DYNASTY AM
PASSION FOR YIELD

How Dynasty navigated February 2024 "frothy market" ?

An active primary market

The month of February saw an exceptional galvanisation of the equity market (+4.1% for the MSCI World in February) led by the outstanding results of the AI and Technology Sector. The combination of an active equity market with the fact that rate cuts seem to be less imminent than what market expected, led to numerous issues of convertible bonds ($7.4bn of debt raised by US companies in February), highest amount since August 2023 and volumes comparable to February 2023.

Issuance of convertibles generally spikes in two main scenarios;
1) long term rise in interest rates to raise debt at lower costs,
2) high market valuations, because if a company thinks it is overvalued, then convertibles allow them to borrow at lower costs with not too much dilution risk.

Dynasty investment strategy has always been based on solid financial fundamentals, profitability of the company, and no exposure to speculative or high systematic-risk positions (e.g. banking and financial services). Such a straight-forward investment approach allowed us to navigate the high convertible issuance of 2023 reaching a performance of 11.3% in 2023 and +2.5% since the beginning of the year with our fund Dynasty Global Convertibles. The same investment principles allowed us to understand which one of the two aforementioned scenarios led to February 2024 increase in issuance to avoid potential speculative positions.

What has changed in 2024 so far?

The drastic increase in convertible bonds issuance last year was mainly caused by the long-term increase of interest rates. Indeed, High-Grade companies before the high inflation period of 2023 had been used to pay a 2% interest rate for their refinancing through conventional bonds. Yet, the cost of raising debt increased to 5-6% in 2023 and forced many High-Grade companies to experiment with convertible bonds to lower their refinancing costs.

On the other hand, this February's issuance spikes were mainly led by High-Yield and Non-Rated companies operating specifically in the technology and AI sector or speculative companies that are exploiting February's market. Indeed, in February ¾ of the volumes of convertibles were issued by tech and fintech companies. For instance, Super Micro Computer, tech company operating in the hardware sector, managed to raise $1.7bn in debt with 0 interest rate. Or Lyft, for instance, issued its convertible note after the surprising 35% share price

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increase, exploiting its February market overvaluation to raise low-cost debt with lower risk of shares compensation.

How to navigate into this market?

Dynasty decided to stick to its core values, take a step back from what it seems to be a frothy market, and base its positions on the company's profitability and economic durability, distancing itself from recent market speculations. Going more in details, during the month of February, we have participated to the US issuance through Parsons 2.625% 2029, company specialised in cybersecurity for the defence. In this context, Parsons has had solid steadily increasing revenues in the last two years, presents solidly growing share prices, and more importantly is expected to increase its profits thanks to the growing government spending in defence in the West. Similarly, we invested in Rapid7 1.25% 2029, software company with high growth potential thanks to the Rapid7, Nexpose, and Metasploit brand names.

Our straightforward approach led us to shun positions like MicroStrategy Incorporation, which issued in February a new convertible bond to buy more Bitcoins. The company, and its subsidiaries, own 205000 bitcoins for a total value of around $15bn as of March the 13th, amounting for almost half of the company's market capitalisation. As always and coherently with Dynasty's core values, it felt unnatural and against our investment philosophy to participate in a position whose primary goal is to speculate upon the crypto market.

Our forecasts for 2024

Overall, as forecasted in 2024 the convertible market seemed to continue to follow the growing path started in 2023. Yet, its conditions are different; whilst the increase of 2023 issuance was mainly driven by High-Grade companies using convertible, February 2024 spikes seem to be cause by Low-Graded companies exploiting an inflated market for cheap financing. In this context, Dynasty decided to stick to its core principles that guided to success our Dynasty Global Convertibles Fund in 2023, and that are still rewarding us in 2024.

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