FIN 366: INVESTMENTS
BRIEFING

Chapters 11: Managing Bond Portfolios

Interest rate risk is the risk that interest rate changes will adversely affect the value of the securities in our portfolio. We consider 5 properties: (1) Bond prices and yields are inversely related, (2) An increase in a bond's YTM results in a smaller price change than a decrease in a bond's YTM of equal magnitude, (3) Prices of long-term bonds tend to be more sensitive to interest rate changes than price of short-term bonds, (4) Sensitivity of prices to yields increases at a decreasing rate as time to maturity increases, and (5) prices of low-coupon bonds are more sensitive to changes in interest rates than prices of high-coupon bonds. **Duration** is a measure of a bond's *effective maturity*, defined as the weighted average of the times until each of a bond's coupon and principal payments. **Immunizing** portfolios entails matching the duration of assets with that of the timing of a liability.