The European Journal of Finance ›
Volume 25, 2019 - Issue 1

Articles

Exploring the benefits of international government bond portfolio diversification strategies

Jonathan Fletcher, Krishna Paudyal & Timbul Santoso

Pages 1-15 | Received 30 Aug 2017, Accepted 01 Mar 2018, Published online: 20 Mar 2018

Cite this article https://doi.org/10.1080/1351847X.2018.1450279 Check for updates

ABSTRACT

We use t... on benefits of invest... g constraints substant... only investin... ficant diversifi... ndex, and emer... . The supe... d that the diversifi...

KEYWO...

JEL CLA...

Disclosure statement

No potential conflict of interest was reported by the authors.

Notes

1 Studies of international diversification are dependent on the currency chosen. Hentschel Kang and Long (2002) use the numeraire portfolio approach of Long (1990) to evaluate the diversification benefits of investing in zero-coupon bonds in the U.S., U.K., and Germany, which is invariant to the currency chosen.

2 We also consider performance measures based on Value at Risk (VAR) and Conditional VAR measures developed by Alexander and Baptista (2003).

3 We also examine the impact of a combined upper bound constraint on the emerging market bonds.

4 A partial list of studies that evaluate the benefits of international diversification using the mean–variance approach include Bekaert and Urias (1996), Li et al (2003), Ehling and Ramos (2006), Eiling, Gerard, Hillion and de Roon (2012), Hodrick and Zhang (2014), Briere et al (2016), and Liu (2016) among others.

5 The CER performance measure is commonly used to evaluate the performance of mean–variance trading strategies such as Kan and Zhou (2007), DeMiguel, Garlappi and Upp … contrast to the Shar … on the level of risk a…

6 Recent … (2014) and Liu (201…

7 We … nthly excess returns. … often close to other … 4), Grauer and Hak…

8 An alte… d Bekaert (2004).

9 An alternative approach is followed by Briere et al (2016) who identify months of rising interest rates, but this approach can only be identified ex post.

10 We thank the reviewer and the Editor for encouraging us to examine this issue.

11 See Alexander (2009) for a review of modern risk management.

12 We do not consider the impact of using portfolio constraints based on VAR or CVAR in the mean–variance optimization, as in Alexander and Baptista (2004) and Alexander, Baptista and Yan (2007) among others, but is an interesting extension for future research.

13 Currency hedging tends to have a positive impact on the performance of international bond portfolios such as Eun and Resnick (1994), Glen and Jorion (1993), Hansson et al (2009), and Liu (2016).

14 Basak et al (2002) find that the standard error of their mean–variance inefficiency measure increases when no short selling constraints are imposed. Basak et al point out that this occurs because the linear approximation of a nonlinear function is less reliable when there are no short selling constraints.

Mats Hansson et al.
The European Journal of Finance
Published online: 2 Dec 2010