

STUDY SESSION

10

Fixed-Income Portfolio Management (1)

The elements of the investment management process, such as the consideration of risk, return, and investment constraints, are the same for a fixed-income portfolio as for any other type of portfolio. As part of the process, an appropriate benchmark is selected to serve as a reference for portfolio construction and performance evaluation. For investors taking an asset-only approach, the benchmark is typically a bond market index. For investors taking a liability-based approach, performance is measured in terms of the portfolio's ability to meet a set of investor-specific liabilities. The first reading addresses these primary elements of managing fixed-income portfolios and introduces specific portfolio management strategies. The second reading discusses additional relative-value methodologies.

READING ASSIGNMENTS

Reading 20	Fixed-Income Portfolio Management—Part I by H. Gifford Fong and Larry D. Guin, DBA, CFA
Reading 21	Relative-Value Methodologies for Global Credit Bond Portfolio Management by Jack Malvey, CFA

LEARNING OUTCOMES

READING 20. FIXED-INCOME PORTFOLIO MANAGEMENT— PART I

The candidate should be able to:

- a compare, with respect to investment objectives, the use of liabilities as a benchmark and the use of a bond index as a benchmark;

- b** compare pure bond indexing, enhanced indexing, and active investing with respect to the objectives, advantages, disadvantages, and management of each;
- c** discuss the criteria for selecting a benchmark bond index and justify the selection of a specific index when given a description of an investor's risk aversion, income needs, and liabilities;
- d** critique the use of bond market indexes as benchmarks;
- e** describe and evaluate techniques, such as duration matching and the use of key rate durations, by which an enhanced indexer may seek to align the risk exposures of the portfolio with those of the benchmark bond index;
- f** contrast and demonstrate the use of total return analysis and scenario analysis to assess the risk and return characteristics of a proposed trade;
- g** formulate a bond immunization strategy to ensure funding of a predetermined liability and evaluate the strategy under various interest rate scenarios;
- h** demonstrate the process of rebalancing a portfolio to reestablish a desired dollar duration;
- i** explain the importance of spread duration;
- j** discuss the extensions that have been made to classical immunization theory, including the introduction of contingent immunization;
- k** explain the risks associated with managing a portfolio against a liability structure, including interest rate risk, contingent claim risk, and cap risk;
- l** compare immunization strategies for a single liability, multiple liabilities, and general cash flows;
- m** compare risk minimization with return maximization in immunized portfolios;
- n** demonstrate the use of cash flow matching to fund a fixed set of future liabilities and compare the advantages and disadvantages of cash flow matching to those of immunization strategies.

READING 21. RELATIVE-VALUE METHODOLOGIES FOR GLOBAL CREDIT BOND PORTFOLIO MANAGEMENT

The candidate should be able to:

- a** explain classic relative-value analysis, based on top-down and bottom-up approaches to credit bond portfolio management;
- b** discuss the implications of cyclical supply and demand changes in the primary corporate bond market and the impact of secular changes in the market's dominant product structures;
- c** explain the influence of investors' short- and long-term liquidity needs on portfolio management decisions;
- d** discuss common rationales for secondary market trading;
- e** discuss corporate bond portfolio strategies that are based on relative value.