Preferred Securities

The preferred and capital securities market had a total return of –0.52% in the first quarter, as measured by a blended benchmark consisting of 60% ICE BofA U.S. IG Institutional Capital Securities Index, 20% ICE BofA Core Fixed Rate Preferred Securities Index and 20% Bloomberg Barclays USD Developed Market Contingent Capital Index.

Investment Review

Preferred securities generated a modest loss in the first quarter but outperformed other investment-grade fixed income categories. Global economic news was generally favorable in the quarter, aided by significant fiscal stimulus and positive COVID vaccine rollout trends. However, in the U.S., this anticipated growth (along with manufacturing bottlenecks and higher commodity prices) generated concerns about inflation and about the prospect of monetary policy accommodation ending sooner than previously anticipated.

Long-term U.S. Treasury yields rose sharply on reflation concerns, particularly impacting longer-duration debt and securities with tighter credit spreads. Securities with larger spreads and shorter maturities or rate resets, including segments of the preferred market as well as high-yield debt outperformed. The high-yield market, which has meaningful exposure to the energy sector, was also aided by a material increase in crude oil prices in the quarter.

Index Performance (US$)

	Linked Index(1)
Q1 2021	-0.52%
1 Year	19.58%
3 Year	7.33%
5 Year	6.68%
10 Year	6.68%

(1) Linked Index: The linked blended benchmark consists of 50% ICE BofA Capital Securities Index and 50% ICE BofA Fixed Rate Preferred Securities Index through 12/31/2016. Thereafter, it consists of 60% ICE BofA US IG Institutional Capital Securities Index, 30% ICE BofA Core Fixed Rate Preferred Securities Index, and 10% Bloomberg Barclays Developed Market USD Contingent Capital Index through 12/31/2018. Thereafter, it consists of 60% ICE BofA US IG Institutional Capital Securities Index, 20% ICE BofA Core Fixed Rate Preferred Securities Index, and 20% Bloomberg Barclays Developed Market USD Contingent Capital Index.

Data quoted represents past performance, which is no guarantee of future results.

This information is not representative of any Cohen & Steers account and no such account will seek to replicate an index. You cannot invest directly in an index and index performance does not reflect the deduction of fees, expenses or taxes.

Periods greater than 12 months are annualized.

With its preponderance of shorter-duration securities with payment resets, the institutional preferred market outperformed exchange-listed issues. The over-the-counter (OTC) preferreds market, which is composed primarily of securities with fixed-to-reset security structures, posted a relatively modest loss in the period. The $25 par market, which is made up mostly of fixed-coupon perpetual securities, came under greater pressure due to its higher interest-rate sensitivity.

Real estate was a top-performing preferred sector, thanks to improving fundamentals and reduced supply. Progress with vaccinations helped improve the outlooks for most REITs, particularly those in sectors most impacted by COVID, including hotel, office and certain retail landlords. The sector also benefited from a lack of new supply at a time of high demand. A number of REITs retired securities in the quarter without replacing them, instead raising lower-cost capital in the debt or equity markets. This had the effect of supporting prices due to high reinvestment demand and lower net supply.

Contingent capital securities (CoCos) advanced, aided in part by healthy earnings. CoCo securities, a type of preferred that can write down in value or be converted to equity in the event an issuer's capital level deteriorates materially, generally outperformed. European banks, the largest issuers of CoCo preferreds, largely mirrored their U.S. bank counterparts in reporting favorable earnings in the quarter. Investors were also heartened by companies releasing a portion of the loan loss reserves set aside in 2020 as expected losses moderated with the stronger economic outlook. Further, CoCos tend to have shorter coupon resets and higher credit spreads, reducing their average duration and rate sensitivity.

Investment Outlook

Preferreds look attractive relative to other high-quality fixed income investments. Preferreds' subordination spreads (credit spread compensation relative to senior debt), while narrowing somewhat in recent months, remain attractive, in our view. We expect the global economy to continue to improve as COVID vaccines are more widely distributed. In that environment, we believe preferreds have the potential to continue to outperform corporate bonds, with higher income, a further narrowing of subordination spreads, and potentially lower duration risk relative to rising Treasury yields driving relative price performance.

Preferreds may also offer advantages relative to the high-yield market, where default rates remain elevated. Trouble spots in high yield have included energy, retailers and lodging—sectors that have scant representation in the preferred securities market. By contrast, the sectors represented in the

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preferred market—including banks, insurance companies, utilities, telecoms and REITs—generally have strong credit fundamentals. Notably, the financial issuers that compose the majority of the preferred market generally have strong balance sheets due to very stringent capital and other regulatory requirements instituted in the wake of the global financial crisis.

We believe interest rate risk could continue to be a more significant factor than credit risk in 2021. The combination of extremely supportive fiscal and monetary programs, together with strong consumer balance sheets and rapidly increasing vaccination numbers, has the potential to lead to strong economic growth in coming months. In this environment, improving employment numbers and the potential for bottlenecks and demand/supply imbalances may spur inflation and further pressure bond yields higher. We have taken steps to make the portfolio defensive relative to rate risk and will continue to adjust the portfolio as conditions warrant.

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The Bloomberg Barclays Developed Market USD Contingent Capital Index includes hybrid capital securities in developed markets with explicit equity conversion or write down loss absorption mechanisms that are based on an issuer's regulatory capital ratio or other explicit solvency-based triggers.

The ICE BofA Core Fixed Rate Preferred Securities Index tracks the performance of fixed-rate US dollar-denominated preferred securities issued in the US domestic market, excluding $1000 par securities.

The ICE BofA US IG Institutional Capital Securities Index tracks the performance of US dollar denominated investment grade hybrid capital corporate and preferred securities publicly issued in the US domestic market.

An investor cannot invest directly in an index and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations as volatility and other characteristics may differ from a particular investment.

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