

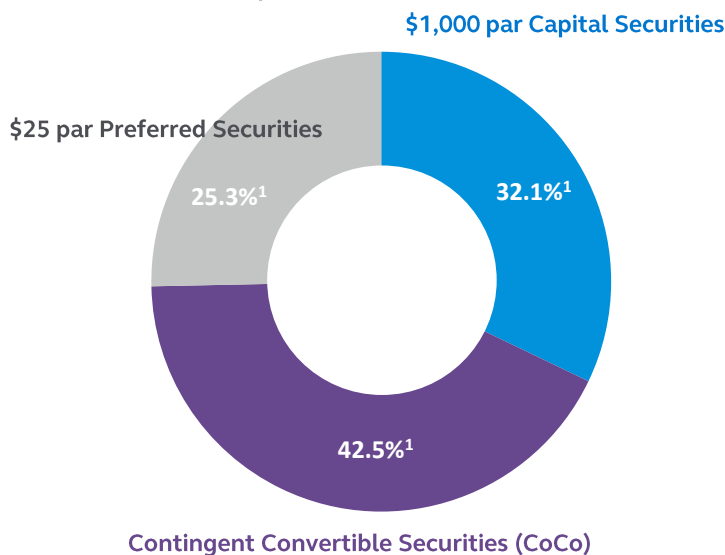
Principal Asset Class Series – Preferred Securities



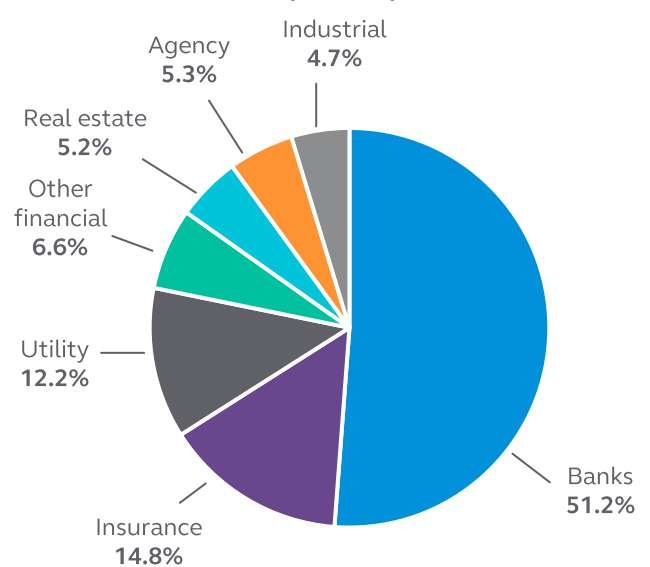
Preferred and capital securities introduction

- Preferred securities and other capital securities are deeply subordinated in the capital structure and can typically defer or skip payments without creating an event of default. They are issued mainly by large banks and insurance companies for regulatory and rating agency capital purposes. Like other fixed income investments, the performance of preferred securities can be affected by interest rates and credit risks.
- Nearly 90% of the senior debt of preferred issuers is investment grade, making preferreds reasonably comparable to high grade rather than below investment-grade fixed income due to better underlying credit fundamentals. Like investment-grade debt, preferred securities have experienced little to no defaults over the past several years.
- There are several types of preferred and capital securities in the market, namely baby bonds, subordinated debt, cumulative junior-subordinated debt and non-cumulative preferred securities, and AT1 contingent convertible (CoCos) capital securities.
- The hybrid securities market can be divided into a retail \$25 par sector and an institutional \$1,000 par capital securities sector. The market for U.S. dollar-denominated preferreds, totaling over US\$500 billion.

Characteristics of the preferred and capital securities market



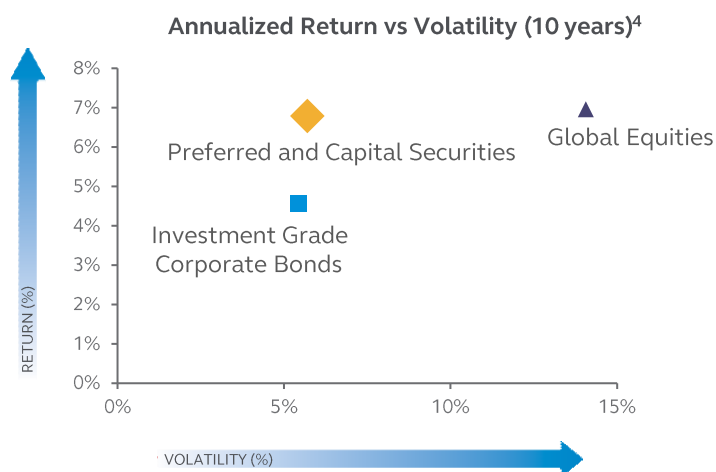
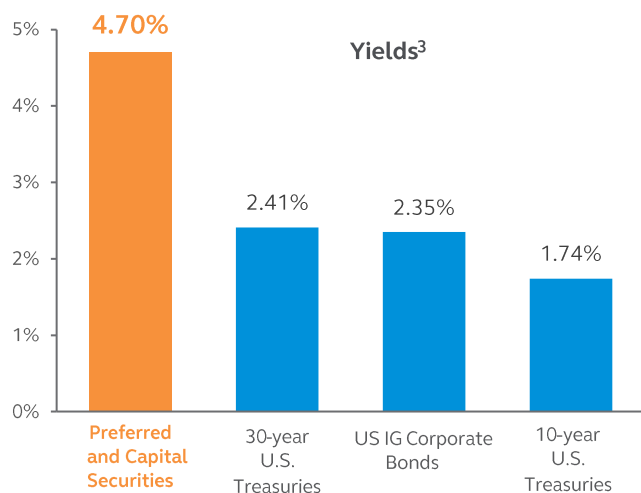
By industry²



Why should preferreds be considered now?

- **Brighter fundamentals:** Credit qualities improved as a result of the economic recovery where expectations on corporate earnings continued to accelerate. Balance sheets of banks and insurance companies may benefit. There have been minimal to no defaults or deferrals as a percentage of junior-subordinated capital security issuance since 2011.

- **Attractive relative yields in regular frequency:** Historically, preferred securities are one of the highest yielding sectors of the fixed income market. Preferreds typically trade at an attractive spread over the same issuer’s senior debt. Demand for subordination premium may continue to be robust given the significant amounts of capital that are looking for returns in a yield starved world.
- **Higher risk-adjusted return capability:** Coupon premium offered due to subordination made up a potentially higher total return matched up to global equities but at a volatility comparable to other fixed income instruments. Preferred securities tend to exhibit less sensitivity to rising interest rates than traditional fixed income asset classes.



Outlook of the preferreds

Country/ Region	Sector
<p>U.S.</p> <ul style="list-style-type: none"> The \$1.9 trillion stimulus in the U.S. will likely supercharge consumer spending and drive GDP expectation for 2021 higher. However, the stimulus and re-openings are threatening inflationary pressure, pushing the 10-year treasury yield much higher in the first quarter. However, we are not expecting the UST 10Y to go significantly higher from here this year. We believe most of the moves have already been baked in. 	<p>Retail \$25 par market</p> <ul style="list-style-type: none"> We continue to see positive flows into Preferreds and Junior Subordinated Capital Securities as the demand for subordination premium remains robust in a low rate environment. The higher volatility in retail can pose challenge for the sector, like what happened in 2020.
<p>Eurozone</p> <ul style="list-style-type: none"> Europe has experienced a double-dip recession in the last two quarters. Yet, most economic indicators suggest that European activity has troughed and should recover from the second quarter onwards. We expect loose central bank policy to continue for some time. With deposit rates unchanged, net interest margin pressure may ease. 	<p>Institutional \$1,000 par market</p> <ul style="list-style-type: none"> The institutional market faces significantly less duration extension risk when compared to the retail market. The best value continues to be in new issue \$1000 par US Preferred sector given spreads and structure and AT1 Cocos.
<p>U.K.</p> <ul style="list-style-type: none"> We expect the U.K. economy to rebound in the remaining of the year, with continued fiscal stimulus, Bank of England support and mass vaccine distributions. We are cautiously optimistic on the major U.K. banks, based on their leading franchises, overall healthy capital and core earnings levels—strengths that will help them meet revenue and loan quality challenges. 	<p>AT1 CoCos</p> <ul style="list-style-type: none"> We continue to remain constructive on AT1 Cocos given our favorable view on European Bank credit for 2021 and the duration profile of the Coco index. About 83% of the USD Coco Index (CDLR) has a duration of less than 5. At this point, we are not expecting significant spread tightening but rather more of a carry trade in the asset class.

References:

¹ Source: Bloomberg, Spectrum Asset Management, Principal Global Investors. As of 31 March 2021.

² Source: Spectrum Asset Management, Principal Global Investors. As of 31 March 2021.

³ Yields refer to Yield to Maturity. ICE BofA Merrill Lynch Fixed Rate Preferred Securities Index represents for Preferred Securities. ICE BofA Merrill Lynch US Corporate Index represents for US Corporate Bonds. Index returns reflect no deduction for fees, expenses, or taxes. Indices are unmanaged, and individuals cannot invest directly in them. 30-Year and 10-Year U.S. Treasuries are issued by the U.S. Treasury Department. Treasury notes have a coupon payment every 6 months. Source: Bloomberg, as of 31 March 2021.

⁴ Source: Bloomberg, as of 31 March 2021. ICE BofA Merrill Lynch Fixed Rate Preferred Securities Index performance represents for Preferred Securities; Bloomberg Barclays Global Aggregate Corporate Total Return Index Value Unhedged USD Index represents for Investment Grade Corporate Bonds; MSCI ACWI Index represents for Global Equities.

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