Junior-Subordinated Capital Securities Markets

April 2023 Updates

The bond markets were choppy and mixed in April with US Treasury prices continuing to absorb the impact of the regional bank system's deposit flows. There was little anticipation on what the Fed would do next on policy rates as another 25bp move was very well baked into prices with some modest steepening as the term structure adjusts in anticipation of the Fed being pressured by impending economic friction. The 30yr bond closed the month yielding 3.67% (1bp higher) and the 10yr note closed yielding 3.43% (5bps lower). Real rates on the front end of the treasury curve (e.g., UST 5yr TIPS) rose by 8bps (to 1.24%); the 5yr implied breakeven inflation rate (i.e., the difference in yields between the 5yr UST and the 5yr Treasury Inflation Protected Security) fell 23bps to close at 2.25%. Clearly, the bond market is continuing to discount a pivot from the Fed coming soon as financial stress from sudden high rates is playing out by outflows in the deposit system. The VIX (i.e., Chicago Board Options Exchange Volatility Index) fell 2.9pts 15.8 as the S&P 500 rose to 4169, up 150 points, which was well above the 20% decline mark (3835) which would suggest that a recession is imminent.

Before we talk hybrids, the performance for comparative references on returns and yield changes in some of the other corporate credit sectors is shown below:

- The junk market (measured by the ICE BofA High Yield ***h0a0*** index) rose 0.97% to close yielding 8.34% (16bps lower).
- Global bank credit (measured by ICE BofA ***e0ba*** index) rose 0.89% to close yielding 5.29% (14bps lower).
- The BBB rated 5-10yr corporate sector (measured by ICE BofA ***c6a4*** index) rose 1.00% to close yielding 5.34% (11bps lower).

Review of Market Structure:

The market for hybrids or **global junior-subordinated capital securities** (*i.e.,* "**Jsubs**") as we call them is comprised of two core sectors:

1. Preferred Securities, and
2. Contingent Capital Securities

Each sector has evolved with unique technical, structural, and fundamental features that are discussed and updated below:

Global junior subordinated capital securities are comprised of two sub-sets that represent a broad group of global junior-subordinated capital securities, which can be referenced by two ICE BofA indexes: 1) The ICE BofA US All Capital Securities Index (***i0cs***) and 2) The ICE BofA US Dollar Contingent Capital Index (***cdlr***).

Our litmus test for hybrids satisfies two core characteristics:

1) any non-payment of distributions would not accelerate an event of default (i.e., distributions are "junior-subordinated" to ordinary interest obligations) and,

2) balance sheet classification is something other than common stock under GAAP disclosure.

The US All Capital Securities (***i0cs***) benchmark of preferred securities represents $329 billion (face amount) of investment grade and below investment grade instruments in both the retail $25par market (35%) and the institutional $1,000par market (65%). The USD Contingent Capital Index of US dollar denominated junior-subordinated capital securities

(cdlr) represents $157 billion (face amount) of investment grade and below investment grade fixed-rate instruments with contractual triggers that could subordinate them to common stock in a reorganization that would not fall into a receivership after the bail-in. These two benchmarks combine for a $467 billion universe of fixed-rate junior subordinated USD capital securities with preferred securities (measured by ***iocs***) being a 71% subset and contingent capital securities (measured by ***cdlr)*** being a 29% subset of the total global USD junior subordinated group.

Preferred Securities

In the preferred securities sleeve, there are four sub-component indexes in the US All Capital Securities Index (***i0cs)*** – this entire index is comprised of global "preferred securities". A **"preferred security"** can represent a capital security issued either through charter amendment (i.e., as a stock) or through indenture (i.e., as a bond) typically within the context of a "gone concern" statutory authority (*e.g.,* US banks). As a gone concern, a company reorganization would be processed through a bankruptcy court. Preferred security payments are in priority to common stock dividends, yet can be deferred (i.e., payments are cumulative) or eliminated (i.e., payments are non-cumulative) without causing an immediate event of default; any principal loss absorption on a preferred security would be forced only *ex-post* through a statutory resolution in a bankruptcy proceeding.

The four sub-components of the *i0cs* benchmark that consolidate into the retail and institutional sectors of rated preferred securities are:

1) **ICE BofA Fixed Rate Preferred Index (*p0p1*) @ 44% *of i0cs***
   - Comprised of IG $25par and IG $1,000par (incl. US AT1)
     - ✞ The *p0p1* rose 1.65% this month to close yielding 6.56% (-20bps)
2) **ICE BofA US Capital Securities Index (*c0cs*) @ 23% of *i0cs***

- Comprised of dated IG $1,000par dated hybrids (excl. US AT1)
  - The *c0cs* rose 2.18% this month to close yielding 6.72% (-34bps)

3) ICE BofA High-Yield Capital Securities Index (*h0cs*) @ 5% of *i0cs*

- Comprised of BIG $1,000par legacy Tier1 and BIG $1,000par hybrids
  - The *h0cs* rose 4.27% this month to close yielding 7.88% (-45bps)

4) ICE BofA High Yield Fixed Rate Pfd Index (*p0hy*) @ 28% of i*0cs*

- Comprised of BIG $25par and BIG 1,000par (incl. US AT1)
  - The *p0hy* rose 0.15% this month to close yielding 8.85% (-13bps)

Overall, the ICE BofA All US Capital Securities Index (***i0cs***) rose 1.53% this month to close yielding 7.24%, which was 17bps lower than last month's closing yield and a spread of +359bps over comparable US Treasury securities (15bps lower).

Contingent Capital Securities

A **"contingent capital security"** (i.e., a "CoCo") represents a capital security issued through indenture typically within the context of a "going-concern" type regulatory regime for banking, which would reorganize a potentially insolvent bank through the contracts of its capital before falling into a conservatorship proceeding. CoCos payments are non-cumulative and *pari passu* to common stock dividends and can be reduced or eliminated without causing an event of default. Principal loss absorption on a CoCo could be forced ex-ante through a regulatory action in advance of any bankruptcy proceeding (note that an actual bankruptcy may not happen because enough loss absorbing bail-in capital, including tier-2 capital, could be available through the "living will" of the entity's core capital). The ICE BofA USD Contingent Capital Index (***cdlr***) is comprised of US dollar denominated constituents (exclusively), which represent 57% of the mature master multi-currency benchmark (*coco*). We will utilize the USD benchmark (*cdlr*)

as it more meaningfully reflects the contingent capital currency primarily held in our portfolios. The ICE BofA USD Contingent Capital Index (***cdlr***) rose 1.34% this month to close yielding

8.52%, which was 10bps lower than last month and a spread of +485bps over comparable US Treasury securities (10bps lower).

Discussion of Retail and Institutional Sectors:

We report on the retail and institutional sectors using statistical tables in a ***Spread Value Matrix*** to provide readers with data on absolute and relative spread positionings. The data samples are sourced from ICE BofA benchmarks starting in March 2017, which is when retail benchmark calculations on yield-to-worst for currently callable $25par preferred securities were improved to reflect actual yields, even if negative. We provide measures of inflation coverage in a ***Purchasing Power Matrix***; and a table for yield-to-worst, net of inflation and of historical default in a ***Real Yield Matrix*** that compares hybrids, investment grade corporates and high yield bonds. Finally, we show data on prior credit cycles for each sector to give you a ***Comprehensive Risk Estimate*** to the average bottom of the last 3 credit cycles (2013, 2016 and 2018) -- the rationale here is to illustrate risk measures relative to prior down credit cycles, but not necessarily an outlook to that direction. By following these tables monthly (and sometimes as “pop-outs” in flash reports), investors should gain consistent insights to assist in making more informed and supportive asset allocation decisions using junior subordinated capital securities. Each signal is intended to be independently supplementary to foster a more balanced value assessment for each sector.

Snapshot of Junior Subordinated Spread Sector Moves vs. Global Financials:

Capital Securities Spread Value Matrix	p0p4 (a) Retail	p0p4-e0ba (b) Retail	stb8 (a) NoCo	stb8-e0ba (b) NoCo	cdlr (a) CoCo	cdlr-e0ba (b) CoCo
Sample Periods	03/31/2017 to Date		03/31/2017 to Date		03/31/2017 to Date	
Jr-Subs	*Absolute	**Relative	*Absolute	**Relative	*Absolute	**Relative
High	588	251	486	205	660	472
Low	-178	-267	176	60	223	143
Range	766	518	310	145	437	329
Average	69	-43	253	141	335	223
Stdev	121	104	48	27	64	37
Monthend	149	1	322	174	449	301
Spread Scores:						
(monthend-ave)/stdev	0.66	0.42	1.44	1.22	1.78	2.11
Δ from Last Month	-0.30	-0.28	-0.31	-0.26	-0.14	-0.03

Source: Bloomberg; ICE BofA Bond Indices

** Absolute = Option Adjusted US Government Spread; (current-ave)/stdev*

*** Relative = spread to global financials measured by e0ba ICE Bond Index; (current-ave)/stdev*

Here, we look at option adjusted spread (OAS) to haircut spread to comparable US Treasuries for interest rate volatility and time to expiry. The way we interpret the above option adjusted spread table is by the statistical positioning of the *Spread Scores* where, **zero** = "*fair value*", **+/- 1stdev.** = "*undervalued"/ "overvalued*", respectively and **+/- 2stdevs** = "*very undervalued"/ "very overvalued*", respectively.

Spread performance for hybrids this month was positive as spreads tightened somewhat in the aftermath of the major moves wider last month caused by the deposit flight that brought down Silicon Valley Bank and Signature Bank. The Absolute Spread Score on retail paper tightened

by 0.30 standard deviations; and at 0.66 is *undervalued*. The Absolute Spread Score for the institutional $1,000par preferred securities sector ("NoCos") tightened by 0.31 standard deviations; and at 1.44 is *undervalued*. The Absolute Spread Score for the CoCo sector tightened by 0.14 standard deviations; and at 1.78 is *undervalued*. Note that these are statistical positionings and the absolute differentials and price risks between sectors are further considered through the Comprehensive Risk Estimates below.

Implications of Market Activity:

$25par Retail Preferred Securities Sector

The retail preferred securities sector measured by *p0p4* rose $1.34 to $85.48 in somewhat of a consolidating move after the big blow-off last month in the regional banking sector. So, despite all the turmoil and uncertainties in the US deposit system, the overall retail sector closed April 6.43% higher than its close of 2022. At the end of last year, our Comprehensive Risk Estimate (CRE) was deeply positive (i.e., 8.90%), which meant that over the next 12mos., the return potential was 8.90% even if the sector's current yield retraced to 6.70% or the average of the last three credit cycle bottoms. There was a point during the prior month that had completely retraced January's 13.72% gain but, after markets absorbed the Fed's cure for the bank-run psychology with its Bank Term Funding Program, the credit markets (and US treasuries) rallied. This month's score computed from the three prior credit cycles is still positive at 2.85%, but not quite as good as last month's (3.95%) because of the modest recovery:

Retail Pfds.	Valuation Implosions			Average		Diff. to
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average
GA10	2.98%	1.64%	2.74%	**2.45%**	3.43%	0.98%
PCE DEFY	1.48%	0.59%	1.86%	**1.31%**	4.20%	2.89%
Real UST10yr	1.50%	1.05%	0.88%	**1.14%**	-0.77%	-1.91%
$25Coupon	6.64%	6.46%	6.05%	**6.38%**	5.43%	-0.95%
$25Price	$94.06	$98.66	$93.09	**$95.27**	$85.47	-$9.80
$25Current Yield	7.06%	6.55%	6.50%	**6.70%**	6.35%	-0.35%
Mdur Worst	9.52	10.44	10.95	**10.30**	12.52	2.22
CY Spread vs. T10yr	4.08%	4.91%	3.76%	**4.25%**	2.92%	-1.33%
Source: Bloomberg; ICE BofA Bond Indices						-3.50%	Est. Price Risk to AveCY
				Comprehensive Risk Est.		2.85%	Est. Price Risk + CY
				Recapture Rate (yrs.)		0.55	Est. Price Risk / CY
					Memo:	6.43%	Total Return YTD

The current yield of the retail sector closed the month at 6.35%, which was 10bps lower than last month and 35bps lower than the average current yield at the bottom of the last three credit cycles. The current yield spread to the 10yr US Treasury note is 297bps which is 133bps less than the average spread of the last three credit cycle bottoms as retail preferred yields are still high but spread is being squeezed by UST yields being high, as well -- a gauge to yields being high is the discount price to the sector. The rebalanced dollar price of the retail sector is $1.33 higher this month and $9.80 lower than the average of the prior bottoms, which means that there is more convexity to the retail market during this cycle than there was during the prior cycles even though yields were higher. The implication of a 0.35% current yield increase to 6.70% (the average current yield of the prior bottoms) is an estimated 3.50% price decrease using the current modified duration of 12.52; then adding back a current book yield (assuming a 12month path) of 6.35% makes the *Comprehensive Risk Estimate* for returns in the retail sector positive 2.85%. The income recapture rate of the illustrated price loss is 0.55yrs because the market yield is higher than the illustrated price risk indicating the retail sector has more opportunity than risk.

Performance Memos (p0p4 +1.92%):

The primary contributors from the p0p4 performance this month were Regional Banks, which contributed 1.92% from performance – the next two contributors were Property and Casualty Insurance (+0.60%) and Investment Banking Brokerage (+0.25%).

The primary detractors to p0p4 performance were Telecom (-0.18%), Office REITS (-0.07%), and Commercial REITS (-0.05%).

Year-to-date, below investment grade (BIG) $25pars underperformed investment grade (IG) paper by 5.02%.

$1,000par Institutional Preferred Securities Sector

The $1,000 par institutional sector of the preferred securities market rose $0.97 as yields declined 17bps to 7.53% this month. The following table illustrates the institutional preferred securities sector's three prior credit cycles compared to closing valuations this month:

Institutional Pfds.	Valuation Implosions			Average		Diff. to	
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average	
GA10	2.94%	1.75%	2.74%	**2.48%**	3.43%	0.95%	
PCE DEFY	1.17%	0.59%	1.86%	**1.21%**	4.20%	2.99%	
Real UST10yr	1.77%	1.16%	0.88%	**1.27%**	-0.77%	-2.04%	
Coupon	6.77%	6.43%	5.88%	**6.36%**	5.18%	-1.18%	
Price	$103.96	$99.62	$97.23	**$100.27**	$91.32	-$8.95	
Current Yield	6.51%	6.45%	6.05%	**6.34%**	5.67%	-0.67%	
Mdur Worst	5.90	5.23	4.64	**5.26**	3.61	-1.65	
CY Spread vs. T10yr	3.57%	4.70%	3.31%	**3.86%**	2.24%	-1.62%	
Source: Bloomberg; ICE BofA Bond Indices						-2.40%	Est. Price Risk to AveCY
				Comprehensive Risk Est.		3.27%	**Est. Price Risk + CY**
				Recapture Rate (yrs.)		0.42	Est. Price Risk / CY
					Memo:	1.42%	Total Return YTD

The current yield of the institutional preferred sector closed the month at 5.67%, which was 7bps lower than last month. This brings the current yield of the sector to 67bps less than the

average current yield at the bottom of the last three credit cycles. The implication of a 0.67% current yield increase to 6.34% (the average current yield of the prior bottoms) is an estimated 2.40% price decline using the modified duration of 3.61; then adding back a current book yield (assuming a 12month path) of 5.67% makes the *Comprehensive Risk Estimate* for the NoCo sector equal to a 3.27% horizon return to accept the risk, which is 30bps lower than last month. It would take 0.42yrs to recapture this capital loss estimate with book income. The NoCo sector continues to be in a cushioned valuation position.

Performance Memos (cips +1.43%; hips +2.18%):

The primary contributors to investment grade (IG) NoCo performance this month were Life & Health Insurance (+0.55%), Oil & Gas (+0.16%) and Diversified Banks (+0.13%).

There lone detractor from investment grade (IG) NoCo performance was Industrial (-0.02%).

The primary contributors to below investment grade (BIG) NoCo performance this month were Retailing (+0.34%), Wireless Telecomm (+0.33%) and Diversified Banks (+0.31%).

There were no detractors from to below investment (BIG) grade NoCo performance this month.

Year-to-date, below investment grade (BIG) $1000pars underperformed investment grade (IG) paper by 3.91%.

Contingent Capital Securities Sector

The CoCo sector rose $0.68 as this month to $88.14 so, after the elimination of Credit Suisse from the benchmark at the end of March, the price of the rebalanced index was adjusted up by $9.12 for April. With a yield of 6.32% net of estimated historical hybrid defaults (i.e., after adjusting for last month's failures) and current inflation expectations, the CoCo sector has a 228bp advantage over high yield (i.e., junk) bonds.

The following table illustrates the contingent capital securities sector's three prior credit cycles compared to closing valuations this month:

CoCo Securities	Valuation Implosions			Average		Diff. to
Credit Cycle Bottoms >	2013	2016	2018	Prior Bottoms	Current	Average
GA10	3.01%	1.75%	2.88%	**2.55%**	3.43%	0.88%
PCE DEFY	1.48%	0.59%	1.86%	**1.31%**	4.20%	2.89%
Real UST10yr	1.53%	1.16%	1.02%	**1.24%**	-0.77%	-2.01%
Coupon	7.63%	6.40%	6.78%	**6.94%**	6.22%	-0.72%
Price	$105.04	$89.12	$96.21	**$96.79**	$88.14	-$8.65
Current Yield	7.26%	7.18%	7.05%	**7.16%**	7.06%	-0.11%
Mdur Worst	4.76	5.30	3.95	**4.67**	2.69	-1.98
CY Spread vs. T10yr	4.25%	5.43%	4.17%	**4.62%**	3.63%	-0.99%

Source: Bloomberg; ICE BofA Bond Indices

	-0.29%	Est. Price Risk to AveCY
Comprehensive Risk Est.	6.77%	**Est. Price Risk + CY**
Recapture Rate (yrs.)	0.04	Est. Price Risk / CY
Memo:	-9.86%	Total Return YTD

The current yield of the CoCo sector closed the month at 7.06%, which was 5bps lower than last month and 11bps less than the average current yield at the bottom of the last three credit cycles (i.e., 7.16%). The current yield spread to treasury 10yr notes is 99bps lower than the average of the last three credit cycle bottoms because 10yr treasury yields are higher than in prior cycles. The CoCo price average of $88.14 is lower than the last 3 three cycles, which (like the other hybrid sectors) highlights that the term structure of interest rates (i.e., high real US Treasury yields) being the primary reason for discounted prices. The implication of an 0.11% current yield increase to 7.16% (the average current yield of the prior bottoms) is an estimated 0.29% price decline using the modified duration of 2.69; then adding back the current book yield (assuming a 12month path) of 7.06% makes the *Comprehensive Risk Estimate* for return in the CoCo sector 6.77%. The recapture rate of the estimated capital risk is less than one month for CoCos.

Performance Memos (cdlr +1.34%):

The primary contributors to CoCo performance this month were Diversified Banks (+1.20%), Diversified Capital Markets (0.07%) and Multiline Insurance (0.05%).

The lone detractor was Custody Banks (-0.02%).

Outlook:

The target federal funds rate, after being raised by another 25bps to 4.75% - 5.00% last month, was not under scheduled review April but the March FOMC minutes provided some insights:

- There are growing concerns of a recession from a credit decline stemming from the Deposit Crisis in March.
- The Staff is projecting a mild recession this year and slowing inflation.
- The banking system remains sound and resilient.

Coming into May, we continued to believe that the risk to the terminal rate was a 5.00% - 5.25% bound given the strength in labor and seeming resilience in the financial system though the deposit flight into money markets virtually guarantees much tighter lending conditions and an imminent recession. As it turned out by the time of this publishing, we were right on the funds target hitting our risk bound of 5.00% - 5.25%. Here is a review of what we said in December:

- Three key questions remain for Fed policy on federal funds:
  1. How high?
     Answer: 4.75% - 5.00%
     ⇧ Risk: 5.25% - 5.50%
  2. How fast?
     Answer: by March 2023
     ⇧ Risk: by June 2023

3. How long?
   Answer: hold for 1yr =
   March 2024
   ✞ **Risk: hold for 6 months = December 2023**

We know that The Fed always gets what the Fed wants, and the Fed wants a PCE Deflator-to federal funds rate gap to show a positive real rate. Now that the gap (Federal Funds – PCE Deflator) has tightened from the combination of more rate hikes and some disinflation, the gap now stands at 0.85% which is a *positive real rate on federal funds* for the first time since November of 2019 (+0.13%). The widest the gap got in 2019 (the end of the last hiking cycle) was 0.84% and that brought a pause from the Fed. We now expect the Fed to pause on further rate hikes to watch the incoming data, which clearly the Fed expects to slow later this year.

Main takeaways:

- The Fed has achieved its goal by inverting the gap to a positive real funds rate.
- Rate hikes should be done for the cycle.

Why they matter:

- The rate hikes and curve inversion are still making lower duration sectors generally more attractive than higher duration sectors, and the stronger rally in retail paper compared to institutional paper (i.e., IG retail outperforming IG NoCos by 5.72% this year) is keeping institutional paper in a better value position when considering the lower duration of NoCos.

The high absolute level of rates and the yield curve inversion continues to create an anomaly where investors can get paid more for less duration when considering the fixed-to-refixed structures typical of NoCos and CoCos – here, capital appreciation potential should be considered in addition to spread scores and the Comprehensive Risk Estimate. Capital appreciation could benefit total return as time ages to a term when coupons gets reset higher

than current coupons. Here's a look at the multiples of 5yr average implied inflation that are available in hybrid yield-to-worst compared to more senior financials:

	A	B	C	D=B/C	E=D/A
Purchasing Power Matrix: Financials	Mdur	YTW%	5yrBE Inflation%	Inflation Coverage	Inflation Coverage/ Mdur
Retail $25par (p0p4)	12.52	6.58	2.25	2.93	0.23
NoCos (stb8)	3.61	7.54	2.25	3.36	0.93
CoCos (cdlr)	2.69	8.57	2.25	3.82	1.42
More Sr. Fins (e0ba)	4.93	5.30	2.25	2.36	0.48

Source: Bloomberg; ICE BofA Bond Indices

The inflation coverages are further improved from last month and quite robust at 2.93x to 3.82x for junior subordination. The contingent convertible sector (CoCos) is the winner on *Inflation Coverage* and risk adjusted coverage when factoring in duration. The NoCo sector wins the silver medal again on both scores. The retail sector measures up too, but one must accept more duration risk of NoCos to get the coverage.

Bottomline:

- The Fed's Bank Term Funding Program completely protects the deposit system from any bank-run – liquidity will be available as needed.
- The Fed reiterates its confidence in the banking system, but short sellers of small cap regionals toward month end is creating more deposit flight (though asset quality and capital are strong) which will likely compel the FDIC to increase deposit insurance, which is overdue given the growth in the money supply since 2010.
- Overall, regional banks are a small (i.e., 10%) concentration in the preferred securities universe so regional bank challenges should not have a meaningful direct fundamental impact the sector, though headlines may drive short term technicals.
- There is still uncommon value in the junior subordinated sectors based on discounted price, current returns in retail paper and total return prospects when considering fixed-to-refixed structures.

Maintaining a core portfolio defense in structure, liquidity and credit concentrations are our three primary investment objectives this year. Real yields are quite attractive in hybrids and even more so when we consider subtracting estimated historical credit default risks from real yields. Below we assess a more comprehensive view of real yields net of inflation and net of estimated 10yr average default in a *Real Yield Matrix* to double risk adjusted yield comparisons in hybrids, investment grade corporates and below investment grade corporates (i.e., junk bonds):

Real Yield Matrix	Hybrids		Corporates	
	Preferreds	CoCos	IG Corps	BIG Corps
Bloomberg Index	*cips+hips*	*cdlr*	*c6c0*	*h0a0*
Mod.Duration	3.61	2.69	6.25	4.06
Yield-to-Worst	7.54	8.57	5.13	8.42
Inflation[1] Adjustment	2.25	2.25	2.25	2.25
Real Yields	5.29	6.32	2.88	6.17
Default[2] Adjustment	-0.44	-0.44	-0.04	-2.57
YTW, net, net adj.	**4.85**	**5.88**	**2.84**	**3.60**
Composite Rating	*BBB2*	*BB1*	*BBB1*	*B1*
Last Month End:	Hybrids		Corporates	
	Preferreds	CoCos	IG Corps	BIG Corps
YTW, net, net adj.	5.11	6.02	2.70	3.45
Change from Last	☆ -0.26	☆ -0.14	☆ 0.14	☆ 0.15

Source: Bloomberg; ICE BofA Bond Indices

[1] *Inflation assuption based on the UST5yr breakeven inflation rate*
[2] *Sprectrum's 10yr annual default study through 2021 adjusted for est. SIVB & CS*

Hybrids offer the most positive double-net real yield opportunity in credit. As the Fed is very likely to take a pause to focus more on the data (now that the gap in inverted), it should keep its more restrictive policy stable and in place until its job is comfortably done on inflation – Hybrid yields rates are likely to stay elevated for some time, especially given the nearing risk of recession. This should keep the window of opportunities in Hybrids open for longer especially as volatility is likely to be somewhat elevated in the near term as the banking sectors continue

to process the changing fundamentals impelled by the more permanent higher rates policy. In a year when we don't expect duration to be a major contributor to institutional performance, the income accretion component of Hybrids (especially those with QDI) looks compelling compared to core corporates and to high yield -- especially net of longer run average default risks. Over the longer term, the combination of more deposit insurance from the FDIC and rate cuts to quell a recession should reward hybrid investors who take advantage of today's lower prices.

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May 9, 2023

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