During Equity Sell-Offs, Historically, Convertibles Have Offered Resilience

Historically, convertible bonds have offered the opportunity to maintain exposure to the long-term potential of equities while better withstanding sharp sell-offs and offering the potential for higher yields.

Tarik Ancrum
Product Consultant

Table 1. Historically, Convertible Bonds Have Outperformed in Market Declines

Max S&P 500 Drawdown Period	S&P 500 Index Return	U.S. Convertible Index Return	Convertibles[1] Downside Capture
10/09/2007 - 3/09/2009	-55.2%	-42.8%	78%
3/24/2000 - 10/09/2002	-47.4%	-38.5%	81%
7/16/1990 - 10/11/1990	-19.2%	-16.8%	88%
9/20/2018 - 12/24/2018	-19.4%	-12.2%	63%
4/29/2011 - 10/03/2011	-18.6%	-16.8%	90%
7/17/1998 - 8/31/1998	-19.2%	-15.0%	78%
04/23/2010 - 7/02/2010	-15.6%	-9.7%	62%
11/27/2002 - 3/11/2003	-14.2%	0.2%	-2%
11/03/2015 - 2/11/2016	-12.7%	-13.9%	110%
5/21/2015 - 8/25/2015	-11.9%	-9.0%	76%
7/16/1999 - 10/15/1999	-11.8%	-5.3%	45%
10/07/1997 - 10/27/1997	-10.8%	-4.7%	44%
1/02/1990 - 1/30/1990	-10.0%	-4.6%	46%
1/26/2018 - 2/08/2018	-10.1%	-6.2%	61%

Average Downside Capture for Converts 65%

Source: Bloomberg. Max intra-year declines, starting January 1, 1990. Start dates inclusive. U.S. Convertible Index = ICE BofA Merrill Lynch All Convertible, All Qualities Index. 1Downside capture: The downside capture ratio measures a manager's performance in down markets relative to a particular benchmark. The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. Past performance is not a reliable indicator or guarantee of future results.

CONVERTIBLES

In Brief

- Historically, convertibles have offered attractive risk/reward characteristics vs. equities.
- The asset class historically has better withstood, on average, sharp sell-offs in the markets than equities alone.
- With a current yield that is more than double their underlying securities, U.S. convertible bonds provide an attractive source of potential income.

The long-term potential upside of the equity markets, historically, has been a crucial factor in portfolio construction decisions for some investors over the years. In the current period of heightened volatility, however, many investors may be seeking to better diversify their portfolios. One asset class they may want to consider is convertible bonds.

Convertible bonds have historically offered an attractive opportunity for investors to remain exposed to the equity markets with the potential for downside protection and higher yields.

Over the past 25 years, convertible bonds (as measured by the ICE BofAML All Convertibles, All Qualities Index) have averaged an annualized return of 8.8%, with a standard deviation of 13.6% compared to the S&P 500® Index's 9.6% average annualized return and 22.1% standard deviation. Moreover, convertibles have clearly displayed attractive risk/reward characteristics compared to U.S. equity markets with a Sharpe ratio– a measure of risk-adjusted returns- of 0.68 versus 0.47 for the S&P 500 Index.

Withstanding market volatility

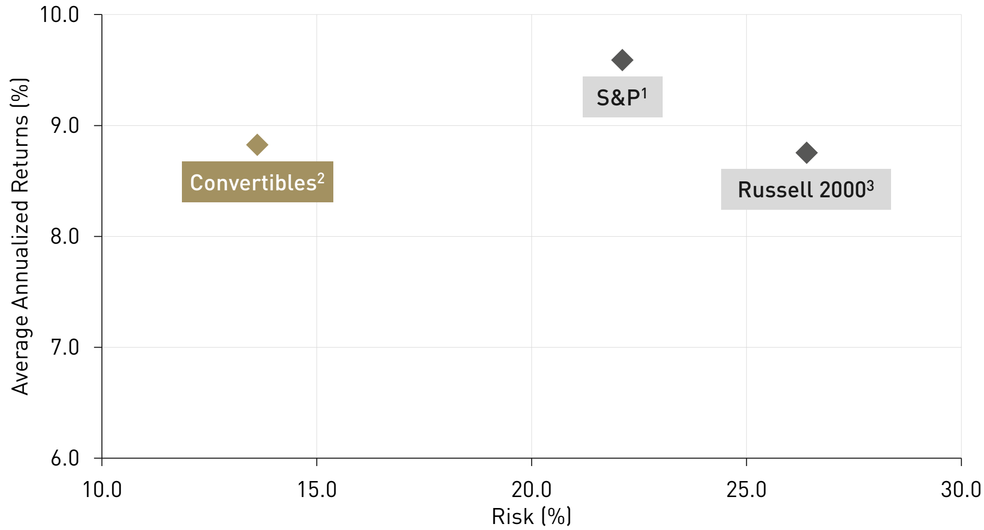
Market volatility is a normal part of the investing experience. In any given calendar year, the average drawdown (peak to trough decline) of the S&P 500 Index has been approximately 14%. However, due to convertible bonds having characteristics of both fixed income and equity securities, the asset class has historically exhibited a comparatively asymmetric return profile and, thus, better withstood, on average, sharp sell-offs in the equity markets. Analyzing the largest drawdowns for the S&P 500 Index since 1990, convertibles have only captured 65% of the downside on average, as seen in Table 1.

More recently, since the market's peak on February 19, 2020 and through the recent turbulence of the coronavirus outbreak and oil shock, the U.S. convertibles market has lost 19.11% compared to the 26.28% decline of the S&P 500 Index, as of March 12, 2020.

In our opinion, the historical resiliency of convertibles is largely due to their fixed income characteristics. The investment value, or "bond floor," (i.e.,the fixed income component of a convertible bond) provides a level below which the overall price of the convertible bond should not fall. As the price of the convertible bond declines, approaching the bond floor, the security becomes more bond-like, providing a potential safety net and reducing volatility and drawdowns.

Chart 1. Historically, Convertibles Have Offered Attractive Risk/Reward Characteristics vs. Equities

Risk/reward over the trailing 25-year period (February 28, 1995 – February 28, 2020)

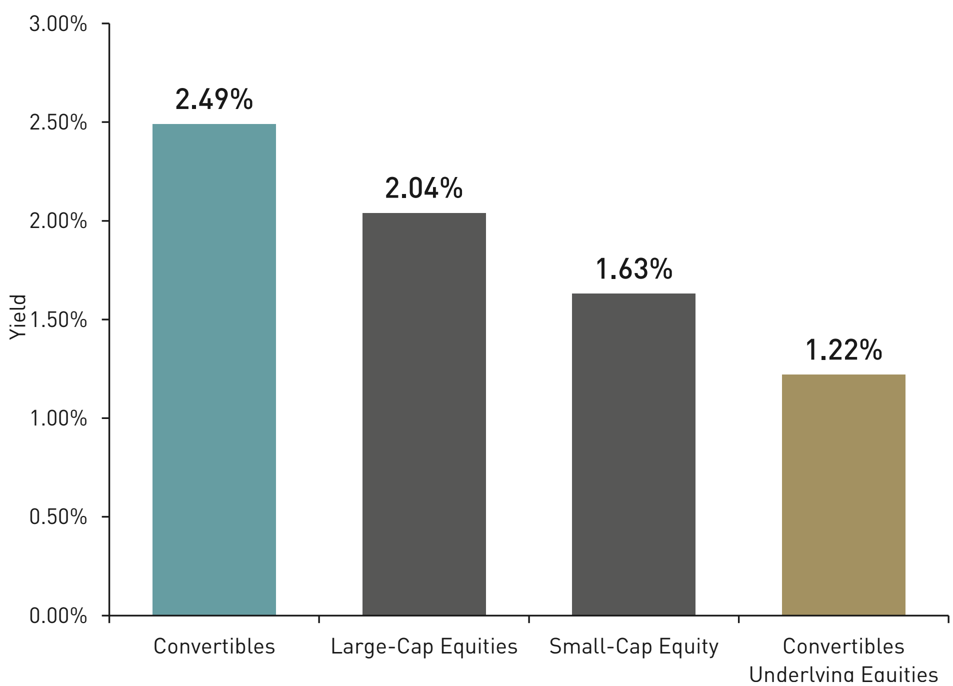


	Risk (%)	Average Annualized Returns (%)	Sharpe Ratio
Convertible	13.62	8.83	0.68
S&P 500	22.12	9.59	0.47
Russell 2000	26.40	8.75	0.34

Source: Morningstar. Past performance is not a reliable indicator or guarantee of future results. [1]S&P 500. [2]ICE BofAML All Convertible, All Qualities Index. [3]Russell 2000 Index. Risk=Standard Deviation. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. The historical data shown are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett or any particular investment.

Chart 2. Historically, the Fixed-Income Component of a Convertible Has Offered Resiliency in Volatile Times

Yields % as of February 28, 2020



Sources: Bloomberg. Convertibles=ICE BofA Merrill Lynch All Convertibles, All Qualities Index. Large Caps=S&P 500 Index. Small-cap stocks=Russell 2000 Index. Convertibles underlying equities based on the equities in the ICE BofAML All. Convertibles, All Qualities Index.Past performance is not a reliable indicator or guarantee of future results. The historical data shown are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett or any particular investment.

Additionally, with a current yield that is more than double their underlying securities, U.S. convertible bonds provide an attractive source of potential income. With relatively generous yields, investors holding these securities, with long-term investment horizons, could potentially accumulate compelling income during periods of volatility, as they wait for markets to recover. This may be appealing to investors enduring significant spikes in volatility and who are trying to avoid the common pit-fall of selling during sharp drawdowns.

Strategic Allocation to Convertibles

The unique risk-return profile and potential diversification benefits of convertible securities may be attractive to some investors in the midst of a highly volatile and uncertain market environment. Moreover, given the nature of the asset class, an active manager is able to adjust a portfolio to adapt to the market environment, moving up or down in credit quality, rotating across sectors and market capitalizations, or modifying a portfolio's equity sensitivity. In our opinion, a strategic asset allocation to an actively managed convertible strategy has a number of appealing characteristics for investors looking to meet their long-term objectives while potentially enhancing the risk-return profile of their portfolios over a full market cycle.

A Note about Risk: Convertible securities are subject to the risks affecting both equity and fixed income securities, including market, credit, liquidity, and interest rate risk. Convertible securities tend to be more volatile than other fixed income securities, and the markets for convertible securities may be less liquid than markets for common stocks or bonds. High yield, lower-rated convertible securities carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal.

No investing strategy can overcome all market volatility or guarantee future results.

Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

This article may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that markets will perform in a similar manner under similar conditions in the future.

Glossary of Terms

The average annual return is a percentage used when reporting the historical return, such as the three-, five-, and 10-year average returns of a mutual fund. The average annual return is stated net of a fund's operating expense ratio, which does not include sales charges , if applicable, or portfolio transaction brokerage commissions.

A **basis point** is one hundredth of one percent,

Downside capture: The downside capture ratio measures a manager's performance in down markets relative to a particular benchmark. A down market is one in which the market's quarterly (or monthly) return is less than zero. For example, a ratio of 50% means that the portfolio's value fell half as much as its benchmark index during down markets.

The **Sharpe ratio** is a measure that indicates the average return minus the risk-free return divided by the standard deviation of return on an investment.

Standard deviation measures the dispersion of data from the mean. Applied to a rate of return, standard deviation is an indication of an investment's volatility.

The **ICE BofAML All Convertibles, All Qualities Index** contains issues that have a greater than $50 million aggregate market value. The issues are U.S. dollar-denominated, sold into the U.S. market and publicly traded in the United States

The **Russell 2000® Index** measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The **S&P 500® Index** is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

Indexes are unmanaged, do not reflect deduction of fees and expenses and are not available for direct investment.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.

The opinions in this Market View are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy, and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decision.

Investors should carefully consider the investment objectives, risks, charges, and expenses of the Lord Abbett funds. This and other important information is contained in each fund's summary prospectus and/or prospectus. To obtain a prospectus or summary prospectus on any Lord Abbett mutual fund, contact your investment professional or Lord Abbett Distributor LLC at 888-522-2388, or visit us at lordabbett.com. Read the prospectus carefully before you invest.