

Convertible IQ

Q: In 2020, Convertibles delivered its best performance since 2009, why should they be an essential part of your portfolio in 2021?

The convex nature and low duration characteristics of Convertibles provide an improved risk/reward profile to the underlying equities, with more enhanced downside protection than common equity positions, and less interest rate risk than most other fixed income investments. This allows for a different outcome as market volatility increases, if we should experience a significant downturn in the market, or if rates adjust.

Meaningful gains were booked in 2020 through the bonds that were exchanged/converted, while new issuance resupplied the momentum of the asset class with a wide breadth of balanced new issues. This natural conversion of securities combined with maturing issues removes downside risk to some equity-like issues in the market. For example, a portion of the outstanding Tesla issues have been converted in 2020, while one Tesla issue matures in March of 2021. The capital from these situations can be replaced in portfolios by companies investing aggressively in innovation, such as cloud computing, gene therapy, SaaS, or other structural growth themes, and in recovery issues benefitting from the reengaging post-COVID economic tailwinds. So, even after a return of 46.22%*, the asset class finds new runways for continued success.

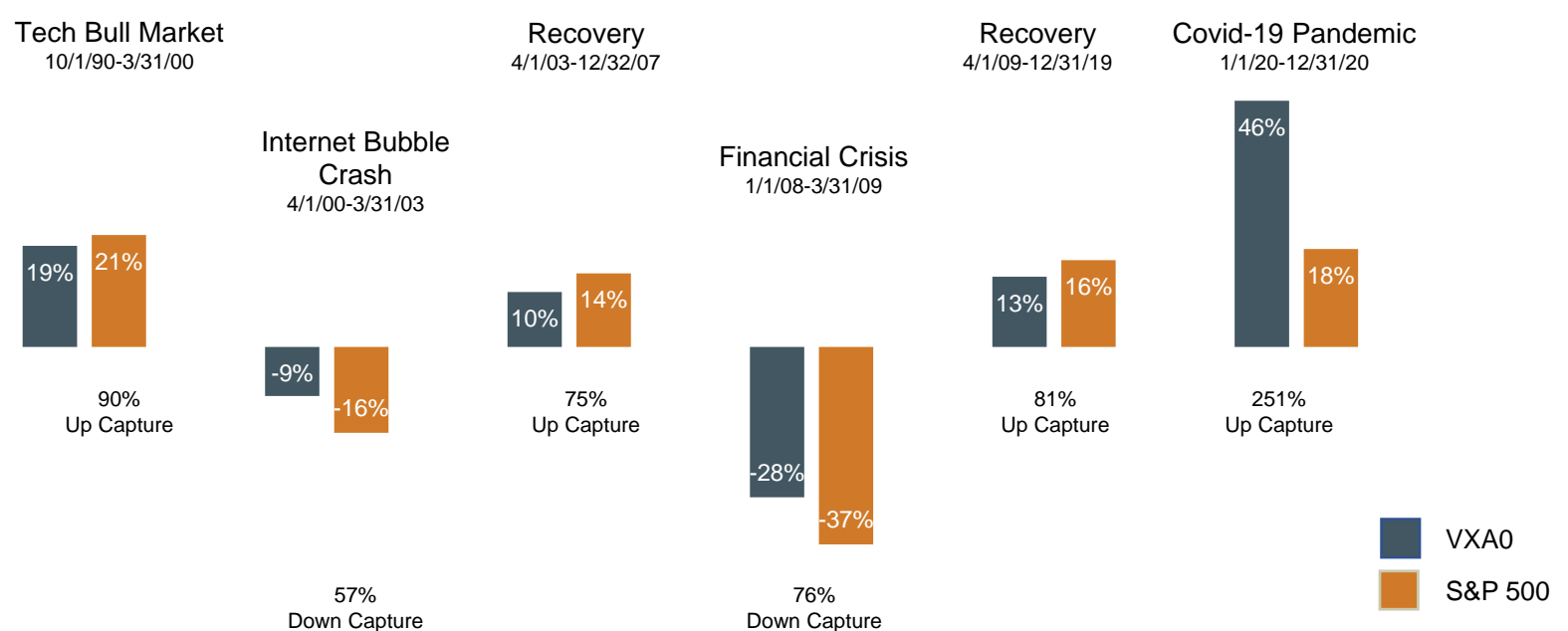
“...the possibility of increased volatility in the New Year, continued strong new issuance, and a low yield environment is the perfect storm for Convertibles that could lead to another strong year for the asset class.”

Active management is also key here, as we can adjust the delta (equity sensitivity) of the portfolio depending on market conditions. We can increase or decrease equity sensitivity to provide an improved risk/reward profile for the portfolio. For example, earlier in 2020, we shifted to a lower delta (lower equity sensitivity) once COVID appeared and steadily increased portfolio delta as the year progressed. Currently, we have a more balanced portfolio allocation as we head into a new year. In addition, we can shift sector allocation to better position the portfolio toward an improved risk/reward profile.

2021 looks to be a great opportunity for you to consider Convertible securities with an active manager, such as SSI, to help you navigate the current market. In fact, the possibility of increased volatility in the New Year, continued strong new issuance, and a low yield environment is the perfect storm for Convertibles that could lead to another strong year for the asset class.

The below showcases the attractive performance of convertibles vs. equities over the last 30 years. Convertibles captured significant equity upside during economic growth periods and withstood sharp sell-offs, due to their defensive bond-like characteristics.

Managing Risk Over Market Cycles



*Source: Bloomberg, BofA Global Research, ICE BofA All US Convertible Index (VXA0) index as of 12/31/2020

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- 11 Investment Professionals