Manulife Investments

Preferred securities essential

A high quality investment with **attractive yield**

Amidst an ever-changing global economy coupled with a lower-for-longer interest rate environment, investors are seeking high quality investments with attractive yields.

Preferred securities: A US$2 trillion market

The global preferred securities market is valued at over US$2 trillion.

Over 90% of preferred issuers are rated as investment grade. With yield levels similar to US high yield bonds, preferred securities offer higher credit quality[1].

	Average credit rating	Yield to maturity	2024 return
Preferred securities market	BBB- (Investment grade)	7.1%	9.6%
US high yield bond market	B+ (Non-investment grade)	7.7%	8.2%

Source: Bloomberg, as of 31 December 2024. Past performance is not indicative of future results.

Mispricing in preferred securities offers opportunities for professional investment managers to add alpha for their portfolios

The difference between $25 par and $1,000 par markets

The preferred securities market is primarily comprised of two types of issues: $25 par value securities targeted at retail investors and $1,000 par value securities targeted at institutional investors. $25 par securities are traded on the major stock exchanges, and the denomination of $25 par securities in small sizes enables a retail investor to buy 100 shares for around $2,500. In contrast, $1,000 par securities are traded over-the-counter and are mainly purchased by institutional investors. Its higher denomination also acts as a hurdle for most retail investors.

The domination of retail investors and passive exchange-traded funds (ETFs) for $25 par securities, may lead to higher volatility driven by sentiment and capital flows, which may also create pricing distortions among $25 and $1,000 par securities in the secondary market prices, even if they are from the same issuer with similar terms. The mispricing in preferred securities offers opportunities for professional investment managers to add alpha for their portfolios.

[1] Preferred securities market represented by ICE BofAML US All Capital Securities Index (IOCS), Global high yield bonds represented by ICE BofAML Global High Yield Index (HW00). For illustration purposes only. Past performance is not indicative of future results.

Issued by large enterprises

Utilities

Regulated utilities provide a stable and predictable stream of earnings that are secured by a lack of competition and low sensitivity from commodity prices and the economic cycle.

In the US, the utilities industry is highly regulated, and companies also have clean balance sheets and an average investment grade rating of BBB-, illustrating the higher quality nature.

Communications

The communications industry includes cable, satellite, media and entertainment businesses. With the advent of the 5G era, the entire industry chain is expected to be upgraded concurrently, while expanding the scope of their applications at the same time.

This sector, like the utilities industry, is also regulated by the government and their business is less affected by global trade conditions.

Banks

Banks are the main issuers of the preferred securities market. The balance sheet of the banking industry stands at its strongest level in 50 years while its Tier 1 common capital ratio remains stable.

Despite the low rate environment weighing on the net interest margin of the banking industry, these low interest rates, coupled with continuous economic growth, can benefit loan and overall revenue growth of the banking industry.

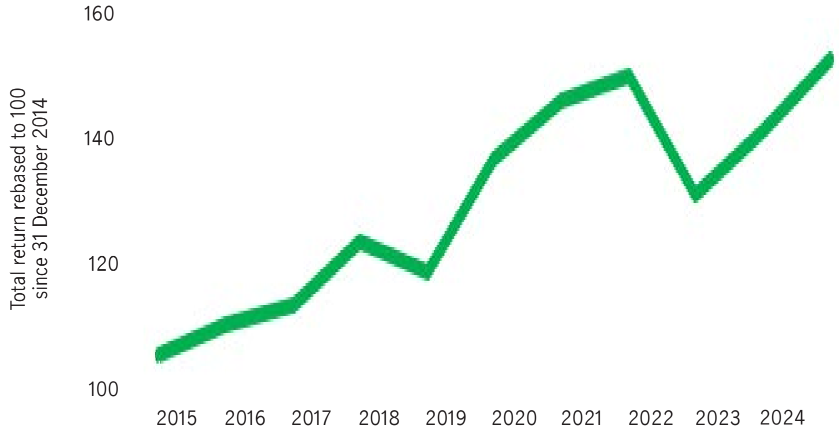
Insurance

Similar to the banking sector, the insurance sector's balance sheet is very healthy. The sector is highly regulated by regulators and has strict guidelines on the level of risk-based capital a company should have. Property and Casualty (P&C) insurance is relatively attractive among insurers, as they are seen as being less sensitive to declining interest rates, and their earnings will likely improve as they are better positioned to increase pricing after recent natural catastrophes.

Source: Bloomberg, as of 31 December 2024. Preferred securities market is measured by ICE BofAML US All Capital Securities Index (IOCS). Industry breakdown follows Bloomberg Barclays Level 2-3 Class classification.

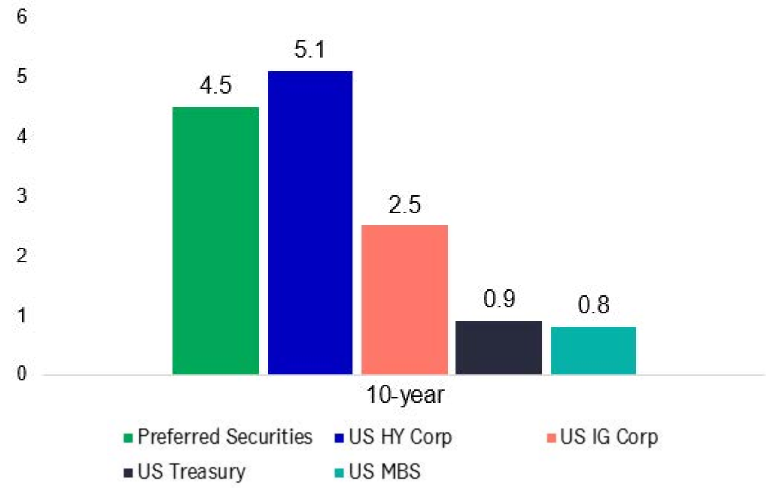
Preferreds offered an annualised
4.5%
total return over the past decade

The preferred market recorded positive returns in eight of the past ten years



Source: Bloomberg, as of 31 December 2024. Performance of preferred securities markets is measured by ICE BofAML US All Capital Securities Index (IOCS). Yield refers to yield to maturity.

Preferreds offered an annualised 4.5% total return over the past decade



Source: Morningstar, Manulife Investment Management, as of 31 Dec 2024. Preferred securities represented by ICE BofA US All Capital Securities Index; US HY Corp represented by ICE BofA US High Yield Index; US IG Corp represented by ICE BofA US Corporate Index; EM Debt represented by ICE BofA Emerging Markets External Sovereign Index; US MBS represented by ICE BofA US Mortgage Backed Securities Index; US Treasury represented by ICE BofA Treasury & Agency Index. For illustrative purposes only. Past performance is not indicative of future performance.

Types of preferred securities

Preferred debt (including subordinated debt and junior subordinated debt)	✓ Normally with regular payouts ✓ Mostly with a maturity date ✓ Non-US investors are not subject to any withholding tax
Traditional preferred stock	✓ Senior to common stock in the capital structure; no voting rights ✓ With a maturity date or perpetual in nature ✓ For dividends: Non-US investors are subject to a withholding tax of about 30% while US investors enjoy a tax advantage
Contingent Convertibles (CoCos)	✓ Must be a perpetual bond ✓ Coupon payments that can be omitted or cancelled at the issuer's discretion ✓ Subject to bond covenants, part or all of the CoCos will be converted to common shares or even cancelled in the event that: 1) An issuer's capital ratio falls below the required level; 2) Regulators believe that the bank's capital ratio is too low

Glossary of preferred securities

Floating rate and fixed-to-float rate	• The coupon of a floating rate security is tied to a short-term benchmark rate plus a premium, such as the 3-month interbank rate plus 400 basis points. • A fixed-to-float rate security pays a fixed coupon for a stated number of years, and then floats. Some reset the coupon rate according every quarterly or semi-annually, for example, 3-month interbank rate plus 300-450 basis points. • This feature has broader appeal for institutional investors given a lower duration and some protection from rising rates.
Cumulative/non-cumulative	• "Cumulative" means that any deferred coupons continue to accrue as a liability to the issuer. Generally speaking, the holders of cumulative preferred securities are entitled to the coupon prior to common shareholders. • For "non-cumulative" securities, the issuer has the right to cancel the coupon due without being in default. • Cumulative preferred securities are senior to non-cumulative preferred securities in the capital structure.
AT1/T2	• Under the Basel III regulations, a bank's capital ratio is composed of three types: Additional Tier 1 Capital (AT1), Tier 2 Capital (T2), and Core Equity Tier 1. • In the capital structure, a Tier 2 bond has the highest priority of claim on an issuer's assets, followed by an AT1 bond and then a common share. In other words, the holders of a Tier 2 bond can receive the proceeds of liquidated assets first, followed by the holders of an AT1 bond and common share respectively. • CoCos, if they fulfill the related requirements, could qualify as either AT1 or AT2 capital of a bank under Basel III.
Callable	• The issuer can redeem the security prior to its maturity. • Callable terms are favourable to issuers as they can redeem and reissue new bonds with a lower coupon in a rate cut environment.
Convertible bond	• Under certain conditions, the issuer can convert the security into common shares.
Perpetual bond	• A bond with no maturity date or a long maturity period. • Most perpetual bonds include early redemption terms. The issuer, for instance, can redeem the bond five years following the issuance with 30 days' notice.
Effective duration	• A bond price is affected by interest rate changes while duration reflects the sensitivity of a bond price to the movement of interest rates. The longer the duration of a bond, the greater its price decline when interest rates increase. • While a traditional bond has one maturity date, some preferred securities have long maturity periods with early redemption terms. These conditions will be reflected in the calculation of "effective duration" to obtain an accurate and effective indicator.

Manulife Investments' investment expertise

30+ years
Investment experience by the US-based lead managers

Established track record with a similar strategy launched in **2002** for institutional clients

Deep fundamental research with **ESG integration**

Source: Manulife Investment Management, as of 31 December 2024.

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