

Spectrum Asset Management

# Discover uncommon value in the preferred and capital securities market

With yields highest and spreads widest since the Global Financial Crisis, now may be an attractive entry point into the preferred and capital securities asset class. Opportunities for upside and higher income potential exists for the asset class now, especially within the contingent convertible (CoCos) subset of the market.

## Spreads for CoCos are the widest since previous periods of crisis

CoCos index spread vs. government (10-year Treasurys)



Source: ICE Data Indices. As of March 31, 2023. CoCos are represented by the ICE BofA Contingent Capital Index (COCO).

Over the past couple of years, CoCos have increasingly made up more of the preferred and capital securities universe. As of March 31, 2023, CoCos made up 42.4% of the preferred and capital securities market, up from 32.7% as of December 31, 2015 – so the landscape is not what it used to be, and we believe there is uncommon value in CoCos today.

## The focus on CoCos

### 1. Higher income potential

CoCos have been repriced down to previous crisis levels and are currently discounted. This sets the stage for attractive income potential.

#### Yields are the highest they've been in recent years

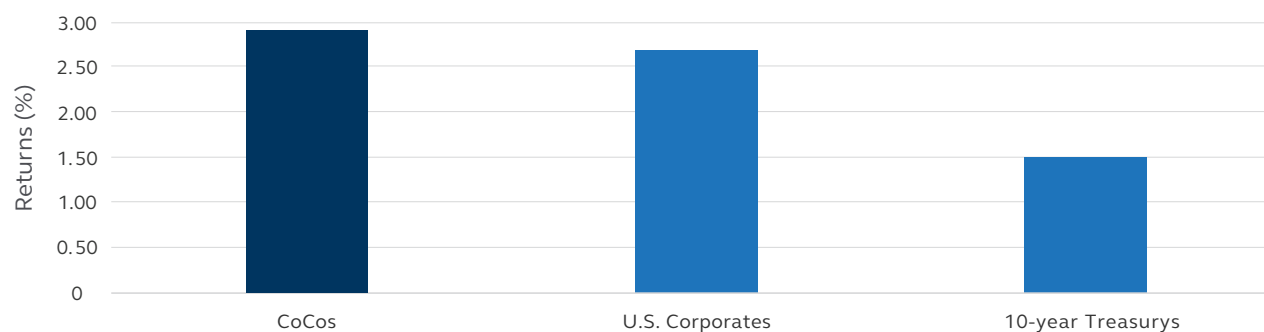
Date	CoCos	U.S. Corporate	10-year Treasury
12/31/2021	5.64%	3.27%	1.39%
12/31/2022	6.69%	4.19%	4.03%
2/28/2023	6.64%	4.24%	3.62%
3/31/2023	7.00%	4.18%	3.49%

Source: ICE Data Indices. As of March 31, 2023. Yields shown are current yields. CoCos are represented by the ICE BofA Contingent Capital Index (COCO), U.S. Corporates are represented by the ICE BofA U.S. Corporate Index (COA0), and 10-year Treasuries are represented by the ICE BofA Current 10-Y U.S. Treasuries TR USD Index (GA10).

### 2. Historical outperformance, weathering multiple market stress periods

Due to their high level of income, CoCos have performed well since inception of the index on December 31, 2013, compared to Corporate and Treasuries, and we believe they will continue to outperform over the long term despite the current market volatility.

#### CoCos vs U.S. Corporates and 10-year Treasuries



Source: Morningstar. As of March 31, 2023. CoCos are represented by the ICE BofA Contingent Capital Index (COCO), U.S. Corporates are represented by the ICE BofA U.S. Corporate Index (COA0), and 10-year Treasuries are represented by the ICE BofA Current 10-Y U.S. Treasury TR USD Index (GA10). The start date, January 1, 2014, is the inception date of the COCO index.

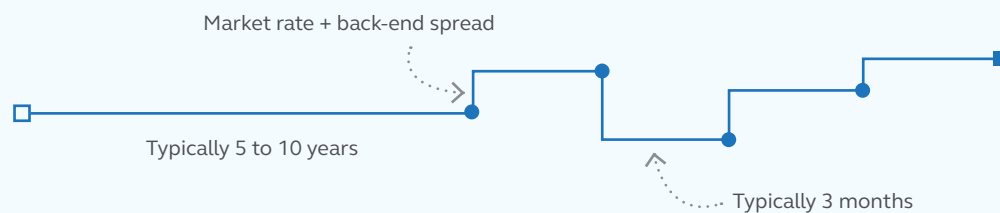
### 3. Predominate coupon structures can help manage interest rate risk and elevate prices from today's deep discounts

Fixed-to-floating and fixed-to-variable-rate (also known as fixed-to-fixed reset) are the predominate coupon structures within the CoCos market. As these structures are callable, absent a decline in credit, prices tend to gravitate to par and then either reset at the new coupon structure or are called at par, creating stability in the market and an opportunity of appreciation. We believe the coupons may reset from the 4% area up to within a 7-8% range just a few years from now, elevating prices from today's deep discounts.

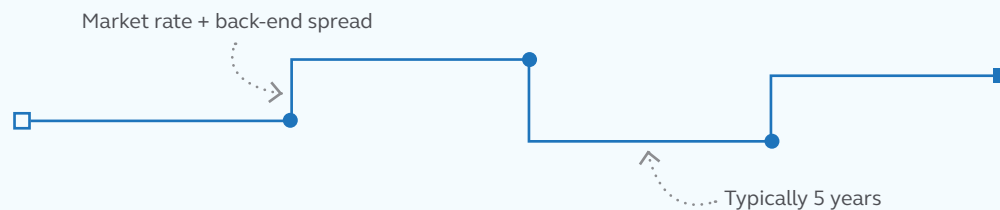
#### Adjustable-rate structures can help manage interest rate risk

□ Issuance ● Reset ■ Maturity

##### Coupon structure: Fixed-to-floating-rate securities



##### Coupon structure: Fixed-to-variable-rate securities



### Spectrum Asset Management

Spectrum Asset Management has had extensive experience managing preferred and capital securities through a variety of challenging market events. We continue to actively manage the assets and are excited about the CoCos sector of the market as they provide an opportunity given the current market environment. We believe that potential investors should take advantage of preferred and capital securities now, given the discounted prices and high yields, potential outperformance in the long term, and various coupon structures that may help mitigate any potential losses from a volatile market.

#### **Index descriptions**

- ICE BofA Contingent Capital Index tracks the performance of investment grade and below investment grade contingent capital debt publicly issued in the major domestic and eurobond markets.
- ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market.
- ICE BofA Current 10-Year U.S. Treasury Index is a one-security index comprised of the most recently issued 10-year U.S. Treasury note.

#### **Risk considerations**

Past performance is no guarantee of future results. Investing involves risk, including possible loss of principal. Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. 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.

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