



THE DRIVE YOU DEMAND

NAVIGATING THROUGH AN AGEING ECONOMIC CYCLE

A market backdrop favourable to convertible bonds

For Qualified Investors in Switzerland or Professional Investors or Eligible Counterparties
as defined by the relevant laws.

UBP Convertible Bond | May 2019



UNION BANCAIRE PRIVÉE

Key points

- ◆ *The economic slowdown, political tensions and central banks' policy shifts have led to large moves in financial markets. Looking ahead, lingering uncertainties call for some caution but positives remain and justify maintaining an exposure to equity markets.*
- ◆ *Against such a market backdrop, convex strategies constitute a solid alternative for investors, and make the case for convertible bonds in a portfolio allocation.*
- ◆ *The convex nature of convertibles has provided investors with long-term benefits, such as equity-like returns with reduced volatility and drawdowns, over a full market cycle. History has shown that convertible bonds can also act as a strong booster in a fixed-income portfolio.*
- ◆ *Convexity is back in the asset class after two years (2016 - 2017) in which it was quite subdued due to low equity volatility. 2018 and 2019 (ytd) are clear examples of convexity's strong benefits over shorter periods of time as well.*
- ◆ *At a time when investors are faced with uncertainties over global activity, convertible bonds give investors access to companies with strong growth prospects, in industries exposed to favourable secular trends.*
- ◆ *Thanks to a management style combining sound fundamental stock picking and attentive credit selection, UBP's global convertible flagship has enhanced the convex potential of the global convertible bond market since its inception.*

An environment conducive to convex assets

From their highs at the end of 2017, financial markets have been on a rollercoaster ride. The relative slowing of global activity, combined with central banks' back-and-forth and political tensions, have led to large moves in financial markets.

Looking ahead, we believe positives remain. Resilient global growth and the US Fed's dovish U-turn could fuel additional upside in global equities. However, lingering uncertainties (such as the outcome of the US–China trade negotiations and developments in “Brexit”) call for some caution.

Against this market backdrop, traditional asset allocations are being put to the test.

After “V-shape” moves in stock markets, and considering valuations that have already largely recovered from their de-rating at the end of 2018, it may be hard for some investors to remain heavily invested in pure equities. On the other hand, straight bonds still offer an only limited alternative to stocks in terms of yield – especially in Europe. In this context, convex strategies constitute a solid alternative for investors, and make the case for convertible bonds as part of a global portfolio allocation.

The long-term benefits of convertible bonds

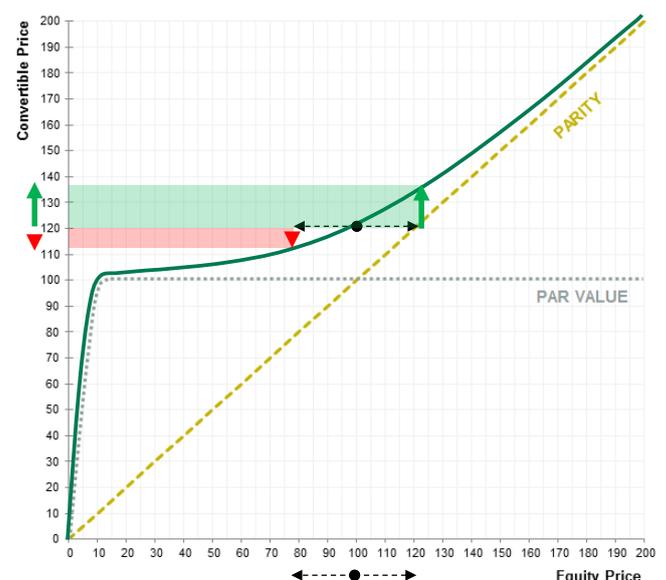
Introducing convertible bonds

Convertible bonds are debt instruments. Unlike straight bonds however, they can be either redeemed at par upon maturity, or exchanged for a defined number of shares of the issuing company during the life of the instrument. That choice belongs to the holder.

The combination of bond-like and equity-like features is at the root of convertible bonds' asymmetric payoff profile: their “convexity”. The bond component grants them defensive qualities of straight bonds (e.g. a bond-floor and a regular income) while the embedded “call” option allows an asymmetric exposure to developments in the underlying stock's price.

All other things being equal, for an equivalent up or down movement in their underlying stock, **convertible bonds tend to capture more of the upside than of the downside** (see Chart 1).

Chart 1: Convertible bonds' asymmetric payoff



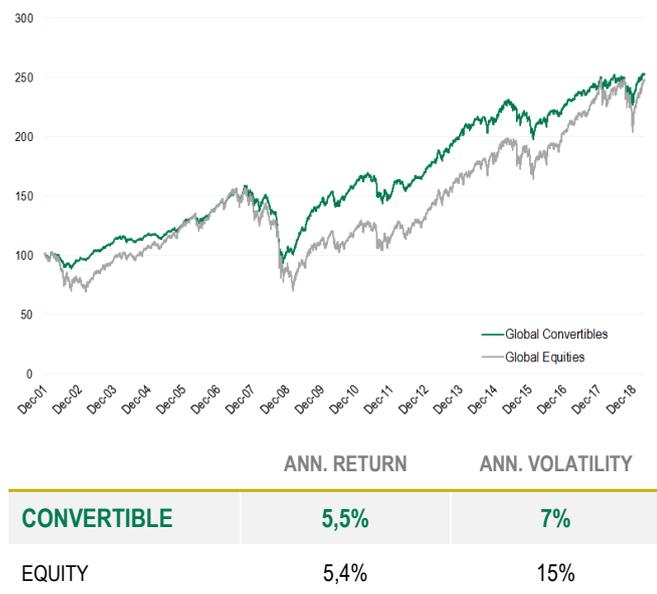
Source: UBP. For illustrative purposes only.

Convexity matters

Historically, the convex nature of convertible bonds has provided investors with long-term benefits, both versus equities and bonds.

Relative to equities, convertible bonds have demonstrated their capacity to deliver similar to higher returns, with half the volatility (Chart 2) and reduced drawdowns (Chart 3), over a complete market cycle.

Chart 2: The long-term benefits of global convertible bonds vs. global equities (two full market cycles)



Sources: UBP, Bloomberg Finance LP, from 31.12.2001 to 30.04.2019. Convertible bond index: Thomson Reuters Convertible Global Hedged EUR. Equity index: MSCI World Net TR Hedged EUR. Past performance is not a guide for current or future results.

In the past twenty years, global convertible bonds have, on average, suffered only 53% of equity markets' downside. This compares attractively with a +65% upside capture in positive equity months (based on monthly figures).

Chart 3: Convertible bonds' average participation in positive vs. negative equity months

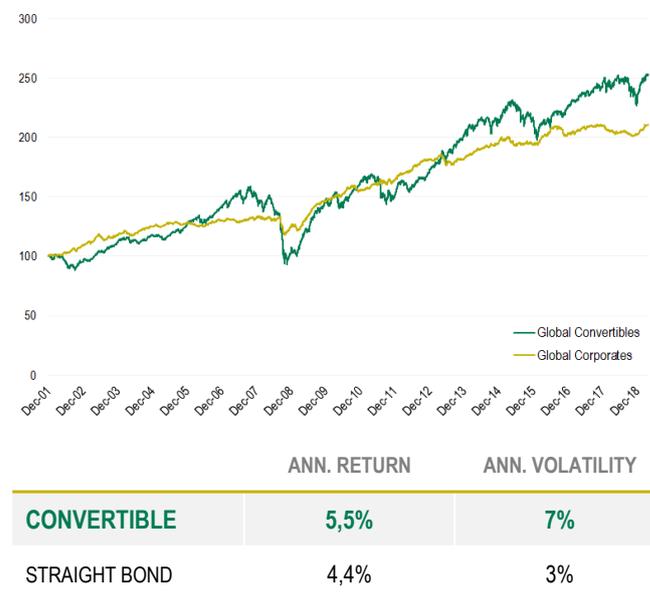


Sources: UBP, Bloomberg Finance LP, 30.04.2019. The chart represents the average participation of convertible bonds in positive (resp. negative) equity months, computed based on monthly returns since 31/12/2001. Convertible index: Thomson Reuters Convertibles Global Hedged EUR. Equity index: MSCI World Net TR Hedged EUR. Past performance is not a guide for current or future results.

In addition to allowing investors to optimise the risk-return of their equity investment over time, convertible bonds can also act as a booster in a fixed-income portfolio.

In exchange for a few additional points of volatility, convertible bonds have demonstrated their capacity to enhance the return profile of a pure fixed-income investment in the long run (see chart 4).

Chart 4: Historical excess return of global convertible bonds vs. global straight bonds



Sources: UBP, Bloomberg Finance LP, from 31.12.2001 to 30.04.2019. Convertible bond index: Thomson Reuters Convertible Global Hedged EUR. Straight bond index: Bloomberg Barclays Global Agg. Corporate TR Hedged EUR. Past performance is not a guide for current or future results.

Aside from the long-term picture, recent quarters have shown convertible bonds' capacity to live up to their historic convex benefits over shorter periods of time as well.

Convexity benefits in the shorter term

After two years (2016 and 2017) where it was quite subdued due to the low equity volatility environment, convexity is back in the asset class.

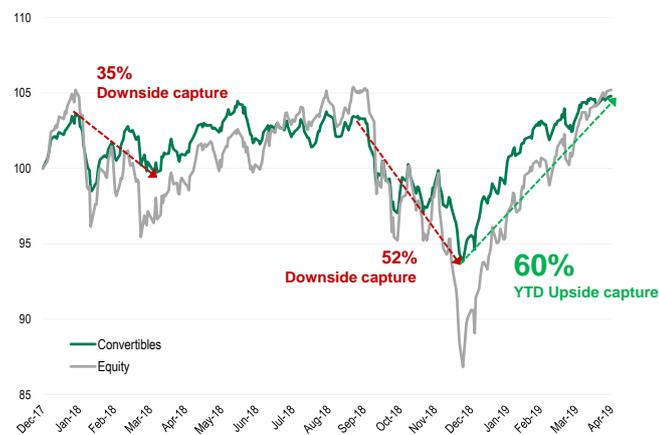
In 2018, amid a highly challenging environment for risk assets, convertible bonds demonstrated strong resilience, suffering only 35% and 52% of global equities' sharp drawdowns in Q1 and Q4 (see chart 5).

Looking at the entire year, global convertible bonds delivered a performance of -4.4% with a volatility of 8% and a maximum drawdown of 10%, when global equities were down -9.4% over the year, with volatility of 13% and a maximum drawdown of 18%. **This leads to only 47% equity downside capture in 2018.**

In addition to these strong downside mitigation benefits, global convertible bonds posted a solid performance during the early-year rally. Year-to-date, as at 30 April, the Thomson Reuters Convertibles Global index (hedged EUR) is up +9.7%, versus +16.1% for the MSCI World (Net TR hedged EUR). **That is a +60% upside capture.**

Such asymmetric behaviour (a downside capture of 47% in 2018 versus a +60% upside participation in 2019 year to date) is precisely what convertible bonds are about.

Chart 5: Global convertible bonds vs. global equities in the shorter term



Sources: UBP, Bloomberg Finance LP. Analysis from 29.12.2017 (rebased at 100) to 30.04.2019. Convertible bond index: Thomson Reuters Global Convertibles Hedged EUR. Equity index: MSCI World TR Hedged EUR. Past performance is not a guide for current or future results.

The competitive behaviour of convertible bonds in the shorter term was also demonstrated against bonds.

As in the longer term, the hybrid nature of convertible bonds – the combination of the bond-floor and an equity option – enabled the asset class to deliver a bond-like defensive performance in 2018 (-4.4% over the year for the global convertible index vs. -3.8% for the bond index) and more than double the performance versus straight bonds year-to-date (+9.7% for the convertible index vs. +4.3% for the bond index) (Chart 6).

Chart 6: Global convertible bonds vs. global straight bonds in the shorter term

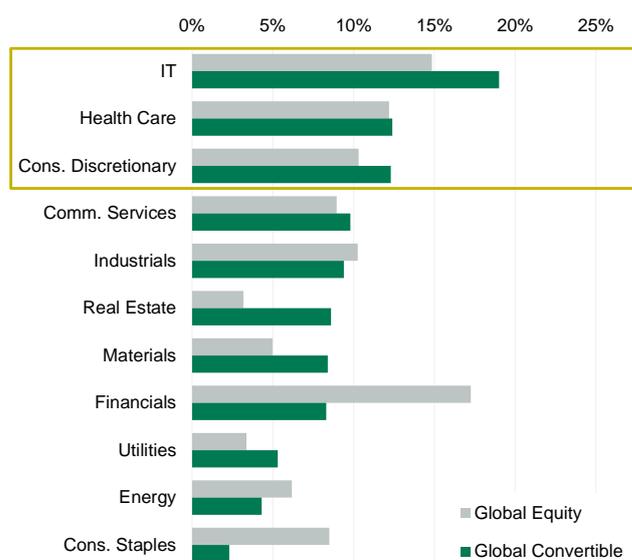


Sources: UBP, Bloomberg Finance LP. Analysis from 29.12.2017 (rebased at 100) to 30.04.2019. Convertible index: Thomson Reuters Global Convertibles Hedged EUR. Bond index: Bloomberg Barclays Global Agg. Corp. TR Hedged EUR. Past performance is not a guide for current or future results.

The diversification benefits of convertible bonds

In the current advanced phase of the economic cycle, the global convertible bond market offers exposure to highly sought-after companies, whose business is linked to favourable secular trends that are less correlated to the overall softening economy. Among these trends, we particularly find value in the **digitalisation of the economy, accelerating middle-class consumption in Asia and the ageing population** (Chart 7).

Chart 7: Sector breakdown comparison Global Equity vs. Global Convertible



Sources: UBP, Bloomberg Finance LP, MSCI, as of 31.12.2018. Convertible index: Thomson Reuters Global Convertibles Hedged EUR. Equity index: MSCI World All Countries. Past performance is not a guide for current or future results.

For growth-focused companies, convertible bonds offer attractive financing terms through reduced interest payments in exchange for the conversion option.

For investors, convertible bonds constitute an attractive way to access these sectors whilst containing their portfolio's overall volatility. We believe this stands out as a true edge, considering the high volatility commonly evidenced by these stocks, which can be a drag for many investors (Chart 8, illustration for the tech sector).

Chart 8: Russell 1000 Tech index vs. Russell 1000 index (2 year rolling)



	Cumulative Perf.	Annualised Vol.
Russell 1000 Tech	44,9%	20%
Russell 1000	23,2%	13%

Sources: UBP, Bloomberg Finance LP. Analysis from 30.04.2017 (rebased at 100) to 30.04.2019. Past performance is not a guide for current or future results.

Active and discretionary management to enhance global convertibles' convexity

UBP's global convertible bond strategy was designed to leverage on the richness and huge diversity offered by the asset class. It aims to provide investors with access to the most attractive convex opportunities across the main convertible markets (US, Europe, Asia) through a bottom-up and fundamental investment process.

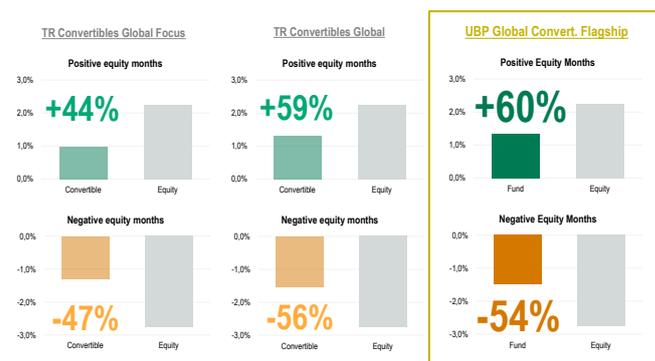
Our management approach is twofold. It is first centred on the analysis of the credit, to filter out convertible bonds with lower quality credit. It then focuses on the underlying stock, in order to isolate companies from our universe that offer, based on our bottom-up assessment, higher potential for share appreciation in the mid-to-long term.

A global allocation, combined with a discretionary management approach, allows us to focus the portfolio on companies that are well exposed to benefit from the positive secular trends we see in the market today. It additionally enables us to adapt the portfolio's sensitivities to the rapidly evolving market environment, with greater flexibility and reactivity.

Since inception at the end of 2012, with an average equity sensitivity of 50% and an investment-grade bias, our global convertible strategy has succeeded in capturing, on average,

60% of global equities' upside, while suffering only 54% of their downside. A solid convexity profile which compares attractively to that offered by the global convertible universe over the same period (Chart 9).

Chart 9: Optimised convex returns versus the universe



Sources: UBP, Bloomberg Finance LP, as of 30.04.2019. The charts represent the average participation of our flagship global convertible fund (gross of fees, rhs) and of the Thomson Reuters Convertibles Global (middle) & Global Focus (lhs) Hedged EUR indices in positive (resp. negative) equity months (based on the MSCI World Net TR Hedged EUR), computed based on monthly returns since 31.12.2012. Past performance is not a guide for current or future results. The product presents a risk of loss of capital.

UBP has been active in the management of convertible bond strategies since 1999. Today, we offer a complete range of investment solutions, both in the global and European spaces, designed to leverage on the richness and singular diversity offered by the asset class.

Convertible bonds' timeless qualities are highly beneficial in the context of portfolio construction. We look forward to having the opportunity to discuss them with you further.

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