

Financial Analysts Journal >

Volume 48, 1992 - [Issue 4](#)

46 Views | 6 CrossRef citations to date | 6 Altmetric

Research Articles

Using Duration and Convexity in the Analysis of Callable Convertible Bonds

Robert Brooks & Bill Attinger


Pages 74-77 | Published online: 31 Dec 2018

🗨️ Cite this article [🔗 https://doi.org/10.2469/faj.v48.n4.74](https://doi.org/10.2469/faj.v48.n4.74)

 CFA Institute members: [sign in to access the Financial Analysts Journal](#).

Sample our
Law
Journals

>> [Sign in here](#) to start your access
to the latest two volumes for 14 days



🗨️ Citations

 Metrics

 Reprints & Permissions

[Read this article](#)

 Share

Using Duration and Convexity in the Analysis of Callable Convertible Bonds

Robert Brooks, Associate Professor of Finance, The University of Alabama in Tuscaloosa, and **Bill Attinger**, Morgan Stanley and Co., Incorporated

Dunetz and Maboney derived measures of duration and convexity for callable bonds. This note extends their analysis to derive duration and convexity measures for callable convertible bonds.

Duration measures the economic life of a bond by weighting all its cash flows relative to the time in which each is paid.¹ Given a bond's maturity date, coupon rate, par value and yield to maturity, one can calculate the price of a bond and its duration. Macaulay's duration (MD) is calculated as follows:

Eq. 1

$$MD = \left\{ \sum_{t=1}^N \frac{t(C_t)}{(1+YTM)^t} + \frac{N(PAR)}{(1+YTM)^N} \right\} / P$$

where

t = time period,
YTM = yield to maturity,
C_t = cash flow at time t,
N = maturity date and
P = price of bond.

74 Another method of calculating duration uses a Taylor-series ex-

pansion to determine the rate of change in bond price with a given change in yield. A Taylor series applied to the price-yield relationship can be expressed as follows:

Eq. 2

$$\frac{\Delta P}{P} = \frac{1}{P} \frac{\partial P}{\partial Y} (\Delta Y) + \frac{1}{2P} \frac{\partial^2 P}{\partial Y^2} (\Delta Y)^2 + \dots$$

Using the Taylor-series expansion, modified duration is the first derivative divided by $-P$:

Eq. 3

$$D = \frac{-1}{P} \frac{\partial P}{\partial Y}$$

and **convexity** is the second-order derivative divided by $2P$:

Eq. 4

$$C = \frac{1}{2P} \frac{\partial^2 P}{\partial Y^2}$$

Modified duration (Equation (3)) implies that the bond price and yield relationship can be estimated by an inverse linear relationship. However, the true relationship between price and yield is not linear, but curvilinear; hence the need for convexity. Convexity measures the curvature of the price-yield relationship (see Figure A).

An investor should not necessarily be indifferent between two bonds with similar maturities and present values (price). The

bonds' durations and convexities may be critical. Given two bonds with the same price and maturity, an investor would normally prefer the bond with the lower duration. If their durations were also similar, an investor would prefer the bond with the higher convexity.

Applications of duration and convexity have been extended to financial instruments other than the traditional straight bond. Measures of interest-rate sensitivity have become instrumental in evaluating portfolios, projects and overall assets and liabilities. Duration and convexity have also been used to evaluate individual securities such as stocks, which theoretically have an infinite maturity. Variations of the straight bond—bonds with indefinite but bounded maturities—have also been evaluated with duration and convexity. This note focuses on one such bond variation—the callable, convertible bond. Before examining this variant, we reexamine the case of the callable bond.

Duration and Convexity of Callable Bonds

Duration and convexity have been applied to callable bonds.² One can measure the duration and convexity of callable bonds in three ways. (1) Ignore the call feature and value the bonds using maturity dates. (2) If the bond sells at a discount, value it using the maturity date, but if it sells at a premium, value it using the call date. (3) Break the callable bond into two components as follows:

Eq. 5

$$P_{CB} = P_{SB} - CO$$

Log in via your institution

➤ Access through your institution

Log in to Taylor & Francis Online

➤ Log in

Restore content access

➤ Restore content access for purchases made as guest


Purchase options *

[Save for later](#)

PDF download + Online access

- 48 hours access to article PDF & online version
- Article PDF can be downloaded
- Article PDF can be printed


EUR 48.00

 Add to
cart

Issue Purchase

- 30 days online access to complete issue
- Article PDFs can be downloaded
- Article PDFs can be printed

EUR 136.00

 Add to
cart

* Local tax will be added as applicable

Related Research

People also read

Recommended articles

Cited by
6

[Convexity and Bond Performance: The Benter the Better >](#)

Bruce J. Grantier

Financial Analysts Journal

Published online: 31 Dec 2018

Information for

[Authors](#)

[R&D professionals](#)

[Editors](#)

[Librarians](#)

[Societies](#)

Opportunities

[Reprints and e-prints](#)

[Advertising solutions](#)

[Accelerated publication](#)

[Corporate access solutions](#)

Open access

[Overview](#)

[Open journals](#)

[Open Select](#)

[Dove Medical Press](#)

[F1000Research](#)

Help and information

[Help and contact](#)

[Newsroom](#)

[All journals](#)

[Books](#)

Keep up to date

Register to receive personalised research and resources by email



Sign me up



Copyright © 2026 Informa UK Limited [Privacy policy](#)

[Cookies](#) [Terms & conditions](#) [Accessibility](#)

Registered in England & Wales No. 01072954
5 Howick Place | London | SW1P 1WG



Taylor & Francis
by informa