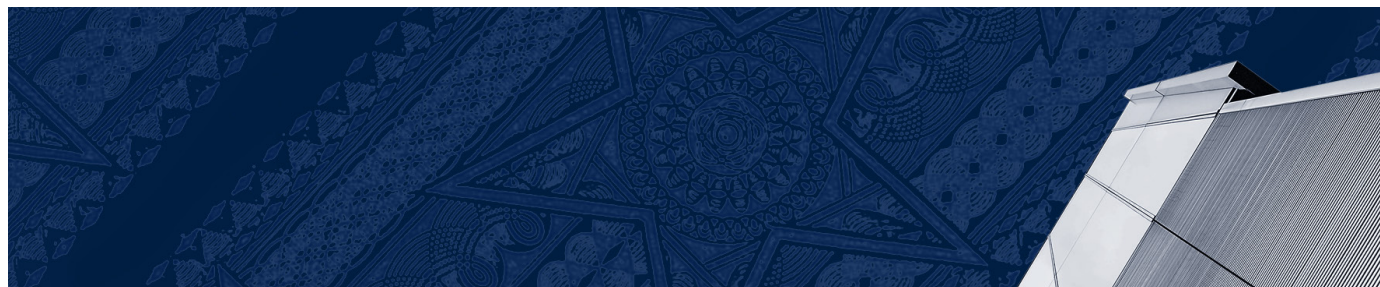




# Perspective



## How much upside for convertible bonds in 2019?

Since the beginning of the year, convertible bonds have been driven up by the equity market rally while retaining their defensive feature; an important characteristic if the economy worsens any further. Kristell Agaesse, Head of Convertible Bond, gives an update on the current situation.



**Kristell Agaesse**  
Head of Convertible Bond,  
Rothschild & Co  
Asset Management Europe

### Is the environment so far in 2019 favourable for convertible bonds?

**Kristell Agaesse:** The environment should be more favourable to convertible bonds (CB) in 2019 for several reasons. Valuations are attractive after the market downturn late last year and the market's liquidity is still quite decent. Furthermore, convertibles have tapped into the market rally so far this year, while continuing to offer downside protection. So, 2019 is a good time for both issuers and investors to look into convertibles. We are still convinced they are assets to own within a global allocation, especially as there are fewer and fewer alternatives for investors at this advanced point in the economic cycle and at current valuation levels.

### How are you navigating through this environment?

**K. A.:** Due to a challenging macroeconomic environment, we are sticking to our convictions with a pragmatic approach. We remain diversified and our sector choices are based on a medium-term vision. Convertible bonds' equity sensitivity is rising gradually, and positioning is key for riding the market rally while continuing to hedge against downside risk. We therefore select CBs on a discretionary basis and recommend being selective in the wake of the shocks experienced last year. Because we remain in a cyclically advanced position, we are on a more defensive stance and are placing close attention to risk management based on high standards of fundamental analysis.

## Why is it worthwhile for investors to hold convertible bonds in their portfolios?

**K. A.:** Convertible bonds are worth having in a portfolio for their potential for diversification, notably in terms of sectors. The convertible bond universe is unique: its bond component includes a large proportion of investment grade and non-rated bonds and its equity component offers a mix of blue chips and midcaps. Convertible bonds can therefore boost a bond portfolio but also optimise the risk-reward of an equity portfolio. Their hybrid character and medium-term investment horizon help resolve the difficult issue of the investment timing in an uncertain market environment.

## What do convertible bonds have to offer over a diversified-allocation fund?

**K. A.:** It would not be fair to compare convertibles, an asset class in their own right, to diversified-allocation funds. A convertible is not a combination of an equity and a bond. It has its own intrinsic features. For example, when equities fall by 50%, the equity manager takes the full hit, whereas in the case of convertibles, a decline in the underlying stock mainly affects its probability of conversion. Likewise, a convertible bond is less sensitive to interest-rate shifts than a “plain vanilla” bond.

Investors may convert the bond or redeem it if ever the underlying stock does not perform well enough before its maturity. So, it is like a stock with a safety cushion. This special feature creates medium-term convexity and is even more attractive as the cycle approaches its end and with the U-turn in monetary policy.

## A dedicated team and specific investment solutions

The convertible bond management team is supported by the equity and fixed-income analysts of Rothschild & Co Asset Management Europe and is composed of two senior fund managers – Kristell Agaesse and Florence de Roux – in charge of selecting CBs and constructing portfolios. This collective work is optimum for covering the investment universe and facilitate the sharing of investment ideas and newsflow. Rothschild & Co Asset Management Europe's range offers an international open-ended convertible fund and dedicated mandates.

### R-co Conviction Convertibles Europe

This fund covers the entire European convertible bond universe. The management team combines top-down and bottom-up research to seize market inefficiencies and opportunities. The fund aims to reduce idiosyncratic risk through diversification of issuers and by seeking out asymmetric investments featuring attractive risk-reward profiles. Convexity is a key objective of the investment process. Portfolio construction is based mainly on rigorous selection of convertible bonds, while options strategies help optimise portfolio diversification by sector and/or issuers.



## Why do you invest only on the European markets?

**K. A.:** We exclusively invest in Europe, as that is where we possess in-depth knowledge and long-standing experience in managing this type of funds. Conviction-based management is a full-time job. Analysts and fund managers must be able to keep up with the markets in real time, to keep track of new issues, and to devote special attention to non-rated CBs with regards to both their financial and extra-financial data.

We are active managers and pay close attention to CB-issuing companies, particularly their earnings but also their environmental, social and governance performances, their carbon trajectories, and, of course, the technical components of their CBs.

All of this is a challenging task to accomplish if you are not physically present on a market, and, correspondingly, no efficient conviction-based strategies would be possible. Finally, from a more macroeconomic viewpoint, European convertibles are an excellent diversification brick within a global allocation.

## What advantages does conviction-based management have over index management?

**K. A.:** Being a conviction-based manager adds true value in medium-term CB-picking. An index does not make any choice and cannot look in-depth into interest-rate trends, shifts in volatility, or the many macroeconomic factors involved. Indices don't think; they don't anticipate; and they don't take into account an issuer's potential or market inefficiencies. They merely aggregate CBs based on a number of criteria, with no flexibility and none of the responsiveness that is the hallmark of active management. Lastly, index management do not allow investors to control their portfolio biases, something that is completely at odds with our philosophy.

***“The hybrid character and the investment horizon of the convertible bonds help resolve the difficult issue of the investment timing...”***

| Performance                               | 2019  | 2018   | 2017  | 2016   | 2015  | 2014  | 3 years | 5 years | 1 year volatility |
|-------------------------------------------|-------|--------|-------|--------|-------|-------|---------|---------|-------------------|
| R-co Conviction Convertibles Europe I EUR | 4.86% | -7.72% | 4.18% | -0.47% | 8.83% | 1.27% | 7.31%   | 4.91%   | 4.70%             |
| Exane Europe Convertibles                 | 5.93% | -4.89% | 3.53% | -0.41% | 7.60% | 4.44% | 8.47%   | 13.99%  | 4.77%             |

Source: Rothschild & Co Asset Management Europe, 29/03/2019



### Recommended investment period: 3 years

This fund is rated in category 4 (volatility between 5% and 10%) reflecting primarily its positioning on European convertible bond markets. Historical data used to calculate the synthetic risk and reward indicator may not be a reliable indication of the future risk profile of the fund; the risk category of this fund is not a guarantee and may go down as well as up. The lowest category does not mean risk free.

The Fund is not guaranteed capital. Other important risk factors, not adequately taken into account by the indicator: credit risk, liquidity risk, counterparty risk, impact of techniques such as derivatives. The occurrence of one of these risks may result in a decrease in the Fund net asset value. More detailed information about risk profile may be found under the “Fees and Expenses” heading in the prospectus.

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