A Final Thought

The market, like everything else in life, is capable of providing incredible and unsuspected storms, as well as unimaginable bounty. Even the most successful traders in the world are not strangers to loss. If you find your confidence shaken by the whims and mood swings of the market, my advice is to step back for awhile and take stock of your situation before stepping back into the game. Whereas the emotions of fear and greed may move the market, it's best if you can avoid letting emotions move you into making rash decisions.

Try to plan your trades, and try even harder to stick to that plan. Remember to expect the unexpected—including the occasional disappointment—and you'll do well. Taking a break from trading now and then can often be one of the most effective strategies. Keep the market in a healthy perspective, and your eventual success will reflect this condition!

Best of luck from our team at eSignal. Please feel free to contact us with any questions you have concerning eSignal. We're here to help!

Notes

APPENDIX A
Glossary

A

after-hours trading: Trading done after the market closes at 4:00 p.m. Eastern Standard Time.

all or none order (AON): A limited price order that can only be executed in its entirety or not at all.

American Depository Receipts (ADRs): Shares of foreign companies listed on U.S. exchanges trading in U.S. dollars.

American Option: An option that may be exercised at any time up to and including the expiration date.

ask: The price at which a holder of a financial instrument is willing to sell.

assignment: The receipt of an exercise notice by an options seller/writer that requires the writer to sell (in the case of a call) or purchase (in the case of a put) the underlying security at the specified strike price.

At the money: An option is said to be at the money if its strike price is equal to the market price of the underlying stock or index. For example, if IBM stock is trading at 90, the IBM 90 option is at the money.

B

balance sheet: A firm's financial statement that provides a picture of its assets, debts, and net worth at a specific time.

bear market: When the general market or a particular stock falls for a prolonged period of time, usually by 20% or more.

bear spread: Applies to derivative products. Options trading strategy designed to take advantage of a fall in the price of a stock, index, or future where one buys a combination of calls and puts on the same underlying instrument at different strike prices in order to profit as the security's price falls.

beta: An indicator that measures a stock's or fund's risk relative to the market. The market's beta is always 1.0. A beta higher than 1.0 indicates that when the market rises, the stock or fund will rise to a greater extent than the market. Likewise, when the market falls, the stock or fund will fall to a greater extent. A beta lower than 1.0 indicates that the stock will usually change to a lesser extent than the market. The higher the beta, the higher the investment risk. A stock with a beta of 1.25 is expected to move 1.25 times the market excess returns. For example, if market excess return is 10%, we expect, on average, the stock return to be 12.5%.

bid price: The price one is willing to pay for a security.

Black-Scholes option-pricing model: A model for pricing call options based on arbitrage arguments. Uses the stock price, the exercise price, the risk-free interest rate, the time to expiration, and the expected standard deviation of the stock return. Developed by Fischer Black and Myron Scholes in 1973.

block: A large quantity of stock or large dollar amount of bonds held or traded. A block is generally defined as 10,000 shares or more of stock and $200,000 or more worth of bonds.

bond: A debt security that pays a set amount of interest on a regular basis. Investors make loans to issuers such as corporations or the government in return for the interest. Issuers also promise to pay back the loan to the lender.

book value per share: The accounting value of a share of common stock, determined by dividing the company's net worth by the number of shares that are circulating.

breakout: A stock is said to break out when its price rises above a resistance level or drops below a support level. Technical analysts/traders take a breakout to signify a continuing move in the same direction and use breakouts as by or sell indicators.

bull market: When the general market or a particular stock rises for a prolonged period of time, usually by 20% or more.

bull spread: An option trading system where an investor buys an out-of -the-money put options financing it by selling an out-of-the-money call option on the same underlying stock, index, or future.

buy-and-hold: A strategy in which the stock portion of one's portfolio is fully invested, including dividends reinvestments, at all times.

C

call option: A contract that gives its buyer the right to buy stock at a specified price within a certain time period.

capital gain/loss: An increase or decrease from the purchase price to the selling price of common stock or any other capital asset; profit or loss from the sale of investments or property. A capital gain that persists for one year or less is called a short-term capital gain. One that persists for more than one year is called a long-term capital gain.

cash flow per share: Earnings, after taxes and depreciation, divided by the number of a firm's shares.

closed-end fund: A type of mutual fund issuing a set number of shares. Share prices of closed-end funds are based on supply and demand.

closing tick: The net of the number of stocks whose closing prices are higher than their previous trades (uptick) against the number of stocks whose closing prices were lower than their previous trades (downtick). A positive closing tick indicates "buying at the close" (a bullish indicator); a negative closing tick indicates "selling at the close" (a bearish indicator).

commodity: A bulk good such as grain, metal, cotton, and coffee.

credit spread: Applies to derivative products. Difference in the value of two options, when the value of the option bought is less than the value of the one sold. One buys a credit spread.

cyclical stocks: Stocks whose success is closely linked to the rise and fall of the general economy (Automobile companies are cyclical stocks).

D

day order: An order to buy or sell a stock at a specific price but expires at the end of the day if not fulfilled.

Diamonds: An index fund tracking the 30 Dow stocks.

diversification: The process of buying securities in different investment types, industry types, risk levels, and companies in order to reduce the loss from a possible company-local or industry-local loss of business.

dividend yield: A portion of a company's profit that is paid to stockholders.

Dogs of the Dow: An investment strategy where investors buy the 10 Dow stocks with the highest dividend yields and hold onto them for a year.

dollar-cost averaging (DCA): A system of buying securities at regular intervals, using a fixed amount of cash over a considerable period of time regardless of the prevailing prices of the securities. DCA protects against the risk of losing a sum of money invested all at once at an inopportune time.

Dow Jones industrial average (DJIA): An indicator showing generally how well the market is doing. The average is found by averaging the prices of 30 industrial blue-chip stocks trading on the New York Stock Exchange.

E

earnings per share: Earnings found by dividing the net income of the company by the number of shares of common outstanding stock.

ex-dividend date: The first day of trading when the seller, rather than the buyer, of a stock will be entitled to the most recently announced dividend payment. The date set by the NYSE is currently two business days before the record date. A stock that has gone ex-dividend is denoted by an x in the newspaper listings on that date.

F

52-week high/ 52-week low: The highest/lowest price for a stock during the past year.

fundamental analysis: An analysis of stocks based on fundamental factors, such as company earnings, growth potential, etc., to determine the company's worth, strength and potential for growth.

futures contract: Agreement to buy or sell a set number of shares of a specific future in a designated future month at a price agreed upon today by the buyer and seller. A futures contract differs from an option. An option is the right to buy or sell while a futures contract is the promise to actually make the transaction. A future is part of a class of securities called derivatives that derive their value from the worth of an underlying investment.

G

good-til-cancelled order (GTC): An order to buy or sell a stock at a specified price that does not expire unless it is filled or the investor cancels it.

growth stock: A stock that generally grows faster than the S&P 500 and will likely produce consistent profits.

H

head & shoulders: A technical pattern that results when a stock price reaches a peak and declines; rises above its former peak and again declines; and rises a third time but not to the second peak, and then again declines. The first and third peaks are shoulders, while the second peak is the formation's head. Technical analysts generally consider a head & shoulders formation to be a very bearish indicator.

I

in-the-money: A put option is in-the-money if its strike price is higher than the underlying stock, option, or future. A call option is in-the-money if its strike price is lower than the underlying stock, option, or futures contract. For example, if IBM is trading at 99, the IBM January 90 2002 call is 9 points in-the-money.

income stock: A stock that generally grows more slowly than the S&P 500, pays a dividend, and will produce long-term profits.

index: A quantity whose variation represents market fluctuation. The S&P 500 index measures the overall change in the value of 500 stocks of the largest firms in the U.S.

initial public offering (IPO): The first time a company sells stock to the public. An IPO is a type of primary offering, which occurs whenever a company sells new stock, and differs from a secondary offering, which is the public sale of previously issued securities, usually held by insiders.

J

junk bond: A weak bond, rated BB or lower, that has a high default risk, and thus carries a high interest rate.

L

Large Cap stock: Large Cap stocks are companies that have a market capitalization of over 5 billion dollars.

limit order: An order to buy or sell a stock, option, or other financial instrument at a specific limit price or better.

long straddle: Buying both a put and a call on the same underlying issue.

Long-Term Anticipation Securities (LEAPS): Long-term options.

M

margin: Borrowing money from a broker to buy securities. The margin is the amount of the money an investor deposits in order to borrow money from the broker. The margin must be at least 50% of the total cost of the purchase.

margin call: A demand for additional funds because margin account equity falls below a required percentage due to adverse price movement.

market capitalization: The value found by multiplying the number of outstanding common stock shares by the share price; indicates firm size and total value held in stock.

market maker: One who maintains a market (firm bid and offer prices) in a particular stock standing ready to buy or sell round lots at publicly quoted prices.

market-on-close (MOC) order: An order to trade stocks, options, or futures as close as possible to the market close.

market order: An order to purchase or sell stock at a current price.

mid cap stock: A stock or company that has a market capitalization between one and five billion dollars.

momentum: The amount of acceleration of an economic, price or volume movement. Momentum traders often purchase stocks that have recently risen in price.

money market fund: A type of mutual fund that invests in short-term securities such as Certificates of Deposits and Treasury Bills.

moving average: An average calculated every new period by putting in latest value and taking the oldest value of previous period.

mutual fund: An investment vehicle pooling money from many different individual investors to purchase stocks or other types of investments. A professional fund manager handles the money and investments. Mutual funds tend to invest in hundreds of companies and, thus, provide high diversification.

N

net asset value (NAV): The price per share for a mutual fund. The NAV, calculated at the end of each business day, is found by dividing the fund's assets by the number of shares outstanding.

New York Stock Exchange (NYSE): The largest stock exchange in the U.S., located in New York City. Also known as Wall Street, this stock exchange carries stocks of well-established companies on its trading floor.

O

odd lot: A lot that is less than 100 shares, or less than a round lot.

open-ended fund: A mutual fund issuing as many shares to fit investor demand. Most mutual funds are open ended and trade like stocks after the shares are issued.

option: An option gives the buyer the right, but not the obligation, to buy or sell an asset at a set price on or before a given date. Call option buyers bet that the stock price will be higher than the option's strike price, plus the price they pay for the option itself. Put option buyers bet that the stock's price will drop below the price set by the option, minus the price they pay for the put option itself.

outstanding shares: The total number of a company's publicly traded shares.

P

penny stock: A stock trading under $5. Penny stocks tend to be very speculative and volatile, most ending up worthless in the long run.

premium: (1) The difference between the price an investor paid for a stock and the price at which the stock was sold. Also a group of securities that are selling at a higher price than others are considered to be selling at a premium. (2) A bond sold above its par value. (3) The price of an option contract; also, in futures trading, the amount by which the futures price exceeds the price of the spot commodity.

premium income: The income received by an investor who sells an options contract.

preferred stock: Stock whose holders have precedence over common stock in claiming dividends and assets.

price-to-book ratio: The ratio found by dividing a stock's market price per share by its book value (defined as assets minus all liabilities) per share. This ratio measures the stock's relative value to its net assets. A high ratio, for example, might suggest that a stock is overvalued.

price-to-cash-flow ratio: The ratio found by dividing a stock's price per share by its cash flow per share. This ratio, similar in type to the price-earnings ratio, serves as a measure of investors' expectations on a firm's future financial success.

price-to-earnings ratio (P/E): The ratio found by dividing market price per share by earnings per share. This ratio indicates what investors think of the firm's earning's growth and risk prospects.

put option: The right given a buyer to sell stock at a specific price within a specific period of time

Q

quick ratio: Indicator of a company's financial strength or weakness. Calculated by taking current assets minus inventories, divided by current liabilities. This ratio provides information regarding the firm's liquidity and ability to meet its obligations. Also called the Acid Test Ratio.

R

Real Estate Investment Trust (REIT): A publicly traded association which pools investors' money to purchase a variety of real estate related investments such as office buildings, shopping centers, medical facilities, and hotels.

real rate of return: The percentage of return on an investment over one year after adjusting for inflation or deflation.

regional stock exchanges: Organized national securities exchanges located outside of New York City and registered with the SEC. They include: the Boston, Cincinnati, Intermountain (Salt Lake City-dormant, owned by COMEX), Philadelphia (Philadelphia and Miami), and Spokane (local mining and Canadian issues, non-reporting trades) Stock Exchanges.

return on equity (ROE): The value found by dividing the company's net income by its net assets (ROE measures the amount a company earns on investments).

Roth IRA: An IRA allowing workers to withdraw all earnings completely tax-free after the age of 59-1/2

S

S&P 500 Composite Index: Index of 500 widely held stocks that measures the general market performance.

sector fund: A mutual fund investing in a particular industry such as technology, natural resources, and real estate.

short interest: Total number of shares of a stock that investors have sold short and that have not been repurchased to close out the short position. The short interest is often an indicator of the amount of pessimism in the market about a particular security, although there are other reasons to short that are not related to pessimism.

short selling: A trading strategy where an investor anticipates a drop in share price and borrows a certain number of shares from an broker. The investor then sells the stock and buys it back if the share price drops, pocketing the difference from the borrowed price.

small cap issue: A company that has a market capitalization between 1 and 5 billion dollars.

Spiders: An index fund tracking the S&P 500 **SPDRs** (Spiders) that are designed to track the value of the S&P 500 Composite Price Index. They trade on the AMEX under the symbol SPY. SPDRs are similar to closed-end funds but are formally known as unit investment trust. One SPDR unit is valued at approximately one-tenth (1/10) of the value of the S&P 500. Dividends are disbursed quarterly, and are based on the accumulated stock dividends held in trust, less any expense of the trust.

spread: The difference between the bid (purchase) and ask (sell) prices.

spread option position: A position consisting of the purchase of one option and the sale of another option on the same underlying security with a different exercise price and/or expiration date.

Standard and Poor's 500 Index (S&P 500): A well-known, value-rated index of 500 major U.S. companies: 400 industrial firms, 20 transportation firms, 40 utilities firms, and 40 financial firms. eSignal symbol is $SPX.

stock: An investment that represents partial ownership of a company. After buying a stock, investors will receive a stock certificate and take part in the gains and losses of the corporation.

stock option: An agreement giving an investor the right to buy or sell a certain stock at a preset price within a specific time period.

stock split: The splitting or dividing of shares to reduce the price needed for the formation of a round lot. To illustrate, in a 2-for-1 split, 1 share splits into 2, and an investor would receive one additional share for each he or she owned at the time of the split.

stop-limit order: An order placed to buy or sell at a certain price or better during a limited period of time.

stop-loss order: An order to sell a stock when its price falls to a specified level.

stop order: An order placed to buy or sell a designated stock once a designated price has been reached. This order limits the amount an investor can lose on that investment.

straddle: Purchase/sale of an equal number of puts and calls with the same terms at the same time.

strike price: The stated price per share for which the underlying may be purchased or sold by the option holder upon exercise of the option contract.

T

technical analysis: Analysis that seeks to detect and interpret patterns in past security prices.

tick indicator: A market index based on the number of stocks whose last trade was an uptick or a downtick. Used as an indicator of market sentiment or psychology to try and predict the market's trend.

time value of an option: The portion of an option's premium that is based on the amount of time remaining until the expiration date of the option contract, and the idea that the underlying components that determine the value of the option may change during that time. Time value is generally equal to the difference between the premium and the intrinsic value.

tracking stock: A stock that is issued to track a certain division of a company. This allows managers and executives for each division to have rewards and compensation tied to the overall performance of the part of the company they control.

trading range: The difference between the high and low prices traded during a period of time. For commodities the high/low price limit an exchange establishes for a specific commodity for any one day's trading.

treasury bills: Debt obligations of the U.S. Treasury that have maturities of one year or less. Maturities for treasury bills are usually 91 days, 182 days, or 52 weeks.

treasury bonds: Debt obligations of the U.S. Treasury that have maturities of 10 years or more.

Trin: Used in the context of general equities. Short-term trading index that shows minute-by-minute correlation of the ratio of advances to declines to the ratio of advancing volume to declining volume. Depicts whether changes in the relationship of advances and declines are taking place more quickly or more slowly than changes in the general volume movement of the market. <1 indicates a bull market, >1 indicates a bear market.

U

uncovered call: A short (naked) call option position where the writer (seller) of the call(s) does not own shares of the underlying stock represented by option contracts. Uncovered calls are much riskier for the writer than covered calls where the writer of the uncovered call owns the underlying stock. If the person long the call exercises the option to call the stock, the writer is forced to buy the stock at the current market price in order to deliver it to the person long the call(s).

uncovered put: A short (naked) put option where the writer (seller) has not established a short stock position or has not deposited, in a cash account, cash or cash equivalents equal to the exercise value of the put. The writer is obligated to buy the asset at a certain price if the buyer of the put option decides to exercise it. Uncovered put options limit the writer's risk to the value of the stock (adjusted for premium received).

undervalued: A stock price perceived to be too low or cheap, as indicated by a particular valuation model. For instance, some might consider a certain company's stock price cheap if the company's price-earnings ratio is much lower than the industry average.

V

volatility: A measure of risk based on the standard deviation of the asset return. Volatility is a variable that appears in option pricing formulas, where it denotes the volatility of the underlying asset return from now until the expiration of the option. There are volatility indexes. Some operate using a scale of 1-9, with a higher rating denoting a higher risk.

W

when issued (W.I.): Refers to a transaction made conditionally because a security, though authorized, has not been issued. Treasury securities, new issues of stocks and bonds, stocks that have split, and in-merger situations after the time the proxy has become effective but before completion are all traded on a when-issued basis.

whisper number or forecast: An unofficial earnings estimate of a company given to clients by a security analyst if there is more optimism or pessimism about earnings than shown in the published number. These are often found on the Internet.

writing puts to acquire stock: Selling put options at an exercise price that would represent a good investment by an option writer who believes a stock's value will fall, so that the writer cannot lose. If the stock price unexpectedly goes up, the option will not be exercised and the writer is at least ahead the amount of the premium received. If the stock loses value, as expected, the option will be exercised, and the writer has the stock at what he had earlier decided was a good buy, and he also has the premium income.

Y

yield: The percentage rate of return paid on a stock in the form of dividends, or the effective rate of interest paid on a bond or note.

yield curve: The graphic depiction of the relationship between the yield on bonds of the same credit quality but different maturities. Harvey (1991) finds that the inversions of the yield curve (short term rates greater than long term rates) have preceded the last five U.S. recessions. The yield curve can accurately forecast the turning points of the business cycle.

Z

zero-coupon bond: A bond in which no periodic coupon is paid over the life of the contract. Instead, both the principal and interest are paid at the maturity date.