

Convertible Bonds

An opportunity exists today for a long only buy and hold strategy. The strategy is vulnerable to further mark to market losses but a strategy of investing in CBs from a credit point of view, as opposed to an equity arbitrage point of view yields interesting opportunities. Things could get cheaper next year, and indeed the way economic fundamentals are deteriorating this seems likely, but current pricing is already very attractive for the investor who can buy and hold.

Note that the classic convertible arbitrage construction doesn't really work and one has to take on both the open equity and credit risk. Neither can one lever the portfolio, not that one needs to. Stock borrow, restrictions on shorting, terms of borrow make delta hedging a potentially futile exercise. Some converts are trading distressed to the extent that while a non zero delta has re emerged, convexity is no longer positive. Credit hedging the CB runs into all sorts of prime broker counterparty risk, and the correlation between CBs and straight bonds let alone CDS is broken at the moment. This makes life simpler, actually, since if one has the resources in credit analysis, there is no need to hire a hedge fund manager.