

Convertible Outlook 2021

By: Ravi Malik, CFA, Portfolio Manager, Principal & Steve Wachtel, CFA, Portfolio Manager

Recap of 2020

Convertibles, as an asset class, delivered very strong returns in 2020. As represented by the ICE BofA All US Convertible Index (VXA0), the asset class produced a return of 46.22%, representing a 251% capture of the return of the S&P 500 of 18.39%. It was the best performance for convertibles since 2009. The underlying equities of the convertible asset class significantly outperformed major equity and credit benchmarks, as demonstrated below:

It was the best performance of the convertible asset class since 2009.

The largest contribution to these returns came from structural growth companies

2020 Performance (12/31/2020)	
Underlying Equities of the Convertible Asset Class US All	51.15%
S&P 500	18.39%
Russell 2000	19.93%
Bloomberg Barclays High Yield Bond Index	7.11%
Bloomberg Barclays US Corporate Inv. Grade Bond Index	9.89%
Bloomberg Barclays Intermediate Treasury Bond Index	5.77%

Source: Bloomberg, BofA Global Research, ICE Data Indices LLS

Convertible bonds got off to a strong relative and absolute start in 2020, but sold off along with almost every other asset class in Q1 when the rapidly spreading Covid pandemic caused a severe global economic shutdown. Convertibles declined less than the S&P 500 index, the S&P Low Volatility index, and the Russell 2000 index during the market plunge in Q1, demonstrating its superior defensive qualities. The S&P Low Volatility index did not provide much protection relative to the S&P 500 during this time period, putting in question its risk mitigation ability in market downturns.

Q1, 2020 Returns (3/30/2020)	
VXA0*	-13.62%
S&P 500	-19.60%
Russell 2000	-30.62%
S&P Low Vol Index (SP5LVI)	-18.97%

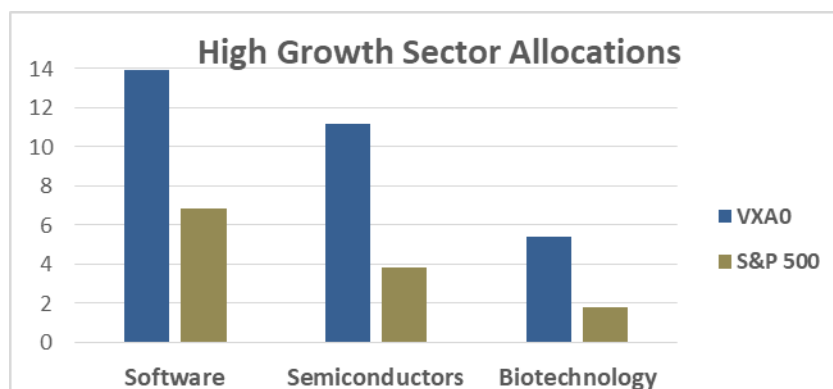
Source: Bloomberg 3/30/2020.

*VXA0 represents the ICE BofA All US Convertible Index

The market bottomed on March 23rd after unprecedented liquidity injections from the Fed and their backstop of the corporate bond market. Convertibles continued to outperform other asset classes as the market rebounded. Starting in April the new issue market for convertibles opened up, thanks to the Fed's implied credit backstop. Businesses who were severely impacted by the economic shutdowns due to Covid, needed financing to ensure enough liquidity until the point where economies fully re-opened. Many of these companies tapped the convertible market including numerous airlines, retail companies, and cruise lines. These rescue financing new issues came at very attractive deal terms and with equities at depressed levels. The three largest cruise liners issued convertible bonds with their equity down 80-90% from just a couple months ago.

Due to the strong monetary and fiscal stimulus and growing optimism on the pace and efficacy of the vaccines, these "re-opening" new issues appreciated sharply from their issue date and contributed meaningfully to the 2020 returns for the convertible asset class. Prior to the new issuances in April, there was minimal representation of travel/leisure/retail companies in convertibles relative to the S&P 500. So the convertible market was impacted less than the S&P 500 by the decline in these stocks in Feb and March but benefitted more from their recovery in April and May.

The largest contribution to convertible returns in 2020 came from structural growth companies. The convertible universe has historically been dominated by structural growth companies in the Technology and Healthcare space that are disruptors with large addressable markets and potential for high growth rates that are likely to be long lasting.



Source: Bloomberg. Above chart as of 9/30/2020. VXA0 represents the ICE BofA US Convertible Index

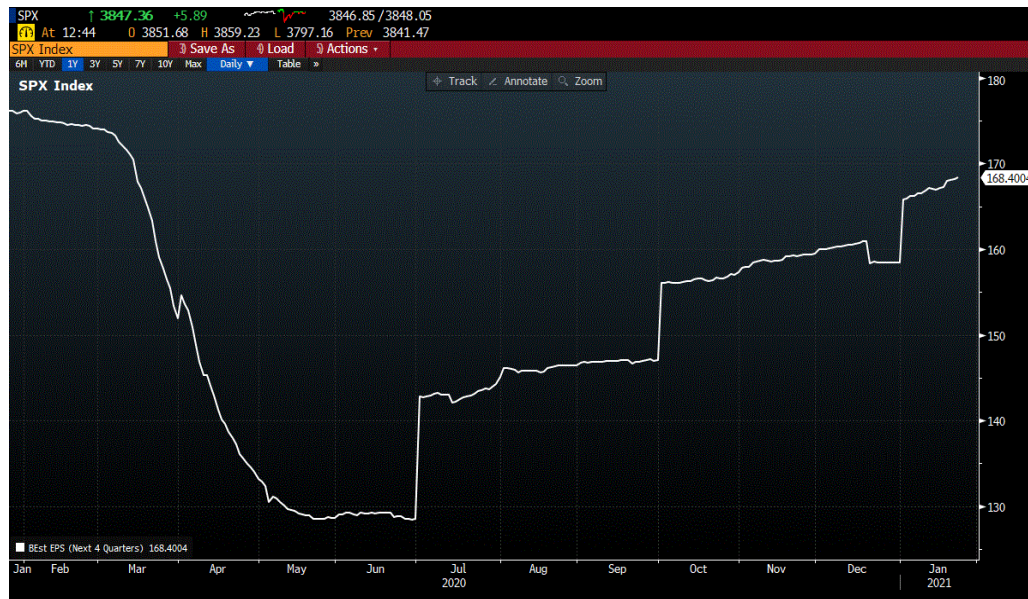
Some of the major structural growth themes for 2020 that have heavy representation in the convertible universe are:

- Digitization of the economy and cloud computing/SAAS (software as a service)
- Genomics, personalized medicine, gene therapy, telehealth, and biotech M&A
- 5G build out, data center build outs, artificial intelligence, and automated mobility
- E-commerce (both domestic and international)
- Green energy – solar, hydrogen fuel cells, electric vehicles

These structural growth companies significantly outperformed the market in 2020 providing a big boost to convertible returns. Since the bottom of the stock market on March 23rd, both these structural growth names and the cyclical re-opening names have both outperformed the S&P 500. The convertible bond asset class benefited from over-representation in both of these segments.

Outlook for 2021

SSI has a positive view on the equity markets for 2021. S&P 500 EPS growth is expected to grow potentially as much as 30% year over year. Consensus estimates for EPS and GDP for 2021 continue to grow due to optimism on the re-opening of the global economies as Covid vaccines are further distributed and countries get closer to herd immunity.



Source: Bloomberg

Estimates have also gotten a recent boost from more expected fiscal stimulus after the Democrats gained control of the Senate. The recent \$900 billion stimulus agreement is likely to be supplemented

by another program in the \$1 trillion range. This could be followed by an infrastructure bill later this year. Demand will be further bolstered by a strong housing market, record consumer net worth, and a high savings rate that will likely drawdown.

Despite the recent rise in interest rates, the 10 year real interest rate remains near the -100 bps level due to the rise in inflation expectations. Global short rates made a new low of 0.65% on Jan 7th, 2021 according to Evercore ISI. This is a very bullish backdrop for equities. However, there are some concerns for the equity markets starting the New Year. One is valuation. Stocks look expensive on several traditional valuation metrics.

S&P 500 Equity Risk Premium



Source: Bloomberg

Equity valuations appear much more reasonable in an equity risk premium framework as evident from the above graph as a result of the current environment of exceptionally low interest rates. We do expect some multiple contraction in 2021 but expect equities to still produce solid returns due to very strong EPS growth.

There is also some concern near term due to overly bullish investor sentiment. Currently, most sentiment gauges (AAII Bull-Bear spread, IIB Bull-Bear spread, Put/Call ratio, hedge fund net leverage, Citi Panic/Euphoria) are at very elevated levels. The last 2 months of 2020 saw the strongest inflows (+\$190 billion) into equity funds (ETFs and mutual funds) on record according to Evercore ISI. This increases the odds of a short-term correction.

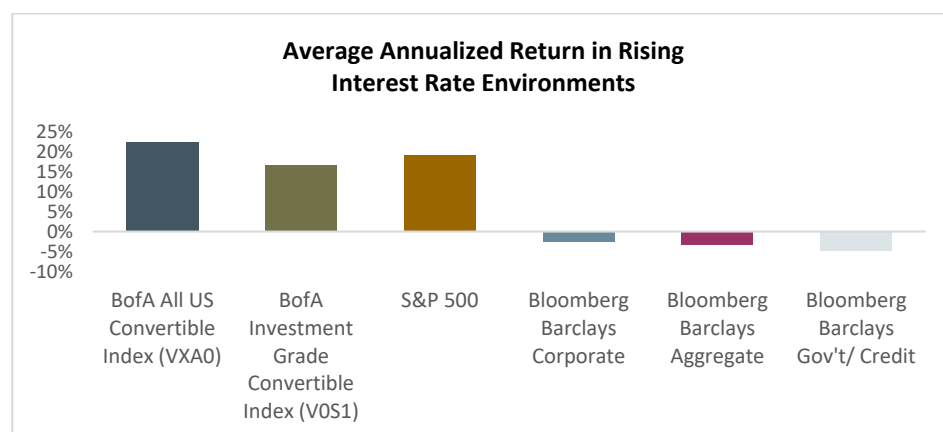
A big part of the stock market rally from the March bottom has been due to a super accommodative Federal Reserve. We do not expect this to change anytime soon. It is possible that the massive fiscal and monetary stimulus does raise inflation levels and causes the Fed to start thinking about lowering

QE and eventually raising rates. This would most likely be a 2H 2021 problem if it is an issue at all this year. The Fed has continually expressed that it is in no hurry to reduce liquidity and that it is willing to let inflation run over the 2% target level before acting. Also, long-term factors that have suppressed inflation over the last 20 years (Demographics, Technology, and Globalization) will continue to be a counter-force.

Convertible Outlook

Convertible returns in 2021 will most likely not be able to match the torrid pace of 2020. None the less, our outlook is still constructive. We expect convertibles to once again outperform most other asset classes for the following reasons:

- **Growth and cyclical companies.** We believe the underlying equities of the convertible bond asset class will continue to outperform major equity benchmarks due to a strong mix of structural growth companies and cyclical companies that will benefit greatly from the re-opening of the economy.
- **Performance in a rising interest rate environment.** Convertible bonds perform strongly on both an absolute and relative basis in a rising interest rate environment. Convertibles have a duration of only 1.58 compared to 6.03 duration for the Bloomberg Barclays US Aggregate Bond Index. Below are historical returns by asset class during rising interest rate environments.



**Convertibles: ICE BofA All US Convertible Index (VXA0); Investment Grade Convertibles: ICE BofA Investment Grade US Convertible Bond ex-Mandatory & Preferred Index (VOS1)*

Source: SSI internal research; ICE BofA Convertible Research; Bloomberg; Barclays. Rising interest rate environment periods based on SSI internal research/evaluation where the 10-Year Treasury rises at least 100 bps in a twelve-month rolling period

- **Strong new issuance.** 2020 set a record for new issuance at \$113.6 billion, breaking the previous record from 2001. We expect 2021 to be another robust year, with new issuance in the \$80 billion range. New issues help boost convertible returns because they usually are priced theoretically cheap. They also increase the convexity of the overall market by introducing new bonds that have ideal risk-reward characteristics upon issue.
- **Room for credit spread contraction.** Convertible credit spreads compared to high yield spreads indicate relative value. Non-IG convert OAS finished the year at 503 bps versus 379 bps for the Bloomberg Barclays US HY 'B' Index. The convertible default rate for 2020 through 12/10 was only 2.2% compared to a 6.5% default rate for high yield. Convertibles typically have a lower default rate than high yield due to a better sector mix (less Energy, more Software) and companies with lower financial leverage on average. The average default rate for convertibles from 2003 through June 2020 was only 1.36% according to Bloomberg Barclays.
- **Emerging markets.** Emerging market representation in the Barclays convertible bond index should continue to boost returns. There are several USD denominated emerging market convertible bonds, some of which were top contributors to the Bloomberg Barclays convertible bond index for 2020 (Sea Ltd, Nio Inc, Pinduoduo Inc, MercadoLibre Inc, and Billibilli Inc). They should continue to benefit from their fast growing underlying markets (E-commerce, online gaming, electric vehicles, online content), market share gains, and a weak USD.

The most compelling reason to own convertible bonds is its long-term risk-adjusted performance against other asset classes. The convex nature and low duration characteristics of convertibles provide an improved risk/reward profile to equities and corporate bonds, with more enhanced downside protection than common equity positions, and less interest rate risk than most other fixed income investments.

20 Years: US Risk Adjusted Returns (as of 12/31/2020)	Annualized Return	Standard Deviation	Sharp Ratio
SSI Convertible Investment Strategy (gross*)	8.40%	12.73%	0.55
S&P 500 Index	7.46%	15.05%	0.40
Russell 2000 Index	8.73%	19.96%	0.37

Source: Bloomberg, SSI internal research. Past performance is not necessarily indicative of future results.

*Please see the accompanying disclosure for a discussion of performance methodology

In general, we believe an allocation to convertible bonds almost always makes sense. Convertibles are a unique asset class that offers solid participation in equity markets with the downside protection of bonds. It is an ideal asset class for investors seeking growth with capital preservation as well as contractual income.

2021 Returns Outlook

S&P total return	12.0% (10.5% price appreciation plus 1.5% yield)
Convertibles total return	13.5%*

*Inputs/assumptions utilized:

Inputs			
S&P EPS estimated growth	30%	Equity Market P/E Compression	15%
Convertible Issuers estimated EPS Growth	37%	Convertible Universe current yield	1.9%
Convertible universe delta	68	Convertible Universe gamma	31

Higher interest rates and lower credit spreads offset each other | 16.45% underlying stock price appreciation | We utilize the current delta of 68 and gamma of 31 for the convert universe | Price appreciation = 11.6% | Total return = 13.5% Price appreciation plus 1.9% current yield

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SSI operated under the name of SSI Investment Management, Inc. (1/1/1973-4/30/2019) and as of 5/1/2019 operates as SSI Investment Management LLC.

Compliance Statement

SSI Investment Management LLC ("SSI") claims compliance with the Global Investment Performance Standards (GIPS®).

Definition of the Firm

SSI was established in 1973 and is a Registered Investment Advisor based in Los Angeles, CA. SSI manages assets in domestic and global capital markets. SSI applies quantitative disciplines and fundamental research in its management of alternative and traditional portfolios for institutional and high net-worth investors. SSI manages separate accounts, a limited partnership, and acts as sub-advisor to mutual funds and an ETF. Effective June 1, 2019, Resolute Investment Managers, Inc. has a majority interest in SSI, however, SSI continues to operate independently. SSI does not have any subsidiaries. SSI acquired the assets of Frole, Revy Investment Co., Inc. ("Frole, Revy") and its composites as of March 1, 2009.

Policies

SSI's policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The Composite & Benchmark

The Convertible Investment Strategy (composite created January 1983) is invested in convertible bonds and convertible preferred stocks, and do not have credit quality restrictions. The Strategy may hold 144A securities. The composite contains fully discretionary accounts including those no longer with the firm. SSI believes a performance comparison versus the ICE BofA All Convertibles Index (the "VXA0") is appropriate. The VXA0 measures the return of all U.S. convertibles. SSI does not hold all convertibles in the VXA0 and may also hold convertibles that are not included in the VXA0. The Strategy is less diversified than the VXA0. The volatility of this strategy may be greater than the volatility of the VXA0 as the strategy holds a smaller number of positions than the Index. The return, if any, above the VXA0 is dependent upon SSI's discretionary management. Any other indices shown are not necessarily comparable to SSI's Convertible Investment Strategy. These are widely recognized market indices that are shown for informational purposes only. The composite name was formally known as SSI Outright Discretionary Convertible Strategy from 1/1/1983 – 3/31/2016 and on 4/1/2016 the new composite name became the SSI Convertible Investment Strategy.

Use of Leverage, Derivatives, and Shorts

The strategy may invest in synthetic convertible bonds and convertible preferred securities. Synthetic convertible securities are generally issued through an investment bank and may provide exposure to the credit of the bank while being linked to the equity upside of an entity we select that is generally not connected with the bank. The synthetic convertible securities we employ do not generally involve the use of leverage and generally do not provide leveraged exposure.

Investment Management Fees

Returns are presented gross and net of management fee. Actual results of an individual account may be materially different from the performance shown herein because of differences in inception date, transaction and related costs, investment guideline restrictions, fees and other factors. All performance is based in U.S. dollars and reflect, on a percentage basis for each of the periods indicated: (a) the net increase (decrease) of all SSI Convertible Investment Strategy portfolios, dollar-weighted, including adjustments for unrealized gains and losses, the reinvestment of dividends and other earnings, the deduction of investment costs except any separate custodial or related fees, time-weighted to adjust for additions and withdrawals, and (b) the net increase (decrease) of the VXA0.

Net performance is reduced by SSI's actual investment management fees. Gross performance does not include deduction of SSI's investment management fees.

If performance is gross of management fees, client's actual return will be reduced by the management fees and any other expenses which may be incurred in the management of an investment advisory account. See SSI's Form ADV, Part 2A for a complete description of the investment advisory fees customarily charged by SSI. As an example, an account with an initial \$1,000,000 investment on January 1, 2003, earning a recurring 5% semi-annual gross return (10.25% annualized), and paying a .5% semi-annual management fee (1% annual fee) would have grown to \$1,340,096 on a gross of fees basis and \$1,300,392 on a net of fees basis by December 31, 2005 (3 years).

List of Composites

A list of the Firm's composite descriptions and/or compliant presentations are available upon request. Please contact helenm@ssi-invest.com.

Additional Disclosure

- SSI operated under the name of SSI Investment Management, Inc. (1/1/1973-4/30/2019) and as of 5/1/2019 operates as SSI Investment Management LLC.
- When representative portfolio information is shown the representative portfolio is selected by comparing any one (but not limited to) the following criteria: most in line with composite investment objectives /consistency of investment strategy, investment restrictions, fee structure, time frame managed, type of client, size of account.
- Performance prior to January 1, 2000 does not comply with the GIPS standards.
- SSI acquired Frole, Revy and its composites as of March 1, 2009. Prior to the acquisition, Frole, Revy claimed GIPS compliance for the periods of 1983-2008 and was independently verified by Ashland Partners.

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