

Global Convertibles Quick Note

Hedge funds own the majority of CBs

Holdings lists suggest hedge funds own most CBs globally

Hedge funds now hold about 55% of global convertible bond assets while outright investors own 45%, according to the most recent holdings lists of all outstanding CB issues (Exhibit 1). Of outright investors, our holdings analysis suggests that close to three-fourths are investment advisors, while the remainder is split among banks, insurance companies, and other, which includes the likes of pension funds, sovereign wealth funds, and private equity (Exhibit 2). While a telling trend, please note that our CB holdings analysis does have limitations—not all investors report their holdings (indeed, we’ve found that a number of large accounts do not appear on owners lists), some report on a delay, and several multi-strategy shops that offer both outright and arbitrage strategies do not specify to which portfolio each CB belongs. Additionally, we rely on Bloomberg’s classification of which investors are outright versus which are hedge funds.

Hedge funds are more dominant in the US than in Europe

Regionally, we’ve found that US and Asian CBs are more-held by hedge funds than European CBs (Exhibit 3), while investor domicile follows a similar trend. Indeed, among US-based holders of CBs, hedge funds own 70% of total assets, followed by UK-based holders (34%) and Asian-based holders (24%). In contrast, our analysis suggests that continental European-domiciled convertible bond holders are almost exclusively outright investors (Exhibit 4). This trend is logical as names in the European convertible bond market generally have lower deltas and less vol, features less-favored by hedge funds (please refer to our comprehensive [Convertible Arbitrage Primer](#) for more details).

A hedge fund-led CB market hasn’t existed since pre-GFC

Our top-down analysis of CB market ownership (based on convertible arbitrage investor total AUM and leverage estimates) also indicates that hedge funds now control a roughly 55% share of the market. Notably, this marks the first time since Q4 2007 that hedge funds have owned the majority of the CB space (Exhibit 5). In the roughly 16 years following the Global Financial Crisis, when the highly levered convertible arbitrage strategy infamously struggled, outright managers have been a more dominant presence in the convertibles market, comprising about two-thirds of the space, on average.

Why? Performance, new supply expectations, and flows

We think the rise in hedge fund participation can be attributed to a number of factors. First, CB arb logged solid performance last year as managers returned 5-10% (see our [02-Jan Postmortem](#)) versus an annual average gain below 5% since 1998, according to the HFR CB Arb Index. Second, we think hedge funds have been gearing up for a sizable pickup in CB new supply (in-line with our expectations—see our [2024 year ahead](#)). Historically, stronger issuance has benefitted hedge funds, who are well-positioned to capitalize on new deal discounts and the technical trading opportunities that arise from portfolio rebalancing. Finally, outright CB funds, particularly those in Europe, have faced outflows in recent months, whereas hedge fund flows have been more stable (Exhibit 6).

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Refer to important disclosures on page 3 to 5.

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Convertibles Strategy
Global

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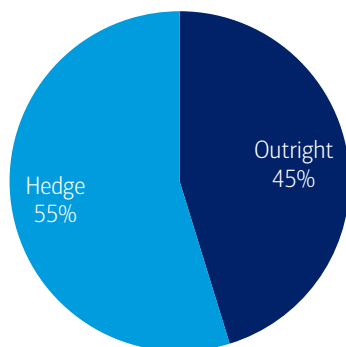
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Abbreviations

- Arb: Arbitrage
- AUM: Assets under management
- CB: Convertible bond
- GFC: Global Financial Crisis
- HF: Hedge fund
- SEC: Securities and Exchange Commission

Exhibit 1: Breakdown of global CBs market based on bond holdings

Based on the holders lists from the most recent SEC filings, hedge funds own 55% of the global convertibles market, while outright investors own 45%

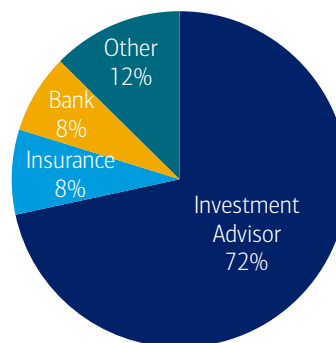


Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 12-Jan-2024.

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Exhibit 2: Breakdown of outright investors based on bond holdings

Of outright managers, investment advisors remain the largest cohort, while insurance companies, banks, and others are much smaller

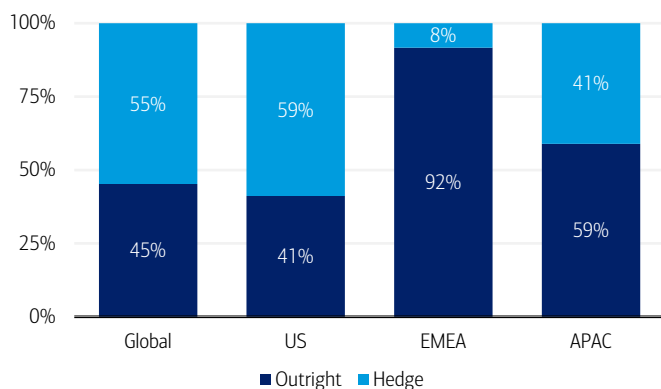


Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 12-Jan-2024.

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Exhibit 3: Regional CB market breakdowns by investor type

Hedge funds hold almost 60% of convertible bonds issued by US companies, whereas they own less than 10% of those issued by European companies

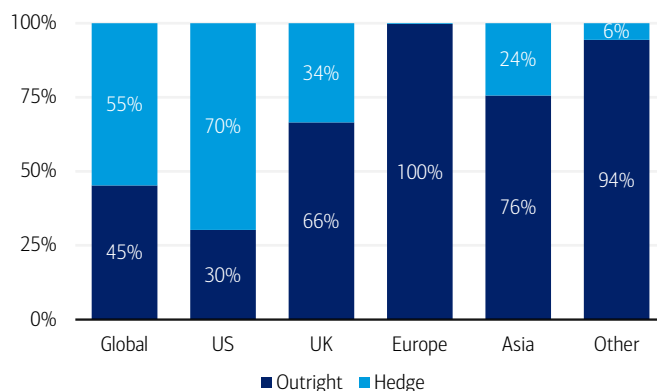


Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 12-Jan-2024.

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Exhibit 4: CB investor domicile breakdown by investor type

Among CB investors domiciled in the US, HFs own 70% of assets, the most of any region, while of UK investors, HFs own about one-third of assets

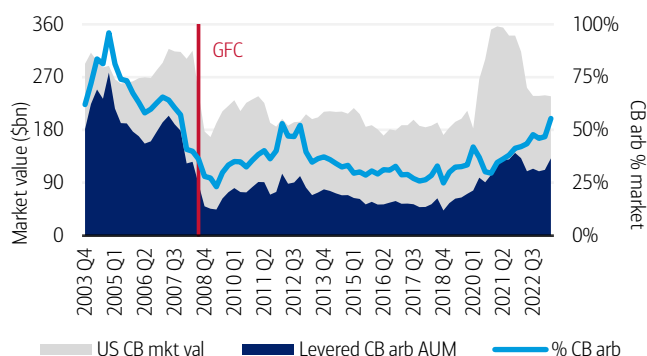


Source: BofA Global Research, Bloomberg, ICE Data Indices, LLC. Data as of 12-Jan-2024.

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Exhibit 5: Estimate of CB arbitrage portion of total convertibles AUM

Applying an approximation of the market's leverage, we estimate CB arb comprises about 55% of total CB assets today, the most since pre-GFC

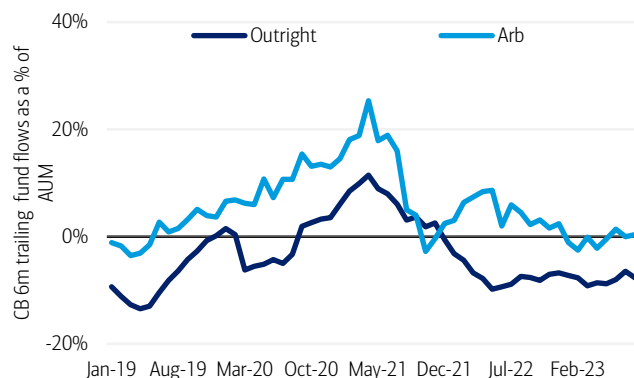


Source: BofA Global Research, BarclayHedge, ICE Data Indices, LLC. Data as of 30-Jun-2023.

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Exhibit 6: CB outright versus arbitrage 6m trailing fund flows

While outright convertible bond funds globally have realized outflows recently, convertible arbitrage funds have been closer to net-flat



Source: BofA Global Research, EPFR Global. Data as of 31-Aug-2023.

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