



Convertible Arbitrage In Asia

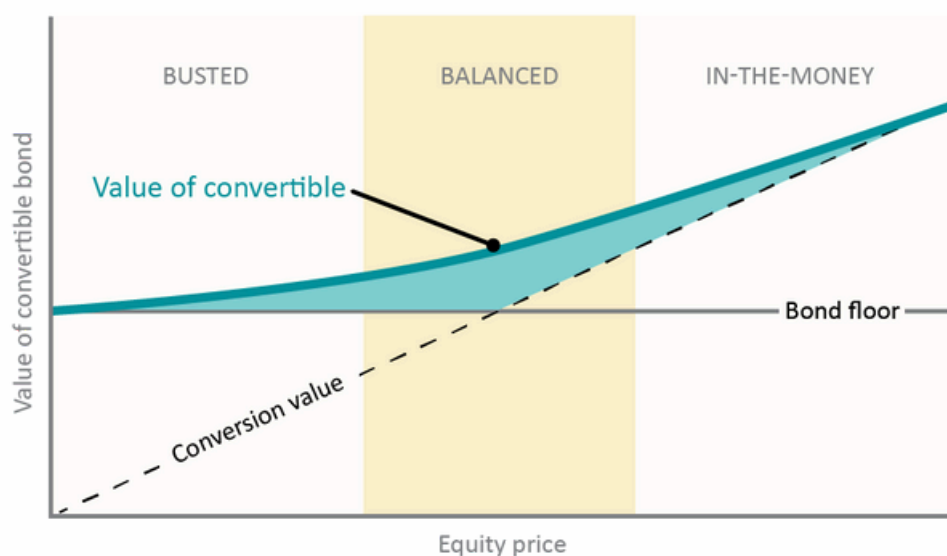
STRATEGIC INSIGHT

For Institutional and Accredited Investors Only

Executive Summary

Convertible arbitrage, the hedge fund strategy of profiting from price inefficiencies in convertible bonds, is experiencing a resurgence, and Asia is at the forefront. After a decade of subdued returns, 2023–2025 has seen convertible arbitrage funds rebound with some of their best performance in years. Key drivers include a surge in new convertible bond issuance, richer implied volatility, and a supportive macro backdrop of higher rates and elevated dispersion. Asia-Pacific markets are contributing significantly as Chinese and Japanese companies have issued large volumes of new convertibles, creating fresh opportunities.

For retail investors, the strategy offers diversification via low correlation to traditional assets and the potential to generate steady, absolute returns even during sideways markets. However, careful fund selection and risk management remain crucial to navigate credit, liquidity, and regulatory nuances across Asia.



Introduction

Convertible bonds are hybrid securities combining features of bonds and stock options and have long offered companies a flexible way to raise capital while providing investors with equity-like upside and bond-like protection. Convertible arbitrage, a market-neutral hedge fund strategy, seeks to exploit mispricings between a company's convertible bonds and its underlying stock, typically by going long the bond and shorting the stock in appropriate ratios.

Market Outlook and Macroeconomic Trends

Global Macro

As 2025 begins, the global economy sits at an inflection point. Central banks that aggressively tightened policy in 2022–2023 have slowed or paused rate hikes, with some beginning to consider cuts as inflation eases. High rates over the past two years widened credit spreads and cheapened convertible bond prices, creating a favorable backdrop for arbitrage. Now, as monetary policy gradually eases, economies are expected to slow without collapsing—a disinflationary environment that tends to benefit convertible arbitrage. Declining rates can support bond values, while moderate growth and lingering uncertainty keep equity volatility alive.

Asia Pacific Focus

In Asia, conditions are mixed but broadly supportive. China has faced property sector stresses and weaker exports, prompting policy easing and stimulus. Lower domestic rates have pushed Chinese companies to raise funds offshore through convertibles, both to access hard currency and diversify funding.

Japan, after decades of ultra-loose policy, has seen rates rise modestly as the Bank of Japan adjusts its yield-curve control. Japanese corporates have responded by issuing convertibles at home and abroad before financing costs rise further. Elsewhere in Asia, economies like India, South Korea, and Southeast Asia have stabilized interest rates and are seeing steady growth, creating fertile ground for new issuance.



Market Volatility and Dispersion

Late 2023 and 2024 saw the return of asset price dispersion. While headline equity indices rallied, performance was narrow, led by a few mega-cap stocks, while many others lagged. In Asia, sectors such as technology and consumer discretionary experienced sharp swings, creating opportunities for arbitrageurs. Importantly, many new Asian convertibles priced their embedded options cheaply, reflecting cautious investor sentiment.

For hedge funds, this provided the chance to buy bonds with strong downside protection while profiting from realized volatility. Looking ahead, volatility is expected to remain moderate but elevated compared to the ultra-low levels of 2017–2019.

Demand Driven Factors

High Interest Rates and Financing Costs

With conventional debt expensive, Asian companies are turning to convertibles, which typically carry much lower coupons thanks to the equity option. Firms that might balk at paying 6–8% interest can issue convertibles at 0–2%, easing their cost of capital. This dynamic has been especially strong in emerging Asia, where local borrowing costs have spiked.

Corporate Growth and Transformation

Asia's technology, e-commerce, biotech, and renewable energy sectors continue to demand capital for expansion. These high growth industries have led recent convertible issuance, using proceeds for R&D, acquisitions, and even share buybacks. The structure allows companies to fund growth cheaply today while potentially sharing upside with investors later.

Refinancing and Balance Sheet Management

A wave of debt maturities in 2025–2026 has prompted Asian companies to refinance with convertibles, avoiding the need to borrow at high fixed rates or issue equity in weak markets. For some, offshore convertibles also serve as a way to secure US dollar funding when local markets are constrained.

Limited Traditional Financing Options

IPO markets in Asia have been sluggish, and banks remain selective in lending. This has opened the door for convertibles as an alternative funding route, particularly for mid-sized firms or those in out-of-favor sectors. Convertible arbitrage funds, willing to hedge the risks, have stepped in as buyers.

Supply Driven Factors

Investor Demand and Market Conditions

Resurgence of Investor Appetite

After years of neglect, convertible arbitrage is back on investors' radar. Strong recent performance has drawn institutional allocators such as private banks, family offices, and endowments, who see double-digit returns with low correlation.

Surge in New Issuance

Global convertible issuance nearly doubled in 2023, with Asia playing a key role. A diverse mix of issuers—technology, industrials, travel, and renewable energy—has provided a wide opportunity set and reduced crowding. Investor-friendly deal terms, such as lower conversion premiums, have made issuance particularly attractive.

Improved Market Infrastructure

Liquidity in convertibles has improved with more active dealers, better stock-borrowing facilities, and electronic trading platforms. Enhanced pricing models and data-driven strategies have also made arbitrage more efficient, enabling funds to capture opportunities across fragmented Asian markets.

Diversification and Portfolio Benefits

Convertible arbitrage offers uncorrelated returns, low beta to equity markets, and the potential for steady mid-to-high single-digit performance. For wealth portfolios, this makes it a valuable diversifier and volatility buffer.

Experienced Managers in Asia

A growing pool of seasoned managers in Singapore, Hong Kong, and Tokyo has strengthened investor confidence. Their local expertise and robust infrastructure make the strategy more accessible and scalable in Asia.

Risks and Challenges

Convertible arbitrage strategies face several key risks. Credit and default risk remain central, as the bond floor depends heavily on issuer solvency, and defaults or severe spread widening can overwhelm equity hedges. Liquidity and crowding risks also matter, since market stress can reduce bond liquidity, raise borrow costs, and amplify drawdowns if crowded positions unwind during de-risking.

Alpha compression poses another challenge, as strong recent performance tends to attract capital and competition, narrowing mispricings and normalizing returns. In addition, regulatory and geopolitical risks can disrupt strategies, with short-selling rules, capital controls, sanctions, or policy shifts impairing hedging or pricing in certain Asian markets. Finally, operational complexity adds further pressure, as dynamic hedging, borrow management, and corporate action handling require both experienced teams and robust infrastructure.

Typical Position



Implementation Considerations

Manager selection is critical. Evaluate a manager's track record across cycles, depth of credit and equity-derivatives expertise, access to borrow and primary issuance, and risk controls (e.g., limits by issuer, country, factor exposure, and liquidity stress tests). For private wealth portfolios, allocations typically sit within the alternatives bucket; sizing should reflect overall risk tolerance, liquidity needs, and diversification goals. Consider complementary exposures (e.g., global vs. Asia-focused convertibles; balanced vs. credit tilted sleeves) to reduce concentration risk.

Conclusion

Asia's convertible arbitrage opportunity is supported by healthy primary markets, supportive macro conditions, and persistent dispersion. For private wealth investors seeking diversification and uncorrelated alpha, a carefully selected Asia-focused convertible arbitrage allocation can offer attractive risk-adjusted returns. Prudent sizing and emphasis on manager skill, credit discipline, and liquidity management are essential to balance the strategy's benefits against its inherent risks.



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