Fallen Angel

REVIEWED BY JAMES CHEN | Updated Feb 28, 2018

What is a Fallen Angel

A fallen angel is a bond that was given an investment-grade rating but has since been reduced to junk bond status due to the weakening financial condition of the issuer. It is also a stock that has fallen substantially from its all-time highs. There is a fine line between fallen angel bonds and value stocks, which have the potential to recover from short-term challenges, and securities that are headed straight toward bankruptcy.

BREAKING DOWN Fallen Angel

Fallen angel bonds, which can be corporate, municipal or sovereign debt, have been downgraded by a rating service such as Standard & Poor's, Fitch, or Moody's Investors Service. The primary reason for downgrades is a decline in revenues, which jeopardizes issuers' capabilities of servicing debt. When declining revenues are combined with expanding debt levels, the potential for a downgrade increases dramatically.

Fallen angel securities are often attractive to contrarian investors seeking to capitalize on the potential for a recovery by the issuer from a temporary setback. Under these circumstances, the downgrade process usually starts with debt being placed on negative credit watch, which may require portfolio managers to sell positions, depending on fund-specific covenants.

angel bonds can present value within the high-yield category but only when the issuer has a reasonable chance of recovering from the conditions that caused the downgrade.

Examples of Fallen Angels

For example, an oil company that has reported sustained losses over several quarters due to falling oil prices may see its investment-grade bonds downgraded to junk status due to increasing risk of default. As a result of the downgrade, the prices of the company's bonds decline and yields increase, making the debt attractive to contrarian investors who see low oil prices as a temporary condition.

There are, however, several conditions under which fallen angel bond issuers may not recover. For example, companies experiencing declining revenues due to the introduction of products superior to theirs may disappear altogether. The progression from VCR tapes, to DVDs, to streaming video is one such example.

Municipal and sovereign debt issuers may also see their investment-grade bonds downgraded to junk status due to a combination of stagnant or declining tax revenues and increasing levels of debt. In many cases, these conditions result in a self-reinforcing downward spiral toward default as revenue shortages resulting from the challenges of increasing tax receipts necessitate the ongoing issuance of debt to fund local or sovereign obligations.

Related Terms

Preferred Stock

Preferred stock refers to a class of ownership that has a higher claim on assets and earnings than common stock has. more

Asset Stripping

Asset stripping is the process of buying an undervalued company with the intent of selling off its assets to generate a profit for shareholders. more

Due Diligence

Due diligence is defined as the care a reasonable person should take before entering into an agreement or a transaction with another party. more

Private Equity

Private equity is a non-publicly traded source of capital from investors who seek to invest or acquire equity ownership in a company. more