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This issue of *The Journal of Fixed Income* begins with several articles on swap spreads. The volatility of these spreads in the last four years has been unprecedented. In our lead article, Professors Eom, Subrahmanyam, and Uno provide evidence on the relationship between the Japanese yen and U.S. dollar interest rate swap markets. In particular, they find that the credit risk factor is country-specific and that the transmission of shocks is only in the U.S. dollar to yen swap market direction. In the next article, Professors Brown, In, and Fang provide empirical evidence on the determinants of swap spreads in the Australian interest rate market. They find that changes in spreads are a function of the level of default-free interest rates and the slope of the term structure. In a multivariate EGARCH model, credit risk also explains a significant amount of the variation of swap spreads.

Treasury returns can be decomposed into their duration, time-passage (theta), convexity, and interactive components. Professors Kang and Chen provide evidence on this decomposition for the U.S. and 10 other countries. Beyond duration, it's the theta effect that is considerably more important than convexity for a wide variety of economic environments.

In today's credit markets, spreads are relatively wide and volatile due to the uncertainty of the timing and magnitude of an expected economic recovery. Hence, the remaining articles focus on corporate bonds and collateralized debt obligations. Wong and Hodges derive and analyze a model for the pricing of risky debt when a firm's asset value follows a jump-diffusion process. This model provides a more realistic evaluation of credit spreads. It is very important to note that a model without jump risk will underestimate the true credit spread.

In the next article, McDermott, Benzschawel, and Khan evaluate the risks and reward of investment-grade CDOs using a Monte Carlo simulation. They provide an in-depth analysis of this rapidly growing market and show that the risk-adjusted returns for investment-grade CDO equity are comparable to those of the best of traditional and alternative asset classes. Finally, Goodman and Lucas investigate the circumstances and effect of when mezzanine tranches of CDOs stop paying current interest, and instead pay-in-kind or "PIK." That is, when the overcollat-

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eralization or interest coverage tests are violated, interest payments are diverted to pay down principal on the senior-most class. In the most likely scenario (high default rates early and decline later), the mezzanine tranches will PIK long before they lose IRR. Therefore, in today's high default rate environment, we should observe PIKing over the next few years, but come out whole if the economic recovery comes before too much damage is done.

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**