

# IS FEARING FALLEN ANGELS FOLKLORE?

“Fallen Angels” (FAs) are those issuers that have been downgraded from investment grade (IG) to high yield (HY). The magnitude of this year’s fallen angels in terms of par amount has surpassed both the Great Financial Crisis in 2009 and the commodity crunch in 2015.

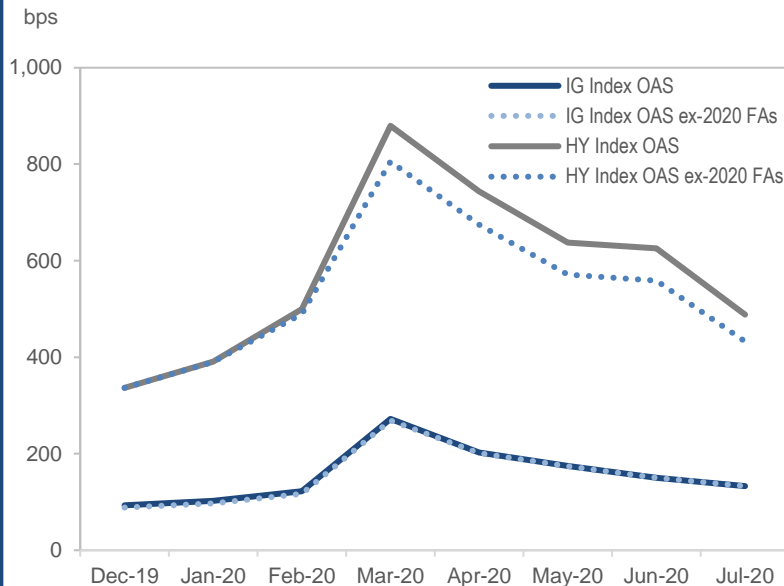
Following the onslaught of the coronavirus pandemic, approximately \$151 billion across 27 issuers was downgraded to high yield. Adjusting the IG Index OAS to exclude these fallen angels results in an index OAS that averaged just 2bps tighter through the end of July. However, the spread impact to the HY index would average roughly 43bps tighter. Expectations vary for an additional wave of downgrades and are largely dependent on the virus’s path in the second half of the year.

Over one-third of the investment grade corporate index is currently on negative watch or negative outlook by at least one of the major rating agencies; nearly 30% of these issuers are currently rated BBB-/Baa3.

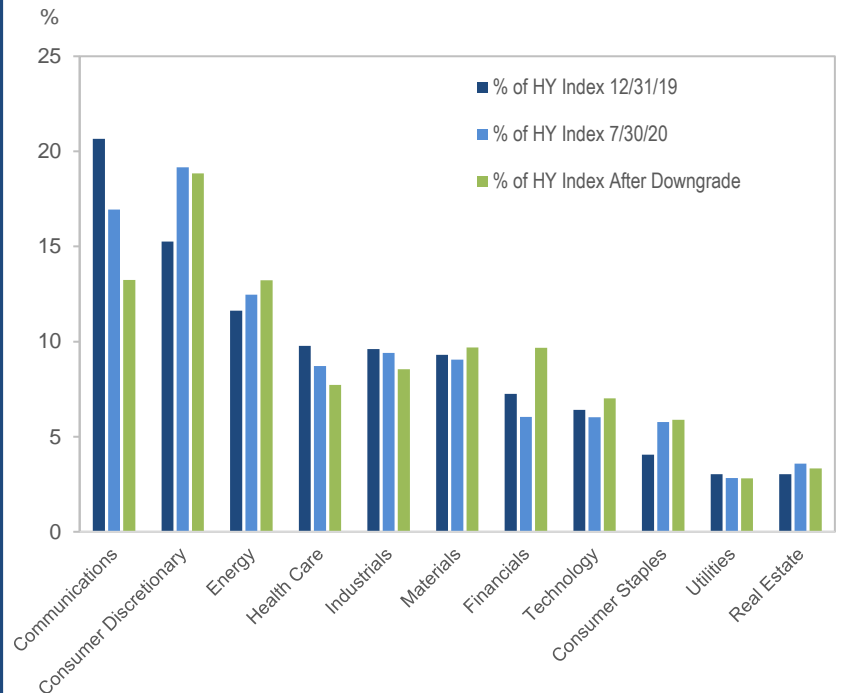
- Negative watch indicates a potential downgrade in the near term, while a negative outlook indicates a downgrade could occur over the medium term (approximately 6-24 months).

Although we do not expect all BBB- issuers on negative watch/outlook to be downgraded to high yield, if they were, the high yield index would increase by approximately 30%, or more than \$430 billion of market value.

## The spread impact this year from fallen angels has been much greater for US High Yield than it has been for US Investment Grade



## Impact to the US High Yield Index from a potential Second Wave of Fallen Angels



Source: JP Morgan as of 7/17/20 and Bloomberg Barclays as of 7/30/20. The IG and HY Indices referenced are the Bloomberg Barclays US Corporate Index and the Bloomberg Barclays US Corporate High Yield Index, respectively. Increase in market value on the HY Index is derived from assuming a one notch downgrade using the average index rating of BBB- OAS ex-2020 FAs for each respective index in the left-hand chart is calculated by excluding index-eligible 2020 fallen angels as of 6/30/20 and recalculating a weighted average OAS at each month-end. The % of HY Index after Downgrade in the right-hand chart assumes that all cusps in the Bloomberg Barclays US Corporate High Yield Index that have an index rating of BBB- and are on negative watch/outlook by either Moody's, S&P or Fitch are downgraded to high yield.

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