GAM Investment Meeting Notes

For accredited, professional, institutional and/or qualified persons only

2 November 2011

Convertible Bonds

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- We moved towards a more cautious capital preservation strategy within our portfolios in August. Since then, we experienced a very difficult third quarter and our funds were down for the year to the end of September. More recently, the funds rebounded somewhat, making up most of their losses for the year by the end of October.
- In late summer, when some economic data releases were more positive, we looked to add some equity risk and bought call options on Hon Hai Precision Industry, the Taiwanese assembler of Apple's iPhone. The trade initially cost us money as the options fell to zero, however, they have bounced back since and have added value.
- A position that we added in GAM Star Global Convertible Bond was a Cap Gemini 2012 bond. For us, this represented a short-dated option that expires on the first day of 2012. On purchase, the bond traded at a premium of 21% over parity, which subsequently rose to 60% as the stock collapsed through the summer in line with markets. With the embedded call option now all but worthless, we were content to sell the bond at a premium to our expected bond floor to French insurers during the worst of the turmoil. Such firms were keen to buy good-quality, short-dated French company debt. However, we still fundamentally liked Cap Gemini, which is why we now own the bond with an embedded 2014 option in order to maintain exposure to this cyclical angle in the fund.
- Further portfolio activity for GAM Star Global Convertible Bond included snapping up some bonds in Sinopec and Tianjin, both Chinese companies in which the government holds a majority stake (SOEs). We also bought TPK, a Taiwanese producer of touch screens. All these securities were sold by Asian forced sellers – funds that needed to raise liquidity due to redemptions. The bonds were therefore trading at distressed levels despite sound fundamentals. We also added to our position in Glencore, the Swiss-based commodities trader, via a secondary market offering following some price weakness. Furthermore, Noble Group, an Asian commodities trader and supply chain manager, was bought at highly attractive levels. Meanwhile, in GAM Convertible Bond Hedge Fund we added three cyclical names: Glencore, Premier Oil and China Unicom.
- Lately, a large part of activity in our funds is relating to the rehedging of positions as prices gyrate violently. In the current volatile environment, this exercise needs to be repeated much more often than normal. In the past two months alone we rehedged each of our portfolios approximately 14 times. This compares to around twice in a normal environment for a similar timeframe. For example, we participated in the rally last week until Thursday, when we rehedged our options and sold futures. Unfortunately, we bought the short futures back on Monday, which turned out to be premature, as the surprise announcement by the Greek Prime Minister to call a referendum led to a sell-off in markets.
- Ignoring the Greek situation, for which we retain our hedges, economic data and sentiment indicators are turning more positive. For example, HSBC's Chinese PMI numbers were positive, pointing to a soft landing in China, where we expect 8.5-9% growth next year. Spending for affordable housing and infrastructure continues to drive demand for raw materials, which makes cyclicals globally interesting investments. In the US, the Citigroup Economic Surprise index has turned positive, although this data is being ignored as the eurozone crisis is currently swamping everything else. So, the overall picture looks reasonably healthy, as long as a solution for the Greek problem can be found. Until then, we will keep our hedges in place and continue to buy attractive, fundamentally sound convertibles on market dips.