MARKETING COMMUNICATION

HYBRID CORPORATE BONDS: AN UNDER-EXPLOITED YIELD LEVER

INTERVIEW

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* The fund managers presented in this document may change over the course of the fund's life.

Edmond de Rothschild Asset Management was one of the pioneering asset managers in the hybrid corporate debt segment, at a time when few active management solutions existed in this segment.

Today, three years after the launch of EdR SICAV Corporate Hybrid Bonds, the fund has established itself as an essential solution for investors seeking yield and bond diversification.

WHAT ARE THE SPECIFIC FEATURES OF HYBRID CORPORATE BONDS, AND WHY DO COMPANIES CHOOSE TO ISSUE THEM?

Hybrid corporate bonds are subordinated debt instruments issued by non-financial companies. They combine the features of traditional bonds, such as coupon, with equity-like attributes, including long, sometimes perpetual maturities, and call options generally 5 to 10 years after issuance.

Rated by agencies as 50% equity and 50% debt, they allow companies to raise capital while enjoying favorable tax treatment, as the coupon payments are deductible.

Unlike the most junior subordinated bank bonds, known as CoCos, corporate hybrid bonds do not include any conversion clauses into equity, thus maintaining a default risk similar to senior debt, although recovery rates tend to be lower in this case.

WHY HAVE CORPORATE HYBRID BONDS BECOME AN ESSENTIAL SEGMENT OF THE BOND MARKET?

We are observing a rapidly expanding asset class with a market exceeding 300 billion euros, historically dominated by European companies and, more recently, by American firms.

Hybrid debt offers a significant subordination premium compared to traditional bonds, while being issued predominantly by strong, Investment Grade-rated companies. This makes them a valuable source of return for investors. We view them as a defensive beta, delivering yields close to BB-rated entities, but with Investment Grade credit risk.

HOW DOES YOUR FUND STAND OUT IN THE HYBRID DEBT MARKET?

We employ an active and discretionary management approach based on three key pillars: Firstly, we conduct a rigorous selection of issuers, favoring strong companies with an average senior rating of BBB+. We also perform detailed analyses of hybrid debt structures, enabling us to execute arbitrages between different bonds from the same issuer to optimize yield while effectively managing duration risk. Lastly, we emphasize sectoral diversification. For instance, we successfully anticipated the revaluation of the real estate sector, which contributed to nearly 50% of the fund's outperformance in 2024.

WHAT IS THE IMPACT OF RECENT MARKET DEVELOPMENTS ON YOUR STRATEGY?

In 2024, the issuance of hybrid bonds in the United States significantly increased, reaching $24 billion, which is five times more than in 2023. This trend allows us to further diversify our portfolio, which has historically been focused on Europe.

Additionally, the decline in interest rates and the compression of credit spreads have reduced the extension risk, meaning the risk that an issuer will not redeem its bond at the scheduled call date. These factors have supported the market's revaluation and are expected to continue driving the performance of this asset class in 2025.

WHY SHOULD AN INVESTOR CONSIDER CORPORATE HYBRID BONDS?

As yields on conventional bonds normalize, corporate hybrid bonds represent an attractive market segment, offering an appealing yield premium.

With a yield to call of 4.5% in euros (6.3% in USD), our strategy positions itself as a relevant alternative to traditional Investment Grade bonds, which offer an average yield of 3.1% in euros.[1] Moreover, their shorter duration allows for better management of interest rate risk in an environment that remains uncertain.

WHAT ARE THE OBJECTIVES AND OUTLOOK FOR THE FUND IN 2025?

We aim to capture the yield premium of hybrid debt while maintaining a controlled exposure to credit risk. The growth in U.S. issuances also presents an opportunity to enhance geographical diversification, while staying vigilant to sectoral opportunities in Europe.

In 2025, the asset class is expected to offer significant carry potential, particularly due to the anticipated decline in short-term rates, with the ECB's deposit rate projected to be 2% by the year's end.

1. Source: ICE BofA Euro Corporate index

DISCLAIMER

EdR SICAV Corporate Hybrid Bonds is a sub-fund of the French SICAV authorised by the AMF and authorised for marketing in Austria, Switzerland, Germany, Spain, France, Luxembourg, Italy and Portugal.

MAIN INVESTMENT RISKS

RISK INDICATOR: 1 **2** 3 4 5 6 7

The risk indicator rates this fund on a scale of 1 to 7. This indicator is used to assess the level of risk of this product in comparison to other funds and a category 1 rating does not mean that the investment is risk free. In addition, it indicates the likelihood that this product will incur losses in the event of market movements or our inability to pay you. This indicator assumes that you hold the product until the end of the recommended holding period of this fund. The actual risk may be very different if you choose to exit before the end of the recommended holding period of this Fund. The risks described below are not exhaustive.

Risk of capital loss: The UCITS does not guarantee or protect the capital invested; investors may therefore not get back the full amount of their initial capital invested even if they hold their units for the recommended investment period.

Credit risk: The main risk is that of the issuer defaulting on payment, failing to pay the interest and/or repay the capital. Credit risk also relates to the downgrading of an issuer. Investors' attention is drawn to the fact that the Fund's net asset value may drop in the event of a total loss being recorded on an operation following a counterparty default. The presence of corporate bonds in the portfolio – either directly or through UCITS – exposes the Fund to the effects of changes in credit quality.

Hybrid and Subordinated Securities Risk: The Fund may be exposed to hybrid or subordinated debt. Hybrid or subordinated debt is subject to specific risks of non-payment of coupons and loss of capital under certain circumstances. For non-financial bonds, hybrid debt is deeply subordinated debt, which implies a low recovery rate in case of default of the issuer.

Risks related to contingent convertible bonds (Cocos): Cocos are subordinated debt securities issued by credit institutions or insurance or reinsurance companies, eligible in their regulatory capital and which have the specificity of being convertible into shares, or whose nominal value can be reduced (a so-called "write down" mechanism) in the event of the occurrence of a "trigger", previously defined in the prospectus. A Coco includes an option to convert into shares at the issuer's initiative in the event of a deterioration of its financial situation. In addition to the credit and interest rate risk inherent in the bonds, the activation of the conversion option may result in a decrease in the value of the Coco above that of the issuer's other conventional bonds. Depending on the terms of the relevant Coco, certain triggering events may result in a permanent write-down to zero of the principal investment and/or accrued interest or a conversion of the bond into equity.

MANAGEMENT COMPANY AND GLOBAL DISTRIBUTOR

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47 rue du Faubourg Saint-Honoré / FR - 75401 Paris Cedex 08
Public limited company with a Management Board and Supervisory Board and a capital of 11,033,769 euros
AMF approval number GP 04000015 - 332.652.536 R.C.S. Paris

DELEGATION OF FINANCIAL MANAGEMENT

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