CQS Strategy Perspectives

May 2022

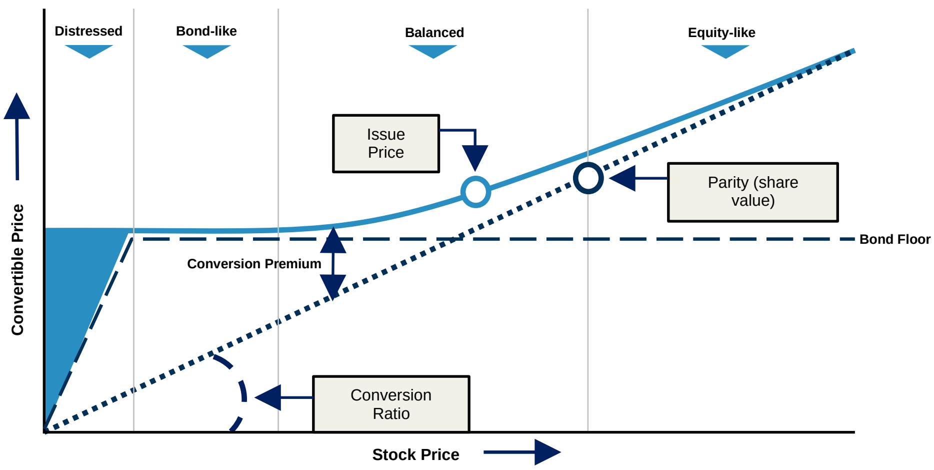
The Case for Convertibles

In the midst of the ongoing market uncertainty, Convertible bonds can be a good way to maintain exposure to stocks without having to endure their full downside. The diversification and embedded optionality that Convertible bonds provide are becoming increasingly valuable as volatility increases, offering investors protection from the bond floor in case the underlying stock loses value.

The Intrinsic Defensiveness of Convertibles

Downside protection is a distinctive characteristic of Convertibles resulting from their bond floor – or the minimum value that they have as a straight bond; this means that they should always trade at or above this value, regardless of how low the underlying stock drops. This, which assumes that the issuer's credit remains robust even when its equity price weakens, produces an asymmetric return profile: Convertible bonds provide greater upside than downside potential.

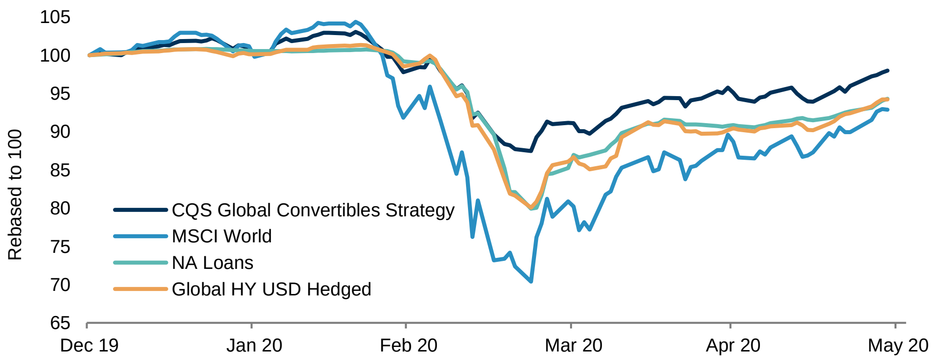
Convertible bond price behaviour



For illustrative purposes only.

Convertible bonds demonstrated the benefit of downside protection in 2020, when they outperformed equities and high yield bonds during the outbreak of Covid-19 and over the course of the year, with less volatility.

Convertible performance vs other indices during Covid-19 stress



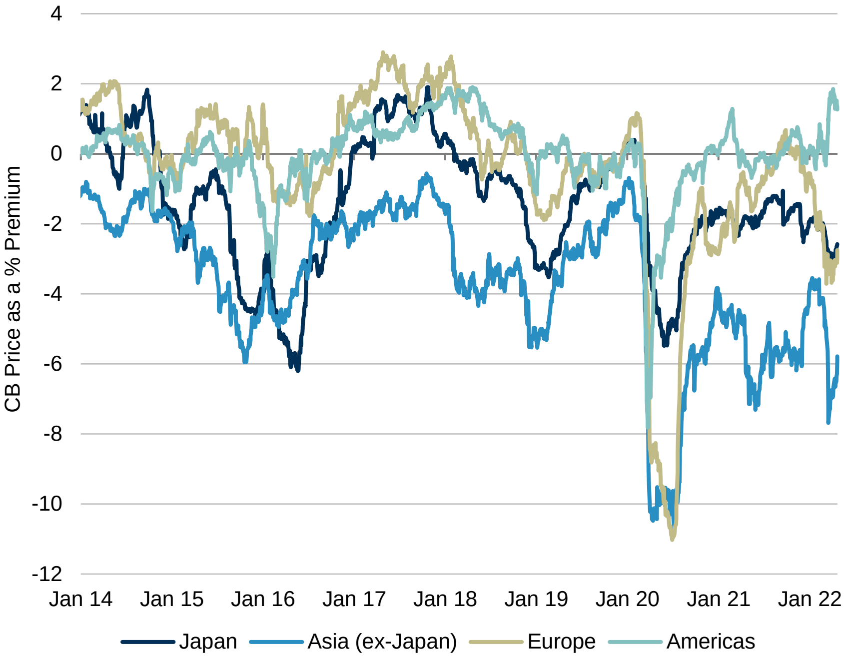
Source: CQS, Bloomberg and LCD as at 29 May 2020. All indices hedged to USD and rebased to 100 as at 31 December 2019. MSCI World: WHANWIHD Index. NA Loans: S&P/LSTA US Leveraged Loan Index. Global High Yield: HYDM (Hedged USD). Past performance is no guarantee to future results.

The value of securities may go down as well us up, depending on the performance of companies and general market conditions. The value at which securities in certain companies can be liquidated may differ, sometimes significantly, from the interim valuations. Investment in securities of certain companies may be less liquid, more volatile and subject to greater risks than securities of other companies. Investment in emerging markets may increase the volatility of the Fund's Net Asset Value, and accordingly, an investment in the Fund's Shares may be worth more or less on redemption than their original purchase value. As the Fund may invest in derivatives, such as swaps, it may lose more than the amount invested in such derivatives. Investors in shares denominated in a currency other than the base currency of the Fund may be affected by changes in currency movements. For full details of the relevant risks reference should be made to the risk factors sections of the Prospectus and Supplement.

Sound Entry Point with Attractive Valuations

In the present uncertain environment, Convertible valuations, in particular in Europe and Asia, are more attractive, offering investors an attractive entry point.

Cheapening valuations in Asia and Europe

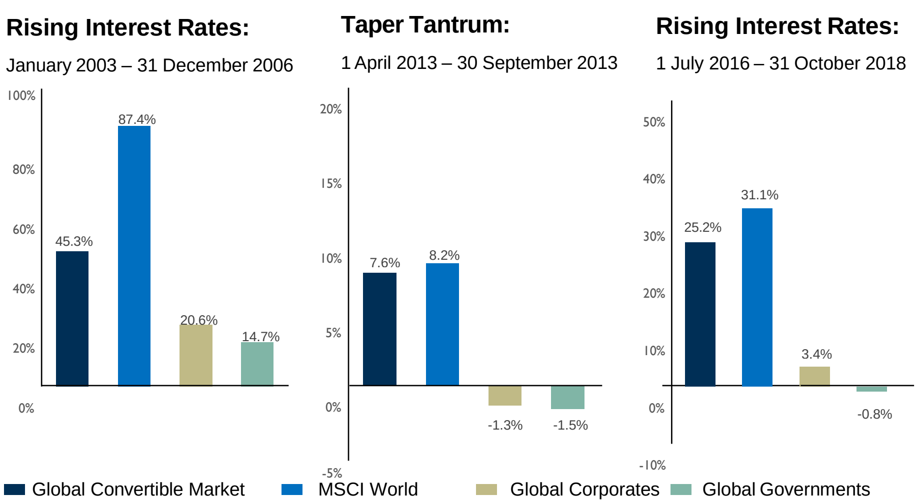


Source: CQS and Nomura as at 22 April 2022.

Convertibles Perform Well in Periods of Rising Interest Rates

The shorter duration of the asset class can also help investors mitigate interest rate risk. Convertible bonds have demonstrated strong performance relative to other asset classes in prior rate-rising periods, as shown in the graphs below.

Strong performance during rising-rate periods



Source: CQS and ICE BofA Merrill Lynch as at 31 December 2020. All total return, USD hedged. Please refer to the end of the Disclaimer for a full description of the indices. Global Convertibles: ICE BofAML Global 300. Convertible Index (VG00). MSCI World: MSCI World Equity Index. Global Corporates: ICE BofAML Global Corporate Index (G0BC). Global Governments: ICE BofAML Global Government Index (W0G1).

Additionally, we believe that Convertible bonds are less negatively exposed to rising inflation when compared to other asset classes. Convertible bond returns have shown strength during periods of moderately rising inflation as well as during the corresponding periods of rising interest rates that typically accompany inflation.

Good Alpha Opportunities from Security Selection

We believe Convertibles may generate alpha, as their return drivers generally differ from traditional asset classes. Record new primary issuance during recent years has led to a rich universe of Convertible bonds from a broad range of sectors and geographies. This provides Convertible bond managers with more opportunity to be selective and actively shift exposure to the areas that offer the best alpha opportunities. Skilled security selection will be a key to success this year.

A Source of Diversification

Convertibles have delivered attractive risk-adjusted returns through a blend of upside participation in rising markets and downside protection when stocks sell off. As shown below, they have produced the same annualised return as equities since 1996 – with lower volatility.

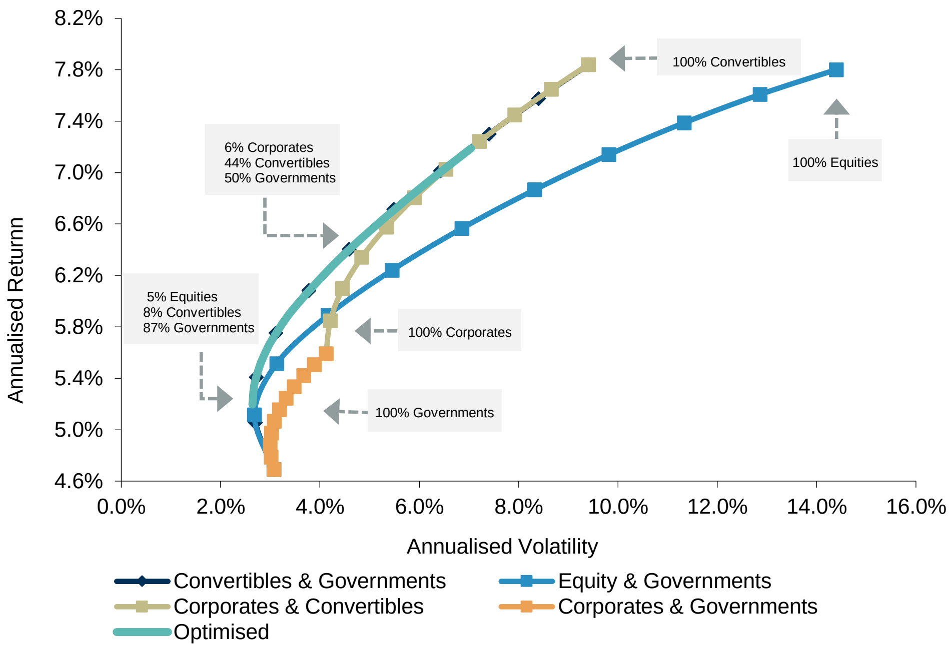
The value of convertible bonds

Asset Class	Annualised Return	Annualised Volatility	Sharpe Ratio
Global Convertibles	7.8	9.4	0.6
MSCI World	7.8	14.4	0.4
Global Corporates	5.6	4.1	0.8
Global Governments	4.7	3.1	0.8

All total return, USD hedged from 31 December 1996 to 31 December 2021. Source: CQS and ICE BofA Merrill Lynch as at 31 December 2021. N.B. 31 December 1996 is the inception date of BoAML G0BC Index. Global Convertibles: ICE BofAML Global 300 Convertible Index (VG00). MSCI World: MSCI World Equity Index. Global Corporates: ICE BofAML Global Corporate Index (G0BC). Global Governments: ICE BofAML Global Government Index (W0G1).

We believe that Convertibles can provide diversification for different levels of risk tolerance when included as a core component in a portfolio. The below chart shows a modelled efficient frontier based on the risk and return profile of the indices used. As shown, investors can achieve better returns with lower volatility by adding exposure to the asset class.

Convertible bonds improve the anticipated risk/return profile



Source: Bloomberg and BofA ML as at 31 December 2021. All indices are USD hedged and rebased as at 31 December 2020. Correlations, volatility and return are for illustrative purposes only.

Responsible Investing

Responsible Investing within Convertibles

The record level of Convertible issuance in 2020 and 2021 has generated renewed interest in the asset class. Consequently, issuance of green Convertible bonds is also on the rise, as Responsible Investing continues to be an increasingly key consideration for investors. Prior to 2020, there were only two green Convertible bond issues, however between May and December 2020, nine companies issued green Convertible bonds including EDF (Électricité de France) and Voltalia (1).

In 2021, approximately 5% of global Convertible primary issuance has been labelled as green. Examples include Enphase Energy, MP Materials, POSCO and Edenred.

Another issuer, Schneider Electric, launched the first sustainability-linked Convertible bond in November 2020. Although not technically a 'green bond', it links the performance of three Key Point Indicators (KPIs) to the coupon paid to investors (the three KPIs are CO2 emissions, gender diversity and the number of underprivileged people trained in energy management).

(1) Source: Responsible Investing Expands Further with Green Convertible Bonds, Crehalet, Kung and de Fay, 11 December 2020.

Article 8

Within the Convertible asset class, CQS has a number of mandates that are classified as Article 8 under the Sustainable Finance Disclosure Regulation (SFDR), which reflects the binding commitments the Funds and mandates are making. There is no change to the Funds' investment approach, the assets in which they invest or the risk and return profile we seek to deliver to investors in the Funds.

As a Firm, we are a signatory to the PRI and have pledged to join the Net Zero Asset Managers Initiative. We support the Task Force on Climate-Related Financial Disclosures and actively engage and collaborate with CDP and are a participant of Climate Action 100+.

Our Investment Team continues to focus on and invest in companies that demonstrate strong ESG characteristics, as well as adaptability and resilience in the transition to a low carbon economy, building a portfolio that considers risk, return and the outcomes of its investment decisions.

Alongside ESG exclusions (such as Thermal Coal, Gambling, Adult Entertainment, Payday Lending, Tobacco and failures of UN Global Compact), the update to the relevant Funds' Investment Policy includes commitments to achieve better ESG ratings and to maintain a lower weighted average carbon intensity than the Refinitiv Global Focus Index, together with achieving a net zero aligned portfolio by 2050 or sooner.

Conclusion

- We view Convertible bonds as well positioned to navigate the dual headwinds of higher inflation and rising rates in 2022
- We believe that an allocation to Convertibles will prove a useful source of diversification in a portfolio
- Record high issuance over the last two years has created opportunities and attractive valuations
- We believe that levels of green Convertible bonds will remain high in the coming months and years, offering opportunity to sustainability-minded investors

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