Financial Term Definitions

Source: http://financial-dictionary.thefreedictionary.com/

Bond: A note obliging a corporation or governmental unit to repay, on a specified date, money loaned to it by the bondholder. The holder receives interest for the life of the bond. If a bond is backed by collateral, it is called a mortgage bond. If it is backed only by the good faith and credit rating of the issuing company, it is called a debenture.

Junk bond: Junk bonds carry a higher-than-average risk of default, which means that the bond issuer may not be able to meet interest payments or repay the loan when it matures.

Credit Default Swap (CDS): The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the creditworthiness of the product. When this is done, the risk of default is transferred from the holder of the fixed-income security to the seller of the swap. For example, the buyer of a credit swap still is entitled to the par value of the bond from the seller of the swap if the bond defaults in its coupon payments.

Collateralized Debt Obligation (CDO): Similar in structure to a collateralized mortgage obligation (CMO) or a collateralized bond obligation (CBO), CDOs are unique in that they represent different types of debt and credit risk. In the case of CDOs, these different types of debt often are referred to as tranches or slices. Each slice has a different maturity and risk associated with it. The higher the risk is, the more the CDO pays.

Mortgage: A debt instrument that is collateralized by real estate property; the borrower (mortgage owner) is obliged to pay back both the principal and the interest with periodic payments over the course of the loan. Mortgages are used by individuals and businesses to make large purchases of real estate without paying the entire value of the purchase up front. Mortgages also are known as liens against property and claims on property.

Pyramid (Ponzi Scheme) A classic investment fraud in which the operator pays promised high returns to current investors from the contributions made by new investors. Thus, funds are never invested in any productive assets but are simply paid out as a return to existing owners. The operator must continue to attract more and more investors in order to pay a return to those who have already committed their funds.

Short Selling: Establishing a market position by selling a security one does not own in anticipation of the price of that security falling.

Subprime Mortgage: A mortgage with an interest rate higher than most other mortgages. Subprime mortgages are provided to borrowers who do not qualify for ordinary loans because of bad credit history or some other reason. There is a higher risk of default on subprime loans.