Preferred Securities Select

Marketing communication | As of 31 Mar 2025

- **The Preferred Securities Select strategy outperformed its benchmark on a gross and net of fees basis.**
- **Coupon structure management was the primary driver of performance.**
- **Duration underweight was the primary detractor from performance.**

Market review

Economic activity remained strong in the first quarter but showed more signs of a potential slowdown ahead. As the quarter progressed, uncertainty surrounding pending U.S. tariffs caused increasing angst as countries and investors wrestled with the wide range of possible policy outcomes and disparate economic impacts. Depending on the magnitude, breadth and duration of tariffs, the drag on growth could range from 0% to 2% or more of gross domestic product (GDP), with a move of similar scope to inflation in the opposite direction. This uncertainty affected surveys of U.S. consumer and business sentiment, which softened in March, while consumer inflation expectations moved higher. Nevertheless, actual data regarding U.S. job creation, personal income, retail sales and industrial production remained resilient during the quarter.

The Federal Reserve (Fed) kept rates unchanged throughout the quarter as policymakers paused to assess the impact of the Trump administration's aggressive economic agenda. Following their March meeting, policymakers lowered their growth outlook and raised inflation forecasts, while reiterating the likelihood of two 25-basis-point rate cuts in 2025. Other global central banks, including the European Central Bank (ECB), Bank of England (BoE) and Bank of Canada, cut rates during the quarter, while the Bank of Japan (BoJ) hiked rates in January to their highest level since 2008. U.S. Treasury yields trended downward over the quarter and the yield curve slightly steepened. The 10-year Treasury yield ended the quarter 35 basis points lower at 4.23%, reversing about half of the fourth quarter's rise.

Despite the backdrop of lower interest rates during the quarter, the $25 par preferred segment, the segment of the market with the longest average duration, underperformed $1000 par preferreds meaningfully. The $1000 par segments has an average duration less than half of the $25 par preferred market. During the quarter, the $25 par preferred market posted a total return of -1.15%, considerably less than the total return of 1.39% for the $1000 par preferred segments.

The quarter was relatively void of headlines specific to the preferred securities market. For the bank sector, the largest issuer of preferred securities, news was generally positive. Banks released fourth-quarter 2024 earnings that, on average, exceeded expectations, a trend that has now spanned several quarters.

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Portfolio Manager

At the end of June, the Fed released annual stress test results, with all 31 participating banks yet again passing this year's exam. Based on this year's test, the 31 participating banks held almost $600 billion of excess capital. While the Trump administration has stated a desire to scale back regulations governing the bank sector, we don't believe the changes will be meaningful enough to alter the underlying fundamental story of the bank sector for three reasons. First, from a political standpoint, the perception of going too easy on the bank sector likely would not resonate well with constituents of either political party. Second, from a fundamental standpoint, bank sector profitability has remained at historically high levels under the current regulatory regime. Surprisingly, some of the most prominent U.S. bank CEOs have urged regulators to refrain from changing the regulatory landscape as meaningful deregulation could burden bank management with the cumbersome exercise of realigning strategic initiatives. Third, under the current regulatory environment, the economy has performed well with adequate access to credit and liquidity necessary to support consistent growth.

Portfolio review

During the first quarter, the Preferred Securities Select strategy outperformed its benchmark, the ICE BofA US All Capital Securities Index, on both a gross and net of fees basis. On an absolute basis, both coupon income and duration contributed to this quarter's total return, while spread widening was a detractor. On a relative basis, the strategy's outperformance primarily came from coupon structure management, which typically coincides with the allocation of $1000 par and $25 par structures, while duration management was the main detractor.

Coupon structure allocation drove relative performance this past quarter. We favor (overweight) securities with coupon reset features versus their fixed-rate counterpart, which we remain underweight. This positioning drove our outperformance as resettable coupon structures outperformed their fixed-rate coupon counterpart. Nearly all fixed-rate coupon structures are issued in $25 par format, while most $1000 par securities are issued with coupon reset features. As coupon structure mostly goes hand-in-hand with security structure, the strategy has an underweight to both fixed-rate and $25 par securities, and has a corresponding overweight to both securities with coupon reset features and $1000 par structures. As mentioned above, the $25 par market materially underperformed it's $1000 par counterpart. The contrasting performance, combined with the strategy's positioning, was therefore additive to relative performance. Additionally, sector allocation was a smaller contributor to relative return. The strategy's overweight to banking was accretive as the banking sector outperformed. The strategy's underweight (no exposure) to the REIT sector was also beneficial as REITs underperformed the broader market.

Duration positioning was the only meaningful detractor this quarter. At the beginning of the quarter, the strategy's duration was 3.0 years, 2.2 years less than that of its benchmark. During the quarter, the lower duration profile of the strategy relative to its benchmark detracted modestly from relative performance, given the above-mentioned decline in rates.

Strategy trades this quarter included adding to several existing securities, as well as introducing a few new securities. Strategy trades were primarily funded by selling short-call securities and moving into longer-call structures, increasing duration at the margin. New additions to the strategy were Goldman Sachs 6.85% perpetual preferred, Bank of New York Mellon 6.3% perpetual preferred, and Reinsurance Group of America's 6.65% 9/15/55 hybrid.

Outlook

While the macro outlook is less certain on the heels of the newly announced U.S. tariff policy, we remain constructive regarding the fundamentals underlying the U.S. bank sector, the largest sector within our market, particularly considering the favorable results of the 2024 bank stress tests and recent bank earnings. Generally speaking, the U.S. bank sector remains significantly derisked compared to before the Covid pandemic. Also, most banks have been conservative from a risk standpoint as the sector positioned for what many thought was the imminent implementation of possibly new and higher capital requirements; implementation which appears, which appear less likely today under the new administration. Our outlook also remains positive for the insurance sector, the second largest issuer of securities in our index, because of historically high risk-based capital levels, the added protection from regulatory oversight, an inherent benefit from higher interest rates and historically high sales of annuity products for consecutive years. we are also reassured by the fact that over the past several years, most property and casualty insurance providers have exited certain high-risk geographies and lines of business that are high risk, leaving those obligations up to various state and/or federal government insurance programs. While our current concerns regarding the outlook for the asset class are more macro in nature, we believe underlying fundamentals should allow the largest sectors in the market to weather even meaningful market turmoil.

Our outlook regarding valuations of the preferred securities market is more constructive than in recent quarters. We believe the recent risk-off sentiment across financial markets, including the preferred securities market, has created a more compelling entry point.

From a technical perspective, we expect net supply to be modestly positive for the foreseeable future. With Moody's officially changing its methodology for assigning equity credit to hybrid securities in early 2024, a move that aligned its methodology closer to S&P and Fitch, we anticipate more corporate hybrid supply as issuers take advantage of garnering the 50% equity content treatment for hybrid structures from each of the Big 3 rating agencies. In addition, capital expenditures are likely to meaningfully increase in the utility sector, with those issuers needing to manage leverage levels and protect their ratings. As a result of these overarching two factors, we anticipate corporate hybrid supply to be net positive $20-$25 billion in 2025. Given much of this new hybrid issuance will be eligible for investment grade or high yield corporate bond indices, investor interest will likely be broad-based and this new supply should be easily absorbed. This wave of index-eligible hybrid supply may also spur more investor interest in the preferred securities asset class, which could further support current valuations.

Barring any unforeseen developments, we anticipate maintaining most of the strategy's current positioning relative to its benchmark index. We continue to favor securities with coupon reset features. These structures have minimal duration extension risk compared to their fixed-rate counterparts, plus in the current rate environment many of those nearing their rate reset have the potential for coupon increases. We also continue to maintain an overweight to the financial sector and underweight to industrials, which is defensive in nature. The financial sector as a whole is comprised of highly regulated industries. Banks and insurance companies, which make up the majority of this sector, are subject to strict financial regulation, plus most banks are required to regularly participate in fairly rigorous stress tests. For these reasons, we continue to favor highly regulated industries over those with less government oversight. We will, however, likely use bouts of weakness to add spread duration to the strategy by rotating out of near-term callable securities, and into securities with longer call protection.

For more information contact: 800.752.8700 or visit nuveen.com

Minimum investment is $400,000.

Important information on risk

All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. The preferred securities strategy entails certain risks, including preferred security risk, interest rate risk, income risk, credit risk, non-US securities risk and concentration/non-diversification risk, among others. There are specific risks associated with investing in preferred securities, including generally an absence of voting rights with respect to the issuing company unless certain events occur. The issuer of preferred securities may redeem the securities prior to a specified date. As with all call provisions, a redemption by the issuer may negatively impact the return of the security held by an account. Investing internationally presents certain risks not associated with investing solely in the U.S., such as currency fluctuation, political and economic change, social unrest, changes in government relations, differences in accounting and the lesser degree of accurate public information available, foreign company risk, market risk and correlation risk. Preferred security investments are generally invested in a high percentage of the securities of companies principally engaged in the financial services sector, which makes these investments more susceptible to adverse economic or regulatory occurrences affecting that sector.

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Glossary

The **Custom Benchmark Index** consists of 60% ICE BofA U.S. All Capital Securities Index and 40% ICE USD Contingent Capital Index.The **Bloomberg U.S. Credit - Financial Institutions Index** measures the performance of U.S. dollar denominated publicly-issued investment-grade corporate bonds in thefinancial sector. **Contingent Capital Securities (CoCos)** are debt or capitalsecurities of primarily non-U.S. issuers with loss absorption contingency mechanisms built into the terms of the security. The **S&P 500® Financials Index** comprises those companies included in the S&P 500® that areclassified as membersof the GICS® financialssector. Contingent Capital Securities (CoCos) are debtor capitalsecuritiesof primarily non-U.S. issuers with loss absorption contingency mechanisms built into the termsof thesecurity. The **ICE BofA Capital Securities Index** tracks the performance of U.S. dollar-denominated investment-grade corporate debt publicly issued in the U.S. domestic market, consisting of fixed-to-floating-rate, perpetual callable and capital securities. **Option adjusted spread (OAS)** is the constant spread that when added to all discount rates from the treasury curve on the binomial interest rate tree model (used by the indices) will make the theoretical value of the future cash flows equal to the market price of the instrument. **It is not possible to invest directly in an index.** Clients should consult their financial professional regarding unknown financial terms and concepts.

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