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Fixed income perspective: preferred securities



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An often overlooked asset class, preferred securities can offer higher, tax-advantaged income potential compared to other fixed income sectors. Primarily investment grade securities, their low correlation to other fixed income sectors and equities may also strengthen portfolio construction in an uncertain environment. Market inefficiencies may also provide opportunities to add alpha in actively managed strategies.

As the U.S. Federal Reserve continues to cut interest rates, investors will continue to seek higher yielding fixed income asset classes. We believe preferred securities offer many additional benefits, including:

- Tax-advantaged income potential, since many preferred security structures pay qualified dividend income (QDI)
- Predominantly investment grade securities to help manage credit risk
- Reduced interest rate sensitivity through non-fixed-rate coupon structures
- Inefficiencies that may create alpha opportunities for active managers
- Solid fundamentals of the banking and insurance sectors, the largest segments of the preferred universe

WHAT IS A PREFERRED SECURITY?

Preferred securities don't fit neatly into a traditional asset allocation category, as they contain features of both stocks and bonds. A preferred security can be classified as either debt or equity on the balance sheet, depending on its features. The easiest way to identify preferred securities is by their placement within the corporate capital structure.

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Figure 1 illustrates how preferreds typically reside on the boundary between debt and equity. In a bankruptcy or liquidation, preferred security owners have a higher priority than common stock owners, but a lower priority than senior debt holders. They will be paid only if there is money left after senior creditors have been made whole.

Preferred securities trace back to the 16th century in England and the 1850s in the United States. However, in the 1980s the asset class evolved from a financing tool for highly regulated utilities to an important financing vehicle and capital instrument for financial institutions.¹ Since then, the preferred securities market has experienced significant growth and a change in issuer composition.

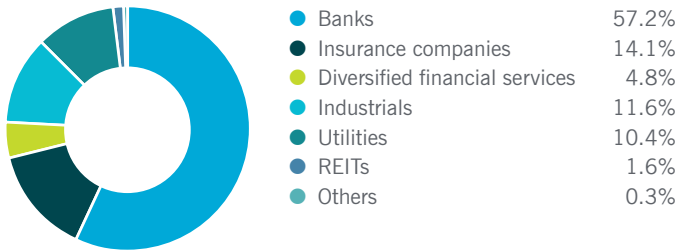
Financial institutions now make up most of the preferred universe (Figure 2). Since 2008, banks and brokerage firms (U.S. and international) have issued preferreds en masse to replenish capital depleted by housing and subprime losses during the Global Financial Crisis. Insurance companies also issue preferreds to meet regulatory capital requirements.

Figure 1: Preferred securities straddle debt and equity

	Class	Seniority
Debt	Secured debt	↓
	Unsecured debt	
	Unsecured subordinate debt	
	Hybrid securities & tier 2 securities	
Equity	Preferred stocks & additional tier 1 securities	↓
	Common stocks	

Source: Standard & Poor's.

Figure 2: Financial institutions dominate the market



Data source: Bloomberg L.P., 30 Sep 2025. Based on 60% ICE BofA U.S. All Capital Securities Index/40% ICE USD Contingent Capital Index.

TYPES OF PREFERRED SECURITIES

A preferred security’s combination of features will classify it as either an equity or a fixed income security, but most preferred securities have elements of each. For example, some preferred securities generate income in the form of interest, while others generate income in the form of dividends. Other common features are shown in Figure 3.

Contingent capital securities (CoCos) are hybrid securities created by regulators after the financial crisis as a way to help undercapitalized banks. CoCos are primarily issued by European financial institutions to help fulfill their capital requirements, while U.S. banks issue preferred stock. Because CoCos and preferred stock play nearly identical roles and rank similarly within an issuer’s capital structure, CoCos are commonly held in strategies that invest in preferred securities.

POTENTIAL BENEFITS OF PREFERRED SECURITIES

Preferred securities offer relatively attractive tax-advantaged income potential. As a high-quality investment, they can enhance portfolio diversification while maintaining only moderate sensitivity to interest rate changes. This compelling combination has generated significant investor interest in the asset class.

Figure 3: Multiple structures exist in the preferred market

Feature	Senior notes	Hybrids	Traditional preferred stock*	Common stock
Character	Debt	Debt	Equity	Equity
Priority of claims	Senior to hybrids, preferreds and common equity	Senior to preferreds and common equities; junior to all other debt	Junior to all debt; senior to common equity	Junior to debt and preferred
Nature of payment	Interest	Interest	Dividend	Dividend
U.S. Tax advantage	None	Mostly non-QDI	DRD ² /QDI ³	DRD ² /mostly QDI ³
Term	Dated	Usually 60 years or longer	Perpetual	Perpetual
Payment deferral option	None	Yes, up to 10 years	Yes, indefinite	Yes, indefinite
Cumulative/noncumulative	N/A (no deferral option)	Cumulative	Mostly noncumulative	Noncumulative

Data source: Preferred Securities Primer, BofA Global Research, 20 May 2024, Nuveen. *REIT preferreds have all the same characteristics with some exceptions. They are not DRD or QDI eligible (but they are eligible for a 20% deduction under 2017 tax reform) and they have cumulative dividends.

Attractive relative yields

Because they are lower in the capital structure and thus carry more subordination risk, preferred securities generally contain wider credit spreads and pay a higher level of income than their more senior debt counterparts. They have historically offered more income-generating power than equities and most fixed income asset classes on a taxable-equivalent basis.

Tax-advantaged income potential

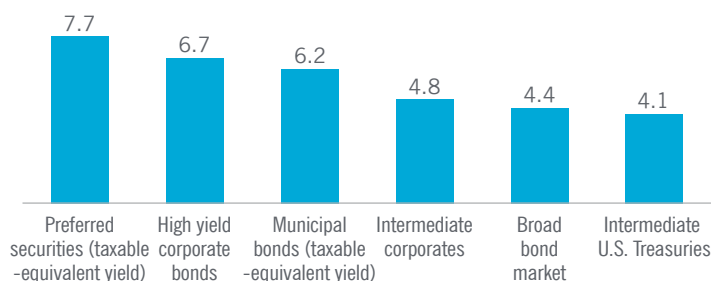
Since preferred securities are stock/bond hybrids, certain preferred securities generate income eligible for qualified dividend income (QDI) tax treatment. QDI-eligible income is typically created by common stocks and taxed at the lower capital gains tax rate. By contrast, income from traditional fixed income investments is taxed at ordinary income tax rates.

Most dividends are classified as either ordinary (unqualified) or qualified, with the primary difference being the rate at which the dividends are taxed. Ordinary dividends, like interest income, are taxed at an investor's federal income tax rate, which ranges from 10% to 37% for 2025. Qualified dividends are taxed at the long-term capital gains rate of 0%, 15% or 20% for the 2025 tax year, depending on the investor's tax bracket. Therefore, investors may see a significant tax savings and higher after-tax return with qualified dividends versus ordinary dividends or interest income, regardless of their income tax bracket.

As shown in Figure 4, QDI eligible preferreds offer higher taxable-equivalent yield than other fixed income sectors, including high yield corporate bonds.

Figure 4: Preferred securities can offer attractive, tax-advantaged income potential

Yield-to-worst (%)



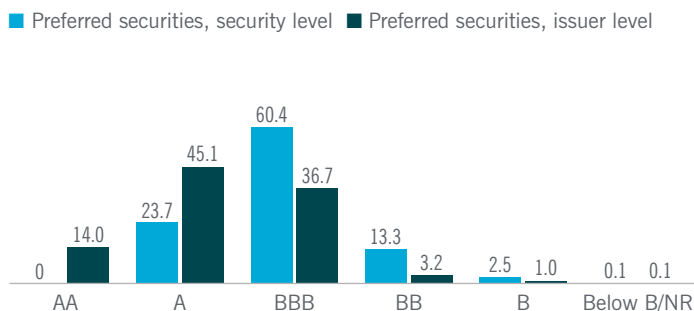
Data source: Bloomberg L.P., 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: **preferred securities**: ICE BofA U.S. All Capital Securities Index; **high yield corporate bonds**: Bloomberg U.S. High Yield 2% Issuer Capped Index; **municipal bonds**: Bloomberg Municipal Bond Index; **intermediate corporate bonds**: Bloomberg Intermediate Corporate Index; **broad bond market**: Bloomberg U.S. Aggregate Bond Index; **intermediate U.S. Treasuries**: Bloomberg 7-10 Year U.S. Treasury Index. The tax treatment of dividends is subject to change based on changes in tax rules and regulations. Chart shows yield-to-worst adjusted for applicable tax rates. For municipals, taxable-equivalent yield calculations use 37% federal income tax and 3.8% Medicare surtax rates. Preferred securities calculations assume all income is QDI-eligible and is taxed at the 20% QDI rate plus 3.8% Medicare surtax rate. Municipal bond income is not subject to federal income taxes or Medicare taxes.

A high quality investment

Preferred securities are generally issued by high quality companies. Due to their subordinate capital structure position, preferreds may be rated 1 to 5 quality notches lower than the senior debt of the same issuer. For instance, an entity issuing a preferred security rated BB would typically have investment grade senior unsecured debt rated BBB or higher. Although preferred securities are lower in the capital structure than traditional bonds, many are investment grade in nature. They may produce a higher yield than investment grade corporate bonds without the credit risk of a below-investment-grade, high yield bond.

Figure 5 shows how the quality of the company issuing the preferred securities is typically much higher than the rating of the individual securities. For example, most individual preferred securities are rated BBB, but most companies issuing preferred securities are A rated.

Figure 5: Preferreds are predominantly from high quality issuers and rated investment grade (%)



Data source: FactSet, Nuveen, 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Breakdown of the credit quality of the constituent components of the ICE BofA U.S. All Capital Securities Index; security and issuer level ratings based on the highest rating of Standard & Poor's, Moody's, Fitch, A.M. Best or DBRS Morningstar (security level only). AAA, AA, A and BBB are investment grade ratings; BB, B, CCC/CC/C and D are below-investment-grade ratings.

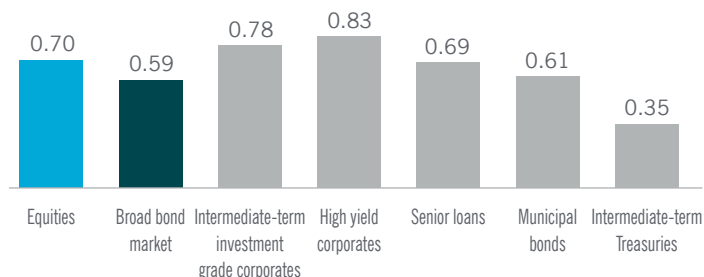
Increased diversification

Since preferred securities include features of both bonds and stocks, the asset class exhibits relatively low correlation to both traditional fixed income and equity categories, as shown in Figure 6. In addition, there is little issuer overlap between preferred securities and high yield corporate bonds/senior loans. These two sectors have little exposure to banks and insurance companies, which

are the largest issuers of preferred securities. Thus, an allocation to preferred securities could help diversify a portfolio with exposure to higher yielding credit sectors.

Figure 6: Preferreds may improve portfolio diversification

10-year correlation



Data source: Morningstar Direct, 01 Oct 2015 to 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: preferred securities: ICE BofA U.S. All Capital Securities Index; equities: S&P 500 Index; broad bond market: Bloomberg U.S. Aggregate Bond Index; intermediate-term investment grade corporates: Bloomberg Intermediate Investment Grade Corporate Index; high yield corporates: Bloomberg U.S. High Yield Corporate Bond Index; senior loans: Morningstar LSTA U.S. Term Loan Index; municipal bonds: Bloomberg Municipal Bond Index; intermediate-term Treasuries: Bloomberg 7-10 Year U.S. Treasury Index. Correlation ranges between -1 and +1. A correlation coefficient of +1 implies that as one security moves, either up or down, the other security will move in the same direction. A correlation coefficient of -1 means that if one security moves in either direction the other security will move in the opposite direction. Correlation of 0 means the movements of the securities are completely random.

Moderate sensitivity to interest rate changes

Managing interest rate risk remains critical. For fixed rate coupon bonds, when interest rates increase, bond prices decrease, and vice versa, all else being equal. However, different types of bonds have varying sensitivities to changes in interest rates. Since most preferreds have longer-dated maturities (many are perpetual), it may seem counterintuitive that their effective durations, a measure of interest rate risk, tend to be more intermediate-term.

There are two main reasons for this: Most preferred securities are callable, which can significantly shorten their duration profile. And preferred securities are often issued with non-fixed-rate coupons that fluctuate with interest rate changes after a preset number of years, making them less sensitive to rate changes, all else being equal. This factor can play an even greater role in reducing duration, all else being equal.

The modest duration profile allows investors to benefit from higher yields without necessarily assuming more interest rate risk than a typical core bond portfolio. In fact, \$1000 par preferreds and contingent capital securities (CoCos) have lower duration on average than the broad bond market (Figure 7). Preferred securities may earn more income per unit of duration, also making their yield opportunity even more compelling on a risk-adjusted basis.

Different available coupon structures

Preferred securities are issued with a number of different coupon structures that active managers can use to help adjust the portfolio for changing rate environments.

Fixed rate coupons generally pay a specified coupon rate for life. These structures can be beneficial when rates are expected to decline, as the coupon will remain more valuable and provide constant income during low rate periods.

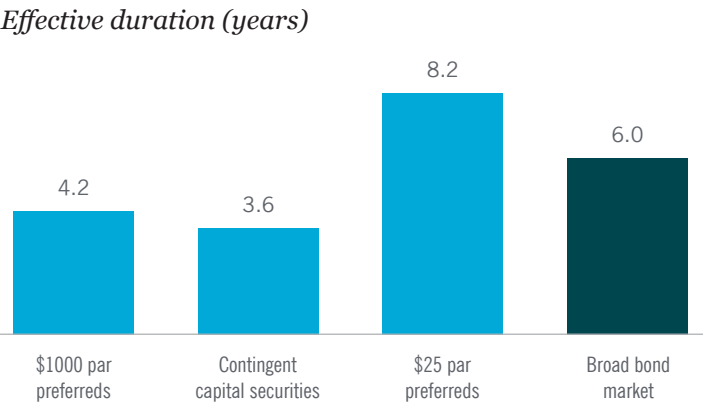
Fixed-to-floating rate coupons pay a fixed coupon for a preset number of years (commonly 5 or 10), then convert to a floating rate coupon for the remaining life of the security or until it is called. The floating rate coupon is based on a benchmark rate, such as 3-month SOFR, plus a predetermined

spread set when the security is issued. Once it converts to a floating rate structure, the coupon will generally reset every three months.

Fixed-to-fixed rate coupons also pay a fixed coupon for a preset number of years, then reset at regular intervals (typically five years) to another fixed rate. The reset rate is based on a market rate plus a margin. For example, a Citigroup preferred security was issued in 2025 with a fixed coupon of 6.875% until 2030, when it resets to the 5-year Treasury rate plus 2.89%.

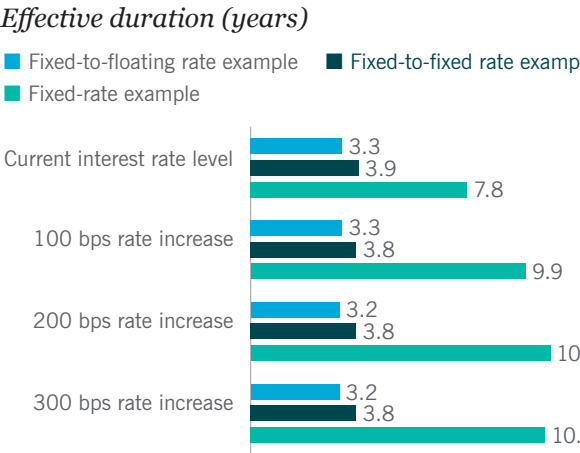
Compared to fixed-rate coupon structures, fixed-to-floating and fixed-to-fixed rate coupon structures typically experience less duration extension when rates rise. This feature makes them less sensitive to rate changes in a rising rate environment. They usually experience better relative price performance (Figure 8), since the prices of lower duration bonds are less affected by rising rates. Lastly, the floating and resetting rate nature of the coupons allows the securities to capture increases in interest rates, because the coupon should increase with interest rates.

Figure 7: The universe is generally intermediate-term in nature



Data source: Bloomberg, L.P., 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$1000 par preferred: ICE BofA U.S. Institutional Capital Securities Index; contingent capital securities: ICE USD Contingent Capital Index; \$25 par preferred: ICE BofA Core Plus Fixed Rate Preferred Index; broad bond market: Bloomberg U.S. Aggregate Index.

Figure 8: Securities with adjustable rate coupons remain less sensitive to interest rate changes



Data source: FactSet, 30 Sep 2025. Assumes immediate parallel shift of the 30 Sep 2025 yield curve with OAS (option-adjusted spread) and volatility held constant. Performance data shown represents past performance and does not predict or guarantee future results. Hypothetical scenarios are for informational purposes only. Scenario data is provided by a third-party source believed to be reliable. Securities mentioned are used as examples for educational/informational purposes only; inclusion does not constitute a recommendation to buy or sell or imply inclusion in any Nuveen investment vehicle.

DISTINCT MARKET SEGMENTS MAY CREATE ALPHA OPPORTUNITIES

In addition to the various structures detailed in Figure 3, the more than \$500 billion U.S. preferred securities market comprises two types of issues:⁴

- **\$25 par value securities** target retail investors and trade on the major stock exchanges.
- **\$1000 par value securities** target institutional investors and trade over the counter.

These distinct market segments create alpha opportunities for professional asset managers as they strategically allocate between denominations.

Investors price risk differently

The most notable distinction between these segments is the way each type of investor evaluates and prices risk.

Retail investors in the \$25 par market typically focus only on the coupon rate when evaluating preferred securities, often overlooking (or even disregarding) duration and other important metrics. As they chase yield, they tend to drive up prices of \$25 par securities with above-market coupon rates.

Some of the oldest and largest passive preferred ETFs invest exclusively in \$25 par securities, amplifying this demand when they experience inflows, regardless of valuation levels. This can distort \$25 par pricing.

The problem intensifies as the \$25 par market shrinks, a trend we believe will likely continue. \$25 par securities now represent just 31% of the U.S. preferred universe, down from 52% in 2012.⁵ With passive ETF growth and retail investors' income focus, more money chases a declining universe, limiting opportunities in this segment.

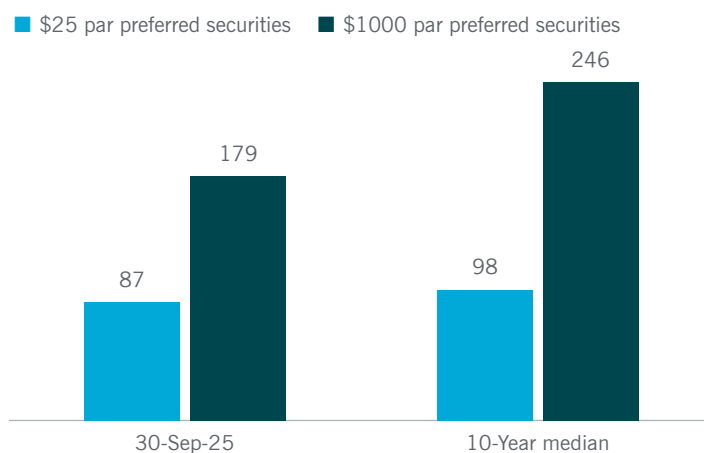
Institutional investors in the \$1000 par market typically value securities based on option-adjusted spread (OAS) – the yield difference to similar-

duration, risk-free U.S. Treasuries, adjusted for the effect of any call provisions. They evaluate their investments on a risk-adjusted basis and often compare opportunities across asset classes. This more sophisticated approach captures true relative value.

These differing dynamics create significant valuation gaps. \$25 par preferreds currently trade at richer levels (lower OAS) than \$1000 par preferreds – a pattern persisting for at least a decade, as shown by 10-year median OAS levels (Figure 9). This demonstrates how retail investors and ETFs distort \$25 par pricing, especially as the investible universe shrinks. Active managers with flexible mandates can allocate to the cheaper \$1000 par market, providing more compelling risk-adjusted opportunities.

Figure 9: \$1000 par preferreds have traded consistently cheaper

Option-adjusted spread (bps)



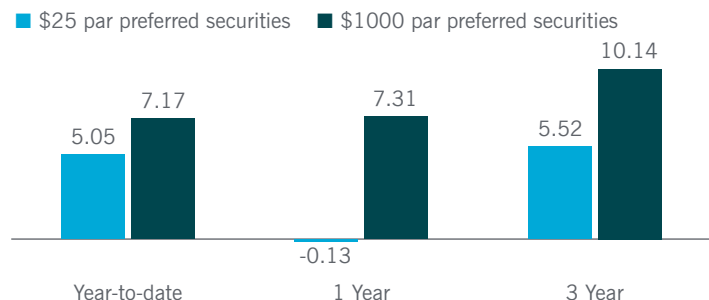
Data source: Bloomberg, L.P., 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$25 par: ICE BofA Core Plus Fixed Rate Preferred Index; \$1000 par: ICE BofA U.S. Institutional Capital Securities Index.

\$1000 par market has outperformed over time

Higher OAS in the \$1000 par market has translated to dramatic outperformance over time (Figure 10).

Figure 10: \$1000 par securities have delivered superior returns

Total return (%)



Data source: Bloomberg, L.P., 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$25 par: ICE BofA Core Plus Fixed Rate Preferred Index; \$1000 par: ICE BofA U.S. Institutional Capital Securities Index.

ACTIVE MANAGEMENT MAY OFFER ADDITIONAL ADVANTAGES

Managers may proactively control call risk

Almost all preferred securities include call provisions. Issuers typically call securities when they hold excess capital or can refinance outstanding securities at lower rates – usually following interest rate declines or tighter credit spreads.

Without active call management, investors may face lumpy principal returns, potentially at times when reinvestment interest rates are unattractive. Investors who do not monitor call dates may unknowingly be exposed to this concentrated reinvestment risk. Active managers typically proactively stagger call risk, reducing reinvestment risk exposure at any single point in the interest rate cycle.

Scheduled calls of preferred securities trading at premiums may also trigger losses, especially when investors are not actively monitoring yields-to-

call – a more common occurrence in the \$25 par market. Active managers have the experience and flexibility to mitigate these risks.

International markets expand opportunity

Non-U.S. entities issuing U.S. dollar-denominated securities represent 44% of the global USD preferred universe.⁶ Retail investors typically ignore, overlook or remain unaware of this segment, which is predominantly institutional \$1000 par securities. Including these securities may increase diversification and expand the search area for compelling risk-adjusted opportunities.

OUTLOOK: WHY WE FAVOR PREFERRED SECURITIES NOW

We see opportunities to redeploy capital into higher-yielding preferred securities. Preferred securities can continue delivering attractive risk-adjusted, after-tax returns due to support from solid credit fundamentals, relatively muted supply and strong demand for high-quality, tax-advantaged income solutions.

Solid fundamentals

We remain constructive on banks and insurers, the two largest segments of the preferred universe. Banks are notably strong and significantly derisked compared to pre-pandemic levels. All 22 participating U.S. banks passed the Fed's June 2025 stress test as expected, demonstrating capacity to absorb over \$550 billion in losses above regulatory minimums and continue lending under dire economic conditions.⁷

Third quarter U.S. bank earnings met or exceeded expectations across most metrics. While a handful of private credit-type losses sparked concerns about systemic credit issues in late 2025, these appear idiosyncratic and limited in nature. We anticipate increased M&A activity among smaller and mid-sized U.S. banks, which should create larger, more diversified institutions and greater sector stability. Unlike many industries, tariffs only indirectly impact banks through their effect on the consumer and the broader economy.

Insurance also has a positive outlook. Insurers maintain historically high risk-based capital levels, offer the added protection of regulatory oversight, and naturally benefit from higher interest rates. Third quarter earnings were strong across both property and casualty (P&C) and life subcategories. P&C companies benefited from major players' decade-long exit from catastrophe-prone geographies. With limited Southeast and West Coast exposure, the P&C industry has been insulated from recent hurricane and California wildfire losses.

Traditional life insurers saw healthy demand continue since the pandemic's onset and benefited from record annuity issuance. As of November 2025, total annuity sales for calendar year 2025 were estimated to reach nearly \$500 billion.⁸ Annuities naturally fit aging demographics in the U.S. and developed economies, while today's elevated rates allow significantly higher payouts than the post-Crisis low-rate era. Like banks, insurers also have minimal tariff exposure.

Supportive technicals

We expect modestly positive net supply. Bank net issuance will remain muted as most maintain capital levels comfortably above regulatory requirements.

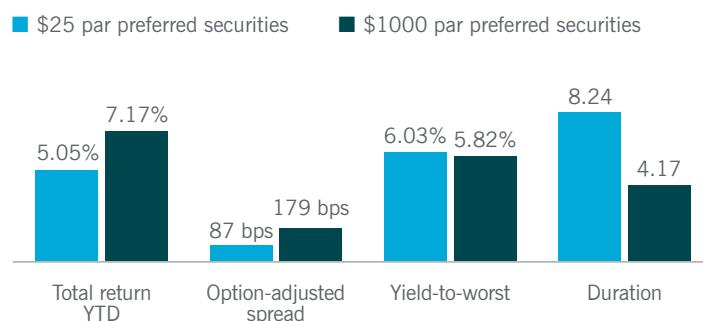
However, we anticipate an increase in hybrid supply. Gross corporate hybrid issuance will finish 2025 at \$38 billion and is expected to increase 45% to \$55 billion in 2026.⁹ Moody's aligned its hybrid securities equity treatment with S&P and Fitch in early 2024. Before this alignment, issuers seeking 50% equity treatment from Moody's for a subordinate security were required to issue preferred stock. Hybrid interest payments are tax deductible for the issuer, like a bond, while preferred stock dividends are paid with after-tax dollars. As a result, some issuers have been refinancing preferred stock with the less expensive hybrid securities.

Utility and energy sector capital expenditures will likely increase meaningfully in response to AI-driven power demand. To protect ratings, these companies must manage leverage. Since the Big 3 rating agencies now treat hybrids as 50% equity, these securities serve a dual purpose: they

provide the proceeds necessary to fund capital expenditures while mitigating the impact on the issuer's overall leverage profile.

Much of this hybrid issuance will be eligible for investment grade or high yield corporate bond indexes, making the investor base broader than solely dedicated preferred securities mandates. This wave of index-eligible hybrid supply may also spur broader interest in preferred securities, further supporting valuations and enhancing liquidity.

Figure 11: \$1000 par preferred remain more attractive



Data source: Bloomberg, L.P., 30 Sep 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: \$25 par: ICE BofA Core Plus Fixed Rate Preferred Index; \$1000 par: ICE BofA U.S. Institutional Capital Securities Index.

Fair valuations

We believe fundamentals and technicals can continue to support current levels. Despite recent outperformance in 2025, we favor \$1,000 par preferreds for their higher option-adjusted spreads (OAS), attractive income and lower duration (Figure 11). By contrast, \$25 par preferreds have traded at meaningfully lower OAS levels for some time. They also tend to exhibit higher volatility, lower liquidity and longer duration, making them even less attractive on a risk-adjusted basis.

For more information, visit us at [nuveen.com](https://www.nuveen.com).

Endnotes

Sources

1 “Hybrid Capital,” J.P. Morgan, 14 Oct 2014. 2 Dividend Received Deduction allows corporations to deduct 70% of the income received from federal taxable income. Please consult a qualified tax advisor for details on your particular situation. 3 Qualified Dividend Income is taxed at the capital gains rate. 4 Data source: Nuveen, 30 Sep 2025. \$50 and \$100 par securities exist, but they are much less common. 5 Data source: Based on ICE BofA Core Plus Fixed Rate Preferred Index and ICE BofA U.S. Institutional Capital Securities Index, 30 Sep 2025. 6 Data source: Based on ICE BofA U.S. All Capital Securities Index and ICE USD Contingent Capital Index as of 30 Sep 2025, Nuveen. 7 Data source: <https://www.federalreserve.gov/publications/files/2025-dfast-results-20250627.pdf>. 8 Data source: Bloomberg, L.P. 9 Data source: Barclays Research, 16 Dec 2025.

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