SPECTRUM SMA TAX ADVANTAGED PREFERRED SECURITIES

Quarterly commentary

2023 FOURTH QUARTER

Market environment

The fourth quarter was primarily a period of U.S. Treasury (UST) bond market capitulation in October and record reversal in November and December after fully pricing expectations for the Federal Reserve (Fed) policy to keep rates elevated for an extended period then suddenly reversing and pricing in six rate cuts next year. Indeed, Chairman Powell had convinced markets that there seemed to be a very long off ramp on inflation by saying, rates are restrictive and “there’s a long way to go” on inflation. But in December, he said rates are “well into restrictive territory” and that the Fed had talked about rate cuts in the December meeting. UST ten-year yields dropped 68 basis points (bps) and UST 30-year yields dropped 65 bps by the end of the quarter. The change in market expectations on Fed policy further disinverted the yield curve by 20 bps, but the difference in yield between the UST ten-year note and the UST two-year note still closed the year inverted by -37 bps which foretells a slowing economy should still forthcoming. The overall market mood was jubilant and there appeared to be “buy at any cost” mentality as shorts were scrambling to cover and hybrid traders were buying just about anything to get long. Issuance surged in November, particularly in the CoCo sector, which saw deals price with coupons ranging between 9%-10%.

The ICE BofA All Capital Securities Index (I0CS) rose 6.46% in the fourth quarter compared to a decline of 0.19% during the last quarter -- the $1,000 par sector returned 6.82% and contributed 4.51% to the overall return, while the $25 par sector returned 6.82% and contributed 1.98% to the overall return. The ICE USD Contingent Capital Index (CDLR) rose 7.38% in the fourth quarter compared to 1.93% last quarter on the heels of an extraordinarily well-received two-part benchmark deal from UBS at 9.25%.

Valuation thoughts going into 1Q of 2024:

Spreads on the ICE BofA U.S. Investment Grade (IG) Index (CIPS) had a 50 basis point range this quarter and closed 16 bps tighter at an OAS of 243 bps. Spreads on the CDLR (CoCos) had a 75 basis point range and closed 51 bps tighter at an OAS of 316 bps. Spreads on the ICE BofA 5-10-year Investment Grade Corporate Index (C6C0) ended the quarter at 121 bps (30 bps tighter) and the ICE BofA U.S. High Yield (H0A0) ended the

KEY TAKEAWAYS

- The UST market rallied significantly during the quarter after the Fed indicated it was likely done raising rates and that next year there may be a series of rate cuts.
- Expanding economic activity supported our sanguine credit expectations as junior subordinated credit performed very well by rallying roughly 100 bps lower in yield and tightening by about 20 bps in preferred securities and about 90 bps in CoCo securities.
- Performance between the institutional sectors and the retail sector was balanced as $1000 par preferred securities gained 6.38% and $25 par hybrids gained 6.42%; CoCo securities gained 7.38%.

SMA PROFILE

SMA Tax Advantaged

$25 par preferred securities portfolio emphasizing qualified dividend income-eligible securities

SMA Benchmark

ICE BofA Core Fixed Rate Preferred Securities Index (P0P2) quarter at 339 bps (64 bps tighter). Compared to the IG Corporate Index, IG preferred securities (i.e., CIPS) offer a higher subordination premium of 2.01 times (i.e., 243/121) this quarter than last quarter; CoCos also offer a higher subordination premium of 2.61 times (i.e., 316/121) this quarter. Also, from a duration standpoint institutional IG preferred securities have an average effective duration of 4.2 years relative to 6.1 years on the IG Corporate Index, which implies less term structure risk for preferred securities. The implication is that within the IG umbrella, investors can pick up over 2.0 times the spread by going down the capital structure into preferred securities but take only about 2/3rds the duration risk which highlights the value proposition available in hybrids. Our Comprehensive Risk Estimates for preferred and capital securities range from 2.82% (NoCos) to 5.52% (CoCos), which implies that all sectors are discounted enough on price, yield, and spread to suggest positive total return outcomes based on a return to the average yield at the bottom of the last three credit cycles – despite the yield declines, hybrids are a better relative value this quarter than last quarter.

Changes in 4Q23 (Source: ICE Bond Indices)	Core fixed rate $25 preferred (P0P4)	$1,000 par IG preferred securities (CIPS)	Contingent capital securities (CDLR)
Govt OAS spreads	-5 bps	-16 bps	-51 bps
% Price change	+3.95	+3.67	+5.76

Source: ICE Bank of America.

$25 par market

The retail $25 par preferred securities sector had a positive quarter. ICE BofA Core Fixed Rate Preferred Securities Index (P0P2) had a total return of 6.87% for the quarter; -4.3%, +8.9%, and +2.5% for October, November, and December, respectively. While the market was concerned that the Fed would maintain elevated interest rates (“higher for longer”) earlier in the quarter, the focus shifted more to rate cuts when both the labor market and the services showed signs of cooling in early November. Long-term Treasury yields dropped significantly during the period, which bolstered the $25 par preferred market performance as well. The government option adjusted spread tightened significantly with the rate cut optimism, fluctuating towards the end of the year as the market tried to balance the expectation of rate cuts against the risk of economic downturn.

The ongoing trend of supply shortage from the primary market and redemptions continued, which exacerbated supply imbalance of the $25 preferred market. There were some senior debt deals with relatively small sizes such as $345 million deal from F&G Annuities & Life (FG), but there was no issuance from major banks. Citigroup called two issues totaling $1.9 billion during the quarter: CpK full call and CpJ with a partial redemption.

The sector closed the quarter yielding 5.78% (51 bps lower than the last quarter’s end). The spread (OAS) over comparable U.S. Treasury securities was 59 bps (6 bps tighter).

$25 par preferred specific ETFs had big outflows totaling over $200 million in October but underwent a complete reversal in November cancelling out the previous outflows. The total inflow for the quarter was approximately $630 million.

SMA portfolio characteristics and performance review

	SMA portfolio	SMA benchmark
	SMA Tax Advantaged	P0P2
Average dollar price ($)	87.04	87.99
Average coupon (%)	5.31	5.31
Current yield (%)	5.94	6.03
Yield to worst (%)	5.32	5.78
Modified duration (years)	13.80	13.02
Quality	BBB2	BBB2

Source: Spectrum Asset Management, Bloomberg. As of 12/31/2023. ICE BofA Core Fixed Rate Preferred Securities Index (P0P2).

	Total returns (%)					
	3-month	Year-to-date	1-year	3-year	5-year	10-year
SMA Tax Advantaged (gross)	5.93	9.79	9.79	-1.94	3.71	5.04
SMA Tax Advantaged (net)[1]	5.35	7.36	7.36	-4.12	1.41	2.71
Performance benchmark[2]	6.87	10.79	10.79	-3.08	2.54	4.57
P0P2	6.87	10.79	10.79	-3.08	2.54	4.57

Past performance is not indicative of future returns.

Source: Principal Global Investors. As of 12/31/2023.

[1] Net fees are 2.25%

[2] The performance benchmark is composed of the ICE BofA Fixed Rate Preferred Securities Index (P0P1) through December 31, 2013 and the ICE BofA Core Fixed Rate Preferred Securities Index (P0P2) subsequently.

Portfolio update

Contributors

- **Arch Capital Group Ltd** 4.55% ACGLN
- **Truist Financial Corp** 4.75% TFCprR
- **Fifth Third Bancorp** 4.95% FITBO
- **American Intl Group** 5.85% AIGprA
- **Allstate Corp** 5.1% ALLprH

Detractors

- **Georgia Power Co** 5% GPJA
- **Voya Financial Inc** 5.35% VOYAprB
- **Keycorp** 6.125% KEYprI
- **Entergy Louisiana LLC** 4.875% ELC
- **Morgan Stanley** 7.125% MSprE

Increased positions

- **Charles Schwab Corp** 4.45% SCHWprJ
- **Wells Fargo & Company** 4.75% WFCprZ
- **Wells Fargo & Company** 4.7% WFCprA
- **Goldman Sachs Group Inc** 6.30069% GSprD
- **Citizens Financial Group** 5% CFGprE
- **Southern Co** 4.2% SOJE
- **CMS Energy Corp** 5.875% CMSD
- **Fifth Third Bancorp** 4.95% FITBO
- **Arch Capital Group Ltd** 4.55% ACGLN
- **American Intl Group** 5.85% AIGprA
- **Morgan Stanley** 4.25% MSprO
- **Metlife Inc** 4.75% METprF
- **Duke Energy Corp** 5.75% DUKprA
- **Huntington Bancshares** 4.5% HBANP
- **Bank Of America Corp** 4.25% BACprQ

Decreased positions

- **Citigroup Inc** 9.63176000000001% CprJ

New additions

- None for this period

Closeout

- **Citigroup Inc** 6.875% CprK – *called*

Calculations exclude cash and derivatives, where applicable.

SMA portfolio characteristics shown are representative accounts that are selected on non-performance-based criteria that may include institutional, model or sponsor portfolio that is most representative of the SMA strategy and is shown for illustrative purposes. Actual client portfolios holdings may differ because of account size, client-imposed investment restrictions, the timing of client investments and market, economic and individual company consideration. Quarterly new additions and closeouts represent all new purchases and full liquidations of securities for the previous quarter of the representative portfolio. Performance results shown reflects the composite for each strategy listed.

SMA Tax Advantaged

SMA Tax Advantaged major security sector components	Weight (%)	Contribution to return (%)
25parPFD ($25 par preferred stock)	77.50	4.77
25parHybrid ($25 par junior- subordinated bond)	10.11	0.82
BabyBond ($25 par senior debt)	1.46	-0.02
REIT Pfd ($25 par cumulative REIT preferred securities)	4.48	0.35
Total return gross	93.55	5.91
Total return net	—	5.35

Portfolio sector attribution

Top contributors	Weight (%)	Contribution to return (%)	Top detractors	Weight (%)	Contribution to return (%)
Banking	46.60	2.91	Utility - Foreign	0.22	0.00
Insurance - Multi Line	5.95	0.57	Reinsurance	0.49	0.01
Reinsurance - Foreign	4.00	0.54	Financial	0.78	0.11

Portfolio allocation

Top 5 issuers	Weight (%)	Top 5 industries	Weight (%)	Top 5 countries	Weight (%)
Bank of America Corp	4.94	Banking	46.60	United States	92.33
Morgan Stanley	4.83	Brokerage	10.75	Bermuda	1.00
JPMorgan Chase & Co	4.74	Insurance - Life	8.04	Canada	0.22
U.S. Bancorp	4.69	Utility	7.77	—	—
Wells Fargo & Co	4.45	Insurance - Multi Line	5.95	—	—

Market outlook

- As spreads were tighter and yields moved lower, our absolute return expectations are trimmed somewhat, but the spreads in junior subordination compared to more senior financials are improved – especially when considering better spreads per unit of duration for hybrids and CoCos.
- There are attractive yields available in hybrid preferred securities which offer significant yield advantages to corporate bonds.
- The UST market appears overbought in pricing in six rate cuts when the Fed seems generous in suggesting three rate cuts despite inflation still being above 3% and trending sideways.
- Ongoing equity complacency has turned to exuberance as real rates have zoomed lower and the Fed is posturing for rates cuts – a steeper UST yield curve and its constructive implications for the U.S. economy bode well for spread performance expectations.
- There is still good value in the junior subordinated fixed-to-refixed sectors based on discounted prices and still generous assumed coupons on a refixing which keeps the "pull toward par" story in play, regardless of the direction for intermediate rates.
- Today's high hybrid yields are attractive based on our Comprehensive Risk profiles which compels us to be bullish on buying junior subordination in quality financials despite money market yields being high as well, though money market yields are expected to decline this year. By the time short rates do finally come down, prices on term spread product should have already made a good move higher (as they proved this quarter) in anticipation of lower rates playing through the back end of this rate cycle.

Calculations exclude cash and derivatives, where applicable.

SMA portfolio characteristics shown are representative accounts that are selected on non-performance-based criteria that may include institutional, model or sponsor portfolio that is most representative of the SMA strategy and is shown for illustrative purposes. Actual client portfolios holdings may differ because of account size, client-imposed investment restrictions, the timing of client investments and market, economic and individual company consideration.

Disclosures

Spectrum Asset Management, Inc. is an affiliate of Principal Global Investors. Spectrum is a leading manager of institutional and retail preferred securities portfolios and manages portfolios for an international universe of corporate, insurance, and endowment clients.

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal. Risks of preferred securities differ from risks inherent in other investments. In particular, in a bankruptcy preferred securities are senior to common stock but subordinate to other corporate debt. Contingent Capital Securities carry greater risk compared to other securities in times of credit stress. An issuer or regulator's decision to write down, write off or convert a CoCo may result in complete loss on an investment. Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise.

This material may contain `forward-looking' information that is not purely historical in nature and may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, tax, legal or accounting advice. You should consult your own tax, legal and accounting advisors before engaging in any transaction.

This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

This strategy is only provided through separately managed accounts program sponsors. Clients should consult their financial professionals before making any investment decisions. Financial professionals should consider the appropriateness of the manager, strategy, and program for its clients on an initial and ongoing basis.

Spectrum Asset Management ("Spectrum") acts as a discretionary investment manager or non-discretionary model provider in a variety of separately managed account or wrap fee programs ("SMA Program") sponsored by either broker-dealers or another financial services firm ("Sponsor"). When acting as a discretionary investment manager, Spectrum is responsible for implementing trades in SMA Program accounts. When acting as a nondiscretionary model provider, Spectrum's responsibility is limited to providing non-discretionary investment recommendations of model portfolios to the SMA Program Sponsor who may utilize such recommendations in connection with its management of SMA Program accounts. In such model SMA Programs ("Model Programs"), it is the Sponsor, and not Spectrum, which serves as the investment manager to, and has trade implementation responsibility for, the Model Program accounts.

Principal Global Investors, LLC (PGI) is registered with the U.S. Commodity Futures Trading Commission (CFTC) as a commodity trading advisor (CTA), a commodity pool operator (CPO) and is a member of the National Futures Association (NFA). PGI advises qualified eligible persons (QEPs) under CFTC Regulation 4.7.

This document is issued in the United States by Principal Global Investors, LLC, which is regulated by the U.S. Securities and Exchange Commission.

MM11484-14 | 01/2024 | 3355331-052024