INVESTMENT COMPANY INSTITUTE® ICI Global

WASHINGTON, DC • LONDON • BRUSSELS • HONG KONG • WWW.ICI.ORG

ICI VIEWPOINTS

AUGUST 4, 2022

Core Bond Mutual Funds Had Little Impact on the Investment Grade Corporate Bond Market

By Sean Collins and Shelly Antoniewicz

Core bond mutual funds' activities during March 2020 had little impact on the investment grade corporate bond market. According to an ICI study, the timing and small size of core bond mutual funds' daily net sales of investment grade corporate bonds is inconsistent with some policymakers' narrative that they substantially amplified market stresses. In addition, core bond mutual funds' net sales generally accounted for a relatively small share of daily trading volume. And, even when their share of daily trading rose to a peak of 20 percent on March 12, 2020, bid-ask spreads on investment grade corporate bonds were unchanged.

A Series on Bond Mutual Funds' Role in the Fixed-Income Markets During March 2020

As a follow-up to a previous post, we examine daily net purchases and sales of investment grade bonds by "core bond"[1] mutual funds during March 2020 using data from an ICI survey.[2] This analysis should help allay concerns policymakers may have about whether these funds' sales pressured the investment grade corporate bond market on any specific day in March 2020.

Core Bond Mutual Funds' Sales of Investment Grade Corporate Bonds

During the height of the crisis in March 2020, core bond mutual funds were relatively small net sellers of US investment grade corporate bonds on a daily basis. In addition, the timing of these daily net sales is inconsistent with the hypothesis that bond mutual funds contributed significantly to the stress in the US investment grade corporate bond market.

Figure 1 shows core bond mutual funds' daily net purchases or sales of US investment grade corporate bonds (shown as the blue bars). Core bond mutual funds are net buyers when the bar is above zero and net sellers when it is below. The solid green line is the bid-ask spread on US investment grade corporate bonds. The bid-ask spread is often used to gauge selling pressure in a market. If the narrative is correct that core bond mutual funds added substantially to stress in the US investment grade corporate bond market, the bid-ask spread would be expected to increase the most on days when core bond mutual funds sold US investment grade corporate bonds more heavily.

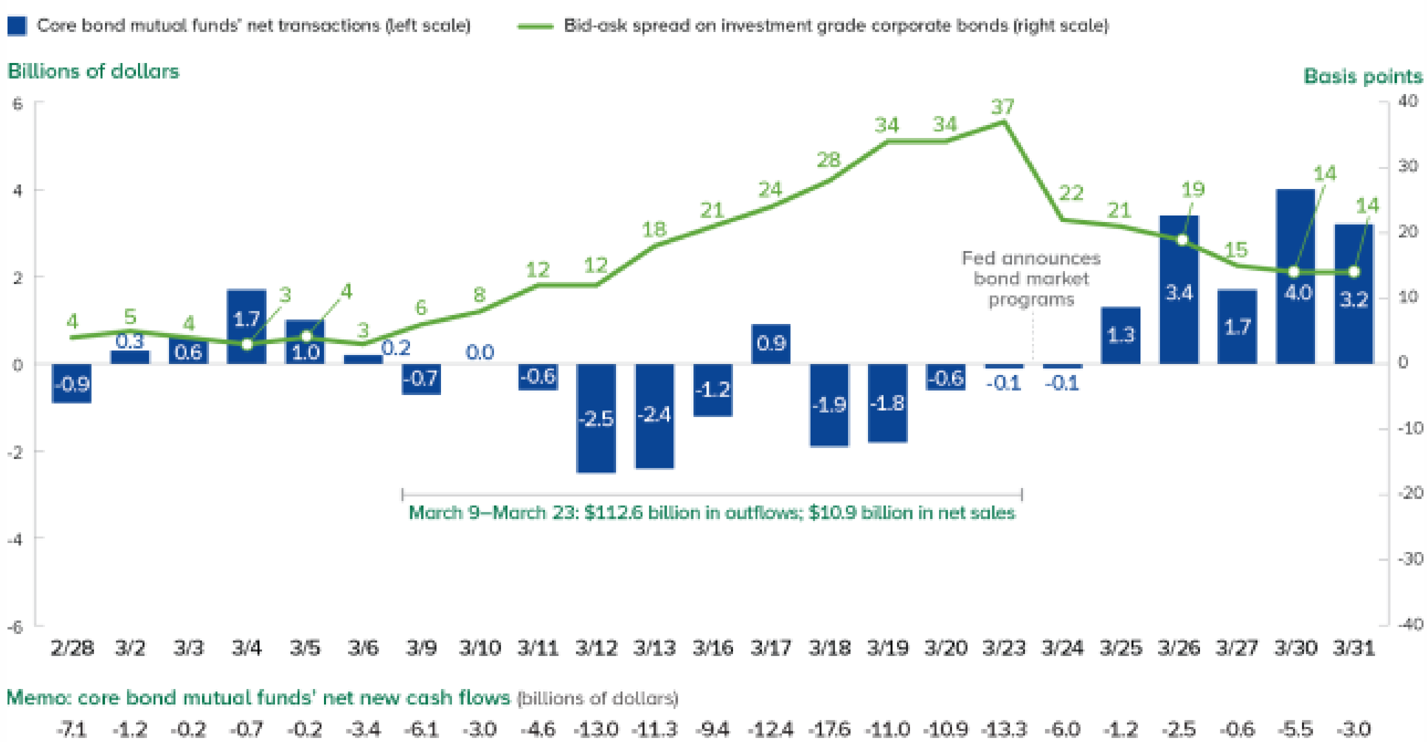
This correlation is far from clear. The bid-ask spread started moving up on March 9, 2020, and while core bond mutual funds turned from being net buyers to net sellers, their daily net sales were quite small—$700 million at most—over the next few days. Moreover, it is questionable whether core bond mutual funds' daily net sales were driving the bid-ask spread. For example, over the next three business days, March 12 to March 16, funds' net sales were larger (although still rather small in dollar terms). Nevertheless, the bid-ask spread widened by 9 basis points—the same amount by which it increased from March 9 to March 11, when funds' net sales were considerably smaller. Then, on March 17, core bond mutual funds were net *buyers* of $900 million in US investment grade corporate bonds. Presumably, if funds' net sales were driving market stress, the bid-ask spread should have *fallen* on that day. But the bid-ask spread increased further, by 3 basis points.

Later in the month, after the Federal Reserve announced programs to support the US investment grade corporate bond market, core bond mutual funds returned to being net buyers. But in the critical period from March 9 to March 23, core bond mutual funds, on net, sold only $10.9 billion in US investment grade corporate bonds.

Figure 1

Timing of Core Bond Mutual Funds' Investment Grade Corporate Bond Sales Is Inconsistent with Stress Amplification

Daily, February 28–March 31, 2020



Note: Core bond mutual funds represent ICI's categories of investment grade (which includes ultrashort funds) and multisector bond mutual funds.

Source: Investment Company Institute and MarketAxess

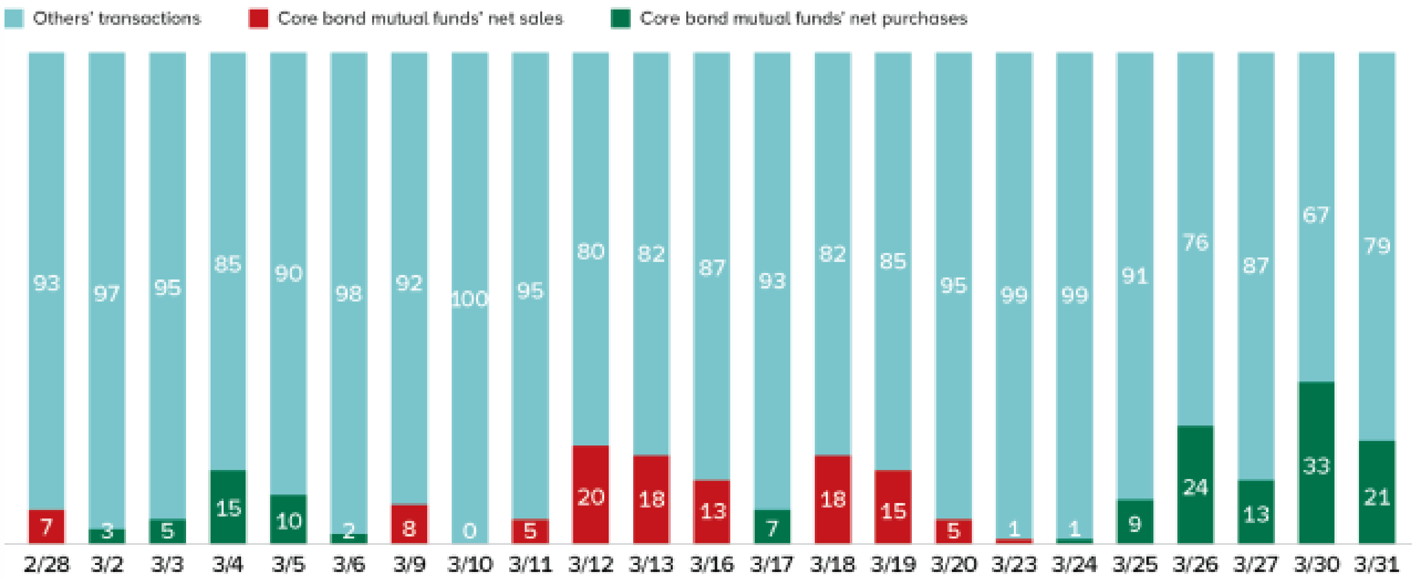
Core Bond Mutual Funds' Net Sales Were a Relatively Small Share of Trading

Another way to establish that that core bond mutual funds' activities had little impact on the investment grade corporate bond market in March 2020 is to examine trading volumes. For the most part, core bond mutual funds' net sales accounted for a relatively small share of overall (dealer-to-customer) daily trading volumes in investment grade corporate bonds (Figure 2). From March 9 to March 11, core bond mutual funds accounted for, at most, 8 percent of daily trading volumes. From March 12 to March 16, their proportion of trading volume did increase, peaking at 20 percent. But there are two reasons why we believe these increased shares of trading volume did not add materially to stress in the US investment grade corporate bond market. First, on March 12 when core bond mutual funds' net sales of $2.5 billion in US investment grade corporate bonds accounted for 20 percent of trading volume (up from 5 percent the previous day), the bid-ask spread remained unchanged at 12 basis points (Figure 1)—an indication that selling conditions did not deteriorate on that day. Second, as noted in our previous post, stress in the US investment grade corporate bond market, as measured by yields spreads, is best explained by fundamental macroeconomic factors (e.g., likelihood of a recession) and not by core bond mutual funds' net sales.

Figure 2

Core Bond Mutual Funds' Net Sales Accounted for a Relatively Small Share of Trading

Percentage of daily trading volume in investment grade corporate bonds,* February 28–March 31, 2020



Memo: net transactions of investment grade corporate bonds by core bond mutual funds (billions of dollars)

-0.9	0.3	0.6	1.7	1.0	0.2	-0.7	0.0	-0.6	-2.5	-2.4	-1.2	0.9	-1.9	-1.8	-0.6	-0.1	-0.1	1.3	3.4	1.7	4.0	3.2

Total dealer-to-customer trading volume (billions of dollars)

27.3	21.6	23.0	22.9	21.4	17.9	17.9	26.8	24.9	24.3	26.4	19.0	23.4	21.2	24.6	24.1	24.1	28.4	28.6	27.9	24.8	24.4	30.8

*Calculated as the absolute value of bond mutual funds' gross purchases minus gross sales divided by one-half of total dealer-to-customer trading volume.

Note: Core bond mutual funds are ICI's categories of investment grade (which includes ultrashort funds) and multisector bond mutual funds.

Source: Investment Company Institute and FINRA

Conclusion

Bond mutual funds had large outflows in March 2020. But an intense focus on this fact, rather than digging deeper, has led some policymakers to overstate bond mutual funds' role and impact on the fixed-income markets during March 2020. These claims are not supported by data. ICI undertook a thorough analysis to investigate these narratives and found that bond mutual funds neither caused nor substantially amplified stress in the Treasury and investment grade corporate bond markets during March 2020. This hard evidence is important because it shows that policymakers' push to propose regulatory reforms, which would be detrimental to bond mutual funds and their investors, is not substantiated.

NOTES

[1] We define *core bond mutual funds* as those funds classified under ICI's investment grade and multisector bond mutual fund categories. In aggregate, core bond mutual funds invest a significant majority of their assets in investment grade debt, of which US Treasuries and agencies are their largest holdings. Investment grade corporate debt accounts for less than 30 percent of their overall assets. See Figure 4 in Shelly Antoniewicz and Sean Collins, "Policymakers Need to Focus on Economic Fundamentals and Not Blame Bond Mutual Funds: Examining the Evidence of Investment Grade Corporate Bond Yield Spreads in March 2020," *ICI Viewpoints* (July 2022).

[2] For a description of the survey, see Shelly Antoniewicz and Sean Collins, "ICI Bond Mutual Fund Survey Brings Facts to the Debate," *ICI Viewpoints* (March 2022).

Sean Collins is Chief Economist at ICI.

Shelly Antoniewicz is Senior Director of Financial and Industry Research at ICI.