

CONVERTIBLE ARBITRAGE— SOURCES OF INCOME

Ask  the PORTFOLIO
MANAGER

What are the sources of income from convertible arbitrage?

Transcript of a video recorded on November 30, 2017.

Eli Pars, Co-CIO, Head of Alternative Strategies and Co-Head of Convertible Strategies, Senior Co-PM, outlines the sources of income from convertible arbitrage, including: coupon income from the convertible bond, short interest credit, capital appreciation from convertibles and rebalancing/trading profits.



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There are a couple of sources of income for convertible arbitrage. The first and foremost is the coupon income from the convertible bond. But on top of that, you also generate income from the shorts. Which is somewhat counterintuitive to a lot of people. But when you short a stock, the proceeds of that are put into a bank account essentially that pays you interest somewhat linked to fed funds, usually to some discount to fed funds.

In today's world where rates are pretty low, that's less of a driver, and a couple of years ago when rates were zero, it was even less important. But you go back to when overnight money was 4% or 5% it was a meaningful part of return. And it's part of the linkage of returns in convertible arb strategy to overnight money and why people often compare the two.

On top of that, we've often talked about gamma trading where we're trading around the convertible position, the underlying stock against the convertible position to keep our hedge in line. The buying low and selling high from gamma trading is another meaningful part of returns.

And in the fourth part is that it's ultimately a trading strategy. So, you're trying to find cheap securities and rotate the book as some of the things you own richen, and other things in the market cheapen, so you're taking advantage of the relative value of different securities in the market.

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Video recorded 11/30/2017.

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