

Collateralized Debt Obligations (CDOs)

An investment constructed out of bundles of debt, like *Residential Mortgage Backed Securities* (bonds in which mortgage repayments are channeled to investors rather than the mortgage issuer). "CDOs were the epicenter of the upheaval, the device that magnified what otherwise would have been a contained subprime bubble into an economy-wrecking meltdown." Yves Smith, author of ECONNED

Credit Default Swaps (CDSs)

A contract used to insure the buyer of a bond against default by the bond issuer. This is what got Joseph Cassano and AIG Financial Products into so much trouble.

Derivatives

Contracts that obtain their value from that of a different commodity or product. (anything from commodity futures to *Residential Mortgage Backed Securities*). Derivatives were developed to help diminish risk (i.e., hedging) but can also be traded for speculative purposes. In 2003 billionaire investor Warren Buffet called highly complex derivatives like *Credit Default Swaps* and *Collateralized Debt Obligations*, "financial weapons of mass destruction".

Market Maker

A trader who commits to posting continuous buy and sell prices to help create a liquid market and facilitate deals. The market maker hopes to make a profit on the difference between prices and from fees charged.

PE Ratio (Price to Earnings Ratio)

The ratio between the price of a stock and the yearly earnings it pays in dividends. It is a key number investors evaluate when deciding whether or not to purchase a stock.

Regulatory Arbitrage

Occurs when companies chose a place of business because of **lower costs and more permissive regulatory, legal or tax regimes** (i.e., offering excessive freedom to financial firms).

Residential Mortgage Backed Securities

Bonds in which mortgage repayments are channeled to investors rather than the mortgage issuer.

Securitization

The process of packaging debts (like subprime mortgages) **into new investments** (like *Residential Mortgage Backed Securities* or *Collateralized Debt Obligations*). “Securitization was the biggest U.S. export business of the 21st century. More than \$27 trillion of these securities have been sold since 2001, according to the *Securities Industry Financial Markets Association*, an industry trade group. That's almost twice last year's U.S. gross domestic product of \$13.8 trillion.” Mark Pittman, Bloomberg News, 2008.

Tranche

French for slice. **Used in finance to denote a section or slice** of a *Collateralized Debt Obligation* (CDO). Some tranches are more risky and pay more. Others are relatively more conservative but pay less.

Yield

The annual income earned from an investment. Usually expressed as a percentage of the money invested.