Fixed Income

Chartered Financial Analyst (CFA®) Program Level I exam

11–14% of the exam · 19 learning modules · 2027 curriculum

Fixed Income covers what bonds are, how and where they are issued and traded, how they are priced from yields and spot rates, how their prices respond to rates (duration and convexity), credit risk and securitization. Level I questions mix definitions with short calculations: prices, yields, forward rates and duration or convexity estimates.

You should be able to: You should be able to price a bond from its yield or from spot rates, convert yields, estimate price changes with duration and convexity, and explain credit risk and securitization structures.

Every learning module: the key point and the trap

FI.1 Bond features and indenture covenants

A bond's basic features are the issuer, maturity, par value, coupon rate and frequency, and the currency of payment.

Trap: Questions turn on mistaking a restriction worded positively, such as 'maintain a maximum leverage ratio', for an affirmative covenant.

FI.2 Cash flow structures and embedded provisions

Principal can be repaid as a bullet at maturity, fully amortized over the life, or partially amortized with a balloon at maturity.

Trap: Candidates mix up who owns the option: the issuer holds a call, the investor holds a put or a conversion right.

FI.3 Bond market segments, indexes and trading

Market segments are classified by issuer (sovereign, government-related, corporate, securitized), credit quality, maturity, currency and geography.

Trap: Bonds trade mostly over the counter, not on exchanges as equities do.

FI.4 How companies and banks borrow

Short-term corporate funding: bank lines of credit, secured loans and factoring, and commercial paper.

Trap: The party that sells the security in a repo is the borrower of cash, not the lender.

FI.5 Government, agency and supranational borrowing

Sovereigns borrow in their own currency (local) and sometimes in foreign currency; local currency debt is usually rated higher.

Trap: Supranationals are owned by many countries; agencies belong to a single government.

FI.6 Pricing a bond from its yield

Price = the sum of each cash flow discounted at the yield per period: PV = C/(1 + r) + C/(1 + r)^2 + … + (C + FV)/(1 + r)^N.

Trap: Quoted (flat) prices exclude accrued interest; the buyer pays the full price.

FI.7 Yield conventions and spreads for fixed coupons

Yields must be compared on the same periodicity: convert with (1 + APR_m/m)^m = (1 + APR_n/n)^n.

Trap: Questions turn on comparing yields with different compounding without converting them first.

FI.8 Floating-rate notes and money market yields

An FRN pays a reference rate plus a quoted margin, reset each period; its price stays near par on reset dates.

Trap: Discount rates are computed on face value, not on the price paid, so they understate the investor's yield.

FI.9 Spot, par and forward rate curves

A spot rate is the yield on a zero-coupon bond for one maturity; a bond's price can be found by discounting each cash flow at its own spot rate.

Trap: A forward rate is not the average of two spot rates; it is the marginal rate that links them.

FI.10 Bond return sources and Macaulay duration

A fixed-rate bond's return comes from coupons, reinvestment of coupons, and the gain or loss on sale or redemption.

Trap: A short-horizon investor faces price risk, not reinvestment risk, when yields rise.

FI.11 Modified duration, money duration and PVBP

Modified duration = Macaulay duration / (1 + yield per period); %price change approx. -ModDur x change in yield.

Trap: Using Macaulay instead of modified duration, or par instead of full price, overstates the price change.

FI.12 Convexity and portfolio duration

Duration is a straight-line estimate; convexity captures the curvature of the price-yield relation.

Trap: The convexity term uses the squared yield change, so it never changes sign with the direction of the move.

FI.13 Effective, key rate and empirical duration

Effective duration and convexity use model prices after shifting the benchmark curve, so cash flows may change with rates.

Trap: Yield-based duration assumes fixed cash flows, which fails for callable and prepayable bonds.

FI.14 Default risk, ratings and spreads

Credit risk has two components: probability of default (PD) and loss given default (LGD = exposure x (1 - recovery rate)).

Trap: Recovery rate and loss given default are complements; questions often swap them.

FI.15 Assessing sovereign and municipal credit

Sovereign analysis weighs institutions and politics, economic strength, fiscal position, monetary flexibility and external position.

Trap: Questions confuse the higher-rated local currency debt with the riskier foreign currency debt.

FI.16 Assessing corporate borrowers

Qualitative factors: business model, industry, competitive position, management, governance; the four Cs are capacity, collateral, covenants and character.

Trap: Questions swap coverage (EBITDA over interest) and leverage (debt over EBITDA).

FI.17 How securitization works

Securitization pools loans or receivables and sells them to a special purpose entity (SPE), which issues securities backed by the pool.

Trap: The servicer and the SPE play different roles; the SPE owns the assets, the servicer collects the cash.

FI.18 Covered bonds, ABS and CDOs

Covered bonds are issued by banks, secured by a dynamic cover pool, stay on the balance sheet and give dual recourse to the issuer and the pool.

Trap: Covered bond pools are dynamic and give recourse to the issuer; ABS pools are usually static with recourse only to the pool.

FI.19 Mortgage-backed securities and prepayment risk

Prepayment risk is the uncertainty in when mortgage principal is repaid: contraction risk when rates fall and prepayments speed up, extension risk when rates rise and they slow.

Trap: Contraction risk goes with falling rates and extension risk with rising rates; questions swap them.

Key terms

Indenture: The legal contract stating a bond's terms, covenants and remedies.

Flat price: The quoted bond price, which excludes accrued interest.

Full price: Flat price plus accrued interest; what the buyer pays.

Spot rate: The yield on a zero-coupon bond for one maturity.

Forward rate: The interest rate for a future period implied by today's spot rates.

Macaulay duration: The weighted average time to receive a bond's cash flows.

Modified duration: The approximate percentage price change for a 1% change in yield.

PVBP: The price change in currency for a 1 basis point change in yield.

Convexity: The curvature of the price-yield relation, improving the duration estimate.

Effective duration: Duration from model prices after shifting the benchmark curve; used for bonds with options.

Loss given default: The share of exposure lost if the issuer defaults: one minus the recovery rate.

Z-spread: A constant spread over the spot curve that makes discounted cash flows equal the price.

Haircut: The amount by which repo collateral value exceeds the cash lent.

Covered bond: A bank bond secured by a dynamic cover pool, with recourse to the bank and the pool.

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