Asian Fixed Income

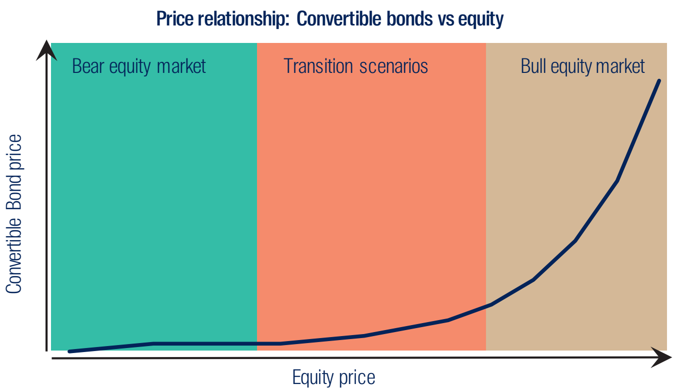
Part 2 : Navigating Market Cycles with Convertible Bonds

December 2025

Building on *Part 1: How Do Convertible Bonds Work?*, where we explored the fundamental mechanics of convertible bonds, we now share how convertible bonds can be strategically deployed across different market cycles.

Convertible bonds combine features of bonds and equities. They offer downside protection like bonds and upside potential like stocks. While issuance often rises during strong equity markets, convertible bonds can offer trading opportunities across varying market conditions - if used strategically. Their hybrid nature make them a versatile tool for alpha generation.

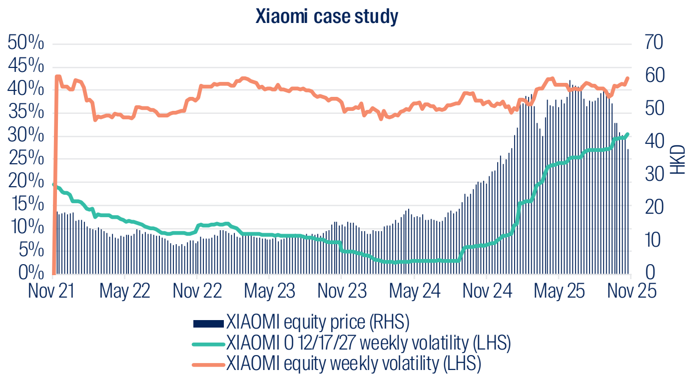
Through the lens of a bond investor, we look at three broad market scenarios: bear equity markets, transition scenarios, and bull equity markets. The relationship between a convertible bond's price and its underlying equity can be visualized as a convex curve—providing equity-linked upside while cushioning downside risk.



Price relationship of Convertible Bond and its corresponding equity, for illustrative purpose.
Source: First Sentier Investors

Bear Equity Market: Focus on Credit Fundamentals

When equity markets fall, we focus on the issuer's credit quality and the bond's ability to repay principal and interest. In these periods, equity investors often avoid convertibles because of high premiums. This reduced demand in convertible bonds from equity investors may lead to more attractive prices for bond investors. Yields on convertibles may exceed those of similar straight bonds, offering attractive income during periods of bear market volatility.



Convertible bonds tend to exhibit significantly lower volatility compared to their underlying equities, particularly during bear market conditions.
Source: Bloomberg, First Sentier Investors as of 30 November 2025.

For example, we purchased **XIAOMI 0.000 17-DEC-2027** back in late 2023, a year when the Hang Seng Index returned -14% for the calendar year. This 0% coupon, non-rated bond was priced below par at 89 with a yield[1] of 5.94% at time of purchase, which providing an attractive yield on par with its longer dated comparable bullet bond, XIAOMI 3 ⅜ 04/29/30 Corp, which yielded 5.93%. Xiaomi was rated Baa2/BBB at time of purchase, so we saw this as a fundamentally sound bond offering attractive income, with a "free" equity option until the bond's puttable date of December 2025. In late 2024, Xiaomi's bonds rallied above par, turning its previously 'free' convertibility option into positive value. We eventually sold this bond in 3Q 2024 for a profit of 12% as market sentiment and the company's business cycle turned positive.

Transition Scenarios: Tactical Positioning Matters

Markets rarely move in a straight line. During periods of uncertain market sentiment, tactical trading within defined risk limits becomes essential. Convertible bonds, with their lower volatility compared to equities, provide opportunities to capture alpha in these conditions. Excluding default scenarios, we see potential for alpha by trading convertible bonds when their yields are lower than comparable bullet bonds, yet still offer a degree of downside protection.

As an example, we invested in **YGCZCH 3.500 03-OCT-2029** in December 2024 at 99, slightly below its par value of 100. We chose this bond for its respectable yield of 4.09%, compared

[1] Yield to put was used, given that the bond came with a puttable option.

to its similar bullet bond YGCZCH 2028 which yielded 4.95%. Given the still uncertain equity environment, YGCZCH's respectable yield made this a name that we were comfortable to hold for the medium term, while remaining well positioning for potential upside should the industry cycle turn and equity rally take place.

We also invested in **WUXAPP 0.000 19-OCT-2025** in December 2024 at 99, with a yield of 1.3%, which was considerably lower than JACI's average yield. At the time of purchase, the Hang Seng Index was showing signs of emerging from a prolonged bear market. This gave us a strong conviction that this bond could benefit from equity-driven upside if the recovery continued into 2025. Ahead of the bond's maturity in October 2025, we sold it in June, achieving an absolute return of 7.3% over a holding period of approximately six months.

Next up...

Stay tuned for Part 3, where we extend our narrative to address convertible bond trading during bullish equity markets and how we optimize upside participation while managing risk.