

# Convertibles Lead the Charge as One of the Most Formidable Asset Classes in 2021

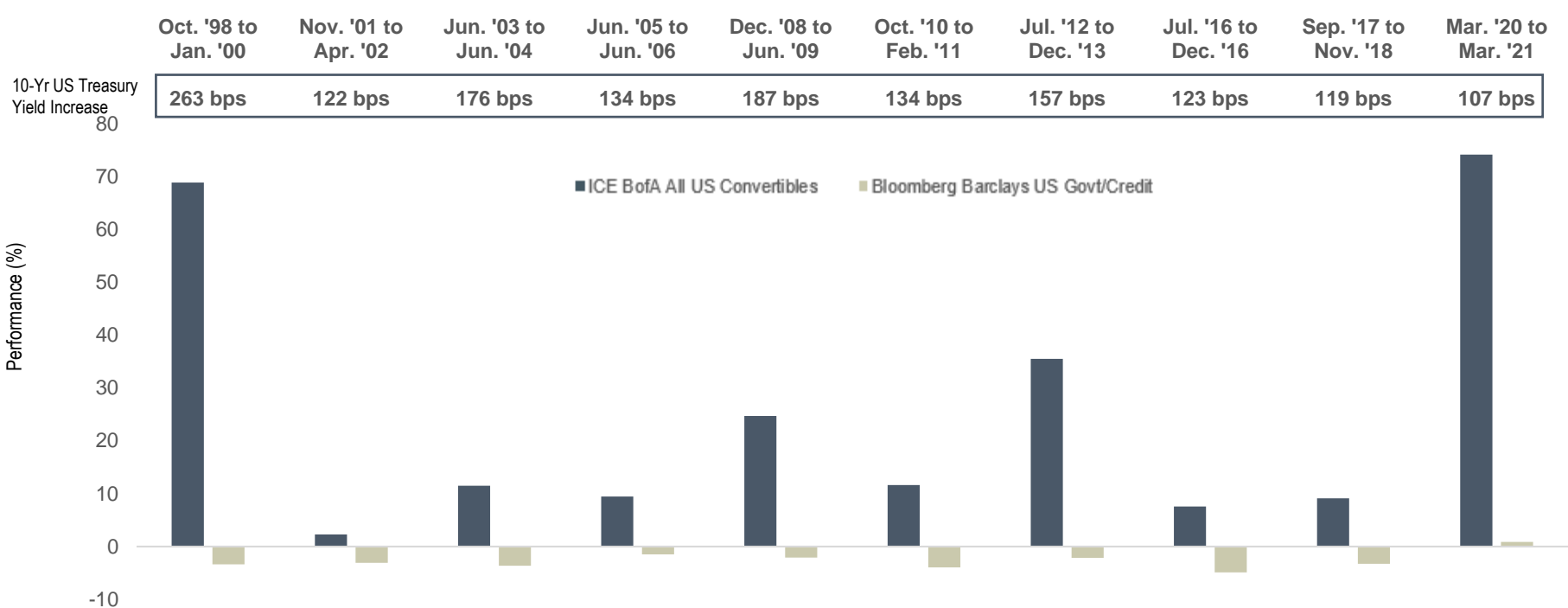
As we approach mid-year, a convergence of factors has helped the Convertibles market maintain its status as a formidable asset class:

- Historically strong Convertible performance in a rising rate environment
- Historically strong Convertible bond performance following a drawdown
- Continued robust and diversified new issuance

## Convertibles in a Rising Rate Environment

- The general outlook for absolute returns from fixed income is challenging due to fears of impending rising interest rates and inflation risks. Investors are exploring alternative solutions in order to reach return targets, while mitigating multiple risk components.
- Historically, Convertibles have consistently delivered strong performance in a rising rate environment, as opposed to traditional fixed income as illustrated by the Chart 1.

**Chart 1: Convertible Bond Performance in a Rising Interest Rate Environment\***



\* Sources: SSI internal research, BofA Global Research, Bloomberg Barclay Research, and US Treasury. Rising interest rate environment periods based on SSI internal research where 10-year US Treasury yield increased by at least 100 basis points (bps) from October 1998 to March 2021. Performance reflected is cumulative.

- Convertible bonds have a much lower duration than treasury or straight corporate bonds, the effective durations of the VXA0 was 1.75 as of March 31, 2021 as compared to the Bloomberg Barclays US Aggregate Bond Index (6.40), and Bloomberg Barclays US Government Credit Index (7.37)\*\*.
- Our recent article, "[Convertibles – A Superior Fixed Income Alternative in a Rising Rate Environment](#)", provides a detailed explanation about why allocators should seriously consider Convertible securities with an active manager to mitigate the risks arising from rapidly rising yields.

\*\* Sources: SSI internal research, BofA Global Research and Bloomberg Barclay Research, accessed April 5, 2021. Data as of March 31, 2021.

## Convertible Rebound after a Drawdown

- After a spectacular bull run from April 2020 - March 2021 where the VXA0 (ICE BofA All US Convertibles) returned 74.1%\*\*\*, some allocators may have been hesitant to invest in what they perceived as a "top ticking" asset class.
- From February 15, 2021 – May 15, 2021, the VXA0 fell by 9.11%, as underlying growth equities underperformed broader equity indices.\*\*\*

## Convertible Rebound after a Drawdown (continued)

- Following recent Convertible drawdown periods, the asset class has typically rebounded strongly over the subsequent four quarters as illustrated in the Chart 2.

**Table 1: US Convertible Rebound After a Market Drawdown\*\*\***

	VXAO	Bloomberg Barclays US Aggregate Bond Index	S&P 500
10/1/2018 - 12/31/2018 Drawdown	-9.3%	1.64%	-13.5%
<b>1/1/2019 - 12/31/2019 Rebound</b>	<b>23.2%</b>	<b>8.71%</b>	<b>31.5%</b>
1/1/2020 - 3/31/2020 Drawdown	-13.6%	3.15%	-19.6%
<b>4/1/2020 - 3/31/2021 Rebound</b>	<b>74.1%</b>	<b>0.72%</b>	<b>56.3%</b>

\*\*\* Sources: SSI internal research, BofA Global Research, Bloomberg Barclay Research, June 3, 2021

- The drawdown over the past few months has created a timely entry point for investors to allocate to the asset class.

## Convertible New Issuance

- The Convertible market has been defined by a very robust new issuance pipeline that has significantly expanded the investment opportunities in the space. New issuance for the U.S. Convertible Market has continued its healthy pace with \$53.7 bn YTD thru May 2021. The YTD 2021 issuance is comparable to the same period in 2020 (Jan.-May 2020 \$54.2 bn), which resulted in a record year of \$113.8 bn of total issuance in 2020\*\*\*\*.
- Given that the typical Convertible issue usually comes to market with terms for 5-7 years, this supply is likely to help maintain a healthy market for years to come.
- The new issuance in the market not only creates more sector diversification, but also provides an expanding opportunity set for active managers to invest in balanced Convertibles which in our view provide the most favorable risk/return profile.
- Balanced Convertibles exhibit characteristics of both equities and bonds, leading to an asymmetric profile that many investors favor. These securities are commonly characterized by moderate yields, stock price sensitivity, and convex return pattern, which provides meaningful downside protection.

## Overview of an Expanding Convertible Universe

ICE BofA All US Convertibles Index (VXA0)****	Market Value of U.S. Convertible Market (\$mn)	Balanced Convertibles %	Market Value of Balanced Convertible (\$mn)
12/31/2018	\$170,727	39%	\$67,276
5/31/2021	\$352,844	44%	\$156,391

\*\*\*\* Source: BofA Global Research, Global Convertibles Chartbook, May 3, 2021

Since 12/31/2018, the VXA0 Universe has:

- Increased in total market value by **107%**
- Increased in total market value of the balanced Convertible market by **132%**
- The size of the balanced segment of the Convertible market, which represents securities with the most favorable risk/return profile, on 5/31/2021 is **92%** of the entire market value of the U.S Convertible universe at the end of 2018.

**We believe the current environment creates a compelling opportunity for Convertible bonds. Convertibles' historical performance during rising interest rate environments and after drawdowns along with a very strong new issuance market suggest a favorable risk-reward set-up.**

For more information, please contact [SSI](#)

## About SSI

- Founded in 1973
- Headquartered in Los Angeles, CA
- \$2.60 Billion AUM
- Registered Investment Advisor
- 30 Employees
- 12 Investment Professionals