INSIGHTS & PERSPECTIVES

SPECIALTY FIXED INCOME | CONVERTIBLES

JUNE 2023

It's Time to Pay Attention to Convertibles

For investors who seek to reduce the downside risk of equities but still maintain some upside equity exposure, we believe convertible bonds may be an interesting alternative. An allocation to convertibles could lower the risk in a portfolio by combining elements of fixed income with the potential for equity upside. The defensive characteristics of convertibles has allowed the asset class to participate in a smaller percentage of the equity price declines. The ability to capture the majority of upside of equity returns, while limiting the downside during the current market selloff (the asymmetric return profile), is what distinguishes convertible bonds from other fixed income securities. Convertible securities have historically provided returns comparable to U.S. large-cap stocks - on average - in rising equity markets and generally have helped to limit downside participation when stocks were falling.

Institutional investors have been diversifying their pension portfolios using this historically defensive, total return. instrument for many years. Convertible bonds provide investors with the income stream of bonds as well as the growth potential of stocks. Convertibles have the potential to participate in the equity markets while giving bond-like defensive features in turbulent markets. At 2% of the US investment-grade market and 15% of the US high yield market, US convertibles are often overlooked by investors. But recent asset class growth and structural dynamics suggest that investors should consider US convertibles, especially in rising rate and inflationary environments.

Understanding Convertibles

While they are technically bonds, convertibles, in the past, have performed more like stocks than bonds over time. This is large part due to its characteristic of having an embedded equity call option – investors have the right or obligation to exchange a convertible bond for a pre-determined number of shares in the issuing company at certain points in the bond's lifetime.

Convertibles may provide effective diversification for portfolios, particularly those that are fixed-income oriented. Unlike straight bonds, convertibles historically have a negative correlation to interest rates, because convertible bond performance is largely driven by the performance of the issuer's equity. In the past periods when interest rates and inflation rise, equities would advance in tandem with corporate profits. Also, convertibles do not necessarily mature at their nominal $1,000 par value. If the underlying equity rises above the bond's conversion price, the bond can be converted into cash or common stock worth more than the bond's par value. Owning a fixed-income security whose performance is relatively independent of interest rates and with capital appreciation potential may be an advantage in the current market environment. For investors who seek to reduce the downside risk of equities but still maintain some upside equity potential, convertible bonds may be an interesting alternative. We have seen numerous instances of investors use convertibles this way, especially in the case of defined benefit plan sponsors as they near fully funded status or are otherwise averse to the downside risk of stocks.

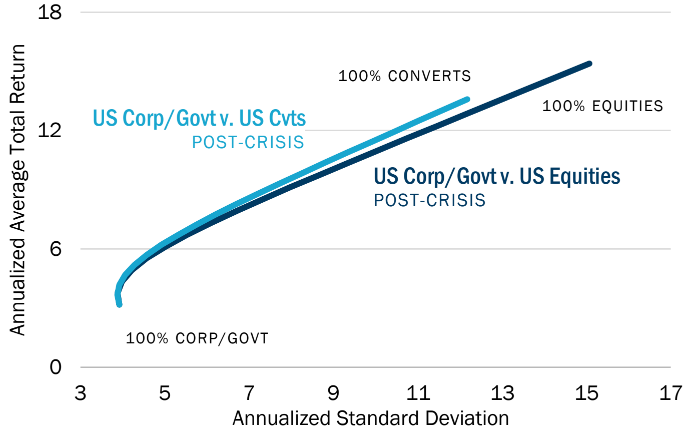
FIGURE 1: EFFECTIVE DIVERSIFICATION USING CONVERTIBLES

The addition of convertibles to a bond/stock portfolio pushes the broader fund returns out on the efficient frontier without adding additional volatility.

CORRELATION WITH OTHER MAJOR ASSET CLASSES[1]

Asset Class	Correlation April 1, 2008 – March 31, 2023
LARGE-CAP STOCKS	0.87
MID-CAP STOCKS	0.92
SMALL-CAP STOCKS	0.88
HIGH YIELD CORPORATE BONDS	0.84
LONG-TERM CORPORATE BONDS	0.50
INTERMEDIATE-TERM CORPORATE BONDS	0.62
LONG-TERM TREASURY BONDS	-0.11
INTERMEDIATE-TERM TREASURY BONDS	-0.13

EFFICIENT FRONTIER ANALYSIS[2]



1. Source: Morningstar. Please see disclosure page at the end of this presentation for important Correlation Table disclosure.

2. Source: BofA (based on data from BofA Global Research, ICE Data Services LLC, Bloomberg). US Corp/Gov't: BofA US Corporate & Government Master Index, US Equities: S&P 500 Index, US Converts: BofA All Convertibles Index. Data from January 1, 1996 to July 31, 2022. The hypothetical returns shown in the Efficient Frontier Analysis above do not represent the returns of any client portfolio or strategy actually managed by MacKay Shields and should not be construed as such. The hypothetical returns shown are index-based; MacKay Shields' portfolios are actively managed and would vary from any applicable index. Therefore, the hypothetical returns are not indicative of investment skill. Actual portfolios would be subject to fees and expenses. No fees or expenses were included in the hypothetical results.

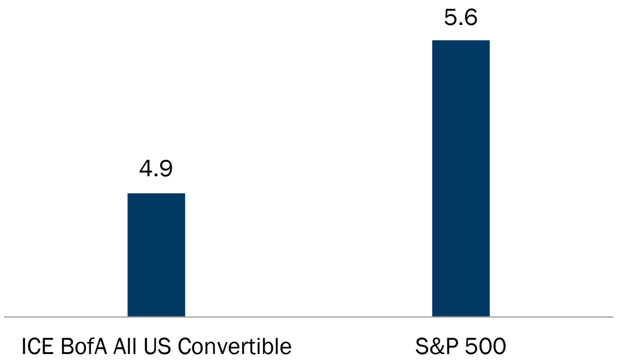
Hypothetical example, for illustrative purposes only. Please see Additional Disclosures pages at the end of this presentation for important information. No representation is made as to the accuracy and completeness of information contained in this presentation that has been obtained from third parties.

Asymmetric Return Capture of Convertibles

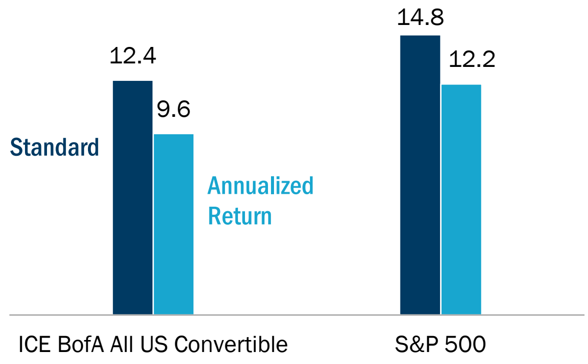
Although past performance is not a guarantee of future results, over the past 20 years, convertible securities have provided returns comparable to U.S. large-cap stocks—on average—in rising equity markets but generally helped to limit downside participation when stocks were falling. Over the past 10 years, the volatility of convertible bonds has been 12% versus 15% for the S&P 500, according to eVestment data as of March 31, 2023.

FIGURE 2: AVERAGE DRAWDOWN AND PERFORMANCE RELATIVE TO US EQUITY | CONVERTIBLES VS. US EQUITY 10 YEARS ENDING MARCH 31, 2023

AVERAGE DRAWDOWN



VOLATILITY[1]

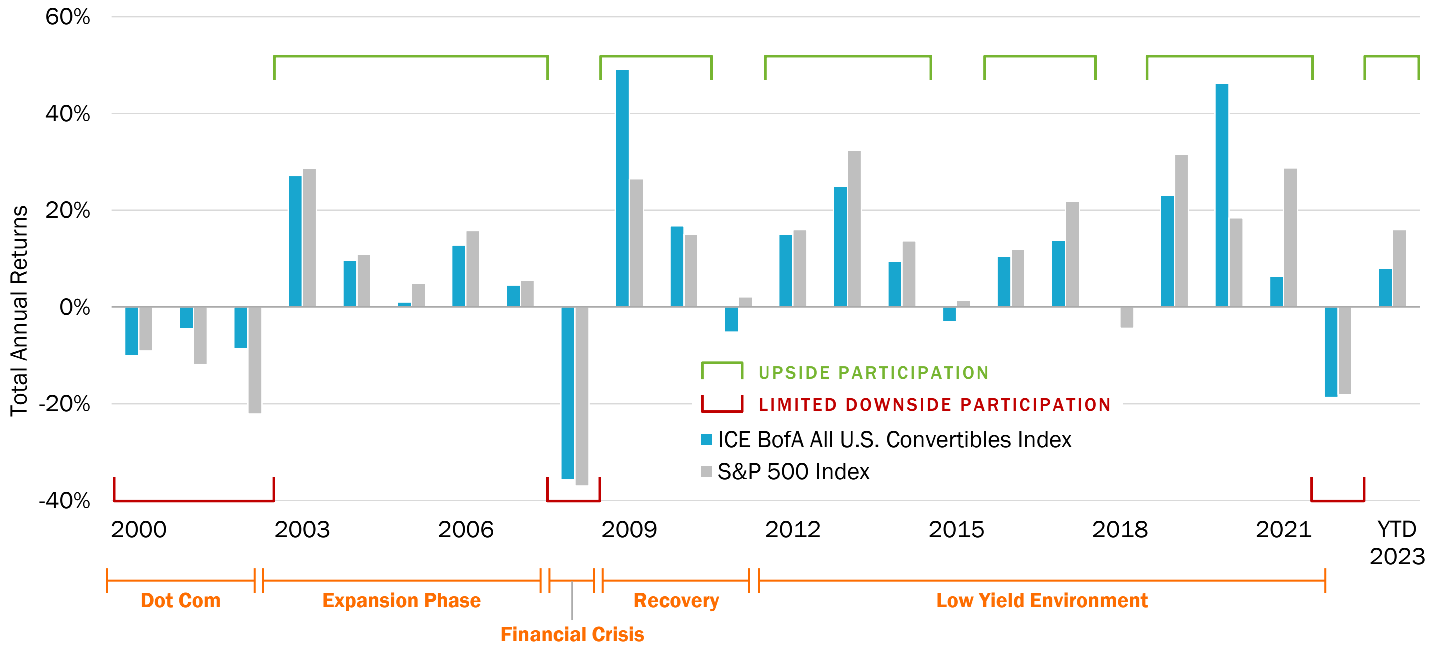


Data as of March 31, 2023

1. Volatility as measured by annualized standard deviation of monthly returns. **It is not possible to invest directly in an index.** Past performance is not indicative of future performance. Please see Index Descriptions at the end of this document.

Source: eVestment, Callan Associates.

FIGURE 3: EQUITY ALTERNATIVE WITH COMPETITIVE UPSIDE AND DOWNSIDE MITIGATION



Data as of June 15, 2023
Due to market volatility, current performance may be less or higher than the figures shown. It is not possible to invest directly into an index.
Past performance is not indicative of future performance. Please see Index Descriptions at the end of this document.
Source: Callan Associates

The defensive characteristics of convertibles has allowed the asset class to participate in a smaller percentage of the equity price declines. The ability to capture the majority of upside of equity returns, while limiting the downside during the current market selloff (the asymmetric return profile), is what distinguishes convertible bonds from other fixed income securities. Historically, converts have only experienced 50% of the downside risk of stocks while capturing 80% of equity market returns in up markets. It's this asymmetric risk and return profile that makes the asset class especially appealing.

Making a Strategic Allocation to Convertible Bonds

The addition of convertible bonds may improve the risk/return profile of a diversified equity and fixed income portfolio. Convertible bonds' strong multi-year returns and potential for limiting downside participation are testimony to the attractiveness of the asset class. While convertible securities do have fixed-income characteristics and are impacted by rising interest rates, the price movement of their underlying stocks is the predominant factor, which has historically helped soften the negative effect of rising interest rates. Adding convertible bonds to a traditional fixed income portfolio also offers the benefit of exposure to sectors, such as IT and Healthcare, with large weightings in the converts universe but little to no weight in most fixed income benchmarks. We believe convertible bonds remain an effective vehicle for those seeking to participate in further equity advances. We think investors should view convertibles as an alternative slice of their bond allocation.

Unique environments require unconventional thinking. We believe it's critical to have a clear understanding of an issuer's underlying fundamentals, including its free cash flow, leverage and future business prospects. In our view, this demonstrates the importance of investing in convertibles with portfolio managers who have the resources to thoroughly analyze individual securities.

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Past performance is not indicative of future results.

COMPARISONS TO AN INDEX

Comparisons to a financial index are provided for illustrative purposes only. Comparisons to an index are subject to limitations because portfolio holdings, volatility and other portfolio characteristics may differ materially from the index. Unlike an index, portfolios are actively managed and may also include derivatives. There is no guarantee that any of the securities in an index are contained in any managed portfolio. The performance of an index may assume reinvestment of dividends and income, or follow other index-specific methodologies and criteria, but does not reflect the impact of fees, applicable taxes or trading costs which, unlike an index, may reduce the returns of a managed portfolio. Investors cannot invest in an index. Because of these differences, the performance of an index should not be relied upon as an accurate measure of comparison.

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DEFINITIONS

Standard Deviation is a statistical measure of portfolio risk. Standard Deviation is equal to the square root of the Variance. It reflects the average deviation of the observations from their sample mean. In the case of portfolio performance, the Standard Deviation describes the average deviation of the portfolio returns from the mean portfolio return over a certain period of time. Standard Deviation measures how wide this range of returns typically is. The wider the typical range of returns, the higher the Standard Deviation of returns, and the higher the portfolio risk. If returns are normally distributed (i.e., has a bell shaped curve distribution), then approximately 2/3 of the returns would occur within plus or minus one Standard Deviation from the sample mean.

A drawdown is defined as the percentage of decline in the value of a security over a period before it bounces back to the original value or beyond. It is expressed as the difference between the highest, i.e., the peak value of that asset, and the lowest, i.e., the trough value of the same. Calculating the drawdown value helps investors identify the risks associated with a particular investment and accordingly prepare themselves to manage it.

ABOUT RISK

Convertible securities are subject to a risk of loss. Convertible securities may be subordinate to other securities. The total return for a convertible security depends, in part, upon the performance of the underlying stock into which it can be converted. Additionally, an issuer may encounter financial difficulties which could affect its ability to make interest and principal payments. If an issuer stops making interest and/or principal payments, an investor could lose its entire investment.

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The following indices may be referred to in this document:

The ICE BofA All U.S. Convertibles Index is an unmanaged index that consists of convertible bonds traded in the U.S. dollar denominated investment grade and non-investment grade convertible securities sold into the U.S. market and publicly traded in the United States. The Index constituents are market value weighted based on the convertible securities prices and outstanding shares, and the underlying index is rebalanced daily.

The S&P 500 Index is an unmanaged index that is widely regarded as the standard for measuring large-cap U.S. stock market performance.

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CORRELATION TABLE DISCLOSURE

Convertible securities are represented by the ICE BofA All Convertible Securities Index, an unmanaged market capitalization weighted index of domestic corporate convertible securities that are convertible to common stock only. Large-capitalization stocks are represented by the S&P 500® Index, an unmanaged index that is widely regarded as the standard for measuring large-cap U.S. stock market performance. Mid-capitalization stocks are represented by the Russell Midcap® Index, an unmanaged index that measures the performance of the 800 smallest companies in the Russell 1000® Index. Small-capitalization stocks are represented by Russell 2000® Index, an unmanaged index that measures the performance of the 2,000 smallest companies in the Russell 3000® Index. Long-Term Treasury Bonds are represented by the Bloomberg Long-Term Treasury Index includes all public obligations of the U.S. Treasury, excluding flower bonds and foreign-targeted issues with maturates of 10 years or longer. Intermediate-Term Treasury Bonds are represented by the Bloomberg Intermediate Treasury Index includes treasury bonds with maturates of at least one year and up to 10 years with an outstanding par value of at least 100 million. They include fixed-rate debt issues, rated investment grade or higher by Moody's Investor Services, Standard & Poor's Corporation, or Fitch Investors Service (in that order). Treasuries include all public obligations of the U.S. Treasury, excluding flower bonds and foreign-targeted issues. Long-Term Corporate Bonds are represented by the Bloomberg Long-Term Credit Index which serves as a measure of all public-issued nonconvertible investment-grade corporate debts that have a maturity of 10 years or more. Intermediate-Term Corporate Bonds are represented by the Bloomberg Intermediate Credit Index which serves as a measure of all public issued nonconvertible investment-grade corporate debts that have a maturity of one to three years. Results assume reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index. Correlation is a statistical measure of how two securities move in relation to each other. Correlations are used in advanced portfolio management.

HYPOTHETICAL PERFORMANCE DISCLOSURES

The hypothetical returns shown do not represent the returns of any client portfolio or strategy actually managed by MacKay shields and should not be construed as such. Therefore, they are not necessarily indicative of investment skill.

This material contains hypothetical analysis based on the stated indices. The returns identified in the Efficient Frontier analysis reflect a backward looking analysis of the returns for each of the indices stated, for the identified time periods. MacKay Shields makes no representations that the Efficient Frontier analysis provided will actually reflect future results or that any investment will actually achieve results similar to those shown. These techniques do not predict future actual performance and are limited by assumptions that future market events will behave similarly to historical time periods or theoretical models. Moreover, the returns shown reflect returns of the blended indices; MacKay Shields' portfolios are actively managed.

No representation is being made that any account, product or strategy will or is likely to achieve profits, losses or results similar to those shown. Hypothetical performance results have several inherent limitations. Unlike an actual performance record, hypothetical results do not represent actual performance and are generally prepared with the benefit of hindsight. There may be sharp differences between hypothetical performance results and the actual results subsequently achieved by any particular account, product or strategy. In addition hypothetical results cannot account for the impact of certain market risks such as lack of liquidity. There are numerous other factors related to the markets in general or the implementation of any specific investment strategy, which cannot be fully accounted for in the preparation of hypothetical results and all of which can adversely affect actual results.

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The identified returns are for illustrative purposes only and are neither a prediction nor a projection of return. The return assumptions are an estimate of what investments may earn over a stated period. Actual returns may be higher or lower than those shown and may vary substantially.

Results shown may not be attained and should not be construed as the only possibilities that exist. Different weightings in the asset allocation illustration will produce different results. Actual results will vary and are subject to change with market conditions. There is no guarantee that results will be achieved. No fees or expenses were included in the hypothetical results; actual portfolios would be subject to fees and expenses. Gross-of-fee performance figures presented do not reflect the deduction of investment advisory fees. A client's returns will be reduced by the advisory fee and other expenses incurred in the management of its account. For example, the deduction of a 1% advisory fee over a 10-year period would reduce a 10% gross return to an 8.9% net return. The scenarios assume a set of assumptions that may, individually or collectively, not develop over time. The analysis reflected in this information is based upon data at time of analysis. This material should not be considered as investment advice nor a recommendation of any particular security, strategy or investment product.
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