David L. Scott

Wall Street Words

David L. Scott

Wall Street Words

HOUGHTON MIFFLIN COMPANY · BOSTON

The inclusion of any word in this book is not an expression of the Publisher's opinion as to whether or not it is subject to proprietary rights. Indeed, no word in this book is to be regarded as affecting the validity of any trademark.

This publication is designed to provide accurate and authoritative information in regard to the subject matter covered. It is sold with the understanding that the Publisher, author, and contributors are not engaged in rendering legal, accounting, or other professional advice, with respect to this publication. If, as a direct result of information supplied through this publication, legal advice or other expert assistance is required, the services of a competent professional person should be sought. The opinions of the contributors of the investment "tips" that appear in this publication are personal, and do not necessarily represent the opinions of the Publisher, the author, or the institutions with which the contributors are affiliated.

Charts by Mary Reilly

Library of Congress Cataloging-in-Publication Data

Scott, David Logan, 1942-
Wall Street words.

Bibliography: p. 403
1. Investments—Dictionaries. 2. Securities—Dictionaries. 3. Stock-exchange—Dictionaries.
I. Title.
HG4513.S37 1988 332.6'03'21 87–21444
ISBN 0–395–43747–4 (Hardcover)
ISBN 0-395-46777-2 (Paperback)

Manufactured in the United States of America

Contributors of Investment "Tips"

Barry Allen
Senior Investment Consultant
Massachusetts Mutual Life
  Insurance Company
Springfield, MA

Anthony L. Bartolini, Esq.
Law Offices
Dechert Price & Rhoads
Philadelphia, PA

David M. Blitzer
Vice President & Chief Economist
Standard & Poor's Corporation
New York, NY

Michele R. Bourgerie, CPA
National Director of Personal
  Financial Planning
Arthur Young
New York, NY

Bonnie Briskin
Stockbroker
Tucker, Anthony & R.L. Day, Inc.
Boston, MA

Jin Wook Choi, Ph.D.
Advisory Economist, Economic
  Analysis & Planning
Chicago Board of Trade
Chicago, IL

George Domolky
Portfolio Manager
Fidelity Management & Research
  Company
Boston, MA

Allan R. Emkin
Vice President
Wilshire Associates
Santa Monica, CA

Mitchell S. Farkas
Vice President
Manager, CMA Marketing
Merrill Lynch, Pierce, Fenner &
  Smith Inc.
New York, NY

Steven Flagg
Research Coordinator
PaineWebber Incorporated
New York, NY

Stephanie R. Goldsborough
Treasury Officer, Private Investment
  Group
Maryland National Bank
Baltimore, MD

Reg Green
Editor, *Mutual Fund News Service*
San Francisco, CA

Kathleen Hegenbart
Vice President
Financial Consultant
Shearson Lehman Brothers
Newton Centre, MA

Steven J. Hueglin
Executive Vice President
Gabriele, Hueglin & Cashman
New York, NY

Neal Litvack
Marketing Manager, Retail Services
Fidelity Management & Research Company
Boston, MA

Richard Mazur
Vice President, Research Marketing
PaineWebber Incorporated
New York, NY

Thomas J. McAllister, CFP
President
McAllister Financial Planning
Indianapolis, IN

Merrill Lynch Asset Management, Inc.
Princeton, NJ

Irwin H. Metzger
Vice President
Merrill Lynch, Pierce, Fenner & Smith Inc.
New York, NY

J. Kendrick Noble, Jr.
First Vice President
PaineWebber Incorporated
New York, NY

Henry Nothnagel
First Vice President—Retail Marketing
Chicago Board Options Exchange
Chicago, IL

Ray Ozyjowski
Regional Sales Coordinator
PaineWebber Incorporated
New York, NY

T. Boone Pickens, Jr.
Founder & General Partner
Mesa Limited Partnership
Amarillo, TX and
Founder & Chairman
United Shareholders Association
Washington, DC

Marilyn J. Pitchford, CPA
Partner
Arthur Young
Boston, MA

J. Blaine Reeve, CFA
Senior Vice President
Commerce Union Bank
Nashville, TN

Katherine L. Robinson
Assistant Vice President
Kidder, Peabody & Company
Boston, MA

John T. Scully
General Partner
Post 63 Partners
Pacific Stock Exchange
San Francisco, CA

Robert G. Segel
Managing Director
Tucker, Anthony & R. L. Day, Inc.
Boston, MA

Gene Walden
Contributor, *Investor's Daily*, *Financial Planning*, and *Corporate Report*
Minneapolis, MN

Herbert F. Wass
Vice President
Federal Reserve Bank of Boston
Boston, MA

Rudolph D. Watz, CLU, ChFC
Vice President & Director of Retirement Plans
Value Line Securities, Inc.
New York, NY

Martin E. Zweig
Editor
The Zweig Forecast
New York, NY

Preface

The stock market is but a mirror which . . . provides an image of the underlying or *fundamental* economic situation. Cause and effect run from the economy to the stock market, never the reverse.

—John Kenneth Galbraith
The Great Crash, 1929

When we reach for words to describe the business of life and the world of business, we tend to invade the Seven Liberal Arts, and sometimes call upon the Seven Deadly Sins.

—Robert Warren Kent, Ph.D.
Money Talks

The language of Wall Street, like the market's performance, reflects ongoing changes in the economy and in society as a whole. Investing—always a dynamic field fraught with risk—has never sustained more radical changes than those witnessed in the last few years. Investors have been confronted with a host of new products and services in volatile, highly competitive markets, complex new avenues of investment opportunity in a global economy, and a substantially altered federal tax code. They have observed scandal and corruption on Wall Street resulting in greater regulation of the securities markets, increased use of sophisticated communications technology, and a rash of corporate mergers, takeovers, buybacks, and restructurings. *Business Week* recently noted that "terrified of the new world of options, stock indexes, and program trading, individuals have been seeking the sanctuary of professional investment managers." *Wall Street Words*, a reference book of over 3,600 investment terms and 87 "tips" from 32 experts, addresses the individual investor's need to understand the language of the changing market in order to make reasoned, prudent decisions in the marketplace. It is to the individual investors that *Wall Street Words* is dedicated; yet the book is an essential reference source for the professionals in the field—the brokers, dealers, traders, analysts, planners, consultants, bankers, and others who drive the markets.

Although a small core of investing vocabulary has remained virtually unchanged through the years, overall it has been dramatically expanded and altered by a steady influx of new terms and new meanings, many of which are not readily understandable to the uninitiated. This book—the only one of its kind that is based on the terminology encountered in transcripts from *Wall $treet Week with Louis Rukeyser* and other financial broadcasts, *The Wall Street Journal, Business Week, Forbes, Barron's, Fortune, Investor's Daily,* and various newsletters—tracks the words of stock and bond trading, options and futures trading, brokerage, financial planning, technical analysis, banking and investment banking, accounting and finance, economics and business law, taxation, insurance, and corporate structure/operations. *Wall Street Words* contains many terms not found in other works of this type, e.g., *preopening indication, auction-rate preferred stock, CARS, LIONS, automated stock trading, electronic funds transfer, sweep account, flip-over pill, suicide pill, ethical fund,* and *vulture fund.*

The words are entered in strict alphabetical order with brief phrasal meanings, often followed by full sentences expanding on the meanings. Many entries are supplemented with "case study" paragraphs that provide actual accounts of the strategies, maneuvers, procedures, laws, concepts, or actions represented by the entry words and their meanings. For instance, at *program trading* you will find a detailed account of this activity and a description of its impact on the markets; at *Tax Reform Act of 1986,* an analysis of the initial and projected effects of the new legislation; at *insider trading,* a case history; and at *greenmail,* another case history with reportage of aftereffects. These paragraphs, unique to *Wall Street Words,* are intended to offer the investor information not readily obtained in a single reference source, certainly not one devoted to the language that is "heard on the Street."

Still another unique feature of the book is the inclusion of brief "tips" from the experts, such as the ones found at *clone fund, bear market, bond swap, cash value life insurance, concept company, devaluation, interest rate futures, load fund, no-load fund, put, takeover,* and *zero-coupon bond.* These "tips," appearing throughout the book near the entries to which they relate, have been prepared by brokers, traders, bankers, financial planners, attorneys, accountants, securities analysts, economists, financial writers, and chief executive officers. The writers of the "tips" answer some of the questions most often asked by individual investors.

Wall Street Words is the culmination of three years' research and writing, augmented by the work of a number of other people, especially my editor, Anne Soukhanov. Anne is America's most organ-

ized, thoughtful, and convincing person; to say that this book would not have been possible without her is a classic understatement. She took my original idea and crafted it into something that I feel is much better. I would also like to thank the contributors of the investment "tips." Their insights give *Wall Street Words* its distinctive character. To John T. Scully, Robert S Pirie, and Gerald C. Meyers, who read the proofs and offered valuable advice before publication, thanks. My gratitude to Houghton Mifflin Reference Department editors David R. Pritchard, Pamela B. DeVinne, Susan M. Innes, James P. Marciano, and Rosemary E. Previte who checked and corrected proof, and to production manager Christopher Leonesio who directed the book through keyboarding into final pages. And now, as the triple witching hour draws near, I would like to thank the Graduate Research Advisory Committee at Valdosta State College, which provided financial assistance for this project.

David L. Scott, Ph.D.
Valdosta, Georgia

Contents

A

a 1. —Used in the dividend column of stock transaction tables in newspapers to indicate a cash payment in addition to regular dividends during the year: *2.75a*. 2. —Used in money market mutual fund transaction tables in newspapers to indicate a yield that may include capital gains and losses as well as current interest: *AmCap Reserv a*.

A 1. —Used in earnings reports in newspapers to identify the primary market of a firm's common stock as the American Stock Exchange. 2. An upper-medium grade assigned to a debt obligation by a rating agency. Such a rating indicates a strong capacity to pay interest and repay principal; however, this capacity is susceptible to impairment in the event of adverse developments.

AA/Aa A high grade assigned to a debt obligation by a rating agency. Such a rating indicates a very strong capacity to pay interest and repay principal. An AA rating indicates only slightly lower quality than the top rating of AAA.

AAA The highest grade assigned to a debt obligation by a rating agency. Such a rating indicates an unusually strong capacity to pay interest and repay principal. —Also called *triple A*.

abandonment —See EXPIRATION.

ABC Agreement An agreement between a firm that finances a seat on the New York Stock Exchange and the employee who purchases the seat. The agreement, approved by the Exchange, permits the member to (1) transfer the seat to another employee of the member firm, (2) keep the seat and purchase a second membership for another individual designated by the lending firm, or (3) sell the membership with proceeds given to the member firm. ABC Agreements are used because of an exchange restriction against organizations rather than individuals being members.

above par Designating a security that sells at more than face value or par value. For example, a $1,000 par bond trading at a market price of $1,050 is selling above par. A fixed-income security is most likely to sell above par if market rates of interest have declined since the time the security was issued. Bonds purchased above par will result in capital loss to the buyer if held to maturity and redeemed at face value. —See also BELOW PAR; PREMIUM 2; PREMIUM BOND.

abusive tax shelter A tax shelter in which an improper interpretation of the law is used to produce tax benefits that are clearly disproportionate to economic reality.

Accelerated Cost Recovery System (ACRS) An accounting technique for calculating the depreciation of tangible assets on the basis of the estimated-life classifications into which the assets are placed. ACRS was initiated by the Economic Recovery Act of 1981. The goal was to make investments more profitable by sheltering large amounts of income from taxation during the early years of an asset's life. The initial law established classifications of 3, 5, 10, and 15 years; these classifications were subsequently modified to longer ones in order to reduce depreciation and increase the government's tax revenues. The classification into which an asset is placed determines the percentage of the cost potentially recoverable in each year. —See also ACCELERATED DEPRECIATION; STRAIGHT-LINE DEPRECIATION.

accelerated depreciation A method of writing off the cost of a capital asset in which the largest deductions are taken in the early years of the asset's life. The purpose of using accelerated depreciation is to delay taxes to a future date so that cash savings from the deferral can be reinvested to earn additional income. —See also ACCELERATED COST RECOVERY SYSTEM; STRAIGHT-LINE DEPRECIATION.

acceptance —See BANKER'S ACCEPTANCE.

accommodative monetary policy The Federal Reserve policy of increasing the supply of money to make credit more readily available. An accommodative monetary policy tends to lower interest rates, especially the short-term ones, at the time credit is made plentiful, but such a policy is likely to result eventually in increased inflation and interest rates. —See also MONETARY POLICY; MONETIZE THE DEBT.

account 1. The client of a broker, brokerage firm, or broker-dealer. The client may be a business, an individual investor, or an institutional investor. 2. The record of a client's transactions and investment position. —See also ACCOUNT STATEMENT.

accountant's opinion —See OPINION.

account executive —See REGISTERED REPRESENTATIVE.

accounting period —See FISCAL PERIOD.

Accounting Principles Board (APB) A group of accountants appointed by the American Institute of Certified Public Accountants to determine accounting principles for financial recordkeeping. The APB was terminated in 1973 with the founding of the Financial Accounting Standards Board. —See also APB OPINION.

account number A unique code assigned to each investor's account at a brokerage firm.

accounts payable Amounts of money owed to others. Accounts payable are current liabilities incurred in the normal course of business as a firm purchases supplies, with payment due at a later date. If a firm pays cash for all of its purchases, no accounts payable will appear on the firm's balance sheet.

accounts receivable Money owed to a business by customers who have bought goods or services on credit. Accounts receivable is a current asset that continually turns into cash as customers pay their bills. —Also called *receivables*.

accounts receivable turnover The number of times in each period that a firm converts credit sales into cash. A high turnover indicates effective granting of credit and collection from customers by the firm's management. Accounts receivable turnover is calculated by dividing the average amount of receivables into annual credit sales. —Also called *receivables turnover*. —See also ACTIVITY RATIO; AGING; COLLECTION PERIOD.

account statement A periodic statement to the investor showing the investor's investment position at a given point in time and transactions for the investor's account during a given period of time. Unless an investor's account is inactive, an account statement is generally sent at the beginning of each month. Statements for inactive accounts are sent quarterly.

accredited investor An investor with sufficient income or wealth to be exempted from the 35-person limit in contributing funds to a private limited partnership. An accredited investor must have an annual income of over $200,000 or a net worth of $1 million, or the investor must purchase $150,000 or more of the offering with the investment representing 20% or less of his or her net worth.

accretion The accumulation of capital gains on discount bonds with the expectation that the securities will be redeemed at maturity. Excluding municipals, the amount of annual accretion is taxable on an original issue discount bond even though only a small amount of interest or no interest at all is paid each year. —See also IMPUTED INTEREST.

accrual accounting A method of accounting that recognizes expenses when incurred and revenue when earned rather than when payment is made or received. Thus, it is the act of sending the goods or receiving an inventory item that is important in determining when transactions are posted on financial statements. For example, using accrual accounting, sales are recorded as revenue when goods are shipped even though payment is not expected for days, weeks, or months in the future. Most firms use the accrual basis of accounting in recording transactions. —See also CASH BASIS ACCOUNTING.

accrued expense An expense incurred but not yet paid. A firm incurs certain expenses such as wages, interest, and taxes that are paid only periodically. From the time the expenses are incurred until the date they are paid, they build up in a firm's balance sheet as accrued expenses.

accrued interest Interest owed but not yet paid. Accrued interest is listed as a liability on corporate balance sheets. It is also added to the price at which bonds are traded. For example, if a 12% coupon bond is now trading at a price of $950 and the last record date for an interest payment was 2 months ago, the buyer must pay the seller $20 (2 months' interest at 1% per month on $1,000 principal) in accrued interest in addition to the quoted price. This additional expense will be recovered when the new owner receives six months' interest after holding the bond only four months.

accrued market discount The gain in the value of a bond that occurs because the bond has been bought at a discount from face value. For example, a $1,000-par bond maturing in 10 years and selling at $800 can be expected to rise gradually in price over its remaining life. The accrued market discount is the portion of any price rise caused by the gradual increase (as opposed to an increase caused by a fall in interest rates).

accumulate To purchase a relatively large amount of stock in a firm over a period of time. —See also DISTRIBUTE.

accumulated depreciation The total amount of depreciation that has been recorded for an asset since its date of acquisition. For example, a computer with a 5-year estimated life that was purchased for $2,000 would have accumulated depreciation of $800 [($2,000/5) × 2] and a book value of $1,200 ($2,000 − $800) after 2 years of using straight-line depreciation. —Also called *depreciation reserve.*

accumulated dividend —See DIVIDENDS IN ARREARS.

accumulated earnings tax A federal tax on a company's retained earnings that are considered in excess of what is reasonable. The purpose of an accumulated earnings tax is to make it more difficult to defer or lower the tax rate (i.e., change from ordinary income to capital gains) on income that would ordinarily be paid to stockholders in dividends. For example, stockholders in high tax brackets generally prefer that earnings be retained rather than paid in dividends so that they can avoid current taxation at ordinary rates. The position of the Internal Revenue Service is that if the funds are not actually needed by the firm and are only being retained for tax reasons, the accumulated earnings should be taxed.

accumulation area In technical analysis, a rectangular-shaped chart formation caused by insiders and other knowledgeable investors who purchase shares of stock from the public. If an accumulation area can be identified, it indicates a time to buy. An accumulation area is generally characterized by little price movement and relatively heavy volume. —See also DISTRIBUTION AREA; RECTANGLE; REVERSAL PATTERN.

acid-test ratio —See QUICK RATIO.

acquisition The purchase of an asset, such as a plant, a division, or even an entire company. For example, General Motors made a major acquisition in 1984 when it purchased Electronic Data Systems Corporation in order to gain expertise in the computer services market.

ACRS —See ACCELERATED COST RECOVERY SYSTEM.

acting in concert Two or more investors acting together to achieve a common goal. For example, a number of relatively large investors may accumulate a major position in a security in an attempt to influence management decisions.

active Pertaining to a security in ~~which there is~~ a great deal of trading. Active ~~securities appeal~~ to many investors because they are easier to ~~trade~~ without affecting the price. In over-the-counter trading, an active security normally has a smaller spread between the bid and ask price. —See also MOST-ACTIVE STOCKS.

> In September of 1986 the stock of USX Corp. (formerly United States Steel), amid rumors of an impending takeover or of possible corporate restructuring, became what is called very active. Over 15 million shares, or 6%, of all USX's outstanding stock were traded, thus making it the most active stock on the New York Stock Exchange (NYSE) on September 17. The extent of the activity in USX is illustrated by the fact that trading in its stock represented approximately 10% of all trades on the NYSE that day. During the day, a 4-million-share block as well as a 2-million-share block changed hands.

active bond crowd Members of the New York Stock Exchange who trade frequently in active bonds. —See also CABINET CROWD.

active box —See OPEN BOX.

active investment management The management of an investment portfolio that involves active trading of securities in an attempt to produce above-average returns on a risk-adjusted basis. Active management is predicated on the belief that it is possible to beat the market averages consistently. —See also PASSIVE INVESTMENT MANAGEMENT.

active market A securities market or the market for a particular security in which trading is relatively heavy. An active market not only results in more profits for brokers but also helps institutional investors wishing to acquire or dispose of large positions without affecting price.

activity The amount of relative trading volume in a security.

activity ratio A measure of how rapidly a firm is able to convert various accounts into cash or sales. In general, the sooner management can convert assets into sales or cash, the more effectively the firm is being run. —See also ACCOUNTS RECEIVABLE TURNOVER; COLLECTION PERIOD; FIXED ASSET TURNOVER; INVENTORY TURNOVER; TOTAL ASSET TURNOVER.

actual In commodities, the physical asset (i.e., the commodity) as opposed to a futures contract on that asset.

A/D —See ADVANCE-DECLINE LINE.

additional paid-in capital Stockholder contributions in excess of the stock's stated or par value. For example, if a firm issues stock with a par value of $1 per share but sells the stock to investors at $10 per share, the firm's financial statements will show $1 in common stock and $9 in additional paid-in capital for each share issued. —Also called *capital surplus; paid-in surplus.*

add-on Funds that are added to a certificate of deposit after the date of purchase at the same rate of interest as the one on the original certificate. Some savings institutions permit add-ons that provide a real benefit to investors during a period of declining interest rates.

adjustable-rate preferred stock —See FLOATING-RATE PREFERRED STOCK.

adjusted basis The cost or basis at which an asset is acquired, adjusted for certain occurrences since the day of acquisition. For example, stock dividends, stock splits, and dividends deemed to be return on capital result in a downward adjustment in the cost basis of a security. Conversely, commissions result in an upward adjustment in the cost basis. Adjusted basis is used in calculating gains and losses for tax purposes. —See also BASIS 2.

adjusted debit balance The amount owed a broker by a customer adjusted by paper profits on short sales and balances in a special miscellaneous account. Adjusted debit balance is used to determine if a customer is permitted to withdraw cash or securities from a margin account.

adjusted exercise price The strike price of put and call options on Government National Mortgage Association (GNMA) pass-through certificates. Because GNMA contracts composed of mortgages at interest rates other than a benchmark rate must be adjusted in price to achieve the benchmark, the exercise prices of options on the contracts must also be adjusted to achieve an exercise price producing GNMA contracts yielding the benchmark interest rate.

adjusted gross income An individual's gross income less certain allowed business-related deductions, which include alimony payments, contributions to a Keogh retirement plan, and in some cases, contributions to an IRA. Adjusted gross income and gross income will be the same for many taxpayers. —See also ADJUSTMENTS TO INCOME.

adjustment 1. —See DIVIDEND ADJUSTMENT. 2. —See INTEREST ADJUSTMENT.

adjustment bond —See INCOME BOND.

adjustment in conversion terms An alteration in the terms under which a convertible security may be exchanged. For example, if an issuer implements a two-for-one split (resulting in a doubling of the number of shares) in the common stock into which its convertible security may be exchanged, the issuer will nearly always be required to reduce the convertible's conversion price by half. Automatic price adjustments also may be scheduled over the life of a convertible security. Scheduled increases in the conversion price on specific dates would be an example of an automatic adjustment.

adjustments to income Reductions from a taxpayer's gross income in arriving at adjusted gross income. These adjustments are permitted even if the taxpayer does not itemize deductions during a tax year. Allowable adjustments of particular interest to investors are interest penalties on early savings withdrawals and payments into IRAs and Keogh plans. —See also ADJUSTED GROSS INCOME.

ADR —See AMERICAN DEPOSITORY RECEIPT.

ad valorem tax A tax that is computed as a percentage of the value of specific property. For example, many states levy an annual tax on the market value of an investor's securities as of a certain date. —Also called *property tax*.

advance-decline index A cumulative total of the daily number of stock issues advancing in price less the daily number of issues declining in price. Technical analysts use the advance-decline index as a measure of breadth in order to determine the strength of market movements. Movement of the advance-decline index in the same direction as the market confirms the market movement and indicates that the movement will continue.

advance-decline line (A/D) A line on a graph representing the advance-decline index over a period of time. The direction of the advance-decline line is used to confirm movements in a stock or the market.

advance refunding —See PREREFUNDING.

adverse opinion An opinion by a firm's auditors that the firm's financial statements do not accurately present its operating results or financial position. This unusual opinion is a strong warning that investors should be wary. —See also CLEAN OPINION; DISCLAIMER OF OPINION; OPINION; QUALIFIED OPINION; SUBJECT TO OPINION.

Advisers Act —See INVESTMENT ADVISERS ACT OF 1940.

advisors' sentiment The view of market forecasters regarding the future course of security prices. Strong bullish sentiment indicated by investment advisors is often considered a bearish sign, while strong, bearish sentiment is considered a bullish sign. This contrarian technical indicator is based on the theory that when most advisors expect a certain market movement, the opposite movement is most likely to occur. —See also SENTIMENT INDEX.

Should investors take advisors' sentiment seriously? Why?

As with any profession, its members include the good, the poor, and the indifferent. It takes a lot of watching to differentiate one category from the other. However, the aggregate opinion of advisors is invaluable. When their sentiment runs to heavy one-sided extremes, it tends to be wrong. So—beware of the crowd if the consensus approaches unanimity.

Martin E. Zweig, Editor
The Zweig Forecast, *New York, NY*

advisory account A brokerage account in which the broker may make limited investment decisions without consulting the customer. Securities traded in the account are confined to those that meet the customer's investment goals. —See also DISCRETIONARY ACCOUNT.

affiliate One organization that is related to another organization through some type of control or ownership. For example, a U.S.-based company may have a foreign affiliate that handles overseas sales.

affiliated person A person who is in a position to influence a firm's management decisions. Affiliated persons normally include directors, officers, owners of over 10% of the firm's outstanding stock, and family members or close associates of these groups. —Also called *control person*.

after-hours trading Trading in securities after the exchanges are closed. After-hours trading often refers to trading a listed security in the over-the-counter market after the exchanges have been closed for the day. This fairly common practice is not illegal.

aftermarket —See SECONDARY MARKET.

aftertax profit —See NET INCOME.

aftertax yield The rate of return on an investment after taxes have been calculated and subtracted. Aftertax yield, as opposed to pretax yield, is generally a preferred basis for comparing investment alternatives.

Why should an investor concentrate on aftertax, rather than pretax yield?

Taxes, after all, are a fundamental cost to the investor and reduce the yield on an investment as surely as any other cost or expense. Therefore, the tax burden on an investment will always be an important factor in determining an investor's true yield. Some investments (for example, municipal bonds) produce income which is not currently subject to federal (and sometimes state and local) income taxes. Thus, it would not be accurate to ignore income taxes when comparing the yield on a municipal bond that produces a 5% return free of income taxes with a corporate bond that produces an 8% return but is subject to federal and state income taxes which may well reduce the 8% yield to 5% or lower. In addition, some investments are subject to state and local taxes other than income taxes such as personal property taxes. Such taxes also erode the yield on an investment and should be taken into account. In short, when comparing investment yields, an aftertax yield comparison will give a more accurate comparison.

Anthony L. Bartolini, Esq.
Dechert Price & Rhoads, Philadelphia, PA

AFUDC —See ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION.

against the box —See SHORT AGAINST THE BOX.