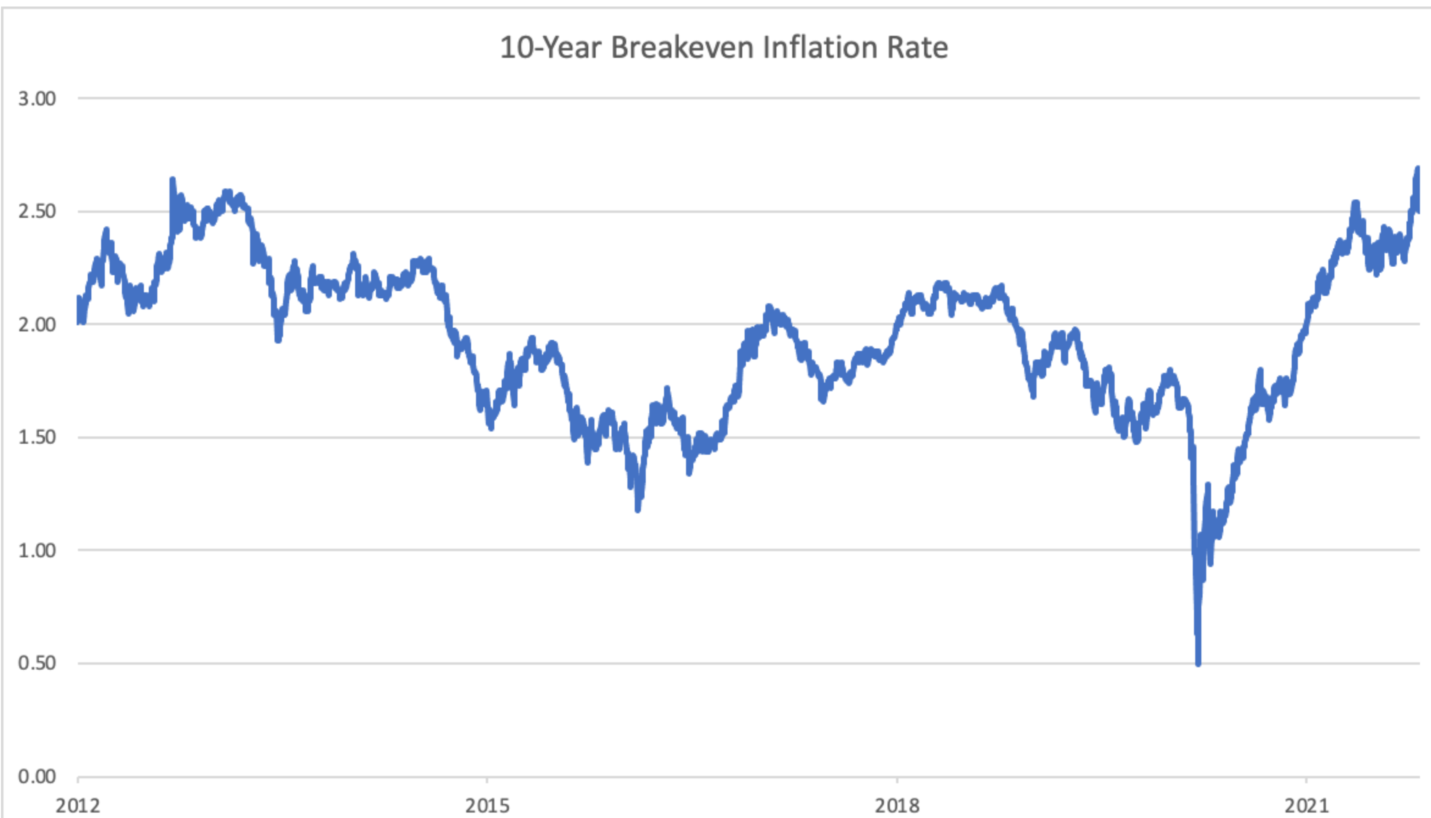
Wellesley Asset Management
Convertible Bond Specialists
20 William Street, Wellesley, MA 02481 | 781-416-4000

By: Greg Miller CPA, CEO & Portfolio Manager
Michael Miller, President, CIO
Dennis Scarpa CFA, Senior Analyst

November 19, 2021

Inflation and its Impact on Portfolios

Until recently, inflation has been seemingly non-existent. Between 2008 and the beginning of 2021, inflationhad increased by approximately 1.6% per year. Fast forward to today -- a basket of goods and services as measured by the Consumer Price Index (CPI) has risen by over 5% each month since May 2021. On October22, 2021, the ten-year breakeven inflation rate or breakeven yield hit 2.64%, the highest rate since 2012.



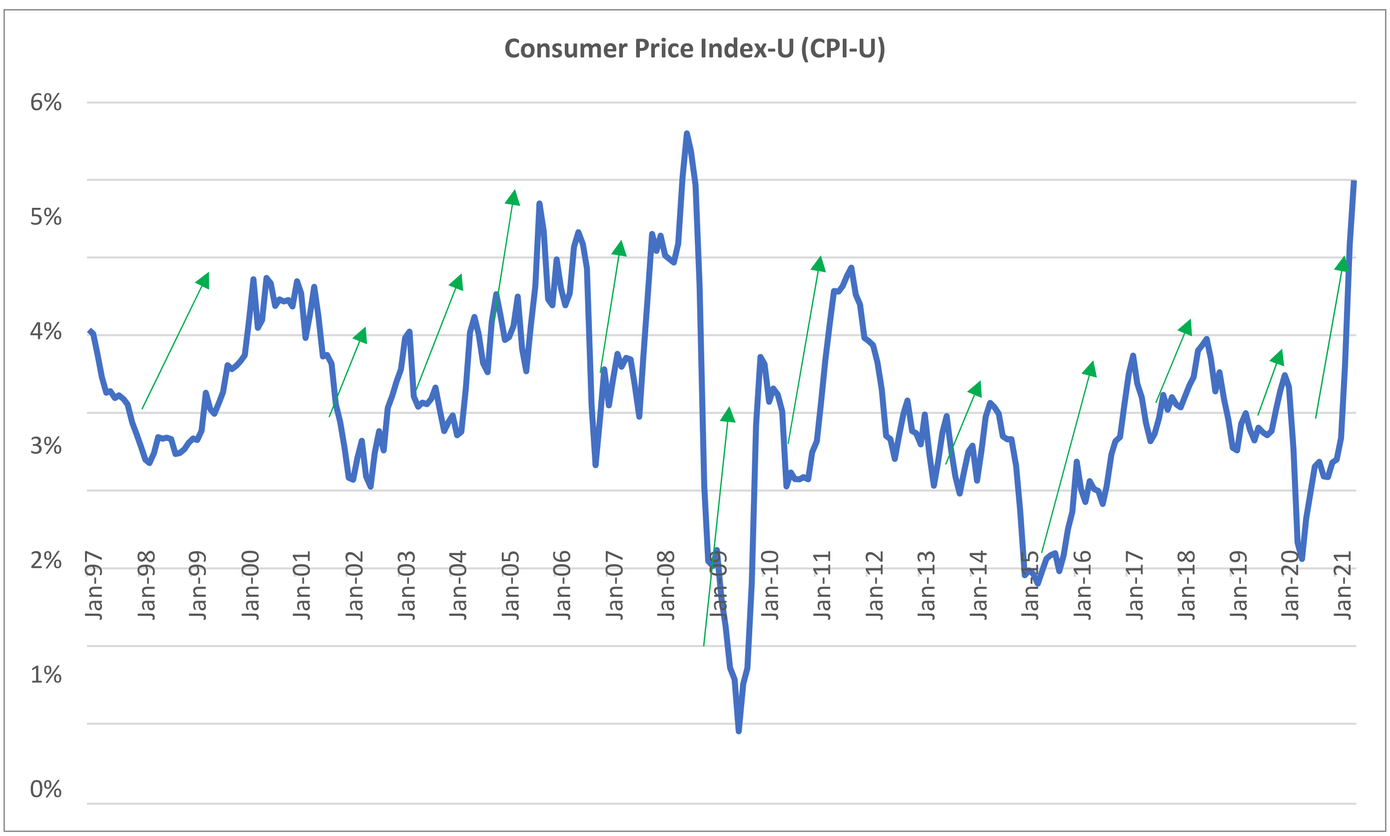
Breakeven yields are measured by the difference between Treasury Inflation-Protected Securities (TIPS) yields and their respective nominal Treasury bond yields. This is one of many important measures to considerwhen analyzing inflation and confirms recent accelerating prices.

Few investment professionals have first-hand experience with rampant inflation such as experienced duringthe late 1970s. The period was the culmination of a decade of intensifying energy prices, modest GDP growthand rising interest rates. It was a period marked by high inflation and slow growth, or stagflation. Average year-over-year inflation when calculated monthly was greater than 10% between 1979 and 1981.

The late 1970's was an example the devastating impact inflation can have on purchasing power and consumer confidence. As overall prices for goods and services rise, real purchasing power is reduced almost without detection. Inflation can be particularly challenging for retirees and individuals with a lower investment risk tolerance, or for those investors with a substantial allocation to fixed-income type investments. **With inflation high, the real rate of return on fixed-income type investments will drop and at times be negative as is the case in today's inflationary environment.** During previous inflationary periods the Federal Reserve often acted by raising interest rates to dampen inflationary expectations. Higher interest rates increase borrowing costs and cause consumers to spend less reducing demand for goods and services. As a result, higher interest rates reduce economic growth. Higher interest rates also produce lower bond prices in fixed-income type investments as interest rates and bond prices are negatively correlated. Higher interest rates therefore are bad for fixed-income portfolios.

Convertible securities are different, however. Analyzing convertible securities' performance, as provided by Morningstar, helps to better understand how the asset class performed between 1979 and 1981. **During thattime frame, the Convertibles Morningstar category outperformed both the S&P 500 Index and the Bloomberg Barclays U.S. Aggregate Bond Index by 7.30% and 18.01% respectively per year.**

Inflation has been present in other periods over the past 20 years, but to a far lesser degree. Below is a chartthat shows Consumer Price Index (CPI) monthly change between 1997 and 2021. The green arrows highlightperiods when the CPI rose above the 2% Federal Reserve target (trough to peak).



Source: bls.gov

The chart below highlights those "inflationary" periods described above and compares the Wellesley convertible bond strategy via the Refinitiv Wellesley Convertible Index (RWC0) with the Bloomberg Barclays U.S. Aggregate Bond Index. On average, the RWC0 outperformed by returning a nominal 8.45% during those periods, while the Bloomberg Barclays U.S. Aggregate Bond Index delivered a nominal 3.76%. As discussed above, these nominal returns would be far less in real terms after considering the deleterious impact of inflation.

Refinitiv Wellesley Convertible Index* When CPI Year-Over-Year Rose Above 2%

	Refinitiv Wellesley Convertible Index (RWC0)	Bloomberg Barclays U.S. Aggregate Bond Index
7/1/2002 – 2/28/2003	5.21	6.51
3/1/2004 – 9/30/2005	2.11	3.49
11/1/2006 – 7/31/2008	8.88	7.46
8/1/2009 – 12/31/2009	9.10	1.26
12/1/2010 – 9/30/2011	-2.95	6.65
2/1/2015 – 2/28/2017	10.90	2.94
7/1/2017 – 7/31/2018	6.68	-0.80
3/1/2019 – 1/31/2020	8.73	7.64
6/1/2020 – 4/30/2021	27.38	-1.35
Average	**8.45**	**3.76**

Wellesley's strategy of constructing portfolios of balanced convertible bonds has historically provided competitive absolute and relative returns during periods of increasing inflation. Such historical performance should be welcome by fixed-income investors looking for protection against the devastating effects of inflation and its negative impact on fixed-income portfolios.

Past Performance is not indicative of future results. A direct investment in an index is not possible.

*No representation is made that the investor will obtain similar results to those shown. The performance presented may not be representative of investments held in any one client account or performance realized in any one client account. An investor's actual performance may differ from the performance presented due to timing of investment, contributions and withdrawals. Returns are net of management fees.

An investment in convertible securities involves a risk of loss. The value of an investment in convertible securities may decrease as well as increase.

IMPORTANT DISCLOSURES:

NOTES ON THE REFINITIV WELLESLEY CONVERTIBLES INDEX ("RWC0"): The RWC0, which is a hypothetical index, was created to show a convertible bond strategy of buying convertible bonds at or near par value. A direct investment in RWC0 is not possible, just as a direct investment in an index is not possible. Any index performance, including RWC0, does not reflect the deduction of advisory fees, brokerage or other commissions, and any other expenses that a client would have paid or actually paid. The RWC0 index performance does not represent performance in any client account, nor is it representative of any actual trading in any client account. Actual client results may be materially less than the index and all hypothetical graph results are approximate. RWC0 has the potential for profit as well as loss.

The Index is a joint venture between Refinitiv and Wellesley Asset Management (WAM) and was created in January 2013. RWC0 index performance from its inception date of January 2000 to 2002 is based on a retroactive selection of convertible bonds from client accounts. Index performance for the period from February 2002 to the creation date is calculated based upon a model portfolio maintained by WAM. Thomson Reuters (now Refinitiv) became the calculation agent for the index in 2013. Wellesley has discretion over the selection of index constituents and does not represent a selection of bonds in any one client account nor is RWC0 representative of performance received in any client account. RWC0's holdings may differ from the holdings of WAM products. The time periods used in any RWC0 charts is solely representative of examples of historical complete market cycles. A complete market cycle is defined either by top-bottom-top or bottom-top-bottom pattern in the stock market. The S&P 500 is used to define the market.

NOTE ON HYPOTHETICAL PERFORMANCE: There are inherent limitations in using hypothetical performance results and they may not reflect the impact that material economic and market factors might have had on the adviser's decision-making process if the adviser were actually managing client money. All hypothetical numbers are approximate and may be significantly higher than any client return and such hypothetical numbers are not used as a benchmark for any client's actual return. Hypothetical growth charts comparing the RWC0 index versus a fixed income and equity index DO NOT represent actual performance any WAM client received. The charts are used for illustrative and educational purposes only and no claim of performance was received by any client.

The information in this presentation is for illustration and discussion purposes only. The reader should not rely on this information for investment purposes. An investment in convertible securities involves a risk of loss and may not be suitable for all investors.

Index returns do not reflect the effect of fees or assume reinvestment of all distributions and transaction costs or taxes. A direct investment in an index is not possible.

The S&P 500 Total Return Index is a cap-weighted index of 500 common stocks regarded as a leading proxy for the U.S. stock market. The Bloomberg Barclays US Aggregate Bond Index represents most investment grade bonds traded in the U.S. ICE BofA All Yield Alternatives US Convertibles Index.

Index returns assume reinvestment of all distributions and do not reflect the effect of fees, transaction costs or taxes. A direct investment in an index is not possible.

SHOULD ONLY BE PRESENTED TO SOPHISTICATED CLIENTS OR WITH OTHER INVESTMENT PROFESSIONALS

DB11102021-8-297 Updated KS02252022-6-67