



# 5 things you should know about convertible securities

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There's definitely a modern-ness to the market, there's a growth bias to the market, and there's a procyclical bias to the market.

### **1: Convertible securities are a hybrid asset class**

Convertible securities are either a bond or preferred stock that gives the holder the right to convert into another common stock usually of the same company. Occasionally through a merger, there'll be a different arrangement where you own a bond of company X and it's convertible under company Y.

It's not a blend between the S&P 500 and government bonds but rather a very interesting hybrid asset class that has stock-like returns. Over long periods of time, convertible securities have matched the return of the S&P 500 with lower volatility and more income.

### **2: Convertible securities are usually issued by growth companies**

Convertibles are correlated to growth stocks. They tend to be issued by growth companies, by cyclical companies, and by companies that need capital to avoid failing. And they have a tendency to do better later in the economic cycle when growth stocks do better.

There's a lot of issuance these days in software companies, in advanced semiconductors for things like self-driving automobiles, alternative energy, and even alternative medical uses including marijuana.

There's an element of the companies that issue convertibles being chic or being new economy, even appealing to the younger generation if you will.

### **3: Convertible securities are less vulnerable to rising interest rates**

Rising interest rates have a very limited effect on the bond and income aspect of convertible securities. They tend to be very short duration notes, meaning the maturity if it's a bond is short, they're convertible into an equity in a short period of time. So they don't behave like long Treasuries or long corporates where the price will go down a lot if rates rise a lot.

And secondarily, the tie in with a lot of late cycle and growth stocks mitigates that anyway. So if you have rising rates but a rising stock market, you'll win on convertibles on that convertibility dimension. So convertibles have actually been shown to be one of the better asset classes of all to own in a rising interest rate environment.

### **4: It's a dealer market**

In terms of the market structure, it's what's called the dealer to dealer market. For people who are familiar with financial markets, it's similar to over-the-counter stocks before Nasdaq. Different dealers make individual markets in the securities, they may sell to each other. And this makes trading very important and the use of a professionally managed portfolio very important. Because if you go to market as an individual, I wish you good luck in getting the best offer and getting the best bid when you sell.

### **5: Professional research is key**

The role of research is very critical in convertibles because we have opportunity and risk both coming from credit and equity. So a really central idea in the way that we manage is to have an open dialogue with all of our equity analysts, as well as our credit analysts and that research applies to us because the convertible is into an equity they cover, or the convertible is issued by a company where we cover the credit. So research is critical and it's research across the whole spectrum that Columbia Threadneedle does.

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