

Seizing opportunities on Europe's convertible bond market



Laurent Le Grin, Fund Manager

What is driving the European convertible market?

In recent months, the European market has been seeing rapid growth. Issuance in 2014 had already topped EUR 9bn¹. This positive trend has gradually helped it reduce the gap with the US market which currently represents USD 198bn or half of the global convertible market. European convertibles account for around USD 123bn.

“Europe offers a variety of opportunities but it is essential to stick with a selective approach”

Enthusiasm for European convertibles is due to investors looking to gradually increase equity risk exposure and companies searching for cheaper funding. New issuance is spread across all sectors and capitalisation sizes.

Disintermediation, in particular, has helped make the market accessible to new issuers, notably small and mid cap companies. This means the market is now getting stronger and more diversified. A good example is Italy's Maire Tecnimont which two months ago used the convertible market to find

funding and reduce its risk premium. It was a small issue which went off very well.

European convertibles are currently helping investors boost returns in their bond allocation or reduce overall risk by diversifying their equity allocation.

This favourable trend has been in place for several months and, in our opinion, has further to go.

Nevertheless, part of the European market is relatively expensive, notably the investment grade segment.

So what approach would you recommend?

As described above, Europe offers a variety of opportunities but it is essential to stick with a selective approach. EdR Fund – Convertible Europe All Caps, which was launched in 2001, offers investors active, high-conviction investing with no rating or capitalisation size constraints. This allows it to invest across all European convertible bond markets so as to tap into a broad range of opportunities.

With neither rating nor capitalisation size constraints, we can decide on significant exposure to very promising market segments like high yield or small/mid cap companies. However, we always ensure that our allocation maintains a certain balance.

For example, the portfolio has currently around 50% in high yield bonds. High yield is now more attractive than investment grade debt and, just like small and mid cap companies, is more sensitive to the European economic recovery.

Thanks to this favourable backdrop, the fund has gained 5.3% YTD² and ranks first in the Morningstar *Convertible Bonds Europe* category³. A pioneer in convertible bond management, Edmond de Rothschild Asset Management has developed specific expertise in European convertibles over more than 20 years and now has EUR 2.5bn under management (as of end of April 2014).

You mentioned that some bonds were expensive. What solutions have you found to deal with this?

Some convertibles can lose their optimal profile

when their convexity deteriorates. And even if the new issues market is still buoyant, the convertible bond universe can be narrow.

But thanks to our team's experience and its investment process, we have been able to “recreate” certain convertibles by combining a traditional bond with an option. Listed options help recreate certain convertibles and maximise their convexity.

We have used this process to create synthetic versions of convertibles that struck us as overvalued. This was the case recently for Deutsche Post and Buzzi Unicem. Instead of subscribing to the Buzzi Unicem issue, we preferred to hold Lafarge bonds and options.

This strategy helps offset these constraints and even gives us access to a larger company universe, notably companies which have no outstanding convertibles like Essilor and Pernod Ricard.

Company Profile:

With 6 investment hubs in the world (France, Switzerland, Germany, Hong Kong, Luxembourg and the UK), Edmond de Rothschild's asset management division is positioned as a multi specialist investment firm. We seek long-term performance through active investing and strong convictions based on a tradition of constant innovation.

This builds on recognised areas of expertise such as European and US equities, corporate debt, multi manager, overlay, asset allocation and quantitative asset management.

Edmond de Rothschild's asset management division had close to EUR 45bn under management at December 31 2013 and employed 550 people including 100 investment professionals.



**EDMOND
DE ROTHSCHILD**

Past figures refer to previous years and are not a reliable indication of future returns.

¹ Source: Deutsche Bank

² Performances & rankings as of 30/04/2014. Data for the A share. Since inception (06/03/2001), the A share posted a performance of +68,11% versus +59,00% for its benchmark (Exane Euro Convertibles Index).

³ Morningstar category: Convertibles Europe. The Morningstar rankings are not market rankings and cannot be interpreted as recommendations to buy, sell or hold the shares or units of the above mentioned Fund. The references to market rankings or awards of these funds are not a reliable indicator of the future results of the Fund or of the Management Company. Source - © 2014 Morningstar, Inc. All rights reserved.

EdR Fund - Convertible Europe All Caps is a sub fund of the Luxembourg regulated SICAV which is approved by the CSSF. The investment company, EdRIA has delegated management of the subfund to EdRAM (France).

Subfund risk profile: Due to its risk/return profile, the fund is ranked in the risk class 4. The sub fund's investments are subject to the usual market fluctuations and other risks inherent to investments in securities and there is no guarantee that the capital invested will appreciate or that distributions will be made. The price of investments and the income they generate, and thus the price of the sub fund's shares, may fall as well as rise; there is a risk investors may not recover the amount invested. Investors should be aware that the sub fund may be exposed to credit risk.

May 14 2014. Non-binding document This document is for information only.

Disclaimer

All potential investors should consult their service provider or advisor and exercise their own judgement independently of and Edmond de Rothschild Group entity, and Edmond de Rothschild Asset Management (France) and Edmond de Rothschild Investment Advisors in particular, on the risks inherent to each investment and its suitability to their own personal and financial circumstances. To this end, investors must acquaint themselves with the key investor information document (KIID) that is provided before any subscription and available at www.edmond-derothschild.eu tab «NAV Center» or on request from the head offices of Edmond de Rothschild Asset Management (France) and Edmond de Rothschild Investment Advisors.