Insight INVESTMENT

February 2021

GLOBAL CONVERTIBLES
BACK AND HERE TO STAY

STRONG PERFORMANCE FROM THE KEY COMPONENTS OF CONVERTIBLE BONDS – EQUITY, VOLATILITY, CREDIT AND RATES – HAS BENEFITTED BOTH LONG-ONLY AND CONVERTIBLE ARBITRAGE STRATEGIES OVER 2020. LOOKING FORWARD, EXPECTATIONS OF FURTHER VOLATILITY BENEFITS GAMMA-BASED ABSOLUTE RETURN POSITIONS, WHILE RECORD ISSUANCE BROADENS THE BREADTH AND DEPTH OF THE GLOBAL CONVERTIBLES MARKET.

A HISTORIC YEAR FOR THE ASSET CLASS

Convertible bond arbitrage strategies thrive as volatility returns to equity markets

Convertible arbitrage strategies have made something of a comeback in 2020, with the return of equity market volatility one of the key drivers of performance. The heightened volatility not only supported returns it also fuelled the market for new issuance, creating new investment opportunities and enhancing market liquidity in the process. Looking forward, with an economic recovery underway, but volatility expected to remain elevated as economies exit pandemic restrictions, we believe that convertible arbitrage strategies will remain compelling in the year ahead.

In convertible arbitrage strategies, well-constructed hedged positions can benefit from the inherent long-volatility nature of “delta-neutral” pair trades. In such trades, a long position in a convertible bond with strong credit characteristics, is hedged with a short position in the underlying equity. The resulting trade is said to be “long gamma”, in essence profiting from equity moves in both directions. In this way, convertible arbitrage strategies are well positioned to take advantage of volatile and uncertain market conditions.

Insight’s Absolute Return Global Convertible strategy

Amidst the severe market volatility over 2020, Insight’s Absolute Return Global Convertible strategy succeeded in mitigating much of the market drawdown experienced during the early part of the year as the pandemic took hold, benefitting in particular from the defensive credit characteristics of the convertible bond component when equity prices fell. As markets rebounded from April onwards, the strategy captured much of the equity market upside. Over the year as a whole, the strategy demonstrated strong positive performance with a low beta to both equity and bond markets (Figure 1).

Figure 1: Insight’s Absolute Return Global Convertible strategy – capital protection and low beta to equity markets[1]

Performance	1 month (%)	YTD (%)	1 year (%)	Since inception (pa)
Insight’s Absolute Rreturn Global Convertible strategy	1.74	1.74	9.25	9.20
1-month EURIBOR	-0.04	-0.04	-0.50	-0.47

Risk statistics (since inception)	(%)
Volatility (pa)	3.93%
Maximum drawdown	-4.91%
Realised beta to global equities[2]	0.06
Correlation to global equities[2]	0.35
Realised beta to global bonds[3]	-0.08
Correlation to bonds[3]	-0.09
Positive months	88.0%

[1] Source: Insight as at 31 January 2021. Please refer to the risk disclosures at the back of this document. Returns are shown in EUR on a net basis (with a 0.75% annual management charge and performance related fee applied). From strategy inception on 1 January 2019 to 3 June 2019, performance relates to a model portfolio. From 3 June 2019 to date performance relates to a UCITS pooled vehicle that employs the absolute return global convertible strategy. All risk statistics are calculated using daily data points. For beta and correlation calculations we have used the rolling 5 day average of the daily returns of both the portfolio and the indices in order to smooth out the volatility related to securities being priced at different times in the portfolio and the indices. [2] Relative to MSCI World Total Return Hedged EUR. [3] Relative to JP Morgan Govt. Bond Hedged EUR.

Global convertibles market now exceeds US $500bn

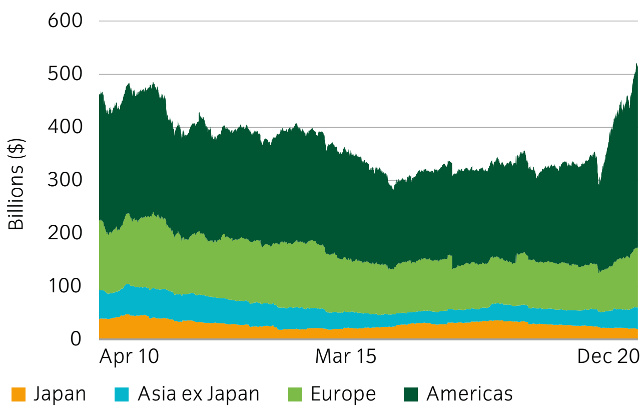
A key feature of the global convertibles landscape in 2020 was the return of new issuance. In excess of USD 160bn of paper was launched globally. In prior years, issuance levels have been suppressed as companies found plentiful cheap finance from credit markets. That all changed in the year of the pandemic.

A confluence of factors created a strong supply backdrop: companies' need for capital injections as the COVID-19 crisis further stretched balance sheets, volatility spiking sharply, anchored low interest rates against wider credit spreads and a rapid rebounding of share prices following the March sell-off. This strong net new issuance together with high organic growth levels have helped propel the global convertible bond market capitalization beyond USD 500bn (Figure 2). New issues have generally come to market at attractive valuations and have led to a significant broadening of the opportunity set across sectors and issuers.

Companies in historically dominant sectors within the convertibles space, such as technology and healthcare, have continued to bring out new bonds, but we have also seen many issuers in the consumer discretionary space and other industries, such as airlines, come to the market – many for the first time. Whilst these issuers have been negatively impacted by the crisis, the convertible bond market has given them the opportunity to monetise their share price volatility and cheapen the cost of 'rescue capital' compared to tapping the credit or equity markets. The resulting broadening of the convertible bond universe has also led to improvement in market liquidity.

The substantial increase in interest from crossover equity and credit investors, as well as asset allocators, has contributed to higher flows into both long only and convertible arbitrage strategies. This should ensure that this positive momentum persists well into 2021.

Figure 2: Convertible market exceeds USD 500bn[4]

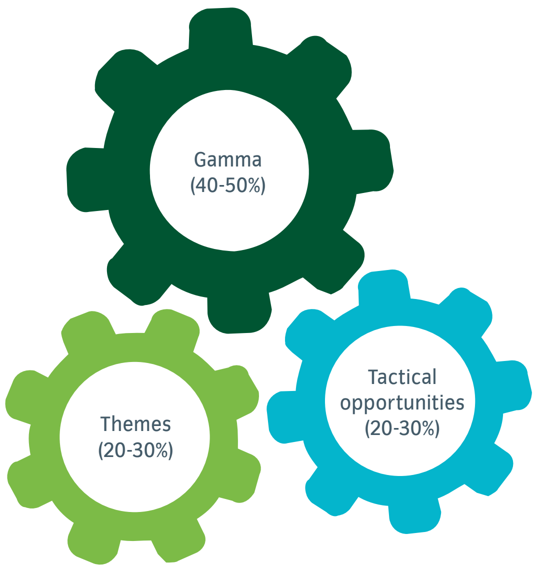


WHAT TO EXPECT IN 2021

Factors align to support continued performance

We expect the convertible bond market to continue to perform strongly. Volatility should persist throughout the year with ongoing uncertainty on the path and economic impact of the virus around the world, and the associated fiscal and monetary responses.

Figure 3: Insight's Absolute Return Global Convertible strategy – capital protection and low beta to equity markets[5]



We expect the strong primary issuance dynamics to continue, enabling convertible strategies to benefit from attractive new issue premia. The broadening of the convertible bond universe should bode well for prospective returns as a pick-up in interest from various investor backgrounds keeps flow momentum into convertible arbitrage strategies strong.

An anticipated global economic rebound coupled with continuing heightened new issuance will benefit the convertibles markets. Likewise, a predicted rebound in global M&A activity and financing will further enhance the opportunity set in the space.

Against this backdrop, we believe Insight's Absolute Return Global Convertibles strategy is well placed to provide solid risk-controlled performance, with strong absolute return opportunities from our three key performance drivers (Figure 3):

1. **Gamma** – capitalising on increases in volatility
2. **Equity Themes** – capturing upside returns from increased dispersion amongst corporate winners and losers
3. **Tactical Trades** – both capturing opportunities from sideways and volatile markets, and from a continued strong new issuance pipeline.

[4] Source: Nomura, Insight, December 2020.
[5] Percentage refers to expected proportion of returns over medium-term windows, typically three years.

IMPORTANT INFORMATION

FIVE-YEAR PERFORMANCE RECORD TO 31 DECEMBER 2020

	Calendar year returns					12-month rolling returns				
	2020	2019	2018	2017	2016	2019-2020	2018-2019	2017-2018	2016-2017	2015-2016
Representative portfolio	7.72	9.58	-	-	-	7.72	-	-	-	-
1-Month EURIBOR	-0.50	-0.41	-	-	-	-0.50	-	-	-	-

Please refer to the following risk disclosures. Returns are shown in EUR on a net basis (with a 0.75% annual management charge and performance related fee applied). Performance is shown for representative portfolios. The representative portfolio is an account we believe most closely reflects current portfolio management style for the Insight's Absolute Return Global Convertible strategy. The characteristics of the representative portfolio shown may differ from those of other accounts in the strategy. Information regarding the representative portfolio and the other accounts in the strategy is available upon request. From strategy inception on 1 January 2019 to 3 June 2019, performance relates to a model portfolio. From 3 June 2019 to date performance relates to a UCITS pooled vehicle that employs the absolute return global convertible strategy.

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

The specific securities identified and described are subject to change, for information only. No assumptions should be made that the securities identified and discussed were or will be profitable. A complete list of contributors/detractors for the period covered is available upon request.

ASSOCIATED INVESTMENT RISKS

Convertible bonds and equities

Currency hedging techniques aim to eliminate the effects of changes in the exchange rate between the currency of the underlying investments and the base currency (i.e. the reporting currency) of the portfolio. These techniques may not eliminate all the currency risk.

Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.

Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.

Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.

Where leverage is used through the use of swaps and other derivative instruments, this can increase the overall volatility. Any event that adversely affects the value of an investment would be magnified if leverage is employed by the portfolio and losses would be greater than if leverage were not employed.

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