Pioneers in Convertibles for over 40 years

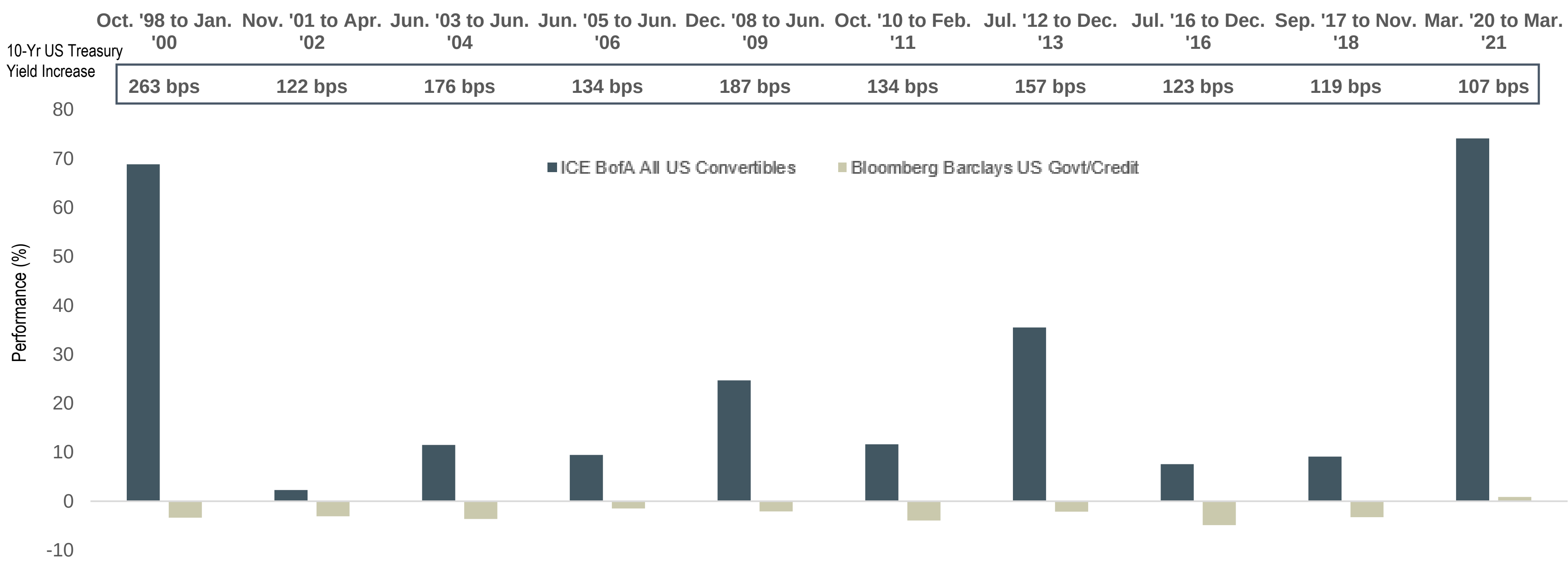
Convertible IQ

With Yields in the High Yield Market at All Time Lows, Investors Should look to Convertibles as a Viable Alternative

Allocators and consultants continue to seek out alternative options to a *core fixed income* allocation as concerns grow over rising rates and the possibility of heightened volatility. As rates have continued to rise, investors are turning to less liquid or non-core options and one of the asset classes that is commonly utilized is the high yield market. This has led to yields of high yield bonds steeply declining to all-time lows of sub 4% and when you combine that with rising interest rates and impending inflation fears, the outlook for the asset class is in question. We believe that this is an opportune time to seek alternatives and one of the optimal allocations given the current environment includes actively managed convertible strategies.

Convertibles have historically performed well in a rising rate and increasing volatility environment. The following chart provides a historical perspective on how convertibles performed when interest rates rise (Chart 1):

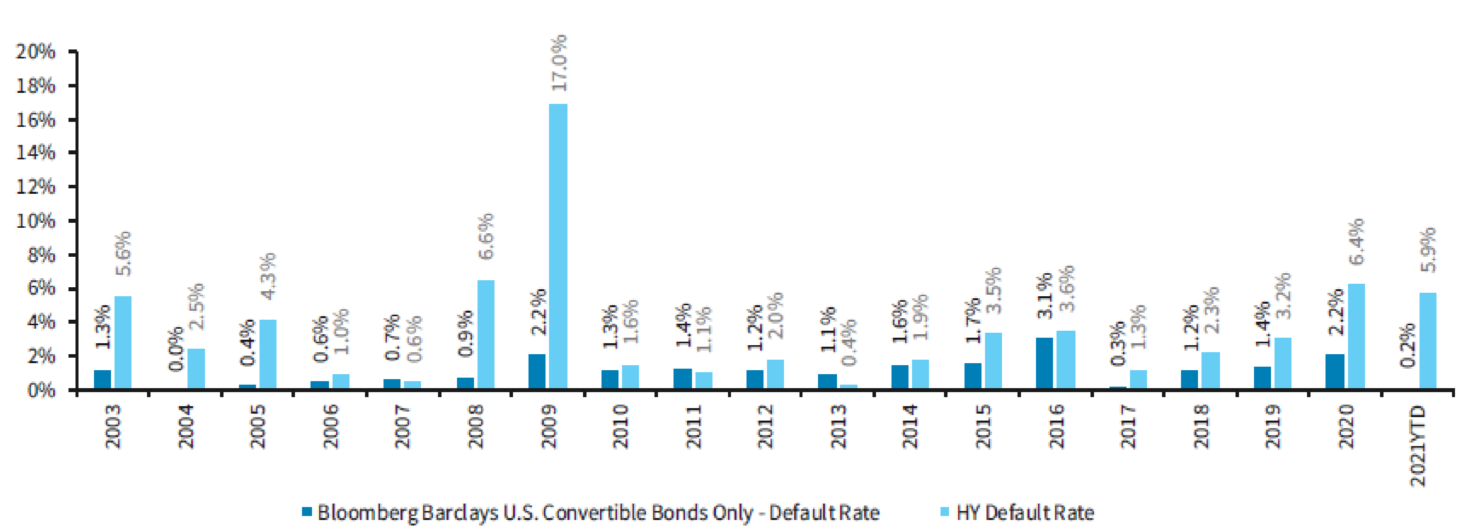
Chart 1: Convertible Bond Performance in a Rising Interest Rate Environment*



** 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.*

A convertible allocation can serve as a non-core option in a fixed income portfolio. When compared to high yield investments, the credit quality profile of convertibles is historically superior to high yield and they have also provided investors with a lower default rate compared to high yield. From 2003-2020, US convertible bonds had a 1.2% average annualized default rate, which was much lower compared to the 3.6% average default rate of the high yield market over the same period (Chart 2).

Chart 2: Lower Annualized Default Rates Convertible Bonds vs. High Yield
(January 2003 – March 2021)



YTD 2021 from 1/1/2021 – 3/31/2021; US Convertibles Bonds securities only
Source: Barclays Research accessed 5/3/2021

Continued

About SSI

- Founded in 1973
- Headquartered in Los Angeles, CA
- $2.72 Billion AUM
- Registered Investment Advisor
- 29 Employees
- 11 Investment Professionals

Unlike high yield, the convertible market is not dominated by highly leveraged companies. They are most notably found in companies that are high growth sectors such as Information Technology, Consumer Discretionary, and Health Care (Table 1). This sector exposure is not typically found in the high yield market..

Table 1: Unlike High-Yield, Convert Market is Not Dominated by Leveraged Companies

	Net Debt to EV (as of 12/31/2020)			
GICS Sectors	Aggregate	25th Percentile	Median	75th Percentile
	%	%	%	%
Communication Services	23.40	-3.80	8.20	33.00
Consumer Discretionary	-1.80	-1.90	1.60	20.10
Consumer Staples	27.60	18.20	23.40	25.40
Energy	38.70	38.30	61.90	75.40
Financials	61.70	32.80	61.70	76.00
Health Care	**9.00**	**-5.00**	**1.30**	**18.20**
Industrials	20.20	11.30	20.60	42.50
Information Technology	**0.10**	**-4.10**	**0.20**	**7.90**
Materials	26.90	9.20	19.60	36.10
Real Estate	37.30	27.30	42.30	62.20
Utilities	33.80	34.70	39.40	43.70
Whole Universe	**13.00**	**-2.10**	**9.00**	**36.40**

Source: Barclays Research as of 12/31/2020

Other advantages convertibles provide as an alternative solution for high yield investors include:

- Favorable duration profile of less than 2
- Gain risk-controlled equity exposure due to protection of principal investment
- Stronger overall credit profile
- Higher risk premium – higher yield relative to comparable credits
- Better protection in tail risk scenario
- Less leverage - attractive Net Debt/ EBITDA ratios

For more information, please contact SSI

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