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Do Junk Bonds Die in Vain? Some Do, Some Don't

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ABSTRACT

The C-1 risk, or the asset default risk, is usually studied quantitatively from the perspective of the credit rating of the issuer, and the spread over the default-free issues. In this work, we propose combining that approach with a market estimate of the default risk provided by the yields of the newly issued bonds versus the risk free Treasuries. We develop a simple theoretical model of the relation on the asset default risk to the bond yield, as related to the risk free yield. We examine the empirical implications of the model. We also expand the model by including quantification of the credit rating.