

# Manager Perspective

APRIL 2021



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Prior to joining Tandem, I was part of a team that managed a convertible securities portfolio for both institutional and retail clients. The convertible asset class has produced an attractive risk/return profile over multiple business cycles and currently provides asset allocators with another vehicle to manage risk within a portfolio. For the past year, we have been operating in a historically low-rate environment driven by central bank action. But an improving economy means longer-term interest rates are expected to move up over time.

In order to combat interest-rate risk within our bond allocation, Tandem has recently added the Victory INCORE Investment Grade Convertible Securities Fund to its asset allocation. We have provided a basic overview of the asset class below.

A convertible bond is considered a hybrid security with the attributes of both stocks and bonds. Simply, a convertible security is a traditional bond combined with an equity call option.

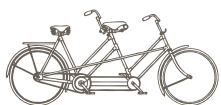


The bond portion of the convertible provides downside support in the form of a semi-annual coupon payment and a stated maturity date which acts as a theoretical “bond floor”. The equity call option provides potential capital growth through equity appreciation. Considered a convex security, on average, the price of a convertible *rises at an increasing rate* as its underlying stock rises, but *falls at a decreasing rate*, as the underlying stock falls. It is this attribute that gives the asset class such an attractive return profile through total market cycles.

Some convertibles are different than others... convertibles generally fall into three broad categories after issuance, depending on the movement and direction of the underlying common stock. *Equity-sensitive* convertibles generally move with the underlying stock on a one for one basis. A *credit-sensitive* convertible security trades on its credit fundamentals while a *total return* convertible moves modestly with underlying stock price movement. Most are issued with a credit rating, either investment grade or below investment grade (junk), while others are not rated (NR).

Portfolio managers have the discretion to construct convertible portfolios based on a combination of convertible attributes, and in general, an active approach to convertible portfolio management is preferred over the use of a passive index ETF in order to manage the overall equity sensitivity of the portfolio.

Asset allocators may use convertibles to either cushion equity returns in a volatile market or to enhance fixed income returns in a low-rate environment.



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APRIL 2021

Convertibles have historically performed particularly well in a rising interest-rate environment when the economy is improving due to their low duration and sensitivity to common stocks.

## RISK AND RETURN COMPARISON: STOCKS, BONDS, AND CONVERTIBLES

<b>AGG (Investment Grade Bonds)</b>	<b>3 Yr</b>	<b>5 Yr</b>	<b>10 Yr</b>
Annualized Return %	4.85	3.28	3.33
Standard Deviation %	3.43	3.26	3.02
Sharpe Ratio (return per unit of risk)	1.12	0.72	0.96
<b>SPY (US Large Cap)</b>	<b>3 Yr</b>	<b>5 Yr</b>	<b>10 Yr</b>
Annualized Return %	14.03	15.11	13.76
Standard Deviation %	18.39	14.98	13.51
Sharpe Ratio (return per unit of risk)	0.73	1.03	0.95
<b>VICIX (Victory INCORE Investment Grade Convertible Fd)</b>	<b>3 Yr</b>	<b>5 Yr</b>	<b>10 Yr</b>
Annualized Return %	10.52	12.68	9.39
Standard Deviation %	11.52	9.49	8.86
Sharpe Ratio (return per unit of risk)	0.84	1.22	0.96

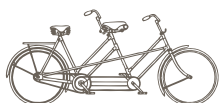
Source: Morningstar Advisor as of 12/31/2020

## CONVERTIBLE SECURITIES HAVE A VERY LOW CORRELATION TO STRAIGHT BONDS

<b>Security</b>	<b>AGG</b>	<b>SPY</b>	<b>VICIX</b>	<b>HYG</b>	<b>CWB</b>	<b>LQD</b>
AGG	1.0000	-0.0360	0.0370	0.2270	0.0830	0.8170
SPY	-0.0360	1.0000	0.8860	0.7760	0.8890	0.3640
VICIX	0.0370	0.8860	1.0000	0.7490	0.8710	0.3980
HYG	0.2270	0.7760	0.7490	1.0000	0.7520	0.6200
CWB	0.0830	0.8890	0.8710	0.7520	1.0000	0.4450
LQD	0.8170	0.3640	0.3980	0.6200	0.4450	1.0000

Source: Bloomberg, 12/31/2010 – 12/31/2020

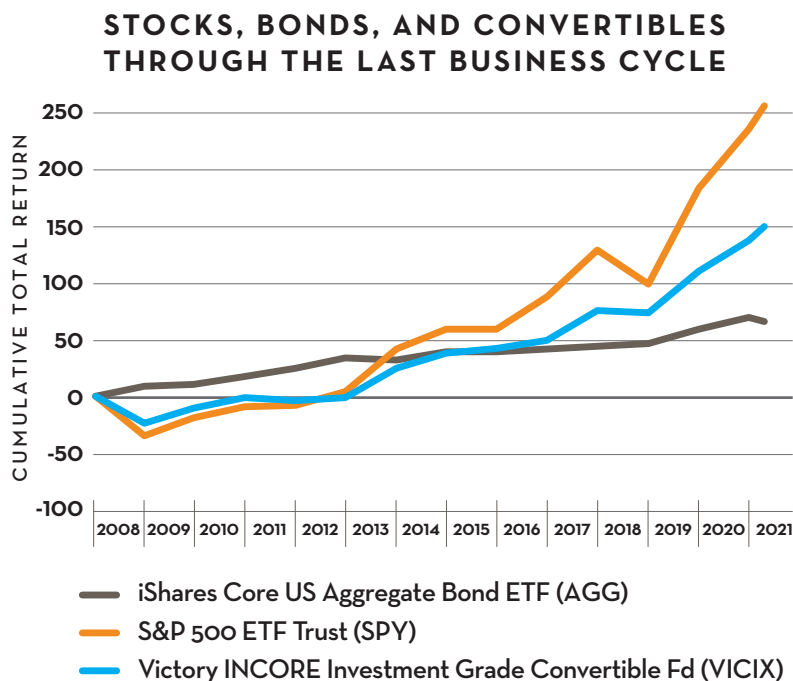
Source: Bloomberg; iShares Core US Aggregate Bonds ETF (AGG), SPDR S&P 500 ETF Trust (SPY), Victory INCORE Investment Grade Convertible Fd (VICIX), iShares iBoxx High Yield Corporate Bond ETF (HYG), iShares iBoxx Investment Grade Corporate Bond ETF (LQD), SPDR Bloomberg Barclays Convertible Securities ETF (CWB).



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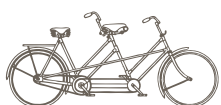
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Security	Annualized Total Return
AGG	3.86%
SPY	10.03%
VICIX	7.22%

Source: Bloomberg, 12/31/2007 – 3/15/2021

By replacing a portion of our bond exposure with convertibles through total market cycles, we may potentially improve the risk/return profile of the bond portion of the portfolio.



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