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The fixed-income markets have exhibited extraordinarily high volatility in the last six months associated with the subprime mortgage crisis and its contagion effect. The stochastic nature of the volatility surface poses an important risk dimension to interest rate contingent claims. Hence, we begin this issue of *The Journal of Fixed Income* with an article by Thomas Ho on managing interest rate volatility risk. The methodology provides a framework for using key rate vega and key rate duration measures simultaneously to manage security and portfolio risks. In the next article, Thomas Ho and Sang Bin Lee develop the multifactor arbitrage-free interest rate model in order to specify and implement these key rate vegas and durations.

The increased equity volatility in the current market environment also has implications for the credit risk of corporate bonds. Santhosh Bandreddi and Sanjiv Das model correlated default on the binomial trees typically used for equity option valuation. They show how equity volatility impacts correlated credit loss distributions and examine the features of correlated default in credit portfolios. The extraordinary volatility in the credit market is also consistent with a higher probability of an economic recession in the near future. Hence, credit fundamentals will be an important factor in managed portfolio performance. In the next article, Dror Parnes examines the power and relative performance of the more well-known bankruptcy prediction models under a variety of business cycles.

There are many investors in the marketplace devoted to the currency carry trade. In the next article, Vineer Bhansali provides both theoretical and empirical evidence on the positive relationship between volatility and carry. Breakdowns in the relationship are used to implement high information ratio trading strategies.

The remaining articles more directly concern the current credit crisis. ABS CDOs backed by subprime mortgages are among the most complex securities to evaluate. It is the lack of transparency that exacerbates the uncertainty concerning ultimate value, and hence, destroyed liquidity in this market. Laurie Goodman, Daniel Newman, Douglas Lucas, and Frank Fabozzi analyze how an event of default declaration by a CDO will affect the distribution of collateral cash flows to its tranches. Understanding the status of the collateral, the effect of agency downgrades and the reaction of the controlling class are all crucial to the cash flow waterfall.

Finally, it is difficult to understand how the markets have gone from a global liquidity glut to a credit crunch in less than a year. The duration of this crisis will depend, in part, on how widespread is the exposure. Jorge Chan-Lau and Li Lian Ong examine global credit risk transfer by estimating institutional exposures to credit derivatives. The evidence indicates a home bias, but does suggest more risky exposures in North America.

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