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The Federal Reserve has recently reversed itself from reflating the economy early in 2003 to a sequence of measured rate increases to moderate inflation. The question for fixed-income portfolio managers is whether rates will increase at a rate greater or less than consensus expectations built into the yield curve. Hence, we begin this issue of *The Journal of Fixed Income* with an article by Haim Reisman and Gady Zohar on the short-term predictability of the term structure. After decomposing the factors that determine the term structure, their factor prediction models are applied out-of-sample to the selection of a bond portfolio that generated substantial cumulative profits. Next, Florian Bardong and Thorsten Lehnert investigate whether index-linked government debt investment returns can be enhanced with a trading strategy based on the difference between inflation forecasts and break-even inflation. They also demonstrate that including TIPS as an asset class can reduce a portfolio's idiosyncratic risk.

Currently credit spreads in the bond market are at multi-year lows. Hence, exposure to spread widening is critical to bond managers. In the next article, Andrew Davies applies regime-switching techniques to credit spread modeling. The results support the theoretical Merton corporate bond-pricing model where increases in the risk-free rate lead to an increase in bond price (spread tightening). Furthermore, equity return, the slope of the yield curve and industrial production growth all have significant explanatory power over the short-term path of credit spreads. Next, Rainer Jankowitsch and Stefan Pichler provide insights into the estimation of credit spread curves.

Recovery rates are an important assumption when analyzing collateralized debt obligations (CDOs). Tania Garcia, Arthur Maghakian, and Sanjay Sharma show that stochastic versus non-variability of recovery rates in a Monte Carlo simulation can result in up to five rating notches for tranches depending on the properties of the underlying pool and the structure of the waterfall. Next, Chih-wei Lee, Cheng-kun Kao, and Jorge Luis Urrutia provide a rigorous valuation model for CDO tranches with common shocks and conditional dependence.

Finally, Jian Hu and Richard Cantor focus on and expand the research on loss severity rate given default (LGD) for residential mortgage-backed securities (RMBS). This is an important input for structured products. On average, RMBS lose 51% of its default-date balance or 34% of its original balance.

We hope you enjoy this issue of *The Journal of Fixed Income.* Your continued support of the Journal is greatly appreciated.

Stanley J. Kon
Editor