Common Factors in Corporate Bond and Bond Fund Returns

March 1, 2018

Journal of Investment Management

Corporate bonds are an enormous, and growing, source of financing for companies around the world. At the same time, the investor base and trading dynamics of corporate bonds has changed dramatically. Dealer inventories are decreasing, average trade size is decreasing and there is a greater presence of ‘retail’ investors via the increase of open ended mutual funds and ETFs targeting corporate bonds. There is, however, surprisingly little research on the cross-sectional determinants of corporate bond returns.

The authors undertake a comprehensive analysis of those cross-sectional determinants of corporate bond excess returns. They find strong evidence of positive risk-adjusted returns to measures of carry, defensive, momentum and value. These returns are diversifying with respect to both known sources of market risk and characteristic returns that have been documented in equity markets.

Investors in actively managed credit funds should be aware of the hidden beta they are exposed to, and should prefer an investment product designed to isolate exposure to well-compensated characteristics that are diversifying to market risk premium.

Hypothetical performance results have many inherent limitations, some of which, but not all, are described herein. The hypothetical performance shown was derived from the retroactive application of a model developed with the benefit of hindsight. Hypothetical performance results are presented for illustrative purposes only.

Diversification does not eliminate the risk of experiencing investment loss.

Certain publications may have been written prior to the author being an employee of AQR.

This material is intended for informational purposes only and should not be construed as legal or tax advice, nor is it intended to replace the advice of a qualified attorney or tax advisor.

AQR Capital Management is a global investment management firm, which may or may not apply similar investment techniques or methods of analysis as described herein. The views