The Impact of the U.S.-China Trade War on Semiconductors

The semiconductor industry is one of the larger subsectors of issuance in the U.S. convertible universe. For over a generation, semiconductor companies large and small have used convertible bonds as a favored method of raising capital for expanding manufacturing, mergers and acquisitions, and research and development. These companies pay a lower interest rate, and in exchange, provide exposure to their higher-than-average equity volatility and the convertible investors' option to purchase stock.

Recently, the fundamentals of the semiconductor group within the technology sector have been challenged by the ongoing trade war between the U.S. and China. Tariffs on Chinese goods levied by the Trump Administration have been a headwind to global demand. Semiconductor executives have noted reluctance on their customers' part to build up inventory, resulting in sluggish orders in recent months. Additionally, Original Equipment Manufacturers (OEMs) are contemplating a move of existing manufacturing capabilities out of China to tariff-free countries. This has introduced another layer of uncertainty to the electronics supply chain.

While tariffs and threats of additional tariffs have slowed global demand generally, the U.S. Department of Commerce's export ban against Huawei, a Chinese OEM, has negatively impacted the semiconductor industry more specifically. Huawei is a significant customer to a number of semiconductor makers. The imposed restriction disallowed OEMs to ship the majority of their products to Huawei starting in May of this year. These trade restrictions have coincided with the sector's struggles to recover from the oversupply in mid-to-late 2018. While the fortunes of some specific semiconductor companies have been bolstered by idiosyncratic product cycles, we believe a broad semiconductor sector recovery can only occur with a resolution of the ongoing conflict.

Convertible bonds may have certain advantages in these volatile times. The consolidation in the semiconductor sector over the past decade has made the surviving companies more profitable, especially during industry downturns. This buttresses and helps solidify the bond floor of the convertible and may reduce downside risk for investors. Simultaneously, the upside participation potential remains intact, with a possible trade war resolution catalyzing the next upcycle.

Despite the sector's cross-currents, semiconductor stocks have outperformed the broader equity indices. We continue to rely on our fundamental, bottom-up process to identify attractive risk/reward opportunities and take advantage of market dislocations. Specifically, we have identified secularly growing product areas, such as 5G wireless, the Internet of Things, and the electronification of automobiles as factors that side-step the U.S.-China trade war.

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Why Advent?

- **Over 23 years of global investment experience and a robust research platform makes it well positioned to navigate the convertible and high-yield asset classes.**
- **Convertible bonds' embedded options provide exposure to volatility and may benefit from an increase in market gyrations both up and down.**
- **Advent's institutional expertise in managing convertibles and high yield is accessible to individual investors through the Advent Convertible and Income Fund (AVK).**

Net asset value (NAV) is the value of all fund assets (less liabilities) divided by the number of common shares outstanding. Market price is the price at which a fund trades on an exchange. Shareholders purchase and sell closed-end funds at the market price, not NAV. A closed-end fund's premium/discount valuation is calculated as market price minus NAV, divided by NAV.

General Risk Warnings Investments in fixed-income instruments are subject to the possibility that interest rates could rise, causing their values to decline. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility. Convertible securities may not be suitable for all investors. Although all markets are prone to change over time, the generally high rate at which convertible securities are retired (through mandatory or scheduled conversions by issuers or through voluntary redemptions by holders) and replaced with newly issued convertibles may cause the convertible securities market to change more rapidly than other markets. For example, a concentration of available convertible securities in a few economic sectors could elevate the sensitivity of the convertible securities market to the volatility of the equity markets and to the specific risks of those sectors. Moreover, convertible securities with innovative structures, such as mandatory-conversion securities and equity-linked securities, have increased the sensitivity of the convertible securities market to the volatility of the equity markets and to the special risks of those innovations, which may include risks different from, and possibly greater than, those associated with traditional convertible securities. A convertible security may be subject to redemption at the option of the issuer at a price set in the governing instrument of the convertible security. If a convertible security held by the fund is subject to such redemption option and is called for redemption, the fund must allow the issuer to redeem the security, convert it into the underlying common stock, or sell the security to a third party. As a result of the conversion feature, convertible securities typically offer lower interest rates than if the securities were not convertible. During periods of rising interest rates, it is possible that the potential for capital gain on convertible securities may be less than that of a common stock equivalent if the yield on the convertible security is at a level that would cause it to sell at discount. Also, in the absence of adequate anti-dilution provisions in a convertible security, dilution in the value of the fund's holding may occur in the event the underlying stock is subdivided, additional securities are issued, a stock dividend is declared, or the issuer enters into another type of corporate transaction which increases its outstanding securities.

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