

The fund managers

CONVERTS MANAGERS FEEL LURE OF THE EAST

Investor interest in convertibles funds looks to be surging again, but who are the leading managers in the sector and how are they positioned? Angus Foote finds out

An eclectic mix of fund managers can be found leading the performance tables in the convertibles sectors. French and German firms are setting the pace, but in the global convertibles sector the leading manager is a Frenchman working for a UK-based firm.

Leonard Vinville, who runs M&G Global Convertibles fund, is the top manager over three years in the global convertibles sector, both on a risk-adjusted basis and ranked by his total return. Over the past three years, he has returned 32.18%.

In the Convertibles Europe sector, the front-runners over three years are the fund managers from the specialist German boutique Convertinvest. On a risk-adjusted basis, the manager of the Convertinvest All-cap Convertibles fund, Nils Lesser, is top. However, his co-manager on the fund, Convertinvest founder Dr Gerhard Kratochwil, is ranked fifth on a risk-adjusted basis, as his figures also take account of the other fund he runs, the longer-established Convertinvest European Convertible & Bond Fund.

So what are they investing in and do they agree on the direction the market is taking? Before we consider these managers' views, here is some background from another international source.

John Calamos is a leading authority on convertibles in the US, having been investing in these instruments since the 1970s.

'I've seen the roller coaster over the years,' he says. 'What I've seen is that when markets are very strong, you don't see much interest in convertibles.'

'Convertibles are a defensive type of equity investment. As people get more nervous about

markets, the interest is there. The short-term perspective is based around valuation. Valuations for many investors are tactical and we have seen a lot of investors going in on the under-valuation.'

'For us, it's really a long-term strategy that cushions the effect of volatile markets.'

Through his firm Calamos, John Calamos has created two Ucits funds for European investors and recently took a tour of major European centres to promote them.

'I think there's an appetite in Europe for US equities, but the convertible theme is still there (in Europe) as well. Every bull market climbs a wall of worry and we have plenty to worry about. But economic leading indicators are good,' he says.

'The other factor that may be driving increased interest is that the straight bond market is making people nervous. Convertibles are the bond choice in a rising interest rate environment.'

However, Calamos does see some potential headwinds. 'We are concerned about inflation and inflationary prospects,' he acknowledges. 'There's a lot of confusion about what inflation actually is.'

Calamos refers to his travels in Europe in recent years, driving around Ireland and being shocked at house prices. 'There was a lot of asset inflation, but in the true economic sense, inflation is a monetary event. If the monetary controllers print too much money...' – the conclusion is clear.

Factors that make the convertibles market interesting to investors now, he believes, are specific to the asset class. 'Over the past couple of years, we've seen more issuance outside the US than inside it. We view that as a positive.'

'Convertibles are all about access to capital. As even the emerging markets get more comfortable about what convertibles are...we're starting to see issues in the Far East. That's positive.'

'The negative for convertibles is the low-interest environment.' Companies use convertibles to lower the levels of interest they pay and when interest rates are so low, they don't need to do this.

Issuance is coming from a range of company types: cyclical and growth firms, says Calamos.

These twin themes of the globalisation of the converts market, alongside increased issuance from across the company spectrum, are echoed by Convertinvest's Kratochwil.



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- 'We are seeing a continuing trend of new issues coming from the mid-cap, non-investment grade sector,' Kratochwil asserts. 'This a trend that started in 2006 and has continued to move upwards, with the exception of 2008.'

'That was why we started the all-cap fund. This is not a new story; it has happened before in the US, starting in 1984-85,' he adds.

Kratochwil points out that as well as enabling the issuer to finance at a low interest rate, a convertible gives the issuer flexibility with regard to timing.

'In 1984-85, growing companies needed financing,' he says. 'These days, the US convertible market has roughly the same make-up (in capitalisation terms) as the US market.'

'When we came out of the 2008 crisis, the first to rally were the quality names, but after that the medium-quality names started to perform well. In 2010, two thirds of new issues were from companies that hadn't issued convertibles before.'

Kratochwil is a bottom-up investor, using a process based on fundamental analysis and holding around 150 meetings a year.

He says understanding the strategy of firms is particularly important with mid-cap investments, 'because there are always the possibilities of refinancing or trying to change the capital structure'.

Agreeing with Calamos, Kratochwil sees non-US issuance as the most positive trend in the sector:

'We've seen the emergence of an Asian convertibles market as a plus, making it more possible to look at convertibles on a global basis.'

Citywire's polling of major European investors has seen a strong ebb and flow of interest in convertibles (see page 5). Kratochwil believes the demand story is more complex than it may appear.

'This past year we've seen significant inflows into the all-cap fund, on the basis that people want to participate in the growth of mid-cap firms,' he says.

But he says there are different drivers of demand in various European countries. 'German-speaking Europe is looking for some kind of fixed income diversification, while we get the impression that people in France want some equity diversification. In fixed income, people are saying "do I really need long duration and where can I find an alternative?"'

But while Kratochwil and Calamos are in agreement about several major trends, there is a dissenting voice from the top of the global table. M&G's Leonard Vinville disagrees with the conclusion that convertibles as an asset class are seeing any significant overall growth.

BOND CONVERTIBLES EUROPE – Three-year risk adjusted performance			Source: Citywire
Name	Sector MR	TR	Contributing Fund
Nils Lesser	0.74	20.76	Convertinvest All-Cap Convertibles T
Pierre-Luc Charron	0.66	26.01	Amundi Convertibles Taux, SG Oblig Convertibles C, SGAM Fund Bonds Europe Convertible B
Marc Favard	0.43	15.23	MAM Obli Convertibles C
Thomas Raffy	0.43	15.23	MAM Obli Convertibles C
Gerhard Kratochwil	0.38	17.00	Convertinvest All-Cap Convertibles T, Convertinvest European Convertible & Bond Fund T
Hubert Lemoine	0.38	32.68	Schelcher Prince Convertibles Global Europe I, Schelcher Prince Convertibles I
Jean-Charles Naudin	0.36	14.97	Etoile Convertibles
Franck Languillat	0.36	16.70	Amarance
Alain Eckmann	0.31	28.15	UBS (CH) Inst Fd-European Convertible Bonds I-B, UBS (Lux) Bond Fund - Convert Europe P-acc
Isabel Levy	0.25	17.07	Metropole Convertibles
Frédéric Hertault	0.25	20.19	BNP Paribas L1 Conv Bond Best Selection Europe I C, NOBC Convictions Convertibles AC, NOBC Europe Convertibles I
Luc Varenne	0.25	20.19	BNP Paribas L1 Conv Bond Best Selection Europe I C, NOBC Convictions Convertibles AC, NOBC Europe Convertibles I
Denis Passot	0.24	10.81	Natixis Convertibles Euro R
Pierre Lepicard	0.21	10.83	BNP Paribas L1 Convertible Bond Eurozone I C
Jean Louis Delhay	0.16	11.54	Barclays Bond Euro Convertible A, Barclays Obligations Convertibles C
Average manager		13.22	

'This is not a new story; it has happened before in the US'



Dr Gerhard Kratochwil
Convertinvest

He accepts that there is a lot of interest in the sector driven partly by macro economic uncertainty, which in turn leads investors to avoid being completely exposed to equities.

He also agrees that the prospect of rising interest rates, plus the concern about fixed income in general, have a positive effect on demand.

However, he does not accept that the market is growing significantly in the US or Europe.

'We had many new issues, since the beginning of the year, but also many companies have called their bonds. So net-net, the issuance isn't good enough to offset the redemptions,' he says.

'We know that in Asia, for instance, we had massive issuance. In Europe you have more redemptions than issuance. In the US it has been fairly neutral. So if you look at the size of the convertibles market, it hasn't grown massively.'

'There's a misconception...the market has grown because credit spreads have tightened and equity markets have rallied. Yes, it's growing in