- **financial asset** (N-count)

A financial asset is a non-physical asset, such as a security, certificate, or bank balance. It is the opposite of a non-financial asset.

- **structured product** (N-count)
  structured credit market (structured credit markets) (N-count)

A structured product is, essentially, a contract that can be assigned a value and traded. It could be a stock, bond or mortgage debt, for example. Structured credit markets, also known as second or third markets, deal with the trading of derivatives, or structured products such as mortgage backed securities or CDOs.

- **mortgage-backed security** (mortgage-backed securities) (N-count)

A mortgage-backed security is created where a large pool of mortgages are collected together and traded between various large investors.

- **tranche** (tranches) (N-count)

(from French: slice) a part or instalment of a large sum of money or a structured product such as a CDO or mortgage backed security. Different tranches correspond to different levels of risk. The senior tranche corresponds to a risk rating of AAA. The mezzanine tranche corresponds to a risk rating of AA to BB and the equity tranche corresponds to the unrated coupons.

- **special purpose vehicle (SPV)** (N-count)

A special purpose vehicle is a company that is created solely for a particular financial transaction or series of transactions. SPVs can be used for other transactions including securitisations and the issue of catastrophe bonds. In addition to reducing tax, SPVs can remove assets or liabilities from balance sheets, transfer risk and (in securitisations) allow the effective sale of future cash flows. The management of an SPV will need to be structured in a way that takes account of accounting standards that require a company controlled by another to be consolidated as a subsidiary. This is not usually a problem as SPVs require very little in the way of management.

- **credit-rating agency** (credit-rating agencies) (N-count)

There are a number of large international companies that are used to assess the risk of various bond issuers. They produce a formal rating measure or for each of them. For example, they can assign the following ratings or risk categories:

AAA = capacity to pay interest and principal extremely strong.
AA = differs only in a small degree.
A = more susceptible to adverse changes in circumstances.
BBB = adequate capacity.
BB, B = speculative
C = no interest being paid
D = In default

- **collateral debt obligation** (collateral debt obligations, CDOs) (N-count)

These are complex financial market securities which are backed by a pool of bond, loans or some other assets. In theory, CDOs attract a stronger credit rating than individual assets due to the risk being more diversified. But as the performance of some assets has fallen, the value of many CDOs has also been reduced.

- **investment-grade status**

Any rating that is at BBB or above is considered to be of investment grade. This means that the credit-rating agencies regard their issuer as having sufficient quality to be able to meet the obligations to the bond holders. If you buy a bond with a below investment-grade status you must accept that it is a speculative investment.

- **hedge fund** (hedge funds) (N-count)

This refers to particular type of investment management where the fund manager will employ a range of different investment tools in an attempt to maximise the returns or try to make gains even in a falling market. The fund will rely on large amounts of borrowing and will use derivative markets and short selling to achieve these aims.

- **equity** (N-uncount)

In a business, equity is how much all of the shares put together are worth. In a house, the amount your house is worth minus the amount of mortgage debt that is outstanding on it.

1. Use the terms in the box to complete the paragraph.

financial assets	special purpose vehicle	tranche	tranches
risk category	mortgage-backed securities		

Structured credit markets

This term is used in financial markets to cover a whole raft of new and highly innovative financial market products. Their common characteristics are:

a) The combining of various ………………… – for example, in the ………………… a whole group of mortgages will be combined to make a large package that can be traded.
b) The creation of various ……………….. supported by the group of financial assets. Each ……………….. will be allocated into a different ………………...
c) There will be a clear divide between the credit risk of the original issuer and the credit risk of this particular group of financial assets. This will be done through the creation of a short-lived ………………...

2. Are the following statements true or false?

i. Hedge funds use a number of strategies to make money for investors.
ii. A hedge fund is an investment that aims to make money year in, year out, no matter what the financial climate.
iii. Hedge funds typically use leverage.
iv. A hedge fund manager is likely to sell a borrowed asset in the hope of buying it back more cheaply later.
v. It is perfectly safe to invest in a hedge fund.
vi. A bond rated B has investment-grade status.

3. Read the text and answer the questions that follow.

Many hedge funds are worth billions of pounds, but it is the frequency with which they trade that gives them a profile even bigger than their size alone would merit. Market experts reckon that hedge funds account for as much as 50 per cent of all trades on the London Stock Exchange. When hedge funds combine to bet on a particular outcome, as they did with the pound in 1992, even governments can find themselves powerless to resist the momentum they generate. The initial investment required in a hedge fund is usually very high. It is rarely less than £50,000 and can be £1 million or more, which rules out all but the wealthiest investors. Hedge funds are based offshore and are not regulated by the Financial Services Authority. Although not all hedge funds are high-risk, some of the strategies used by some of the funds undoubtedly are. They typically charge 2 per cent a year in annual fees, plus a performance fee of 20 per cent or more of any rise in the fund's value. Performance fees are rewards to managers for achieving a certain level of return. The idea is that by offering these incentives the fund ensures that both the managers and the investors have a strong interest in the fund doing well.

a. How often do hedge funds trade managers trade their assets in the hedge fund?
b. Is it likely that a man in the street would invest in a hedge fund? Why/why not?
c. How much power do hedge funds wield in the economy?
d. How much money is a hedge fund manager likely to make?
e. Are hedge funds regulated?
f. Do hedge funds have a high risk image?