Preferred Securities

Five Reasons to Consider Preferred Securities if You Own Municipal Bonds

Preferred securities can be a compelling complement to municipal bonds for investors seeking high, tax-efficient income, especially with muni yields near historic lows.

1. **High coupons from blue chip issuers.** Preferred securities are issued mostly by high-quality companies in the banking, insurance, real estate and utility sectors, many of them household names such as Bank of America, Prudential, AT&T and JPMorgan Chase.(1) However, because preferreds sit lower in the capital structure than senior and subordinated debt, they tend to pay higher income rates than similarly rated bonds.

2. **Tax-advantaged income.** Typically, distributions from most preferreds are treated as qualified dividend income (QDI), taxed at a top rate of 20%, versus 37% for interest income (plus a 3.8% Medicare surcharge). If we conservatively assume that 65% of preferreds are QDI eligible, the effective top tax rate would be 29.8%—an 11% tax savings.

3. **Higher current income potential than munis, before and after taxes.** Using current index yields, a $1 million investment in preferred securities would potentially generate $47K per year in pre-tax income (see chart at left below). Assuming 65% QDI, that would translate to $33K per year after taxes for investors in the top tax bracket—providing $5.2K more in after-tax income than if it were fully treated as interest.(a) This compares favorably to municipal bonds, which potentially offer only $25K per year in tax-free income. Preferreds’ yield advantage may be narrower versus municipal bonds that are exempt from state and local income taxes for investors who purchase the bonds issued by their state or municipality of residence.

Investors emphasizing capital preservation over appreciation may want to consult with their investment professional about low-duration preferred securities, which also offer attractive after-tax yields, as shown in the chart at right below.

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**Intermediate-Duration Fixed Income Yields**

- Preferred Securities: 4.7%
- Municipal Bonds: 3.3%
- Corporate Bonds: 2.5%
- 10-Year Treasury: 0.3%

**Low-Duration Fixed Income Yields**

- Preferred Securities: 4.2%
- Municipal Bonds: 2.9%
- Corporate Bonds: 1.1%
- 5-Year Treasury: 0.2%

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At July 31, 2020. Source: Cohen & Steers, ICE BofA.

**Data quoted represents past performance, which is no guarantee of future results.** 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. The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. See page 3 for index representations and definitions.

(a) Yields represented on a yield-to-maturity basis for intermediate-duration securities and a yield-to-worst basis for low-duration securities. After-tax income calculations based on current yields, do not include state and local taxes or Fund expenses, and assume taxation at the highest marginal Federal income tax rates. Preferred securities assumed to be taxed as 65% QDI-eligible and 35% interest income. Tax advantage of $5.2K based on $47K of income taxed as interest at the highest marginal rate of 40.8% ($27.8K after taxes), versus 65% of income assumed to be taxed as QDI, with an effective tax rate of 29.8% ($33K after taxes).

(1) Although a company’s senior debt rating may be rated investment grade by S&P, Moody’s and Fitch, an underlying security issued by such company may have a below investment grade rating.
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4. **A track record of comparable (and often lower) risk.**
   While municipal bonds are often perceived as being lower-risk securities than preferreds, preferreds have historically compared favorably on key risk factors. Both have a history of low default rates, according to Moody’s data going back decades. We believe preferreds have the potential to maintain low default rates, viewing them as well positioned to withstand periods of slowing or negative economic growth. Regulators annually subject financial companies—the leading issuer of preferreds—to rigorous economic “stress tests” aimed at ensuring adequate capital reserves. The preferred market is also well represented by high-cash-flow, less cyclical companies that investors trust to make regular payments.

5. **Better together.** Over the past 10 years, a 50/50 mix of municipal bonds and preferred securities would have delivered a higher return than municipals alone. The mix also appears attractive from an after-tax yield perspective, generating 30 basis points of extra yield over standalone municipal bonds, as shown in the chart to the above right.

**Cohen & Steers’ Actively Managed Preferred Securities Open-End Mutual Funds**

<table>
<thead>
<tr>
<th>Cohen &amp; Steers Preferred Securities and Income Fund</th>
<th>Cohen &amp; Steers Low Duration Preferred and Income Fund</th>
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<tbody>
<tr>
<td>CPXAX—Class A</td>
<td>LPXAX—Class A</td>
</tr>
<tr>
<td>CPXCX—Class C</td>
<td>LPXCX—Class C</td>
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<tr>
<td>CPXIX—Class I</td>
<td>LPXIX—Class I</td>
</tr>
<tr>
<td>CPRRX—Class R</td>
<td>LPXRX—Class R</td>
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<tr>
<td>CPZXIX—Class Z</td>
<td>LPZXIX—Class Z</td>
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Cohen & Steers U.S. registered open-end funds are distributed by Cohen & Steers Securities, LLC, and are available only to U.S. residents.

If you already own municipal bonds, you may want to talk with your financial professional about shifting some of your allocation to preferred securities. This can broaden your portfolio’s diversification—spreading risk across a wider range of issuers—while potentially enhancing take-home income.

Adding preferred securities to a portfolio of municipal bonds may help investors achieve better risk-adjusted performance while maintaining a focus on high-quality issuers.

(1) Preferreds: 2.0% average annual dividend impairment based on Moody’s study of annual dividend impairments, including default events and dividend omissions, for non-trust preferred securities from 1980–2012. Munis: 0.09% for the entire study period of municipal default rates over a five-year horizon for all public finance issuers from 1970–2017.
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infrastructure and natural resource equities, as well as preferred securities and other income solutions. Founded in 1986, Cohen & Steers is a global investment manager specializing in liquid real assets, including real estate securities, listed

About Cohen & Steers

Cohen & Steers is a global investment manager specializing in liquid real assets, including real estate securities, listed infrastructure and natural resource equities, as well as preferred securities and other income solutions. Founded in 1986, the firm is headquartered in New York City, with offices in London, Dublin, Hong Kong and Tokyo.
We believe accessing investment opportunities around the world requires local knowledge and insight into specialized and regional markets. Cohen & Steers maintains a global presence through the following offices:

**Americas**

**NEW YORK**

Corporate Headquarters  
280 Park Avenue, 10th Floor  
New York, New York 10017  
Phone 212 832 3232  
Fax 212 832 3622

**Europe**

**LONDON**

Cohen & Steers UK Limited  
50 Pall Mall, 7th Floor  
London SW1Y 5JH  
United Kingdom  
Phone +44 207 460 6350

**DUBLIN**

Cohen & Steers Ireland Limited  
77 Sir John Rogerson’s Quay, Block C  
Grand Canal Docklands, Dublin 2  
D02 VK60, Ireland  
Phone +353 1 592 1780

**Asia Pacific**

**HONG KONG**

Cohen & Steers Asia Limited  
Suites 1201-02, Champion Tower  
3 Garden Road  
Central, Hong Kong  
Phone +852 3667 0080

**TOKYO**

Cohen & Steers Japan Limited  
Pacific Century Place, 16F  
1-11-1 Marunouchi Chiyoda-ku  
Tokyo 100-6216 Japan  
Phone +81 3 4530 4710

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