Alphabet Soup

The financial services industry is notorious for the overuse of acronyms. The Merriam Webster dictionary defines an acronym as “a word formed from the first letters of each one of the words in a phrase”. Following are some commonly used acronyms related to financial matters, broken down and explained.

* ADR – American Depository Receipt. These are units of ownership which represent interest in shares of a foreign company. ADRs are issued in dollars and they trade on major exchanges making it an easy way for investors to invest in companies domiciled outside the United States.
* EPS – Earnings Per Share. This is a metric used by investors to gage profitability of a company. EPS is determined by dividing earnings of a company into the total number of shares outstanding. Because companies have varying amounts of shares issued, EPS is a valuable gage for investors to compare valuation of different companies.
* ESOP – Employee Stock Ownership Plan. This is a plan offered by some employers which allows employees to purchase stock in the company, often at a discounted price. An ESOP is used by employers as a way for employees to “have skin in the game” as they have direct ownership in the company they work for. The idea behind an ESOP is that if an employee owns part of the company they work for, they will be better, more productive employees.
* LIBOR – London Interbank Offered Rate. LIBOR is a widely used benchmark for short-term interest rates. This is a metric that gages, in general, what large banks across the globe charge each other to borrow on a short-term basis. LIBOR impacts investors as many fixed income investments pay interest, at least in-part, on this rate.
* P&L – Profit and Loss. This is also often referred to as an Income Statement. P&L reports in arrears a company’s income or loss for a certain time period. It breaks down areas of income from the operation, lists and categorizes expenses for the organization, and finally lists a net income (or loss). This is a valuable tool for investors to gage the financial health of a company.
* P/E Ratio – Price Earnings Ratio. P/E Ratio is simply a calculation of a stock’s price divided by is earnings per share (see above). This can be a valuable metric for investors to determine if the current share price of a company is over or undervalued.
* YTM – Yield to Maturity. This is a figure on fixed income investments (generally bonds) that calculates what an investor’s long-term annualized yield will be on that investment if it is held until the maturity date. This calculation factors in the coupon rate, the number of coupon payments, price the investor initially pays for the bond, and what price the bond is set to mature at. Related is YTC, which stands for Yield to Call. This calculates what an investor’s annual yield would be on that investment if it was held until called back from the issuer.

This is only a small sampling of the vast amount of acronyms used in the financial services industry. A quick search of the acronym on the web generally will yield good results and explanations of the acronym. When it comes to your money, don’t drown in alphabet soup, be an informed investor and make sure you ask clarifying questions if an acronym is used that you don’t understand.

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