

JPMorgan Global Convertibles Income Fund

Total returns from underappreciated asset class

JPMorgan Global Convertibles Income Fund Limited (JGCI), launched in mid-2013, seeks to provide investors with income (current yield of 4.4%) and long-term capital growth potential by investing globally in convertible bonds, which combine a degree of equity upside with the regular income and capital preservation characteristics of bonds. It is the only closed-end fund of its kind in the UK, and has so far delivered on its income objective, paying a 4.5p dividend in its first year. Unfavourable conditions in the higher-yield segment of the convertibles market have made total returns harder to achieve in recent months, but the managers see catalysts for recovery and performance year to date in 2015 has been positive.

Investment strategy: Striking the right balance

Because of its primary income focus, JGCI invests in convertible bonds in the bond-like to balanced segments of the market (see Exhibit 2, page 3). These offer greater yield but less capital appreciation potential than more equity-like convertibles. The management team at J.P. Morgan Asset Management uses bottom-up analysis of issuing companies and individual securities, combined with a more top-down assessment of market fundamentals, to build a portfolio with the appropriate balance of yield, capital appreciation and downside protection. The managers aim to employ the investment process consistently over time, to ensure repeatability of returns.

Rationale for convertible investment

Convertibles can offer the yield and capital protection characteristics of a corporate bond – they can be redeemed at par, providing a ‘floor’ value (as long as there is no default) and pay regular coupons. However, because they can be converted into equity at a date in the future, they also give investors the chance to participate in a rising share price. While they may underperform straight bonds in times of significant risk aversion, and will tend to lag a strongly rising equity market, over significant periods they have delivered superior risk-adjusted returns versus both bonds and equities (see page 6 of our [June 2013 initiation note on JGCI](#)).

Outlook: Upside potential with downside protection

Stock markets have continued to perform strongly in an environment of continued monetary accommodation, pushing out the possibility of interest rate rises further into the future. Convertibles will tend to lag a rising equity market, but the equity-like and balanced segments of the sector will still benefit from rising equity valuations, while the bond-like space is benefiting from downward pressure on straight bond yields as a result of QE in Europe.

Valuation: Regular issuance to manage premium

JGCI has been in high demand since launch, probably owing to a combination of its attractive yield and the lack of direct competitors. At 28 April its shares were trading at a 1.0% discount to NAV compared with a 2.9% average premium since inception in June 2013. Regular share issuance helps to manage the premium, and 59.8m shares have been issued in the past 12 months (an increase of 37.7%).

Investment companies

1 May 2015

Price 102.8p
Market cap £225.7m
AUM £242.6m

NAV* 103.8p
Discount to NAV* 1.0%
Yield 4.4%

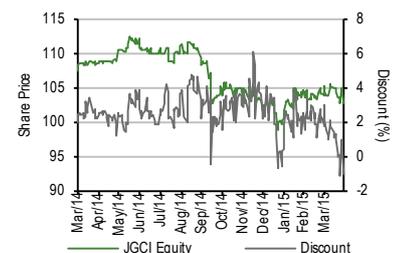
*Including income. Data at 28 April 2015

Ordinary shares in issue 219.6m
Code JGCI

Primary exchange LSE

AIC sector Sector specialist: Debt

Share price/premium performance



Cumulative performance graph



52-week high/low 112.5p 99.0p

NAV* high/low 108.7p 99.1p

*Including income

Gearing

Gross 0.0%
Net cash 1.2%

Analysts

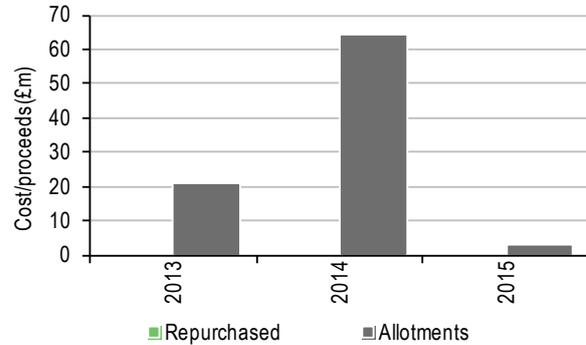
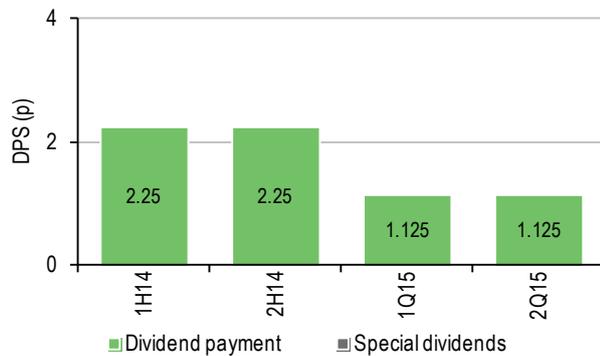
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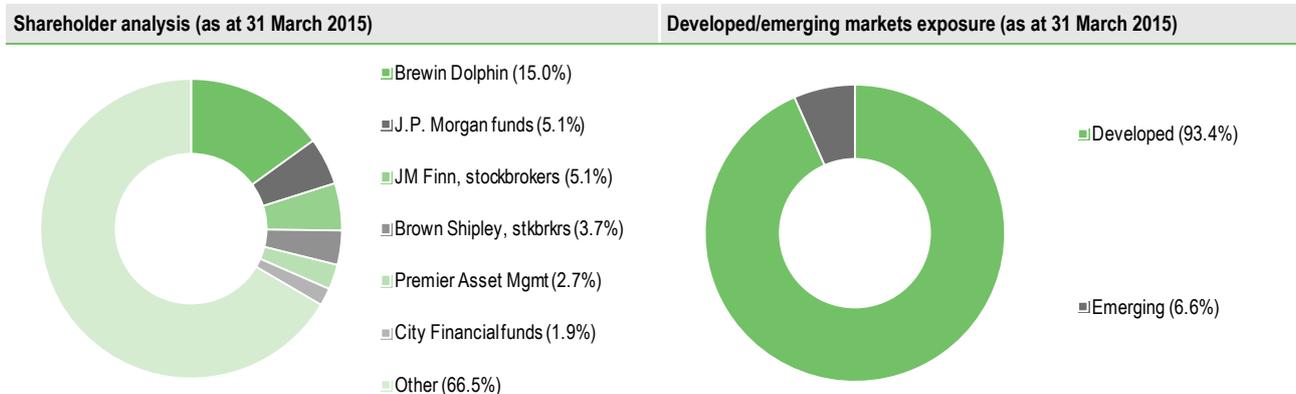
[Edison profile page](#)

Exhibit 1: Fund at a glance

Investment objective and fund background				Recent developments	
<p>JPMorgan Global Convertibles Income Fund Limited (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 J.P. Morgan Asset Management follows a well-developed process that combines equity and credit selection techniques. Currency exposures for capital and income are hedged.</p>				<p>27 February 2015: Interim results to 31 December 2014. NAV total return of -4.8%; share price total return of -5.8%.</p> <p>25 February 2015: Second quarterly interim dividend of 1.125p declared (equal to first quarterly dividend).</p>	
Forthcoming announcements		Capital structure and fees		Fund details	
AGM	November 2015	Ongoing charges	1.1%	Group	J.P. Morgan Asset Management
Annual results	September 2015	Net cash	1.2%	Manager	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	Company life	Indefinite (cont. vote)	Website	www.jpconvertiblesincome.co.uk
Continuation vote	AGM 2018 and 3-yearly	Loans, facilities	N/A		
Dividend policy			Share buyback policy and history		
<p>In the first year dividends were paid half-yearly, but have 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 financial year, and two dividends of 1.125p each have so far been declared for FY15.</p>			<p>JGCI may buy back up to 14.99% pa of the 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 net asset value exceeds 5% for any significant period of time.</p>		



Portfolio characteristics 31 March 2015		Portfolio allocation 31 March 2015 (%)	
Portfolio yield to best**	5.0%	Financials	30.9
Delta (a measure of sensitivity to equity movements)	33.3%	Real estate	17.7
Duration (to put)	3.9 years	Other financials	10.9
Number of securities	74	Communications	9.7
Available cash	1.2%	Consumer cyclicals	8.0
Bond quality		Energy	5.6
Investment grade	11.4%	Industrials	4.3
Sub-investment grade	34.4%	Consumer non-cyclicals	3.8
Non-rated	54.2%	Other (materials, utilities, banks, technology)	9.1
	100.0%		



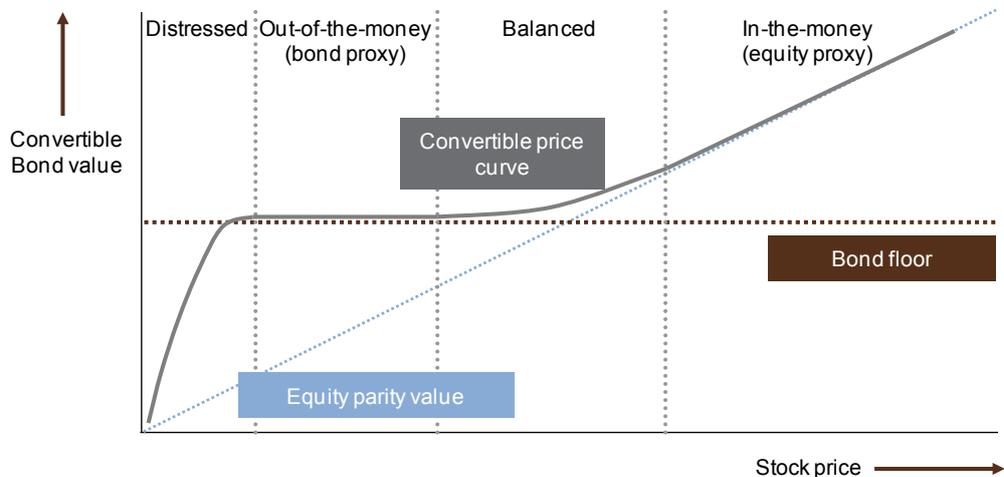
Source: JPMorgan Global Convertibles Income Fund. Note: *See dividend policy. **Yield to best: highest yield for each bond with all future put dates treated as possible maturity dates and a yield-to-maturity calculation performed for each date. Yield to maturity is the internal rate of return of a bond for an investor holding it to maturity. Yield to best figure is at 31 December 2014.

Convertible bonds in brief

Convertible bonds are securities that combine characteristics of bonds and equities. They are issued by companies in the form of bonds, paying regular coupons, but offer the option of redemption at face value or conversion into the equity of the issuing company at a predetermined date and price. The bonds will rise in value as the issuer's share price increases, but have downside protection in the form of the 'bond floor', as they can be redeemed at par. The equity component reduces sensitivity to interest rate changes. However, like corporate bonds convertibles are exposed to default risk if the issuing company encounters difficulties.

Exhibit 2 illustrates how the bond and equity components of a convertible bond might interact at different stock price levels (horizontal axis). The solid line represents the price of the convertible. At the right-hand side of the chart, if the conversion price is below the stock price (dotted blue line), the convertible is in-the-money and its price moves closely with the equity price. Towards the left-hand side, in the out-of-the-money segment, the convertible is valued as a bond and does not respond significantly to marginal moves in the stock price; this is where the downside protection, or bond floor, is evident. On the extreme left, were the company to become distressed, the bond is exposed to default risk: hence the illustrative price line trends to zero in this segment. Because of its income/total return focus, JGCI tends to invest in the out-of-the-money and balanced segments to benefit from superior yield compared with the in-the-money category, although there is potential for selected bonds to move up the curve between categories. 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.

Exhibit 2: Illustration of interaction of bond and equity components of convertible bond



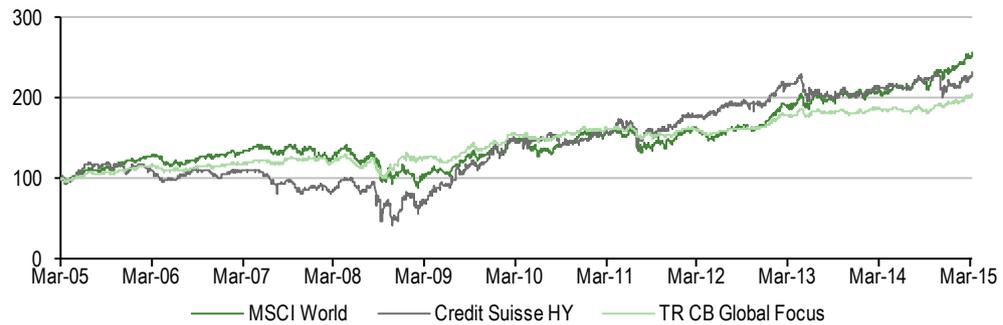
Source: JPMorgan Global Convertibles Income Fund

Outlook for the convertible market

Exhibit 3 below shows total returns from the Thomson Reuters (formerly UBS) Convertible Bond Global Focus index alongside the MSCI World index of global equities and the Credit Suisse High Yield bond index. A flatter period since mid-2013 has seen the convertibles index lag the equity and high-yield indices overall, although over 10 years a notional investor would have doubled their money with less volatility than either equities or bonds.

The lacklustre returns over the more recent period may be attributed to a combination of factors: strong equity market performance driven by continued monetary easing; a steady stream of new convertibles issuance meaning supply was more than equal to demand; falling oil prices affecting issuers exposed to this sector; and selling pressure to meet redemptions from funds investing in both high-yield debt and convertibles, as convertibles tend to be more liquid.

Exhibit 3: Global convertible index versus world equity and high-yield bond indices



Source: Thomson Datastream, Edison Investment Research. Note: Sterling-adjusted total return performance.

Looking ahead, the historically high levels of many global equity markets could make the downside protection offered by convertibles a more attractive proposition should risk aversion increase. Equally, the risk of a bond market reversal may be tempered by the equity element. While a continued strong run for stock markets may benefit the balanced and equity-like segments, the downward pressure on bond yields caused by QE in Europe should boost bond-like valuations.

Fund profile: Income-focused convertibles portfolio

JPMorgan Global Convertibles Income Fund (JGCI), launched in June 2013, is the only UK-listed closed-ended fund focusing on the convertible bond market. It is incorporated in Guernsey as an investment company and listed on the London Stock Exchange. The fund aims to achieve income and the possibility of capital growth by investing in convertible bonds globally. It is managed by Antony Vallée, global head of the convertible bonds team at J.P. Morgan Asset Management (JPMAM), together with Natalia Bucci and Robin Dunmall. JPMAM's convertibles team includes portfolio managers, analysts and traders, and the firm is adding to its research resources in response to an increase in the number of convertible bonds, particularly from smaller issuers.

The fund managers: Vallée, Bucci and Dunmall

The managers' view: Recovery potential after tricky 2014

A lack of appetite for convertible bonds in the last third of 2014 has affected JGCI's performance but also created opportunities, according to Antony Vallée. From the summer all convertibles became cheaper, but high-yield and bond-like convertibles – areas of focus for the fund because of its income objective – were most affected. Vallée notes that most convertible bond investors prefer the balanced space, so when there is selling pressure at the high-yield end, the effect tends to be amplified because of a lack of willing buyers. Figures from J.P. Morgan Asset Management show the relatively small size of the high-yield and bond-like convertible segments, at 16.5% of the global convertible bond market compared with 40.5% for balanced and 43% for equity-like convertibles.

However, the managers are mindful of the need to balance yield and risk in the portfolio: some high-yield convertibles are cheap for a reason and have a high risk of default, while in an environment where there is more support for equity markets, the balanced to equity-like convertibles may offer greater upside. Vallée says the team would prefer a bond with a degree of equity sensitivity to a higher-yielding issue with no equity upside. Economic recovery benefits the balanced space as it tends to feed through into increased company earnings.

Other catalysts for improved performance include a potential recovery in energy markets, a good pipeline of opportunities from a robust new issue market, and a tightening of spreads on bond-like convertibles as QE boosts sentiment in Europe.

Asset allocation

Investment process: Diversified, higher-yielding approach

As illustrated in Exhibit 2, the convertibles market can be split into three main segments: bond-like, balanced and equity-like convertibles. Because of its income objective, JGCI focuses on the bond-like segment, where yields are higher, as well as the total return potential from the balanced area.

The managers assess the prospects for yields and overall convertible bond market valuations to decide on a strategic allocation between bond-like and more equity-sensitive securities, while bottom-up factors include issuer analysis, industry outlook and technical factors for specific securities. The portfolio will normally hold between 60 and 80 securities, with no more than 10% in a single issuer. In practice individual holdings are unlikely to exceed 5% of the portfolio.

JGCI has a diversified portfolio, with issuers from a spread of geographies, industry sectors and market capitalisation sizes. Convertible bonds from smaller issuers are seen as less liquid, and the liquidity premium they attract can boost the portfolio yield. The majority of the bonds held are non-rated (52.5% of the portfolio at 28 February). Non-rated does not necessarily mean sub-investment-grade, and focusing on this under-researched area can be a way of accessing quality issuers with high yields at attractive valuations.

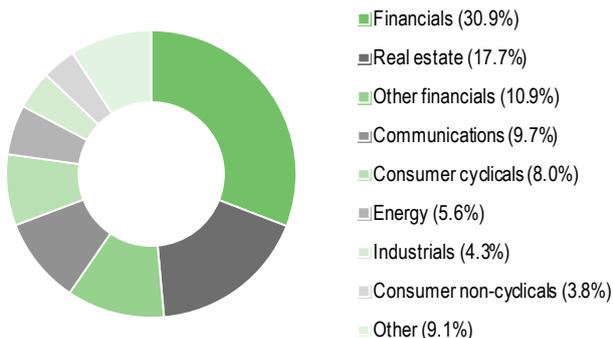
Current portfolio positioning

At 31 March JGCI held positions in 74 securities. Over half the portfolio (56.7%) was held in US issues, with 32.9% in Europe and the balance in Asia Pacific. Vallée says that while he would prefer to hold more in Europe based on the macroeconomic fundamentals, from a yield perspective there are more opportunities in the US. JGCI holds no Japanese investments because of the lack of yield on offer, although JPMAM favours the market in its balanced (rather than income) portfolios.

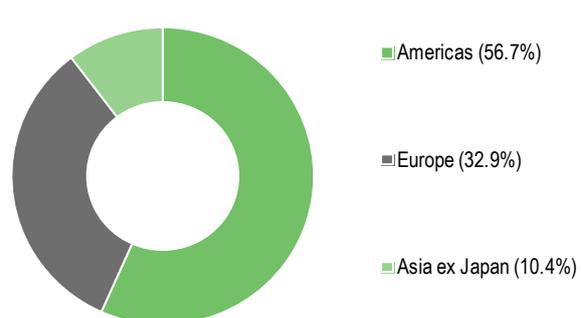
Financials is the largest broad sector exposure, with real estate and REITs the biggest component. Relative to the equity market, the financials sector in the convertibles market has greater exposure to real estate and less in banks. JGCI's real estate holdings are mainly in France and Germany on the expectation of better total return potential from property in the light of QE, although there are US holdings too. The managers have also increased consumer cyclical exposure (another area where the convertibles market is more heavily weighted relative to the equity market), mainly in the US where this area is expected to benefit from the more advanced economic recovery. Vallée says a key consideration at the moment is navigating the energy space, in view of the falling oil price. Energy exposure has been cut and greater emphasis put on holding high-quality names. Opportunities are beginning to emerge in higher-yielding energy and mining convertibles, although given continued commodity price pressures, Vallée says a move into these areas would be premature.

Exhibit 4: Sectoral and geographic portfolio analysis as at 31 March 2015

Portfolio analysis by sector



Portfolio analysis by region

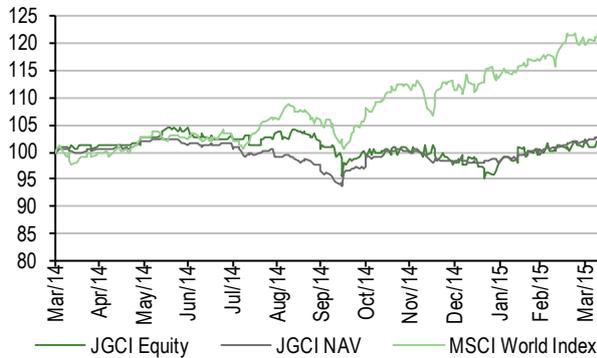


Source: JPMorgan Global Convertibles Income Fund, Edison Investment Research

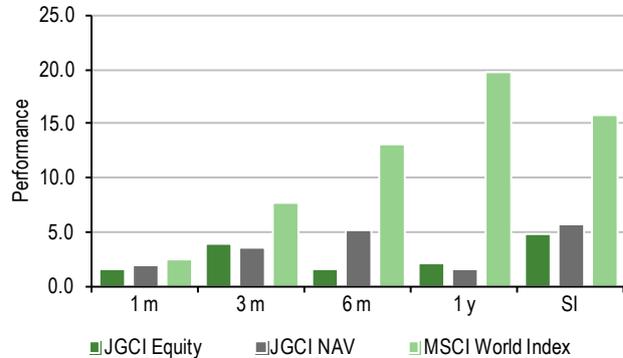
Performance: Coming out of a difficult period

Exhibit 5: Investment company performance

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)*



Source: Thomson Datastream, Edison Investment Research. *Since inception (SI) figures are annualised. Launched 11 June 2013.

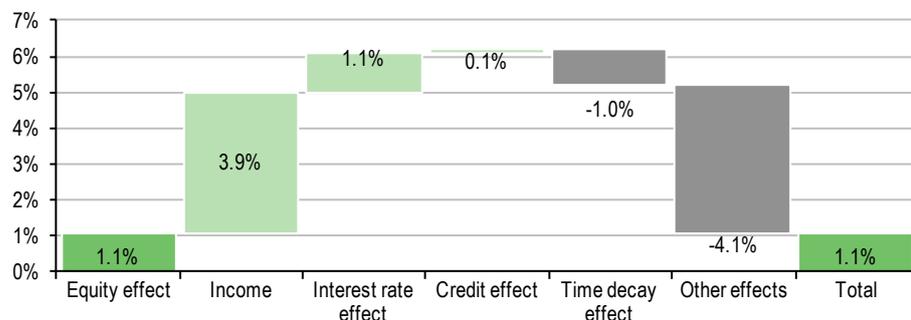
Exhibit 6: Share price and NAV total return performance relative to indices (%)

	One month	Three months	Six months	One year	SI
Price relative to MSCI World Index	(1.0)	(3.4)	(10.3)	(14.6)	(16.5)
NAV relative to MSCI World Index	(0.5)	(3.8)	(7.0)	(15.2)	(15.2)
Price relative to Credit Suisse HY	(1.2)	(2.9)	(1.8)	(5.0)	(1.6)
NAV relative to Credit Suisse HY	(0.7)	(3.2)	1.9	(5.6)	(0.1)
Price relative to TR CB Global Focus	(1.4)	(1.5)	(7.0)	(5.0)	(3.5)
NAV relative to TR CB Global Focus	(0.9)	(1.8)	(3.6)	(5.6)	(2.0)

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2014. Geometric calculation. Indices sterling-adjusted.

JGCI does not have a benchmark, but uses the MSCI World index as a reference. Strong equity market performance over the past year means JGCI's small positive return looks lacklustre in comparison (Exhibit 5). With a delta (sensitivity to equity movements) of 33.3% at 31 March, JGCI is likely to underperform a strongly rising equity market. In Exhibit 6 we show performance relative to two bond indices – the Credit Suisse High Yield index and the Thomson Reuters Convertible Bond Global Focus index, which focuses on the balanced segment of the convertibles market. JGCI has underperformed in both price and NAV terms, particularly over one year. Returns since inception are closer to those of the bond indices, while over the most recent periods (one and three months) the underperformance versus both bonds and equities is more marginal.

Exhibit 7: NAV performance attribution analysis – one year to 31 December 2014



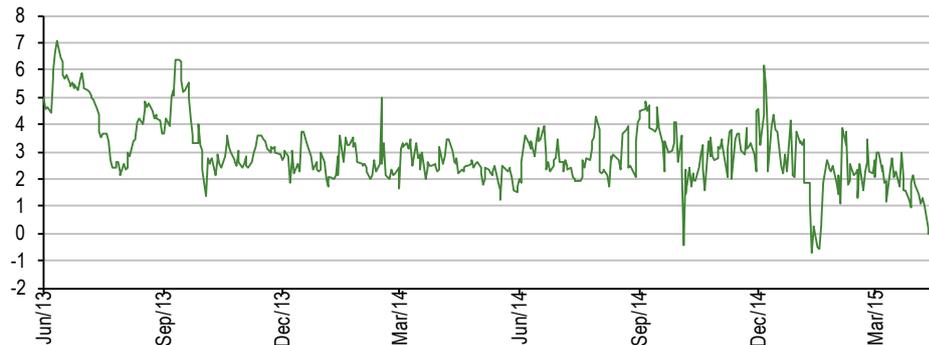
Source: JGCI, Edison Investment Research. Note: Other effects include impact of volatility on convertibles valuation. Time decay effect = combination of option cost and accrual to maturity.

Exhibit 7 illustrates the components of JGCI's NAV performance over one year to 31 December 2014, highlighting that the greatest positive contributor to performance over this period has been income. However, this was outweighed by 'other effects', which include changes in the valuation of holdings relative to the fund managers' estimate of their fair value.

Discount: Trading at a premium since launch

With few exceptions, JGCI has traded at a premium since launch and has regularly issued shares to meet demand (see Capital structure, below). At 28 April the shares traded at a 1.0% discount to cum-income NAV, below the 2.6% average premium over one year and the 2.9% since inception. The shares initially touched a discount of 0.5% in October 2014 after 41.5m new shares were issued, and again in January after the introduction of quantitative easing in the eurozone. JGCI has the authority to buy back up to 14.99% of shares pa, but has not done so in practice.

Exhibit 8: Share price premium/discount to NAV (including income) since launch



Source: Thomson Datastream, Edison Investment Research.

Capital structure and fees

JGCI was launched with 136m ordinary shares in June 2013 and has issued a further 83.3m on an ad hoc basis to meet demand, bringing the total at 23 April to 219.6m. Shares are always issued at a premium to cum-income NAV to avoid diluting existing shareholdings. JGCI may gear up to 20% of net assets, but has no borrowing facilities in place and held net cash of 1.2% at 31 March.

JPMorgan Funds is the fund's manager under the Alternative Investment Fund Managers Directive (AIFMD) and is paid a management fee of 0.75% pa of net asset value, with no performance fee. Fees are charged 35% to capital and 65% to income, in line with the fund's expected return profile. Ongoing charges stood at 1.1% at the FY14 year end, although as this first trading period was a little over a year and included additional costs around the launch of the fund, it would be reasonable to expect these charges to fall for FY15, particularly given the increased size of the fund.

Dividend policy and tax treatment

JGCI paid two 2.25p interim dividends in respect of its first financial year, totalling 4.5p. The board has stated its intention to continue to target a 4.5p annual dividend, but from the current financial year this will be paid quarterly, in December, March, June and September. So far two interim dividends of 1.125p have been paid for the year ending 30 June 2015. In H115 portfolio income fell short of the dividends paid, with £1.3m transferred from the revenue reserve. The 34.5% increase in the number of shares during the six months (most were issued in September) may have been a factor in the shortfall, although JGCI seeks to mitigate the effect of income dilution by recognising the income accrued by each share at the point of issuance (based on the difference between cum-income and ex-income NAV) as an income rather than a capital receipt.

Under the regime applicable to companies incorporated in Guernsey, JGCI may pay no tax itself on interest receipts and a UK investor may pay the lower marginal rate of tax that applies to dividends rather than interest income.

Peer group comparison

JGCI is the only UK-listed investment company specialising in convertibles. For comparison purposes, Exhibit 9 shows the fund alongside a selection of US-listed peers, although these are predominantly invested in US securities whereas JGCI invests globally.

Over one year JGCI has posted a small positive NAV return, but has underperformed the peers in the table. This is likely at least in part to result from the currency hedging of the JGCI portfolio during a period in which the US dollar has been strong against sterling. JGCI currently trades close to par, while all but two of the US funds are at a material discount to NAV. It has the equal highest net cash position in a group that is on average 36.8% geared. Its yield is around the median for the group. Risk-adjusted NAV performance as measured by the Sharpe ratio is broadly average over one year.

Exhibit 9: Closed-end funds investing in convertibles as at 29 April 2015

Fund name	Listing	Market cap £m	NAV TR 1 Year	NAV TR 3 Year	NAV TR 5 Year	Ongoing charge	Perf fee	Discount (ex-par)	Net gearing	Yield (%)	Sharpe 1 year (NAV)	Sharpe 3 year (NAV)
JPMorgan Global Convert Inc	LSE	225.7	2.5	--	--	1.1	No	-0.4	98.0	4.4	0.2	--
Advent Claymore Cnvt Secs&Inc	NYSE	143.7	12.2	40.3	22.9	2.0	No	-12.9	165.0	8.2	n/a	1.0
Advent Claymore Conv & Income	NYSE	265.3	11.1	38.4	35.6	1.0	No	-9.9	157.0	3.5	0.0	1.0
AGIC Convertible & Income	NYSE	521.0	8.8	48.8	65.8	1.2	No	10.5	147.0	11.8	-0.1	1.4
Bancroft Fund	NYSE	72.6	18.7	45.6	50.9	1.0	No	-13.2	98.0	4.7	0.9	1.4
Calamos Convertible & High	NASD	670.5	15.7	43.3	58.8	1.2	No	2.4	139.0	8.4	0.4	1.29
Calamos Convertible Opps & Inc	NASD	594.5	15.6	44.5	59.6	1.2	No	0.0	139.0	8.7	0.4	1.3
Ellsworth Growth and Income	NYSE	78.4	19.5	47.6	55.5	1.0	No	-13.8	100.0	2.4	0.9	1.46
Putnam High Income Securities	NYSE	81.4	13.1	38.1	47.5	0.9	No	-11.2	99.0	4.0	0.5	1.64
Weighted average			12.7	44.1	55.1	1.2		-0.2	136.8	7.9	0.3	1.29
JGCI rank in peer group		5	9	n/a	n/a	5		4	8	6	6	n/a

Source: Morningstar. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for 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/cash equivalents as a percentage of shareholders' funds. 100 = ungeared.

The board

JGCI has four independent non-executive directors, appointed at launch. They are Simon Miller (chairman), Philip Taylor, Paul Meader and Charlotte Valeur. The directors have backgrounds in fund management and accountancy. In February 2015 Fiona Davies was appointed as a board apprentice for a period of one year, under an initiative aimed at increasing the diversity of boards.

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