

# *The Journal of* **FIXED INCOME**

## **Editor's Letter**

Stanley J. Kon

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# The Journal of **FIXED INCOME**

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The goal of active bond portfolio managers is to provide superior risk-adjusted returns (alpha) to their customers. It seems logical to employ an optimizer that maximizes a portfolio's Sharpe (or information) ratio, as is common in equity portfolio management, but this process is not as straightforward for bonds. We begin this issue of *The Journal of Fixed Income* with an article by Romain Deguest, Frank Fabozzi, Lionel Martellini, and Vincent Milhau that examines the difficulties in the constrained optimization of a bond portfolio and suggests solutions to them. The authors' empirical results are supportive of their proposed methodology.

In the next article, Laurie Goodman and Jun Zhu make it clear, with empirical evidence from loan-level data, that the main driver of the mortgage crisis was the default and loss behavior refinances—cash-out refinances, in particular—rather than the expansion of lending to more-marginal borrowers.

The term structure of credit spreads to Treasuries has been a long-standing criteria in the selection of corporate bonds. However, Martin Fridson, Yaxian Li, and Kai Zhao isolate the time variation in the slope of this curve as it relates to perceived credit risk. They argue that price as a percentage of face value is the better valuation metric for default risk. Then, Dror Parnes examines rating agency modifications and finds that initial credit ratings are too lenient.

In the next article, Alejandro Balbás and Ricardo Laborda describe the diversification benefits of the “quality option asset strategy” and demonstrate empirical support for increased Sharpe ratios due to the low correlation between quality options and stocks.

Finally, Denis-Alexandre Trottier, Van Son Lai, and Anne-Sophie Charest propose and test a utility-based catastrophe bond-pricing model that explains the risk–return trade-off in this corner of the market.

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

**Stanley J. Kon**  
Editor