

PERSPECTIVES

SHARING AN INTERESTING ANALYSIS

December 18, 2017

Topics: [Pension Risk Management](#), [Taxable Portfolio Management](#) / Contributors: [David G. Eichhorn, CFA](#)



Sometimes you come across a piece of analysis that is interesting enough to feel compelled to pass it on. I had this reaction while reading AQR's recently published paper titled "[The Illusion of Active Fixed Income Diversification](#)," which examined the excess returns of active bond managers and concluded that a majority of managers may be simply overweighting credit to produce alpha. Perhaps unsurprisingly, it is a characteristically well-researched and well-written piece. It's natural to want to give high marks to analyses that confirm your own biases, but in this case we think it's deserved.

AQR's analysis corroborates our own research in this space that we have previously shared, both for [Long Government/Credit managers](#) as well as [Aggregate managers](#). One aspect we really enjoyed in AQR's paper was the direct manner in which they highlighted the potentially harmful effects on overall

portfolio diversification that a systematic overweighting of credit can have—in other words, if an investor’s fixed income allocation is highly correlated with the equity market (if there is indeed beta hiding in his alpha), it may not provide the diversification benefit that fixed income is expected to deliver. This is a legitimate concern for investors and one of which they should be mindful.

For what it’s worth, we do think there is at least one exception to the rule that active bond managers simply overweight credit to generate alpha. (Since you are on this distribution list, you probably already knew that.) In any event, AQR has put together a well done piece of analysis and it is worth a read if you can spare the time.

Disclaimer: By accepting this material, you acknowledge, understand and accept the following:

This material has been prepared by NISA Investment Advisors, LLC (“NISA”). This material is subject to change without notice. This document is for information and illustrative purposes only. It is not, and should not be regarded as “investment advice” or as a “recommendation” regarding a course of action, including without limitation as those terms are used in any applicable law or regulation. This information is provided with the understanding that with respect to the material provided herein (i) NISA is not acting in a fiduciary or advisory capacity under any contract with you, or any applicable law or regulation, (ii) that you will make your own independent decision with respect to any course of action in connection herewith, as to whether such course of action is appropriate or proper based on your own judgment and your specific circumstances and objectives, (iii) that you are capable of understanding and assessing the merits of a course of action and evaluating investment risks independently, and (iv) to the extent you are acting with respect to an ERISA plan, you are deemed to represent to NISA that you qualify and shall be treated as an independent fiduciary for purposes of applicable regulation. NISA does not purport to and does not, in any fashion, provide tax, accounting, actuarial, recordkeeping, legal, broker/dealer or any related services. You should consult your advisors with respect to these areas and the material presented herein. You may not rely on the material contained herein. NISA shall not have any liability for any damages of any kind whatsoever relating to this material. No part of this document may be reproduced in any manner, in whole or in part, without the written permission of NISA except for your internal use. This material is being provided to you at no cost and any fees paid by you to NISA are solely for the provision of investment management services pursuant to a written agreement. All of the foregoing statements apply regardless of (i) whether you now currently or may in the future become a client of NISA and (ii) the terms contained in any applicable investment management agreement or similar contract between you and NISA.