

# Investment Glossary

## The BAM ALLIANCE Edition

### A-Z: Investing Glossary

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With its big words, rampant jargon and buzzwords, the financial world has a language all its own. Our investing glossary can help you follow along as it defines various terms through the lens of our evidence-based investing philosophy and the viewpoints of our National Thought Leaders. This glossary isn't exhaustive (it covers A to Z but not every point in between), but we hope it is educational, enlightening and, perhaps, entertaining. If you want to get a word in, [send us](#) your glossary suggestions and check back as we update it periodically.

#### A-C

**Active Management:** The belief that someone can use their skill — honed through a blend of research and judgment — to profit by timing the stock market and identifying mispriced securities. Director of Research **Larry Swedroe** says, “Active management is the triumph of hype, hope and marketing over wisdom and experience.”

**Behavior Gap:** Coined by Director of Investor Education **Carl Richards**, this is a comparison of the returns *investors* get to the returns *investments* get. For far too many investors, their returns are comparatively lower because of their lack of patience and their attempts to time the market. As Richards wrote in his first book (titled, of course, *The Behavior Gap*): “It's clear that buying even an average mutual fund and holding on to it for a long time has been a pretty decent strategy. But real people don't invest that way. We trade. We watch CNBC ... We buy what's up and sell what's down. In other words, we do exactly what we all know we shouldn't do.”

**Biases:** Assorted biases are prevalent in investing. National Thought Leaders from the BAM ALLIANCE offer their perspectives on [behavior bias](#), [cognitive bias](#) and [recency bias](#).

**Bonds:** Director of Personal Finance **Tim Maurer** wrote for Forbes.com, “The antidote to stock volatility is fixed income, or bonds. We invest in stocks to make money, but we invest in bonds to keep us invested in stocks when volatility threatens to derail us from our long-term financial plan. Yes, a well-diversified, all-stock portfolio should certainly earn more than a balanced portfolio over your lifetime. But if you abandon your portfolio due to high volatility in the worst of times, it's all for naught.”

**Cramer, Jim:** See *Noise*.

## D–H

**Diversification:** Making sure you don't have all your eggs in one basket. There's a good chance you won't be entirely happy with some part of your portfolio each year. Diversification also means there's a good chance your portfolio won't get wrecked each year.

**Evidence-Based Investing:** Director of Investor Advocacy Dan Solin wrote in his blog on HuffingtonPost.com: "I am a proponent of evidence-based investing. The evidence is compelling that investors have higher expected returns when they reject actively managed funds and invest in a globally diversified portfolio of low-management-fee index funds, in an asset allocation appropriate for them."

**Fama-French Three-Factor Model:** This oft-cited model is a pillar of evidence-based investing. Through their research, Eugene Fama and Kenneth French statistically explain how, from a historical perspective, 1) stocks return more than bonds, 2) small company stocks return more than large-company stocks and 3) stocks of value companies (those that are undervalued) return more than growth companies. A *Forbes* commentary called the Fama-French Three-Factor model "the most widely accepted explanation of stock prices in the aggregate and investor returns."

**Goals:** Goals are a good thing, except when they aren't. Like when we set unrealistic ones, or obsess over them, or stray from rational thoughts and behaviors in an attempt to reach them. It's healthy to have goals, financial or otherwise, but only as long as we have guards in place to make sure the pursuit of them doesn't throw us off course.

**Hedge Funds:** Investopedia defines hedge funds as "alternative investments using pooled funds that may use a number of different strategies in order to earn active returns, or alpha, for their investors." Or not earn. Hedge funds have underperformed U.S. stocks (as measured by the S&P 500 Index) for seven straight years.

## I–M

**Index Funds:** *Indexing* involves owning a portfolio of funds that is designed to match or track a market index such as the S&P 500. The index fund seeks to provide broad market exposure, low expenses and low turnover. All index funds are passively managed, but not all passive asset class funds are index funds.

**Investment Policy Statement:** This document can serve as an investor's rules of behavior when it comes to risk tolerance — how much to invest in stocks vs. bonds, when to rebalance, etc. These rules, of course, are only good if followed, as Carl Richards writes in his New York Times column: "Perhaps the only thing that's worse than not having an investment policy statement is not following the one you do have. The rules set by the statement are very important because they prevent us from making rash, emotional decisions at precisely the time when calm, collected, logical thought is most valuable. When we abandon those rules in our most vulnerable state, we open the door for potential disaster."

**Market Downturns:** When markets take a sharp downturn, investors are faced with an uphill battle that they can never climb. At least, that's the message often spread loudly by the financial media. The more logical (but boring) sentiment to share would be to remind investors that these downturns are what allow stocks to produce higher returns than bonds over the long run.

## N–S

**Noise:** Information and communication that can distract you from carrying out a well-thought-out, long-term investment plan. This can come in many forms, be it a hot stock tip from a co-worker or projections from gurus in the financial media on which way the market might go next.

**Risk:** When it comes to risk, investors should only take what they are able, willing and need to take in order to reach their long-term goals, while also sleeping OK at night.

**Safety Net:** The role that fixed income plays in your portfolio; it is there to provide stability and to balance risk while your stocks live in an up-and-down environment. BAM's Fixed Income Desk typically builds the fixed income portion of a portfolio using individual high-quality, short- to intermediate-term bonds.

## T–V

**Tracking Error:** Morningstar defines it as "the amount by which the performance of the portfolio differed from that of the benchmark." **Tim Maurer** defines it as "the empty feeling in your gut screaming that you missed out on something which was yours to be had." True, tracking error can test the discipline of some investors, who covet what could have been if they had invested solely in an S&P 500 index fund during a good run for stocks. But what about the not-so-good runs? That's why a well-diversified portfolio usually is a better option for the long haul.

**Underperformance:** The historical evidence shows this is what the highest-cost mutual funds tend to display, as explained by Larry Swedroe in his blog "[Don't Buy Winners.](#)"

**Volatility:** Big swings in the market that can cause big swings in logic (buy high, sell low).

## W–Z

**Why:** This one word can provide the base to your focused yet multilayered investment plan. *Why are you doing what you're doing with your money? Why is money important to you? Why am I listening to someone who knows nothing about my situation?* When planning your financial future, make sure you're asking *Why?*

**Zweig, Jason:** Wall Street Journal columnist and author of the book *The Devil's Financial Dictionary*, a far more comprehensive, witty guide that offers a wide, wide array of financial terms (including "dead-cat bounce") that are accentuated with Zweig's personal takes. Larry Swedroe [strongly endorses](#) Zweig's offering, writing, "Not only is the book wickedly humorous, irreverent and wise, it contains a wealth of knowledge regarding the historical derivation of many terms in common use today."