Preferreds rebounded in March as interest rates stabilized and retail inflows supported the asset class. $25 par nearly recovered year-to-date losses with a 2.8% rally while $1000 par finished flat on the month with longer call securities underperforming. March also featured some regulatory developments as the Federal Reserve updated investors on the Supplementary Leverage Ratio and the State of New York made headway on LIBOR legislation. First quarter results are the next catalyst with banks updating investors on loan growth, net interest margins and issuance needs.

March supply was led by new issues from a financial services firm and a money center bank. The month also included some less-frequent issuers, with a utility as well as an aircraft lessor tapping the market. The aircraft leasing sector has been the focus of recent M&A activity and as these companies scale they are becoming more relevant for preferred investors. We are constructive on certain names in the sector and we anticipate additional supply later this year.

At month-end, year to date supply of U.S. preferreds, excluding issuers smaller than 100mm, was a touch under $20B, at $19.5, or in-line with last year’s pace.¹ Refinancing activity continued

Past performance is no guarantee of future results. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. See Disclosure section for index definitions.

¹ Source: Bloomberg as of April 9, 2021

Basis point. One basis point = 0.01%
as well, with a money center bank calling over $4 billion in securities after issuing a like amount earlier this year. As a number high coupon securities approach call date, we expect this trend to continue.

The fundamental case for financial sector preferreds begins, in our view, with the regulatory regime implemented post the 2008 financial crisis, which included higher capital levels and enhanced oversight in the form of annual stress tests. During the March downturn last year, the Fed relaxed the Supplementary Leverage Ratio (SLR) which requires a minimum capital ratio relative to the firm’s entire balance sheet. Bank balance sheets grew rapidly in the spring of 2020 as corporate clients drew down credit lines and deposits flooded into branches, and authorities did not want these vital bank functions encumbered by capital concerns in a time of crisis. As a result, bank holdings of Treasuries and excess reserves were excluded from the SLR calculation.

The exclusion expired at month end, and the implication for some of the largest banks is they may need to shed assets or raise capital in the coming quarters. We were surprised to see the exclusion expire and we believe this could potentially lead to a pick-up in preferred issuance. Strictly from an economic standpoint, issuing additional tier 1 capital (preferreds) to support excess reserves is hardly efficient, but if not, certain banks may need to reprice deposits in such a way to delicately manage out excess cash. Quarterly earnings calls could offer more clarity, but SLR-related supply expectations are top of mind for preferred investors.

Earnings are the next signpost for the asset class, with results beginning mid-April. Capital markets-leveraged institutions should be buoyed by strong equity markets and underwriting. The narrative around the U.S. consumer has been very positive, and any weakness in auto or credit cards would come as a surprise. Commercial real estate is the perceived soft spot for loans and investors will scrutinize any fundamental deterioration there closely. Net interest margins may decline sequentially, but the recent steepening in the yield curve should allow for a stronger outlook. Recently tepid loan growth should improve as the economy expands as well.

Lastly, New York State made progress on LIBOR legislation in March. For legacy LIBOR-based securities, which includes most pre-2019 issued fixed to floating rate preferreds, the state senate advanced a bill incorporating suggested language from the Alternative Reference Rate Committee (ARRC) on LIBOR fallback. Assuming it is signed into law by Governor Andrew Cuomo, the law will allow securities without explicit “fallback language”, a defined reset rate post-LIBOR, to reset at SOFR plus a historical spread, similar to the solution agreed on by the interest rate derivatives market. The additional certainty is a positive for investors, although at the margin, this may reduce the likelihood of calls and tenders for LIBOR securities without an economic justification.

### DISPLAY 1

**Returns**

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<thead>
<tr>
<th>INDEX</th>
<th>MTD</th>
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<th>YTD</th>
<th>2020</th>
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<tr>
<td>BofA Fixed Rate Preferred Index</td>
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<td>-1.03</td>
<td>-1.03</td>
<td>6.95</td>
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<tr>
<td>25 Par Preferreds</td>
<td>2.82</td>
<td>-0.52</td>
<td>-0.52</td>
<td>7.38</td>
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<tr>
<td>1000 Par IG</td>
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<td>-0.69</td>
<td>8.22</td>
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<tr>
<td>1000 Par HY</td>
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<td>0.88</td>
<td>0.88</td>
<td>6.03</td>
</tr>
<tr>
<td>USD CoCo</td>
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<td>0.73</td>
<td>0.73</td>
<td>7.54</td>
</tr>
<tr>
<td>US High Yield</td>
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<td>0.90</td>
<td>0.90</td>
<td>6.17</td>
</tr>
<tr>
<td>US Corporate</td>
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<td>-4.49</td>
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<tr>
<td>5-10yr. Financials</td>
<td>-1.64</td>
<td>-3.85</td>
<td>-3.85</td>
<td>10.69</td>
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</table>

Source: Bloomberg data as of March 31, 2021

**Metrics**

<table>
<thead>
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<th>YTM</th>
<th>OAS</th>
<th>EFF. DUR.</th>
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<td>BofA Fixed Rate Preferred Index</td>
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<td>1.81</td>
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<td>5-10yr. Financials</td>
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<td>2.26</td>
<td>2.30</td>
<td>96</td>
<td>6.43</td>
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</table>

Source: Bloomberg data as of March 31, 2021

The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. Past performance is no guarantee of future results. See Disclosure section for index definitions.
DISPLAY 2
Preferred ETF Flows

Source: Bloomberg, as of April 2, 2021

Cumulative U.S. Preferred Issuance

Source: Bloomberg, as of April 2, 2021

1000 Par OAS

Source: Bloomberg, as of April 2, 2021

25 Par OAS

Source: Bloomberg, as of April 2, 2021

Ratio of 1000 Par to BB High Yield OAS

Source: Bloomberg, as of April 2, 2021

Ratio of 1000 Par to Senior Financial OAS

Source: Bloomberg, as of April 2, 2021

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Risk Considerations

There is no assurance that a portfolio will achieve its investment objective. Portfolios are subject to market risk, which is the possibility that the market values of securities owned by the portfolio will decline and that the value of portfolio shares may therefore be less than what you paid for them. Market values can change daily due to economic and other events (e.g., natural disasters, health crises, terrorism, conflicts and social unrest) that affect markets, countries, companies or governments. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events. Accordingly, you can lose money investing in this portfolio. Please be aware that this portfolio may be subject to certain additional risks.

Fixed-income securities are subject to the ability of an issuer to make timely principal and interest payments (credit risk), changes in interest rates (interest-rate risk), the creditworthiness of the issuer and general market liquidity (market risk). In a rising interest-rate environment, bond prices may fall and may result in periods of volatility and increased portfolio redemptions. In a declining interest-rate environment, the portfolio may generate less income. Longer-term securities may be more sensitive to interest rate changes. Municipal securities are subject to early redemption risk and sensitive to tax, legislative and political changes. Taxability Risk.

Changes in tax laws or adverse determinations by the Internal Revenue Service (“IRS”) may make the income from some municipal obligations taxable. By investing in investment company securities, the portfolio is subject to the underlying risks of that investment company’s portfolio securities. In addition to the Portfolio’s fees and expenses, the Portfolio generally would bear its share of the investment company’s fees and expenses. Preferred securities are subject to interest rate risk and generally decreases in value if interest rates rise and increase in value if interest rates fall. High yield securities (“junk bonds”) are lower rated securities that may have a higher degree of credit and liquidity risk.

DEFINITIONS

The indexes shown in this report are not meant to depict the performance of any specific investment, and the indexes shown do not include any expenses, fees or sales charges, which would lower performance. The indexes shown are unmanaged and should not be considered an investment. It is not possible to invest directly in an index.

The Bloomberg Barclays U.S. Corporate 1-3 Year Index measures the investment grade, fixed-rate, taxable corporate bond market with 1-3 year maturities.

The CIPS/Markit UK Manufacturing Purchasing Managers’ Index (PMI) is a composite index based on five of the individual indexes with the following weights: New Orders - 0.3, Output - 0.25, Employment - 0.2, Suppliers’ Delivery Times - 0.15, Stock of Items Purchased - 0.1, with the Delivery Times Index inverted so that it moves in a comparable direction.

The Citigroup Economic Surprise Indices are objective and quantitative measures of economic news. They are defined as weighted historical standard deviations of data surprises (actual releases vs. Bloomberg survey median). A positive reading of the Economic Surprise Index suggests that economic releases have on balance been beating consensus.

ICE BofAML Core Plus Fixed Rate Preferred Securities Index tracks the performance of fixed-rate US dollar-denominated preferred, U.S.-domiciled securities.

The ICE BofAML U.S. All Capital Securities Index is a subset of the ICE BofAML Merril Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities.

The ICE BofAML U.S. High Yield Master II Constrained Index (ICE BofAML U.S. High Yield) is a market-value-weighted index of all domestic and Yankee high-yield bonds, including deferred interest bonds and payment-in-kind securities. Its securities have maturities of one year or more and a credit rating lower than BBB-/Baa3, but are not in default.

The ICE BofAML U.S. Corporate Index (COAO) tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market.

The ICE BofAML US Corporate BB Index is a subset of the ICE BofAML US High Yield Master II Index tracking the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. This subset includes all securities with a given investment grade rating BB.

The ICE BofAML US Corporate B Index is a subset of the ICE BofAML US High Yield Master II Index tracking the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. This subset includes all securities with a given investment grade rating BB.

The ICE BofAML US Corporate C Index is a subset of the ICE BofAML US High Yield Master II Index tracking the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. This subset includes all securities with a given investment grade rating CCC or below.

The ICE BofAML Eurodollar Banking Index (EOBA) is a subset of ICE BofAML Eurodollar Index including all securities of Bank Issuers and tracks the performance of US dollar denominated investment grade quasi-government, corporate, securitized and collateralized debt publicly issued in the eurobond markets.

The ICE BofAML Fixed Rate Preferred Securities Index tracks the performance of fixed-rate, U.S. dollar denominated, investment-grade preferred securities in the U.S. domestic market.

The ICE BofAML U.S. High Yield Institutional Capital Securities Index (CIPS) tracks the performance of US dollar denominated investment grade hybrid capital corporate and preferred securities publicly issued in the U.S. domestic market.

The ICE BofAML U.S. High Yield Institutional Capital Securities Index (HIPS) tracks the performance of US dollar denominated investment grade hybrid capital corporate and preferred securities publicly issued in the US domestic market.

The ICE BofAML Contingent Capital Index (CDLR) tracks the performance of investment grade and below investment grade contingent capital debt publicly issued in the major domestic and Eurobond markets.

Current yield is a measure that looks at the current price of a bond instead of its face value and represents the return an investor would expect if he or she purchased the bond and held it for a year. Calculated by dividing the Annual Cash Inflows / Market Price.

Effective duration takes into account that expected cash flows will fluctuate as interest rates change.

Option Adjusted Spread is a measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst would use the Treasury securities yield for the risk-free rate. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond.

Yield-To-Maturity is the rate of return anticipated on a bond if it is held until the maturity date.
Yield-To-Worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting. The yield to worst is calculated by making worst-case scenario assumptions on the issue by calculating the returns that would be received if provisions, including prepayment, call or sinking fund, are used by the issuer.

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