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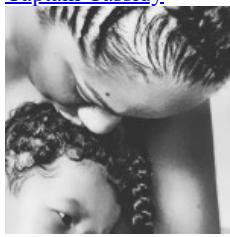
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42 Important Financial Terms You Should Know

December 29, 2010 by [Tim](#)[0 Comments](#)

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You may already be well versed in financial terms, but if you are open to a refresher course or expanding your financial word bank, this post is for you. I've taken 42 financial terms that I feel are important for general personal finance and gave a brief definition of each term. Most are just a sentence or two and give a simple definition of the term.

I hope you benefit from reading through this list (or maybe emailing it to a friend) – I know I got a nice refresher on some of the terms I don't use every day!

Financial Terms Defined

- 1. 401(k) Plan** – A qualified retirement plan through an employer to which eligible employees can make salary deferral (salary reduction) contributions on a post-tax and/or pretax basis.
- 2. 403(b) Tax Sheltered Annuities** – A qualified retirement plan for eligible employees of public schools, tax-exempt organizations and eligible ministers. Similar to a 401(k) plan but mainly for non-profit organizations.
- 3. Amortization** – Paying off of debt in regular payments over a period of time.
- 4. Annuity** – A financial product designed to grow an individual's funds and then upon annuitization, pay a fixed payment for the designated number of periods. Annuities are used primarily as a way to secure cash flow during retirement years.
- 5. APR** – Annual Percentage Rate. The annual cost of a loan; including all fees and interest. Expressed as a percentage.
- 6. APY** – Annual Percent Yield. The annual return of an investment for a one-year period. This rate includes compounding, which makes it greater than the periodic interest rate multiplied by the number of periods.
- 7. Asset** – Any resource that has economic value that an individual or corporation owns. Assets are generally viewed as resources that produce cash flow or bring added benefit to the individual or company.
- 8. Bankruptcy** – A legal proceeding in which a debtor's assets are liquidated and the debtor is released from further liability.
- 9. Bear Market** – A market condition where securities are falling and investors have a pessimistic outlook on the market as a whole. A downturn of 20% or more for more than two months within multiple indexes like the Dow Jones Industrial Average or the S&P 500 is considered the start of a bear market.
- 10. Bond** – A debt instrument used by corporations, governments (including Federal, State and City) and many other institutions that are used to generate capital. The investor does not become part owner like a shareholder, but does have a greater claim on the issuer's income than a shareholder.
- 11. Bull Market** – Opposite of bear market. A market condition where securities rise faster than historic averages; usually from an economic recovery, boom or spike in investor confidence (psychological).
- 12. Capital Gain** – A capital gain is realized when an investment's selling price exceeds its purchase price.
- 13. Cash Flow** – One of the main indications of a company's overall financial health. Calculated by subtracting cash payments from cash receipts over a period of time (month, quarter, year).
- 14. CD** – Certificate of Deposit – Interest bearing note offered by banks, savings and loans, and credit unions. CDs are FDIC insured and provide interest on the investor's money that is locked in for a certain term (usually three months to six years).
- 15. Compound Interest** – Interest that is calculated not just on the initial principal but also on the accumulated interest from previous periods. As interest is added back to the principal, the rate of return applies to the entire balance, making the balance grow even faster than simple interest (simple interest is when the interest is applied only to the initial principal, not the accumulated interest as well).
- 16. Coverdell Educational Savings Account** – A replacement to the Educational IRA, the Coverdell ESA is a savings vehicle for parents to use for their child's education. Though contributions to the account are taxed, earnings used for educational expenses are not. The funds within the account must be used for qualified educational expenses before the beneficiary's 30th birthday. Taxes and penalties may apply if distributions are not taken properly.
- 17. Credit Report** – A summary of a person's credit history, showing historical information such as bankruptcies, loans, late payments, and recent inquiries. Individuals can obtain one free credit report from each of the three credit bureaus each year.

18. Credit Score – A measure of credit risk that is based on activities such as credit use and late payments. Credit scores can be obtained for a fee from one of the three credit bureaus. One of the most common credit scores in the U.S. is the FICO score.

19. Debt – An amount owed to a person or corporation for funds borrowed.

20. Delinquency – When a borrower fails to repay a debt obligation by the agreed term.

21. Diversification – Spreading risk by investing in a range of investment tools such as securities, commodities, real estate, CDs, etc.

22. Garnishment – A legal process whereby a debtor's personal property is seized in order to satisfy a debt or court award.

23. Inflation – The gradual increase or rise in the price of goods of a period of time.

24. Interest – The fee paid for using other people's money. For the borrower, it is the cost of using other people's money. For the lender, it is the income from renting the good (the money).

25. Keogh Plan – A pension plan for self-employed individuals or employees of unincorporated businesses. It is also known as self-employed pension.

26. Liability – An obligation to repay debt.

27. Liquidity – The ability of an asset to be converted to cash quickly without sacrificing value or giving a discount on the price.

28. Loan-to-value – The ratio of the fair market value of the asset to the value of the loan used to purchase the asset. This shows the lender that potential losses may be recouped by selling the asset.

29. Mutual fund – An investment that is made up of a pool of funds from multiple investors who want to invest in securities like stocks, bonds, money market accounts, and other assets. Mutual funds are operated by money managers who invest capital and try to create gains for the investors.

30. Net worth – Basic calculation of assets minus liabilities. Used both for corporations and individuals to measure financial health.

31. Option – A contract that gives the buyer the right, but not the obligation, to buy (call) or sell (put) a security at a price that has been set (strike price) during a set period of time or certain date (exercise date).

32. Prime Rate – Determined by the federal funds rate (the overnight rate at which banks lend to one another) the prime rate is the best rate available to a bank's most credit-worthy customer.

33. Principal – The original investment on which interest is generally paid.

34. Recession – An economic condition defined by a decline in GDP for two or more consecutive quarters. During a recession, the stock market usually drops, unemployment increases, and the housing market declines.

35. Risk Averse – An investors desire to avoid risk; a more conservative approach to investing is generally upheld by risk averse investors.

36. RMD – Required Minimum Distribution – The minimum annual amount required for retirement account holders to withdraw, starting at age 70 ½. This amount is calculated based on the account value on December 31 of the prior year divided by the factor on the IRS RMD table. (RMD does not apply for Roth IRAs.)

37. Roth IRA – Retirement vehicles that allow certain individuals who meet income restrictions to contribute funds that have already been taxed in order to save for retirement. The withdrawals from Roth IRAs will never be taxed (including interest – after five years of the initial investment).

38. Share – One unit of ownership in a corporation, security, or limited partnership.

39. Stock – A proportional share of ownership of a corporation. A company may offer 100 shares of stock and if you own 10, you have 10% ownership of the company.

40. Tax-deferred – Postponing taxes until a later date – common tax-deferred vehicles include IRAs, 401(k), Keogh Plans, 403(b), and pension plans.

41. Traditional IRA – A retirement vehicle that allows you to save pretax funds for retirement. These funds are taxed upon withdrawal and may be subject to penalty if withdrawn before age 59 ½.

42. Yield – The annual rate of return for an investment expressed as a percentage.

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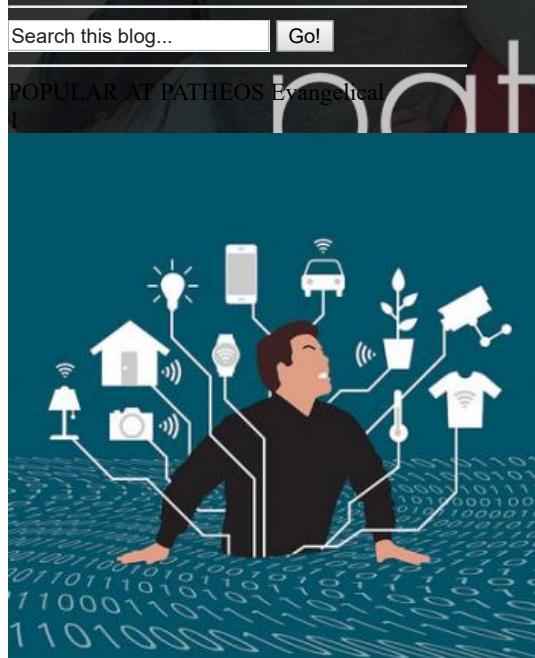
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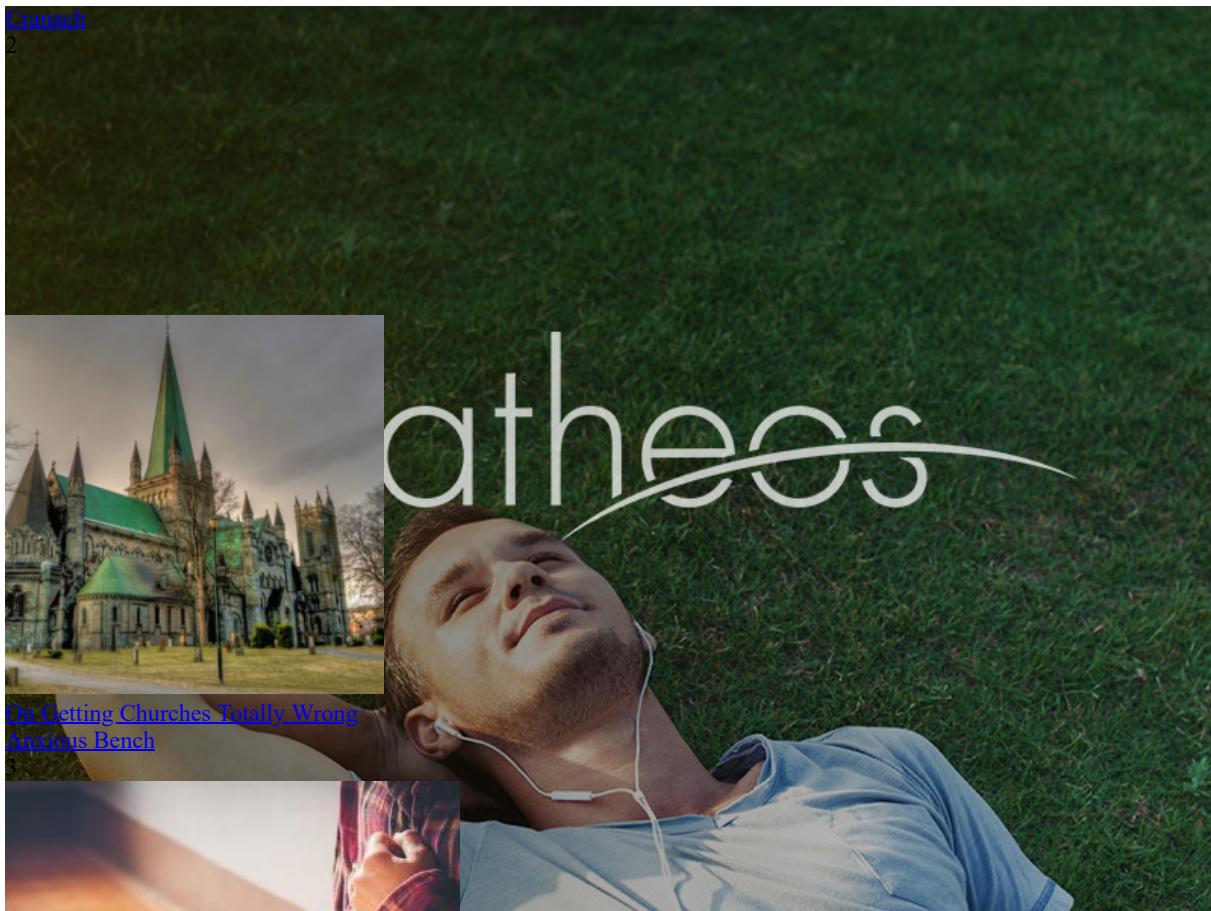
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