



Convertible fourth quarter update and 1Q 2026 outlook

From Convertibles

2025 has been a very good period for the U.S. Convertible market. Through the first eleven months of the year, the ICE BofA U.S. Convertible Index is up 18.48%, slightly ahead of the S&P 500's 17.79% advance but trailing the NASDAQ's 21.74% gain

Performance

Despite the presence of many small and mid cap companies in the U.S. convertible market, the asset class has not been dragged down by the performance of the small cap Russell 2000 Index which is up 13.45% year-to-date. The solid performance of convertible securities relative to stocks has been helped by the large gains of several Index securities tied to AI infrastructure spending and nuclear energy which has seen renewed enthusiasm tied to the potential of supplying electric power to newly built data centers.

While this year's gains are impressive, they have been relatively concentrated in securities within the Information Technology and Industrials sectors and more specifically to companies seen as beneficiaries of the enormous spending that is expected to go to the buildout of data centers, data storage, and power demands related to the

needs of AI infrastructure. In addition, almost all of these securities are either not rated or rated speculative. While the ICE BofA U.S. Convertible Index is up 18.48% year-to-date, the Investment Grade portion of that Index is up just 9.71% for the same time period, highlighting the outperformance of speculative securities versus their higher quality peers.¹

Issuance

Through the end of the November 2025, new issuance totaled \$107.1 billion, (from Bank of America data) ahead of last year's \$73.0 billion of new issuance for the same period. At the current pace, new issuance may exceed the record \$113 billion seen in 2020 when companies, desperate to raise capital during the pandemic, issued convertible securities to raise funds with a lower cost of capital than what was available in the straight high yield market. This year, companies are issuing convertible securities at a rapid pace to fund projects tied to AI spending and often to refinance securities issued in 2020 and 2021 that are nearing maturity. In addition, while interest rates have declined somewhat since the start of the year, they remain well above the lows of two years ago and investment grade companies, particularly in the Utilities sector continue to issue low coupon convertible notes to refinance maturing debt that would otherwise be

1. Data source: Bloomberg

refinanced with higher cost straight debt. We purchased numerous new issue offerings this year in companies that as we believe have solid underlying businesses, strong prospects for growth, and reasonable valuations based on prospective free cash flow estimates. We expect new issuance to continue at a healthy clip as many companies are comfortable issuing a low coupon security linked to a share price that in many cases is at or close to record high levels. We continue to exercise caution in evaluating new issues particularly from companies that have no identifiable use for the capital.

Positioning and Outlook

The convertible market's tremendous performance, up over 18% year-to-date, has prompted us to take a slightly more cautious view of the equity-linked asset class. In addition, the increased equity sensitivity of the average convertible bond makes the market slightly more vulnerable in the event of an equity selloff. We have reduced our exposure

to several securities with elevated bond prices, high degrees of equity sensitivity and lack of downside protection. More importantly, we have not chased those segments of the markets such as cryptocurrency, whose valuation is not supported by a sound underlying business and free cash flow. While we are cautious around the direction of equities, we maintain a measured and agnostic stance on the broad market's direction, focusing instead on valuation discipline and issuer fundamentals. We are not incorporating any macro-economic view into our investment decisions. Our largest exposure is to the Information Technology sector which also has the largest representation in the U.S. convertible universe. We are relatively in-line with the benchmark's 29% weighting to that sector. We remain overweight the Healthcare sector and underweight Utilities and Financials. We continue to believe that our process, which emphasizes strong company fundamentals and reasonable valuation, will outperform over a complete market or economic cycle.

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