Analysis: the top performers in European convertibles

By Angus Foote | 07:11:00 | 04 May 2009

With the rising popularity of convertibles, Citywire highlights some of the top performing fund managers in the European convertibles sector.

Most years it might seem disappointing that only two fund managers have achieved a positive total return in the European convertibles sector over the past three years.

But to put that in context, the average manager in the European equity sector up to the end of February has lost 43.45% over three years – and the best performer in that sector has lost 9.57%.

Suddenly, the 5.55% total return delivered by Roland Scherf looks a lot more exciting. Scherf has posted this three-year figure for his management of the Convertinvest European Convert & Bond fund. His three-year risk-adjusted return has also earned him a Citywire A-rating.

Third in the table is Gerhard Kratochwil, who works alongside Scherf on the European Convert & Bond fund. However, Kratochwil's personal track record also takes in another fund he runs, the Convertinvest All-Cap Convertibles fund, giving him an overall total return of -1.92%. On a risk-adjusted basis, however, his performance is also good enough to earn him an A-rating.

Scherf and Kratochwil are the co-founders of Vienna-based Convertinvest, a boutique specialising in convertible bonds.

Over five years the duo have returned 18.6% with their flagship European Convert & Bond fund, which currently has assets of some €210 million. Over the same period the benchmark UBS Global Bond Convertibles Europe index has risen just 1.2% and the average manager in the sector has lost 5.7%.

The traumas of the past year have left many investors wary of equity markets in particular. In this environment, the combination of equity upside and bond-style levels of downside risk offered by convertibles have attracted the attention of many.

Talking to Citywire in January, Scherf explained how his fund came through the financial crisis virtually unscathed and outlined where he thought opportunities in the sector now lay.

Although the fund lost 3.9% over the 12 months to the end of February, the benchmark index fell 19% and the average manager in the sector lost just over 17%. The average manager in the Equity Europe sector, in comparison, has lost an eye-watering 42.8% over the same 12-month period.

Scherf said one of the factors behind the duo's performance over the past year had been their bets on some off-benchmark short term bonds.

'The drivers were strict management of the delta (stock sensitivity) of the fund and the overall defensive structure of the portfolio,' he said. 'At the beginning of

July 2008 the portfolio only had a delta of between zero and 10% while several benchmark indices still had 24%-30%. In addition we were until the beginning of December also invested in government and corporate bonds with short duration.'

With more and more investors entering the convertibles sector recently, at the beginning of 2009 Scherf was positioning himself less defensively in order to participate in a rally.

'During the recent credit crisis, especially in October/November, convertible bond valuations cheapened dramatically,' he said. 'This created opportunities for investors who were looking to establish long positions in higher yielding distressed and investment grade assets, enhance the returns of equity portfolios by replacing long stock positions with higher-yielding convertible bonds which are more senior in the capital structure, or replace investment grade or high-yield bond positions with convertible bonds that provide similar – or higher – yields as well as equity upside exposure.

'Hence we started in November to replace our defensive bond part of the portfolio consisting of government and corporate bonds with investment grade convertible bonds. At that time yields of convertible bonds were much higher than for corporate bonds with similar quality.'

Looking ahead, Scherf predicted that opportunities would emerge in areas such as non-investment grade convertibles.

'We still see some chances in non-investment grade and distressed assets whereas investment grade names were getting more and more expensive,' he said.

Names that appear among his largest holdings include Mercedes-Benz Australia, Italian conglomerate Finnmeccanica, Portugal Telecom, Erste Group Bank and AXA.

With Scherf and Kratochwil appearing at number one and three in the rankings, second place is taken by Sébastien Jallet of Generali. Jallet has an AA-rating for his combined risk adjusted performance across the France-domiciled Generali Euro Convertibles and Luxembourg-domiciled GEN INV Euro Convertible Bond funds.

Over three years the French domiciled fund, which has assets of €188 million, has returned 4.7% in euro terms but the €69 million Luxembourg-based vehicle has fared less well, losing 8.2% over the same period.

The scope of the different funds run by Scherf, Kratochwil and Jallet provides a good illustration of the challenges facing fund analysts. Although all three are classified in this sector, the freedom they have to invest in instruments other than convertibles varies widely.

The Luxembourg Euro Convertible Bond fund always has at least two-thirds of its assets in convertibles, but it can also invest in warrants and can hold up to 10% in cash. The manager can also use derivatives for hedging purposes.

However Jallet's French Euro Convertibles fund can have anything between 50% and 100% of its assets in convertible bonds, with the ability to hold up to 50% in cash and European monetary instruments.

The Convertinvest fund run by Scherf and Kratochwil, meanwhile, has nearly 80% of its assets in convertible bonds and the rest in cash.

This potential for a wide variation in asset allocation may go some way to explaining the contrasting performance of funds and managers in this sector.

In all, there are nine managers in the Bond Convertibles Europe sector who held a Citywire rating at the time of writing.

Among them are Julien Levy-Kern of CPR, maintaining the strong French flavour in the upper reaches of this sector. A-rated Levy-Kern is the sector's most consistent fund manager, having beaten the sector average in every one of the past five years – the only manager in the sector to do so.

The CPR Convexite fund run by Levy-Kern is another France-domiciled vehicle and has over €250 in assets. While it has lost 9.8% over the past three years, that figure still keeps the fund comfortably ahead of both the benchmark and the sector average.

Also rated in this sector is Jefferies International's convertibles specialist Gianluca Biggi, featured as the Star Manager in the February issue of Citywire Fund Selector and who currently has an A-rating.

Natixis Convertibles Euro manager Denis Passot gained his first Citywire rating in November last year and is currently A-rated. Over the three years to the end of February the Natixis fund is down 10.3%, but again this keeps it well ahead of both the benchmark and the sector average.

This article originally appeared in the April issue of Citywire Fund Selector magazine. All performance figures are quoted in euro terms up to the end of February.

Citywire Financial Publishers Ltd.
Registered Office: 1st Floor, 87 Vauxhall Walk, London SE11 5HJ
Registered in England no: 3828440.