## 1. DIVERSIFICATION BENEFITS

↳ occur when combining assets with

lower correlation ⇒

Fixed income + equities ⇒ typically provides diversification benefits

— " —

— " — } may provide — " —

Correlation between fixed-income indexes / segments

driven mainly by

! correlations ARE NOT constant over time

In times of CRISIS

EQUITIES → Government bonds

HY BONDS → Government bonds

! standard deviations (volatility) of asset class returns also NOT constant over time

but rate volatility ↗

in periods of financial stress

## 2. BENEFITS of REGULAR CASH FLOWS

Bonds = regular CFs $\xrightarrow{\text{allow to}}$

↳ may be estimated with reasonable certainty

⇓

Fixed income securities often acquired and to future liabilities

# 3. INFLATION-HEDGING POTENTIAL

→ adjust coupons with market reference rate (which should adjust to inflation)

↳ BUT no adjustment of

= adjust principal/par value for inflation

return = Real return + return tied to rate of inflation

exhibit LOWER return volatility than conventional bonds & equities

Real int. rate VOLATILITY

Nominal int. rate VOLATILITY →

Adding inflation-linked bonds to a portfolio $\xrightarrow{\text{typically}}$ adjusted returns risk-real

Efficient frontier