Appendix III – Definitions

Appendix III: Definitions

1. **Alpha –** "[C]oefficient measuring the portion of an investment's return arising from specific (nonmarket) risk. In other words, alpha is a mathematical estimate of the amount of return expected from an investment's inherent values, such as the rate of growth in earnings per share. It is distinct from the amount of return caused by volatility, which is measured by the Beta coefficient."[1]

    a. Simplistically, Alpha measures the returns that were achieved by 'talent' such as stock selection or asset allocation as opposed to returns from the market or an index.

2. **Call Option –** "[R]ight to buy…a particular stock or stock index at a predetermined price before a preset deadline in exchange for a premium. For buyers who think a stock will go up dramatically, call options permit a profit from a smaller investment than it would take to buy the stock."[2]

3. **CBOE –** The Chicago Board Options Exchange ("CBOE") is the exchange where S&P 100 or "OEX" options are traded.

4. **CFA –** "CFA® charterholders are trained in portfolio management, risk analysis, financial modeling, and valuation through a rigorous, globally recognized program… CFA® charterholders adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct, committing to the highest levels of professionalism and integrity. Their decisions are guided by transparency and accountability."[3]

5. **Correlation or Correlation Coefficient**- The "statistical measurement of the degree to which the movements of two variables are related."[4]

6. **Counterparty –** A counterparty is simply any person or entity that stands on the opposite side of a transaction or contract.[5]

---

[1] John Downes And Jordan Elliot Goodman, Dictionary of Finance and Investment Terms (Barron's Educational Series ed., 5th ed. 1998) (hereinafter "Dictionary of Finance and Investment Terms").

[2] Dictionary of Finance and Investment Terms.

[3] CFA Institute, *Why hire a CFA® Charterholder?* https://www.cfainstitute.org/business/hire (last visited August 21, 2025).

[4] Dictionary of Finance and Investment Terms.

[5] *See* New York Institute of Finance, *How Institutions Manage Counter-Party Risk* https://www.nyif.com/articles/how-institutions-manage-counter-party-risk (last visited August 21, 2025).

7. **Counterparty Risk –** Counterparty risk comes in a variety of forms. In trading, it is the risk that the counterparty will default on its obligations. Counterparty risk also resides in vendors. In funds, for example, there is counterparty risk in brokers, administrators, valuation agents, and pricing services, among others. In these cases, it is the risk that they do not produce accurate information, or worse, cease to exist.[6]

8. **Exchange Traded –** Refers to any instrument executed on an organized and recognized public exchange such as the New York Stock Exchange or Chicago Board of Options Exchange.[7]

9. **Factor Analysis –** "[A] sophisticated statistical technique designed to draw out the substance of complex data by identifying observable variables and all of the underlying factors that account for the observed correlations among multiple variables."[8]

10. **FRM –** The Financial Risk Manager designation is given to those who have passed rigorous testing on a variety of risk management matters and abide to a code of conduct and professional standards.[9]

11. **Fund-of-Funds –** A Fund-of-Funds is best described as a legal entity that invests in a number of funds (such as hedge funds, mutual funds, or private equity funds) in order to provide investors with a diversified portfolio managed by professional investment managers.[10]

12. **Hedge –** "A transaction or position designed to mitigate the risk of other financial exposures."[11] For example, in the SSC Strategy purportedly executed by Madoff, the equity position was hedged by options.

13. **Hedge Fund –** While there is no standard definition of a "hedge fund," hedge funds are simply legal structures which can provide investment flexibility. The two descriptions below are most common:

---

6 *See* New York Institute of Finance, *How Institutions Manage Counter-Party Risk* https://www.nyif.com/articles/how-institutions-manage-counter-party-risk (last visited August 21, 2025).

7 *See* Corporate Finance Institute, "Exchange-Traded Product" https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/exchange-traded-product-etp/ (last visited August 21, 2025).

8 Corporate Finance Institute, "Factor Analysis" https://corporatefinanceinstitute.com/resources/data-science/factor-analysis/ (last visited August 21, 2025).

9 *See* GARP, FRM Certification Overview, https://www.garp.org/frm (last visited August 21, 2025).

10 *See* Corporate Finance Institute, "Fund of Funds (FOF)," https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/fund-of-funds-fof/ (last visited August 21, 2025).

11 Oxford Dictionary of Finance and Banking (2018) sixth ed., Oxford University Press.

a. "The term 'hedge fund' refers generally to a privately offered investment vehicle that pools the contributions of its investors in order to invest in a variety of asset classes, such as securities, futures contracts, options, bonds, and currencies."[12]

b. "The term 'hedge fund' is commonly used to describe a variety of different types of investment vehicles that share some common characteristics. Although it is not statutorily defined, the term encompasses any pooled investment vehicle that is privately organized, administered by professional money managers, and not widely available to the public."[13]

14. **Investment Manager –** "a person or financial organization that manages their own money or that of others, in order to make as much profit as possible."[14]

15. **Notional Value –** "[T]otal value of a position in a financial security... Notional value (also known as notional amount or notional principal amount) is the face value on which the calculations of payments on a financial instrument (e.g., swap) are determined. In other words, the notional amount indicates how much money is controlled by a position on a particular financial instrument."[15]

16. **NYSE** – The New York Stock Exchange is "[t]he main U.S. stock exchange and the largest in the world by market capitalizations."[16]

17. **OCC –** Options Clearing Corporation is a U.S. facility for the clearing and settlement of equity derivatives. "Founded in 1973, OCC is dedicated to promoting stability and market integrity by delivering clearing and settlement services for options, futures and securities lending transactions."[17]

---

[12] A Report to Congress in Accordance with § 356(C) of the USA Patriot Act of 2001, Submitted by the Secretary of the Treasury, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, (December 2002), p. 19, https://www.fincen.gov/sites/default/files/shared/356report.pdf (last visited August 21, 2025).

[13] Hedge Funds, Leverage, and the Lessons of Long-Term Capital Management, Report of the President's Working Group on Financial Markets (April 1999), at Section I.A., https://www.cftc.gov/sites/default/files/tm/tmhedgefundreport.htm (last visited August 21, 2025).

[14] Cambridge Dictionary, https://dictionary.cambridge.org/us/dictionary/english/investment-manager (last visited August 22, 2025).

[15] Corporate Finance Institute, "Notional Value," https://corporatefinanceinstitute.com/resources/valuation/notional-value/ (last visited August 21, 2025).

[16] Oxford Dictionary of Finance and Banking (2018) sixth ed., Oxford University Press.

[17] OCC, "What is OCC," https://www.theocc.com/company-information/what-is-occ (last visited August 21, 2025).

18. **Open Interest –** "The total number of options contracts on a particular underlying security that are still open (i.e. they have not been exercised, offset, or permitted to expire)."[18]

19. **OTC –** "Over-The-Counter (OTC) securities are securities not listed on a national securities exchange. These securities generally trade on Alternative Trading Systems (ATSs) which are quotation mediums and might include electronic interdealer quotation systems that display quotes from broker-dealers for many OTC securities."[19] OTC trades are traded between counterparties off-exchange and are privately negotiated transactions.

20. **Put Option –** "[C]ontract that grants the right to sell at a specified price a specific number of shares by a certain date. The put option seller grants this right in return for receiving this premium… the put option seller… hopes the stock will remain stable, rise, or drop by an amount less than his or her profit on the premium."[20]

21. **Sharpe Ratio –** The Sharpe Ratio measures the amount of return above a risk-free rate per unit of risk. It is calculated as the mean portfolio return less a risk-free return ($r_p - r_f$), divided by the standard deviation of the returns.[21] A higher Sharpe Ratio indicates that the investment is generating more return for the same amount of risk.

22. **Sortino Ratio –** The Sortino Ratio is a form of the Sharpe Ratio where only downside risk is incorporated into the formula by calculating the standard deviation of only negative returns.[22] In this manner, the Sortino Ratio does not penalize performance for being volatile if the volatility always results in positive performance.

23. **Value at Risk -** VAR is "a measure of risk developed by J.P. Morgan Chase in the 1990s, now most frequently applied to measuring market risk and credit risk. It is the level of losses over a particular period that will only be exceeded in a small percentage of cases."[23]

---

[18] Oxford Dictionary of Finance and Banking (2018) sixth ed., Oxford University Press.

[19] Investor.gov, "Over-The-Counter (OTC) Securities," https://www.investor.gov/introduction-investing/investing-basics/glossary/over-counter-otc-securities (last visited August 21, 2025).

[20] Dictionary of Finance and Investment Terms.

[21] *See* William Sharpe, *Mutual Fund Performance*, The Journal of Business, 119-128 (Vol. 39, No. 1, Part 2, January 1966) [PUBLIC0704485-505].

[22] *See* Frank Sortino and Lee Price, *Performance Measurement in a Downside Risk Framework*, The Journal of Investing 59-64 (Vol. 3, No.3 Fall 1994) [PUBLIC0704397-402]. *See also*, FRANK J. TRAVERS, INVESTMENT MANAGER ANALYSIS 93-94 (2004) [PUBLIC0704408-462 at -415-416].

[23] Oxford Dictionary of Finance and Banking (2018) sixth ed., Oxford University Press.

24. **Volatility –** "[T]he extent to which the value of a security, bond, commodity, market index, [or other instrument] varies over time. . . . A stock's volatility relative to the volatility of the market as a whole is measured by its beta coefficient."[24]

[24] Oxford Dictionary of Finance and Banking (2018) sixth ed., Oxford University Press.