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Forced Selling of Fallen Angels

Brent W. Ambrose, Nianyun (Kelly) Cai, Jean Helwege

The Journal of Fixed Income Summer 2008, 18 (1) 72 - 85

DOI: 10.3905/jfi.2008.708844

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What happens when investment grade bonds are downgraded to junk status? The received wisdom is that these fallen angels are sold by fixed income investors who, by regulation, are prohibited from investing substantial portions of their portfolios in speculative grade bonds. We investigate insurance company sales of bonds that were downgraded to junk in order to document the extent of forced selling of fallen angels. We document substantially greater selling activity in fallen angel bonds around the time of the downgrade than in comparable bonds that are not downgraded. However, we also find that the level of bond trading activity is sufficiently low that a relatively small number of trades could result in a statistically significant effect. When we consider the overall magnitude of fallen angel sales activity relative to insurance company holdings, we conclude that regulatory pressure does not result in the wholesale liquidation of fallen angel holdings.

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