

BOND INVESTMENT STRATEGY

ALPER YILDIRIM



CONTENTS

Portfolio Construction


- Global Market Outlook
- Portfolio Distribution

Strategy

- Laddering
- Global Diversification
- CDS/Yield Arbitrage

Risk Considerations

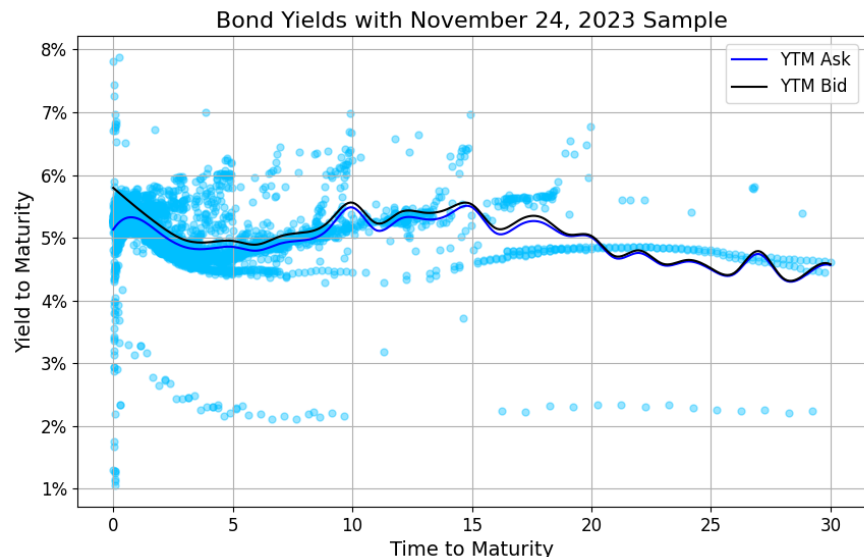
- Interest Rate Risk
- Inflation Risk
- Credit Risk
- Inflation Risk
- Geopolitical Risk



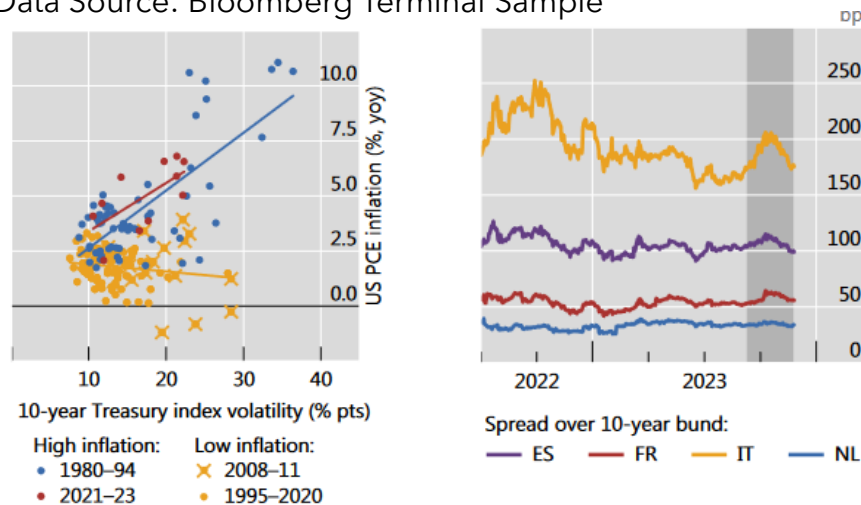
PORTFOLIO CONSTRUCTION

GLOBAL MARKET OUTLOOK

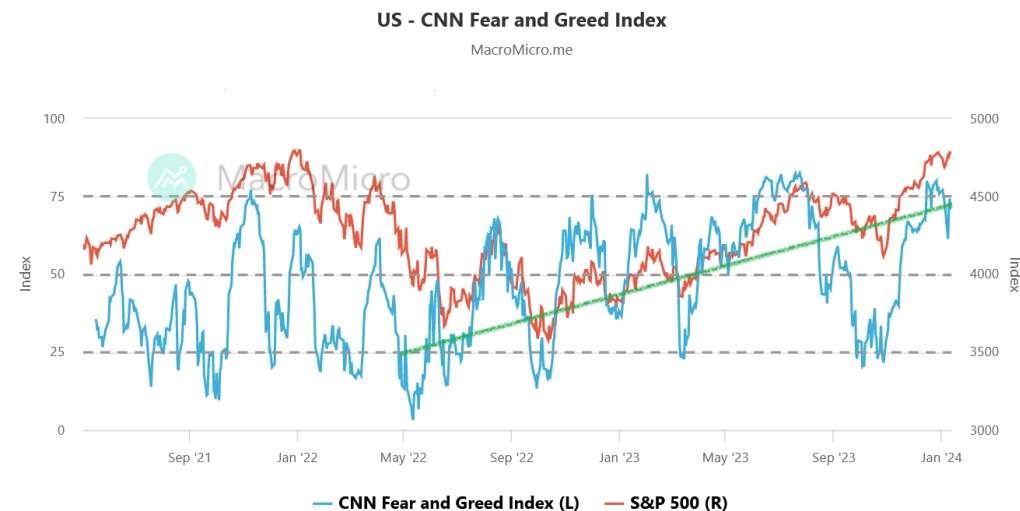
- Inflation ↓ ↔ Investor Sentiment ↑ ↔ Interest Rates ↓
- Political agenda: Red Sea conflict, Taiwan elections, Russia-Ukraine War...



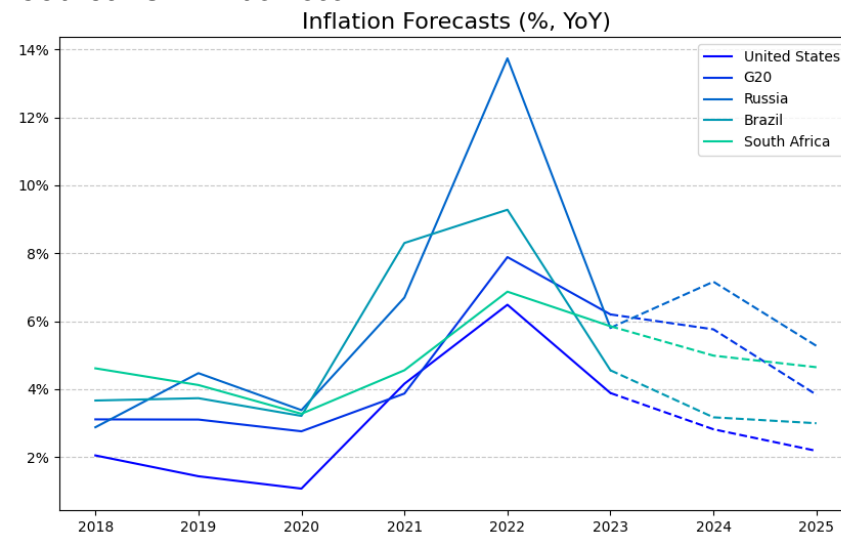
Data Source: Bloomberg Terminal Sample



Source: Bank of International Settlements (BIS)



Source: CNN Business

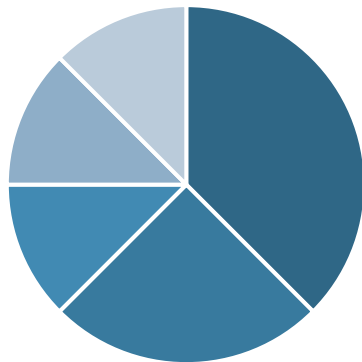


Data Source: OECD Economic Outlook, November 2023

PORTFOLIO DISTRIBUTION

| | YTM | Price | Maturity | Cpn | Rating |
|--------|-----|-------|----------|-----|--------|
| Bond 1 | | | 1 | | AAA |
| Bond 2 | | | 1 | | AA |
| Bond 3 | | | 1 | | AA |
| Bond 4 | | | 2 | | BBB |
| Bond 5 | | | 2 | | AAA |
| Bond 6 | | | 5 | | AA |
| Bond 7 | | | 10 | | BBB |
| Bond 8 | | | 30 | | BBB |

Maturity Distribution



■ 1 ■ 2 ■ 5 ■ 10 ■ 30

Bond Selection Criteria:

- Geographical Diversification
- Laddering for Risk Aversion
- High Cpn Rate

Summary:

- 60% US Treasuries
- Rating Distribution:
 - AAA : 40%
 - BA : 30%
- Portfolio Duration:
- DV01:

... A MORE COMPLETE PICTURE



STRATEGY

STRATEGY

- **No “callable” and “putable” bonds**
 - Anticipating interest rate cuts after 2024Q2
 - “callable”: cheaper re-financing for issuers → increasing reinvestment risk
 - “putable”: declining rates → less value of put option
- **Yield curve** starts steepening, but not fast → “riding the yield curve” with 2yrs

STRATEGY

- “Key interest rates are likely to fall significantly in 2024. However, this **does not necessarily mean that yields will fall** and prices on the bond markets will rise.”
- *Börse Frankfurt (on German bonds)*
- “The baseline view is for the **2yr to get to 3% and for the 10yr to get to 4%**, with the risk of an overshoot to the downside, as a call for 2024. The 30yr likely tracks the 10yr to a point, but is unlikely to get much below 4%, resulting in net 10/30yr steepening, likely targeting 30-50bp.”
- *Padhraic Garvey, CFA (ING Think)*

COMPARISON

| Bond Fund | YTM | Weighted Price | Weighted Coupon | Avg Credit Rating <i>(surveyed)</i> | Modified Duration | Effective Maturity |
|--------------------------------------|------|----------------|-----------------|-------------------------------------|-------------------|--------------------|
| JPMorgan Government Bond I | 5.08 | 88.79 | 2.90 | AAA | - | 7.41 |
| iShares Core Total USD Bond ETF | 4.80 | 92.16 | 3.43 | A+ | 6.11 | 8.35 |
| Vanguard Total Bond Market Index | 5.00 | 92.85 | 3.21 | AA | - | 8.70 |
| Schwab Short-Term US Treasury ETF | 5.10 | 96.88 | 2.48 | AA | 1.88 | 1.97 |
| PIMCO Diversified Inc Instl | 7.87 | 87.06 | 4.96 | BBB+ | 5.07 | 8.43 |
| TankX Bond Portfolio Proposal | 5.70 | 95.55 | 3.30 | AA | | |

Data Source: Morningstar

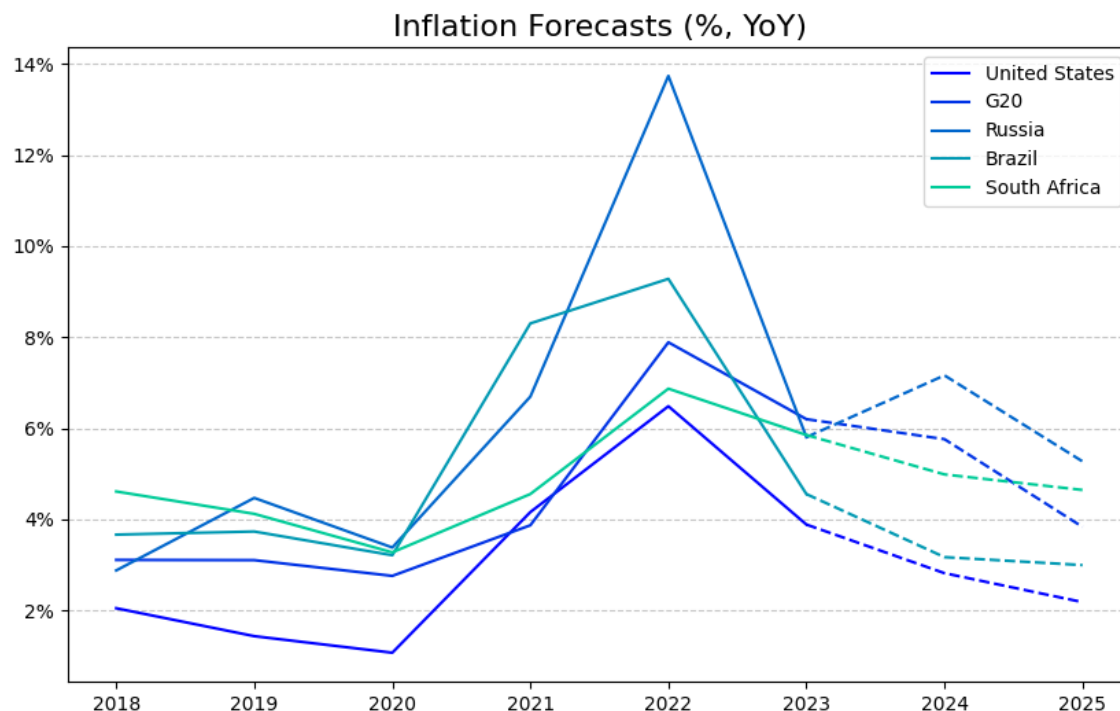
NEGATIVE BASIS TRADES



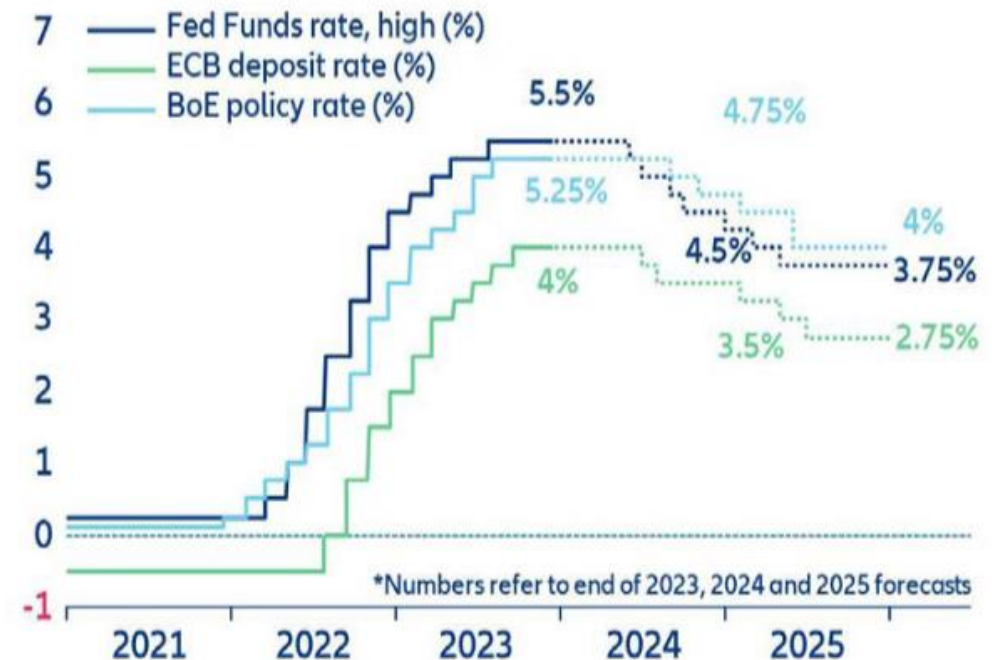
RISK CONSIDERATIONS

INFLATION AND INTEREST RATE RISK

- Even though risks persist, inflation started to cool down
- Following 2024Q2, interest rate cuts may start
- Dollar Duration:
Convexity:
DV01:



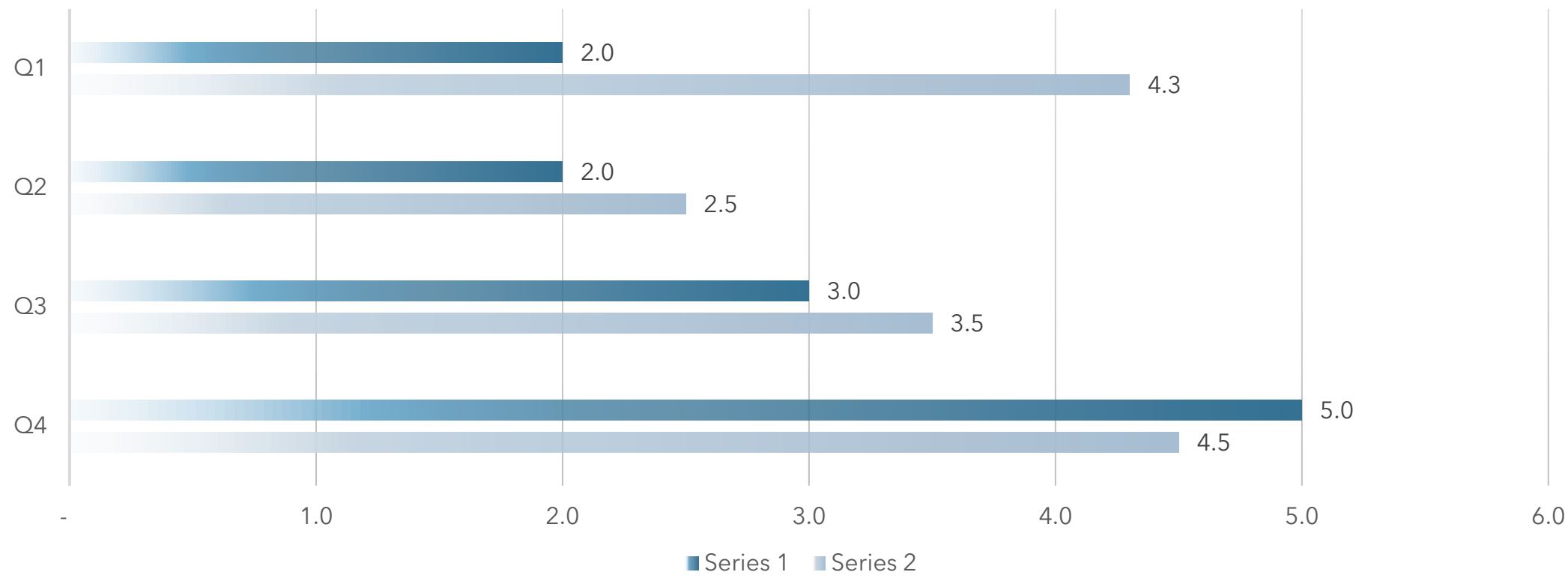
Data Source: OECD Economic Outlook, November 2023



Source: Allianz SE, Global Economic Outlook 2023-25

LIQUIDITY RISK

PRODUCT GROWTH



LIQUIDITY RISK MEASURES

- Given the cross-sectional nature of data, the liquidity proxy is: **Bid-Ask Price Difference**
- If high-frequency time series data is available:

- **Roundtrip** (Feldhütter (2012))

$$RT = \frac{2 * (P_{\max} - P_{\min})}{(P_{\max} + P_{\min}) / 2}$$

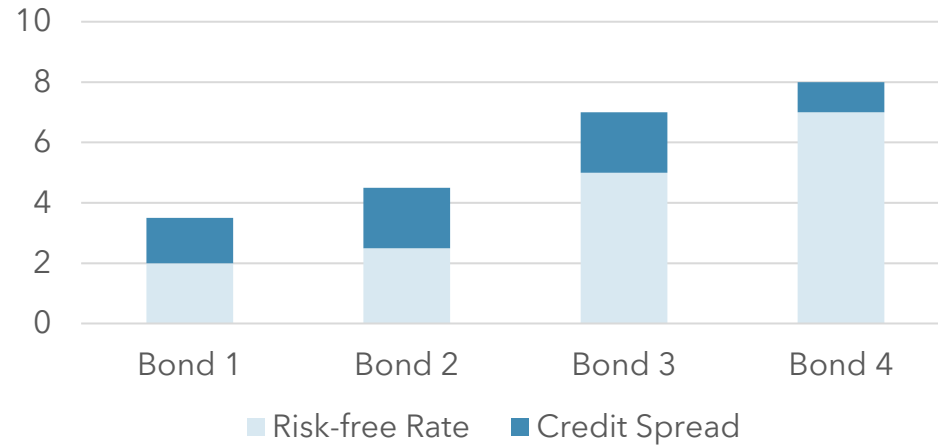
- **Inter-Quartile Range** (Han and Zhou (2007))

$$B_IQR = \frac{P_t^{75th} - P_t^{25th}}{\bar{P}_t}.$$

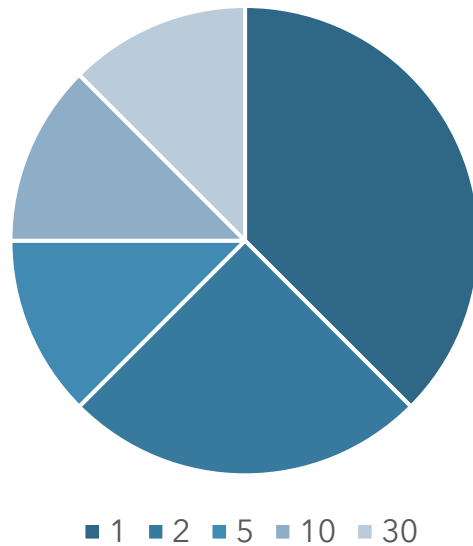
- **Roll** (Friewald, Jankowitsch, and Subrahmanyam (2012))

CREDIT RISK

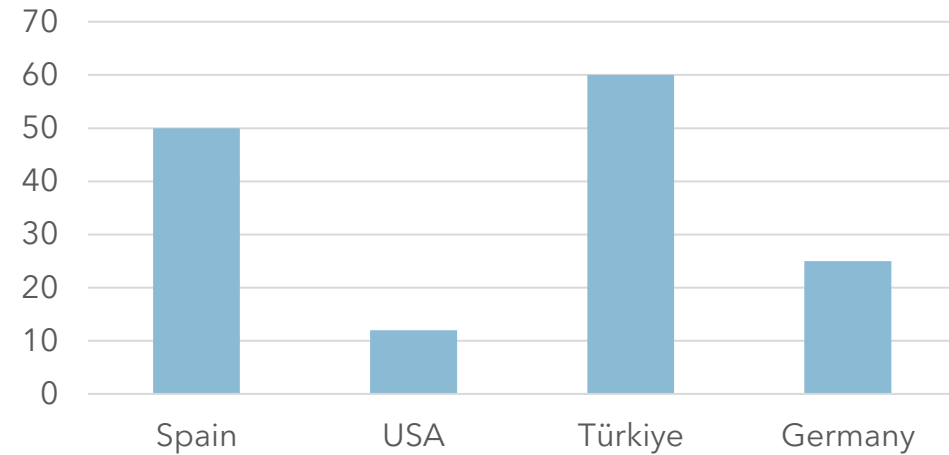
Credit Spreads



Credit Rating Distribution



5-year CDS



GEOPOLITICAL RISK

- Avoid Chinese and Middle East Region bonds
- Rising political and military tensions may eventually lead economic downturn and declining markets

BloombergEurope Edit

Taiwan Election: The Winner | Lai's Political Rise | Mapping the Results | Status Quo Wins | Xi's Taiwan Strategy | A \$10 Trillion War?

Markets
Odd Lots

The Massive Economic Impact If China Invades Taiwan

How economists are thinking about the risks.

By [Tracy Alloway](#) and [Joe Weisenthal](#)
15 Ocak 2024 at 10:00 GMT+1



 Gift this article

 Save

 Listen 1:01

Europe Edition ▾

IndustriesTechAIPoliticsWealthPursuitsOpinionBusinessweekEqualityGreen

Volvo Car Joins Plant Halts on Red Sea Crisis

FINANCIAL TIMES

USCOMPANIESTECHMARKETSClimateOPINIONWORK & CAREERSLIFE & ARTSHTSI

Chinese economy + Add to myFT

China's consumer prices fall for third month as economic recovery lags

Deflation proves persistent in December despite policymakers' efforts to stimulate growth

FINANCIAL TIMES

USCOMPANIESTECHMARKETSClimateOPINIONWORK & CAREERSLIFE & ARTSHTSI

Oil + Add to myFT

Oil tops \$80 a barrel after Houthi threat diverts tankers from Red Sea

Brent rises following US-UK strikes in Yemen and advisory warning to vessels



THANK YOU

Alper Yildirim

yildirimalper@outlook.de