



# A LONG RECORD OF OUTPERFORMANCE AND LOW VOLATILITY ADDS TO THE APPEAL OF MONTPENSIER'S M CONVERTIBLES STRATEGY

The track record of European convertibles may surprise even the most experienced of asset allocators. Since January 1996, the Exane Eurozone Convertible Bond Index has delivered an annualized 6.2%, versus 6.4% for the Euro Stoxx 50 NR. Over the same period European convertibles volatility was 8.1% against 23% for European equities. For more than 20 years European Convertible Bonds clearly offer good risk/ returns characteristics. There is a real upside potential when investment grade bonds have almost no yield. Convertibles can capture equity-like returns for balanced fund-like volatility; say Julien Coulouarn and Bastien Rapoport, co-managers of the Montpensier M Convertibles strategy. They think investors should consider convertibles as a structural play, particularly when active strategies have the potential to deliver consistent alpha over time.

The global convertible universe is around €280 bn in size. The European convertible market is worth roughly €71 billion. The market is diverse, by issuer type and quality. More than half of the European market is investment grade, and less than 10% classified as high yield. The remainder is non-rated, but investors should not automatically assume that such issuers have junk status. Adidas and Safran choose not to be rated by the big agencies: says Coulouarn. The US convertibles market is less balanced, with a larger high yield component, driven by more aggressive tech-, biotech- and financial related issuance in recent years. Europe's equity sensitivity remains more balanced too; Europe has an average delta of 0.35 versus 0.55 in the US. Co-managers, Coulouarn and Rapoport aim to make the most of the inbuilt characteristics of European convertibles. The Montpensier M Convertibles strategy only invests in pure convertibles to maximize the benefits of convexity. The strategy does not hold straight credit, equities or derivatives. 'Convertibles have options built in that run for three or four years. We don't need to buy other options that only run for a maximum of 9-12 months. The

clauses in convertibles are unique; Rapoport says. He also thinks that managers using options have to be right very quickly or end up losing money.

Montpensier's strategy also focuses on names and issues that can balance the portfolio, reducing credit and interest risks on one side, to ensure that equity risk is contained too. When an underlying equity has had a good run, the team will look to reduce or liquidate the holding. Regarding liquidity, the team mainly steers clear of issuances under €100 million and will tend to cap exposure to larger, high conviction issues at 5%. The result is consistent outperformance. Over the five years period as of end of March, M Convertibles Is up 28,5% with a volatility of 5.4%, against a sector return of 25,8% for the same level of volatility. The strategy is first quartile over three, five and ten years'. Investors also benefit from the team's socially responsible investment policy and adherence to the UN Principles for Responsible Investment. Coulouarn admits that central bank policy and Quantitative Easing has lowered convertible spreads; implied volatility of European convertible bonds now looks relatively cheap compared US convertible bonds. Interest rates sensitivity is also much lower for convertibles than for straight bonds. Historically, rates hike periods were rather opportune for convertible bonds.

On the primary market side, issuance has been fairly strong over the last 2 years. With €25bn, 2016 was the best year since 2007. Companies see the value in convertible bonds because rates are low and a diversifying source of financing. 2017 has also enjoyed a good course at €19 bn and pricing of latest issues has shown that companies have to make fair offers in order to attract investors. Big or mid companies like Michelin, Symrise, Bayer/Covestro, Artemis/Kering, STM, Carrefour, Deutsche Wohnen, Korian, Vallourec, GN Store, Deutsche Post, AMS, Cellnex feature in the long list of recent issues. Discretionary tenders by issuers may also add value for investors: some have been priced with a substantial premium (like Nexity, Azimut, Assystem



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In a market dominated by volatility and uncertainty, convertibles are a good place to be. If you think 2018 and 2019 will be a continuation of the current long growth cycle, equities and convertible bonds will benefit. But if equities remain jumpy, the bond-like qualities of convertibles can reduce volatility, concludes Coulouarn.