

## Convertibles and Rising Interest Rates

In the coming years, the potential exists for rising interest rates in conjunction with an improving economy or rising inflation. That possibility raises questions for convertible securities, hybrids with characteristics of both bonds and stocks. Bonds tend to lose value in an environment of rising interest rates while equities, in many cases historically, have gone the opposite direction.

**In general, the more a convertible's price is determined by the value of its underlying equities, the greater its tendency not to be influenced by changing interest rates.**

Convertible securities<sup>1</sup> have fixed-income qualities and can be affected by rising interest rates, but they also can take on equity qualities because of the option to convert them into a predetermined number of issuer shares.

The table below shows what has happened to stocks, bonds and convertible indexes in the past 20 years when the 10-year Treasury yield rose more than 100 basis points. Convertible returns tended to more closely reflect equity returns than bond returns.

### RETURNS IN RISING INTEREST RATE ENVIRONMENTS

	7/11/01- 1/4/02	13/6/03- 14/6/04	1/6/05- 28/6/06	30/12/08- 10/6/09	7/10/10- 8/2/11	26/7/12- 27/12/13	8/7/16- 16/12/16	8/9/17- 8/11/18	5/8/20- 31/3/21	20/7/21- 24/10/22
CUMULATIVE RETURN (%)										
Yield increase (bps)*	122	176	134	187	134	157	123	119	122	306
ICE BofA All US Convertibles Index	2.29%	11.49%	9.46%	24.68%	11.63%	35.49%	7.58%	9.12%	28.41%	-13.33%
S&P 500 Index	3.07	14.66	6.71	9.41	14.89	42.09	8.65	16.41	21.46	-7.28
Bloomberg Barclays US Government/Credit Bond Index	-3.09	-3.64	-1.49	-2.08	-3.94	-2.14	-4.88	-3.26	-4.83	-14.66

\*10-year Treasury yield

Sources: Morningstar and Bloomberg

<sup>1</sup> Convertible securities are interest-paying securities, similar to corporate bonds, in which investors have the option to turn the bonds into a predetermined number of shares. The hybrid nature of the securities offers investors the principal risk mitigation and income characteristics of bonds with the opportunity for higher returns if the issuer's stock price rises. This discussion includes convertible bonds and preferred shares.

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**Past performance is no guarantee of future results. Current performance may be lower or higher than the performance quoted.**

There are certain risks associated with an investment in a convertible bond such as default risk—that the company issuing a convertible security may be unable to repay principal and interest—and interest rate risk—that the convertible may decrease in value if interest rates increase.

Government credits are subject to interest rate risk, if rates increase the value of the security declines. Equity securities are subject to "stock market risk" meaning that stock prices in general (or in particular, the prices of the types of securities in which a fund invests) may decline over short or extended periods of time.

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#### Index Definitions

The ICE BofA All US Convertibles Index (VXA0) measures the return of all US convertibles. The S&P 500 Index is considered generally representative of the US stock market. The Bloomberg Barclays US Government/Credit Bond Index includes treasuries and agencies that represent the government portion of the index, and includes publicly issued US corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements to represent credit interests. Unmanaged index returns assume reinvestment of any and all distributions and, unlike fund returns, do not reflect fees, expenses or sales charges. Investors cannot invest directly in an index.

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**NOT FDIC INSURED | NOT BANK GUARANTEED | MAY LOSE VALUE**

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