The Journal of

FIXED INCOME

VOLUME 25, NUMBER 3 WINTER 2016

Fixed income securities come with a bundle of risks. One of the key insights in modern fixed income portfolio management is to employ derivatives to hedge risks about which managers have no superior information and focus risk-taking on those for which they have a comparative advantage. That is, efficient use of the risk budget leads to higher information ratios. But what if the manager does not have superior information and/or the costs of hedging are high? We begin this issue of *The Journal of Fixed Income* with an article by Douglas T. Breeden and S. Viswanathan that provides a framework for understanding the nuances of predicting managerial hedging for differential information and the costs of hedging. They show that hedging occurs when higher-ability managers are substantially different from lower-ability managers or the costs of hedging are low.

An example of a security with bundled risk dimensions is a convertible bond. The default and conversion risks clearly affect the timing of cash flows to the bondholder, and hence, the bonds effective duration. In the next article, Sana Horchani examines the factor inter-relationships and empirical evidence on convertible bond duration: Individually and jointly, the default and conversion potential decrease bond duration. Analyzing bond duration, however, begins with an interest rate process. Next, Vincenzo Russo and Frank J. Fabozzi derive analytic solutions for discount bonds, bond options, caps/floors, and swaptions based on a one-factor shifted squared Gaussian model for interest rates. A comparative analysis with competing models provides substantial evidence of its superiority.

Is there still a lot to learn from the euro sovereign debt crisis? In the next article, Dirk G. Baur and Gunter Löffler examine the potential consequences of contagion from market timing and country selection perspectives for bond investors. They find that the joint occurrence of extremely negative bond returns has only small and transitory effects on broad government bond portfolios. For concentrated country exposures, however, the frequency of exposure is not informative.

The credit default swap (CDS) market is a risk management tool employed across the globe. Tobias Berg and Daniel Streitz analyze sovereign CDS markets in 57 countries. They find that, relative to a country's debt, markets are larger for smaller countries, those with a rating just above the investment-grade cutoff, and those with weaker creditor rights. Furthermore, agencies' ratings are a major determinant of the size of the sovereign CDS market.

The Journal of
FIXED INCOME

There is a long and extensive history of research on insider trading and stock prices. But how do bond investors fair? In our last article, Andreas Oehler, Kuntara Pukthuanthong, Thomas J. Walker, and Stefan Wendt provide evidence that insider purchases negatively influence corporate bond prices whereas insider sales result in a positive signal. Furthermore, transactions by insiders who are corporate executive officers and chairmen or those made during the crisis period have the largest magnitude.

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