BLOG POST

Corporate Bond Dislocations

4/9/2020

With the onset of the coronavirus panic, investors have been de-risking their portfolios and moving to cash. While equities receive most of the headlines, the bond market – in particular the corporate and municipal sectors – have come under immense selling pressure as well. Liquidity, or the ability to sell bonds without a significant reduction in price, has dried up in some cases. In the chart to the left, we illustrate the rolling volatility of the Barclay's Aggregate Bond Index (AGG) going back to 2004. For comparison, we also include the median volatility level.

- When liquidity becomes scarce, bond prices tend to fluctuate more than normal. On March 12th alone, the aggregate index dropped -4%, its largest single day move ever. As the chart shows, volatility has spiked to levels not seen since 2008. The current reading of 15% is well above the long-run median volatility of roughly 3%.

- Recent volatility is due in part to COVID-19. In addition, a collapse in oil prices has put the energy sector, which is highly leveraged, under considerable stress. However, the Fed has stepped in to provide a liquidity backstop, which should help markets trade more smoothly.