International Journal of Finance & Economics / Volume 19, Issue 4 / pp. 267-278

Research Article

THE IMPACT OF FALLEN ANGELS ON INVESTMENT GRADE CORPORATE BONDS PORTFOLIOS: EVIDENCE FROM THE EUROPEAN MARKET‡

Enrica Bolognesi, Marianna Ferro, Andrea Zuccheri

First published: 09 May 2014

https://doi.org/10.1002/ijfe.1496

‡ Although the article is the result of a joint effort, Sections 1, 2, 4 and 5 are due to E. Bolognesi; Section 6 is due to M. Ferro and Section 3 is due to A. Zuccheri. The authors are in alphabetical order.

PDF

ABSTRACT

This work examines the impact on the price of corporate bonds denominated in Euro of a downgrade to high yield announced by Standard & Poor's and/or Moody's Investors Service. In particular, we observe the bond price behaviour around three events. The first event is the first downgrade announcement from one of the rating agencies, and we find significant cumulative abnormal returns before and at around the event. The second event is the downgrade announcement by the second rating agency: in this case, the security becomes a fallen angel and must leave the institutional portfolios constrained to investment grade (IG) securities. We record again a significant negative price reaction but larger than in the previous case and significantly higher when preceded by a widening of the credit spread in the corporate bonds market. Broadening the existing literature, we perform a third event study, focused on the subsequent bond deletion from an IG benchmark. In this case, our results show positive and significant excess returns after the month-end index rebalancing, revealing a price reversal pattern of the fallen angel after its release from the index. This price rebound is the higher, whereas the stronger was the bond price pressure at the downgrade announcement. These insights offer some practical guideline for those professionals that manage IG and high-yield portfolios.

Ambrose BW., Cai N, Helwege J. 2008. Forced selling of fallen angels. *Journal of Fixed Income* **18**: 72–85.

Google Scholar

Ambrose BW, Cai N, Helwege J. 2012. Fallen angels and price pressure. *Journal of Fixed Income* **21**: 74–86.

Google Scholar

Bank of America, Merrill Lynch, 2009. *Fallen Angels: Gems or Empty Shells?* High Yield Strategy: New York City, USA.

Google Scholar

Ben Dor A, Xu Z. 2011. Fallen angels: characteristics, performance, and implications for investors. *Journal of Fixed Income* **20**: 33–58.

Google Scholar

Bessembinder W, Kahle K, Maxwell W, Xu D. 2009. Measuring abnormal bond performance. *Review of Financial Studies* **22**: 4219–4258.

Web of Science® | Google Scholar

Brown S, Warner J. 1985. Using daily stock returns: the case of event studies. *Journal of Financial Economics* **15**: 3–31.

Web of Science® | Google Scholar

Cai J, Houge T. 2008. The long-term impact from Russell 2000 rebalancing. *Financial Analysts Journal* **64**: 76–91.

Web of Science® | Google Scholar

Ellul A, Jotikasthira C, Lundblad CT. 2011. Regulatory pressure and fire sales in the corporate bond market.

Goltz F, Campani CH. 2011. *A Review of Corporate Bond Indices: Construction Principles, Return Heterogeneity, and Fluctuations in Risk Exposures*. EDHEC-Risk Institute Publications: Nice, France.

Google Scholar

Grier P, Katz S. 1976. The differential effects of bond rating changes on industrial and public utility bonds by maturity. *Journal of Business* **49**: 226–239.

Web of Science® | Google Scholar

Hand J, Holthausen R, Leftwich R. 1992. The effect of bond rating agency announcements on bond and stock prices. *Journal of Finance* **47**: 733–752.

Web of Science® | Google Scholar

Hite G, Warga A. 1997. The effect of bond-rating changes on bond price performance. *Financial Analysts Journal* **53**: 35–51.

Google Scholar

May AD. 2010. The impact of bond rating changes on corporate bond prices: New evidence from the over-the-counter market. *Journal of Banking and Finance* **34**: 2822–2836.

Web of Science® | Google Scholar

Steiner M, Heinke VG. 2001. Event study concerning international bond price effects of credit rating actions. *International Journal of Finance and Economics* **6**: 139–157.

Web of Science® | Google Scholar

Wansley J, Glascock J, Clauretie T. 1992. Institutional bond pricing and information arrival: the case of bond rating changes. *Journal of Business Finance & Accounting* **19**: 733–749.

Google Scholar

Weinstein M. 1977. The effect of a rating change announcement on bond price. *Journal of Financial Economics* **5**: 329–350.

Web of Science® | Google Scholar

Citing Literature