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A View of the Convertible Securities Market

May 2009

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Convertible bonds are interest-paying securities, similar to corporate bonds, in which investors have the option to exchange the bonds for a predetermined number of shares of common stock. The hybrid nature of the securities offers investors the principal protection and income characteristics of bonds with the opportunity for higher returns if the issuer's stock price rises. Convertible securities are senior to common stock. The Convertible Market also includes Convertible preferred shares, which have similar characteristics.

Four letters are at the heart of the current economic debate, the letters "L", "W", "U" and "V" each of which are meant to describe the shape of a recovery in the U.S. economy. DCM believes the debate is encouraging to promote dialogue about the pace of recovery. Not long ago, recovery was not a word used with much conviction. In early March, perception was that stocks could go to zero. Even good companies had no sense of a bottom in their share price. Conditions were ripe for positive surprises or news that didn't reflect the absolute worst-case scenario. Anything marginally better than bad was cheered and rewarded. The recent powerful rally in financial markets reflects the perception that this scenario is no longer the case. Now, as we head into the summer months, talk of the next Great Depression has faded and the focus is on the signs of economic recovery.

In addition to debating the letter that best describes the profile of the recovery, discussions now rage over topics that recently seemed irrelevant. Are stocks overvalued? Will the U.S. Federal Reserve be forced to increase interest rates to cool inflationary pressures? The “end-of-the-world” trade may be off the table but we are still confronting a challenging environment where volatile markets are the new norm. Nonetheless, DCM is confident that the fundamental research we do and our specialization in convertibles will mitigate the speed bumps on the road to recovery.

Convertibles posted a strong 5.60% return in May, as measured by the Bank of America/Merrill Lynch All U.S. Convertibles Index. Returns were lifted by equity results, the S&P500 Index rose 5.59%, and a continuation of narrowing credit spreads as the Credit Suisse High Yield Index rose 5.44%. The underlying stocks of the Bank of America/Merrill Lynch All U.S. Convertibles Index returned 8.7%. Performance this year continues to be stellar as convertibles have returned 18.68% through the end of May compared with 2.96% for the S&P 500 Index.

Convertibles are still attractively valued (Bank of America/Merrill Lynch estimate 4% undervalued) and we believe that our time tested process of identifying opportunities within the market will benefit investors even during uncertain economic and market conditions.

At May 2009 month end The Bank of America Securities/Merrill Lynch All Convertible Index (VXA0) had a current yield of 4.57%, a yield advantage of 3.40% over the underlying common stock, a conversion premium of 79% and a BB+ average rating. For the YTD as of May 2009 Month End, the index gained 18.68% while the underlying stocks of those issues were up 19.19%

and the S&P 500 total return was 2.96%. For the same time period (YTD through May 2009) the investment-grade convertibles index (VXA1) was up 6.33% and trailed the all speculative-grade index (VXA2) which was up 37.59%. The investment grade index has 99 issues with an average rating of A- and the speculative grade index has 230 issues with an average rating of B+. The U.S. convertible market is represented by the Bank of America/Merrill Lynch All U.S. Convertible Index (VXA0), which is comprised of approximately 565 issues of convertible bonds and preferred shares of all qualities.

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