Financial Terms - 1

Merger Deficit ...1

An accounting term used to describe the situation when the total value of the share capital used to purchase another company is less then the total value of the equity purchased. The merger does not necessarily have to be an all-stock acquisition.

In other words, a merger deficit arises when a company uses funds it raised in new stock issues to purchase the stock of another company. The stock purchased must be worth more then the share capital used to purchase it in order for the deference to be classified as a merger deficit

http://www.caclubindia.com/forum/term-of-the-day-merger-deficit-81821.asp

Tequila Effect 2

Informal name given to the impact of the 1994 Mexican economic crisis on the South American economy. The Tequila Effect occurred because of a sudden devaluation in the Mexican peso, which then caused other currencies in the region (the Southern Cone and Brazil) to decline. The falling peso was propped up by US$50 billion loan granted by then U.S. president Bill Clinton.

Also referred to as the "Mexican Shock".

Immediately after the Mexican peso was devalued in the early days of the Presidency of Ernesto Zedillo, South American countries suffered rapid currency depreciation. It was a known fact that the peso was overvalued, but the extent of Mexico's economic vulnerability was not well known. Since governments and businesses in the area had high levels of U.S. dollar-denominated debt, the devaluation meant that it would be increasingly difficult to pay back the debts.

http://www.caclubindia.com/forum/term-of-the-day-tequilla-effect-81988.asp

Salad Oil Scandal 3

One of the worst corporate scandals of its time. It occurred when Allied Crude Vegetable Oil Company discovered that banks would make loans secured by its salad oil inventory.

When the ships full of salad oil would arrive in the docks, inspectors would test it and confirm that the ship was full of salad oil. However, the company didn't remind anyone that oil floats on water. They had filled salad oil tanks with water and put a few feet of oil on top, fooling everyone. The company would even transfer oil to different tanks while taking inspectors out to lunch. In 1963, the scam was busted and over $175 million worth of salad oil was missing.

Commodities trader and company founder Anthony De Angelis was convicted of fraud and conspiracy in the scandal and served seven years in prison. American Express took one of the biggest hits from the scandal, losing nearly $58 million and experiencing a 50% drop in AMEX stock as a result.

http://www.caclubindia.com/forum/term-of-the-day-salad-oil-scandal-82161.asp

E-Mini ……4

An electronically traded futures contract on the Chicago Mercantile Exchange that represents a portion of the normal futures contracts. E-mini contracts are available on a wide range of indexes such as the Nasdaq 100, S&P 500, S&P MidCap 400 and Russell 2000.

For example, the E-mini S&P 500 futures contract is one-fifth the size of the standard S&P 500 futures contract. Advantages to trading E-mini contracts include liquidity, greater affordability for individual investors and around-the-clock trading.

http://www.caclubindia.com/forum/term-of-the-day-e-mini-82276.asp

Stalking-Horse Bid ….5

An initial bid on a bankrupt company's assets from an interested buyer chosen by the bankrupt company. From a pool of bidders, the bankrupt company chooses the stalking horse to make the first bid.

This method allows the distressed company to avoid low bids on its assets. Once the stalking horse has made its bid, other potential buyers may submit competing bids for the bankrupt company's assets. In essence, the stalking horse sets the bar so that other bidders can't low-ball the purchase price.

http://www.caclubindia.com/forum/term-of-the-day-stalking-horse-bid-82420.asp

Rogue Trader ….6

A trader who acts independently of others - and, typically, recklessly - usually to the detriment of both the clients and the institution that employs him or her. In most cases this type of trading is high risk and can create huge losses.

One of the most famous rogue traders is Nick Leeson, who was a derivatives trader at the Singapore office of Britain's Barings bank. Leeson incurred heavy losses through the unauthorized trading of large amounts of Nikkei futures and options. Leeson took large derivative positions on the Nikkei which leveraged the amount of money at stake in the trades.

At one point Leeson had 20,000 futures contracts worth over $3 billion on the Nikkei. A large chunk of the losses came from the downturn in the Nikkei after a major earthquake in Japan caused a broad-based sell-off in the Nikkei within a week. Total loss to the 233-year-old Barings Bank was well over $1 billion and led to its eventual bankruptcy. Leeson was charged with fraud and served several years in a Singapore prison.

http://www.caclubindia.com/forum/term-of-the-day-rogue-trader-82540.asp

Black Swan ……7

An event or occurrence that deviates beyond what is normally expected of a situation and that would be extremely difficult to predict. This term was popularized by Nassim Nicholas Taleb, a finance professor and former Wall Street trader.

Black swan events are typically random and unexpected. For example, the previously successful hedge fund Long Term Capital Management (LTCM) was driven into the ground as a result of the ripple effect caused by the Russian government's debt default. The Russian government's default represents a black swan event because none of LTCM's computer models could have predicted this event and its subsequent effects.

http://www.caclubindia.com/forum/term-of-the-day-black-swan-82664.asp

GAMBLER'S FALLACY …..8

When an individual erroneously believes that the onset of a certain random event is less likely to happen following an event or a series of events. This line of thinking is incorrect because past events do not change the probability that certain events will occur in the future.

For example, consider a series of 20 coin flips that have all landed with the "heads" side up. Under the gambler's fallacy, a person might predict that the next coin flip is more likely to land with the "tails" side up.

This line of thinking represents an inaccurate understanding of probability because the likelihood of a fair coin turning up heads is always 50%. Each coin flip is an independent event, which means that any and all previous flips have no bearing on future flips.

This can be extended to investing as some investors believe that they should liquidate a position after it has gone up in a series of subsequent trading session because they don't believe that the position is likely to continue going up.

http://www.caclubindia.com/forum/term-of-the-day-gambler-s-fallacy-82800.asp

May Day …..9

Refers to May 1, 1975, when brokerages changed from a fixed commission for securities transactions to a negotiated one. Previous to this, commissions were standard from broker to broker.

At the time, the majority of Wall Street felt that these changes would have little effect on their commisions. However, shortly after the switch, Charles Schwab pioneered what are now known as discount brokerages, which charged much lower fees, and in some cases none at all - known as no-advice accounts. As a result, the number of individual investors expanded greatly. This was the first step in the creation of the discount brokerage houses that we know today.

http://www.caclubindia.com/forum/term-of-the-day-may-day-82769.asp

Structured Finance …..10

A service that generally involves highly complex financial transactions offered by many large financial institutions for companies with very unique financing needs. These financing needs usually don't match conventional financial products such as a loan

Structured finance has become a major segment in the financial industry since the mid-1980s. Collateralized bond obligations (CBOs), collateralized debt obligations (CDOs), syndicated loans and synthetic financial instruments are examples of structured financial instruments.

http://www.caclubindia.com/forum/term-of-the-day-structured-finance-82974.asp

Time Decay ……11

The ratio of the change in an option's price to the decrease in time to expiration. Since options are wasting assets, their value declines over time. As an option approaches its expiry date without being in the money, its time value declines because the probability of that option being profitable (in the money) is reduced.

Time decay of an option begins to accelerate in the last 60 to 30 days before expiry, provided the option is not in the money. But in the case of options that are deep in the money, time value decays more rapidly. The market finds these options too expensive compared to other strike prices or futures. As such, the holders of deep-in-the-money options nearing expiry discount the time value to attract buyers and in turn realize the intrinsic value.

The greater the certainty about an option's expiry value, the lower the time value. Conversely, the greater the uncertainty about an option's expiry value, the greater the time value.

http://www.caclubindia.com/forum/term-of-the-day-time-decay-83199.asp