BlueBay
Asset Management

Where to take cover when volatility hits

PUBLISHED
March 2021

READ TIME
5 minutes

AUTHORS

Pierre-Henri de Monts de Savasse
Senior Portfolio Manager

Zain Jaffer
Portfolio Manager

With equity markets continuing to experience higher levels of volatility since the onset of the Covid-19 pandemic and greater uncertainty surrounding the withdrawal of fiscal and monetary support, could convertible bonds add something different to your portfolio?

As developed economies begin to emerge from the Covid-19 pandemic, uncertainty and fear has started to penetrate markets. The unprecedented levels of monetary and fiscal support that were issued to combat the economic and financial impact of the coronavirus need to be unwound, but the lack of clarity over how this will be achieved has resulted in increased volatility.

Concern has been rising among investors over the unwinding of the long-duration trade in recent months as they expect central banks to begin normalising interest rates from ultra-low levels.

This could have a significant impact on equity market leadership as growth stocks, such as the mega-cap tech companies, that have benefited from the long-duration trade, start to underperform more economically sensitive value stocks.

As such, the VIX Index – Wall Street's so-called 'fear gauge' and a measure of expected volatility in the S&P 500 Index – has risen in recent weeks amid expectations of a market rotation. In fact, the VIX has continued to trade at elevated levels since the onset of the pandemic in March 2020. We believe the pandemic acted as a trigger for a new regime characterised by higher volatility. Elevated levels are likely to remain in place as uncertainty persists regarding reflation, sector rotation and monetary policy.

But with further stimulus in the pipeline and a higher inflation environment likely – fuelled by stronger economic growth and higher levels of disposable income – we expect equity markets to continue to outperform.

When the going gets tough

Against such a backdrop, we believe there is a compelling case for an overlooked asset class – convertible bonds.

In volatile market conditions, convertible bonds have the potential to stand out. As a hybrid asset class, they comprise features of equities and bonds, combining the benefits of both.

Typically, when markets become more volatile or correct abruptly, a convertible bond's fixed income component offers a degree of protection for investors. In an income-starved environment where traditional fixed income assets offer low yields and dividends have been cut back, convertible bonds can seem more attractive.

The equity component means that as stock markets continue to rise, convertible bonds should also appreciate over the medium-to-long term. Our research has found that during more volatile times, convertible bonds can sometimes outperform equities.

The liquid hybrid

While the asset class hasn't attracted the huge sums that have been pumped into equities in recent weeks, more measured inflows mean there is a compelling valuation argument as prices, in our view, have not been pushed higher by indiscriminate buying.

As one of the leading asset managers in the space with an established track record, we can help you navigate one of the more specialist areas of the fixed income universe. Our actively managed approach and considerable experience means we can offer investors a volatility-managed strategy with compelling alpha-generation potential.

We believe convertible bonds can offer equity-like returns with lower volatility and some income at a time when stock markets are likely to remain volatile as the world emerges from a once-in-a-century pandemic.

We believe convertible bonds can offer equity-like returns with lower volatility and some income at a time when stock markets are likely to remain volatile.

Global Asset Management

BlueBay Asset Management