



Convertible 3Q 2026 outlook

From Convertibles

Performance

At the time of writing this outlook the U.S. convertible market has posted remarkable year-to-date returns. Through June 19, the ICE BofA U.S. Convertible Index is up 22.78%. The outsized advance in the convertible market compares to more modest gains in the large cap U.S. equity indices. Through the close of June 19th the S&P 500 advanced 10.18% and the NASDAQ Composite rose 14.43%. The Russell 2000 Index, whose smaller cap constituents have outperformed their larger cap counterparts, rose 20.81% over the same period. The outperformance of the convertible market versus equities is in part due to a set of AI-related securities in the convertible benchmark that has posted astounding gains over the past 12- 15 months. We estimate that nearly one-quarter of the convertible benchmark's weighting has some connection to the development of AI, either directly through the construction of data centers, manufacture of processors used in those data centers, or more tangentially, by producing fuel or electric generation, a portion of which may be used to power these data centers. A smaller subset of these issuers have accounted for more than one-third of the Index's gain year-to-date. Through a single large issuance or multiple issuances followed by tremendous gains in the underlying share prices, companies such as optical equipment manufacturer,

Lumentum, (common shares up 130% year-to-date), and data storage developers, Seagate Technology (common shares up 289% year-to-date) and Western Digital (common shares up 333% year-to-date) have had a substantial impact on Index returns. We have pared back our exposure to several large AI benchmark leaders as strong price appreciation has shifted the profile of these securities toward a more equity-like risk exposure, reducing the downside mitigation that is often a key feature of convertible bonds.¹

Issuance

New issuance for the first six months of 2026 is proceeding at a record pace. Officially, through the end of May, \$54 billion of new convertible securities were issued in the U.S. compared to \$31 billion at the same point in 2025. (from Bank of America data) Keep in mind that 2025 itself was a record year for convertible issuance. Through the first four weeks of June, approximately \$30 billion of new issuance has come to market including a \$15 billion convertible preferred offering from Alphabet, Inc. As with performance, the pace of issuance in 2026 has been heavily impacted by the growth of AI development as the proceeds from many of the convertible offerings have been earmarked for development of AI-related projects. We have concerns about the massive spend on these projects

1. Data source: Bloomberg

since the economic justification for them is unknown and perhaps unknowable at this stage. In addition, the terms of several of these new offerings have been aggressive with coupons of less than 50 basis points and conversion premiums (the appreciation of the common equity required before it becomes advantageous to convert the bond to common shares) in excess of 40%.

Positioning and outlook

We are amazed by the year-to-date performance of the convertible market particularly given the backdrop of rising interest rates and a three-month spike in energy prices. While the market rise has some measure of speculation, much of the gains are rooted in the rise in corporate earnings. Despite the narrow scope of the convertible

market's advance, we have generally kept pace with the Index even with our relatively conservative portfolio positioning which outperformed the Index on most down days. We have benefitted from our holding of large benchmark winners in the AI category. We remain overweight the Healthcare, Consumer Staples, and Information Technology sectors, market-weighted the Communication, Consumer Discretionary, Real Estate, and Energy sectors, and underweight Financials, and Utilities. We believe that the economy can maintain its pace of low single-digit GDP growth combined with relatively low, sub-5% unemployment. We continue to believe that our process, which emphasizes strong company fundamentals and reasonable valuation, will outperform over a complete market or economic cycle.

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INDEX DEFINITIONS

ICE BofA All U.S. Convertibles Index

The ICE BofA All U.S. Convertibles Index is an unmanaged index that consists of convertible bonds traded in the U.S. dollar denominated investment grade and non-investment grade convertible securities sold into the U.S. market and publicly traded in the United States. The Index constituents are market value weighted based on the convertible securities prices and outstanding shares, and the underlying index is rebalanced daily.

Russell 2000 Index

The Russell 2000 Index prominent stock market index that tracks the performance of 2,000 small-cap publicly traded U.S. companies.

S&P500 Index

The S&P 500 Index is a stock market index that tracks the performance of 500 of the largest publicly traded companies in the United States. It is widely considered the best single gauge of large-cap U.S. equities and represents about 80% of the total U.S. stock market's value.

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