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**

**Reading 22**
Introduction to Fixed-Income Portfolio Management by Bernd Hanke, PhD, CFA, and Brian J. Henderson, PhD, CFA

**Reading 23**
Liability-Driven and Index-Based Strategies by James F. Adams, PhD, CFA, and Donald J. Smith, PhD
LEARNING OUTCOMES

READING 22. INTRODUCTION TO 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 23. 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.