

STUDY SESSION

7

Fixed-Income Portfolio Management (1)

Fixed-income securities represent a significant portion of all available financial assets and are included in most investor portfolios.

This study session begins by explaining the role played by fixed-income securities in portfolios and then introduces the two primary types of fixed-income mandates (liability-based and total return). A model for decomposing expected bond returns, which identifies the driving forces behind expected returns, is presented. The effects of illiquidity, leverage, and taxes on fixed-income portfolios are discussed. Next, liability-driven and index-based strategies are examined in greater detail. Coverage includes approaches, risks, and challenges associated with both immunization of single and multiple liabilities and the indexation and laddering of a fixed-income portfolio.

READING ASSIGNMENTS

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| Reading 18 | Overview of Fixed-Income Portfolio Management
by Bernd Hanke, PhD, CFA, and Brian J. Henderson, PhD,
CFA |
| Reading 19 | Liability-Driven and Index-Based Strategies
by James F. Adams, PhD, CFA, and Donald J. Smith, PhD |

LEARNING OUTCOMES

READING 18. OVERVIEW OF FIXED-INCOME PORTFOLIO MANAGEMENT

The candidate should be able to:

- a discuss roles of fixed-income securities in portfolios;

- b** describe how fixed-income mandates may be classified and compare features of the mandates;
- c** describe bond market liquidity, including the differences among market sub-sectors, and discuss the effect of liquidity on fixed-income portfolio management;
- d** describe and interpret a model for fixed-income returns;
- e** discuss the use of leverage, alternative methods for leveraging, and risks that leverage creates in fixed-income portfolios;
- f** discuss differences in managing fixed-income portfolios for taxable and tax-exempt investors.

READING 19. LIABILITY-DRIVEN AND INDEX-BASED STRATEGIES

The candidate should be able to:

- a** describe liability-driven investing;
- b** evaluate strategies for managing a single liability;
- c** compare strategies for a single liability and for multiple liabilities, including alternative means of implementation;
- d** evaluate liability-based strategies under various interest rate scenarios and select a strategy to achieve a portfolio's objectives;
- e** explain risks associated with managing a portfolio against a liability structure;
- f** discuss bond indexes and the challenges of managing a fixed-income portfolio to mimic the characteristics of a bond index;
- g** compare alternative methods for establishing bond market exposure passively;
- h** discuss criteria for selecting a benchmark and justify the selection of a benchmark;
- i** describe construction, benefits, limitations, and risk–return characteristics of a laddered bond portfolio.