is applied to the principal balance of the loan.

Private Mortgage Insurance (PMI): This is mortgage insurance provided by a private mortgage insurance company. PMIs insure lenders in the event that the borrower doesn't pay. Most lenders generally require PMI for all loans where to loan-to-value (LTV) percentage is greater than 80%.

Qualifying Ratios: Lending institutions use several ratios to decide whether a borrower can qualify for a mortgage. The two ratios primarily used are the "top" or "front" ratio and the "back" or "bottom" ratio.

- The top ratio is a calculation of the borrower's total monthly housing costs (mortgage payment, taxes, insurance, mortgage insurance, etc.) divided by monthly income.
- The bottom ratio includes housing costs and also all other monthly debt. These ratios are very important to lenders.

When investing, you can make your best choices when you have a clear understanding of the terms used in the industry.

Now that you're familiar with these investment terms, you can use your new knowledge to improve your financial situation by starting a regular investment program today!

It is recommended that you have and consult your CPA, Financial Advisor, and lawyer in making decisions.

By Nathaniel X Ross, International Empowerment Life Coach

Want to learn more?

Go to my website www.nathanielxross.com