

A long record of outperformance and low volatility adds to the appeal of Montpensier's M Convertibles strategy



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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 5.9%, versus 6.4% for the Euro Stoxx 50 NR. Over the same period European convertibles volatility was 8% against 22% 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 €66 billions. The market is diverse, by issuer type and quality. 52% of the European market is investment grade, and 13% 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 0.26 versus 0.52 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.

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had a good run, the team will look to reduce or liquidate the holding. Regarding liquidity, the team mainly steers clear of issuances under E100 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 September, M Convertibles is up 15.8% with a volatility of 5.9%, against a sector return of 7.8% with a volatility of 5.5%. 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 to US convertible bonds. Interest rates sensitivity is also much lower for convertibles than for straight bonds.

In terms of sector or thematic exposure, European convertible bonds allow you to be invested in interesting thematics. You can get exposed to luxury-consumption, where topline growth is expected to be around 6%/year over the next 5 years, thanks to a keep-growing Chinese consumer and strong online sales penetration (+30%/year through 2025). Artemis/Kering 2023, LVMH 2022, Adidas 2023, Kering/Puma 2022, GN Store Nord 2022, Remy Cointreau 2026 are examples of convertible plays in luxury-consumption. Aerospace expects also a strong topline growth : it should be 1.5-2 X World GDP growth over the next 3 years; Airbus 2022, Safran 2023, MTU Aero 2023, Airbus/Dassault Aviation 2021 are convertible bonds of

this sector. German Residential Real Estate also plays his role inside European convertible bonds universe. Maybe less glamorous than luxury, but nonetheless very effective in terms of performance, Deutsche Wohnen 2024 & 2026, Leg Immobilien 2025, Tag Immobilien 2022 register underlying steady growth of their businesses.

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In a market dominated by volatility and uncertainty, convertibles are a good place to be. If you think 2020 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.