

RWC Global Convertible Bonds: Convexity in Action

March 2018

The last few months of volatility provide a good example of convexity at work. In the two Bloomberg snapshots on the next page, we have compared MSCI World and our

Fund. We looked at recent peak to trough moves in early February, then the subsequent rally decline and further rally and have summarised the returns in the following table:

	MSCI	RWC	Participation
26 January to 9 February	-9.0%	-4.3%	47.8%
9 February to 26 February	5.5%	2.9%	52.4%
26 February to 2 March	-3.2%	-1.4%	42.8%
5 March to 8/9 March	1.6%	1.6%	100%
26 January to 9 March	-5.6%	-1.3%	23.2%
YTD	1.3%	1.1%	85%

Source: RWC, Bloomberg, as at 28 February 2018

It is interesting to note that in the first drop, participation was just under 50% (slightly better than our delta would have implied). The subsequent rise is greater than the fall thanks to the convexity, and so the fall is lower and the following participating rise much greater. It's important to note that the subsequent rise is slightly larger than expected thanks to some active adds and good security selection which performed particularly well in March. However, the asset class dynamics are clearly helping. Hence in conclusion the participation from the current market peak, to today on the way down, has been small at 23.2%, which is exactly what the asset class should be providing. You can see that the YTD participation with the higher markets is very high. There is a small timing mismatch which is in our favour however we think the magnitude is small and negligible.

A specific question came up in a recent client meeting – “what would the participation to markets be like, if volatility picks up?”

We answered by saying that the first drop would be in line with our delta moves, but as volatility picked up we would start protecting more on the downside and participating more to the upside. This means that if markets were to rise in a volatile way, our participation to the upside would be meaningfully higher than in the last few years. This is playing out exactly as expected and we think this will continue. This environment is ideal for the asset class and we believe a higher volatility and rate environment will persist for the foreseeable future.

No investment strategy or risk management technique can guarantee returns or eliminate risks in any market environment.



Source: RWC, Bloomberg, as at 28 February 2018

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