Glossary

12(b)-1 fee: Fee assessed shareholders by mutual funds for certain promotional expenses.

Abnormal return: The part of a security's return that was not expected; that is, it appears to be attributable to something other than time value of money or risk. Also called excess return or residual.

Adverse selection: Precontractual opportunism where one party to a contract (e.g., purchaser of insurance) uses his private information (e.g., information with respect to risk-taking) to the other counterparty's disadvantage.

Agency issue: A security issue by an agency of the U.S. federal government. Includes securities issued by GNMA (Ginnie Mae), FNMA (Fannie Mae), and SLMA (Sallie Mae).

Alpha: (1) See Jensen's alpha. (2) Model, program, or strategy intended to generate a profit.

Agency trader: Trader who acts as a commission broker on behalf of clients.

Algo trading: See algorithmic trading.

Algorithmic trading: (1) Automated trading with the use of live market data and rule-driven computer programs for automatically submitting and allocating trade orders among markets and brokers as well as over time so as to minimize the price impact of large trades. Also called automated trading, black box trading, and robotrading. (2) Alpha model automated trading that is used to make trade decisions to generate profits or control risk.

Alpha model: (1) Gauges the performance of a trading strategy relative to a benchmark on a risk adjusted basis. (2) Model that seeks to outperform a benchmark on a risk-adjusted basis.

Alternative trading system (ATS): A securities trading venue that is not registered with the SEC as an exchange.

American depository receipts (ADRs): Shares issued by banks evidencing ownership of shares of foreign company stock that are held by its sponsor through a trust.

American option: Can be exercised any time prior to expiry.

Arbitrage: (1) The simultaneous purchase and sale of the same asset. (2) The near-simultaneous purchase and sale of assets generating nearly identical cash flow structures.

Arbitrage opportunity: Arbitrage transaction producing a profit, by purchasing at a price that is less than the selling price.

Arbitrageur: Trader who seeks to profit from arbitrage opportunities.

Arrival price (bid−ask midpoint or BAM): The midpoint of the bid−offer spread at the time the order is received.

Ask: A solicitation to sell (also called an offer).

ATS: See Alternative trading system.

Auction: A competitive market process involving multiple buyers, multiple sellers, or both. An auction is the process of trading a security through bidding, then selling it to the winning bidder.

BAM: See Arrival price.

Banging the close: Flooding a market sell orders its final minutes of trading before the close, thereby forcing prices down as buying interest diminished. A form of wash sale intended to manipulate prices.

Banker's acceptance: Marketable security originated documenting a bank's acceptance of a responsibility to pay a client's loan or for assuming some other financial responsibility on behalf of a client.

Bargaining: The negotiation process over transaction contract terms that occurs between a buyer and a seller for a transaction.

Basis point: 0.0001 of a unit. Typically used in foreign-exchange and fixed-income market quotes.

Basis: The potential for a price to move in the direction anticipated by an arbitrageur, at least in the short run.

Basis risk: Risk that markets might move too slowly to profit from an apparent arbitrage, or that markets might move opposite to the arbitrageur's expectations, at least in the short run.

Beta: Coefficient that measures the risk of a security relative to the risk of some factor (usually the market).

Bid: A solicitation to buy.

Binomial option pricing model: Valuation model based on the assumption that the underlying stock follows a binomial return generating process.

Binomial process: The asset value takes on only one of two potential constant values at any given time period.

Black-Scholes option pricing model: A continuous time−space option pricing formula.

Blockholder: An owner of a significant number of shares of a firm. Sometimes refers to an owner of 10,000 or more shares.

Block trade: Transaction involving more than 10,000 shares or $200,000 of a security.

Bluffing: The act of fooling other traders into making unwise trades by convincing them that the bluffer has superior material information.

Bond: Financial security that makes fixed payment(s) at specified interval(s).

Broker: A security market participant who acts as an agent for investors, buying and selling on their behalf on a commission basis.

Brownian motion: A Newtonian nondifferentiable stochastic continuous time-space process whose increments are independent over time.

Buy side traders: Traders who buy liquidity services in the marketplace. Such traders often include individual investors, mutual funds, and pension funds.

Call: Security or contract granting its owner the right to purchase a given asset at a specified price on or before the expiration date of the contract.

Call market: Market where orders can be executed only at specific points in time, when orders are called (when buy orders are matched against sell orders or when orders are accumulated before being executed).

Clearance: Recording and comparison of records associated with a trade.

Clearing: See Clearance.

Clearing firm: Firm authorized by a clearing house to manage trade comparisons and other back office operations.

Clearing house: Institution that clears transactions for an exchange or other market.

Closed-end investment company: Investment company that issues a specified number of shares that can be traded in secondary markets such as the New York Stock Exchange.

Coefficient of correlation: A measure of the strength and direction of the relationship between two sets of variables. Ranges between −1 and +1 and may be regarded as a "standardized" covariance (dividing covariance by the product of the standard deviations of the two variable sets).

Collar: A portfolio consisting of a long position in a put and a short position in a call, collaring the underlying security selling price to lie between the exercise prices of the two options contracts.

Co-location: The practice by high-frequency traders to rent space from or very near market centers, such as the major exchanges ECNs and other and alternative trading systems for the purpose of co-locating their servers next to the market center's data servers to reduce latency and access to information. Also called proximity hosting.

Common value auction: Auction where all bidders place the same value on the item to be auctioned, and that value is known with certainty.

Confirmation: Verification of a trade.

Consolidated tape: High-speed electronic system for reporting transaction prices and volumes for securities on all U.S. exchanges and markets.

Consolidated Quotations System: Provides traders with price quotes from the various exchanges and FINRA and calculates the NBBO.

Continuous market: Market where orders can be executed whenever the market is open.

Convexity: (1) The slope of the slope of a function. (2) The sensitivity of the duration of a bond to changes in the market rate of interest.

Corner: The purchase of a sufficient level of a given security to obtain market or monopoly power over its price.

Counterparty: Person or institution with whom one trades.

Counterparty risk: The potential that a trade counterparty fails to fulfill their side of a transaction.

Coupon: The interest rate on debt as a percentage of its face value.

Covariance: A statistical measure of the co-movement between two sets of variables.

Covered call writing: Writing or selling a call while owning the underlying asset (or appropriate combination of other assets) needed to generate a hedge.

Covered put writing: Writing or selling a put while shorting the underlying asset (or appropriate combination of other assets) needed to generate a hedge.

Crossed market: Market where one or more bids exceeds one or more offer prices.

Crossing network: Alternative trading system that matches buyers and sellers with respect to agreed-upon quantities, and does not publicly display quotations, thereby enabling participants some degree of anonymity. Trades are priced by reference to prices obtained from other markets rather than by auctions. Traders using crossing networks announce their order sizes, which are matched at prices obtained auction markets such as the NYSE.

Cumulative average residual (CAR): The sum of abnormal returns or residuals over a period of time around an event.

Current yield: Measure of the annual interest payments made by a bond relative to the initial investment required by the bond.

Custodian: Holds assets on behalf of owners.

Dark liquidity pool: Broadly defined, any willingness to buy or sell that is not publicly displayed. Often refers to portions of large trades broken up into small trades to be executed in different markets and over time so as to minimize the price impact (slippage) of the trade. Sometimes refers to crossing networks.

Dealer: Securities market participant who trades directly with clients and brokers, seeking trade counterparties for clients, facilitating their trading process, posting and maintaining quotes, and buying and selling for their own portfolios on a profit basis.

Delta: Sensitivity of an option's price to changes in the price of the underlying security.

Delta neutral: Portfolio of options and underlying securities whose weighted average Black-Scholes delta is zero, and whose value is constant with respect to small changes in the value of the underlying asset.

Depth: A market's ability to process and execute a large order without substantially impacting its price.

Derivative security: Security whose payoff function is derived from the value of some other security, rate, or index.

Designated market maker (DMM): Exchange official and market participant charged with the responsibility to maintain a fair and orderly market in their stocks, quote at the NBBO a specified percentage of the time, and facilitate price discovery throughout the day as well as at the open, close, and in periods of significant imbalances and high volatility. The DMM provides price improvement and matches incoming orders based on a preprogrammed capital commitment schedule, which has been added to the NYSE Display Book and minimizes order latency. DMMs compete as market participants, trading on their own accounts.

Direct access: Trading systems that provide for direct access to markets bypassing brokers.

Discount rate: A rate used to discount (usually reduce) future cash flows to express their values relative to current cash flows.

Discrete process: A process whose variable can be assigned only a countable number of values.

Diversification: Holding multiple assets whose returns are not perfectly correlated.

DKs (don't knows): Trade reports filed with clearing firms or clearing houses with discrepancies resulting from recording errors, misunderstanding, and fraud.

DMM: See Designated market maker.

Don't knows: See DKs.

Dow Jones Industrial Average (DJIA): A price-weighted average of 30 actively traded blue chip stocks.

Double auction: Used for the trading of most publicly traded securities in secondary (resale) markets where buyers submit bids (maximum purchase prices) and sellers submit offers (minimum selling prices) that are ranked from best to worst. Also called bilateral auctions.

Drift: The predictable change component of a stochastic process.

Duration: Measures the proportional sensitivity of a bond value or price to changes in the market rate of interest.

Dutch auction: Auction that begins with the auctioneer calling out a high offer price, which is reduced until some participant submits the first, highest, and winning bid. Also called descending bid auction.

ECN: See electronic communication network.

Efficient market: A market where security prices fully reflect all available information.

Electric communication network: Virtual meeting place and screen-based system for trading securities.

English auction: Auction where participants bid openly against one another, with each successive bid higher than the previous one. Also called ascending bid auction.

Equity: Security that represents ownership in a business or corporation. Normally called stock.

ETF: See Exchange traded fund.

European option: Can be exercised only when it expires.

Exchange: A physical or electronic marketplace for trading securities.

Exchange-traded fund (ETF): Closed-end investment company whose shares are traded on an exchange.

Execution: The process of selling or buying a security.

Execution speed: The time it takes for an order to be executed.

Exercise price: See striking price

Eurodollar: Freely convertible dollar-denominated time deposit or debt instrument issued outside the United States and outside of the jurisdiction of the U.S. Federal Reserve.

Exercise price: Price at which an option can be exercised; that is, the price that the call owner has the right to pay for the underlying asset or put owner has the right to sell the underlying asset for. Also called striking price.

Expectations theory: See Pure expectations theory.

Face value: The principal or par value of debt.

Federal funds rate: The rate at which the excess reserves of one bank can be loaned to other banks for satisfaction of borrower reserve requirements.

Filtration: History, or indexed set of subobjects in a stochastic process.

Financial Institutions Regulatory Authority (FINRA): The largest independent regulator for all securities firms and exchanges conducting business in the United States. Formed by the merger of the NASD, and member regulation, enforcement, and arbitration operations of the New York Stock Exchange.

FINRA: See Financial Institutions Regulatory Authority.

First-price sealed-bid auction: All bidders simultaneously submit sealed bids so that no bidder knows any of the other bids. Does not allow for price discovery until the auction concludes. The winner submits the highest bid and pays the bid price.

Fisher effect: Defines the real interest rate as the ratio of the nominal rate to the inflation rate.

Fishing: Practice intended to obtain secret information concerning order sizes in dark pools. Occurs when a trader sends a series of small orders to a dark pool to detect whether there is a large order waiting in that pool.

Flash order: Quote that is immediately executed or canceled (within 500 milliseconds of the original quote), need not be publicly displayed, and may be displayed to select clients. Flash quotes are the basis for flash trading.

Flash trading: Trading motivated by private or select market participant receipt of quotes (flash orders) in advance of the public quote stream (also called prerouting displays). This means that the recipients of flash orders receive access to quotes before the public and can engage in flash trading on the basis of these quotes.

FHLMA: Federal Home Loan Mortgage Association. Founded in 1969 by the federal government of the United States to facilitate mortgage lending to prospective homeowners. It provides capital for the mortgage industry by selling securities backed by other mortgages issued by banks.

FNMA: Federal National Mortgage Association (Fannie Mae or FNMA). Founded in 1938 by the federal government of the United States to facilitate mortgage lending to prospective homeowners. It provides capital for the mortgage industry by selling securities backed by other mortgages issued by banks.

Forward contract: Instrument that obliges participants to either purchase or sell a given asset at a specified price on the future settlement date of that contract.

Forward rate: Locked-in interest rate on loans originating after time zero or in the future.

Front running: Using the information in another participant's order to set a bid or quote in a subsequent order with priority. An example of front-running might be where a broker with information about a client's order uses this information to set a bid or offer in her own order in setting a bid or offer so as to exploit the client's order.

Futures contract: Instrument that obliges participants to either purchase or sell a given asset at a specified price on the future settlement date of that contract. Normally traded on an exchange, with standardized contractual terms and providing for margin and marking to the market.

Gamma: Sensitivity of an option's delta to changes in the price of the underlying security.

GNMA: Government National Mortgage Association (Ginnie Mae or GNMA). Founded by the federal government of the United States to facilitate mortgage lending to prospective homeowners. It guarantees mortgage-backed securities issued by banks and other institutions.

Greeks: Sensitivities of options and portfolios of options to Black-Scholes pricing model inputs.

Hedge fund: A private fund that allows investors to pool their investment assets. To avoid SEC registration and certain regulations, hedge funds usually only accept funds from small numbers (often less than 100) of accredited investors, typically high-net-worth individuals and institutions.

Hedge: To take a position to reduce risk.

Hedge ratio: Defines the number of units of one security required to offset the position in one unit of another security in order to form or maintain a riskless portfolio.

HFT: See High frequency trading.

High frequency trading: The practice of rapid executions of multiple transactions for securities followed by extremely short holding periods, perhaps as short as fractions of seconds.

Hot potato trading: Repeated passing of inventory imbalances among dealers.

Iceberg order: Partially revealed order whose full size is not revealed. Also called hidden-size order.

Immunization: Strategies concerned with matching the present values of asset portfolios with the present values of cash flows associated with future liabilities. More specifically, immunization strategies are primarily concerned with matching asset durations with liability durations.

Implementation risk: Risk taken by arbitrageur that one or more arbitrage transactions might fail to execute or be executed at prices that differ from what the arbitrageur anticipated.

Implementation shortfall: The performance difference between hypothetical profits realized by a paper portfolio replicating an actual portfolio and the profits realized by the actual portfolio.

Index: A portfolio of stocks or other instruments intended to reflect performance of a particular market or sector.

Infinitesimal: Value approaching zero.

Information asymmetry: Scenario where agents have information that differs in quality.

Inside information: Material nonpublic information concerning the prospects of a security.

Interest rate parity: States that anticipated currency exchange rate shifts will be proportional to countries' relative interest rates.

International Fisher effect: By combining purchase power parity, interest rate parity, and the Fisher effect, the international Fisher effect demonstrates that different economies will have identical real interest rates.

Investment company: Institution that accepts funds from investors for the purpose of investing on their behalf.

Intermarket trading system: Displays quotes in different markets and links markets for trade executions to facilitate investors' access to the best quotes.

Investment company: An institution that accepts funds from investors for the purpose of investing on their behalf.

Jensen's alpha: Excess return on a portfolio over the CAPM-implied risk-adjusted return.

Jitney game: A series of wash sales at ever-increasing prices.

Latency: The amount of time that lapses from when a quote or an order is placed by a trader and when that order is actually visible to the market.

Late trading: An illegal fund trading strategy purchase or redeem shares after daily net asset values (NAVs) are computed.

Law of one price: States that securities or portfolios of securities offering the same cash flow characteristics or baskets offering the same commodities must sell for the same price.

Leveraged buyout: The purchase of a firm by private group of investors with substantial debt financing. It is usually a going private transaction; that is, a publicly traded company is transformed into a privately owned company in the transaction.

Level I quotes: Displays the best bid and offer prices (inside quote or BBO, best-bid-offer) and, in some cases, quote sizes.

Level II quotes: Display the best bid and offer prices, quote sizes along with other quotes in descending order for the best bids and ascending for the best offers with market maker symbols for each.

Level III quotes: Offered to Nasdaq members, provide the same information as Level II and enables traders to have direct access to enter and revise quotes.

Limit order: Sets an upper price for a purchase or a lower price limit for a sell, preventing the broker from paying more or accepting less for the security. The limit order restricts the price of the order.

Liquidity: An asset's ability to be easily purchased or sold without causing significant change in the price of the asset.

Liquidity rebate: See Payments for order flow.

Load fund: A mutual fund that charges a sales fee.

Long: (1) To have purchased or owned (2) position that obligates or enables the investor or participant to purchase a given or underlying asset on the expiration or settlement date of a derivative contract.

Make-or-take pricing: Refers to exchanges allowing patient traders to post standing limit orders that await execution until some other trader takes the other side, providing liquidity rebates to the patient trader making the market.

Management buyout: The purchase of a public firm by the management of that firm. It is usually a going private transaction.

Market architecture: The set of rules governing the trading process.

Market impact: The effect that a given transaction has on the market price of a security.

Market microstructure: Area of financial economics concerned with trading and market structure, market fairness, success and failure, and how the design of the market affects price formation and discovery. Market microstructure is concerned with costs of providing transaction services along with the impact of transactions costs on the short-run behavior of securities prices.

Market on close: The last price obtained by a trader at the end of the day relative to the last price reported by the exchange. Used for trader evaluation purposes.

Market timing: A fund trading strategy intended to exploit stale security prices and net asset value (NAV) deviations from fundamental values.

Markov process (random walk): A stochastic process whose increments or changes are independent over time.

Mark to market: Accounting for the fair value of an asset or liability based on its current market price, or, if unavailable, based on either similar instruments or an appropriate valuation model.

Martingale process: A Markov process whose increments have expected value 0.

MOC: See Market on close.

Model risk: Failure to fully understand the implications of a trading model.

Multilateral Trading Facility: European variation on the alternative trading system.

Multiplicative movement: The proportion by which an asset changes over a given time period.

Mutual fund (open-end investment company): An institution registered with the SEC under the Investment Act of 1940 that pools investors' funds into a single portfolio.

Naked access: Where algorithmic trade orders do not pass through pre−trade-risk controls, potentially leading to runaway executions.

Naked call writing: Writing or selling a call without owning the underlying asset (or appropriate combination of other assets needed to generate a hedge).

Naked put writing: Writing or selling a put without shorting the underlying asset (or appropriate combination of other assets) needed to generate a hedge.

NASD: See National Association of Security Dealers.

National Association of Security Dealers (NASD): Formerly the primary independent self-regulatory organization for the securities industry responsible regulation of the Nasdaq stock market and over-the-counter markets and for administrating competency exams for investment professionals. Merged with the member regulation, enforcement, and arbitration operations of the New York Stock Exchange to form FINRA.

National best bid and offer (NBBO): The highest bid and lowest offer prices available on a security at a given point in time.

Nationally Recognized Statistical Rating Organization (NRSRO): A credit rating agency whose ratings the U.S. Securities and Exchange Commission has designated as authoritative for certain regulatory purposes.

NBBO: See National best bid and offer.

Negotiable certificate of deposit: Tradable depository institution certificate of deposit with a denomination exceeding $100,000.

Net asset value (NAV): Market value of portfolio assets minus its liabilities at a particular point in time divided by the number of shares in the portfolio outstanding at that time.

Netting: The simplification process used by clearing institutions of adding all of a given firm's purchases of each security, adding the sales of each security, deducting sells from buys to determine the net change in holdings of that security for the firm, and computing the net cash flows associated with all transactions.

Newsreader algorithms: Electronic-based rules based on text mining and statistical techniques to analyze news sources, blogs, tweets, and other data to obtain relevant trading information and infer its impact on security prices.

Noise trader: Trades on the basis of what he falsely believes to be special information or misinterprets useful information concerning the future price or payoffs of a risky asset.

No-load fund: Mutual fund that accepts investments directly from investors without a sales charge.

Novation: The process whereby a clearing house assumes the settlement obligations of both counterparties to a transaction, in effect becoming the counterparty to both sides of the transaction.

NRSRO: See Nationally Recognized Statistical Rating Organization.

OARS: See Opening Automated Report Service.

Offer: A solicitation to sell (also called an ask).

Opaque markets: Markets that lack transparency.

Open-end investment company: See Mutual fund.

Opening Automated Report Service: (OARS) NYSE system that allows orders that have accumulated overnight or while the exchange is closed to be matched so that the designated market maker attempts to establish a market clearing price.

Option: Security that grants its owner the right to buy (call) or sell (put) an asset (underlying asset) at a specific price (exercise or striking price) on or before the expiration date of the option contract.

Order-driven markets: Markets where traders can trade without the intermediation of dealers.

Order precedence: Rules that determine which traders can place bid and offer quotations with greatest priority for execution and which can accept the quotations of other traders.

Order Protection Rule: Provision from the 2007 NMS legislation that provides intermarket price priority for quotations that are immediately accessible. Also known as the trade through rule.

Out trades: Trade reports filed with futures clearing firms or clearing houses with discrepancies resulting from recording errors, misunderstanding, and fraud.

Over-the-counter (OTC) markets: Securities markets other than those provided by exchanges.

Pairs trading: An arbitrage strategy that involves taking offsetting positions in two different stocks (perhaps options or index contracts) with correlated returns, one long and one short, such that gains in one position are expected to more than offset losses in the other position.

Parasitic trading: Broker trading on the basis of knowledge of her client's trading activity.

Pattern day trader: SEC definition for a trader who executes four or more round trip transactions in the same account within five consecutive business days.

Payment for order flow: Compensation received by brokers and other institutions from exchanges and alternative trading systems as payment for directing their order flow to those markets.

Penny jumping: A type of parasitic trading where the broker places a buy (sell) order one uptick above (downtick below) below the client's buy (sell) limit order, expecting to benefit either from the market's reaction to the client order or to limit his losses by transacting with the client.

Ping: To place a small order to detect the level of liquidity and possibility of large orders. If small orders are quickly executed, there might be significant interest in the security.

Ping destination: A pool, typically operated by a hedge fund or electronic market maker, that accepts only immediate or cancel (fill or kill) orders.

Pip: Basis point, or 0.0001 of a unit. Typically used in foreign exchange markets quotes.

Precedence: Which traders can execute bid and offer quotations and which can accept and execute the quotations of other traders. In most cases, the primary precedence is price priority; the participant with the highest bid or lowest ask has priority on an execution.

Predatory algo trading: Strategies designed to exploit other institutional algo orders.

Prediction market: A trading venue created to predict an outcome based on prices of specially created and traded securities that pay contingent on that outcome.

Price discovery: The process of determining the worth or price of an asset in the marketplace through the interactions of buyers and sellers.

Price improvement: Providing a better execution price than the quoted NBBO on market and limit orders; that is, providing a higher bid or lower offer price than the posted NBBO.

Price priority: Rule or rules dictating that the highest bids or lowest offers will be executed against in the presence of competing quotes.

Priority: Rule or rules dictating which quotations are to be executed in the presence of competing quotes.

Private equity: Refers to asset managers that make equity investments in companies that are not publicly traded.

Program trading: Defined by the NYSE as computer-initiated trades involving 15 or more stocks with value totaling more than $1 million.

Prop shop: See Trading arcade.

Prop trader: See Proprietary trader.

Proprietary trader: Trader *who* seeks profits by trading on his own account.

Proprietary trading firm: See Trading arcade.

Proximity hosting: See Co-location.

Public Company Accounting Oversight Board (PCAOB): Nonprofit corporation created by Sarbanes-Oxley to oversee public auditing firm practices.

Pump and dump: Market manipulator touts a security with false and misleading statements, causing the price to rise before selling their own holdings at the inflated prices.

Purchase power parity: States that commodities selling in different countries must sell for the same price after adjusting for exchange rates.

Pure discount note: A debt security paying no interest; it only pays its face value or principal.

Pure expectations theory: Term structure theory that states that long-term spot rates can be explained as a geometric mean of short term spot and forward rates.

Put: Security or contract granting its owner the right to sell a given asset at a specified price on or before the expiration date of the contract.

Qualified institutional buyer (QIB): Institution with an investment portfolio exceeding $100 million.

Quote: A solicitation to buy (bid) or solicitation sell (offer or ask).

Quote-driven markets: Markets where dealers post quotes and participate on at least one side of every trade.

Quote matching: Occurs when a small trader places an order one uptick (downtick) from that of a large trader so as to profit from the large trader's transaction upward (downward) price pressure, or to use the large trader as a trade counterparty should prices decrease (increase).

Quote Rule: Formally referred to as SEC Rule 602 of Regulation NMS, requires that all market centers publicly disseminate their best bids and offers through the securities information processors (such as the Consolidated Tape, Consolidated Quotations System, and the Intermarket Trading System).

Quote stuffing: The placement of large numbers of rapid-fire stock orders, with most or all of which being canceled almost immediately, frequently for the purpose of clogging trading HFT and other algorithms and data computations.

Random walk: A process whose future behavior, given by the sum of independent random variables, is independent of its past.

Real estate investment trust (REIT): A fund that invests in real estate and/or real estate mortgages, providing investors with opportunities to diversify into real estate with relatively small investment sums.

Repo: See Repurchase agreement.

Repurchase agreement (repo): Marketable security issued by a financial institution acknowledging the sale of assets and a subsequent agreement to repurchase at a higher price in the near term. This agreement is essentially similar to a collateralized short-term loan.

Revenue equivalence theorem: States that under specific restrictions, the auction type will not affect auction outcomes.

Rho: Sensitivity of an option's price to changes in the riskless return rate.

Robotrading: See Algorithmic Trading.

Routing: The process of executing the trade, involving broker selection, deciding which market(s) will execute the trade(s), and transmitting the trade(s) to the market(s).

Rule 144A market: Market specifically created for "qualified institutional buyers" to trade unregistered securities held by less than 500 shareholders.

SDBK: See Super Display Book System.

Second-price sealed-bid auction: All bidders simultaneously submit sealed bids so that no bidder knows any of the other bids. Does not allow for price discovery until the auction concludes. The winner submits the highest bid and pays the second-highest bid price (the highest losing bid). Also known as a Vickrey auction.

Security: Tradable claim on the assets of an institution or individual.

Sell side traders: Traders who sell side liquidity services, buying or selling when others need to execute transactions. Such traders normally include day traders, market makers, and brokers.

Semistrong form efficiency: Scenario where prices reflect all publicly available information.

Settlement: Physical or electronic actual delivery of the security and payment involved in a trade.

Sharpe ratio: Index of risk-adjusted portfolio performance, calculated as the portfolio's excess return to the riskless rate relative to its standard deviation.

Short: (1) To have sold or short sold (2) position that obligates or enables the investor or contract participant to sell a given or underlying asset on the expiration or settlement date of a derivative contract.

Short sell: To sell a security without actually owning it. Normally requires its purchase at a later date and may involve borrowing the security from another investor first, returning it when it is repurchased at a later date.

Simple time slicing: Order is split up and sent to markets at regular time intervals.

Slippage: Unwanted price impact as a trader's buy pressure forces the price up or his sell pressure forces the price down.

Speculate: To take a position of risk based on a forecast of the direction of a security price change.

Speculator: Trader who speculates.

Sponsored access: Where brokers loan their market participation identification numbers (MPIDs) to high-frequency trading traders, enabling them to gain faster, direct access to markets by bypassing the broker's trading systems.

Spoofing: Placing a quote that is intended to be canceled prior to execution.

Spot rates: Interest rates on loans originating at time zero or now.

Spot transaction: Occurs at the time of the agreement to make the exchange.

Spread: The difference between the best offer and bid prices.

Stat-arb: See Statistical arbitrage.

Statistical arbitrage (stat-arb): Strategies that seek to exploit mispricing of one or more assets based on their expected values. By using statistical methods, the arbitrageur takes positions in large numbers of trades, expecting to gain from expected mispricing through the law of large numbers.

Stealth trading: Trading with an effort to remain hidden or to hide intentions, often by spreading trades to different markets and at different times.

Stochastic process: A sequence of random variables x_t indexed by time t. In other words, a stochastic process is a random series of values x_t sequenced over time.

Stop order: Instructs the broker to place the buy order once the price has risen above a given level or place the sell order once the price of the security has fallen beneath a given level. The stop order triggers an order execution.

Stop limit sell order: Authorizes the broker to initiate the sell order once its price drops to the stop trigger, but only if the limit price can be realized for the sale.

Straddle: A combination of put and call options with identical exercise prices on the same underlying asset.

Strike price: See striking price.

Striking price: Price at which an option can be exercised; that is, the price that the call owner has the right to pay for the underlying asset or put owner has the right to sell the underlying asset for. Also called exercise price.

Strong form efficiency: Scenario where prices fully reflect all information, public or private.

Stub quotes: Quotes submitted with no intention of execution, often for the purpose of quote stuffing.

Strip: Single payment fixed income instrument issued through the U.S. Treasury's Separate Trading of Registered Interest and Principle Securities (STRIPS) program.

Submartingale process: A Markov process whose increments have expected value greater than 0.

Supermartingale process: A Markov process whose increments have expected value less than 0.

Sunshine trading: Occurs when traders announce their intentions, perhaps in an effort to increase the competition to act as counterparties on the same transactions, but when additional competition on the same side of the transaction is either unexpected or won't hurt the trader.

Super Display Book System (SBDK): The New York Stock Exchange ECN, order routing, and processing system.

SuperMontage: Nasdaq's automated exchange.

Swap contract: Instrument that provides for the exchange of cash flows associated with one asset, rate, or index for the cash flows associated with another asset, rate, or index.

Tailgating: A form of parasitic trading where the broker places an order immediately after the client's order.

Tâtonnement: A preliminary auction process to determine supply and demand levels at various prices.

Technical analysis: Concerned with finding situations where historical price sequences can be used to forecast price movements.

Term structure of interest rates: How interest rates on debt securities vary with respect to varying dates of maturity on the debt.

Theta: Sensitivity of an option's price to changes in the option's time to expiry.

Tick: The smallest unit of price change between successive transactions, 0.01 in some markets; 1/16, 1/8, or 1/4 in others.

Time weighted average return: Geometric mean of daily returns accounting for fund inflows and outflows.

Trade: A security transaction that creates a portfolio position based on an investment decision.

Trade through: The execution of an NMS stock trade at a price inferior to a protected quotation for that stock.

Trade-through rule: See Order protection rule.

Trader: Security market participant who trades, competing with others to generate profits, seeking compatible counterparties in trade, and seeking superior order placement and timing.

Trading arcade: Sometimes referred to as a proprietary trading firm or prop shop, is a location for traders to work and trade from.

Trading floor broker: NYSE member who work orders on behalf of clients.

Trading rebate: Payment for order flow.

Transfer agent: Processes orders to purchase and redeem a given security and maintains investor records.

Transparency: The extent to which a market quickly disseminates high-quality information to the public.

Treasury bill: Short-term zero coupon note issued by the U.S. Treasury. Considered to be relatively free of risk.

Treasury bond: Long-term (2 to 30 years) coupon-bearing debt instrument issued by the U.S. Treasury. Considered to be relatively free of default risk.

Treasury note: Intermediate-term (2 to 8 years) coupon-bearing debt instrument issued by the U.S. Treasury. Considered to be relatively free of default risk.

Treynor ratio: Index of risk-adjusted portfolio performance, calculated as the portfolio's excess return to the riskless rate relative to its beta.

Triangular arbitrage: Currency arbitrage transactions intended to exploit relative price differences between one currency and two other currencies.

Underlying asset: Security or asset on which an option is written.

Unit investment trust: An entity that invests its funds in some portfolio of securities when it is established and does not normally rebalance its portfolio. The shares of the trust are often publicly traded.

Upstairs markets: Markets where institutions trade securities directly among themselves. Also called fourth markets.

Vega: Sensitivity of an option's price to changes in the underlying security's standard deviation of returns.

Venture capital (VC): An alternative management vehicle that invests capital in private portfolio companies in development stages that have strong potential for rapid growth.

Vickrey auction: See Second-price sealed-bid auction.

Volume weighted average price (VWAP): The ratio of the total value traded to total volume traded over a given time horizon.

VWAP: See volume weighted average price.

Walrasian auction: A simultaneous auction where each buyer submits to the auctioneer his demand and each seller submits his supply for a given security at every possible price.

Wash sales: Transactions intended to create the appearance of sales where, in effect, no sales actually take place.

Weak form efficiency: Scenario where security prices reflect all information regarding historical prices.

Winner's curse: Problem occurring when the winning bidder bids the most, and is the most likely to have bid too much for the auctioned object.

Term structure of interest rates: How interest rates on debt securities vary with respect to varying dates of maturity on the debt.

Yield curve: Plotting of bond yields or market interest rates with respect to terms to maturity.

Yield to maturity: The internal rate of return for a bond.

Zero coupon bond: A bond that makes no interest payments.

Zero cost collar: A collar where the time zero proceeds from the call sale exactly offsets the cost of the put purchase. The options' exercise prices are set so that the call and the put have the same values.