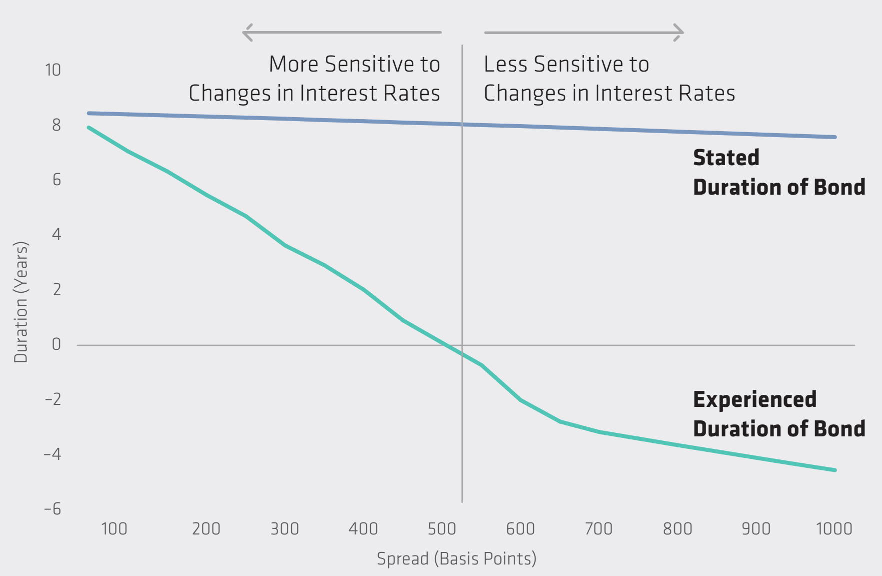
FIXED INCOME

NOT ALL DURATIONS ARE CREATED EQUAL

Given that short-term interest rates might rise, investors are naturally concerned about duration risk—the sensitivity of their bond prices to changing interest rates—in their portfolios. But not all durations are created equal. For investors concerned about rising rates, we believe there are three approaches to consider using for fixed-income portfolios.

HIGHER YIELD SPREADS MAY MEAN LOWER RATE SENSITIVITY.

CORPORATE BOND YIELD SPREADS AND DURATION



For illustrative purposes only. Past performance and current analysis do not guarantee future results.
The display shows the hypothetical duration of a 10-year corporate bond held to duration adjusted for spread. Empirical duration is estimated on the actual and historical 10-year corporate bond performance data. We use a three-factor model (based on option-adjusted spread, currency and spreads) to estimate the performance of corporate bonds in rising interest-rate environments. Duration is a measure of the sensitivity of an asset's or portfolio's price to interest-rate movements.
Source: AB

1. ADD NONGOVERNMENT DEBT

A bond's stated duration is simply the mathematical calculation of the bond's interest-rate sensitivity, based on its maturity, coupon and yield and on how often its coupon is paid. However, since corporate bonds are exposed to credit factors, they're not driven exclusively by changes in interest rates. As a result, the actual sensitivity that these bonds exhibit when rates move can be much less than the math implies.

The experienced duration is the actual sensitivity to interest-rate changes experienced by a bond. The larger the yield spread, the lower the experienced duration. This means that these bonds may be less sensitive than you'd expect to movements in government interest rates.

And generally, when a bond's spread is higher than 500 basis points, or 5%, that bond acts as if it's not sensitive to interest-rate movements at all! Not all duration is "bad" in a rising-rate environment. It's important to look carefully at the source of duration in a portfolio in order to get a true sense of its vulnerability to rising rates.

2. GLOBALIZE—LOCATION MATTERS

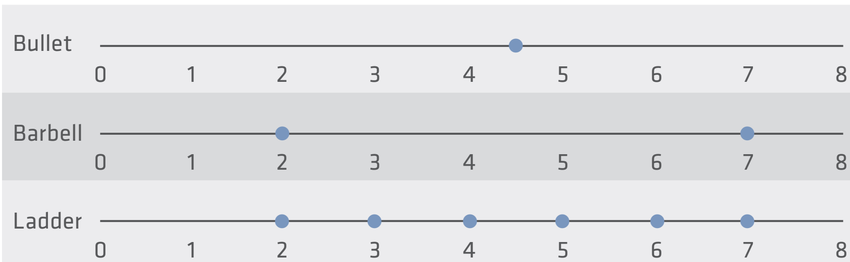
Another way to help reduce exposure to changes in interest rates is to diversify globally. In environments when interest rates in the US rise, US Treasuries have historically underperformed. In the last interest-rate-hike cycle, the Barclays Global Aggregate Bond Index (hedged) outperformed US Treasuries in all three calendar years—2004, 2005 and 2006—when the US Federal Reserve raised rates, by 1.25%, 2.00% and 1.00%, respectively. We think investors should diversify this interest-rate-cycle exposure by investing globally. That way, they can maintain earnings power while reducing portfolio sensitivity to a single country's interest-rate environment.

3. ADOPT AN APPROPRIATE MATURITY STRUCTURE STRATEGY

Diversification of yield-curve positioning is a key component to helping offset interest-rate risk—and will have an impact on performance, because duration assumes a parallel movement. However, rarely does the yield curve shift in a parallel manner. The curve can steepen, flatten or spin around a maturity. That's why anticipating how the yield curve will shift in the future is a critical tool for portfolio managers. Historically, when yield curves have flattened, barbells have outperformed. When yield curves have steepened, bullets and ladders have outperformed. This is because those strategies have less allocation to longer-maturity bonds that have longer durations.

YIELD-CURVE STRATEGY

Maturity selection matters when yield curves change shape



	Average Duration (Years)	Return (Percent) 2005 Curve Flattened 1.5%	Return (Percent) 2009 Curve Steepened 1.6%
Bullet	4.5	1.4	**–1.5**
Barbell	4.5	**3.3**	–3.4
Ladder	4.5	1.7	–1.9

For illustrative purposes only. Past performance and current analysis do not guarantee future results.
Bullet: A fixed-income investment strategy in which the bonds' maturity is the same.
Barbell: A fixed-income investment strategy that concentrates holdings in both short-term and long-term maturities.
Ladder: A fixed-income investment strategy in which the bonds' maturities are evenly spaced at regular intervals.
Returns represented by Barclays US Treasury Index
Source: Barclays and AB

LEARN MORE

(800) 247 4154 | ABGLOBAL.COM

15-2362
FHI–6945–1015