Credit Suisse Investment Partners

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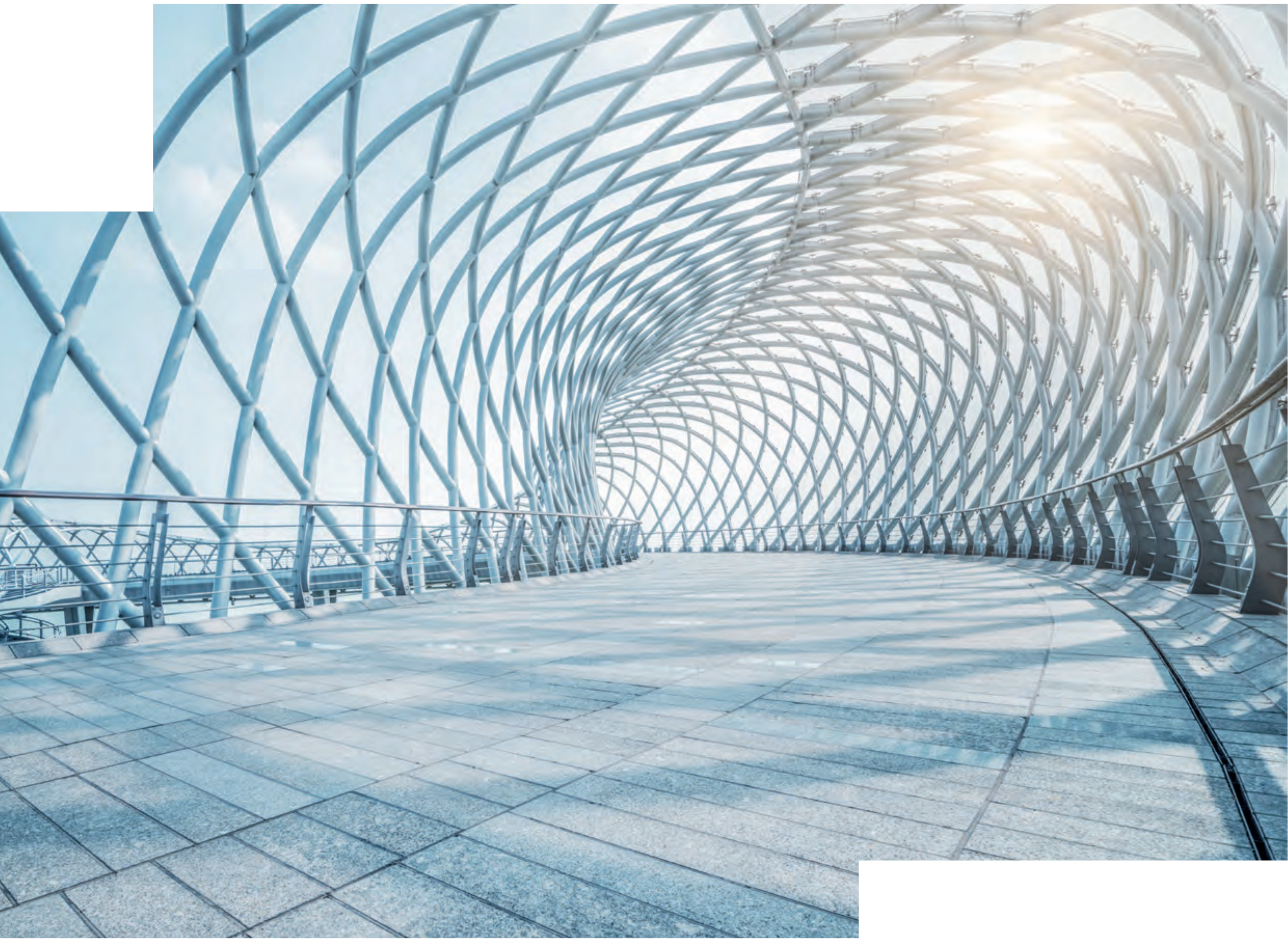
Convertible bonds in brief



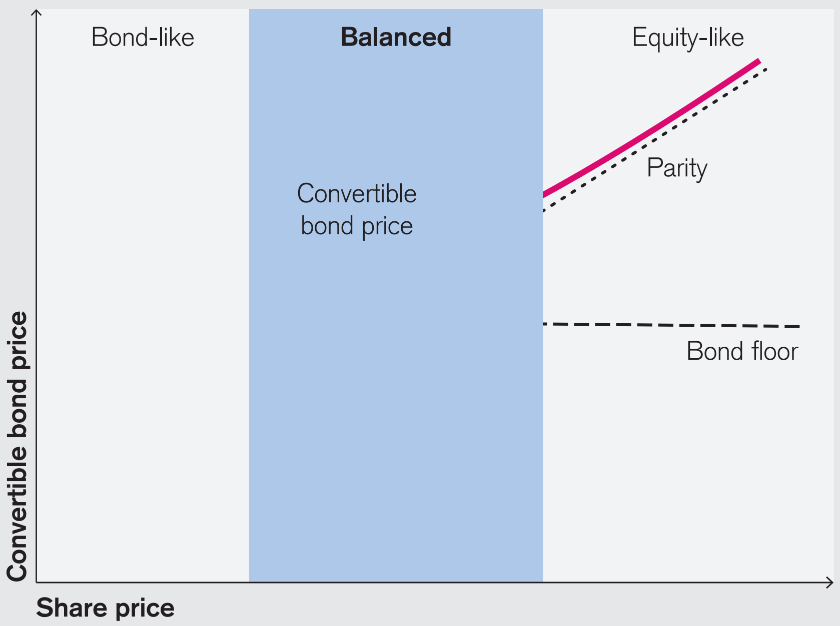
Q1 2021

Convertible bonds combine the advantages of stocks and bonds

Upside potential
When the price of the underlying stock rises, convertible bonds may capture part of the capital appreciation.

Downside protection
When the price of the underlying stock falls, convertible bonds still provide benefits such as interest (coupons) and the repayment of capital when the bond expires.

Various profiles of convertible bonds



What are convertible bonds?

Convertible bonds are corporate bonds with an embedded option giving investors the right to convert them into shares of the underlying company. Convertible bonds thus combine features of bonds (debt) and stocks (equity). Like conventional bonds, convertible bonds have a fixed term, at the end of which the investor is entitled to a repayment of capital. The difference is that unlike conventional bonds, convertible bonds also benefit from price gains in the underlying shares due to the embedded conversion right.

When markets are on the rise, the value of the option component increases, as does the convertible bond's sensitivity to the change in the share price (the convertible bond's price approaches parity). However, in falling markets, a convertible bond's price moves closer to the value of the underlying corporate bond (its price approaches the bond floor). In the balanced segment, the payoff is particularly asymmetric because the value of a convertible bond is more sensitive to a rise in the share price than it is to an equivalent drop.

Convertible bond investment universe

The world's first convertible bonds were issued in the nineteenth century in the US to finance the building of railroads. Today, the convertible bond market is globally diversified, and the majority of issuers are medium-sized and large companies from high-growth sectors such as IT/technology, industrials, and pharmaceuticals. While some issuers tap the market multiple times, many of them do so just once or twice. This makes the universe of convertible bonds very dynamic with regard to its regional and sector composition.

The US market accounts for the lion's share of the global convertible bond universe at just under 65%, followed by Europe (approximately 22%). In February 2021, the global convertible bond market reached a record-high volume of over USD 490 billion, offering an attractive range of very diverse investment opportunities.

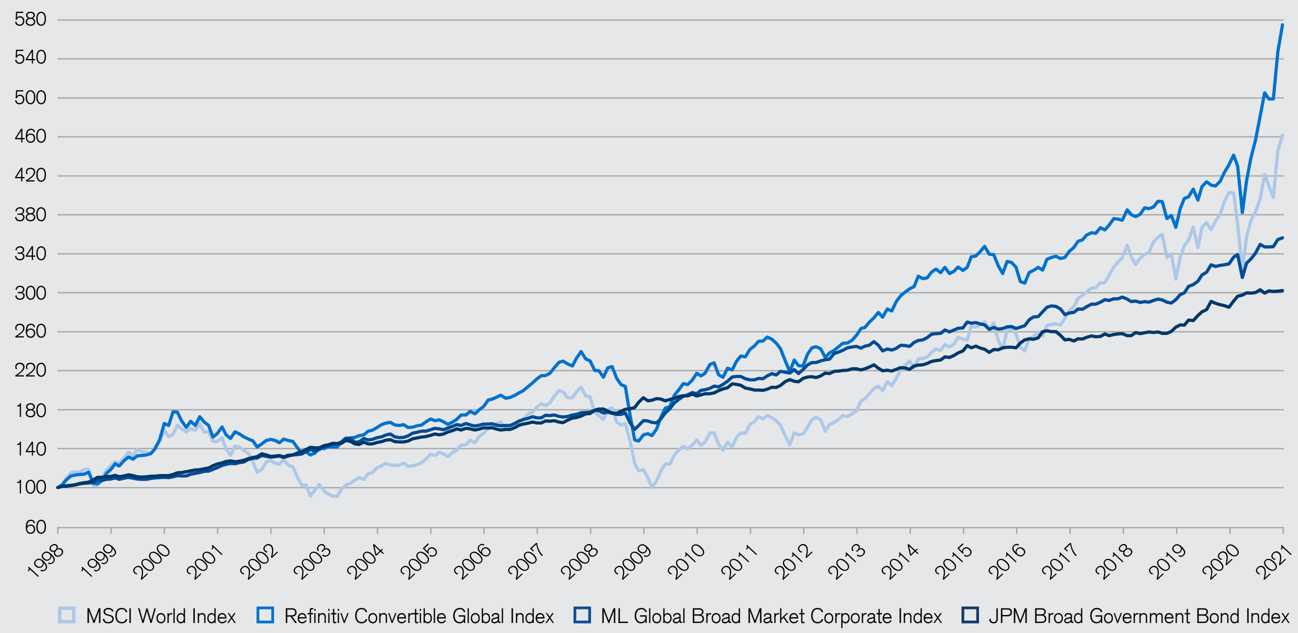
Why choose convertible bonds?

While the potential returns from standard bond strategies are limited at present due to the overall environment of low interest rates, convertible bonds additionally benefit from stock-market gains. Over the past 20 years, convertible bonds, as measured by the Refinitiv Global Convertible Index, have significantly outperformed conventional bond and equity markets. The performance of convertible bonds has particularly stood out during exceptional market corrections and subsequent recoveries. At an annualized return of +7.9%, convertible bonds have surpassed the returns generated by global equities, yet their volatility has been significantly lower.

Convertible bonds and asset allocations

Adding convertible bonds to a mixed portfolio can help reduce portfolio risk without changing return expectations or can increase the expected return without increasing the risk. This risk diversification effect is significantly influenced by global convertible bonds' low correlation with global government and corporate bonds. In addition, portfolio risk can be reduced as a consequence of global convertible bonds' lower volatility compared to that of equities. However, investors need to define their expectations when adding convertible bonds to their portfolios because the risk/return profile can vary considerably depending on the underlying strategy (bond-like, balanced, equity-like). Because of their structural complexities, convertible bonds require active management within asset allocations. It is not the convertible bonds themselves that make a strategy work, but the way they are managed to achieve a particular investment objective.

Convertible bonds outperformed conventional bonds and equities between 1997 and 2020



Asset class	Return p.a.	Volatility
Global equities	+6.9%	14.5%
Global convertible bonds	**+7.9%**	**10.8%**
Global government bonds	+4.9%	3.0%
Global corporate bonds	+5.7%	4.2%

Sources Credit Suisse, Bloomberg
Returns hedged in USD, data range: December 31, 1997, to December 31, 2020.
Indices: MSCI World, Refinitiv Convertible Global, ML Global Broad Market Corporate, JPM Broad Government Bond

Historical performance indications and financial market scenarios are not reliable indicators of future performance. It is not possible to invest in an index. The index returns shown do not represent the results of actual trading of investable assets/securities. Investors pursuing a strategy similar to an index may experience higher or lower returns and will bear the cost of fees and expenses that will reduce returns.

Read our white paper to learn more about convertible bonds
Thanks to their unique characteristics, convertible bonds present an attractive alternative to equities and conventional bonds, particularly in a challenging market environment. Credit Suisse Investment Partners published a white paper in March 2021 to provide you with more information about this compelling asset class. The white paper explains how convertible bonds work, discusses the related rewards and risks, and shows you how to incorporate convertible bonds into your asset allocation.

Download the white paper

Risks

- Investors may lose part or all of the invested amount.
- Bonds carry a risk of issuer default, which means that the principal may only be partially repaid or not at all.
- Convertible bond returns may be volatile in the short term, i.e. the value of the investments may fluctuate significantly.
- Issuer default risk – and thus the risk of losses for the investor - increases in a recessionary environment.

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For more information, please contact your relationship manager.

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