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Separately Managed Accounts | Global Fixed Income

Preferred Securities Select

Marketing communication | As of 30 Jun 2026

Key takeaways

- During the second quarter, the Preferred Securities Select SMA strategy posted a positive absolute return and outperformed its benchmark, the ICE BofA US All Capital Securities Index.
- The preferred securities market returned 2.24% as measured by the ICE BofA US All Capital Securities Index.
- Coupon structure allocation and duration positioning primarily contributed to this quarter's relative outperformance versus the benchmark.

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Market review

U.S. economic growth remained healthy in the second quarter, supported by a steady labor market, slightly lower unemployment and a robust pace of job creation. The dominant theme shaping fixed income markets, however, was the U.S.–Iran war, which sparked a sharp increase in oil prices early in the quarter and brought stagflation concerns to the forefront. That narrative shifted meaningfully in mid-June when an interim peace deal was signed, triggering a collapse in oil prices, receding stagflation fears and a broad rally in both bonds and risk assets. Inflation moved materially higher over the period, with the most recent Consumer Price Index running above 4% year-over-year, reflecting the volatility in energy prices. Although rising inflation weighed on consumer purchasing power, U.S. spending proved resilient, with real consumer spending rebounding to approximately 2.0% annualized in the second quarter after tracking near 0.5% annualized in the first.

The rate backdrop was volatile for the quarter, with the 10-year Treasury yield peaking at 4.68% in mid-May before retreating to end the period only 14 basis points higher at 4.44%. Yields rose more sharply at the short end of the curve, as expectations for Federal Reserve (Fed) rate cuts gave way to anticipation of at least one hike. Two-year Treasury yields rose 35 basis points over the quarter, while 30-year yields finished only three basis points higher.

The shift in rate expectations was catalyzed by the first meeting under new Fed Chair Kevin Warsh in June, which struck a more hawkish tone than markets anticipated. While Fed policymakers continued to hold rates steady in the 3.50%–3.75% range, they upgraded their median core inflation forecast for the year to 3.3%, and half of the 18 committee members favored a rate increase by year-end. Sticky inflation, resilient economic data and a solid labor market underpinned this shift. Other global central banks broadly signaled more hawkish intentions as well. The European Central Bank (ECB) and Bank of Japan (BoJ) each raised rates by 25 basis points in June, while the Reserve Bank of Australia delivered its third consecutive hike in May before pausing to assess the impact. Despite the volatile rate environment, credit spreads tightened, leading to positive total returns across fixed income asset classes. The broad-based Bloomberg U.S. Aggregate Bond Index returned 0.67% for the quarter.

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The asset class, represented by a Custom Index that encompasses the preferred securities and U.S. dollar-denominated contingent capital securities (USD CoCos) markets, returned 2.74% in the second quarter. The index outperformed financial senior debt, but materially underperformed financial equities. Given the hybrid nature of this asset class, we expect performance to typically fall between senior debt and equities from the same issuers. For context, the Bloomberg U.S. Credit-Financial Institutions Index returned 1.43% for the quarter, while the S&P 500 Financials Sector Index returned 9.00%.

Within the asset class, $25 par preferreds underperformed both $1000 par preferreds and USD CoCos, returning 1.3% for the quarter versus 2.6% and 3.5%, respectively. This marked the third consecutive quarter in which $25 par preferreds performance lagged the other two segments. The underperformance primarily reflected the segment's longer duration profile at a time when interest rates moved meaningfully higher. At quarter-end, the average duration of the $25 par preferred segment was roughly nine years, more than double the effective duration of the $1000 par preferred and USD CoCo segments (4.3 years and 3.8 years, respectively). Exacerbating $25 par preferreds relative underperformance, the average option-adjusted spread (OAS) for $25 par preferreds was unchanged during the quarter, while OAS decreased by 38 basis points for $1000 par preferreds and 63 basis points for USD CoCos. Despite continued underperformance, $25 par preferreds still screen rich versus the other segments. At quarter-end, their average OAS was 144 basis points, below 161 basis points for $1000 par preferreds and 202 basis points for USD CoCos. From a relative-value standpoint, we continue to view $1000 par preferreds and USD CoCos as more attractive, especially on a risk-adjusted basis.

Despite the precarious U.S.–Iran negotiations and other lingering geopolitical uncertainty during the quarter, sector-specific news for banks and insurance companies, the two largest sectors in our market, remained relatively benign. Banks, the largest issuers of preferred and USD CoCo securities, reported first-quarter 2026 earnings that generally exceeded expectations, extending a trend of positive earnings surprises across multiple quarters. The quarter also brought the release of the 2026 U.S. bank stress test results, which covered 32 of the largest U.S. banks. As in previous years, these banks demonstrated strong resilience under dire hypothetical situations, absorbing more than $700 billion in aggregate losses with capital ratios declining by an average of just 1.6% under the severely adverse scenario. Key assumptions embedded in the severely adverse scenario included unemployment rising to 10%, home prices declining by 30%, commercial real estate prices falling nearly 40% and equity prices dropping 60%.

First-quarter earnings from the insurance sector, the second-largest segment of our market, were also strong, with both property and casualty (P&C) and life insurers performing well. The P&C category continued to benefit from a decade-long trend of larger carriers reducing exposure to catastrophe-prone geographies. With limited exposure in the Southeast and West Coast, the sector has been relatively insulated from insured losses tied to hurricane activity and California wildfires. In the life insurance segment, product demand remained robust, supported by post-pandemic trends. Life insurers have also benefited from record annuity issuance in recent years, with annuity sales reaching approximately $450 billion in 2025. Annuities align naturally with the aging demographic in the United States and other developed economies. Also, the still-elevated rate environment allows many annuity products to offer meaningfully higher income streams compared to the prolonged low-rate period following the Global Financial Crisis. Overall, our outlook for both the bank and insurance sectors remains constructive.

Portfolio review

During the second quarter, the Preferred Securities Select SMA strategy posted a positive return and outperformed its benchmark, the ICE BofA US All Capital Securities Index, on a gross and net of fees basis. On an absolute basis, coupon income was the largest contributor to total return, spread return was a meaningful contributor and duration was a detractor. On a relative basis, the strategy's outperformance was primarily driven by coupon structure allocation but, to a lesser extent, interest rate positioning also contributed.

Coupon structure positioning helped drive relative outperformance this quarter, driven by the strategy's roughly 25% underweight to fixed-rate coupon structures and a corresponding 22% overweight to securities with coupon reset features. This positioning proved beneficial to the strategy, as fixed-rate coupon structures significantly underperformed securities with coupon resets during the quarter.

The strategy's interest rate positioning also modestly contributed to relative performance this quarter. While the

strategy benefited from its shorter duration profile relative to its benchmark — with a portfolio duration of 3.0 years at quarter-end, roughly 2.6 years shorter than the benchmark — this benefit was largely offset by yield curve positioning. Although U.S. Treasury yields increased during the quarter, they did not move in unison and the curve flattened as two-year, 10-year and 30-year Treasury yields rose 35, 14 and 3 basis points, respectively. Relative to its benchmark, the strategy was overweight interest rate exposure at the short end of the curve and underweight at the long end. As the curve flattened, this yield curve positioning detracted, offsetting most of the benefit of the strategy's duration underweight.

Additionally, security selection within the banking sector was additive to relative performance. Some of this contribution stems from the strategy's underweight to fixed-rate coupon structures, but the primary driver was the strategy's underweight to callable $25 par securities. Low-coupon securities that have extended past their first call date also tend to carry significant interest rate sensitivity. Despite remaining callable, these securities are typically left outstanding by issuers as a lower-cost source of financing. The strategy's underweight to these securities proved beneficial, as the sharp rise in rates this quarter caused high-duration securities to underperform.

Trading activity was limited this quarter. In April, the strategy initiated two new positions: Charles Schwab 6.1% and Ally Financial 7.1% perpetual preferred securities. The strategy also continued to rotate out of short-call positions and into securities with longer call protection, though it executed fewer such swap trades than in prior quarters.

Outlook

Despite ongoing uncertainty related to the U.S.–Iran conflict, negative headlines in private credit, trade friction from U.S. tariff policy and the ongoing Russia–Ukraine war, we remain constructive on the U.S. economic outlook. In our view, consumer resilience and meaningful fiscal stimulus expected to flow into the economy later this year from the One Big Beautiful Bill Act should provide ample support.

We are similarly constructive on the global banking sector, the largest issuer in our market, which has meaningfully reduced risk relative to pre-pandemic levels. In the United States, we also expect increased merger and acquisition activity among small- and mid-sized banks. Greater scale and diversification should further strengthen the banking sector. Our outlook for the insurance sector — the second-largest issuer within our benchmark — also remains positive. We see several supportive factors, including historically high risk-based capital levels, enhanced regulatory oversight, a business model that benefits from higher interest rates, and record annuity sales over the past four years. In addition, as noted above, most P&C insurers have reduced exposure to high-risk geographies in recent years, shifting more of those risks to state and/or federal government insurance programs. While our current concerns for the asset class are primarily macroeconomic, the largest sectors in our market are positioned well to weather volatility should economic conditions deteriorate.

Although average OAS across preferred market segments ended the quarter below longer-term median levels, we remain constructive on the asset class's relative value narrative. In our view, current valuations are supported by both strong fundamentals and technicals. Within the market, we continue to prefer $1000 par preferreds over $25 par preferreds for two reasons. First, OAS levels are meaningfully higher in this segment than in $25 par preferreds. Second, on a risk-adjusted basis, $25 par preferreds carry more than double the average duration of the other category. As a result, the average OAS and yield per unit of duration for $25 par preferreds compare unfavorably with opportunities in $1000 par preferreds. Importantly, this valuation gap is not driven by tax treatment differences: QDI-eligible securities exist within both the $25 par preferred and $1000 par preferred segments.

Recent signs of renewed inflationary pressures following the U.S.-Iran conflict and lingering tariff effects have led investors to scale back expectations for Fed cuts in 2026. At the start of the quarter, the market implied a high probability of one 25-basis-point cut in 2026. By quarter-end, fed funds futures had priced in one or two 25-basis-point hikes before year-end 2026.

We continue to monitor employment data closely, as consumer spending represents approximately 70% of U.S. economic activity and remains a key indicator of overall economic health. The unemployment rate has remained broadly stable year-to-date, while recent JOLTS job openings data actually came in above expectations, returning to a ratio of more than one job opening per

unemployed worker. As of this writing, we estimate the probability of a U.S. recession over the next 12 months at approximately 25%, which represents the low end of the range we have cited in recent quarters.

From a technical standpoint, we expect a modest amount of net positive supply in the near term. Utility issuers, in particular, must balance capital expenditures related to artificial intelligence (AI) against rising leverage and potentially punitive rating-agency actions. Issuing hybrid securities that receive equity-content treatment from rating agencies is an effective way to raise capital while limiting incremental balance-sheet leverage. We expect the market to absorb this hybrid supply, especially because much of it should be eligible for investment grade or high yield corporate bond indexes, broadening demand beyond traditional preferred investors. Also, the much-anticipated Basel III proposals were released by the Fed and FDIC last quarter, which included updated capital guidelines for U.S. banks. If implemented, we estimate U.S. banks could issue roughly $13 billion of additional preferred securities to optimize their capital stacks. We also expect this supply to be well received, given that bank-issued preferreds generally pay tax-advantaged, QDI distributions that are attractive to tax-sensitive investors.

Absent a material change in the market environment, we expect to maintain the strategy's current positioning relative to the benchmark. We continue to believe an underweight to $25 par preferreds relative to $1000 par preferreds is appropriate given current valuations. We also maintain our preference for securities with coupon-reset features. Relative to fixed-rate structures, coupon-reset securities carry lower duration-extension risk, and in the current elevated rate environment, securities approaching their reset dates stand to benefit from higher reset coupons.

We also continue to overweight financials and underweight industrials as a defensive positioning choice. The financial sector is dominated by highly regulated industries: banks and insurers are subject to stringent oversight, and most banks also undergo regular and rigorous stress testing. For these reasons, we continue to prefer more highly regulated industries over those with less government oversight, which supports our financials overweight and offsetting industrials underweight.

That said, we will likely use periods of market weakness to add spread duration 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.

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Glossary

*The Custom 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 the financial sector. The **S&P 500® Financials Index** comprises those companies included in the S&P 500® that are classified as members of the GICS® financials sector. The **ICE BofA U.S. All Capital Securities Index** is a subset of the ICE BofA U.S. Corporate and U.S. High Yield Index including all fixed-to-floating rate, perpetual callable and capital securities, and fixed-rate preferred securities. 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. **Contingent capital securities (CoCos)** are debt or capital securities of primarily non-U.S. issuers with loss absorption contingency mechanisms built into the terms of the security. **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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