Quoniam

Factor Investing in Fixed-Income Instruments

Dr Desislava Vladimirova, 2024

Abstract – Dissertation

Factor investing in credit requires not only a deep knowledge of the underlying systematic factors, but also expertise in their implementation, which can be influenced by lack of liquidity, interactions with other systematic risks, or increasing regulations to adopt sustainability measures. Previous research has focused on formulating general factor models to identify the optimal set of common factors, but important questions remain unanswered. This dissertation seeks to fill a gap in the literature on factor investing in emerging market corporate bonds in the presence of illiquidity and country-specific risk. Additionally, this thesis analyzes the integration of sustainability measures into systematic factor strategies.

The first study addresses the liquidity of emerging market corporate bonds, which appears to be significantly lower than that of developed market bonds and is also influenced by macroeconomic variables. Additionally, the paper presents a liquidity forecast model that reduces the proportion of illiquid assets in a factor portfolio. The second study analyzes the cross-sectional variation of emerging market corporate bonds and finds that it is significantly affected by country-specific risk. Furthermore, it shows that an asset pricing model designed specifically for emerging markets produces better out-of-sample model fit and portfolio performance than models designed for developed markets. The final study reveals the implications of integrating sustainability targets in systematic credit strategies. The results indicate a non-linear, concave relationship between factor and impact investing, suggesting that investors can improve their sustainability/outperformance profile at marginal cost.