Selected Global Equity Glossary of Terms

Active Performance – The return of a portfolio that is in excess of its benchmark return. This is the return of the active portfolio.

Active Portfolio – A portfolio that is managed with the expectation of earning investment returns in excess of those earned by its benchmark.

Active Risk – The difference in the volatility of the returns in an active portfolio relative to the portfolio's benchmark.

Benchmark – A set of securities with associated weights that provides a passive representation of a market segment. A benchmark's return is often used as a comparative measure of a manager's performance results in an active portfolio.

Beta – A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole

Capitalization Weighted – A weighting method based on the equity market capitalization of a stock. Market capitalization is calculated by multiplying the total outstanding shares of a stock by its price per share.

Common Factor – An element of return that influences many securities and hence, is a "common factor" in the returns on those securities. By virtue of their common influence on many stocks, common factors contribute to market return as well as residual returns of the stocks that they influence most. Some common factors for domestic equity are capitalization, beta, price/earnings, price/book, interest sensitivity, and yield.

Common Factor Return – A portfolio’s or individual asset’s return component that is attributable to exposure to a particular common factor. This is derived from the unique return attributed to the common factor.

Derivative – An instrument whose value is based on the performance of an underlying financial asset, index, or other investment. Classes of derivatives include futures contracts, options, currency forward contracts, swaps, and options on futures.

Dividend Yield – An indication of the dividend generated by a stock. The yield is calculated by dividing annual dividends per share by price per share.

Earnings/Price Ratio – The relationship of earnings per share to current stock price. The stock's trailing 12 months of reported earnings is often used as the earnings per share figure.

Emerging Equity Market – A market classified by FTSE as an emerging market based on an assessment of World Bank gross national income per capita, as well as factors related to the market and regulatory environment, custody and settlement, trading, development of a derivatives market and size of the country's stock market. Emerging Equity Markets are distinguished from: (1) Developed Markets which are markets domiciled in high-income countries, as defined by the World Bank, that most investors consider to have a well-developed operating and regulatory structure for its capital markets. These markets are included in the FTSE Benchmark Classification as Developed Markets. (2) Frontier Markets which are markets domiciled in low-income countries, as defined by the World Bank, whose capital market structure and regulatory mechanisms are not developed enough to be included in Emerging Markets. These are markets that are investable but not classified by FTSE as Developed or Emerging Markets. (3) Uninvestable Markets which are those markets that are not classified by FTSE as Developed, Emerging, or Frontier Markets. These markets generally lack a convertible currency and do not allow for investment by non-residents.

Enhanced Indexation – An equity-based strategy or synthetic strategy where managers are expected to add consistent alpha above the passive index by controlling tracking error at a level that is below traditional active management. For example, for U.S. large capitalization core equity, the expectation is a return of 1.00 percent per annum above the benchmark, net of fees, with annual tracking of 2.00 percent-2.50 percent.

Equitize – Combining cash with derivative instruments to produce returns comparable to the equity market.

Equity Based Strategy – Combination of active stock selection with risk mechanism designed to minimize tracking error relative to the benchmark. Seek to add value through minor variances relative to the market in sector/industry weightings, style (growth/value) tilts or stock weightings. Key inputs into the process come from either analysts' fundamental research or quantitative models.

External Manager – An asset management firm retained by CalPERS to manage a portfolio of securities for a fee. The external manager usually has full discretion to manage CalPERS' assets, consistent with investment management guidelines provided by CalPERS and fiduciary responsibility.

Financial Times Stock Exchange (FTSE) – The index publisher that produces the Custom FTSE All World ex-US Index for CalPERS. FTSE was originally a partnership between the London Stock Exchange (LSE) and Financial Times and has been fully owned by the LSE since early 2012.

Forecasted Tracking Error – The expected or ex ante annualized standard deviation of the difference between the total return of the portfolio and the total return of the benchmark.

Information Ratio – A measure of risk adjusted return calculated by dividing the active performance by the tracking error or active risk.

Kurtosis – A statistical measure that describes the shape of a data distribution (peaked or flat). High kurtosis indicates a higher proportion of data points being further away from the mean value (fat tails). A normal distribution has a kurtosis of 3.

Market/Book Ratio – A stock's equity market value, divided by book value at the most recently available fiscal year end (assets minus liabilities).

Nonsystematic Risk – That part of a total return that cannot be explained by a single- or multi-factor model of returns. Such components of return can be diversified away in a sufficiently large and well-diversified portfolio.

Normal Distribution – A “normal” data distribution is described by the mean and standard deviation measures of the data set where approximately 68 percent of the observations fall within one standard deviation of the mean, about 95 percent fall within two standard deviations and nearly 100 percent fall within three standard deviations. Skew in a normal distribution is 0 and kurtosis is 3.

Non-normal Distribution – A data distribution that displays statistical characteristics of skew and kurtosis that differ from the measurements of these parameters observed for a normal distribution.

Optimization – The best solution among all solutions available for consideration. Constraints on the investment problem limit the region of solutions that are considered and the objective function for the problem by capturing the investor's goals correctly, providing a criterion for comparing solutions to find the better ones. The optimal solution is the solution among those admissible for consideration that has the highest value of the objective function.

Optimizer – Mathematical algorithm that maximizes an objective function subject to minimizing given constraints.

Passive Investment – Investing in a manner that attempts to replicate the characteristics and performance of a market index or benchmark. In theory, passive investing/management assures investment performance is neither worse nor better than the market as a whole. In practice, actual results differ from the results reported for the index due to transactions costs and tracking error.

Performance Attribution – The process of attributing portfolio returns to causes. It decomposes past performance into separate components or factors contained within a multi-factor model.

Rebalancing – The process of modeling a portfolio through an optimizer or other portfolio construction method to generate a trade list that better aligns a portfolio with its investment objective.

Reconstitution – The periodic reformulation of a benchmark index which may entail the addition or deletion of securities along with changes to the parameters which determine the relative weight of included assets.

Return Deviation – The difference between the total return of a portfolio and the total return of the benchmark index.

Risk – A measurable probability of losing or not gaining value. Risk is differentiated from uncertainty, which is not measurable. Risk in this context is also referred to as "standard deviation", which is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

Risk Adjusted Performance – Performance results evaluated on the amount of risk taken to generate the results, generally by evaluating the standard deviation of the returns generated.

Risk Attribution – The process of decomposing total risk and attributing it among the factors contained within a multi-factor model.

Risk Budget – An investment approach where one uses measures of risk to assist in the allocation, management, and monitoring of the investments of an entity, such as a pension fund.

Security Selection – Strategies that seek to mitigate market factors through a variety of hedging techniques with the objective of providing a return based solely on its stock/bond selection analysis.

Skew – Asymmetry from a normal distribution where more data points are to the left (negative) or right (positive) from the average or mean data point. A normal distribution has a skew value of 0.

Specific Risk – The component of total risk that is unique or idiosyncratic to an individual security.

Standard Deviation – A statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. It is widely used as a measure of risk for portfolio investments. It is the square root of variance. In a symmetrical distribution, such as the normal distribution, approximately two-thirds of all outcomes fall within +/-1 standard deviation, and approximately 95 percent of all outcomes fall within +/- 2 standard deviations.

Style Benchmark – A custom benchmark composed of individual securities or a combination of published benchmarks with returns closely tracking an individual manager's returns. Style benchmarks help determine what portion of a manager's performance can be explained by its style and what portion can be attributed to stock selection.

Synthetic Strategy – Combination of obtaining market exposure via futures contracts or swaps and enhancing return through the management of the underlying cash portfolio. The market exposure is achieved through a long S&P 500 futures position and the remaining capital is invested in money market instruments with a maturity of 90 days or longer that have greater duration or credit risk.

Systematic Risk – That portion of total risk that stems from exposure to the market in general and cannot be eliminated by diversification.

Tracking Error – The annualized standard deviation of the difference between the total return of the portfolio and the total return of the benchmark. The term tracking error is frequently used to describe return deviation, the total return of a portfolio, minus the total return of a benchmark index.

Variance – A statistical term for the variability of a random variable about its mean. The variance is defined as the sum of the squares of the deviation from the mean.

Volatility – Expected or historical annualized standard deviation of returns. Returns can be total returns or the differential returns between a portfolio and its benchmark.