

# JPMorgan Global Convertibles Income Fund

Seeking opportunity in more difficult conditions

JPMorgan Global Convertibles Income Fund (JGCI) is the only UK-listed fund investing in convertible bonds. It aims to produce income with the potential for capital growth from a diversified global portfolio. A difficult period recently for the sector has seen the fund experience some share price volatility, although NAV has largely been protected by avoiding the capital risk inherent in some very high yielding issues. Over the past year the number of securities in the portfolio has risen as a further element of diversification and risk reduction, and a new hire to the team has facilitated greater exposure to the under-researched Asia Pacific market. The current wider-than-average level of discount and 5%+ yield may represent an opportunity for investors prepared to weather continued near-term volatility.

12 months ending	Total share price return (%)	Total NAV return (%)	MSCI World (%)	Credit Suisse Global HY (%)	FTSE All-Share (%)
31/01/12	--	--	(1.0)	12.7	(0.3)
31/01/13	--	--	16.1	18.8	16.3
31/01/14	--	--	12.6	(0.1)	10.1
31/01/15	(0.9)	2.3	17.7	6.8	7.1
31/01/16	(11.6)	(1.5)	1.1	(7.7)	(4.6)

Note: Twelve-month rolling discrete £-adjusted total return performance.

## Investment strategy: Diversified, global income fund

JGCI's primary focus is on income, with the potential for some capital appreciation. Because of this it concentrates on the bond-like to balanced segments of the convertible bond market (see diagram, Exhibit 2). The team at JP Morgan Asset Management also runs funds in the balanced to equity-like segments; this full coverage of the sector allows it to spot opportunities where securities may be moving between market segments. The team combines a strategic view of market fundamentals with bottom-up security analysis to produce a global portfolio of securities, diversified by geography, industry and issuer size.

## Market outlook: Rising rates historically favourable

Credit generally underperformed equities in the latter half of 2015 as investors focused on the negative implications of a normalising interest cycle. Analysis of returns from different asset classes in rising interest rate environments suggests convertibles have tended to perform better than other types of bond in such times, however. Since the turn of the year volatility has hit equity markets, which may favour convertible bonds because of their built-in downside protection (the 'bond floor').

## Valuation: Discount wider in tricky credit conditions

Having traded at a premium to NAV for most of its life, JGCI has moved to a discount since mid-2015, as a more difficult backdrop for the convertible bond market has led to greater share price volatility. At 3 February 2016 the fund stood at a 6.6% discount, compared with an average of 1.8% over 12 months and an average premium of 1.1% since launch. Shares may be bought back if the discount remains above 5% for a prolonged period, although limited use has been made of this power to date as the board wishes to avoid shrinking the fund unnecessarily.

Investment companies

10 February 2016

**Price** 87.0p  
**Market cap** £190.5m  
**AUM** £217.6m

NAV\* 93.2p  
Discount to NAV 6.6%

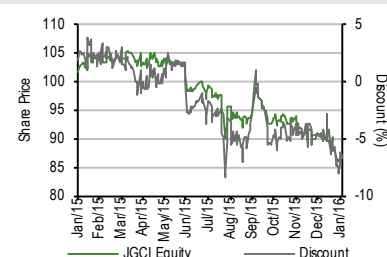
\*Including income. Data at 3 February 2016.

Yield 5.2%  
Ordinary shares in issue 218.98m  
Code JGCI

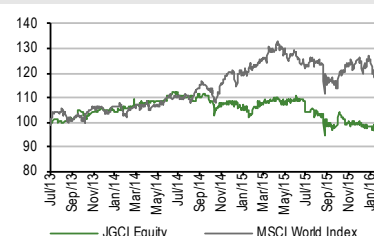
Primary exchange LSE

AIC sector Sector specialist: Debt

### Share price/discount performance



### Cumulative perf. since launch



52-week high/low 105.5p 86.0p

NAV\*\* high/low 104.0p 92.7p

\*\*Including income.

### Gearing

Gross\* 6.0%  
Net\* -0.9%

\*As at 3 February 2016.

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**JPMorgan Global Convertibles  
Income Fund is a research  
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**Exhibit 1: Fund at a glance**
**Investment objective and fund background**

JPMorgan Global Convertibles Income Fund (JGCI) seeks to generate dividend income combined with the potential for long-term capital growth by investing in a globally diversified portfolio of convertible securities and other suitable instruments exhibiting convertible or exchangeable characteristics. The dedicated convertibles team at JP Morgan Asset Management follows a well-developed process that combines equity and credit selection techniques. Currency exposures for capital and income are hedged.

**Recent developments**

- 26 November 2015: First interim dividend of 1.125p per share declared for FY16.
- 22 October 2015: Final results for the year ended 30 June. NAV total return of -1.0% and share price total return of -4.8%, reflecting a widening discount. Yield target of 4.5p per share achieved.

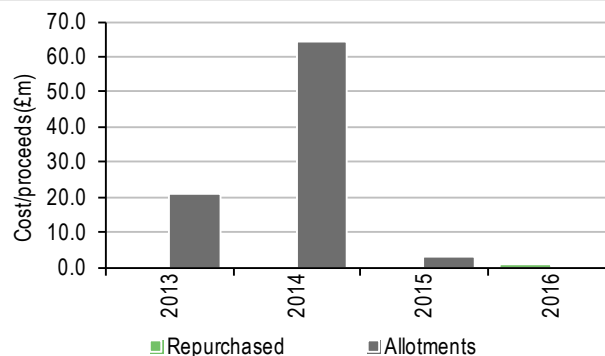
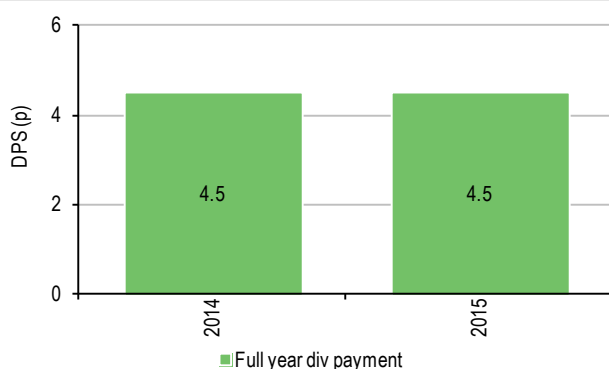
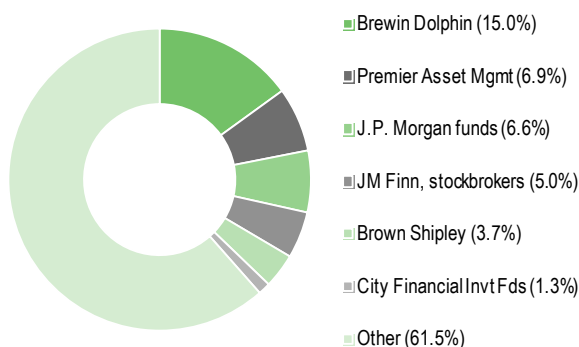
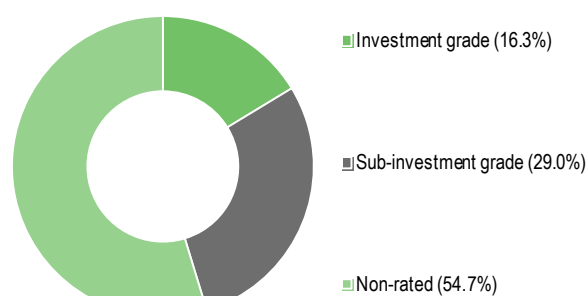
Forthcoming		Capital structure		Fund details	
AGM	November 2016	Ongoing charges	1.1%	Group	JP Morgan Asset Management
Interim results	February 2016	Net gearing	1.0%	Managers	Team led by Antony Vallée
Year end	30 June	Annual mgmt fee	0.75% of net assets	Address	60 Victoria Embankment, London EC4Y 0JP
Dividends paid	Quarterly	Performance fee	None	Phone	+44(0)20 7742 9995
Launch date	11 June 2013	Trust life	Indefinite	Website	<a href="http://www.jpconvertiblesincome.co.uk">www.jpconvertiblesincome.co.uk</a>
Continuation vote	AGM 2018/3-yearly	Loan facilities	\$32m multicurrency		

**Dividend policy and history**

In the first year dividends were paid half yearly, but moved to quarterly payments thereafter. The launch target for a gross dividend yield of 4.5% on the issue price (100p) was delivered in the first two financial years.

**Share buyback policy and history**

JGCI may buy back up to 14.99% pa of its issued share capital. New shares may be issued under a placing programme. Subject, among other things, to directors' discretion, the company would expect to make purchases if the share price discount to NAV exceeds 5% for any significant period of time.


**Shareholder base (as at 25 January 2016)**

**Breakdown by official credit quality (as at 31 December)**


Portfolio characteristics 31 December 2015		Portfolio allocation 31 December 2015 (%)	
Portfolio yield to best*	5.1%	Real Estate	25.2
Equity sensitivity (delta)	18.9%	Communications	18.3
Duration (to put)	3.9 years	Consumer cyclicals	11.7
Number of securities	106	Consumer non-cyclical	10.1
Running yield	3.4%	Technology	8.3
<b>Bond quality</b>		Industrial	6.6
Investment grade	15.3%	Other Financials	4.3
Sub-investment grade	26.4%	Others and Cash	4.0
Non-rated	58.4%	Utilities	3.9
	<b>100.0%</b>	Energy	3.9
		Banks	3.7

Source: JPMorgan Global Convertibles Income Fund, Edison Investment Research, Morningstar, Thomson. Note: \*Yield to best: highest yield for each bond with all future put dates treated as possible maturity dates and a yield-to-maturity calculation performed for each date.

## Background to convertible bonds

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Convertible bonds are securities that combine some of the characteristics of bonds and equities. They are essentially bonds with an embedded option to convert into the shares of the issuing company at a predetermined date and price. Until maturity they pay a regular coupon, and can be redeemed at par, which gives an element of downside protection (the 'bond floor') not shared by equities. The price of a convertible is linked to that of the underlying equity, meaning they are less sensitive to interest rate movements than ordinary bonds.

The different segments of the corporate bond market are illustrated in Exhibit 2, showing how the bond and equity components of a convertible might interact at different stock price levels. An out-of-the-money convertible is one where the equity price is below the par value of the convertible. At this part of the curve the convertible is most bond-like, with returns coming principally from the coupon (except at the extreme left, in cases of distress, where the issuer may default). As the share price rises, the value of the convertible also rises, meaning there is more of a balance between income and capital returns. When the bond price moves above par value, the convertible is in-the-money and moves more in line with the underlying equity.

The higher-yield (bond-like) part of the market is JGCI's main area of focus. Convertibles may occupy this space for a number of reasons: smaller issuers may need to offer higher coupons to attract investors; or yields may rise as prices fall on specific companies' bonds or those in out-of-favour sectors or regions. As well as providing a high current yield, these convertibles have longer-term potential for price appreciation.

## Fund profile: UK's only closed-end convertibles fund

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JGCI is a Guernsey-incorporated, London-listed closed-end investment company, launched in June 2013 to address a gap in the market for a globally invested convertible bond fund with a bias towards income generation as well as the possibility of capital growth. It remains the only UK-listed fund of its type.

JGCI is managed by the convertible bonds team at JP Morgan Asset Management, led by Antony Vallée. The team also includes fund managers Natalia Bucci and Robin Dunmall, as well as four analysts, three of whom have specific sector responsibilities, while the fourth, recent hire Paul Levene, looks across the market at more credit-sensitive areas, and has a particular focus on Asia ex-Japan.

## The fund managers: Vallée, Bucci and Dunmall

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### The managers' view: Cautiously optimistic as US rates rise

JGCI's managers currently see both opportunities and risks in the convertible bond market. While aware of the need to achieve their income objective, they are positioned relatively cautiously and are largely avoiding the riskier areas such as energy and materials, arguing that the high yields on offer are insufficient compensation for the real possibility of capital loss. Dunmall notes that while it would be possible to build a portfolio with a higher yield, there is a trade-off between what is achievable and what is prudent.

While convertibles as an asset class offer greater equity sensitivity than ordinary bonds, JGCI invests at the more bond-like end of the convertible market (see Exhibit 2) to achieve its yield, which means there is less 'optionality', or exposure to share price moves. This is beneficial when share prices are falling (as has been the case since the start of 2016), but meant the fund missed out on some of the upward moves in equity markets in 2015. JGCI's managers also run a SICAV

that invests in the balanced to equity-like space and, while the two products saw similar total returns in calendar year 2015, JGCI's NAV volatility was lower, because more of its return came from income and less from share price movements. Another expression of the managers' caution can be seen in their preference for shorter-dated high-yield names, as they are less rate-sensitive and there is a greater chance of negative events with longer-dated bonds.

The recent interest rate rise in the US has focused investor attention on prospects for fixed income markets. While a rate rise is usually seen as negative for bonds, JGCI's managers point out that an improving economy is good for companies from a credit as well as an equity point of view. With elements of both equity and bond exposure, they say convertibles could perform well in a benign economic scenario with gently rising interest rates, yet spreads on US high-yield bonds are already at levels that are pricing in recession. Historical analysis by JP Morgan Asset Management shows that convertible bonds have performed positively in previous rising interest rate cycles, unlike almost all other fixed income asset classes. While the immediate future path is far from certain, JGCI's managers say this suggests a positive performance impact over the medium term.

## Asset allocation

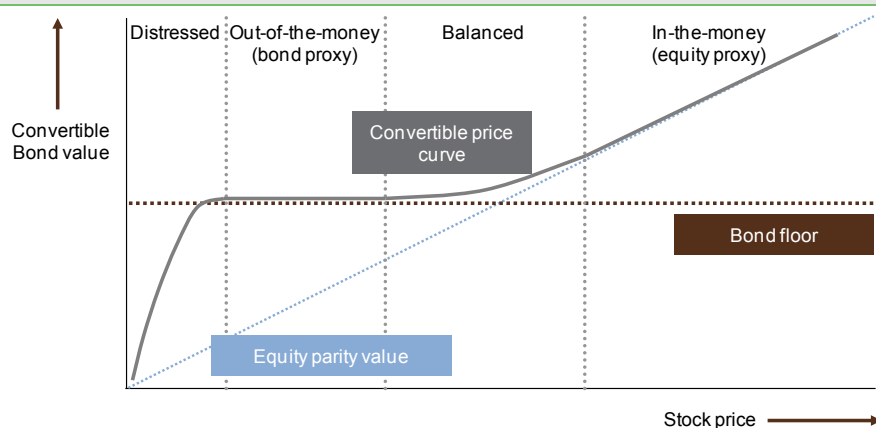
### Investment process: Diversified, income-focused approach

As shown in Exhibit 2 below, the convertible bond market can broadly be split into three segments: bond like, balanced and equity like. Because of its income focus, JGCI concentrates on the bond-like to balanced part of the universe. This allows it to achieve the optimum blend of yield and total return potential. The fund tends not to convert the bonds it holds; as they approach parity with the equity value, the managers are more likely to sell to investors seeking more equity exposure, and reinvest in higher-yielding convertibles.

The managers arrive at a strategic allocation between the segments by assessing the prospects for yields and overall convertible bond market valuations. Individual securities are selected following analysis of the issuer and the outlook for its industry, as well as technical factors specific to each issue. The portfolio is global and is diversified by geography, industry and market capitalisation. A new analyst with extensive experience of the Asian convertibles market has been recruited to the team, and JGCI has significantly increased its exposure to the Far East ex-Japan.

The portfolio also holds a spread of credit qualities, and includes a significant weighting to unrated securities. These are not necessarily of lower credit quality than rated bonds; as a trade-off for the greater research effort required to assess each issue, the managers can find attractively valued convertibles from strong issuers at higher yields than might otherwise be the case.

**Exhibit 2: Interaction of bond and equity components of a convertible bond**



Source: JPMorgan Global Convertibles Income Fund

## Current portfolio positioning

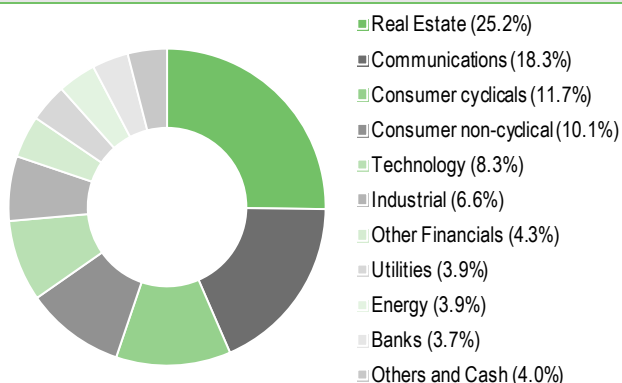
At 31 December 2015 JGCI had 106 holdings, a large increase on the 66 names held 12 months previously. The managers note that while aggregate valuations look attractive in terms of yields and spreads, there is a higher level of idiosyncratic or company-specific risk, meaning a greater level of diversification is appropriate. At the same time the managers have increased exposure to larger issuers, and the breakdown of holdings is now c 37% each in small- and mid-cap names and c 26% in larger companies. Opportunities have arisen among the larger issuers as sentiment towards credit has turned negative, lowering convertible bond prices and raising yields commensurately. Larger companies' bonds have the added benefit of being more liquid and therefore easier to trade. Examples of larger companies in the portfolio include US discount travel website Priceline, Telecom Italia and Twitter.

Over the past 12 months there has been a slight decrease in the proportion of the portfolio held in officially investment grade securities (from 18.0% to 16.3%), while unrated names have increased from 51.7% to 54.7%. The JGCI team does its own analysis of the credit quality of all unrated securities, assessing them as c 75% high yield and 25% investment grade at 31 December.

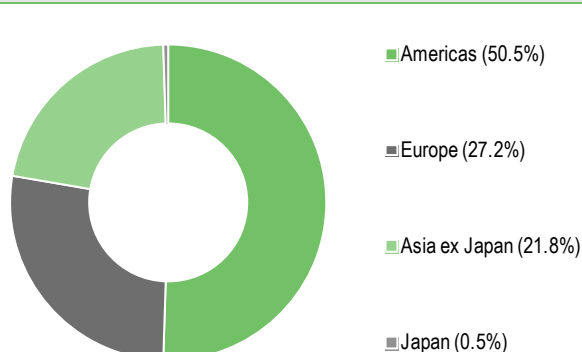
In sector terms, the proportion in 'other financials' (particularly in the US) has fallen from c 15% to c 4% over the past 12 months, as the managers see better opportunities elsewhere. Real estate exposure is broadly steady at c 25%, but the composition has moved from a tilt to continental Europe (bought in anticipation of Eurozone QE) to more exposure to the UK, which has greater growth potential. However, the managers say the property story is maturing and they would expect exposure to fall. They see emerging opportunities in industrials, where the issuers tend to be larger.

**Exhibit 3: Sectoral and geographic portfolio analysis as at 31 December 2015**

Portfolio analysis by sector



Portfolio by region



Source: JPMorgan Global Convertibles Income Fund, Edison Investment Research

As the oil price has continued to fall, the managers have been cautious on the energy sector in spite of the high level of yields on offer. Robin Dunmall notes that they are able to achieve a portfolio yield of c 5% without leaning too heavily on energy and materials, therefore it is better not to expose the portfolio to the extra capital risk of these issuers.

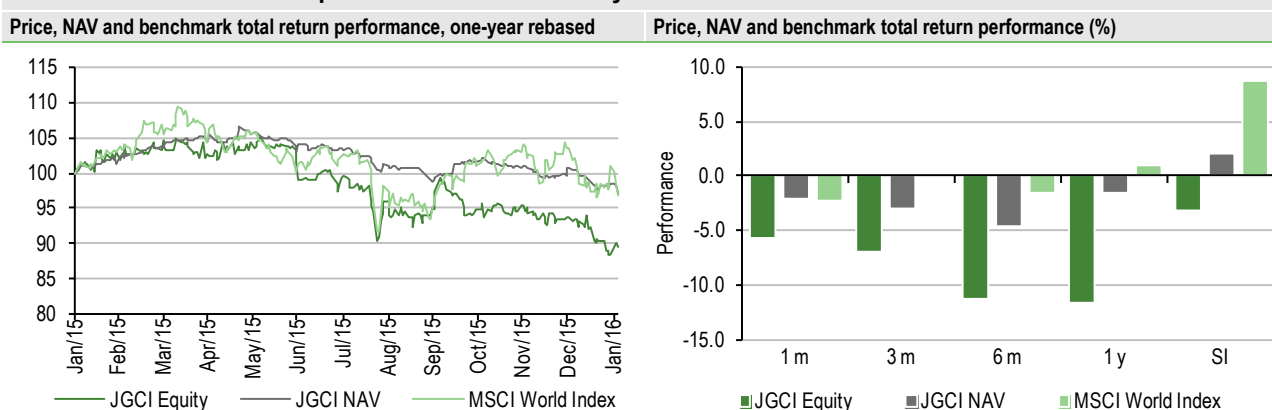
Turnover was higher in 2015, largely as a result of the increased number of names. Antony Vallée adds that while JGCI is not a short-term trading fund, it will act in response to opportunities: a recent example was a bond bought at a high yield and held for only a week as the price recovered sharply. "If we have the opportunity to take profits we will, rather than keep a bond just to get the income," says Vallée. Gearing has also been employed to exploit shorter-term opportunities, buying short-dated bonds in the balanced space where there is a yield spread over the cost of the gearing. Convertibles are inherently shorter duration than the majority of the bond market, with most issues having a maturity of three to five years. Because of this the managers note that investors see the sector as a way of maintaining fixed income exposure while reducing duration risk.

## Performance: Negative period presents opportunities

JGCI was broadly flat in NAV performance terms over 12 months to 31 January (Exhibit 4), but experienced greater share price volatility as credit-focused investments fell from favour. As seen in Exhibit 5, the fund's NAV has outperformed high-yield bonds over one year and since inception. It has lagged the reference convertible bond index, which is skewed more to the balanced and equity-like end of the convertibles market compared with JGCI's focus on bond-like convertibles, and has also underperformed global equities. The manager notes that the convertible universe gives JGCI exposure to smaller, higher-risk companies than those represented in the MSCI World index.

Exhibit 6 breaks down the contributors to NAV performance in 2015. Income was an important part of the total return but the managers stress they are not seeking yield at any cost: many high-yield convertibles in areas such as energy and materials carry an unacceptable capital risk. Credit effects were negative as bond spreads widened, and valuations had a negative impact for the full year, having been positive in the first six months. The managers note that poor sentiment and widening spreads are uncomfortable to live through, but give rise to longer-term buying opportunities.

**Exhibit 4: Investment trust performance to 31 January 2016**



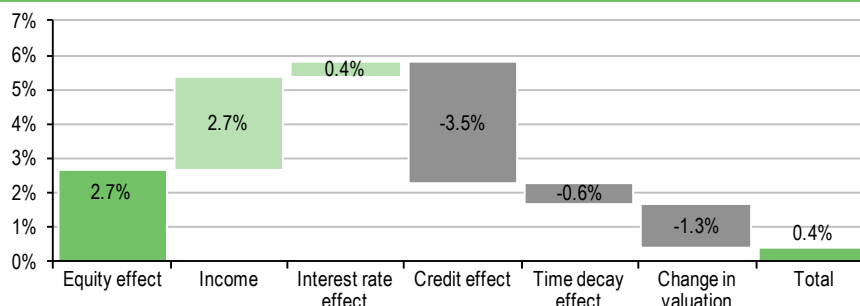
Source: Thomson Datastream, Edison Investment Research. Note: SI = since inception, 11 June 2013.

**Exhibit 5: Share price and NAV total return performance, relative to indices (%)**

	One month	Three months	Six months	One year	SI
Price relative to MSCI World Index	(3.4)	(7.1)	(9.8)	(12.5)	(26.2)
NAV relative to MSCI World Index	0.2	(3.1)	(3.0)	(2.5)	(15.7)
Price relative to Credit Suisse HY	(3.4)	(6.3)	(11.4)	(4.2)	(5.5)
NAV relative to Credit Suisse HY	0.1	(2.4)	(4.8)	6.7	8.1
Price relative to TR CB Global Focus	(4.9)	(8.7)	(14.4)	(13.2)	(17.8)
NAV relative to TR CB Global Focus	(1.4)	(4.9)	(8.0)	(3.3)	(6.0)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-January 2016. Geometric calculation.

**Exhibit 6: Estimated NAV contribution by performance factors in calendar 2015**



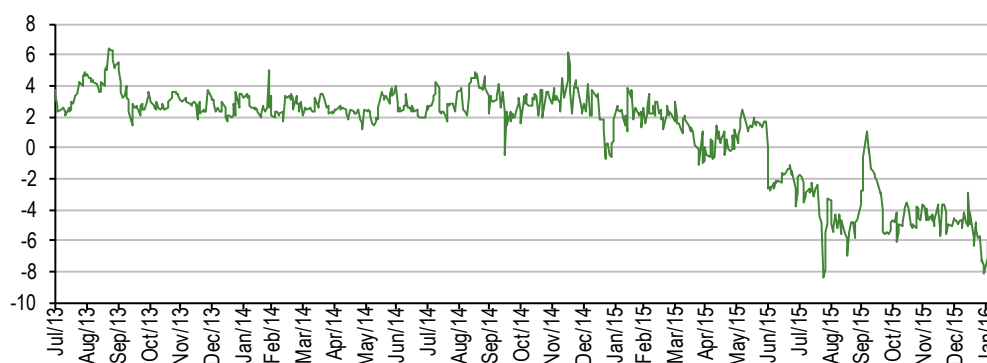
Source: JPMorgan Global Convertibles Income Fund, Edison Investment Research



## Discount: Wider in more difficult market conditions

In more difficult market conditions for convertible bonds, JGCI has experienced some share price volatility, and moved from a premium to a discount to NAV in the second half of 2015. At 3 February the discount stood at 6.6%, compared to a 12-month average of 1.8% and an average premium since launch of 1.1%. The trust may buy back up to 14.99% of shares annually to manage a discount, and its policy is to employ buybacks where the discount exceeds 5% for an extended period in normal market conditions. So far buybacks have been limited (646,518 shares in 2015 and a further 985,644 in early February 2016), with the board and the management keen not to shrink the fund unnecessarily in response to what may prove a short-term market dislocation.

**Exhibit 7: Share price premium/discount to NAV (including income) since launch (%)**



Source: Thomson Datastream, Edison Investment Research.

## Capital structure and fees

JGCI is incorporated in Guernsey as a closed-end investment company, and listed on the London Stock Exchange. At launch it in June had 136m shares, and issued a further 83m in response to investor demand between July 2013 and March 2015. With the shares moving from a premium to a discount to NAV from mid-2015, 1.6m shares have been bought back into treasury since September.

The fund has a \$32m borrowing facility, set up in July 2015, in order to aid investment flexibility. Gearing is permitted up to 20% of net assets and the managers have drawn \$20m of the facility (c 6% of net assets based on current exchange rates). The level of net gearing has fluctuated between c 5% net cash and c 5% geared because of moves in the cash balance rather than the drawn borrowing, and stood at 1.2% at 25 January. JPMorgan Funds, the alternative investment fund manager (AIFM) under the AIFM Directive, receives an annual management fee of 0.75% of net asset value, with no performance fee. Ongoing charges were 1.1% at 31 December 2015.

## Dividend policy and record

JGCI's stated intention since launch has been to pay dividends amounting to 4.5p per share per year. In the first financial year this was paid in two instalments of 2.25p, moving to four quarterly dividends of 1.125p from FY15. These are paid in December, March, June and September. So far one dividend of 1.125p has been declared for FY16. Dividends for both 2014 and 2015 were partly uncovered (revenue per share for FY14 was 4.33p and 4.06p for FY15), meaning a transfer from reserves was necessary. The revenue reserve stood at £811,000 at end-FY15. JGCI has the flexibility to pay dividends out of capital if necessary. Based on the FY15 dividend and the 3 February 2016 share price of 87p, JGCI currently has a dividend yield of 5.2%.

## Peer group comparison

JGCI is the only UK-listed closed-end fund specialising in convertibles, and as such it is difficult to put it in context. Exhibit 8 below shows a number of US closed-end funds investing at least part of their assets in convertible bonds, with all data translated to sterling. Even in a group of convertibles funds it is important to remember that JGCI's income focus and global remit sets it apart.

In NAV total return terms, JGCI ranks third of nine funds in the group over one year, a challenging period for the asset class. The fund does not yet have a long enough track record to appear in the three- and five-year columns. JGCI ranks third in terms of risk-adjusted performance as measured by the Sharpe ratio over one year. Six of the nine funds in the table currently have some level of gearing, of which JGCI's is the lowest. The fund trades at the smallest discount to NAV in the group, and has the third-lowest ongoing charges. The dividend yield of 5.2% is in line with the median for the group.

**Exhibit 8: Selected peer group**

% unless stated	Market Cap £m	NAV TR 1y	NAV TR 3y	NAV TR 5y	Ongoing Charge	Discount/premium	Net Gearing	Dividend yield (%)	Sharpe 1y (NAV)	Sharpe 3y (NAV)
<b>JPMorgan Global Convertibles Income</b>	<b>190.5</b>	<b>(1.6)</b>			<b>0.9</b>	<b>(5.3)</b>	<b>107.0</b>	<b>5.2</b>	<b>(0.9)</b>	<b>(0.2)</b>
Advent Claymore Cnvt Secs&Inc II	110.3	(4.9)	10.9	7.6	2.0	(17.0)	146.9	4.3	(1.0)	0.0
Advent Claymore Conv & Income	199.1	(7.3)	8.4	16.0	1.1	(16.1)	172.0	5.3	(1.3)	(0.1)
AllianzGI Convertible & Income	298.0	(16.3)	3.8	26.3	1.2	(10.7)	125.0	19.8	(3.0)	(0.4)
Bancroft Fund	58.9	(0.1)	29.6	40.1	1.0	(17.4)	100.0	3.5	(0.6)	0.7
Calamos Convertible & High Income	470.3	(7.5)	14.5	37.6	1.2	(10.3)	150.0	9.3	(1.5)	0.2
Calamos Convertible Opps & Income	429.4	(7.4)	15.3	37.8	1.2	(10.2)	148.0	7.8	(1.5)	0.2
Ellsworth Growth and Income	63.6	(0.5)	29.9	43.3	0.3	(15.6)	100.0	3.0	(0.5)	0.6
Putnam High Income Securities	71.1	(4.5)	15.5	32.3	0.8	(13.0)	100.0	4.9	(1.9)	0.3
<b>Peer group weighted average</b>		<b>(7.5)</b>	<b>13.0</b>	<b>31.3</b>	<b>1.2</b>	<b>(11.3)</b>	<b>148.4</b>	<b>8.9</b>	<b>(1.6)</b>	<b>0.0</b>
<b>JGCI rank in peer group</b>	<b>5</b>	<b>3</b>	<b>N/A</b>	<b>N/A</b>	<b>7</b>	<b>1</b>	<b>6</b>	<b>5</b>	<b>3</b>	<b>8</b>

Source: Morningstar, Edison Investment Research, at 3 February 2016 (performance figures to 31 January 2016). Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

## The board

JGCI has four non-executive directors, all appointed at the company's launch in June 2013. Simon Miller is the chairman; the other directors are Philip Taylor, Charlotte Valeur and Paul Meader. All directors except the chairman are resident in the Channel Islands. The directors have backgrounds in fund management and accountancy.

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