Why Convertible Bonds now ?

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Mirabaud Convertible Bonds — Europe (MCBE) & Global (MCBG)

We believe the pullback in equities is unlikely to go beyond the levels we saw earlier this month and therefore advise investors to use this recent correction to allocate to convertible bonds for the following reasons:

1- **Economic growth remains on track**

We believe a rise in inflation expectations and global growth is the reason behind the correction of the bond market rather than a reappraisal of credit risk. We expect government bond yields to trade erratically depending on economic data and monetary policy decisions.

2- **Equity upside has more to deliver**

The re-rating of European equities should continue as reflation this year is translating into positive net earnings revision and the emergence of earnings momentum, this is the first time we have since this in a while.

3- **Sectors dispersion should increase in the next up leg**

Sectors that should perform best are those that are cheap and likely to see earnings upgrades due to USD appreciation and oil-commodity weakness. Cyclical sectors and banks should do well whereas defensives like healthcare and staples should underperform as they are expensive.

4- **Profitability is going up**

Return on equity looks likely to continue to improve as companies are making efforts to strengthen corporate governance, especially in Japan.

5- **The underlying credit fundamentals are not worrying**

Default rates remain very low, leverage is rising but cost of debt remains low and rates of profitability are still very high.

6- **Capital usage remains in favour of shareholders**

Shareholder returns should continue to expand via dividends raise and buybacks. These remain higher than bond yields provided by the same company.

7- **M&A volumes are still below pre-crisis levels**

The number of M&A transactions should rise because many corporates show surplus liquidity, limited debt and good FCF generation on average.

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8- **Market technicals remain broadly supportive**

Despite the recent fair increase in valuation, redemptions/conversions and supply have improved the overall profile exposure of global convertibles to 39% high delta, 25% convex, 23% low delta and 13% concave.

9- **The Primary market remains strong**

Year to date issuance is at $27bn, which brings the global convertible market capitalization close to $450bn. We expect robust issuance to continue on the back of improving growth, a pick-up in capital spending, M&A trends, stock buybacks and firm equity valuations.

10- **Mirabaud Convertible Bond funds should deliver competitive returns**

Mirabaud Convertible Bonds Europe (MCBE) & Mirabaud Convertible Bonds Global (MCBG) offer a decent current yield of 1.9%/1.50%, a relatively short option adjusted duration of 2.4/2.3 years and an attractive equity exposure of 47/51%.

We ran a scenario-based return analysis on the funds to predict likely returns over the next 12 months. We arrived at our estimates under two different scenarios that incorporate credit spread changes (-/+30%/50%) and equity returns (+/- 20%) : the upside case total return estimate is approximately +11.4%/12.2% for MCBE/MCBG over a one-year period whereas the downside case is estimated at -5.5%/-6.4%.

These scenarios highlight why convertible strategies must be actively managed to maximize their potential benefits. It is not simply the asset class that make a strategy work but how convertibles are managed and therefore achieve a particular investment objective.

Our goal is to provide an asymmetrical risk profile with greater equity market participation than downside over full market cycles.

In this period of global market volatility and rising interest rates, we expect the characteristics of convertibles to serve investors well.

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