Asset View

Whitepaper

CONVERTIBLES
Best of both worlds

Convertibles
Sweet Spot

Navigating with
Convertible Bonds

U.S. convertibles:
An opportune time to invest when hybrid features can help protect portfolios

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CONTENTS

Credit-Focused, Multi Strategy Asset Management

CQS is a credit-focused multi-strategy asset manager founded by Sir Michael Hintze in 1999. We are an active asset manager with expertise across the credit spectrum, including corporate credit, structured credit, asset backed securities, convertibles and loans.

Our deep experience allows us to offer solutions for investors across a range of return objectives and risk appetites.

We are committed to delivering performance and high levels of service to our investors. CQS has offices in London, New York, Hong Kong and Sydney. Our investors include pension funds, insurance companies, sovereign wealth funds, funds of funds and private banks.

NN Investment Partners is the asset manager of NN Group N.V., a publicly traded company listed on the Euronext Amsterdam. NN Investment Partners with its Dutch roots and a heritage dating back to the 1845 offers its institutional and individual investors expert solutions in fixed income, both public and private markets and multi-asset solutions. NN Investment Partners manages over USD 250 bln in assets across 16 countries in Europe, US, Middle East and Asia.

Putnam Investments incepted in 1937. In the 1960s, Putnam entered the institutional investment marketplace with a dedicated defined benefit investment program while also becoming one of the first architects of defined contribution plans. In 1983, the firm expanded operations globally.

Putnam manages $163 billion in assets, $88 billion of which comprises institutional investor assets across fixed income, equity, global asset allocation, and alternative investment strategies, as of June 30, 2017. With offices in Boston, London, Frankfurt, Tokyo, Singapore, and Sydney, Putnam manages money for a broad range of global clients including endowments, foundations, retirement plans, and sovereign entities.

INTRODUCTION
Convertibles Whitepaper

Best of both worlds

For income-focused investors looking to tap into equity performance, while taking less risk, convertible bonds may well be just the ticket.

A convertible bond is one that can be converted into a predetermined amount of the company's equity at specific points during its life, so they combine the characteristics of more traditional bonds — including a maturity date, principal repayment at maturity, a fixed coupon payment and a credit rating — with more equity-like characteristics.

Proponents state that convertibles could help lower schemes' vulnerability to rising interest rates as they are less sensitive to rate moves compared with that of gilts and traditional bond investments and are coupled with the ability to give investment managers the flexibility to invest across the capital structure.

But whilst there are some strategic diversification benefits to this asset, could the underlying investment characteristics be replicated using a combination of corporate bonds and equities? If this is to be believed then one needs to assess the additional governance associated with a dedicated allocation to convertible bonds. Given that issuers are usually smaller, growth companies with lower credit ratings that are trying to reduce their borrowing costs by offering the equity incentive as part of their debt. Additionally not all companies issue convertibles, and one would have to assess whether the companies that are issuers, are concentrated in specific sectors ; such as we witnessed with the dot.com bubble. Having said that, if there is a bust within these sectors, at least the convertible bonds could potentially continue to pay a coupon.

Given that 2017 has been a year where protection featured as an important focus for investors' asset allocation, it makes sense to build up smart equity exposure and convertibles fit neatly between a pension scheme's allocation to equities and corporate bonds.

As the following articles will emphasise, comparing convertible bonds to other asset classes, the advantages are quite compelling: low duration risk, strong stock market participation on the way up, in built inflation adjustment, effective protection against short-term set-backs, and to top it all, an under-researched and overlooked asset.

“Given that 2017 has been a year where protection featured as an important focus for investors' asset allocation, it makes sense to build up smart equity exposure and convertibles fit neatly between a pension scheme's allocation to equities and corporate bonds.”

Written by Natasha Silva
Director, Client Relations
CAMRADATA

Convertibles Sweet Spot

We believe that convertibles are particularly attractive and timely in the current market environment due to their asymmetric investment profile.

Over the long-term a strategic allocation to convertibles has afforded investors equity-like returns with a lower risk profile and negative correlation with global government bonds.

The Tactical Attraction of Convertibles

In our view convertibles represent an attractive tactical investment opportunity due to the changing investment landscape.

Convexity in an Environment of Greater Corporate Change

We believe that we are experiencing a period of heightened corporate change driven by multiple factors including rapid advances in technology, the global economy and shifts in government policy. The environment of greater change and greater dispersion in equity returns is positive for convertibles - simply, the asymmetric payoff profile of convertibles 'plays out' more in this type of environment, where there are both more winners as well as more losers, given the downside protection offered by convertibles.

Upside Exposure to a Potential Shift from Deflationary to more Inflationary Environment

Convertibles are generally well-placed to benefit from any asset class rotation from fixed income to equities. Convertibles have tended to do well in more inflationary environments due to their underlying equity exposure.

Positive Exposure to Corporate Activity and M&A

Greater corporate change will likely increase M&A and other corporate activity, from which convertibles are often well-placed to benefit. M&A activity can be especially helpful to convertible investments as convertibles participate in the equity upside, often with enhanced terms.

> "Over the long-term a strategic allocation to convertibles has afforded investors equity-like returns with a lower risk profile"

Benefit from Volatility

The theoretical valuation of convertibles is positively affected by volatility. Importantly, convertible securities are currently being priced off very low levels of overall equity volatility, and their relative valuation should increase with rises in volatility.

Positive Outlook for New Convertible Issuance

We expect rising interest rates and potential changes to US corporate tax to increase convertible issuance. Global issuance in 2017 to date has been healthy at $60 billion[1]. More issuance increases the investment opportunity set in convertibles and also the potential for idiosyncratic profits generated from new issues being priced to sell.

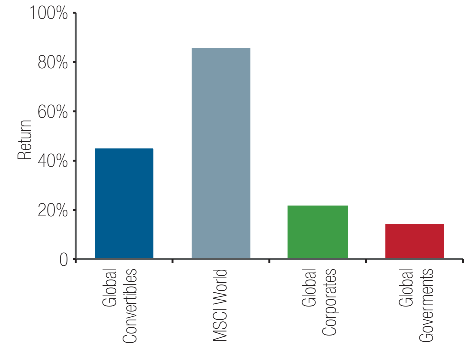
Protection from Rising Interest Rates

Convertibles are a short duration asset class and have demonstrated minimal to negative correlation to government bond market returns.

Convertible bonds have an effective duration of approximately 2.6 years, which compares to the effective duration of high yield of 3.9 years and investment grade credit of 6.7 years[2]. The short effective duration of the convertible market means that convertibles can be expected to outperform other credit asset classes in periods of rising interest rates. This has been observed in previous periods of rising interest rates, as illustrated by Figure 1.

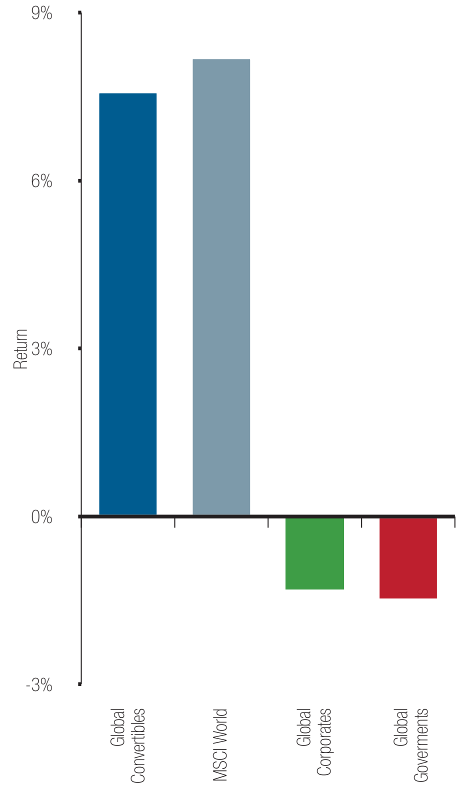
Figure 1: Convertibles in Rising Rate Environments[3]

Rising Interest Rates:
1 January 2003 – 31 December 2006



1. Source: UBS Convertibles Marketing / MACE to 30 September 2017. 2017 is annualised based on year-to-date data.
2. Bloomberg and CQS analysis as at 29 September 2017.
3. Bloomberg, BofA Merrill Lynch (ML) and MSCI. Global Convertibles: BofA ML Global Convertible Master Index (VG00). MSCI World: MSCI World Equity Index. Global Corporates: BofA ML Global Broad Market Corporate Index (G0BC). Global Governments: BofA ML Global Government Bonds Index (W0G0) and MSCI World Index. All indices are total return and US dollar hedged.

Taper Tantrum:
1 April 2013 – 31 September 2013



The Strategic Attractions of Convertible Bonds in a Portfolio

As shown in Figure 2, convertible bonds have outperformed equities, corporate bonds and government bonds over the long- term, while demonstrating lower volatility than equities.

Equity-like Returns with Lower Volatility

As illustrated in the risk and return data in Figure 2, convertible bond returns have matched or exceeded the returns of global equity market indices over the long-term, with lower volatility. Given these historic returns, convertible bonds tend to 'displace' equities in portfolio optimisation. In practice the relative size of the global convertible bond and equity markets (at approximately $380 billion and $70 trillion respectively[2]) limits implementation of the theoretically optimised asset allocation, however there remains a clear case for a long-term allocation to convertibles in addition to equities.

Figure 2: Asset Class Performance Analysis[4]

Asset Class	Return p.a.	Volatility p.a.	Sharpe
Global Convertibles	6.5%	8.9%	0.43
MSCI World	6.1%	14.4%	0.24
Global Corporates	5.8%	3.9%	0.82
Global Governments	5.1%	3.1%	0.82

Negative Correlation with Global Government Bonds

Convertible bonds have a negative correlation with government bonds. Looking at data from 1996, which includes the 2008 credit crisis period, the correlation is (0.24)[5]. We believe the short effective duration of convertible bonds will continue to support this view in the short-term.

Convertible Bond Outperformance of, and Moderate Correlation with, Corporate Bonds

Convertible bonds have similarly outperformed investment grade corporate bonds, while correlating moderately with them (we estimate correlation of approximately 0.40)[5]. We believe this strengthens the argument for employing convertible bonds as a diversifying asset, which is likely to be additive to a portfolio's anticipated return per unit of risk ('risk-adjusted return').

Solvency II

We believe that convertible bonds can offer attractive risk-reward opportunities for European insurance companies under Solvency II regulations. Convertible bonds typically have low duration and offer an attractive convexity: the bond-like floor offering downside protection with a significant proportion of the upside of equities. The Solvency Capital Requirement that applies to convertible portfolios can be as little as half that of equities, while over the long-term, convertible portfolios can offer equity-like returns.

> "Convertible bonds have outperformed equities, corporate bonds and government bonds over the long- term, while demonstrating lower volatility than equities"

Conclusion

We believe that convertibles now have multiple potential tailwinds behind them:

- Central bank policy normalisation is an impetus towards greater dispersion of outcomes across markets from equities to credit, rates and foreign exchange. The asymmetric payoff profile of convertibles 'plays out' more in this type of environment
- Convertible valuations are reasonable: volatility has been driven down by strong markets – with the caveat that credit spreads are tight, driven by quantitative easing
- Greater corporate change, driven by technology and tax, will likely increase M&A and other corporate activity, from which convertibles are often well-placed to benefit
- Changing perceptions of inflation and growth and potential changes to US corporate tax are likely to increase convertible issuance
- Convertibles are a short duration asset class, have demonstrated minimal to negative correlation to government bond market returns and have strong risk-adjusted returns

About the Author

James is responsible for managing CQS' range of Long-Only Convertibles strategies.

Prior to joining CQS in 2003, James was the Global Head of Convertibles at DrKW. Before he joined DrKW, he was Head of International Convertible Research at Merrill Lynch, responsible for Europe, Asia and Japan. At Merrill Lynch, James was top-ranked by Institutional Investor magazine five years for European convertible research in addition to awards for Asian convertible research. James was previously head of International Arbitrage at Oppenheimer & Co. Inc. having started his career in the Arbitrage department of L.F. Rothschild, Unterberg, Towbin, trading convertibles and risk arbitrage opportunities.

James holds an MA (Honours) in Electrical Sciences from Trinity College, Cambridge.

CQS' Long-Only Convertibles Strategy

An active, but patiently managed, strategy which targets attractive risk-adjusted returns by investing in globally diversified portfolios of convertible securities. The strategy focuses on individual security selection aiming to maximise asymmetry of upside potential with downside protection.

Written by James Peattie
CQS
Head of Long-Only Convertibles

Article supplied by CQS

4. Bloomberg, BofA ML and MSCI as at 31 August 2017. Refer to footnote 3 for index names.
5. Bloomberg and BofA ML as at 31 August 2017.

Navigating with Convertible Bonds

NN investment partners

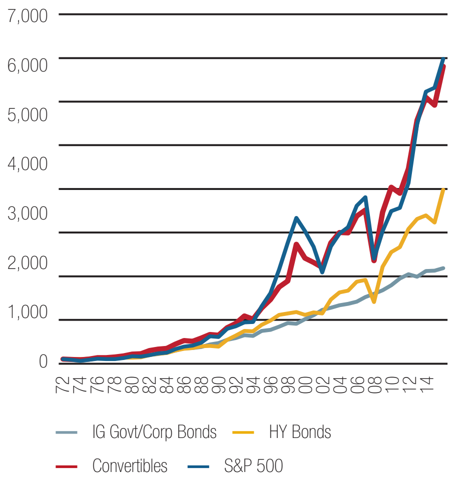
The current low-yielding world has created a new environment, upside of fixed income investments is more limited than in the past, and decisions concerning equity allocations deserve, at the very least, to be revisited. In this context, convertible bonds are definitely worth a consideration.

Convertible bonds display asymmetrical returns; they offer equity-like returns with less volatility and downside protection beyond a certain point.

History shows that the convertible indices have slightly outperformed equity and bond indices. More importantly they have dampened equity volatility by reducing the full impact of the peaks and troughs of market cycles.

Figure 1 illustrates this point; we look at the US market from 1973 through to 2015. 1973 to 1999 equities drove the growth in asset prices, far ahead of fixed income. We note convertibles followed closely, capturing 75% of equity performance.

Figure 1. US asset classes total return (1972 = 100)

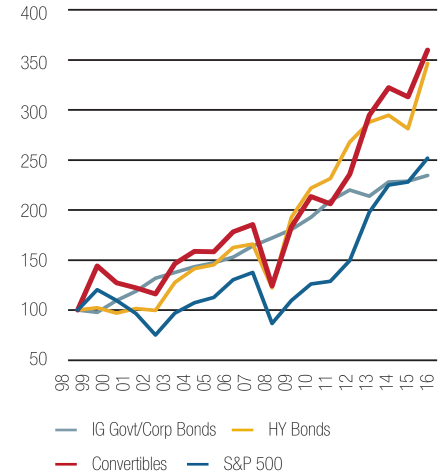


As shown in Figure 2, the story, however; was very different in the period 1999 to 2015.

Equity markets suffered two severe downturns and recoveries, in what was overall a much more volatile environment. Driven by the governments' concerted effort to drive down rates and a contained default rate has resulted in a very strong performance in fixed income.

Convertibles, whose bond element enabled them to benefit from these factors, significantly outperformed equities as well.

Figure 2. US asset classes total return (1998 = 100)

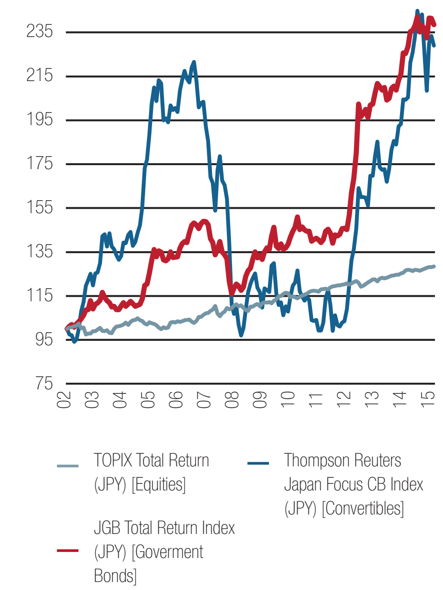


In addition to their ability to benefit from the bull markets of both asset classes during different periods, global convertibles have shown a volatility that has on average been about 45% of that of equities. Some of the drivers of the relative performance of convertible bonds are tied to the credit characteristics of the underlying issuers and the returns of the underlying stocks. A fair compensation for credit risk associated with a lower historical default rate of issuers displaying a moderate leverage, as well as a better performance of underlying equities.

Convertible bonds and a low yield environment

The consensus is that the global economy will be characterised by low growth, low interest rates and compressed credit spreads for the foreseeable future. The situation is similar to the one experienced in the past by Japanese institutional investors with constraints to invest in JPY-denominated assets. Whilst today's global economic environment is different to that faced by Japan over the last decade, there are some key similarities. Japan experienced negative real yields, where convertibles bonds were issued with a zero coupon and redeemed at par. A situation similar to what we are experiencing now in Europe, as real yields have continued to fall. In Figure 3 the Japanese experience is captured, it shows that convertible bonds are still able to benefit from the rise in equity valuations and deliver a respectable return. JPY bond market returns were mediocre while Japanese equity returns had a wide dispersion.

Figure 3. JPY asset classes total return (2001-2014)



Overall, Japanese convertibles delivered the best returns over the period. This outcome demonstrates the quality and stability of convertible returns in a period where bonds have low carry and equity returns are volatile and uncertain.

Convertible bonds and a rising interest rate environment

As bond investments, convertibles might be expected to be negatively impacted by a rise in yields. In fact, we have observed the opposite: periods of rising Treasury yields have consistently been periods of very strong equity returns over the past 30 years. Since 1983 we have had eight periods, totaling 48 quarters during which Treasury yields have attempted to break their declining trend. These periods demonstrated solid equity returns with an average annualised return of 18%. During the six periods/ 33 quarters of rising treasury yields that took place within the recorded history of the Thomson Reuter Global Convertible Index, the annualised return of this convertible index was 20%. The asymmetric return profile of convertible bonds allows then to capture this strong equity upside.

Looking into 2018 and beyond, we consider that the relative case for convertible bonds is stronger than ever. Convertible bonds historically competed with high yield, with similar expected return/volatility characteristics. Both asset classes ranked highly in terms of expected efficiency and demonstrate moderate correlation. Given the unprecedented tightening in credit, and more specifically in high yield, our preference now leans towards convertible bonds, which remain close to average historical valuation levels.

With respect to equities, the valuation argument stands as well: equities have steadily been rising, which makes equity downside protection an even more valuable merit. Additionally, we expect equity markets to become more discriminating in the wake of higher rates. This should lead to more return dispersion and less correlation. A convertible bond fund, as a basket of convex exposures to equities, tends to perform better in relative terms when correlation decreases.

There is more to convertibles than their traditional tactical risk-on/risk-off use by either bond or equity investors. Their asymmetrical returns and ability to perform well in low yield and rising rate environments provides a strong case for being part of the strategic asset allocation, rather than a mere tactical play.

At NN Investment Partners we manage an investment strategy well-suited to capturing the essence of the opportunities offered by the convertible bond market. Our strategy offers a higher relative risk-adjusted expected return, equity participation with contained expected volatility and downside protection. Our strategy is global, supported by in-depth credit research and concentrated on a selective number of convertibles that combine solid credit fundamentals, underlying equity upside and a balanced convertible profile with attractive valuations; managed by a team with extensive experience.

Written by Tarek Saber

NN Investment Partners
Head of Convertible Bonds

Article supplied by NN investment partners

CAMRADATA

Upcoming conferences

Investor Conference

Incorporating Change, Driving Potential

Grocers' Hall, Princes Street, London EC2R 8AD

30 November 2017
9.00 - 16:00: Including lunch and drinks

CAMRADATA's Investor Conference will highlight how institutional investors can adapt to ongoing changes in the financial markets and investigate opportunities that offer potential for maintaining and generating return for the future.

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All our events are free to institutional investors and investment consultants.

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Convertibles: An opportune time to invest when hybrid features can help protect portfolios

Putnam INVESTMENTS

With central banks beginning the process of normalizing monetary policy and equity valuations at elevated levels, convertible securities may offer an attractive asset for investors whose investment objectives may include current income and total return potential, while also lowering portfolio volatility.

After an extended bull market in global equities and corporate credit securities, investors may be thinking about reallocating assets within their portfolios. Investors seeking attractive risk-adjusted returns should consider an allocation to convertible securities, which offer investors many of the advantages of both equities and fixed income in a single investment. As hybrid securities, some potential benefits of this asset class include:

- Equity upside participation with historical long-term performance comparable with that of major equity indices.
- Potential downside protection; convertibles' fixed-income characteristics may provide a floor when the underlying equities decline in value.
- An attractive income stream with limited exposure to rising interest rates.
- Diversification that may enhance portfolio efficiency.

Offensive strategy: Equity exposure with less historic volatility

Convertible securities are typically issued as bonds or preferred shares that pay current income while giving the owner the right to convert the security to a specific number of shares of common stock at a predetermined "conversion" price. Convertibles tend to take on their equity characteristics during rising markets due to an embedded call option feature that links the securities to the performance of their underlying stocks. When the underlying stock price is higher than the conversion price, the convertible is "in the money" and behaves more like a stock. In this case, the convertible has a higher delta, or greater price sensitivity to changes in the underlying stock. When the underlying stock price falls below the conversion price, the convertible is "out of the money" and has a lower delta. In this scenario, the convertible behaves more like a bond and is therefore less equity sensitive.

Over time, convertible securities have generally provided asymmetric returns — capturing more of the upside potential when stock markets rallied and experiencing less downside price deterioration than stocks when equity markets declined. Furthermore, convertibles have offered returns more in line with large-cap stocks, on average, in rising equity markets while generally helping to protect principal when equity markets were falling.

From December 31, 1994, through December 31, 2016, the annual average upside capture rate for convertibles was 74%. Conversely, the average downside capture rate for the same time frame was 44%. Convertibles generally moved lower during market declines, but at a slower rate than stocks because the coupon and the issuers' obligation to repay the investors at par upon the bonds' maturities helped support the convertibles' valuations.[1]

The bottom line? By losing less ground in declining equity markets and capturing a significant portion of their upside performance over time, convertibles may continue to offer investors a superior risk-adjusted return alternative to directly owning stocks.

Defensive strategy: Low sensitivity to interest rates

A common misperception about convertibles is that their return performance depends more on interest rates than on other factors. However, data suggest that over time, convertibles are driven more by the strength and weakness of the equity markets and corporate credit spreads than by rates. In fact, convertibles historically have performed well amid rising interest rates because of their sensitivity to underlying equities. In looking at the most recent rising-rate environments — 1988, 1994, 1999–2000, 2004–2006, and the current period since December 2016 — higher rates, economic expansion, and equity market strength led to solid performance for the asset class.

Since convertibles have low duration, or interest-rate sensitivity, they do not perform like traditional fixed-income securities such as corporate bonds, which are closely correlated to U.S. Treasuries and generally fall during periods of rising interest rates. Convertibles have approximately one third the duration of longer-maturity investment-grade bonds as well as roughly half the duration of high-yield bonds— providing more support to the asset class during periods of rising rates.

1 Sources: Putnam, BofA Merrill Lynch, as of 12/31/16. Data based on BofA Merrill Lynch U.S. Convertibles Index. Upside capture rate is the percentage that convertibles increased in value relative to their underlying stock price increases in up years. Downside capture rate is the percentage that convertibles decreased in value relative to their underlying stock price decreases in down years. Past performance is not a guarantee of future results.

An attractive diversification opportunity for more conservative investors, convertibles have often outperformed fixed-income assets

Calendar-year total returns ranked from best to worst for various asset classes

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	YTD 2017 (8/31/17)
Best	MSCI World 20.07%	Global Aggregate 9.48%	U.S. Gov't Bonds 12.39%	Global High Yield 60.91%	U.S. Converts 16.77%	U.S. Gov't Bonds 9.02%	Global High Yield 18.29%	MSCI World 26.68%	U.S. Converts 9.44%	Global Converts 3.83%	Global High Yield 15.69%	MSCI World 13.47%
	Global Converts 15.42%	MSCI World 9.04%	Global Aggregate 4.79%	U.S. Converts 49.13%	Global High Yield 15.26%	U.S. IG Bonds 8.15%	EM Hard Currency 17.44%	U.S. Converts 24.92%	U.S. IG Bonds 7.46%	EM Hard Currency 1.18%	U.S. Converts 10.43%	U.S. Converts 10.47%
	U.S. Converts 12.83%	U.S. Gov't Bonds 8.66%	U.S. IG Bonds -4.94%	EM Hard Currency 29.82%	EM Hard Currency 12.24%	EM Hard Currency 7.35%	MSCI World 15.83%	Global Converts 13.03%	EM Hard Currency 7.43%	U.S. Gov't Bonds 0.86%	EM Hard Currency 10.15%	EM Hard Currency 8.98%
	Global High Yield 10.80%	Global Converts 8.59%	EM Hard Currency -12.03%	MSCI World 29.99%	MSCI World 11.76%	Global Aggregate 5.64%	Global Converts 11.26%	Global High Yield 7.27%	MSCI World 4.94%	U.S. IG Bonds -0.68%	MSCI World 7.51%	Global Aggregate 7.22%
	EM Hard Currency 9.86%	EM Hard Currency 6.16%	Global High Yield -26.63%	Global Converts 23.91%	Global Converts 9.38%	Global High Yield 3.16%	U.S. Converts 14.96%	U.S. IG Bonds -1.53%	U.S. Gov't Bonds 4.92%	MSCI World -0.87%	U.S. IG Bonds 6.11%	Global High Yield 6.28%
	Global Aggregate 6.64%	U.S. IG Bonds 4.56%	Global Converts -27.61%	U.S. IG Bonds 18.68%	U.S. IG Bonds 9.00%	Global Converts -4.58%	U.S. IG Bonds 9.82%	U.S. Gov't Bonds -2.60%	Global Converts 4.73%	U.S. Converts -2.99%	Global Aggregate 2.09%	U.S. IG Bonds 5.37%
	U.S. IG Bonds 4.30%	U.S. Converts 4.53%	U.S. Converts -35.73%	Global Aggregate 6.93%	Global Aggregate 5.54%	U.S. Converts -5.18%	Global Aggregate 4.32%	Global Aggregate -2.60%	Global High Yield 3.00%	Global High Yield -3.07%	Global Converts 1.59%	Global Converts 4.93%
Worst	U.S. Gov't Bonds 3.48%	Global High Yield 2.09%	MSCI World -40.71%	U.S. Gov't Bonds -2.20%	U.S. Gov't Bonds 5.52%	MSCI World -5.54%	U.S. Gov't Bonds 2.02%	EM Hard Currency -5.25%	Global Aggregate 0.59%	Global Aggregate -3.15%	U.S. Gov't Bonds 1.05%	U.S. Gov't Bonds 3.12%

- U.S. Converts — BofA Merrill Lynch U.S. Convertibles Index
- Global Converts — Thomson Reuters Global Focus Convertibles Index - Hedged in USD
- MSCI World — MSCI World
- EM Hard Currency — JPM EMBI Global Diversified
- Global Aggregate — Bloomberg Barclays Global Aggregate Bond Index
- Global High Yield — BofA Merrill Lynch Global High Yield IG Country Constrained Index
- U.S. IG Bonds — Bloomberg Barclays U.S. Corporate Investment Grade Index
- U.S. Gov't Bonds — Bloomberg Barclays U.S. Government Index

Source: Putnam, as of 8/31/17. Past performance is not a guarantee of future results. Indexes are unmanaged and do not incur expenses. You cannot invest directly in an index.

> "A common misperception about convertibles is that their return performance depends more on interest rates than on other factors."

Income with lower risk than equities

For investors seeking income in today's relatively low-interest-rate environment, the yield offered by convertible securities is noteworthy versus equities and some fixed-income alternatives.

Also, amid current concerns about extended valuations in the equity markets, convertibles' yield advantage gives them a source of returns independent of price appreciation, and, thus, a lower risk profile than owning equities directly.

Furthermore, unlike equity dividends, the convertible coupon (or dividend) is contractually guaranteed, providing investors with a more secure income stream. On August 31, 2017, the BofA Merrill Lynch U.S. Convertibles Index offered a 3.01% yield that was roughly the equivalent of that of the Bloomberg Barclays U.S. Corporate Bond Index (3.07%) and greater than that of the S&P 500 Index (2.00%).

Best of both worlds

Convertibles offer investors a unique opportunity to capitalize on the structural advantages of both equities and fixed income. On one hand, convertibles can benefit from both the attractive current income and downside protection offered by fixed-income characteristics, a benefit that eludes investors in common stock.

At the same time, convertibles can profit from the potential price appreciation of the issuer's common stock, a benefit that eludes investors in corporate bonds. Furthermore, these bonds provide investors with one of the only fixed-income investments that can increase in price more than they fall, while also having a lower correlation to both U.S. Treasuries and investment-grade corporate bonds.

Ultimately, in diversified investment portfolios, the inclusion of convertibles can improve risk-adjusted returns. As a result, institutional investors seeking lower portfolio volatility can potentially benefit from allocations to the asset class in their investment programs.

Robert L. Salvin

Putnam Investments
Portfolio Manager
Convertible Securities

Article supplied by Putnam Investments

Asset View