Convertibles | Fourth Quarter 2024

New Positions

ARES Management Corporation (ARES) announced the acquisition of GLP Capital Partners' international business GCP for $3.7 billion in cash and stock. As part of the financing, ARES issued $1.35 billion of a 6.75% mandatory convertible preferred. This new security was added to the portfolio. It was priced with a 20% conversion premium and will mature/convert on October 1, 2027. This will double ARES's real estate assets to $96 billion globally. GCP has investments in areas such as logistics, digital infrastructure, and renewable energy. As is typical of mandatory convertible structures, the security will be more equity sensitive as evidenced by the horizon analysis of 23.8%/-14.26% (participation rate of +86%/-63%). The security did receive a BBB- credit rating.

Boeing (BA) has been in the headlines quite a bit recently. The company was in the midst of a crippling strike by the International Association of Machinists and Aerospace Workers union, which has since been settled. Also,the company was burning a lot of cash during the shutdown. To replenish the cash balance, shore up the balance sheet, and maintain an investment grade rating, the company issued 112.5 million common shares for $143.00 each, raising approximately $16.1 billion. In addition, the company issued $5 billion in a 6% mandatory convertible preferred. With a 20% conversion premium, the security will be equity sensitive, with a horizon analysis of +20%/-16% on a +/- 25% move in the underlying common. This security matures and converts on October 15th, 2027. We initiated a 3% position, and we like the yield-enhanced way to play the recovery in Boeing's operations and potential improvement in the stock. In March of 2020 the company discontinued their dividend on the common, so the 6% yield advantage is very attractive. Income-oriented investors who could not own Boeing stock due to it having no dividend now have a way to play it by owning the convertible preferred.

With some of the proceeds from the AMG trade, we initiated a position in **Capital Southwest Corp. (CSWC)** 5.125% convertible bond. CSWC is a small investment grade-rated business development company (BDC) based in Dallas, Texas. The company provides flexible capital to lower middle market companies across the capital structure. The bond trades with a 40 delta, so it can be considered a total-return type security. With a solid credit rating and high coupon, bond floor is at 93, so downside is limited. And with a conversion premium of 8%, there is upside potential. The horizon analysis shows +15%/-7% on a +/- 25% move in the common. The bond matures in November of 2029.

UBER Technologies (UBER) is a name that has been on the radar for inclusion in the convertible portfolio since the original 144a issue became registered in mid-November. The common is owned in both the Laffer Tengler Equity Growth and 12 Best Ideas portfolios, so I have spoken quite a bit to the equity investment team at Laffer Tengler about this name. We got our chance this week to initiate a 2% position in the 0.875% convertible bond. The stock was weak following the news that General Motors was scrapping their robotaxi program, of which UBER was a partner (Microsoft was also involved). While the long-term outlook for self-driving taxis is unknown, we like the fundamental story of UBER. The bond checks a lot of boxes: investment grade rated, an attractive total-return profile with a 64 delta and a 30% conversion premium, and a positive horizon analysis. The bond matures in December of 2028. While the coupon is low and the current yield is only 0.80%, it out-yields the non-dividend paying common.

Some of the proceeds from the Ford disposal (see below in exited positions) flowed into a new position in **Tetra Tech (TTEK)** 2.25% convertible bond. TTEK is a $11 billion market capitalization company that provides specialized consulting and engineering services, primarily focused on water, environment, infrastructure management and energy. The bond is investment grade and matures in August of 2028. This bond, which trades on a 70 delta and has a 14% conversion premium, is considered an equity alternative and will provide a +16%/-14% return on a +/- 25% move in the common.

Exited Positions

We exited our position in **Dexcom (DXCM)** 0.25% convertible bonds. Last quarter's earnings report was disappointing, and the common stock got crushed. As a result, with the bond outperforming the common stock (the bond sold off but held just above bond floor) the premium widened drastically, and the delta (equity sensitivity) collapsed to less than 10. The bond matures in November of 2025, so with just over a year left, there was not enough time to recapture any upside due to the large conversion premium. We decided to sell the position and look for more attractive opportunities.

Prospect Capital (PSEC) has been a controversial name of late. They use payment-in-kind (PIK) arrangements for funding, and they have a complicated relationship with a real estate investment trust that they fully control. On top of this, there is a potential for a credit downgrade due to these issues. As a result, we sold our position. The bonds mature in March of 2025 and with a high conversion premium, there was little chance for any upside move, and the potential credit downgrade could have produced some downside pressure.

We exited our position in **NICE Systems (NICE)**. While the fundamental story remains compelling, the valuation of the bond was not attractive enough to remain in the portfolio. The bond matures in September of 2025, so it is effectively a ten-month security. With a 65% conversion premium and short maturity, the bond trades on a delta of 8, so there is virtually no equity sensitivity at all. At best the bond would accrete slowly to par (from the 96 level currently), but no matter how much the stock moved to the upside, the bond would never rise above the 100 level because parity is so low and the time frame too short.

We sold our position in **Affiliated Managers Group (AMG)**. The common stock was trading close to the most optimistic one-year out price targets. With very little upside remaining on the underlying common shares, we decided to exit the position.

Bently Systems (BSY) stock had been somewhat of an underperformer recently. Third quarter results were mixed, but the stock could not get any traction to the upside. Like NICE and DXCM above, the bonds held up relative to the underlying common stock. As a result, the premium widened, and the delta fell. With just a year left until maturity, the runway was not long enough to capture any upside if the common rallied over that time period.

Similar rationale with **BSY** and **NICE** also drove us to exit our position in **Ford Motor Co. (F)** 0% convertible bond. The stock had been weak over the last few quarters, as their results were disappointing. The bond held up very well, but the result was a widening of the premium and a declining delta, thus there was an erosion in equity sensitivity. The bond matures in March of 2026 and the time frame was not long enough to capture any meaningful upside.

Replaced Positions

None for this period.

Increased Positions

We added approximately 1% to our position in **ON Semi (ON)** 0.5% convertible bond. The stock had been weak recently, and the bonds traded south of par (100), so we took advantage and added to our position. With exposure to automotive, industrial and communication end markets, we like the fundamental story, and this bond provides an attractive way to be involved in the name until the bond matures in March of 2029.

Decreased Positions

None for this period

Leaders

Apollo Global Management (APO) was one of our better performers for the quarter. Their Q3 results were impressive on every metric. Earnings, revenue, and net income all exceeded expectations. Fundraising was also a positive development, as the company generated $42 billion of inflows. Assets under management and originating activity boosted results as well. Also, during the quarter it was announced that Apollo would be included in the Standard and Poor's 500 Index, which aided the stock's momentum.

Booking Holdings (BKNG) was another holding that did well during the quarter. The company's Q3 report for earnings and revenue exceeded estimates across the board. Room night growth and gross bookings were both strong and accelerating and those trends continued into the fourth quarter. Trends in Europe also bounced back following a weak second quarter, which was a positive development. Also, management highlighted free cash flow and margin expansion and raised expectations for Q4 and 2025.

Boeing Co. (BA), one of the newer names in the portfolio (see previous in new positions), was one of our better performers for the final quarter of the year. Once the company had their large capital raise and settled the strike, management could focus on the resumption of production of the MAX and 787 jets. As deliveries ramp up, cash flow will improve. There is optimism that new CEO Kelly Ortberg will be successful in transforming the culture at Boeing where product quality and employee morale will improve, which will begin a turn-around at the company.

Laggards

Lantheus Holding's (LNTH), a radiopharmaceutical-focused company, the common stock took a dive after reporting Q3 results. While earnings and revenue were above expectations, management indicated on the call that Q3 to Q4 results would "step down" due to higher research and development expenses. The company narrowed 2024 earnings and revenue guidance toward the higher end of previous estimates, but it did not help the stock's performance the day of the release. However, over the course of the quarter, the stock did bounce off its lows. We still like the fundamental story, as the company has cardiovascular and dementia imaging agents in the pipeline.

Parsons Corp. (PSN) reported solid Q3 results. Earnings and revenue were above estimates, and the company raised guidance for the fourth quarter. However, the stock was weak, along with all the other government contractors, with the election of Donald Trump and the creation of DOGE. While no specific contractors were named, nor how the efficiency efforts will be implemented, the companies with government contracts fell drastically. Management spoke at an investor conference and stated that they are not involved with any agencies that DOGE has discussed eliminating. This caused the stock to recover some, but it was still a rough quarter. We still like the story, as the company continues to win many new contracts, both in the United States and abroad.

Wells Fargo (WFC) stock actually had a good quarter. Earnings were above consensus estimates while revenue came in slightly below. Net income was well above guidance. Financial stocks rallied on the outcome of the election. We own the 7.5% perpetual convertible preferred, and since this security is considered a yield alternative, it underperformed due to the rise in interest rates. The yield on the ten-year US Treasury bond rose from 3.78% on September 30th to 4.57% at quarter's end. Such a dramatic upward move in rates negatively impacted most fixed income type securities.

DISCLOSURE INFORMATION

Laffer Tengler Investments, Inc. ("Laffer Tengler") is registered as an investment adviser with the U.S. Securities and Exchange Commission. Registration with the SEC or state securities authority does not imply a certain level of skill or training. For information filed by Laffer Tengler with the U.S. Securities and Exchange Commission, please go to www.adviserinfo.sec.gov and search for Laffer Tengler Investments under the "Investment Adviser Search" option. The firm's current market outlook is subject to change from time to time and without notice. A change in market outlook would generally lead to changes in account compositions, which may impact the characteristics presented herein. The information contained in this commentary is not intended to be used as the sole basis of investment decisions and is not a recommendation to buy or sell. Past performance is no indication or guarantee of future results.

This document may contain forward-looking statements relating to the objectives, opportunities, and the future performance of the U.S. market generally. Forward-looking statements may be identified by the use of such words as; "believe," "expect," "anticipate," "should," "planned," "estimated," "potential" and other similar terms. Examples of forward-looking statements include, but are not limited to, estimates with respect to financial condition, results of operations, and success or lack of success of any particular investment strategy. All are subject to various factors, including, but not limited to general and local economic conditions, changing levels of competition within certain industries and markets, changes in interest rates, changes in legislation or regulation, and other economic, competitive, governmental, regulatory, and technological factors affecting a portfolio's operations that could cause actual results to differ materially from projected results.