

Equity Reverse Convertible Model Portfolios

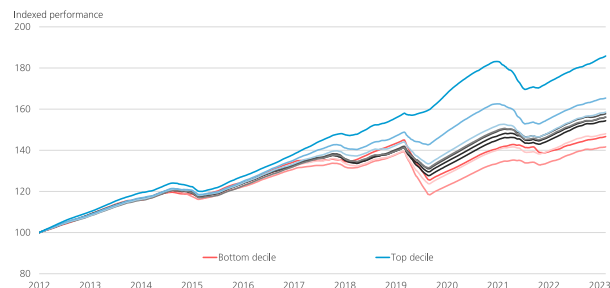
Reverse Convertible Model Portfolios

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- Reverse convertibles (RCs) are structured solutions that investors can use both to generate additional income while waiting to purchase the underlying stock at lower levels, and also as a means to generate yield in equity markets.
- We highlight model portfolios for the USD, the EUR, and the CHF, using our CIO RC methodology.
- Equity implied volatility has decreased following the US elections, but single-stock volatility remains higher compared to that of broader indexes.

Figure 1 - Approach with consistent historical performance

Historical performance using CIO method setting strike level at 90% of initial spot and diversifying every week, using six-month tenors.



Source: UBS, Bloomberg, as of April 2024.

Introduction

Structured products like reverse convertibles (RCs) allow investors alternative access to underlying stocks or to take advantage of more tactical opportunities within markets. Investors looking to gain exposure to equities at lower levels can use reverse convertibles to gain exposure to the stock in the case of a market correction ("buy on dip"), earning a yield while waiting. In this publication, we highlight the stocks that we believe offer the best risk-return trade-off for reverse convertibles and highlight our top picks across USD, EUR, and CHF. We focus on six-month tenors.

Portfolio construction

For each currency, we select ten stocks that we view as suitable for reverse convertibles. We use our CIO reverse convertible methodology and take the stocks which score best within each currency. The methodology takes both market-based data, such as implied volatility and momentum, as well as fundamental data—such as leverage or valuation ratios—into account. Overall, it shows a bias toward stocks with relatively higher levels of implied volatility, but lower risk metrics versus peers. Additionally, we integrate the views from UBS's bottom-up equity research analysts by only considering stocks rated either 'Buy' by UBS Investment Bank or 'Most Preferred' by UBS CIO. Note that for Swiss franc-denominated stocks, we also consider those rated 'Neutral' by UBS Investment Bank, due

to the smaller investment universe. To achieve diversification within each portfolio, we limit the exposure to each sector to a maximum of 30%. All stocks are weighted equally. This provides a fair level of sector diversification and ensures that the portfolios are not overly exposed to a few specific risk factors. Furthermore, we apply some operational filters and exclude stocks with low levels of implied volatility which are not able to deliver a coupon above a minimum threshold. We also do not consider any American depositary receipts (ADRs) listed on the US exchanges.

Benefits of the CIO model portfolios

The portfolio approach allows investors to build defensive equity exposure and generate income from an alternative source (i.e., implied volatility) in a diversified way. It is based on our CIO selection methodology, which has performed well historically over the past 10 years and better than benchmark approaches (e.g., selecting stocks with the highest levels of implied volatility), although it must be noted that past performance is no guarantee of future returns. Furthermore, the approach allows for diversification across single stocks and sectors. In order to generate consistent long-term returns, an investment approach that diversifies across time and entry points remains critical, in our view.

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US Dollar Model Portfolio

Company	Country	CIO Rating	IB Rating	Sector	Currency	Tenor	Coupon p.a.	Strike
DuPont de Nemours Inc	USA		Buy	Materials	USD	6M	7.0%	88.0%
MasterCard	USA	Most Preferred	Buy	Financials	USD	6M	7.0%	94.0%
Southern Co	USA	Most Preferred	Neutral	Utilities	USD	6M	7.0%	93.0%
ServiceNow	USA	Most Preferred	Buy	Information Tech.	USD	6M	7.0%	82.0%
Sempra Energy	USA	Most Preferred	Buy	Utilities	USD	6M	7.0%	93.0%
CME Group Inc.	USA		Buy	Financials	USD	6M	7.0%	91.0%
Sysco	USA		Buy	Consumer Staples	USD	6M	7.0%	92.0%
Coca-Cola Co.	USA	Most Preferred	Buy	Consumer Staples	USD	6M	7.0%	93.0%
Marvell Technology Group Lt	USA	Most Preferred	Buy	Information Tech.	USD	6M	7.0%	72.0%
S&P Global	USA		Buy	Financials	USD	6M	7.0%	92.0%

Euro Model Portfolio

Company	Country	CIO Rating	IB Rating	Sector	Currency	Tenor	Coupon p.a.	Strike
Deutsche Telekom	Germany	Most Preferred	Neutral	Communication Svcs.	EUR	6M	6.0%	93.0%
Adyen NV	Netherlands		Buy	Financials	EUR	6M	6.0%	80.0%
Enel	Italy	Most Preferred	Buy	Utilities	EUR	6M	6.0%	93.0%
Safran SA	France	Most Preferred	Neutral	Industrials	EUR	6M	6.0%	90.0%
SAP AG	Germany	Most Preferred	Buy	Information Tech.	EUR	6M	6.0%	90.0%
Deutsche Boerse	Germany		Buy	Financials	EUR	6M	6.0%	93.0%
Stellantis	Italy	Most Preferred	Buy	Consumer Disc.	EUR	6M	6.0%	79.0%
Caixa Bank	Spain		Buy	Financials	EUR	6M	6.0%	85.0%
Mercedes-Benz Group	Germany	Most Preferred	Buy	Consumer Disc.	EUR	6M	6.0%	82.0%
Continental AG	Germany		Buy	Consumer Disc.	EUR	6M	6.0%	82.0%

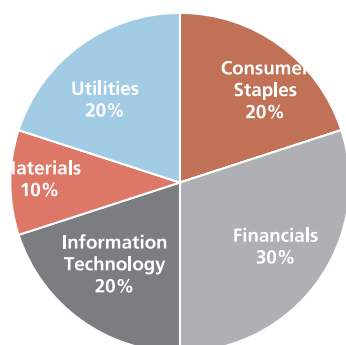
Swiss Franc Model Portfolio

Company	Country	CIO Rating	IB Rating	Sector	Currency	Tenor	Coupon p.a.	Strike
Givaudan SA	Switzerland		Neutral	Materials	CHF	6M	5.0%	93.0%
Geberit	Switzerland		Neutral	Industrials	CHF	6M	5.0%	91.0%
Tecan Group	Switzerland		Neutral	Healthcare	CHF	6M	5.0%	85.0%
Lonza Group AG	Switzerland	Most Preferred	Buy	Healthcare	CHF	6M	5.0%	89.0%
Roche Holding AG	Switzerland		Neutral	Healthcare	CHF	6M	5.0%	92.0%
Sika AG	Switzerland		Buy	Materials	CHF	6M	5.0%	92.0%
Nestle SA	Switzerland	Most Preferred	Neutral	Consumer Staples	CHF	6M	5.0%	94.0%
Richemont SA	Switzerland	Most Preferred	Buy	Consumer Disc.	CHF	6M	5.0%	90.0%
Clariant	Switzerland		Buy	Materials	CHF	6M	5.0%	93.0%
Helvetia	Switzerland		Neutral	Financials	CHF	6M	5.0%	94.0%

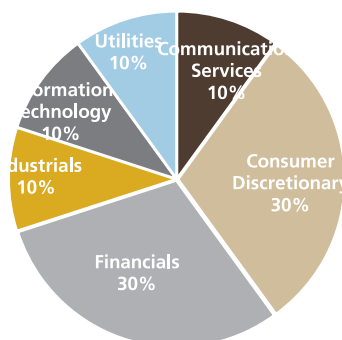
Source: Bloomberg, UBS, as of 18/11/2024. Note: Pricing is for a six-month reverse convertible and includes a 2% p.a. distribution fee. The values are indicative and may change over time. Note IB ratings refer to UBS Investment Bank ratings. UBS CIO GWM does not have any influence on UBS IB ratings or their changes. The rating and or target price may change after the publication of this document. Please consult <https://research.ibb.ubs.com> for the latest ratings. For further information regarding third-party research and disclosures under the EU Market Abuse Regulation (MAR) please consult ubs-cio-wm@ubs.com or your client advisor. Please also consider further disclosures at the end of this report.

Sector exposure

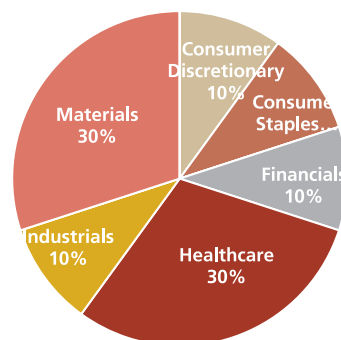
USD model portfolio



EUR model portfolio

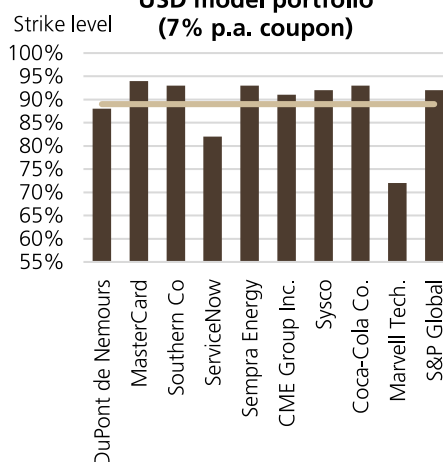


CHF model portfolio

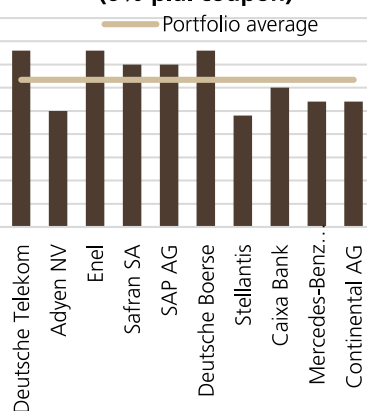


Strike comparison

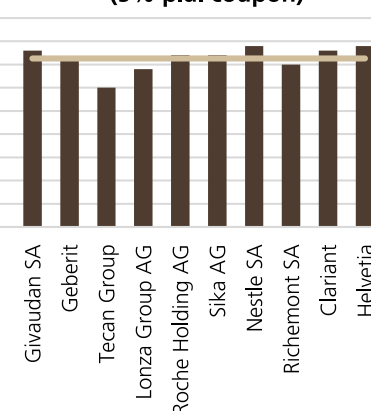
**USD model portfolio
(7% p.a. coupon)**



**EUR model portfolio
(6% p.a. coupon)**

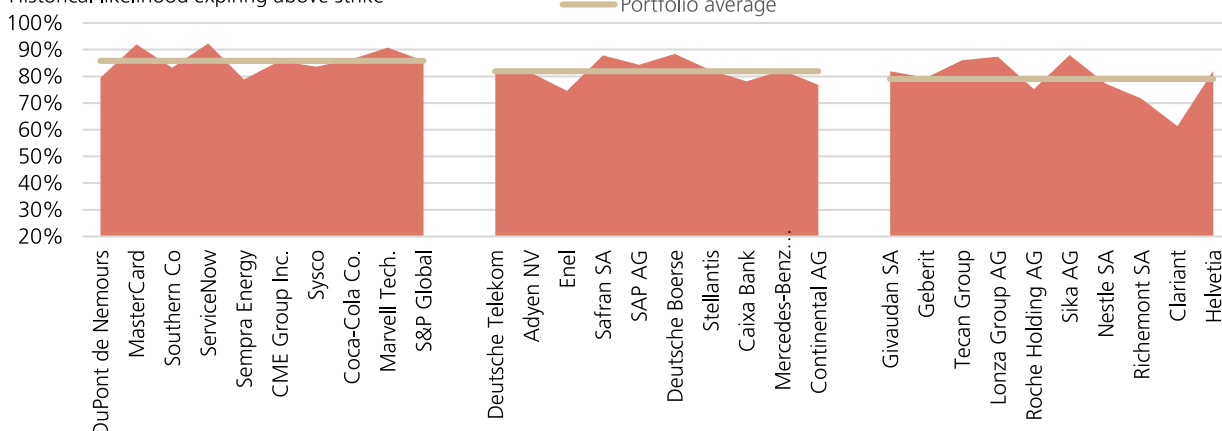


**CHF model portfolio
(5% p.a. coupon)**



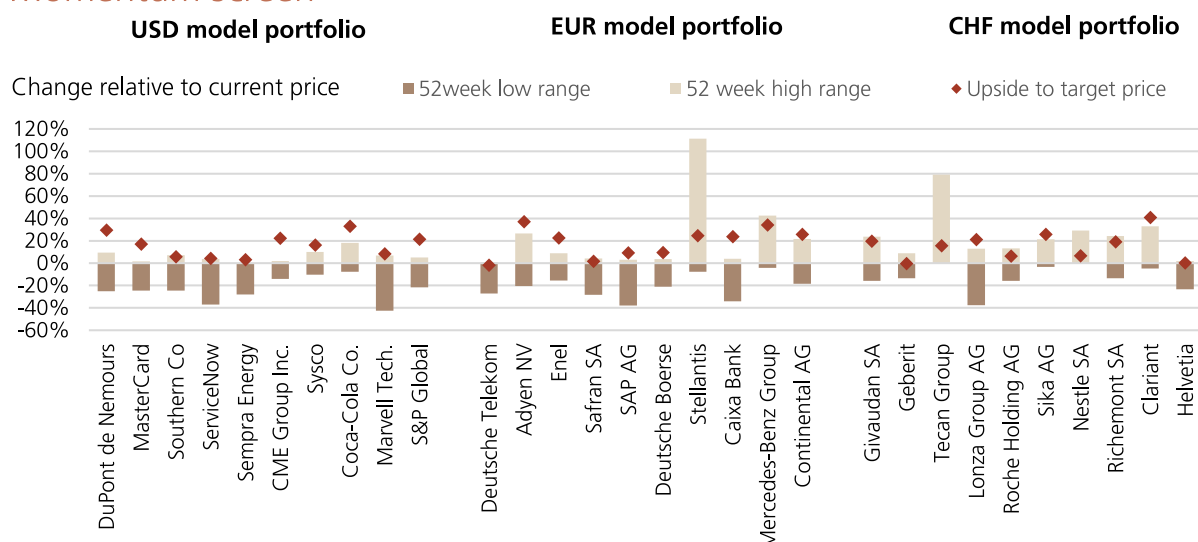
Historical simulation

Historical likelihood expiring above strike

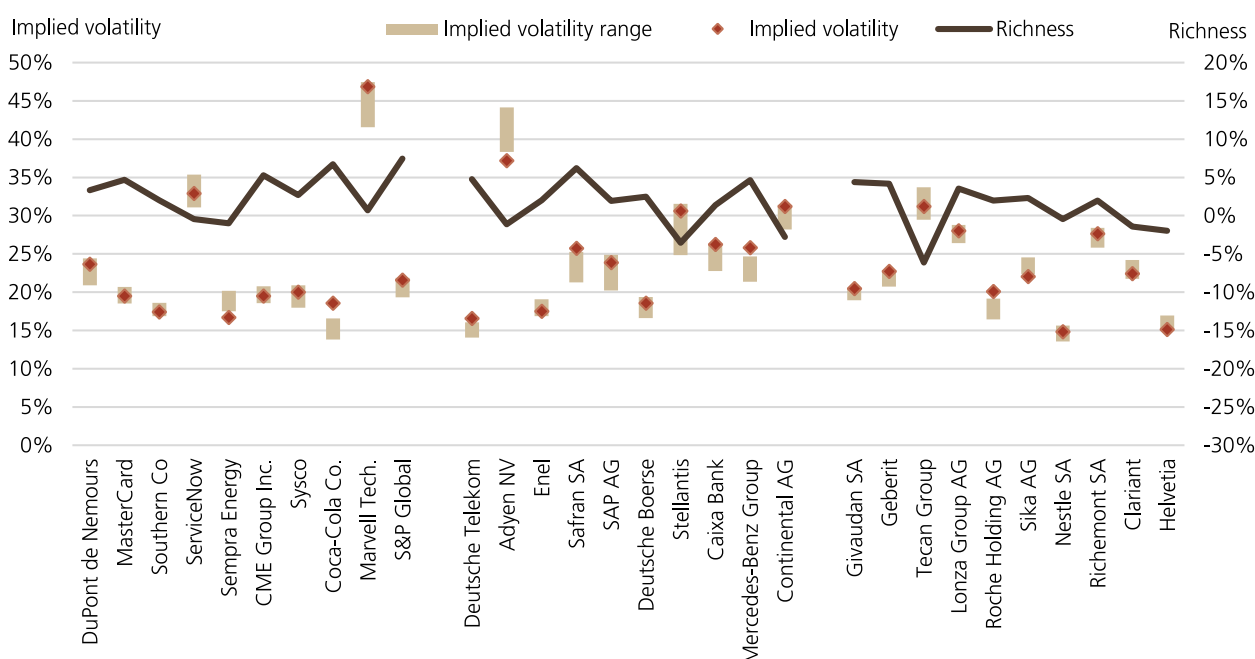


Source: Bloomberg, UBS, as of 18/11/2024 The historical simulation shows how frequent the stock has ended up above the current strike level in a six-month period. The analysis considers data for the past 10 years or since the stock has been listed. Note that this metric does not show the historic performance of a reverse convertible on the stock, as it assumes current pricing.

Momentum screen



Volatility screen



Source: Bloomberg, UBS, as of 18/11/2024. The momentum screen compares the current spot level to the 52-week low and high range. It indicates how much the stock would need to fall to hit the 52-week low or how much it would need to rise to hit the 52-week high. The following market and volatility snapshot illustrates these values in absolute terms. Implied volatility refers to six-month, at-the money implied volatility. The implied volatility range reflects the range between the 10th and the 90th percentile values of a stocks implied volatility over the past year. Richness refers to the difference between current six-month implied volatility and current realized volatility over the past six months. UBS CIO GWM does not have any influence on UBS IB ratings or their changes. The rating and/or target price may change after the publication of this document. Please consult <https://research.ibb.ubs.com> for the latest ratings. For further information regarding third-party research and disclosures under the EU Market Abuse Regulation (MAR) please consult ubs-cio-gwm@ubs.com or your client advisor. Please also consider further disclosures at the end of this report.

Market & Volatility Snapshot

Company	PF	Price		52 Week range		UBS Investment Bank				Volatility	
		Current	YTD return	Low	High	Rating	Target Price	Upside	Last Update	Percentile	Richness
DuPont de Nemours	USD	81.9	6.4%	61.2	89.5	Buy	106.0	30%	05/11/2024	66.7	3.3%
MasterCard	USD	521.9	22.4%	394.4	530.1	Buy	610.0	17%	13/11/2024	50.0	4.7%
Southern Co	USD	87.9	25.4%	66.3	94.2	Neutral	93.0	6%	31/10/2024	81.5	2.0%
ServiceNow	USD	1011.4	43.2%	638.4	1048.3	Buy	1055.0	4%	24/10/2024	59.3	-0.4%
Sempra Energy	USD	92.2	23.4%	66.4	92.2	Buy	95.0	3%	06/11/2024	3.7	-1.0%
CME Group Inc.	USD	225.3	7.0%	193.4	229.7	Buy	275.0	22%	23/10/2024	63.0	5.3%
Sysco	USD	75.0	2.5%	67.2	82.4	Buy	87.0	16%	29/10/2024	1.9	2.7%
Coca-Cola Co.	USD	61.7	4.8%	56.9	73.0	Buy	82.0	33%	23/10/2024	98.1	6.7%
Marvell Technology Gr	USD	87.8	45.6%	50.4	93.9	Buy	95.0	8%	29/08/2024	81.5	0.7%
S&P Global	USD	503.3	14.2%	394.8	529.0	Buy	610.0	21%	25/10/2024	55.6	7.5%
Deutsche Telekom	EUR	28.6	31.4%	20.8	28.8	Neutral	28.0	-2%	14/11/2024	63.0	4.8%
Adyen NV	EUR	1241.4	6.4%	988.5	1570.0	Buy	1700.0	37%	08/11/2024	7.4	-1.1%
Enel	EUR	6.7	0.2%	5.7	7.3	Buy	8.3	22%	18/11/2024	72.2	2.0%
Safran SA	EUR	216.6	35.8%	155.1	225.5	Neutral	220.0	2%	25/10/2024	90.7	6.2%
SAP AG	EUR	217.3	55.8%	135.3	223.9	Buy	237.0	9%	22/10/2024	63.0	1.9%
Deutsche Boerse	EUR	210.4	12.8%	165.9	218.1	Buy	230.0	9%	13/11/2024	72.2	2.5%
Stellantis	EUR	12.8	-39.3%	11.9	27.2	Buy	16.0	25%	31/10/2024	85.2	-3.5%
Caixa Bank	EUR	5.6	51.0%	3.7	5.9	Buy	7.0	24%	11/11/2024	75.9	1.4%
Mercedes-Benz	EUR	53.7	-14.2%	51.3	76.5	Buy	72.0	34%	25/10/2024	94.4	4.6%
Continental AG	EUR	63.7	-17.2%	51.9	77.5	Buy	80.0	26%	15/11/2024	88.9	-2.8%
Givaudan SA	CHF	3779.0	8.5%	3183.0	4670.0	Neutral	4520.0	20%	13/11/2024	98.1	4.4%
Geberit	CHF	523.0	-3.0%	453.0	568.8	Neutral	520.0	-1%	31/10/2024	90.7	4.2%
Tecan Group	CHF	208.6	-39.3%	208.6	373.8	Neutral	241.0	16%	01/11/2024	57.4	-6.1%
Lonza Group AG	CHF	520.4	47.1%	325.0	587.4	Buy	630.0	21%	24/10/2024	90.7	3.5%
Roche Holding AG	CHF	254.1	3.9%	214.1	287.7	Neutral	270.0	6%	12/11/2024	100.0	2.0%
Sika AG	CHF	234.9	-14.2%	227.4	284.8	Buy	295.0	26%	31/10/2024	22.2	2.3%
Nestle SA	CHF	77.8	-20.2%	77.5	100.5	Neutral	83.0	7%	15/11/2024	29.6	-0.4%
Richemont SA	CHF	121.0	4.5%	104.6	150.1	Buy	144.0	19%	11/11/2024	74.1	2.0%
Clariant	CHF	11.4	-8.5%	10.8	15.1	Buy	16.0	41%	29/10/2024	50.0	-1.4%
Helvetia	CHF	149.7	29.2%	114.7	152.7	Neutral	150.0	0%	05/11/2024	20.4	-2.0%

Source: Bloomberg, UBS, as of 18 November 2024. Note: Percentile refers to the percentile of current implied volatility (six months, at-the-money) compared to its past one-year range. Richness refers to the difference between current implied volatility and realized volatility for the past year. Last update refers to last change of UBS Investment Bank price target. UBS CIO GWM does not have any influence on UBS IB ratings or their changes. The rating and/or target price may change after the publication of this document. Please consult <https://research.ibb.ubs.com> for the latest ratings. For further information regarding third-party research and disclosures under the EU Market Abuse Regulation (MAR) please consult ubs-cio-wm@ubs.com or your client advisor. Please also consider further disclosures at the end of this report.

What is a reverse convertible?

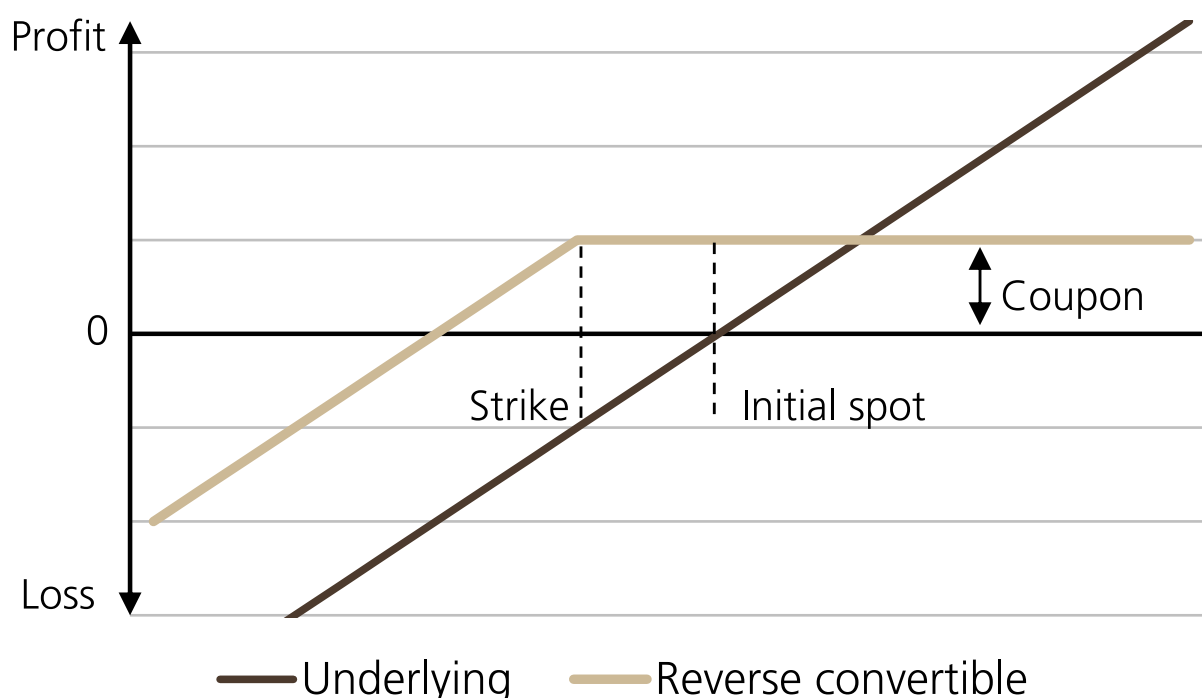
Reverse convertible notes are structured investment products that are linked to a reference asset (e.g., individual stock, share index, or equity basket) and may offer above-market yield. They generally consist of two components:

- a coupon-paying bond;
- a put option that gives the issuer of the note the right to sell the underlying asset to the investor at a predetermined price (strike).

The payoff of a reverse convertible can be summarized as follows (Fig. 3). At the product's maturity, if the price of the underlying asset is equal to or greater than the strike, the investor gets a cash payment equivalent to the invested capital. If the price of the underlying asset falls below the strike at maturity, the investor receives either a physical delivery of the underlying asset or the then-applicable value of the asset in cash. So the coupon compensates the investor both for being exposed to the downside risk of the underlying asset and for giving up the upside participation of the asset above the strike level.

Figure 2 - Payoff profile of a reverse convertible compared with the underlying asset at expiry

In this example, the strike level is set below the initial price of the underlying asset



Source: UBS, as of July 2021

Key features of investing in reverse convertibles:

- **Buy at a discount:** If the product is physically settled, an investor can use it to build up exposure to the reference asset. In such a case, the investor should set the strike level below the inception spot price at which he would like to purchase the asset (e.g., to 90% of spot). Acquiring a reverse convertible enables the investor to "buy the dip."
- **Play defensively:** An investor who is looking to add exposure, but expects the price fluctuations of the underlying asset to be relatively moderate (i.e., flat return expectation), may look to reverse convertibles for a return rather than buy the asset itself.
- **Get a stable cash flow:** The coupon provides a stable and predictable income source. Investors who add reverse convertibles to their portfolios can therefore optimize the total yield, particularly when interest rates are low.

- **Sell volatility:** Investors who want to profit from high volatility and cautiously add exposure can invest in reverse convertibles and take advantage of the fact that higher coupons mean higher volatility.

Risks associated with reverse convertibles

Investors must understand the risks associated with the structured products that they intend to purchase. These include:

- **Loss of invested capital:** Investors that buy a reverse convertible are selling a put option, which involves the possibility of losing part of their invested capital should the underlying asset fall significantly below the strike level at expiry.
- **Liquidity:** Risk of limited liquidity in the secondary market could complicate the daily pricing of the product, so investors should be prepared to hold a reverse convertible until maturity to avoid incurring additional costs or losses.
- **Default risk:** Investors in reverse convertibles are exposed to the default risk of the product issuer.
- **Limited return potential:** The return potential is limited to the coupon payment. Investors forgo potential dividend payments or capital appreciation of the underlying stock.

Price transparency can be a problem with certain types of structured products. In our view, this is less the case for reverse convertibles, given their relatively plain payoff. Furthermore, in the case of reverse convertibles, demand and supply for protection (i.e., volatility) may change over time and hence impact return characteristics. For more information on reverse convertibles please see our report "[CIO explains: Reverse Convertibles](#)."

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UBS Investment Bank Global Equity Rating Definitions

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Global Equity 12-Month Rating Definitions

Buy: FSR is > 6% above the MRA. **Neutral:** FSR is between -6% and 6% of the MRA. **Sell:** FSR is > 6% below the MRA.

Key Definitions

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk pre-mium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

Exceptions and Special Cases

Core Banding Exceptions (CBE): Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified the Companies Mentioned or Company Dis-closure table in the relevant research piece.

UBS Global Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage¹	IB Services²
Buy	FSR is > 6% above the MRA.	51%	36%
Neutral	FSR is between -6% and 6% of the MRA.	40%	38%
Sell	FSR is > 6% below the MRA.	8%	33%
Short-Term Rating	Definition	Coverage³	IB Services⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 March 2024.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Appendix

Required Disclosures

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UBS CIO GWM equity selection system

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Most preferred

We expect the stock to outperform the benchmark in the next 12 months.

Least preferred

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Suspended

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1. Most attractive – We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
2. Attractive – We consider this asset class to be attractive. Consider opportunities in this asset class.
3. Neutral – We do not expect outsized returns or losses. Hold longer-term exposure.
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