

Risk Perceptions in Credit Markets

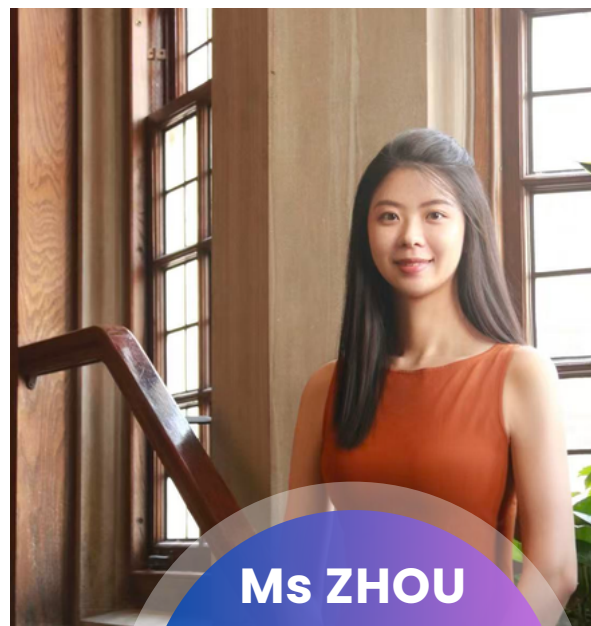
Abstract

This paper studies subjective risk perceptions by constructing and examining a novel dataset linking corporate bond analysts' recommendations to their textual comments. Two stylized facts emerge: (i) bond analysts favor higher-yielding, riskier bonds only in higher-rated categories, even when fundamentals are comparable; moreover, recommendation-sorted portfolios generate positive alphas only in lower-rated bonds; (ii) perceived credit risk extracted from analysts' comments predicts subsequent credit deterioration, but is not reflected in their recommendations for higher-rated bonds. These patterns hold across investor types and client and non-client issuers, suggesting that catering to investors or catering to clients do not fully explain the results. Rather, the evidence supports categorical thinking: analysts infer from credit rating categories instead of rational Bayesian updating, leading them to underweight their perceived bond-specific risks for purportedly safe bonds.



Biography

Yunrong Zhou is a Ph.D. candidate in Finance at Purdue University. Her research focuses on behavioral finance, empirical asset pricing, and household finance. Her job market paper, "Risk Perceptions in Credit Markets," studies subjective risk perceptions by constructing and examining a novel dataset that links corporate bond analysts' recommendations to their textual comments on risk. The paper shows that behavioral biases arise not only in return expectations but also in beliefs about risks. In particular, analysts engage in categorical thinking. They infer from credit-rating categories instead of applying rational Bayesian updating, which leads them to underweight bond-specific risks for purportedly safe bonds.



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