

The Passionate Shepherd

What the dickens?

CAPITAL MARKETS VAGUERIES

capital markets. Collective term for various types of markets where money can be raised from investors. They comprise: share markets; bond markets; commercial paper markets; domestic and international (euromarkets); the primary market and the secondary market. The markets for the purchase and sale of medium- to long-term financial instruments such as bonds and equities, commodities, and the derivative instruments created on the same.

stock exchange An institution through which company shares and government stock are traded. Originally the exchange would be a building, where traders would gather and trade proceeded either by individual negotiation or by 'open outcry', where prices bid and offered were announced out loud so as to inform all traders within earshot. Modern stock exchanges are institutions with traders linked by computer networks and telephones. Market-makers work either on a quote-driven system, announcing bid and offer prices at which they will trade with all comers, or on an order-driven system, where buy and sell orders are brought together and matched as far as possible at regular intervals, for example daily. In either case large deals usually get special treatment. Stock exchanges have rules about the information companies have to provide for their shares to be listed, the individuals or firms allowed to trade, the notification of trades carried out, and the procedure for settlement, that is actual delivery of shares and money payments. There are stock exchanges in all major world commercial centres, for example Frankfurt, London, New York, Paris, and Tokyo.

stock 1. In the UK, a fixed-interest security (see gilt-edged security) issued by the government, local authority, or a company in fixed units, often of £100 each in the UK and \$1,000 in the USA. They usually have a redemption date on which the par value of the unit price is repaid in full. They are dealt in on stock exchanges at prices that fluctuate, but depend on such factors as their yield in relation to current interest rates and the time they have to run before redemption. See also tap stock.

2. The US name for an ordinary share.

3. The stock-in-trade of an organization.

4. Any collection of assets, e.g. the stock of plant and machinery owned by a company.

stock 1. A variable which refers to the state of affairs at a point in time. This is contrasted to a flow, which refers to the rate at which something happens over a period of time. For example the money supply, the price level, the assets of a firm, or the level of employment are stock concepts; whereas the national income, the profits of a firm, or the level of industrial production are flow concepts.

2. A synonym for stocks, a collection of goods held by an enterprise. Stock appreciation is an increase in the value of stocks held due to price changes. A stockpile is a large holding of commodities, held for example by a government as a strategic reserve.

3. A synonym for share. Common stock is the US term for ordinary share. Government stock is

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government debt instruments.

bonds A contract or a written promise to pay a specific sum of money (the principal) at a certain date in the future, with interest paid according to an explicit schedule during the interim. Bonds are issued by governments and corporations to finance deficits or to acquire assets. They differ from other debt instruments such as loans or notes in that they have long maturities, or sometimes none at all (as in the case of *consols*). For some bonds, the issuers have the right to call them in after they have been outstanding for a specified period—these are *callable* bonds. While bondholders have no ownership stake in the issuer's common stock, some corporate bonds have a clause that permits the conversion of the bond to shares in the common stock at a specified conversion value. These are *convertible* bonds. The Black-Scholes option pricing formula is designed to determine the value of such an option.

Bonds are usually negotiable and are traded in an established secondary market. The return from a bond has two components: the sum of the interest payments and the change in its price in the secondary market, which yields capital gains or losses if the bond is sold.

bond A security with a redemption date over a year later than its date of issue. Bonds may be issued by firms, financial institutions, or governments. They may have a fixed redemption date, an option for the borrower to repay at any date over a period, or even be perpetuities. They may carry fixed interest, or interest variable with notice or linked to some financial index. Their interest and redemption payments may be specified in money terms, or index-linked to a suitable price index. Finally, they may vary in the degree of risk attaching to them. Government bonds are called 'gilt-edged', and are generally regarded as very safe. Well-established firms issue 'investment-grade bonds', which are also regarded as safe, while financially adventurous firms issue 'junk bonds', where there is recognized to be a non-negligible danger that the borrower may default.

When bonds have a long time to go to maturity, their market price is sensitive to changes in current and expected interest rates, which control the present discount value of future redemption and interest payments. A rise in interest rates lowers present discounted value; thus even bonds which are extremely safe, in the sense of absence of risk if held to maturity, suffer from large variations in their market value as interest rates change. Bonds are therefore not liquid assets. This liability to price fluctuations diminishes as redeemable bonds approach maturity.

secondary market (after market) A market in which existing securities are traded, as opposed to a primary market, in which securities are sold for the first time. In most cases a stock exchange largely fulfils the role of a secondary market, with the flotation of new issues representing only a small proportion of its total business. However, it is the existence of a flourishing secondary market, providing liquidity and the spreading of risks, that creates the conditions for a healthy primary market.

new issues market. The market in which securities are first offered to investors

aftermarket or secondary market. That part of a market that trades securities previously issued securities up to their maturity. It is considered to be important to have an active aftermarket in order

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to stimulate demand for new issues. In the eurobond market, it is used sometimes for the period between the launch of an issue and the ending of restrictions on trading.

parallel money markets Money markets in which banks, companies, and local government bodies can borrow or lend to each other without using traditional discount houses. The primary parallel money market is the interbank market.

equity or equities. **1.** The risk capital of a firm. It is that part of the long-term liabilities used to fund a company that take part in the profits after prior charges have been met or the residual value of the company in liquidation after paying off all creditors. There are many different types of equity: common stock, and a wide range of preferred stock. The major distinguishing factors between equity and debt instruments (bonds, debentures and loans) are the ownership rights, voting rights, and the tax treatment. Equity receives dividends after company or corporation tax has been paid and holders of equity sometimes have to pay an additional tax on such receipts under a classical corporation tax system, although with an imputation tax system they may receive a balancing tax credit. From an accounting perspective, retained reserves are also shareholders funds .

2. Often used to mean the common stock of a company. Sometimes called the firm's *equity capital*, but this may include preferred stock.

3. The major class of security listed on a stock exchange.

4. A holder's stake or contribution to a transaction.

5. Another term for net worth, i.e. total assets less fixed liabilities.

6. A beneficial interest in an asset. Hence, an *equity interest*.

7. The excess margin in an account over and above that required to maintain the position.

over the counter (OTC). Markets or transactions arranged bilaterally between two principals without the participation of an exchange. Prices in OTC markets are set by dealer trading rather than the auction system of most organized exchanges.

cash instruments. Those financial instruments, which are generally bought and sold for immediate delivery as opposed to derivative, such as forwards, futures, swaps, or options, where the payment on the underlying is deferred to a later date.

securities. Tradable claims on a corporation or the state. *Securities* is a generic term for both debt claims, such as bonds or promissory notes and certificates representing ownership, such as common stock, as well as being used for derivatives although, in this case, the term instrument is to be preferred.

instrument. **1.** A generic term for securities and risk management contracts, ranging from debt to negotiable deposits and bonds and including derivatives. Normally used to describe financial arrangements with short-term maturities, such as *money market instruments*.

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2. An official document.

3. A means for achieving an end. For instance, manipulating interest rates is the instrument or means for controlling demand in an economy.

securitization The process of creating a tradeable financial instrument (a security) from a non-tradeable financial asset, such as a bank loan.

securities pl. n. Loosely, stocks, shares, debentures, bonds, or any other rights to receive dividends or interest. Strictly, the term should only be used for rights backed by some sort of security, as in the case of debentures.

hedge fund An investment fund specializing in taking speculative positions in markets, for shares or currencies. This may involve selling short, that is, selling forward shares or currency which the fund does not actually possess, in the expectation that the price will fall. Hedge funds are thus extremely risky; they are in principle the only form of investment fund which can profit from bear markets, though in practice most do not.

hedging Activities designed to reduce the risks imposed by other activities. If a business has to hold stocks of a commodity, it runs a risk of making losses if the price falls. This loss can be avoided by hedging, which involves selling the good forward, that is for delivery at an agreed price on a future date, or by selling in the futures market. If the good is homogeneous, it may be possible to remove the risk completely by hedging. If the good is not homogeneous, the price of the particular goods held may not move in precisely the same manner as the standard commodity traded in forward or futures markets, but provided that there is some correlation between the two prices, hedging reduces the risk. An alternative method of hedging the risk of stock-holding is to buy a put option, which allows but does not compel the holder to sell at the contract price. Similarly, a firm which knows it will have to obtain supplies of a good at a future date may wish to protect itself against the risk that when the time comes the cost of the goods will be very high. It can hedge this risk by buying forward or buying a futures contract, or by buying a call option, which gives it the right but not the obligation to buy at the contract price.

leverage or leveraged. 1. (USA) The US term for gearing or the debt-equity. Also gives rise to the phrase *leveraged buyout* or *takeover* where such transactions are financed mainly or exclusively on the basis of debt.

2. Sometimes used to describe a portfolio's exposure to market risk.

3. In margin purchases and derivatives, the ratio of the amount of principal required to the amount of exposure to the underlying.

4. Any transaction involving derivatives where the payoff is greater than the amount of principal involved. It can also apply to securities which have embedded options or swaps. Sometimes also called *elasticity*.

5. Colloquially used for a transaction allowing the opportunity for large gains at little cost.