

1. DIVERSIFICATION BENEFITS

↳ occur when combining assets with lower correlation \Rightarrow

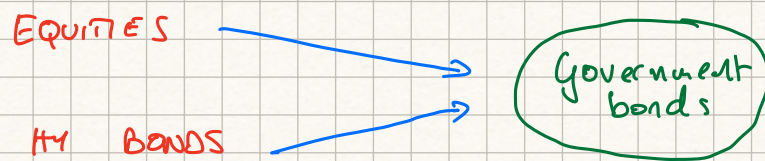
Fixed income + equities \Rightarrow typically provides diversification benefits

— " —
— " — } may provide — " —

Correlation between fixed-income indexes / segments

driven mainly by

! correlations ARE NOT constant over time
in times of crisis



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

lat rate volatility \nearrow
in periods of financial stress

2. BENEFITS of REGULAR CASH FLOWS

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

\hookrightarrow may be estimated with reasonable certainty

\Downarrow

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/far 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 typically → adjust returns risk - real

