Definitions

Finance

I. Definitions (Problem Set Financial s - establishments composed of organizations such as banks, trust companies, insurance companies and investment dealers involved in dealing with financial transactions as investments, loans, and deposits.

Financial Intermediaries - institutions (such as bank, finance company, credit union, brokerage) that serves as ‘ middleman’ between investors and firms raising funds.

Financial Markets - any marketplaces where buyers and sellers participate in the trade of assets such as equities, bonds, currencies, and derivatives, allowing only participants that meet certain criteria by which such markets are normally defined by having transparent pricing, basic regulations on trading, costs and fees, and market forces that are determinants to trading prices of securities.

Financial System - system that enables transfer of money between savers or investors/lenders and borrowers and may also pertain to the set of implemented procedures that track the financial activities of the company.

Financial Instruments - real or virtual, typically equity-based, documents representing a legal agreement involving some sort of monetary value.

Stock - the ‘ goods’ or merchandise kept on the premises of a business or warehouse and available for sale or distribution.

Bond - A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate.

Equity - A stock or any other security representing an ownership interest.

Debt - something owed, such as money, goods, or services; an obligation or liability to pay or render something to someone else.

Diversification - a risk management technique that mixes a wide variety of investments within a portfolio and strives to smooth out unsystematic risk events in a portfolio so that the positive performance of some investments will neutralize the negative performance of others.

US T-bill - a short-term debt obligation backed by the U. S. government with a maturity of less than one year.

Commercial Paper - an unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities.

Bankers' Acceptance - a short-term debt instrument issued by a firm that is guaranteed by a commercial bank.

Repurchase Agreement - (repo for short) is a type of short-term loan much used in the money markets, whereby the seller of a security agrees to buy it back at a specified price and time; the seller pays an interest rate, called the repo rate, when buying back the securities.

Eurodollars - U. S.-dollar denominated deposits at foreign banks or foreign branches of American banks.

CD - (Certificate of Deposit) is a savings certificate entitling the bearer to receive interest; a CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination.

Federal Funds - excess reserves that commercial banks deposit at regional Federal Reserve banks and can then be lent to other commercial banks with insufficient reserves.

US Treasury Security - government debt issued by the United States Department of the Treasury through the Bureau of the Public Debt; treasury securities are the debt financing instruments of the United States federal government, and they are often referred to simply as “ Treasuries.”

Money Markets - segments of the financial market in which financial instruments with high liquidity and very short maturities are traded.

Capital Markets - made of both the primary and secondary markets in which individuals and institutions trade financial securities.

OTC Markets - decentralized (Over-The-Counter) markets of securities not listed on an exchange where market participants trade over the telephone, facsimile or electronic network instead of a physical trading floor.

Primary Markets - markets that issue new securities on an exchange.

Secondary Markets - also called ‘ aftermarkets’, are financial markets in which previously issued financial instruments such as stock, bonds, options, and futures are bought and sold.

Derivative Markets - the markets for the sale of futures, forwards, options, and other securities except for regular stocks and bonds.

Auction Markets - markets in which buyers enter competitive bids and sellers enter competitive offers at the same time.

Cash Markets - the marketplace for immediate settlement of transactions involving commodities and securities.

Adverse Selection - also called anti-selection or negative selection refers to a market process in which “ bad” results occur when buyers and sellers have asymmetric information (i. e. access to different information): the “ bad” products or services are more likely to be selected.

Moral Hazard - The risk that a party to a transaction has not entered into the contract in good faith, has provided misleading information about its assets, liabilities or credit capacity, or has an incentive to take unusual risks in a desperate attempt to earn a profit before the contract settles.

Money - a medium that can be exchanged for goods and services and is used as a measure of their values on the market, including among its forms a commodity such as gold, an officially issued coin or note, or a deposit in a checking account or other readily liquefiable account.

Federal Reserve System - a U. S. banking system that consists of 12 federal reserve banks, with each one serving member banks in its own district.

Barter - the act of trading goods and services between two or more parties without the use of money.

M1, M2, M3, and L - money supply

Commodity Money - is money whose value comes from a commodity out of which it is made.

Fiat Money - currency that a government has declared to be legal tender, despite the fact that it has no intrinsic value and is not backed by reserves.

Transaction Costs - costs incurred when buying or selling securities.

Purchasing Power - The value of a currency expressed in terms of the amount of goods or services that one unit of money can buy.

I. Definitions (Problem Set #2)

Yield to Maturity - the rate of return anticipated on a bond if it is held until the maturity date and is considered a long-term bond yield expressed as an annual rate.

Current Yield - annual income (interest or dividends) divided by the current price of the security.

Real Interest Rate - an interest rate that has been adjusted to remove the effects of inflation to reflect the real cost of funds to the borrower, and the real yield to the lender.

Fisher Hypothesis - an economic theory proposed by economist

Irving Fisher that describes the relationship between inflation and both real and nominal interest rates.

Nominal Interest Rate - the rate of interest prior to taking inflation into account.

Present Value - the current worth of a future sum of money or stream of cash flows given a specified rate of return.

Capital Gain - an increase in the value of a capital asset (investment or real estate) that gives it a higher worth than the purchase price.

Discount Bond - a bond that is issued for less than its par (or face) value, or a bond currently trading for less than its par value in the secondary market.

Coupon Bond - (also known as a " bearer bond") is a debt obligation with coupons attached that represent semi-annual interest payments.

Fixed Payment Loan - the amount due every period by a borrower to a lender under a fixed-rate loan.

Simple Loan - loan bearing simple interest which is determined by multiplying the interest rate by the principal by the number of periods.

Consol - a " perpetual bond" or a bond with no maturity date; consols are not redeemable but pay a steady stream of interest forever.

Total Rate of Return - the actual rate of return of an investment or a pool of investments over a given evaluation period when measuring performance and this includes interest, capital gains, dividends and distributions realized over a given period of time.