How Integrated Are Corporate Bond and Stock Markets?

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Abstract

This paper proposes a model-free measure of the extent of relative market integration between U.S. corporate bond markets and the equity markets of the same issuers. The measure is grounded in asset pricing theory, consistent with both no-arbitrage and the presence of financial frictions, and quantifies pricing consistency across markets without relying on structural assumptions. Empirically, I show that transaction costs and short-selling constraints—key frictions faced by market participants—lead to realistic optimal positions and materially affect cross-market alignment. The evidence suggests that U.S. corporate bond and equity markets exhibit substantial, though incomplete, integration, reaching between 50% and 90% of a full-integration benchmark. The degree of integration varies systematically with firm characteristics, financial intermediary constraints, and the intensity of market frictions.