Discussion of
“Systematic Risk and Yield Premiums in Bonds”

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• The authors show that traditional measures of corporate bond systematic risk based on unadjusted past returns have very large downward biases.

• They develop an improved method for calculating the market $\beta$'s of credit instruments, which takes into account the default impact on corporate bond prices, and therefore gives rise to better estimates of the exposure to the systematic risk.

• The empirical results show that these $\beta$'s along with yields enable estimation of the overall price of risk, which is found to be useful in predicting future returns on the aggregate market.
Is the systematic risk per se also biased?

- The logic of the argument in the paper:
  unadjusted bond price returns $\Rightarrow$ biased $\beta$ estimates $\Rightarrow$
  biased estimates of the systematic risk exposure

- “The magnitude of the virtually immediate downward co-movement (...) would likely be totally camouflaged for most firms…”

- Then the proxy of systematic risk, which is constructed from unadjusted returns, would not be able to have the “downward co-movement” risk component.

- Therefore, the problem cannot be resolved by just adjusting the $\beta$ estimates.
Portfolio management using the new $\beta$ estimates

- Assuming the new $\beta$s are better than the those estimated using unadjusted returns, it would be very interesting to see if the $\beta$s can lead to better portfolio management.

- For example, you might compare with the traditional $\beta$s to see if the new $\beta$s are able to provide a better hedge against the “downward co-movement” risk.