

Convertible Bonds: Celebrating 5 Years of Asymmetry

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- In October 2019, the SPDR® Thomson Reuters Global Convertible Bond UCITS ETF celebrated its five-year anniversary.
- The ETF provides exposure to the global convertible bond market, giving investors access to equity growth opportunities while within a fixed income wrapper.
- Today, convertible bonds continue to sit firmly at the core of the financial instrument toolkit for both strategic and tactical asset allocation decisions.

Five Years of Asset Growth

Since inception, the fund's net asset value has enjoyed six-fold growth. The ongoing asset gathering program has helped in bucking the overall industry trend, which has shown outflows of \$8 billion during the period (see Figure 1).

The global convertible bond market has seen a clear evolution since the Global Financial Crisis. Developments have shown a shift away from leverage and speculation and into long-only, outright investment vehicles. In fact, over the previous two years, the widely tracked annual survey performed by Greenwich Associates has shown the primary strategy for convertible investors as being 76% and 24% for outright versus hedged, respectively.

This overall trend has likely also supported the rapid growth of the SPDR Thomson Reuters Global Convertible Bond UCITS ETF. The transparency of this trading vehicle has provided additional comfort to investors seeking an effective and cost-efficient* convertible strategy.

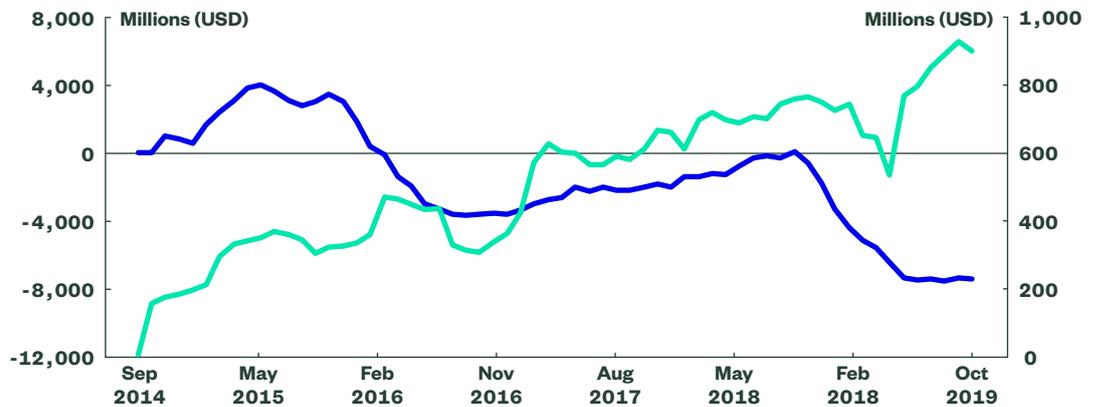
State Street Global Advisors now manages in excess of \$5 billion within its dedicated convertible bond strategies, primarily through its SPDR ETF offering. As such, it is now ranked amongst the top five largest mutual fund investors within the industry.

* Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

Figure 1

Cumulative Flows Since Inception

- Active Universe
- SPDR Thomson Reuters Global Convertible Bond ETF



Source: State Street Global Advisors, Morningstar Direct, as of 31 October 2019. Flows are as of date indicated and should not be relied on thereafter.

Index Performance: The Devil is in the Detail

The fund shows a robust five-year track record, having outperformed the index of choice of the active industry over the period. The Thomson Reuters Global Focus Index is often used by active managers as the bellwether index to beat. SPDR dedicated a significant portion of time to the index design. Based on Morningstar Direct information, of the \$36 billion of assets tracking global indices in European-domiciled ETFs, close to \$29 billion of those assets are benchmarked to a Global Focus family index.

However, the Thomson Reuters Qualified Global Convertible Index — designed by SPDR and the State Street Global Advisors portfolio management team in collaboration with Thomson Reuters — has relatively outperformed the Focus index by c. 195bps (annualised) since the fund launch (covering the period from October 2014 to October 2019).

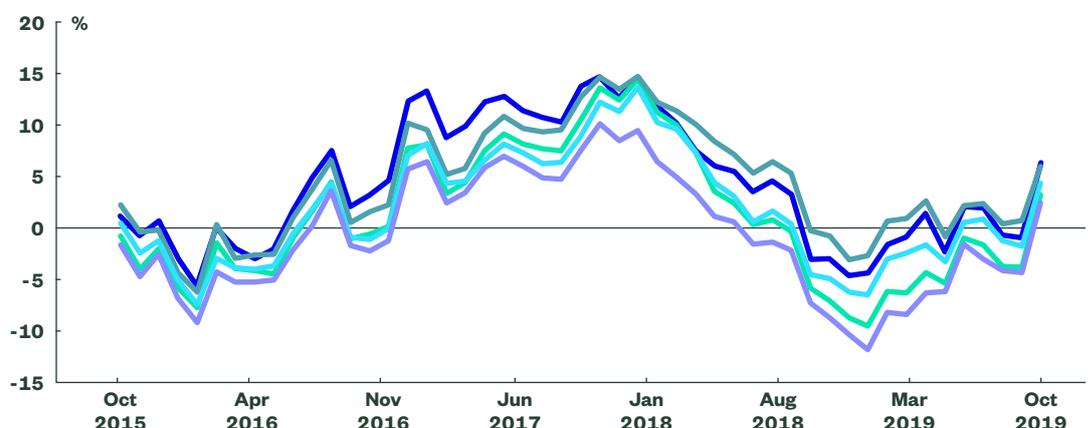
While the ETF has never positioned itself as a direct competitor to an active strategy, it has nevertheless been consistent in providing upper quartile annualised performance when compared with the overall universe of convertible bond managers, which is dominated by active investors (see Figure 2).

Instead, the Qualified strategy is honed to extract what we believe is a more exact beta of the global convertible market, with four key principals at the core of its selection criteria: liquidity, diversification, cost-efficiency and proactive portfolio management. To this extent, the fund could instead be treated as a complement or alternative for investors seeking an effective global convertible bond exposure.

Figure 2

Global Convertible Bond Performance: Index vs. Manager

- Thomson Reuters Qualified Global Convertible TR USD
- Morningstar Universe Aggregated Global Convertible Bond Fund Return
- 25th Percentile
- 50th Percentile
- 75th Percentile



Source: State Street Global Advisors, Morningstar Direct, as of 31 October 2019. Performance represents global convertible bond one-year rolling returns mapped against the Morningstar universe of European-domiciled global convertible bond funds. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Convertible Bonds: Why Now? A Look at the Market

In 2019, more than 40 central banks have reduced their base rates as economic growth comes under increased pressure, especially in those countries that have a skew towards primary manufacturing. Conditions have been compounded by the seesaw dynamics of ongoing trade wars.

Over the last year, we have seen a reversal in policy from both the US Federal Reserve (Fed) and European Central Bank (ECB). While the former was the first to normalise rates, it is now leading the charge in reducing. The ECB is embarking on further rounds of quantitative easing, with the underlying mantra of “as long as needed.” Asia and Japan continue to struggle with their own growth policies while they attempt to reignite inflation inside key pockets of their economies.

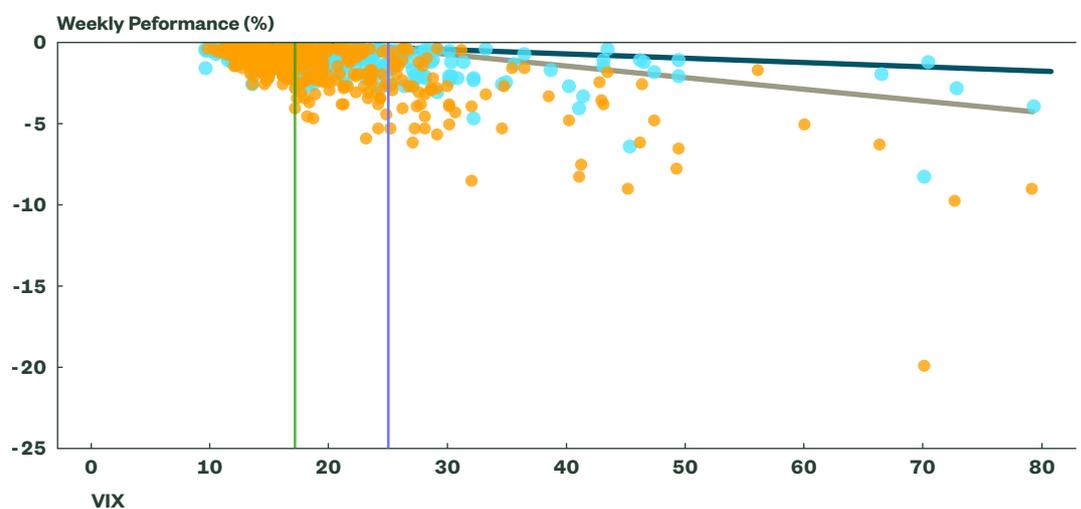
Meanwhile, as the cycle slows down, calls are increasingly being made for the advent of real fiscal easing. This could seed some green shoots for the later part of 2019 and into 2020. But caution has remained in investors’ minds as they seek refuge in lower volatility strategies. Indeed, it is difficult to determine whether we are entering the transition from bull to bear market. As such, investors will need to remain vigilant as oncoming waves of volatility continue to strike the hull of global financial markets.

In each of the last five periods where the VIX (volatility index) has broken through 25 — a threshold that tends to illustrate increasing risk, especially given the long-term VIX average is close to 18 since 2003 — equities have tended to underperform most growth assets, as they reside at the lower end of the overall capital structure (see Figure 3).

In response to this, we would advocate the addition of convertible debt to help provide more balance to an investor’s portfolio. Enabling exposure to the returns that can be enjoyed during periods of equity strength, while providing an additional layer of buffer through a fixed income wrapper, convertibles can provide the additional convexity that investors require during drawdown periods.

Figure 3
**Global Converts
vs. Global Equities
vs. VIX — Weekly
Negative Performance
Since April 2003**

- Thomson Reuters Qualified Global Convertible Index
- Linear (TR Qualified Global Convertible Index)
- MSCI ACWI NR USD Index
- Linear (MSCI ACWI NR USD Index)
- Avg Long-Term VIX
- 1 Standard Deviation of VIX



Source: State Street Global Advisors, Bloomberg Finance L.P., as of 10 October 2019. Past performance is not a reliable indicator of future performance. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Focusing on the Thomson Reuters Qualified Global Convertible Index, at the end of October the equity sensitivity (delta) was trading slightly inside its longer-term mean of 0.45. This indicates a relatively fair valuation versus history and an ability to participate in a relief rally if trade discussions arrive at a better outcome.

Meanwhile, implied volatility has remained turbulent during the second half of 2019, which suggests a need to stay protected. With yields already low, interest rate sensitivity is less of a worry, but the duration of the exposure is “only” 3.8 and its Rho (or rate sensitivity including the equity option price) is -1.94 for a 100bps parallel shift upward in the Treasury curve.

Total issuance in September of almost \$17 billion across global convertible bonds was strong compared with the previous five years, which averaged c. \$6.5 billion. Coupled with \$69 billion of new issuance and total net issuance for 2019 surpassing \$10 billion, it is clear there continues to be a thirst for new paper and deployment of capital in the asset class where potential upside could still exist.

Why SPDR Thomson Reuters Global Convertible Bond UCITS ETF?

During its early stages, when the fund was less well known and still building a track record, it was met with curiosity by market participants. Indeed, rarely had investors seen this type of strategy or structure succeed within the convertible bond space.

Today, investors have embraced the fund after it has become clear that the ETF provides some compelling advantages for accessing the asset class. The ETF is a cost-effective* vehicle and it can potentially help to provide convexity in portfolios. Ranking within the top 10 largest global convertible bond funds in Europe, and available with currency-hedged share classes, the SPDR Thomson Reuters Global Convertible Bond UCITS ETF has become more mainstream.

Over the past five years, the fund has tracked its index closely, with an annualised tracking error of less than 0.2%. The fund has achieved this return through a skilled portfolio management team that has focused on both idiosyncratic risk and transaction costs. This approach, coupled with skilled execution of trading around index rebalancing and primary market issuance, has also allowed the fund to modestly outperform its index by approximately 10bps since its inception (on an annualised, gross of fees basis).

A diverse set of investors use the SPDR Thomson Reuters Global Convertible Bond UCITS ETF, ranging from insurance companies to wealth managers and multi-asset managers for both long and short-term exposures. Some of the fund’s key highlights include:

- A strong five-year track record
- 9th largest global convertible bond fund in Europe
- Relatively attractive pricing at 0.50% TER unhedged and 0.55% hedged (EUR and CHF share classes are already seeded)
- Transparency: Holdings, investor tools and insights are available daily on spdrs.com
- Physical replication, and fund does not employ securities lending
- Solvency 2 capital contribution: 23%, of which 10.5% is linked to currencies (can be lowered with a currency-hedged share class)¹

¹ Source: State Street Global Services.

* Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

Figure 4
Fund Details

	SPDR Thomson Reuters Global Convertible Bond UCITS ETF (Dist)	SPDR Thomson Reuters Global Convertible Bond EUR Hdg UCITS ETF (Acc)	SPDR Thomson Reuters Global Convertible Bond CHF Hdg UCITS ETF (Acc)
ISIN	IE00BNH72088	IE00BDT6FP91	IE00BDT6FS23
Share Class CCY	USD	EUR	CHF
Tickers	LSE: GCVB LN (USD)/GLCB LN (GBP) Deutsche Borse: ZPRO GY Borsa Italiana: CONV IM SIX Swiss: GCVB SE	Deutsche Borse: SPF1 GY Borsa Italiana: GCVE IM SIX Swiss: GCVE SE	SIX Swiss: GCVC SE
TER (%)	0.50	0.55	0.55
Index Name	Thomson Reuters Qualified Global Convertible Index	Thomson Reuters Qualified Global Convertible Monthly Hedged (EUR) Index	Thomson Reuters Qualified Global Convertible Monthly Hedged (CHF) Index
Index Tickers	UCBITRUS	UCBITREH	UCBITRCH
No. Index Constituents	267	267	267
Portfolio Construction	Physical — Sampled	Physical — Sampled	Physical — Sampled
Income Treatment	Distributing	Accumulating	Accumulating
Dealing Models Available	Cash	Cash	Cash
Cash Subscription	Yes	Yes	Yes

Source: State Street Global Advisors, Bloomberg Finance L.P., as of 31 October 2019.

Figure 5
Annualised Performance
(%, Expressed in Fund's
Base Currency)

	1 Month	3 Months	YTD	1 Year	3 Years	5 Years	Since Inception
Inception Date 14 October 2014							
SPDR® Thomson Reuters Global Convertible Bond UCITS ETF	2.89	7.09	13.52	13.52	20.83	26.44	30.12
Thomson Reuters Qualified Global Convertible Index	2.91	7.04	13.69	13.69	22.11	28.63	32.57
Difference	-0.02	0.04	-0.17	-0.17	-1.28	-2.20	-2.45
Inception Date 23 May 2018							
SPDR® Thomson Reuters Global Convertible Bond EUR Hdg UCITS ETF	2.09	5.68	11.45	11.45	—	—	1.91
Thomson Reuters Qualified Global Convertible Monthly Hedged (EUR) Index	2.12	5.65	11.71	11.71	—	—	2.25
Difference	-0.03	0.03	-0.26	-0.26	—	—	-0.35
Inception Date 17 Jul 2018							
SPDR® Thomson Reuters Global Convertible Bond CHF Hdg UCITS ETF	2.01	5.55	11.03	11.03	—	—	2.76
Thomson Reuters Qualified Global Convertible Monthly Hedged (CHF) Index	2.05	5.52	11.34	11.34	—	—	3.33
Difference	-0.03	0.02	-0.30	-0.30	—	—	-0.56

Source: State Street Global Advisors, as at 31 December 2019. **Performance quoted represents past performance, which is no guarantee of future results. Investment return and principal value will fluctuate, so you may have a gain or loss when shares are sold. Current performance may be higher or lower than that quoted. All results are historical and assume the reinvestment of dividends and capital gains. Visit spdrs.com for most recent month-end performance.** The calculation method for value added and returns may show rounding differences. Index returns are unmanaged and do not reflect the deduction of any fees or expenses. **Some of the products are not available to investors in certain jurisdictions. Please contact your relationship manager in regards to availability.**

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