CONVERTIBLE BONDS:
AN ATTRACTIVE ASSET CLASS IN TODAY'S ENVIRONMENT

Convertibles are hybrid securities combining features of both bonds and equities with the capability to give investors access to "best of both worlds". In today's volatile equity markets and low interest rate environment, they are particularly interesting.

How have convertible bonds fared in 2015?

2015 equity markets got off to a very strong start, particularly in Europe, and convertible prices quickly benefited. But from April onwards, events like the Greek crisis, strong tensions in China and persistent worries over a rate hike in the US started to trouble international bond and equity markets.

However, convertibles managed to perform well and proved relatively resilient, cushioning equity falls and posting the best performance in the bond universe. Convertibles stood apart because of their convexity, i.e. the capacity to capture a relatively large percentage of the equity market rise whilst cushioning losses in down periods thanks to their bond floor.

As a result, European convertibles have so far risen 2.3%[1] in 2015 compared to only 1% for the MSCI Europe equities index. This also compares favourably to other fixed income styles, with the High Yield € category up 1.7%[1] while Investment Grade € credit is in negative territory.

This year has illustrated the value of convertible bonds, they are a credible alternative to equities and can also outperform the bond universe during low interest rate periods.

Which zones or investment themes look the most promising?

Europe is our favoured zone due to good fundamentals, structural reform, a gradual return to growth and the ECB's accommodating monetary policy which is set to continue. Company results have also been generally upbeat. At the same time, support will come from the weak euro and cheap commodities, notably (oil and steel) provide further stimulus.

Meanwhile, the US is more advanced in the cycle. Consumption was an interesting theme last year but is no longer as appealing. With interest rates predicted to rise soon, and after 5 continuous years of positive returns from equities we are more cautious of the US market. Nevertheless, there are still some opportunities on what is the world's largest and most diversified bond universe. Japans macroeconomic outlook looks promising but the universe is generally limited and its convexity is not very interesting.

Lastly, we are cautious the Emerging Markets bond market for two reasons; firstly the economic slowdown is hitting several large countries and the number of new bond issues has slowed dramatically limiting liquidity.

As far as themes this year are concerned, M&A is still interesting both in Europe and the US. European consumption is at the heart of our strategy. Europe is fortunate in having a broad consumer base and we believe consumption will act as a big macro catalyst.

Other themes like US technology or spin-offs have also made a solid contribution to our portfolio's performance.

Issuance in the first half came to an impressive USD 50bn. Do such strong volumes necessarily correspond with opportunities?

The convertible universe is gradually being refreshed in 2015 with new issuance running at the same pace as 2014. The US still represents more than 50% of this, Europe 28%, Asia ex-Japan 10% and Japan 9%[2].

This year saw some mega issues: of the 14bn USD in European issuance, close to half came from the KPN Mobil, Telecom Italia and Aabar Investments deals. New companies like Whiting Petroleum, FireEye, Airbus, and Outokumpu have appeared on the international convertibles market. Despite their large size, these new issues have not always represented good value opportunities. When interest rates are low, spreads tight and equity markets are flirting with all-time highs, conversion prices are typically very high as a result convertibles can produce negative yields. Issue conditions like these lead us to be very selective.

Which funds are particularly well-adapted to the current environment?

We have a comprehensive range of 5 open-ended funds covering all geographical zones. Due to our strong convictions on European equities today, we prefer EdR Fund - Convertibles Europe All Caps. The fund, which has a dynamic profile with no rating or capitalisation size constraints, can tap into varied opportunities and especially companies which are tied to a European recovery. The fund has risen by close to 4% in 2015, outperforming its benchmark by 1.3%[3].

Another of today's interesting solutions is the EdR Global Convexity fund. Launched 3 years ago, it invests across all international markets using a prudent approach and keeping volatility under control. Equity market sensitivity varies between 15% and 35%. The fund can also synthetically replicate convertibles so as to optimise their risk profile and has an attractive risk/return profile. Given the fraught situation in certain zones, such an approach makes a lot of sense.

Laurent Le Grin, Head of Convertible Bonds, Edmond de Rothschild Asset Management

Edmond de Rothschild Asset Management has more than 20 years of experience in convertible bonds and is one of Europe's largest players as far as assets under management are concerned. Our dedicated convertibles team is part of the Corporate Debt division which houses Edmond de Rothschild Asset Management's ten private debt experts and thrives on strong interaction with the firms other investment areas.

Company Profile:

Founded in 1953 by Baron Edmond de Rothschild and presided over since 1997 by Baron Benjamin de Rothschild, the Edmond de Rothschild Group specialises in Asset Management and Private Banking. As of 31 December 2014 the Group holds €136 billion of assets under management and employs nearly 2700 employees spread across 31 offices, branches and subsidiaries throughout the world. In addition to its core businesses of Asset Management and Private Banking, the Group is also active in Corporate Finance, Private Equity and Fund Administration.

With 6 investment hubs in the world (France, Switzerland, Germany, Hong Kong, Luxembourg and the UK), the Edmond de Rothschild Group is positioned as a multi-specialist investment firm in Asset management. This builds on recognised areas of expertise such as European and US equities, corporate debt, multimanager, overlay, asset allocation and quantitative asset management.

In Asset Management, the Edmond de Rothschild Group had close to EUR 49bn under management on December 31st 2014 and employed 530 people including 100 investment professionals.

FOOTNOTES

[1] **Figures refer to previous years. Past performance is not necessarily a guide to future returns.** Data from 31/12/2014 to 01/09/2015. Source: Bloomberg – Edmond de Rothschild Asset Management (France) Indices: Exane Euro Convertibles (European convertibles), BofA Merrill Lynch BB-B Euro Non Financial (High Yield €). Cumulative returns for the fund's A shares over 5 years: +26.93%.

[2] Source Edmond de Rothschild Asset Management (France). Data at 30/06/2015

[3] Figures refer to previous years. Past performance is not necessarily a guide to future returns. Data from 31/12/2014 to 01/09/2015. Source: Edmond de Rothschild Asset Management (France). Cumulative returns for the fund's A shares over 5 years: +26.93%.

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