



FIXED INCOME

Credit Markets and Financial Information

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Lakshmanan Shivakumar, Oktay Urcan, Florin P. Vasvari and Li Zhang have shown (*Review of Financial Studies*, 2011) a positive relationship between corporate managers' public forecasts of cash flow and returns on the corporation's credit instruments.

This was not a surprising result, because research had already shown a positive relation between managers' cash flow forecasts and equity returns, and that equity and credit markets are interdependent. Further, finding that this relation is stronger when distance to default is lower is also not very surprising.

We show how this option theory identifies firm specific attributes which can be used to sharpen hypotheses about how a given attribute is expected to affect credit markets given prior knowledge of how that attribute affects equity markets.

We recommend that future empirical research seeking to identify relations between accounting information and credit markets focus on settings where the information attribute is of primary relevance to the credit market and/or settings where you have clear priors for a differential reaction across equity and credit markets.

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