

Glossary of terms

Active Money

The difference between the weighting of the individual stock within the portfolio and that stock's weighting in the relevant index.

Active Risk

The sum of the absolute differences between the weighting of each individual stock within the portfolio and that stock's weighting in the relevant index, divided by two.

Alpha

The term used to describe the outperformance of an investment. A large Alpha indicates good performance relative to the relevant benchmark.

Attribution

A process whereby the performance of a portfolio is broken down into its underlying causes, usually the asset allocation and stock selection effects. It is a way of determining what contributed to the resulting total return and involves approximation.

BARRA Factors

BARRA is a risk management tool which measures the components of a portfolio's risk. It isolates factors contributing to risk, such as industry risk, stock specific risk or other factors as defined below:

Non-FTA Indicator

For the UK portfolios only, it captures the behaviour of smaller companies that are not in the main UK market, which consists of all the constituents of the FTSE All-Share Index.

Size

Differentiates between large cap and small cap stocks using the total market capitalisation.

Momentum

Measures the success of the company over the last year and over the last five years using its stock price behaviour in the market.

Volatility

Predicts a stock's volatility based on its historical behaviour. Unlike Beta, this factor measures the stock's overall volatility, including its response to the market.

Foreign Sensitivity

Captures the exposure to international business activity.

Trading Activity

Measures the relative turnover of a firm's shares as a fraction of total capitalisation.

Midcap Indicator

For UK portfolios only, identifies assets with a middle-range capitalisation and captures the tendency of stocks in this range to trade together, thereby generating a common source of portfolio risk.

Yield

Measures a company's current dividend yield and yield over previous years.

Value

Captures the extent to which a company's ongoing business is priced inexpensively in the market.

Growth

Measures the growth of company's earnings or assets.

Financial Leverage

Captures the balance sheet strength of a company.

Benchmark

The yardstick against which the portfolio's performance and risk is to be measured. This may be an index, a composite of indices, a notional fund, or the aggregate results of similar funds such as those constituting the CAPS or WM Universe.

Beta

An indicator of a portfolio's exposure to market risk as measured by the relevant benchmark. It measures the sensitivity of the portfolio's return to the return of the benchmark. The market, and the benchmark, has a beta of 1.0 as it moves in line with itself. A portfolio with a Beta of 1.05 can be expected to rise (fall) by 1.05% for each 1.0% rise (fall) in the benchmark.

Composite

The term used to describe the aggregation of a number of like portfolios, the performance of which is used for comparative purposes.

Correlation

The way in which the portfolio and its benchmark have moved relative to each other. Correlation coefficients range between +1.0 for assets which consistently move in the same direction, and -1.0 for assets which consistently move in the opposite direction. Assets with a correlation of zero are unrelated (or uncorrelated).

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Duration

A measure of the volatility of the price of a debt instrument. The longer the duration of a bond, the greater the extent to which its price is affected by changes in the level of interest rates.

ECB

European Central Bank.

EMU

Economic and Monetary Union.

Eurobond

A bond issued in a currency other than that of the country or market in which it is issued. Interest is paid without the deduction of tax.

Excess Return

Another term for Alpha.

FTSE Indices

FTSE 100, popularly known as the 'Footsie', is an index of 100 leading UK shares listed on the London Stock Exchange. It provides a continuous picture of how share prices are moving and is the basis of futures and traded options listed on the London International Financial Futures and Options Exchange (LIFFE). The benchmark for medium sized companies is the FTSE Mid 250, consisting of the 250 next largest companies. The FTSE 350 is a combination of the FTSE 100 and the Mid 250 indices. The FTSE Small Cap provides investors with a daily measure of the performance for around 500 smaller companies. The FTSE All-Share Index is the principal index for UK portfolio performance – covering large, medium and smaller companies.

Futures

Securities or goods bought or sold for future delivery. There may be no intention to take them up but to rely on price changes in order to sell at a profit before delivery.

Growth Stocks

Stocks which investors expect to enjoy a rapid growth in earnings.

Index

A representative basket of securities assembled to indicate the performance of a market in which those securities and other similar securities are traded. Indices are constructed and calculated by a number of different methods. The most

appropriate for comparison purposes is the "weighted average" approach, i.e. each constituent's influence on the index is weighted according to its market capitalisation. Some are used as a benchmark against which to compare the performance of portfolios invested in those marketplaces.

Index Tracker

A fund which is invested to replicate the index that it is tracking.

Information Ratio

Difference between the annualised average return and the annualised benchmark return (Alpha) divided by the tracking error. The higher the ratio the better as it shows the risk taken by the fund manager relative to the benchmark has been rewarded.

Monetary Policy

Efforts by a central bank through the fixation of interest rates to regulate money supply and credit conditions in the economy.

MPC

Monetary Policy Committee. The Committee within the Bank of England responsible for monetary policy decisions.

Money Weighted rate of return

A component of the time-weighted return (see below).

Option

The right (but not the obligation) to buy or sell securities at a fixed price within a specified period.

P/E or PER

Price Earnings Ratio; share price divided by earnings per share. A widely used method of comparing the value of a share with that of companies in a similar sector.

Quartiles (Upper-Lower)

When all funds in a universe are ranked in order of performance, the upper quartile is the return achieved by the fund one quarter of the way from the top. The lower quartile is the return achieved by the fund one quarter of the way from the bottom.

Risk

The most frequently encountered statistical measure of risk is the volatility or variability of returns compared to a portfolio's benchmark (see volatility).

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Risk Adjusted Return

A measure which seeks to allow a fair comparison of the achievements of portfolios with different risk profiles. This can be achieved by the use of return to risk ratios such as the Information Ratio (see above).

Standard deviation

Standard measure of the degree to which an individual value in the probability distribution tends to vary from the mean of the distribution.

Time Weighted Return

A return measure that eliminates the effect of cash flows on performance calculations. This is the measure used to compare the performance of a portfolio to a chosen benchmark. The TWR is derived by compounding Money Weighted Returns calculated on a monthly basis, with cash flows within the month being day dated and chain linking these Money Weighted Returns to create longer term TWRs.

Total Return

The return on an investment or portfolio that reflects both capital appreciation and income received.

Tracking Error

Measures the volatility (in terms of standard deviation) of relative returns (i.e. the fund return less the benchmark return). Tracking error is often used as a measure of risk taken against the fund's benchmark with a larger tracking error indicating that greater risk positions were taken relative to the benchmark in achieving the return of the fund.

Turnover

The measure of the total volume of dealing undertaken during the period. There are many different methods of calculating turnover and care should be exercised when comparing turnover data.

Value Stocks

Stocks having a low price relative to their earnings or to their asset value. Usually contrasted with 'Growth Stocks'.

Volatility

A measure used to assess the risk of a portfolio as it helps to describe the likely range of achievable returns. In statistical terms, it is the standard deviation of the return distribution. Greater volatility of monthly fund returns means that there is a wider range of likely returns in the future, or greater uncertainty regarding the fund return. Most investors would equate this greater uncertainty with greater risk.