Schelcher Prince Gestion

CONVERTIBLE BONDS TRIBUNE

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The return of Goldilocks: an April Fool's Day 2021?

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NOT TOO HOT, NOT TOO COLD... BUT FOR HOW LONG?

The contained increase in US inflation during April and a fierce appetite for developed country sovereign bonds from Japanese buyers have eased US real rates and restored colour to the growth/quality style. The prospect of a European reopening has allowed cyclical positions to continue to rise with hopes of a return to pre-covid 19 living conditions. The European Commission, for example, expects to reach at least 70% of the adult population of the 27 by July. So is the first trimester taper tantrum finally over?
Like the Omaha sage, W. Buffett, we believe that the structural elements of inflation should not be underestimated. The US economy has probably already returned to pre-covid GDP levels by Q1-2021, the UK should reach it by Q4-2021 and the Eurozone by Q1-2022. The Eurozone composite PMI is expected to exceed 60 as early as this summer.

For the month of May 2021, we therefore maintained portfolios oriented towards cyclicality, reduction of equity-duration and the search for convexity via at-the-money profiles.
In particular, the month of April was dedicated to strategies to replace convertibles with excessive equity profile or convertibles being just too expensive with more convex option structures, which are better able to protect capital if volatility returns in May. At the same time, we continued to implement some value positions, and locally accepted to go to more degraded credit qualities when we were comfortable with the credit analysis of the issuer.
Despite exceptionally good results (Goldman Sachs estimates that never before has a reporting season seen so many companies beat estimates by more than one standard deviation), many companies are suffering from the «travel and arrive» phenomenon. Excellent results are barely greeted by the stock market. Companies reporting results one standard deviation above expectations outperformed the S&P by only 26bps. Conversely, the slightest disappointment leads to a significant correction. Thus, the penalty for companies reporting earnings one standard deviation below expectations is severe: -322bps of underperformance. With double-digit gains since the beginning of the year, we believe that developed equity markets have already incorporated a lot of good news. Interestingly, there has not been a correction of more than 5% in the MSCI World since seven months (October 2020).

SAVE THE DATE

Webinar

May 11th — 5pm

Inflation and Convertible Bonds: threat or opportunity?

More than ever, we believe that convexity should be favoured in an asset allocation and that convertibles have their role to play.