24 APRIL 2020

THE RETURN TO GRACE OF CONVERTIBLE BONDS

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An update on Mirabaud – Convertible Bonds Global

We believe that investors currently have an attractive entry point in terms of Convertible bonds. Indeed, even the US Federal Reserve has been buying them. Valuations are at record lows and the carry is positive again. We have therefore been cautiously positioned without giving up convexity.

What's happened so far this year?

Over the first quarter of 2020, Convertible bonds captured 43% of the equities losses, delivering a hybrid performance in-between Equities and Credit. Global Convertibles captured – 8.6%, Global Investment Grade – 3.0%, Global High Yield – 14.1% and Global Equities MSCI World – 19.8%. Against this backdrop, we believe Convertibles can offer investors a defensive equity strategy. For example, between the 31 of December 2008 and the 31 March 2020, Equities had an annualised return of 9.9%, Convertibles 8.2% and Corporate/Government bonds 3.6%.

In terms of annualised volatility, Equities had 14.8%, Convertibles 7.5% and Corporate/Government bonds 5.0%. We therefore think Convertible Bonds combine the best of both worlds.

We also believe that a portfolio of Convertible Bonds and Corporate/Government bonds can achieve a higher efficient frontier than a portfolio of Equities and Corporate/Government bonds. For example, a combination of 78% Corporate/Government bonds and 22% Equities has a volatility of 5.0% whereas a combination of 70% Corporate/Government bonds and 30% Convertible Bonds has a volatility of 4.2%.

What makes Convertible bonds attractive?

The answer is convexity. By excluding equities you can add performance without adding risk. And this may help to reduce the risk of missing a market recovery or suffering in a falling market. It's more of a strategy rather than a tactical investment. As a result, we think that Convertibles have never been so important as they are today. The two biggest sectors currently in our universe are Information Technology and Communications services, mostly held in companies based in the US.

Valuations have hit record lows with an average discount of 6.3% and the carry is now positive again with a yield to maturity of 2.3% at the end of March. As a result, the primary market is now looking more promising. There was $71bn in global issuance in 2019 and $18.3 bn in the first quarter of 2020. We therefore expect some $41.4bn of redemptions/conversions over the next twelve months. We believe that with many dividends at risk, convertibles may offer a safer source of income while still providing equity-like exposure.

How are we positioned for the future?

We think we are most likely to have a U or W-shaped recovery. As a result, we think investment grade credit could outperform equities on a risk adjusted basis. We are cautiously positioned in terms of equity sensitivity and credit allocation. The average delta, ie the sensitivity to risk, varies between 30 and 60% (currently at 33%, at the low end of our target) and we have increased portfolio credit quality with our highest ever exposure to Investment Grade at around 54%. The equity sensitivity reflects our upside potential to equities over the medium term. The Fund's average rating is BBB-. We look for a 60% exposure in a balanced portfolio with no concession on convexity. We currently have a duration of 2.5 years, which means we are being paid to wait for a recovery. We are currently positioned on the most convexed portion of the valuation curve. We also believe that our use of Environmental, Social & Governance (ESG) principles makes convexity even stronger and that there is a high correlation between ESG scores and credit metrics.

Pure Convertibles

In summary, we believe we have a very clear strategy. Our 100% pure global convertible strategy, Mirabaud – Convertible Bonds Global, consists of a concentrated portfolio of around 50 holdings and also employs ESG principles in its approach. We seek to outperform our benchmark (Refinitiv Global Focus CB Hedged USD) and our peers while minimising risk. We have an active approach and a focus on convexity with a delta target of between 30 and 60% with a minimum exposure of 60% within a balanced exposure.

Our high conviction approach employs extensive fundamental analysis to find value and minimise default risk. Cumulatively, our highly experienced team has over 60 years working on convertibles. To conclude, we believe that the current market environment is one of the best periods for Convertibles to flourish.

All sources for information: Mirabaud Asset Management and Bloomberg at 31/3/2020.