Global Convertibles Chartbook

The CB market is ripe for arbitragers

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Convertibles
Global

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CB investor mood has improved, especially within the US

While the results from our most recent Global Convertibles Investor Survey were not overly bullish, they did indicate an improvement in mood compared to our previous results from last November, particularly among the US market. Indeed, investors believe that the US will deliver the best performance, and they have boosted their positioning within the region. Why? Investors are now hopeful that rates have peaked, and they have a more favorable opinion of growth and tech, among the most prominent of CB sectors.

Sentiment suggests arbs are best positioned within CBs…

Notably, however, investors favor convertible arbitrage over outright strategies for the first time. Manager sentiment offers clues as to why—respondents believe that market valuations now look cheap (particularly outside the US), their expectations for new supply remain elevated (exceeding even our own forecasts), and concerns about rising geopolitical tension may support volatility. Outflows from CB funds, most notably European outrights, help to underscore this view, as does our earlier analysis, which shows that hedge funds have overtaken outright investors as the leading holders of CBs.

…though there's plenty of opportunity for outrights as well

Nonetheless, investor sentiment still suggests there plenty of opportunity for outright investors within the CB space. Indeed, outrights would also benefit from a strong primary calendar, and they'd stand to gain meaningfully if declining interest rates boost tech, growth, and small-caps, which remain under-owned even within the CB market.

CB momentum stalled, but broader rally may fuel next leg

Global convertible bonds lost 0.6% last month, curbing the rates-driven momentum that powered CBs higher in November and December. However, our equity strategists believe that small- and mid-caps may outperform from here, which may benefit the CB space. Regionally, within CBs, Japan-Euro outperformed (+3.9%), while the US dropped (-1.2%).

Issuance off to slow start, but that's in line with history

Global CB primary volumes totaled just under $5.2bn in January. While disappointing versus elevated expectations for 2024, the volumes were aligned closely with history. Indeed, January totals are usually light amid the holiday hangover and earnings blackouts.

Outflows persist, though US funds were relatively resilient

Weekly fund flow data from January suggests that the outflow trend that tested CB funds in 2023 continued into the first month of 2024. Outflows remained heavier among global, European, and Asian CB funds, while in comparison, US fund outflows were much lighter.

Chartbook access

To view the Excel Chartbook, which includes a variety of data, tables, and charts focused primarily on returns, markets characteristics, and supply and demand, among other topics, please refer to our Global Convertibles Chartbook.

Chartbook access:

Access the Chartbook here.

Exhibit 1: Global convertible performance

Local currency terms

Region	Code	Jan '24	YTD
G300	VG00	-0.62%	-0.62%
US	VXA0	-1.16%	-1.16%
Europe	VE00	-0.29%	-0.29%
Asia-ex Japan	VASI	-2.37%	-2.37%
Japan Domestic	VJDM	--	--
Japan Euro	VJEU	3.92%	3.92%
Emerging Markets	VEMK	-2.74%	-2.74%

Source: ICE Data Indices, LLC

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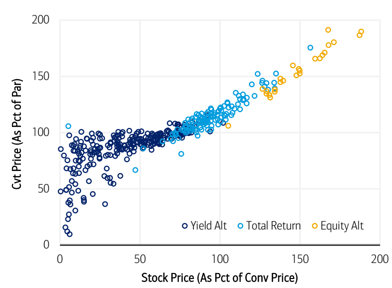
Exhibit 2: Global convertibles Tableau visualization tool

Click the chart to access the tool



Source: BofA Global Research, ICE Data Indices, LLC. Universe capped at names which are trading at less than 200% of par. Mandatories are excluded.

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We include a list of abbreviations at the end of this report.

Trading ideas and investment strategies discussed herein may give rise to significant risk and are not suitable for all investors. Investors should have experience in relevant markets and the financial resources to absorb any losses arising from applying these ideas or strategies.
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Refer to important disclosures on page 19 to 21. 12647382

Timestamp: 01 February 2024 02:33PM EST

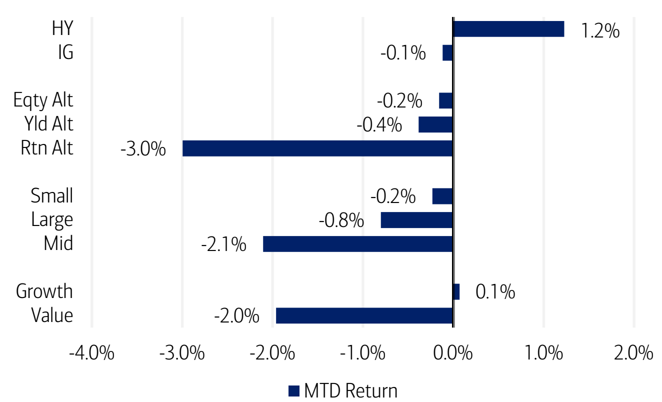
CB returns stalled in January, but small cap gains may provide a boost in 2024

In a reversal of its Q4 2023 rates-driven resurgence, global CB momentum stalled last month (the ICE BofA Global G300 index lost 0.6% in January) as the market's rate-cut expectations for 2024 subsided. Indeed, following the January FOMC meeting, our economists trimmed their call to three 25bps rate cuts, starting in June (see their 31-Jan US Watch). Regardless, we're hopeful that CB performance can improve from here, particularly if the current stock rally broadens out to small- and mid-cap names, which dominate the CB universe—a notion that now seems more feasible in light of recent disappointment among big tech earnings. Indeed, our equity strategists think that small caps may outperform large caps for the first time in a decade due to fundamental macro support, improving market breadth, light positioning, and a historic valuation discount to large caps, among other reasons (see their 19-Jan Small/Mid Cap Strategy Year Ahead report). Nonetheless, ongoing momentum among mega-cap tech remains a key risk to this view.

On CB regional performance, Japan-Euro (+3.9%) was the only market to gain last month, while Europe (-0.3%), the US (-1.2%), and Asia (-2.4%) each declined (Exhibit 1). On a hedged basis, CBs returned -0.8%, as measured by the HFR Convertible Arbitrage Index. Digging into US CB performance last month, mid-delta "balanced," value, and mid-cap names underperformed (Exhibit 3), while on sectors, materials and consumer discretionary lagged. In contrast, telecoms, media, and tech led to the upside (Exhibit 4).

Exhibit 3: US convertible bond performance by bucket

Mid-delta "balanced," value, and mid caps underperformed last month…



Source: ICE Data Indices, LLC

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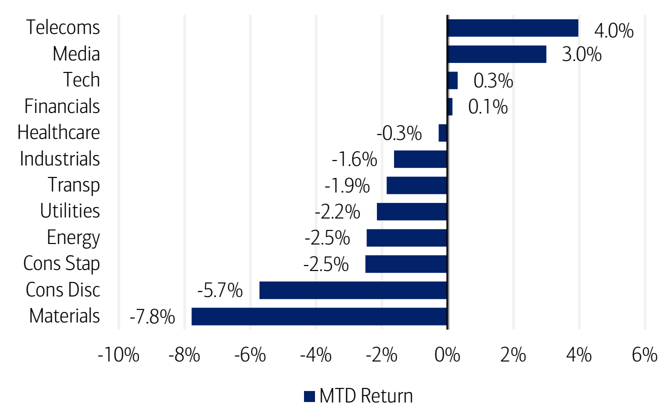
Exhibit 4: US convertible bond performance by sector

…while the telecoms, media, and tech led sectors on the upside



Source: ICE Data Indices, LLC

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Last month, among the asset classes we track, global IG bonds, HY bonds, and equities realized gains, while convertibles and government bonds declined (Exhibit 5). In detail, on a local currency basis, equities, as represented by the MSCI World index, led (+1.3%), followed by HY (+0.4%), IG (+0.1%), sovereign credit (-0.6%), and CBs (-0.6%).

Exhibit 5: Global cross asset returns

Both USD and local currency terms

Asset Class	Code	Jan '24 USD	Jan '24 LOC	YTD USD	YTD LOC
Global Govt Bonds	W0G1	-1.80%	-0.55%	-1.80%	-0.55%
Global IG Index	G0BC	-0.47%	0.06%	-0.47%	0.06%
Global HY Index	HW00	0.06%	0.41%	0.06%	0.41%
MSCI World Equity Index	GDUEACWF	0.61%	1.26%	0.61%	1.26%
Global Convertibles (G300)	VG00	-1.05%	-0.62%	-1.05%	-0.62%

Source: ICE Data Indices, LLC

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For comprehensive data on returns, including detailed breakouts by structure and sector, heat maps, and single names, please refer to section 1 of the attached Excel Chartbook.

Feb '24 Global Convertibles Survey

The CB market is ripe for arbitragers

Last month, we concluded our quarterly Global Convertibles Investor Survey, aimed at both our institutional and hedge fund clients spanning across all regions. Participation was solid as we tallied 41 respondents from both institutional accounts and hedge funds across the US, Europe, Asia, and other (please refer to Exhibit 6 for a breakdown, and we include a more detailed section at the end of the survey). Key takeaways from the current survey include the following:

Exhibit 6: Survey response breakdown

How can your fund be classified, and where are you based?

	All	US	Europe	Asia-ex Jp	Other	Instit	HF	Other
Convertibles	35	18	15	1	1	19	15	1
Equity	2	1	1	0	0	2	0	0
Fixed Income	4	3	1	0	0	0	3	1
Total	41	22	17	1	1	21	18	2

Source: BofA Global Convertibles Survey

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- **Mood has improved, particularly among the US market:** While it would be hard to characterize investor sentiment as overly bullish, broadly the mood has become more favorable relative to November's survey, particularly among the US CB market. Indeed, positioning has improved among US names (Exhibit 7 and Exhibit 8), US CB valuations have remained well-supported (Exhibit 15), and performance expectations among US names is the strongest in the both the short and long term (Exhibit 21). Versus other asset classes, now more than half of respondents expect CBs to deliver the best risk-adjusted performance over the next 12 months, a reversal from November, when relatively few investors favored CBs (Exhibit 19 and Exhibit 20).

- **Why the upgrade in sentiment? Lower rates and improved tech and growth:** Respondent views on the direction of rates and their sector and style expectations offer clues as to why their sentiment has improved. Indeed, managers now expect borrowing costs to decline over the next 6 months, their first expectation for falling rates since May 2020 (Exhibit 34), and most expect the Fed to cut benchmark rates 3-4 times before year-end (Exhibit 40). Additionally, compared to last quarter investors now have a more favorable opinion of tech and growth (Exhibit 9, Exhibit 37, and Exhibit 45), which are among the most prominent sectors in the CB market.

- **Regardless, participant think relative value exists only outside the US:** Though clients are most optimistic on the US, they see little value there. Indeed, they think all regions excluding the US look cheap to fair value, especially Asia (Exhibit 15). However, investors have little conviction that Europe, Asia, and Japan will richen (Exhibit 16).

- **Though lower than the previous quarter, issuance expectations remain high:** While the bullish sentiment on new supply has dropped somewhat, investors remain quite hopeful for abundant issuance volumes in 2024 (Exhibit 24). In fact, manager expectations for this year's primary market volumes exceed our own (Exhibit 27).

- **What's keeping managers up at night? Escalating geopolitical tensions:** CB investors indicated their leading macro concern as rising geopolitical risk (Exhibit 30 and Exhibit 31). Notably, while geopolitical tension has been on investors' radar over the shorter term for a while, it also superseded both recession and defaults as the top long-term concern for the first time since mid-2022 (Exhibit 32 and Exhibit 33).

- **This considered, participants see CB arb as the top market strategy:** For the first time, survey participants indicated that convert arbitrage was the top market strategy (Exhibit 42 and Exhibit 44). This is no surprise given the sentiment around valuations, issuance, and volatility—all which are supportive of CB arb. However, within outright strategies, respondents noted a preference for owning mid-delta "balanced" CBs over "busted" CBs or high-delta names (Exhibit 43 and Exhibit 18).

- **CB managers continue to report net outflows:** Consistent with the above, CB funds, particularly European-based outright investors, continued to report net outflows over the last 3 months (Exhibit 22). However, there's more optimism going forward as investors globally expect net inflows over the next 3 months (Exhibit 23).

Market positioning

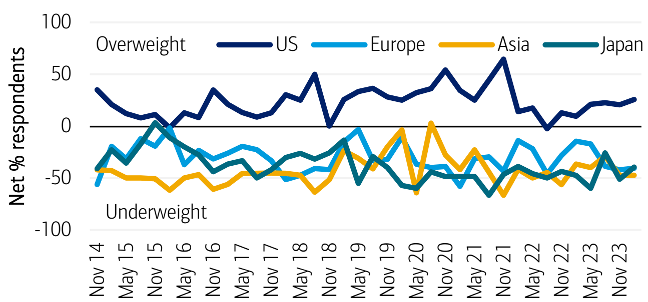
Regional positioning: Investors more optimistic on the US and Japan

In our most recent survey, global respondents suggested that positioning improved across CBs in all regions, though they remain overweight US CBs and underweight the names in the other three regions. Specifically, net 26% of global respondents said that they were overweight US securities, up modestly from last quarter's net 21%. Positioning among both European and Asian CBs rose very slightly from net 42% to net 41% underweight and from net 48% to net 47% underweight, while sentiment improved much more sharply among Japanese convertibles. Indeed, the underweight positioning in Japan moved from net 51% to net 39% (Exhibit 7).

Regional sentiment becomes clearer when looking at European convertible bond investor positioning on its own given that European investors are generally more globally focused than their US counterparts. Here, the pickup in US and Japanese CB positioning becomes even more evident, while the gain in positioning among European and Asian CBs was much more modest. Notably, European investor sentiment among US CBs rose to its most bullish levels since November 2021 (Exhibit 8).

Overall, this sentiment generally indicates modestly better CB performance expectations from here, particularly among US and Japanese names, which is aligned with our views (see our 2024 year ahead outlook report for details).

Exhibit 7: Client positioning among CBs across all regions improved versus the previous quarter, especially among US and Japanese names
What is your position in convertibles by region relative to your benchmark?



Source: BofA Global Convertibles Survey
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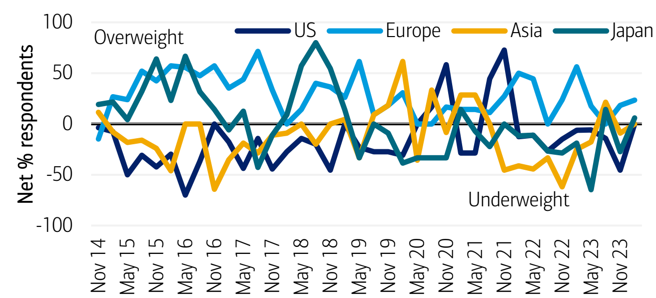
Exhibit 8: European respondent data suggests global-focused investors are saw the biggest rise in sentiment among US and Japanese names
What is your position in convertibles by region relative to your benchmark?



Source: Global Convertibles Survey
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Sector positioning: Positioning among higher-beta sectors generally improved

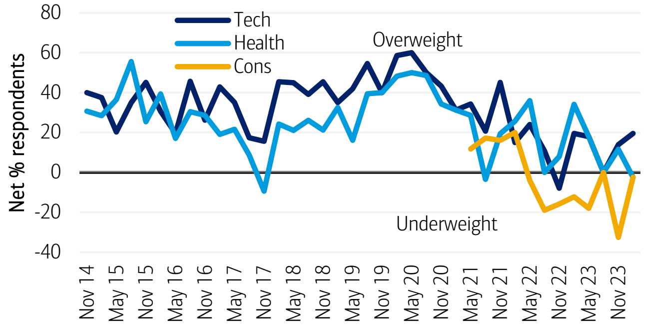
Positioning in the higher-beta, growth-proxy sectors mostly rose versus last quarter, though it remains depressed relative to history (Exhibit 9). Specifically, global survey respondents were net overweight tech (20%), up from net 14% last quarter, and consumer discretionary sentiment improved largely from net 33% to net 2% underweight. However, positioning among healthcare CBs dropped to net 2% underweight, near all-time lows, according to our data (Exhibit 9).

Among value-proxy sectors, sentiment was also mixed. Most notably, positioning in industrials names rose to net 7% overweight, though positioning in energy and financials sector CBs dropped to net 23% and net 46% underweight, respectively (Exhibit 10).

When comparing each sector's net positioning to its own history using a Z-score, it is evident that despite the drop in sentiment, energy remained the most overweight versus its own history. Following energy was consumer discretionary. On the other hand, the healthcare sector moved to the most underweight compared to its own history (Exhibit 11).

Aligned with this positioning data, in this quarter's special survey question, respondents suggested that the tech sector offered the best value, while financials and real estate offered among the least value (Exhibit 45 and Exhibit 46).

Exhibit 9: Positioning in the high-beta tech and consumer sectors rose relative to last quarter, though positioning in healthcare declined
What is your position in convertible sectors relative to your convertibles benchmark?



Source: BofA Global Convertibles Survey

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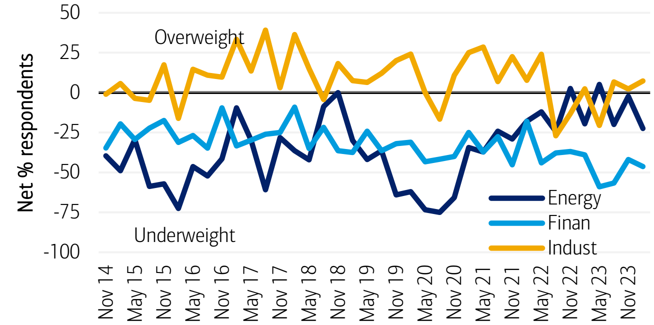
Exhibit 10: Positioning among energy and financials sector converts declined relative to the previous quarter
What is your position in convertible sectors relative to your convertibles benchmark?



Source: BofA Global Convertibles Survey

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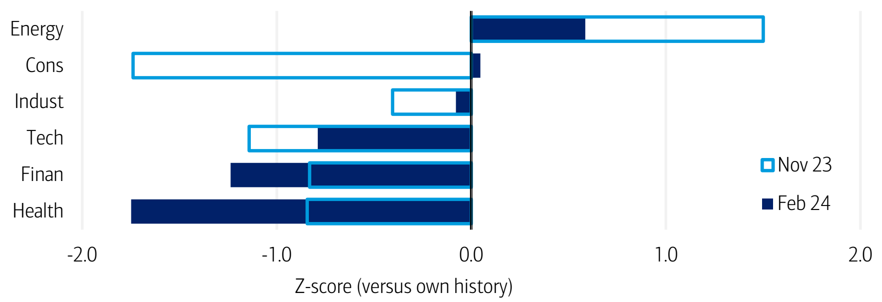
Exhibit 11: Versus its own history, energy remains the most overweight sector (though sentiment is weaker than it was in the previous quarter), while healthcare is now the most underweight
What is your position in convertible sectors relative to your convertible benchmark?



Source: BofA Global Convertibles Survey

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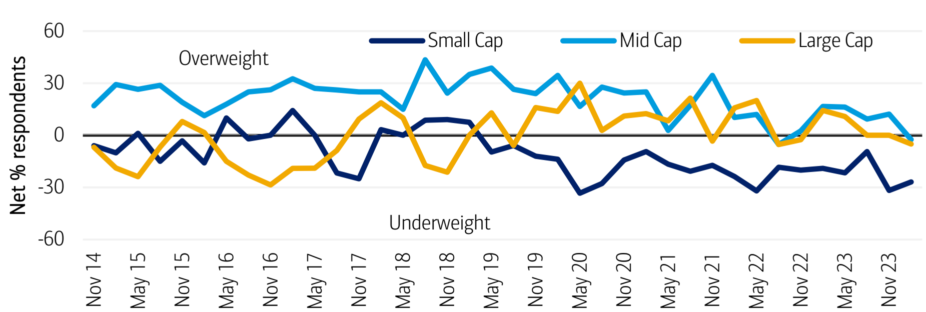
Company size positioning: CBs from small-cap issuers remain under-owned

Last quarter's survey results show that global convertible investor positioning in small-cap issuers increased slightly compared to the previous survey (now net 27% underweight from net 32% underweight), though they remain under-owned versus those from larger-cap issuers (despite their attractive relative value versus their larger-cap peers). In contrast, positioning in CBs from mid- and large-cap issuers dropped from net 12% overweight to net 2% underweight and from net flat to net 5% underweight, respectively—the most bearish sentiment for each since August 2022 (Exhibit 12).

Exhibit 12: Investors are now less underweight small-caps than they were during the previous quarter, though CBs from small-cap issuers remain under-owned
What is your position in convertibles based on company size relative to your convertible benchmark?



Source: BofA Global Convertibles Survey

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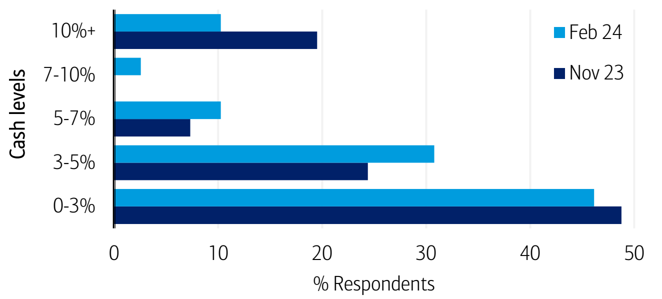
Cash levels: Portfolio cash balances remain low versus history

Survey response data on cash levels suggests that portfolio cash balances slightly fell relative to the previous quarter, and they remain modestly low versus history. Indeed, the most respondents (46%) still hold just 0-3% cash, the second-most (31%) hold just 3-5% cash, and additionally much fewer (just 10%) now hold 10%+ cash (Exhibit 13). This considered, the global weighted-average cash level rose to 3.8%, low versus the historical average of 4.3% (Exhibit 14).

Exhibit 13: Most investors hold 0-3% cash in their portfolios
What is the current cash weighting within your portfolios?



Source: BofA Global Convertibles Survey

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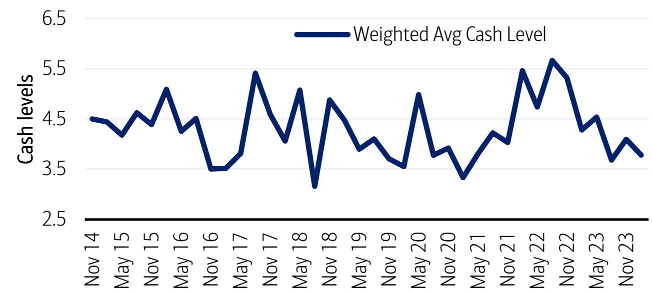
Exhibit 14: Weighted-average cash levels remain low versus history
What is the current cash weighting within your portfolios?



Source: BofA Global Convertibles Survey

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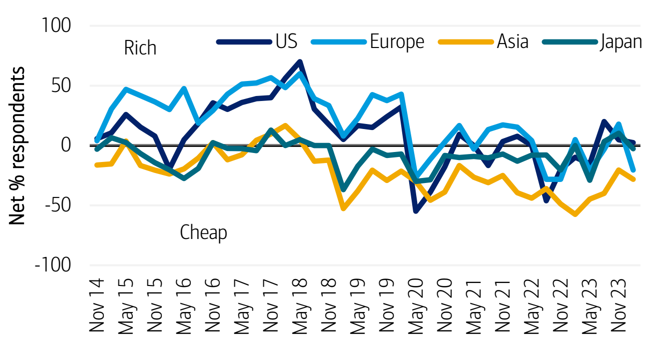
Valuations

Regional valuations: Clients think CBs outside the US are cheap to fair value

Clients generally think that CBs are cheap to fair value across regions, except for the US, where net 2% of respondents think that the CBs are rich, down from net 5% in the previous quarter (Exhibit 15). In contrast, net 21%, net 28%, and net 3% think that CBs in Europe, Asia, and Japan are cheap to fair value—sharp shifts for Europe and Japan, which clients thought were rich in the previous quarter. This sentiment is also consistent with our fair value data, which also indicates that Asia remains the cheapest of all CB regions (see tab 2.05 of our [Global Convertibles Chartbook](https://)).

Notably, clients expect CBs in nearly all regions (except for the US) to be cheaper during the next quarter. Specifically, net 16% think that European CBs will be cheaper, while net 37% and 13% of respondents think that Asian and Japanese CBs will be cheaper. In contrast, net 5% of clients think that US CBs will trade richer to fair value (Exhibit 16).

Exhibit 15: Clients think that Asia, European, and Japanese CBs are cheap, while they think that the US CBs are rich to fair value
Do you think valuations in convertibles are rich, cheap, or fair value?



Source: BofA Global Convertibles Survey

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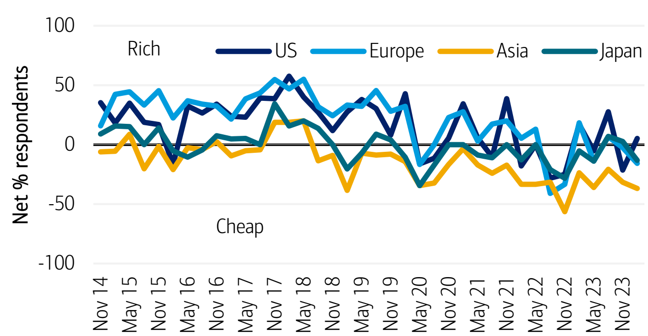
Exhibit 16: Clients expect non-US CBs to remain cheap, while they think that US CBs will stay rich
Where do you see valuations over the next 3 months?



Source: BofA Global Convertibles Survey

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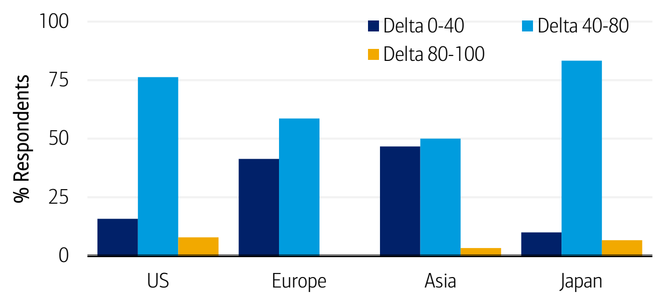
Value across delta ranges: Sentiment on "balanced" names continues to climb

Survey respondents thought mid-delta "balanced" names (40-80% delta) were the most attractive for CBs across all regions (Exhibit 17). Globally, respondents preferred "balanced" to "busted" for the fourth time in a row, in contrast to early last year and 2022, when low-delta (0-40% delta) yield alternatives and "busted" CBs were in favor. Preference for high-delta equity-alternatives (80-100% delta) also remained very low (Exhibit 18).

These results are aligned with the results of one of our special survey questions, which indicated that investors thought that among the most attractive opportunities in CBs were "balanced" names (behind only CB arb). Fewer clients preferred "busted" names, and just a handful preferred high delta and mandatories (Exhibit 42 and Exhibit 43).

Exhibit 17: For CBs across all regions, global investors prefer mid-delta "balanced" names

Where do you see the best value in convertibles today?



Source: BofA Global Convertibles Survey

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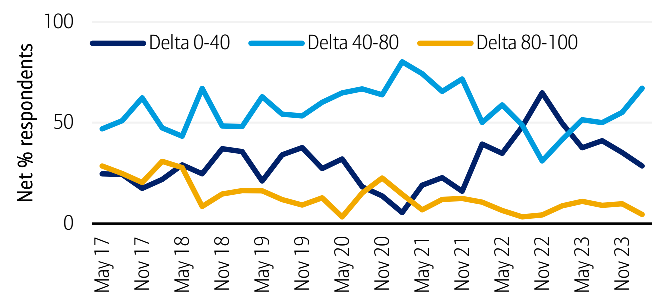
Exhibit 18: Clients globally prefer mid-delta "balanced" CBs to low-delta CBs, and that sentiment continues to grow

Where do you see the best value in convertibles today?



Source: BofA Global Convertibles Survey

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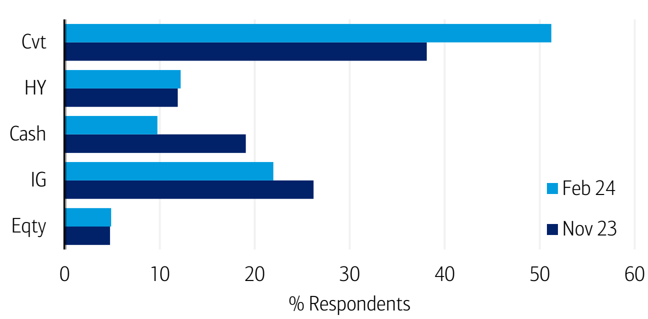
Top asset class and regional picks: After CBs, clients still favor IG bonds

On risk-adjusted performance expectations, most respondents (51%) indicated that CBs would outperform over the next 12 months compared to stocks, HY, IG, and cash. While the sentiment certainly improved versus the previous quarter (when just 38% said that CBs would outperform), January's results were still weaker than the historical average, according to our data (Exhibit 19 and Exhibit 20).

Second to converts, 22% of clients said that IG bonds would see the best risk-adjusted performance over the next 12 months, indicating a bid to quality and duration for the second month in a row. Fewer clients preferred HY bonds (12%), cash (10%), and stocks (5%). Notably, this marked the fourth time since August 2019 that clients ranked stocks last in terms of risk-adjusted performance expectations.

Exhibit 19: 51% said CBs would outperform on a risk-adjusted basis over the next 12 months, higher than in the previous quarter

Which asset class will have the best risk-adjusted returns over the next 12 months?



Source: BofA Global Convertibles Survey

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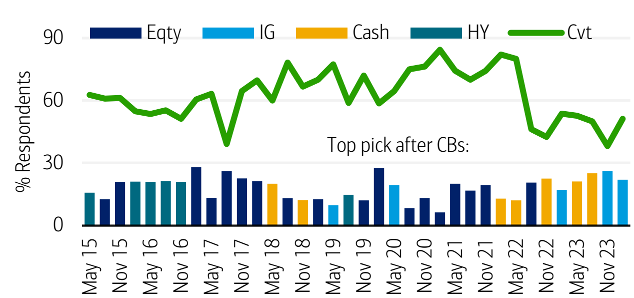
Exhibit 20: Following CBs, the second-largest portion of clients thought IG bonds would offer the best risk-adjusted performance

Which asset class will have the best risk-adjusted returns over the next 12 months?



Source: BofA Global Convertibles Survey

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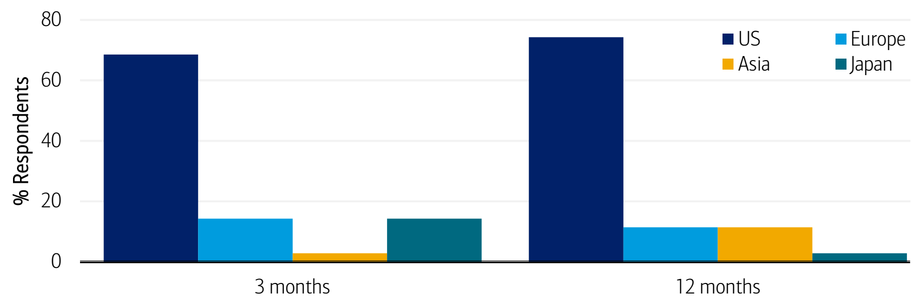
Within CBs explicitly, a majority of our global respondents believed that US CBs would offer the best risk-adjusted returns over the next 3-month (69%) and 12-month (74%) periods (Exhibit 21). This corresponds with the regional positioning data from global investors, which suggests that clients are still overweight US CBs while underweight the other regions (Exhibit 7).

Exhibit 21: Clients strongly preferred US CBs in both the short and long term
Which region will have the best convertible returns over the next 3 and 12 months?



Source: BofA Global Convertibles Survey

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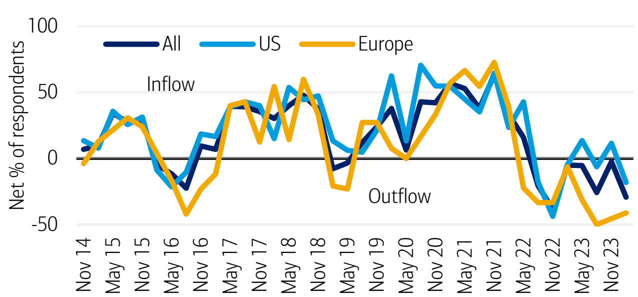
Supply and demand

Expectations for net inflows: CB funds saw outflows, topped by European funds

Last quarter, net 29% of global respondents saw net outflows, more than what we saw during the previous quarter (Exhibit 22). European managers continued to experience the most outflows (net 41%), though US investors also saw outflows (net 18%). Sentiment going forward looks more optimistic, as net 15% of global investors expect inflows next quarter, led by US-domiciled investors (net 33%). However, net 6% of European CB investors expect further net outflows, underscoring their bearishness (Exhibit 23).

Exhibit 22: CB funds globally reported net outflows
Over the last 3 months, have you seen net inflows or outflows to the convertible funds that you manage?



Source: BofA Global Convertibles Survey

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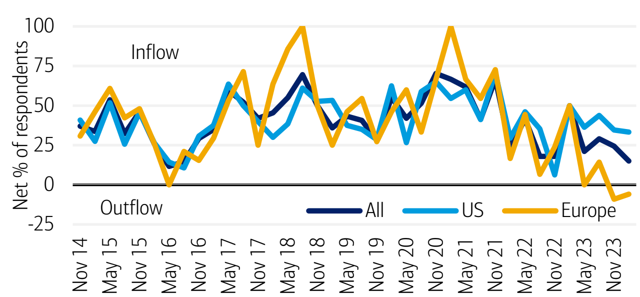
Exhibit 23: US investors expect inflows, but European expect outflows
What are your expectations for net inflows or outflows over the next 3 months?



Source: BofA Global Convertibles Survey

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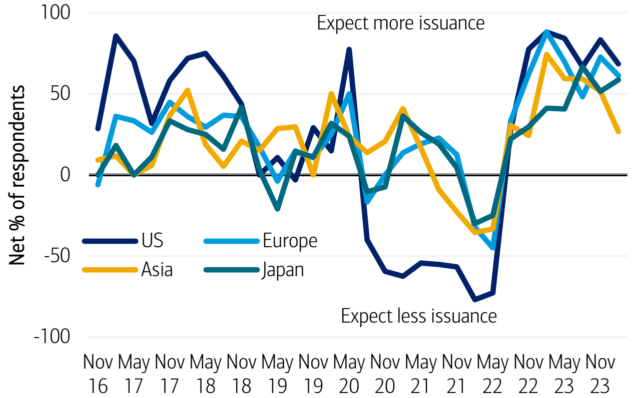
Supply expectations: CB new deal hopes have come down, but they remain high

Though issuance expectations remain below February's records (and the previous quarter's levels), they are still quite optimistic versus history. Specifically, net 68% of investors globally indicated that they expect to see more new deals from US issuers in the next 12 months versus 83% in November. Sentiment was similarly bullish for more European new deals (net 61%), though it was less strong for Asian (net 27%) and Japanese (net 59%) new deals (Exhibit 24).

On new deal credit quality, most expect quality to improve for US, Asian, and Japanese new deals, though for European new deal quality sentiment is pretty muted. Indeed, for European CBs, investors were evenly split as to whether or not new deal credit quality will improve (Exhibit 25). Indeed, we saw a record amount of IG-rated new paper in 2023 (see our 02-Jan-2024 Global Convertibles Chartbook for details).

Exhibit 24: CB new issuance expectations remain elevated for all regions, though sentiment has weakened for Asia new deals
New issuance levels over the next 12 months relative to the previous 12 months will be higher or lower?



Source: BofA Global Convertibles Survey

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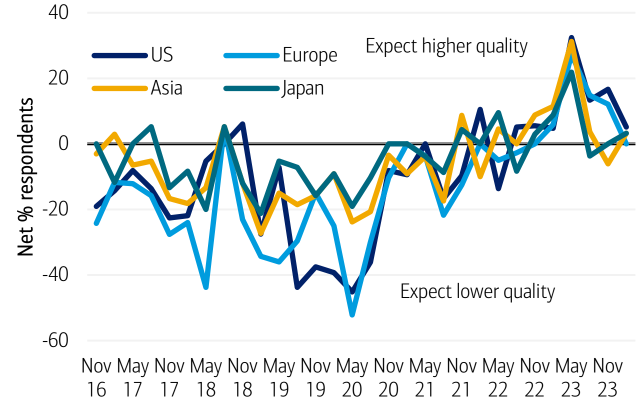
Exhibit 25: Clients think that deals will be of higher quality, though sentiment has softened
Credit quality of new issuance over the next 12 months will be higher or lower?



Source: BofA Global Convertibles Survey

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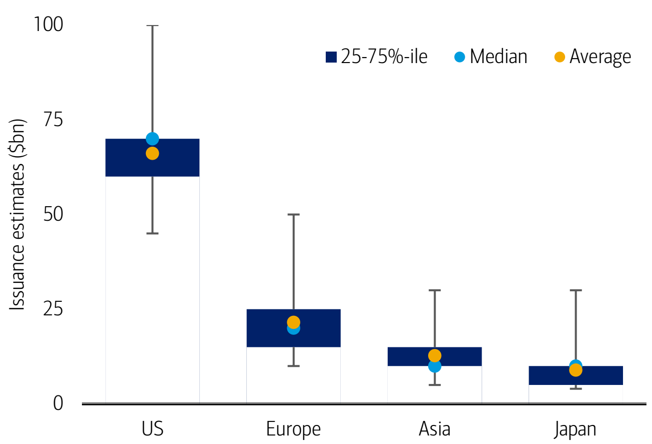
This month, we also asked our survey respondents to specify their issuance forecasts by region for year-end 2024. Results were quite mixed, and the range of forecasted totals was quite wide across regions. However, it is clear that investor estimates are generally more bullish than ours, especially in the US and Japan. Indeed, the median of client forecasts suggests $70bn in the US (versus our call for $60-65bn), $20bn in Europe (versus our call for $16-18bn), $10bn in Asia (versus our call for $10-12bn), and $10bn in Japan (versus our call for $4-5bn). Globally, we're calling for $90-100bn (Exhibit 26 and Exhibit 27).

As we noted in our 2024 outlook, we think that the "higher-for-longer" rates backdrop may encourage both improved CB issuance volumes and deals from higher-quality crossover borrowers (see our 2024 year ahead outlook report for details).

Exhibit 26: Investors except healthy issuance volumes in 2024
How much CB issuance do you expect by year-end in each region?



Source: BofA Global Convertibles Survey

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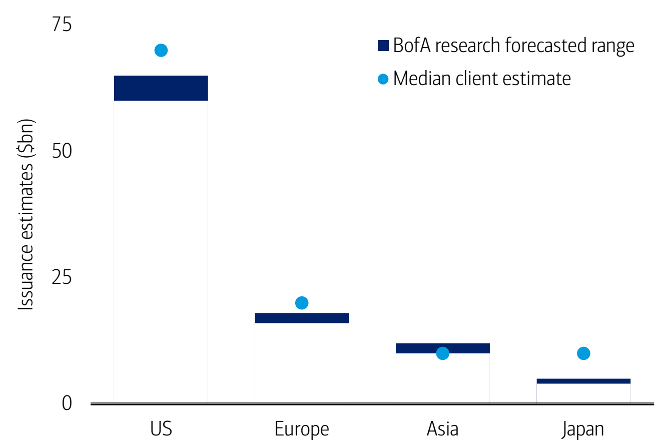
Exhibit 27: Client expectations are more optimistic than our forecasts
How much CB issuance do you expect by year-end in each region?



Source: BofA Global Convertibles Survey

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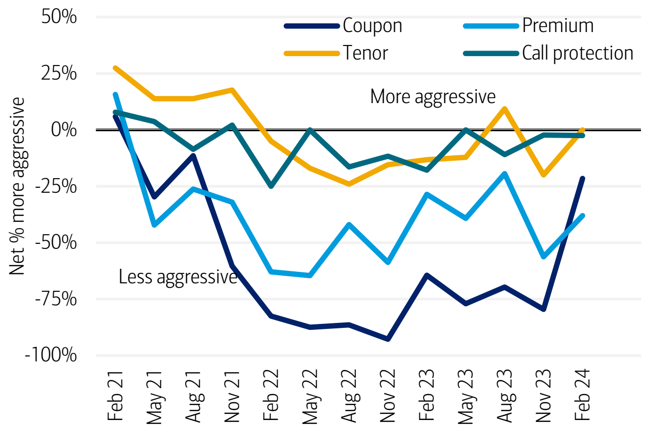
Once again, we asked clients for their opinions on the direction of new deal pricing over the next 6 months. Generally, clients expected that new deal coupons, premiums, and call protections would continue to become less aggressive, though that sentiment has softened considerably—particularly on coupons (Exhibit 28). Regionally, clients believed that deals across all regions would be less aggressively priced, though the results also suggest that conviction has declined relative to the previous quarter, particularly for deals from US-based issuers (Exhibit 29).

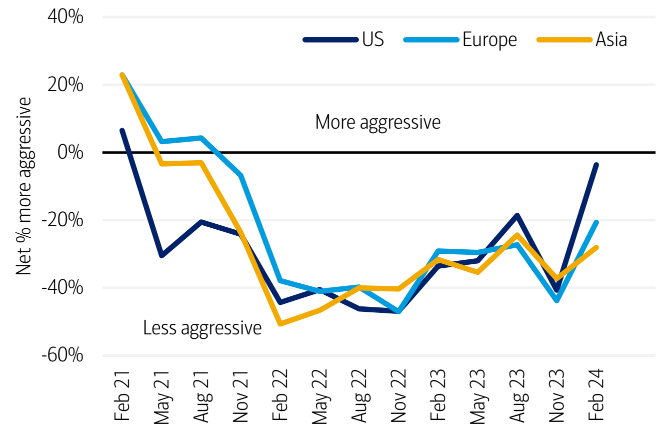
Exhibit 28: Generally, clients expect less aggressive deal pricing, though sentiment has weakened, particularly on coupons
What are your views on new deal pricing in the next 6 months?



Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

Exhibit 29: Clients still think that deals across regions will be priced cheaper, though sentiment has softened meaningfully
What are your views new deal pricing in the next 6 months?



Source: BofA Global Convertibles Survey

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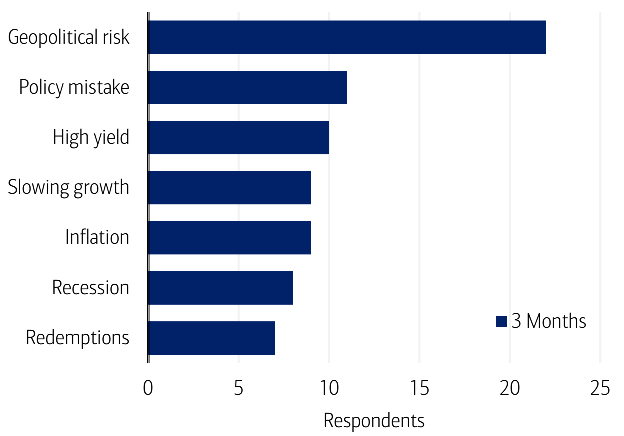
Macro

Top concerns: Geopolitical risk and a policy mistake are the top macro concerns

Over the next 3-month window, our survey respondents suggested that they were most concerned about geopolitical risk (Russia/Ukraine and the Middle East), a central bank policy mistake, and the high yield bond market (Exhibit 30). In fact, this marked the fifth time in the past six surveys that geopolitical risk ranked as the leading short-term worry (Exhibit 32).

Over the longer term, defined here as the next 12 months, clients indicated that they were most worried about geopolitical risk, a central bank policy mistake, and the rising default rate (Exhibit 31). Notably, geopolitical risk overtook rising defaults this past quarter, marking the first since 2017 that investors were most concerned about geopolitics over the longer term (Exhibit 33). Indeed, for the past two years, investors have been more worried about a recession and rising defaults in the longer term.

Exhibit 30: Geopolitical risk, a central bank policy mistake, and high yield credit were the top short-term macro woes
What do you see as the biggest macro risk to convertible markets in the next 3 months?



Source: BofA Global Convertibles Survey

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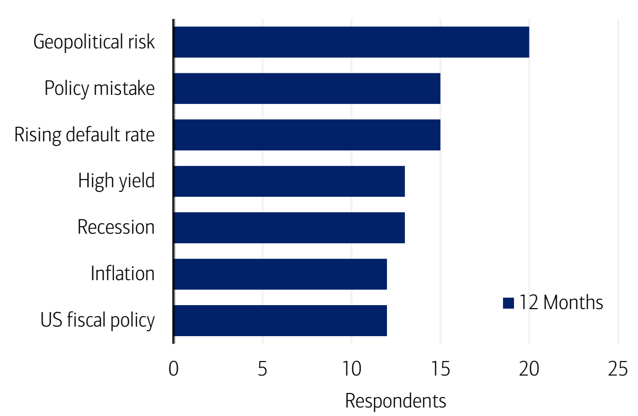
Exhibit 31: Longer-term macro concerns were geopolitical risk, a central bank policy mistake, and a rising default rate
What do you see as the biggest macro risk to convertible markets in the next 12 months?



Source: BofA Global Convertibles Survey

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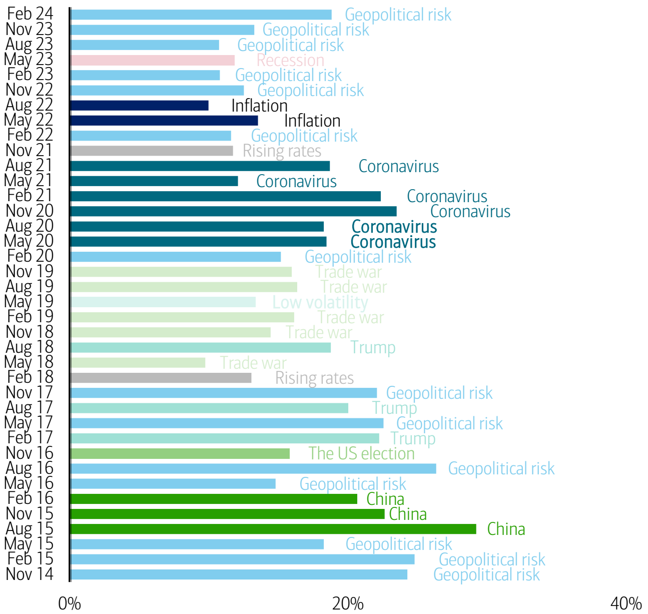
Exhibit 32: Geopolitical risk topped the list of clients' short-term macro concerns for the fifth time in the past seven surveys

What do you see as the biggest macro risk to convertible markets in the next 3 months?



Source: BofA Global Convertibles Survey

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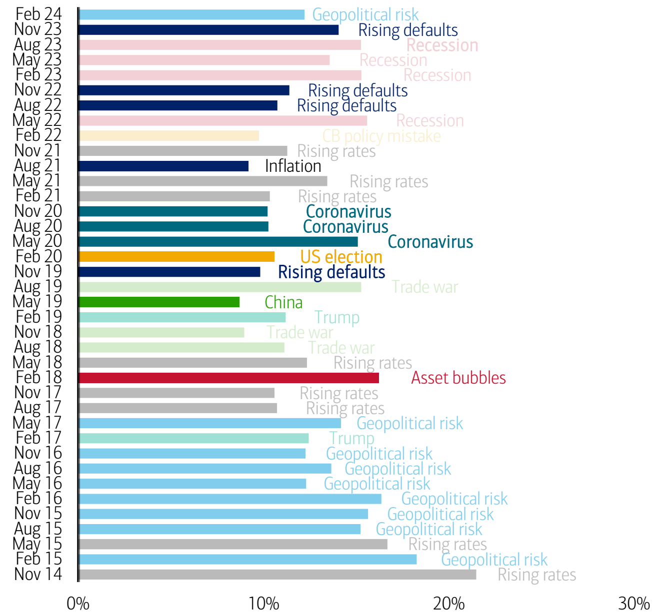
Exhibit 33: Geopolitical risk overtook rising defaults as investors' top long-term macro concern

What do you see as the biggest macro risk to convertible markets in the next 12 months?



Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

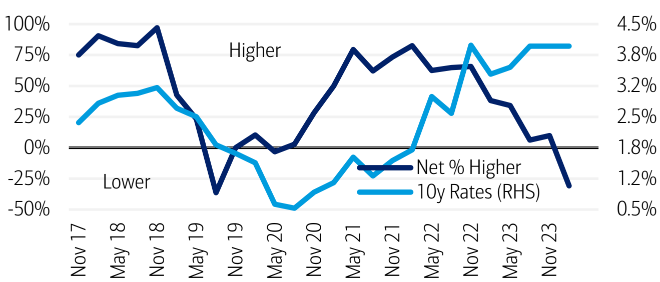
Interest rate and liquidity expectations: Investors expect rates to fall

Overall, net 31% of our global survey respondents indicated that interest rates would fall during the next 6-month window, marking the first aggregate expectations for a rate decline since May 2020 and the strongest since August 2019. For context, net 10% of respondents expected rates would be higher in our previous survey (Exhibit 34). Indeed, this aligns with investor expectations that the rate hiking cycle has peaked, and the Fed will begin to cut rates this year (Exhibit 40).

On liquidity, investors noted that conditions would improve over both the next 3-month and 12-month windows (Exhibit 35).

Exhibit 34: Net 31% of CB clients said rates would drop over the next 6 months, the strongest sentiment for rate declines since August 2019

In the next 6 months, will interest rates be higher or lower?



Source: BofA Global Convertibles Survey

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Exhibit 35: Investors thought liquidity would improve in both the next 3-month and 12-month periods

In the next 3 and 12 months, will liquidity conditions improve or worsen?

Source: BofA Global Convertibles Survey

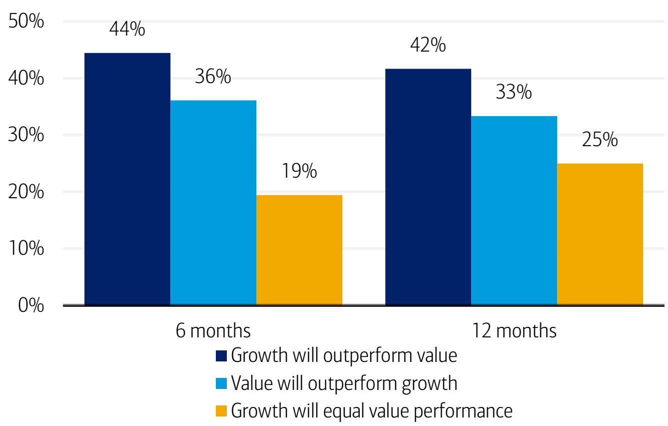
BofA GLOBAL RESEARCH

Growth and value: Clients now prefer growth in both the short and long term

In accordance with the results from our sector positioning section (which suggested that client positioning in most growth-proxy sectors improved versus the previous survey—see Exhibit 9), 44% of global survey respondents preferred growth over value in the short term, defined here as over the next 6-month window (Exhibit 36). Considered on a net basis (offsetting those that preferred growth to value), net 8% of global investors indicated that growth would lead value in the next 6 months, a big shift from the previous quarter, when net 53% said value would lead. Perhaps more notably, this was the strongest sentiment for growth (in the short term) since August 2021 (Exhibit 37).

The growth-over-value trend also has taken hold over the longer term (defined here as the next 12 months). Indeed, most global respondents (42%) said that the growth factor would top the value factor during the next year (Exhibit 36). On a net basis, now net 8% of investors prefer growth to value over the next 12-month window (Exhibit 37).

Exhibit 36: 44% of clients preferred growth over value during the next 6 months, while 42% preferred growth during the next 12 months
Which style converts will see better performance over the next 6 and 12 months: growth or value?



Source: BofA Global Convertibles Survey

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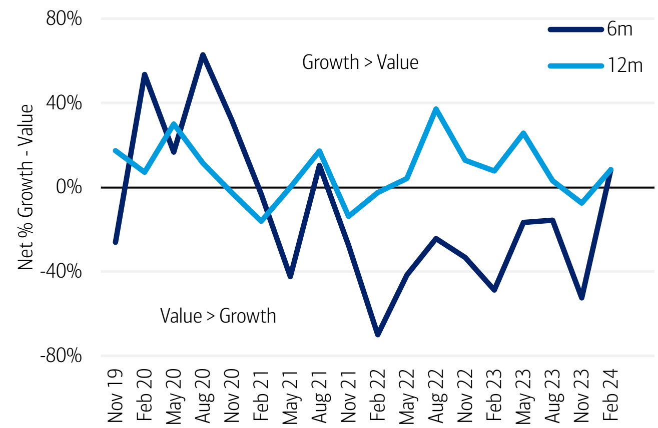
Exhibit 37: Clients now prefer growth over value CBs over both the next 6-month and 12-month windows
Which style converts will see better performance over the next 6 and 12 months: growth or value?



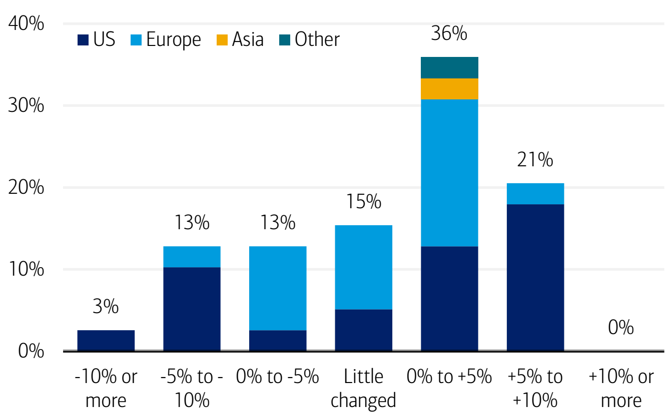
Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

Views on stocks: Views vary, but they generally still favor upside to downside

Once again, we asked our clients for their views on the direction of broad market US equities over the next 6 months. Overall, sentiment was once again highly dispersed, as 3% expected losses of more than 10%, 13% losses of 5-10%, 13% losses of less than 5%, 15% little change, 36% gains of less than 5%, 21% gains of 5-10%, and 0% gains of more than 10% (Exhibit 38). These results imply a return of +0.8% over the next 6 months (Exhibit 39).

Exhibit 38: Client views on the direction of broad equities from here remain highly divergent, though it slightly favors upside to downside
What is your view on the direction of broad market US equities (the S&P 500) in the next 6 months?



Source: BofA Global Convertibles Survey

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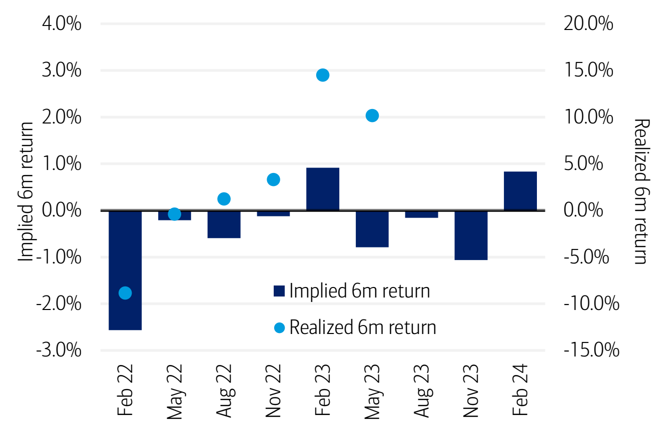
Exhibit 39: Based on investor responses, their implied expectation is the S&P will rise 0.8% in the next 6 months
What is your view on the direction of broad market US equities (the S&P 500) in the next 6 months?



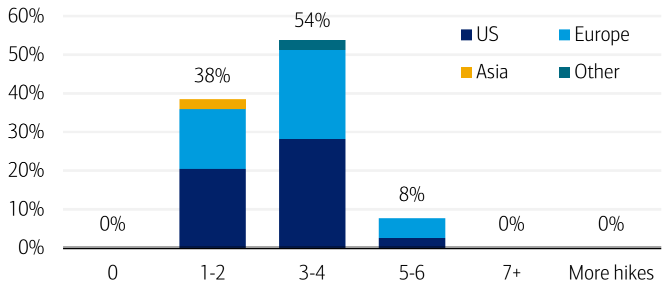
Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

Views on the Fed and the economy: Most believe that the Fed will cut 3-4 times

This quarter, we asked our clients for their view on the Fed rate cuts this cycle and on permanence of inflation. On the rates cycle, just over half (54%) expect the Fed to cut 3-4 times (25bps each) before year-end 2024. 38% expect 1-2 cuts, and 8% expect 5-6 cuts. Nobody expects more hikes or zero cuts (Exhibit 40). On inflation, just over half of our clients (51%) think that the recent inflationary pressure will be transitory (Exhibit 41).

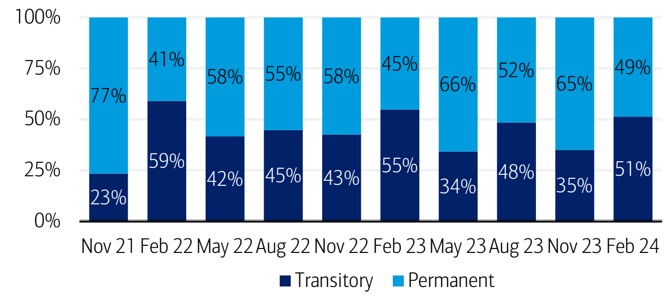
Exhibit 40: Most respondents (54%) expect the Fed to cut rates 3-4 times before year-end, in light with our economists' call
How many times will the Fed cut rates (25bp cuts) by year-end 2024?



Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

Exhibit 41: Just under half of survey respondents think that the recent bout of inflation will be transitory
Do you think the recent bout of inflation is transitory or permanent?



Source: BofA Global Convertibles Survey

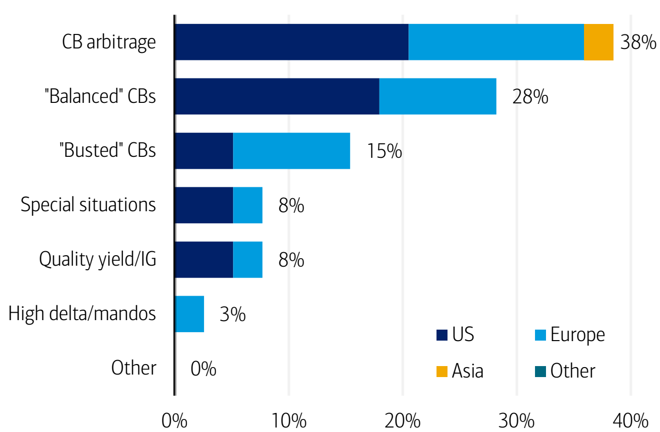
BofA GLOBAL RESEARCH

Top CB strategy: Managers see CB arb as most attractive for the first time

Once again, we asked our clients what they see as the most attractive CB strategy at the moment. Overall, most global respondents said that they preferred CB arbitrage (38%), following by owning "balanced" CBs (28%), "busted" CBs (15%), special situations such as targeting M&A or refi candidates (8%), owning quality yield or IG (8%), and owning high-delta names and mandatories (3%). Overall, the results align with our earlier findings that clients have a preference for mid-delta "balanced" names over low- and high-delta CBs (Exhibit 42 and Exhibit 18). Notably, this was the first time in our survey that clients said that CB arb was the top strategy (Exhibit 44)—indeed, last month we found that hedge funds have overtaken outright accounts as the dominant players in the global convertibles market (see our 16-Jan-2024 Global Convertibles Quick Note for details).

When breaking the results down by outright versus hedge fund respondents, there's clear bifurcation. Unsurprisingly, while outrights like "balanced," most hedge fund respondents said that they think CB arbitrage is the most attractive strategy (Exhibit 43).

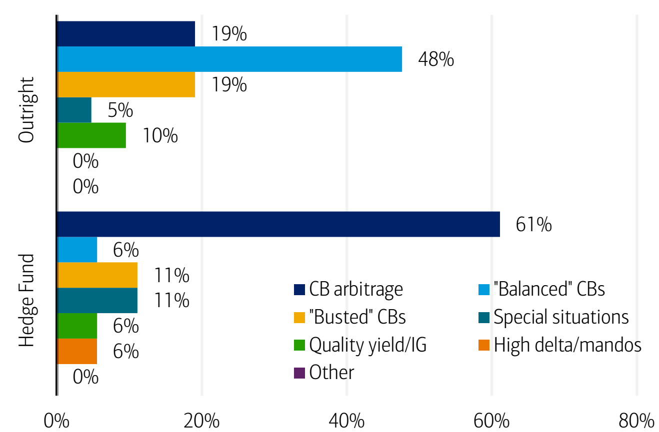
Exhibit 42: Overall, clients now believe that CB arbitrage is the most attractive CB market strategy, following by owning "balanced" CBs
Currently, what do you see as the most attractive convertible bond strategy?



Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

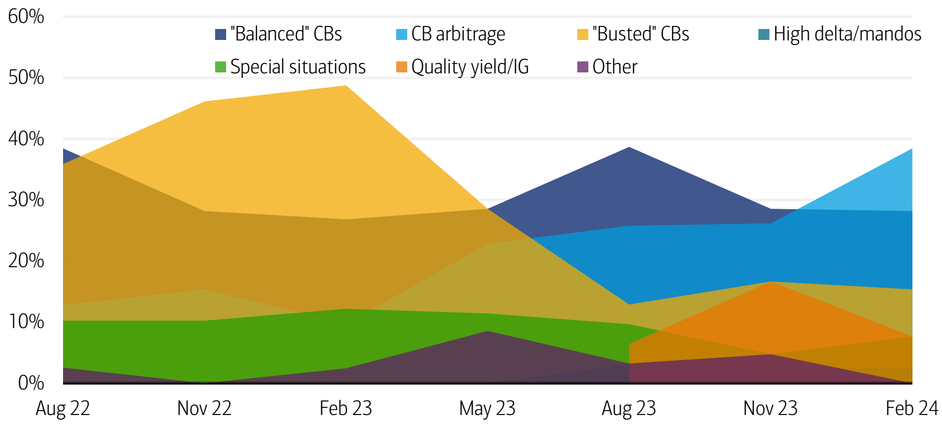
Exhibit 43: However, outright funds still overwhelmingly preferred "balanced" names, while hedge funds opted for CB arbitrage
Currently, what do you see as the most attractive convertible bond strategy?



Source: BofA Global Convertibles Survey

BofA GLOBAL RESEARCH

Exhibit 44: For the first time, CB arbitrage was seen as the most attractive CB market strategy
Currently, what do you see as the most attractive convertible bond strategy?



Source: BofA Global Convertibles Survey

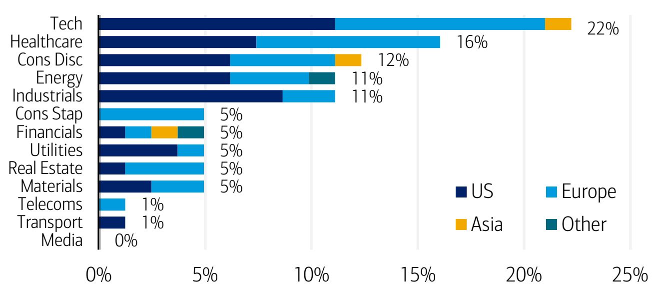
BofA GLOBAL RESEARCH

Special question: CB investors think that the tech sector offers the most value

This quarter, we asked our clients which sectors they think offer the best value. Globally, CB investors noted that the top value can be found among the tech, healthcare, and consumer discretionary sectors, while the telecoms, transportation, and media sectors offer the least value (Exhibit 45). Results look quite comparable when breaking down by investor type (Exhibit 46).

While investors said that tech and consumer CBs offered value, our previous data suggests that positioning in such sectors still remains light versus history, though it has been improving (Exhibit 9). However, positioning in energy remains very elevated compared to the past (Exhibit 10).

Exhibit 45: Globally, CB investors think that the tech sector offers the best value
Which sectors do you think currently offer the most value?



Source: BofA Global Convertibles Survey

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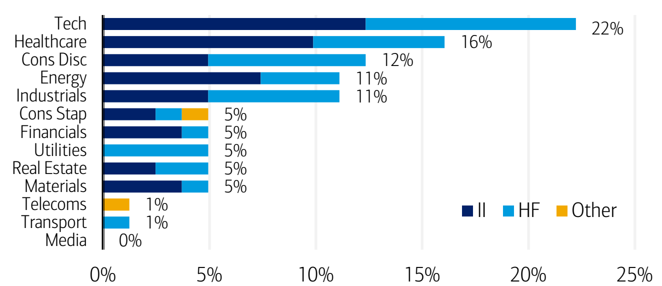
Exhibit 46: Both hedge funds and outright CB investors alike prefer tech names
Which sectors do you think currently offer the most value?



Source: BofA Global Convertibles Survey

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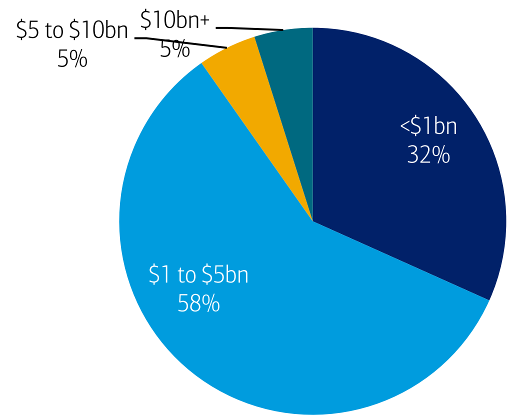
About the survey

Our survey was conducted from January 16, 2024, to January 19, 2024, with 41 investors participating across the US (22), Europe (17), Asia (1), and other (1). Participating investors consisted of institutional investors (21), hedge funds (18), and other (2). We also grouped investor type by dedicated convertibles (35), equity (2), and fixed income (4). In terms of assets under management, 32% of respondents identified themselves as having assets of <$1bn, 58% between $1bn and $5bn, 5% between $5bn and $10bn, and 5% $10bn+ (Exhibit 47).

As the majority of respondents were convertible investors, and the majority of hedge fund respondents were based in the US, representing the data by regional domicile provided a good cross section while eliminating unnecessary redundancy in the data we have presented here.

We note that responses were recorded as anonymous, they remain confidential, and results were collected on an aggregate basis only.

Exhibit 47: Survey participation by AUM
What is your AUM?



Source: BofA Global Convertibles Survey

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Exhibit 48: Survey participation by asset class
What is your primary asset class?

	All	US	Europe	Asia-ex Jp	Other	Instit	HF	Other
Convertibles	35	18	15	1	1	19	15	1
Equity	2	1	1	0	0	2	0	0
Fixed Income	4	3	1	0	0	0	3	1
Total	41	22	17	1	1	21	18	2

Source: BofA Global Convertibles Survey.

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Exhibit 49: Survey participation by fund classification
Which of these classifications best describes you?

	All	US	Europe	Asia-ex Jp	Other	Instit	HF	Other
Institutional Investor	21	8	12	0	1	21	0	0
Hedge Fund	18	13	4	1	0	0	18	0
Other	2	1	1	0	0	0	0	2
Total	41	22	17	1	1	21	18	2

Source: BofA Global Convertibles Survey

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Exhibit 50: Survey participation by region
Where are you based?

	All	US	Europe	Asia-ex Jp	Other	Instit	HF	Other
US	22	22	0	0	0	8	13	1
Europe	17	0	17	0	0	12	4	1
Asia-ex Japan	1	0	0	1	0	0	1	0
Japan	0	0	0	0	0	0	0	0
Other	1	0	0	0	1	1	0	0
Total	41	22	17	1	1	21	18	2

Source: BofA Global Convertibles Survey

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Issuance

Last month, global CB issuance totaled just under $5.2bn—not far behind historical norms, which suggests that January is among the quieter months of the year for global new issuance (Exhibit 51 and Exhibit 52). For the US specifically, on average, January is the third-lightest month for volumes (ahead of only July and October), and the US's $2.3bn last month was aligned with its historical January average of $2.3bn. As earnings blackouts start to wane, historical trends suggest that primary may pick up in February and March. Regionally, second only to the US, Japan's primary market saw almost $1.4bn, an impressive feat for the relatively small market, driven entirely by one large two-tranche mega-deal, while Europe and Asia saw totals of over $1.1bn and $400mn, respectively.

In our latest note (see our 16-Jan Global Convertibles Quick Note), we highlighted the increasing dominance of hedge funds with respect to CB ownership and trading volumes. Notably, we think that part of their recent rise is a function of their heightened CB issuance expectations, as arbitragers may benefit most from elevated primary volumes (see our Convertible Arbitrage Primer). What's more, we expect that further hedge fund involvement in the primary market may help cheapen the pricing terms of new deals.

Exhibit 51: Global convertible issuance ($mn)

Global CB issuance totaled $5.2bn last month, driven by the US and Japan

	US	Europe	Asia	Japan	Total
Jan	2,257	1,139	400	1,377	5,174
Dec	3,664	326	220	149	4,360
Nov	5,705	3,099	330	757	9,890
Oct	2,954	0	670	336	3,960
2024 YTD	2,257	1,139	400	1,377	5,174
2023 YTD	1,225	706	431	0	2,362
2023	53,400	13,381	9,019	3,634	79,434
2022	28,704	6,215	4,218	417	39,555
2021	84,332	22,912	33,208	7,373	147,824

Source: BofA Global Research

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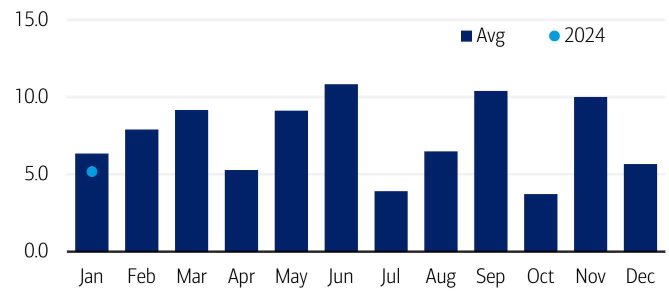
Exhibit 52: Average global issuance by month ($bn)

Though not far behind historical norms, January's volumes were modest



Source: BofA Global Research

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Counter to the norm, January's largest offering came from Japan via a large mega-deal. Daiwa House launched just under $1.4bn in a two-tranche deal split evenly between 0% up 15% notes due in 2029 and 0% up 13% notes due in 2030. The firm plans to use roughly 40% of the proceeds for share buybacks and the remaining 60% for real estate projects and investments (Exhibit 53). Other relatively large, noteworthy deals last month include Campari's nearly $550mn 5-year 2.375% up 32.5% bonds (to fund its acquisition of Courvoisier from Beam Suntory) and Federal Realty Investment Trust's $485mn 5-year 3.25% up 20% IG-rated senior unsecured notes (with proceeds slated to repay outstanding debt and general corporate purposes).

Exhibit 53: Global convertibles issued during January

Last month's largest deal was the $1.4bn Daiwa House converts, offered in two equal-sized tranches

Region	Date	Cusip	Issuer	Description	Coupon	Issue Amt (USD)	Issue Amt (LOC)	Currency	Initial Cv Prem	Seniority	Rating	Mandatory	Cvt Sector
Japan	1/11/2024	ZF2943735	DAIWA HOUSE IND CO LTD	DAIWAH 0 03/30/29	0.000	688.47	100,000.00	JPY	14.99	Unsecured	NR	N	Financials
Japan	1/11/2024	ZF2943743	DAIWA HOUSE IND CO LTD	DAIWAH 0 03/29/30	0.000	688.47	100,000.00	JPY	13.00	Unsecured	NR	N	Financials
Europe	1/10/2024	ZF2609377	DAVIDE CAMPARI-MILANO SP	CPRIM 2 3/8 01/17/29	2.375	547.50	500.00	EUR	32.50	Unsecured	NR	N	Consumer Staples
US	1/9/2024	313747BD8	FEDERAL REALTY OP LP	FRT 3 1/4 01/15/29	3.250	485.00	485.00	USD	20.00	Unsecured	IG	N	Financials
Asia	1/17/2024	ZF4229505	ZHEN DING TECH HLD LTD	ZHEDIN 0 01/24/29	0.000	400.00	400.00	USD	8.00	Unsecured	NR	N	Technology
US	1/26/2024	10950A205	BRIGHTSPRING HEALTH SERV	BTSG 6 3/4	6.750	400.00	400.00	USD	17.50	Preferred	NR	Y	Healthcare
Europe	1/16/2024	ZF4074141	GLOBALWAFERS GMBH	GLOWAF 1 1/2 01/23/29	1.500	374.99	345.20	EUR	30.00	Unsecured	NR	N	Technology
US	1/19/2024	974637AE0	WINNEBAGO INDUSTRIES	WGO 3 1/4 01/15/30	3.250	350.00	350.00	USD	30.00	Unsecured	NR	N	Consumer Discretionary
US	1/31/2024	45258DAA3	IMMUNOCORE HOLDINGS	IMCR 2 1/2 02/01/30	2.500	350.00	350.00	USD	40.00	Unsecured	NR	N	Healthcare
US	1/4/2024	68375NAE3	OPKO HEALTH INC	OPK 3 3/4 01/15/29	3.750	230.00	230.00	USD	26.83	Unsecured	NR	N	Healthcare
Europe	1/31/2024	ZF7265464	ORPAR	ORPAR 2 02/07/31	2.000	216.88	200.00	EUR	40.00	Unsecured	NR	N	Consumer Staples
US	1/25/2024	09228FAL7	BLACKBERRY LTD	BBCN 3 02/15/29	3.000	200.00	200.00	USD	32.50	Unsecured	NR	N	Telecommunications
US	1/2/2024	35953DAC8	FUBOTV INC	FUBO 7 1/2 02/15/29	7.500	177.51	177.51	USD		Secured	NR	N	Media
US	1/6/2024	401617AE5	GUESS INC	GES 3 3/4 04/15/28	3.750	64.83	64.83	USD		Unsecured	NR	N	Consumer Discretionary

Source: BofA Global Research

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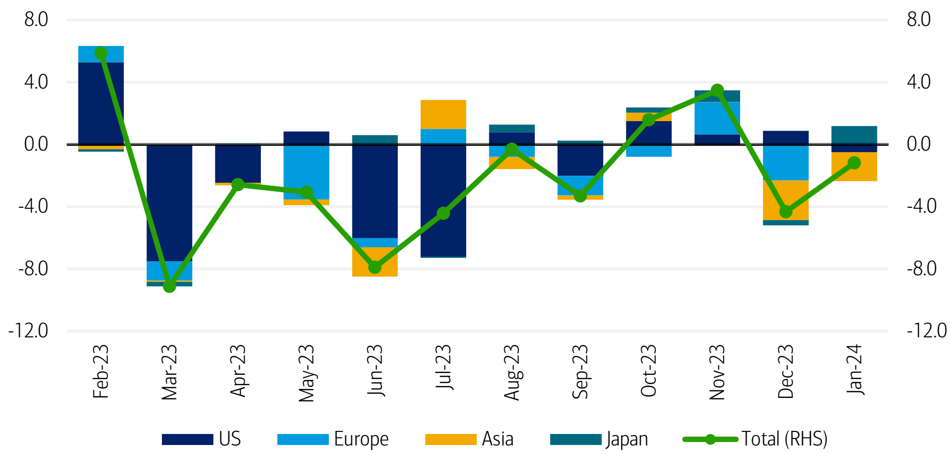
On redemptions, the global CB market realized just shy of $6.4bn, driven primarily by the US's $2.8bn. Asia saw close to $2.3bn in redemptions, followed by Europe's $1.1bn and Japan's $203mn. More than one-third of redemptions came from maturities ($2.3bn), such as the $690mn DocuSign 0% notes and €500mn Fresenius 0% notes. The remaining redemptions came from a mix of debt repurchases or conversions to shares calls (including EQT Corp's soft-call), puts (Hansoh Pharma and NIO), exchanges (Guess and FUBO TV), and defaults (Arrival and Gol Airlines).

On a net-new supply basis, the global convertible bond market net-contracted about $1.2bn last month (Exhibit 54). Japan realized solid net-expansion (+$1.2bn), while all other regions were effectively net-flat or saw net-contraction, topped by Asia's -$1.9bn.

Exhibit 54: Global net supply by month (last 12 months)

Global net supply totaled -$1.2bn last month as redemptions offset new supply



Source: BofA Global Research

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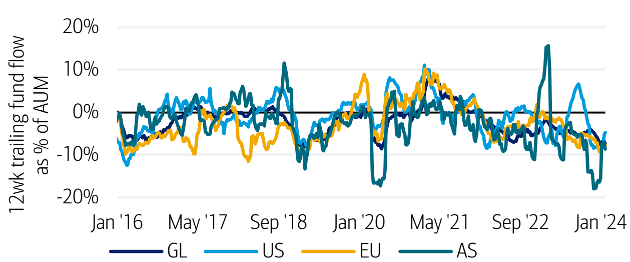
For comprehensive data on issuance and redemptions trends, including net supply totals, sector and structure trends, and use of proceeds information, please refer to section 3 of the attached Excel Chartbook.

Fund flows

Weekly fund flows aggregated to monthly totals show that convertible funds that invest globally (-$414mn, -1.2% of AUM), in the US (-$122mn, -0.6% of AUM), in Europe (-$104mn, -1.7% of AUM), and in Asia-ex Japan (-$9mn, -2.2% of AUM) all realized net outflows in January (Exhibit 56). On a 12-week trailing basis, CB funds that invest in all regions continued to endure moderate net outflows, particularly those focused on Asia and Europe, while the US funds have held up the best relative to the other regions (Exhibit 55). This is consistent with our survey results, in which respondents globally reported net outflows over the last three months, led by those in Europe (Exhibit 22).

Exhibit 55: 12-week trailing flows as a percentage of AUM

On a trailing 12-week basis, CB funds across regions have reported outflows



Source: EPFR Global

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Exhibit 56: Aggregated weekly flows from January

Weekly fund flows indicate that CB funds globally saw outflows last month

	Flows $mn	Flow % AUM	Total Assets	NAV %
Global	-414	-1.2	33,489	-0.8
US	-122	-0.6	21,903	-1.4
Europe	-104	-1.7	6,103	-0.3
Asia-ex Japan	-9	-2.2	409	-0.2

Source: EPFR Global

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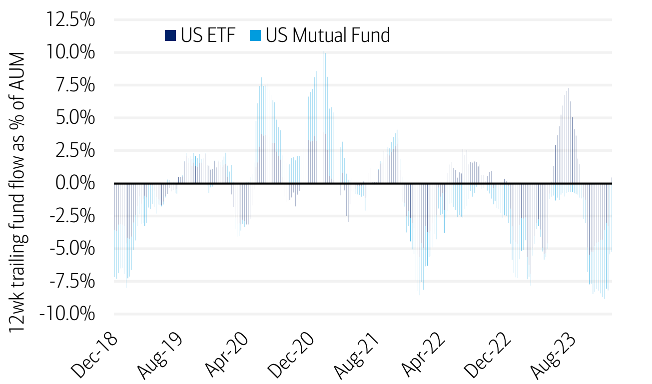
Digging into US convertible bond fund flows in more detail, over the past 12 weeks outflows from convertibles have been driven largely by net-declines from mutual funds, while ETF flows were slightly net-positive (Exhibit 57). In fact, outflows from mutual funds are near the most extreme levels (below the 1st percentile) they have ever experienced since 2018. In contrast, CB ETFs have realized net-positive, albeit small, inflows for the first time since September 2023 (Exhibit 58).

Exhibit 57: US ETF vs. mutual fund breakdown of 12-week trailing flows
Over the past 12 weeks, US convertible bond mutual funds saw net outflows, while ETFs saw slight inflows



Source: EPFR Global

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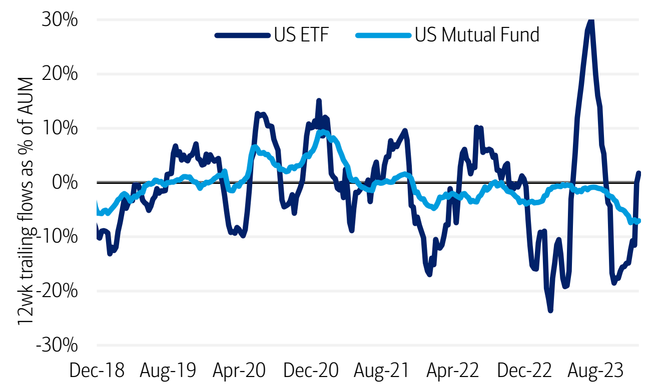
Exhibit 58: US ETF and mutual fund trailing 12-week fund flows
CB mutual funds realized strong outflows last month, while ETFs have realized inflows for the first time since last September



Source: EPFR Global

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Monthly fund flow data, which is reported on a one-month lag, indicates that funds that invest in CBs across all regions realized outflows during December (Exhibit 59). In more detail, global convertible bond funds net-contracted $969mn (-2.8% of AUM), US funds net-contracted $465mn (-1.9% of AUM), European CB funds endured outflows of $208mn (-3.3% of AUM), and Asia-ex Japan funds realized net outflows of $7mn (-1.7% of AUM). Notably, the outflows in December mark the fifth consecutive month of outflows across all regions. Further, during the whole of 2023, CB funds across all regions net contracted. Asia-ex Japan and Europe CB funds endured the largest losses relative to their asset bases (-32.7% and -21.8% of total AUM, respectively), while global funds saw the most extreme outflows in dollar terms (-$8.0bn). In contrast, the US was the most resilient as a percentage of AUM (-14.4% of AUM).

Exhibit 59: Monthly flow breakdown for 2023
Convertible bond funds across all regions continued to see net outflows during December

	Global		US		Europe		Asia-ex Jap	
	% AUM	Flows $mn	% AUM	Flows $mn	% AUM	Flows $mn	% AUM	Flows $mn
October	-2.7	-984	-0.6	-161	-0.8	-51	-2.5	-13
November	-0.3	-121	-0.7	-192	1.1	74	1.1	5
December	-1.3	-493	-2.7	-796	-0.9	-63	7.3	37
January	-0.3	-107	-4.5	-1,229	-1.0	-75	2.3	13
February	-1.4	-565	1.1	311	0.8	58	-0.4	-2
March	-2.3	-885	-3.9	-1,073	-2.2	-168	-9.4	-54
April	-1.7	-654	-0.7	-178	-0.7	-48	-1.4	-8
May	-1.3	-470	-0.3	-74	-1.4	-101	-0.7	-4
June	-2.2	-800	1.9	485	-3.8	-264	-1.4	-7
July	-1.7	-632	1.5	418	-2.2	-153	-3.8	-20
August	-1.9	-726	-0.2	-69	-2.5	-171	-0.5	-3
September	-1.5	-550	-1.4	-390	-1.4	-90	-4.8	-25
October	-1.8	-621	-4.5	-1,202	-3.5	-224	-9.8	-47
November	-3.1	-1,042	-2.1	-499	-2.6	-160	-5.1	-22
December	-2.8	-969	-1.9	-465	-3.3	-208	-1.7	-7
YTD	-21.2	-8,022	-14.4	-3,964	-21.8	-1,603	-32.7	-184

Source: EPFR Global

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For additional charts and data on flow trends, please refer to the Fund Flows slide on tab 3.01 to the attached Excel Chartbook.

Chartbook access

To view the Excel Chartbook, which includes a variety of data, tables, and charts focused primarily on returns, markets characteristics, and supply and demand, among other topics, please refer to our Global Convertibles Chartbook.

Abbreviations

AUM: Assets under management
CB: Convertible bond
ETF: Exchange-traded fund
FOMC: Federal Open Market Committee
GFC: Global Financial Crisis
HF: Hedge fund
HY: High yield
IG: Investment grade
II: Institutional investor
OAS: Option adjusted spread
USD: US Dollar
vs.: versus
YTD: Year-to-date

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