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Research Article

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

Enrica Bolognesi, Marianna Ferro, Andrea Zuccheri

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‡ 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.

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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

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