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INVESTING: TERMS AND VOCABULARY

Some of the vocabulary surrounding investing and finance can be confusing, and whether you're just starting out or find yourself in a place where you must make financial decisions for the first time, this list of some of the more commonly used terms in finance should help.

Asset / Asset Allocation: An asset is anything you own that has monetary value. **Asset Allocation** has to do with the positioning of your assets among various types of investments. Decisions about where and how to invest assets are based upon desired objectives, such as long-term growth, capital preservation, or income generation. This may be done with the help of a financial advisor who uses complex mathematical models. While asset allocation is not a guarantee against losses, it can help manage risk.

Beneficiary: When investors open retirement accounts or buy life insurance policies, or annuities, they are usually asked to name a person who would receive the financial benefits of the accounts in the event of their death. That person is called a beneficiary. This also applies to wills, trusts, and other agreements, and a named **beneficiary** can also be an individual, company, or an organization.

Bonds: Bonds can be described as a loan made by an investor to a borrower. Buying a bond implies that you hold a share of an entity's debt, and are entitled to receive periodic interest payments, thus the term fixed income, plus the return of the principal, or face value of the bond, once it matures. Bonds are often issued by corporations, municipalities, states, or nations looking to fund a project.

Capital Gain or Loss: A capital gain is the profit an investor earns on the sale of an asset like stocks, bonds, or any other type of asset. If the selling price of the asset exceeds the purchase price, it is a capital gain. If the sale price of the asset is less than the purchase price, the difference is called a capital loss.

Certificate of Deposit (CD): CDs are financial products commonly sold by banks, thrift institutions, and credit unions. A CD is different from a savings account. Where savings accounts tend to earn a very low interest rate, they are very liquid, allowing withdrawals when needed. CDs, however, have a specific, fixed term (ranging from 1 month to 5 years) and normally offer a higher fixed interest rate than a savings account. Because banks expect CDs to be held until maturity, an investor who withdraws money from a CD early will face penalties. Once the CD matures, the investor receives her original deposit plus any remaining accumulated interest.

Closed-End Fund: A closed-end fund is a collective investment model based on issuing a fixed number of shares through an IPO. After the initial offering, the shares are listed on a stock exchange. Each shareholder owns a portion of the fund's investment portfolio. The portfolio is overseen by professional fund managers who actively buy and sell its assets. Unlike an open-end mutual fund, closed end funds' shares are not redeemed by the fund company but are purchased and sold only on the secondary market, where the share price fluctuates according to supply and demand.

Common Stock/Equity: When a publicly owned company issues shares of its stock, investors who purchase them gain fractional ownership in that corporation, becoming shareholders. Stock shares are bought and sold by investors on an open exchange and the price at any time may be higher or lower than the price when purchased. When a company is thriving, shareholders may benefit through appreciation of the share value and the receipt of dividends paid out of the company's profits. Corporations use the proceeds to operate their businesses.

Compound Interest: Compound interest on a loan or deposit that is calculated using both principal and accrued interest from previous periods. With compound interest, sums grow at a faster rate than they would if they were based on simple interest, or interest that is calculated using only the principal amount. Compound interest may be computed continuously, daily, monthly, quarterly, semiannually, or annually, so the earlier an interest bearing account is opened, the more it will grow over time.

Diversification: Diversification is a way to reduce risk in an investment portfolio by spreading funds across several different types of investments, such as stocks, bonds, or other assets. Like the idea of not putting all of your eggs in one basket, diversifying by including a variety of assets within a portfolio limits exposure to one single asset type or risk. While diversification is not a guarantee against losses, it certainly helps investors mitigate risks.

ESG Investing: Environmental, Social and Governance investing, also known as "sustainable investing," is a class of investing in which non-financial factors are applied to investments. These investments seek to make a positive social or environmental impact while also positively impacting the performance of a socially responsible business.

Exchange Traded Fund (ETF): Exchange traded funds are collections of securities—such as stocks—that track an underlying index, business sector or commodity. Several of the most popular ETFs track the S&P 500 index, which is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. This index is typically seen as one of the best measurements of how the largest companies in the U.S. are doing at any given time. ETFs can be bought and sold on a stock exchange throughout the day, just like regular stocks, whereas mutual funds can only be purchased once a day at the end of trading, based on a calculated price.

Retirement Accounts

- **Traditional IRA:** A "traditional" IRA, or individual retirement account, allows anyone with earned income to save for retirement on a tax-deferred basis. Contributions made to a traditional IRA may be deductible from earned income when calculating state and federal income taxes, if the taxpayer meets certain requirements. Assets held in IRAs accumulate tax-deferred, and are subject to income taxes at the time of withdrawal which can begin when you reach age 59 ½. If an investor needs to withdraw money from her IRA prior that age, she can; however, the amount withdrawn will be subject to taxes plus penalties. Contribution limits apply.

- **Roth IRA:** Roth IRAs allow investors to save for retirement on a tax-free basis. In a Roth IRA, the tax break comes at the time of withdrawal, in contrast to the traditional IRA's tax-deductible contributions and taxable withdrawals. Withdrawals from Roth IRAs are tax-free, and investors do not have to pay taxes on investment gains. Unlike traditional IRAs, Roth IRAs present with income limits such that investors making a certain amount of income over the IRS's threshold can no longer contribute to the account. Contribution limits also apply.

- **401(k) Plan:** A 401(k) plan is a tax-advantaged retirement account offered by many employers to their employees. Like an IRA, contributions and investment earnings in the accounts are not taxed until investors withdraw the money. Plan participants may allocate a portion of their salaries into 401(k) plans, and those contributions are not included in their income as taxable (with some exceptions). Employers often provide matching funds to encourage retirement savings. When investors withdraw money from a 401(k), usually starting at age 59 ½, those withdrawals are taxed as ordinary income. If investors withdraw money from the account prior to reaching age 59 ½, they may be subject to an additional 10 percent Federal tax penalty. Contribution limits apply.

- **Roth 401(k) Plan:** Similar to a 401(k) plan, a Roth 401(k) is an employer-sponsored account; however, Roth 401(k) plans are funded with after-tax dollars, whereas traditional 401(k) plans are funded with pre-tax dollars. Like standard 401(k) plans, Roth 401(k)s have annual contribution limits. Withdrawals on Roth 401(k) plans are not taxed, as long as a) the account has been held for at least five years, and b) the withdrawal occurs due to a disability, on or after the death of the account owner, or when the account owner reaches age 59 ½.

- **403(b) Plan:** 403(b) plans are tax-sheltered annuity, or TSA plans, that are similar to 401(k) plans, with the main difference being that these plans are offered to employees of tax-exempt organizations such as nonprofits, churches, hospitals, and public education institutions. Contribution limits apply.

- **401 (k) Rollover:** A qualified plan rollover can occur when a 401(k) plan participant changes employers or accounts. The IRS allows up to 60 days to transfer the assets to another qualified retirement plan to preserve the tax-deferred status of the assets, and investors are only allowed one rollover per 12-month period from the same account. However, plan to plan rollovers may be exempt from this limit.

IPO: An initial public offering, or IPO, is a type of public offering in which shares of a company are sold to institutional and individual investors. An IPO is usually underwritten by one or more investment banks, who also arrange for the shares to be listed on one or more public stock exchanges. Through this process, commonly known as floating, or going public, a privately held company is transformed into a public company.

Money Market Fund: A money market fund is a type of mutual fund that specializes in investing in short-term, highly liquid securities. This can include cash, cash equivalent securities, and other types of securities with short-term maturity, such as U.S. Treasuries. Money market funds attempt to maintain a constant net asset value of $1. Money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any government agency. Although money market funds seek to preserve the value of your investment at $1 per share, it is possible to lose money when investing in a money market fund.

Mutual Fund: Mutual funds are professionally managed investment funds that pool money from many investors to purchase a diversified portfolio of securities like stocks, bonds, money market instruments, and other types of assets. Mutual funds are managed by professional money managers who invest the fund's assets to produce gains for the fund's investors. Shares of an open-ended mutual fund are sold, or redeemed, by the fund company directly to investors at set daily intervals, rather than being traded on an open market. The share price, or net asset value, is based upon the underlying market value of the portfolio holdings. Mutual funds offer smaller investors a chance to participate in the markets and to benefit from diversification achieved through a large investment portfolio There are thousands of mutual funds available catering to a wide range of investment objectives.

Price/Earnings Ratio (P/E Ratio): The price earnings ratio helps relate a company's stock price to its earnings per share. This is a calculation made by dividing the market price of a stock by the company's annual earnings per share. Because the P/E ratio is a widely regarded yardstick for investors, it often appears with stock price quotations.

Principal: The term **principal** refers to the original amount of money that an investor has borrowed or put into an investment, excluding earnings. Principal can also refer to the face value of a bond.

Risk: Risk is the chance that an outcome on an investment will differ from its expected outcome or return. This includes the possibility of losing some or all of an original investment. Risk is the measure of chance an investor is willing to take in relation to her expected return. **Risk tolerance**, then, is the amount of risk an investor is willing to handle when making investment decisions.

Short Position: "Shorting" is the process of borrowing securities and selling them with the hope of repurchasing them at a lower price. An investor may short a stock when she believes the price of the stock is likely to decrease soon. This strategy is considered higher risk than purchasing the securities because the investor is obligated to purchase and replace the borrowed securities at the prevailing market price at the time the short position expires.

Tax-Exempt Bond: In some instances, interest from bonds issued by government entities like states, cities or others, are exempt from federal income taxes, and in some states this interest is also exempt from state and local income taxes. If an investor sells a tax-exempt bond at a profit, she may incur capital gains taxes. Because the principal value of bonds fluctuates based on market conditions, if an investor sells a bond prior to maturity, the bonds may be worth more or less than the original cost.