



Global Convertibles Blog: "All Summer long"

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Market review (Performance data in USD, except otherwise stated)

The title summarizes the simple imperative strategy over the summer months. Since June global convertible markets went up again by an impressive 7.5%, lead by equity performance of 10% and continued credit spread tightening. The earnings season went through smoothly with overall better than expected results. Economic indicators continued to improve globally. Risk appetite among investors advanced further, as benchmarked participants, after missing the most part of the breathless rally, might have reached relative stop loss levels fueling the buying spree. Volatility has now fallen back to the mid 20 level in European and US markets. US high yield credit spreads however stand at 870 bps, still comfortably in recessionary territory and well above long term averages.

Performance

Given the witnessed market recovery, the last twelve months have to be rebranded from being one of the most difficult absolute performance periods into being one of the most difficult periods for market relative managers. Excessive market volatility, hardly analyzable company fundamentals and dysfunctional markets all together explain a good part of the extreme alpha divergence among different managers and different sub periods in these last 12 months. Any strong directional move in the market makes it difficult to judge on the alpha quality, as even slight systematic deviations can lead to huge but noise like out- or underperformance. For our portfolios, the period since June overall was positive in terms of outperformance. Biggest systematic performance drivers were high yield and equity sensitivity in lower quality names. The market was characterized by relatively few outperformers compared to underperformers. Among single names, most positive contributions came from Beckman Coulter (Pharma, US) and Swiss Re (Insurance, Switzerland) as well as underweight Deutsche Telekom (Telecoms, Germany). Slightly negative contributions came from Nippon Yusen (Marine Transport, Japan) and underweight IGT (Hotels & Leisure, US).

The aggressive global portfolio (AgaNola Global Convertibles Fund) returned an impressive 12.8% net (I class, USD), beating the convertible and equity market comfortably. The European portfolio (AgaNola European Convertibles Fund) gained 8.5% (in EUR) net (D class, EUR) beating its market too.

Portfolio policy and outlook

The portfolio rebalancing activities concentrated on security selection, while maintaining a relative market neutral positioning in terms of equity sensitivity which proved right in light of the ongoing strong market dynamics. Profit taking has been selective and limited with overall reduced turnover. It might be more pronounced into ongoing strength. Despite short term potential overboughtness, structural trends, technical as well as fundamental, would point to an ongoing recovery. High yield names of better quality as well as more defensive delta names are seen most promising in search for new ideas. The case for convertibles as an asset class is the still existing recovery return potential of more than 30%, looking at the gap to the long term total return trend of the global convertibles market.

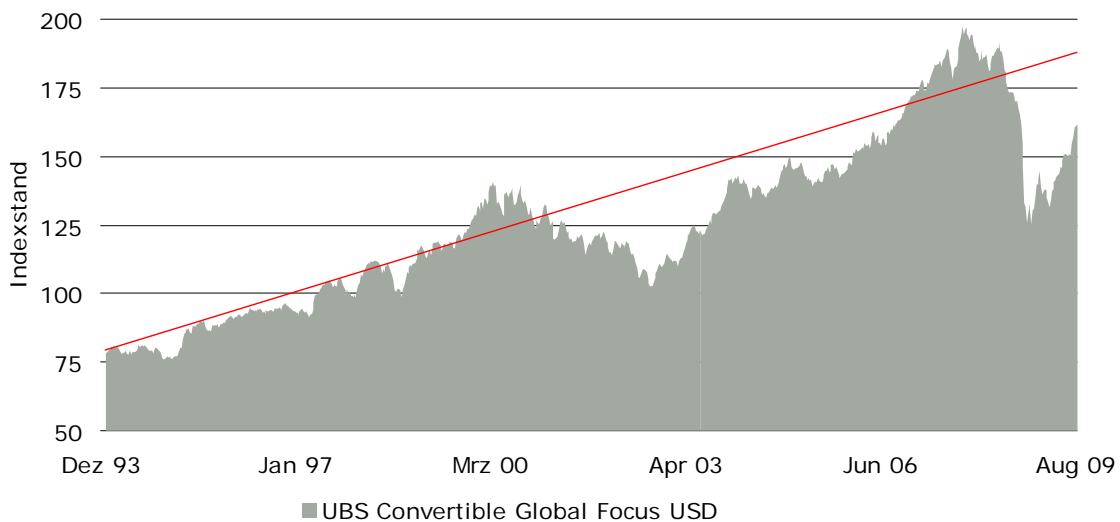


Chart: Gap - UBS Global Convertible Index level versus long term return trend

Remarkable

- Earnings – The year over year earnings change for S&P 500 Index members is expected to narrow to -21% in the current 3rd quarter, after declines of an estimated 34% in the 2nd quarter and 60% in the 1st quarter of this year. (source: Bloomberg)
- Real Growth – According to official numbers US real GDP grew by 121% over the last 30 years. On the other side, car (unit) sales are lower than ever since beginning of records in 1976, new home (unit) sales are lower since beginning of records in 1959 and energy consumption is a mere 23% higher than 1978. (source: FTD)

- Shadow Statistics – According to the US Labor Department workday deaths in 2008 reached their lowest point on record with 5,071 fatalities, as the recession forced employers to trim back hours. Workplace suicides, meanwhile, hit an all time high of 251. Bernard Madoff, who ran a hedge fund Ponzi scheme for at least 20 years was sentenced to the statutory maximum of 150 years in prison. The sentencing, while high, isn't a record for financial fraud. In the past decade there have been sentences as high as 330 and 845 years. (source: WSJ)
- Distressed – Top soccer league clubs in Italy inherited a loss of EUR 369 Mio in the last business year, representing 23% of their revenues. The total debt of the league is adding up to EUR 2 bn. (source: FTD)

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