When Interest Rates Rise

A Case Study on the Opportunities and Risk Management Strategies in Today’s Preferred Securities Market

William Scapell, CFA, Director of Fixed Income and Portfolio Manager
Jerry Dorost, CFA, Vice President and Research Analyst
Edited by David Shanahan

Preferred securities have performed very well in the post-financial-crisis era of record low interest rates. Investors have been rewarded by the high income they produce and the rapidly improving fundamentals of most issuers. Prices have risen as the rate environment has remained supportive and as risk spreads have contracted. But what will happen when the interest-rate environment becomes less accommodative? We think the answer is that some securities will perform much better than others, with the lower duration fixed-to-floating rate securities that dominate the over-the-counter (OTC) preferred market likely besting the fixed-rate ones found in the $25 par or exchange-listed market. This was certainly the case in 2013 as OTC preferreds generated a positive return and outperformed not only the exchange-listed preferred market but also many other fixed income choices. As active managers, we seek structures, income rates and credit spreads that can help protect investors when rates rise.
Executive Summary

What will happen to preferreds when interest rates rise? We think 2013 was very informative. As the year progressed, Federal Reserve (the Fed) officials began to talk of tapering bond purchases. Fixed income markets reacted negatively, with the 10-year U.S. Treasury benchmark vaulting from 1.65% in late April to 3.0% by the year end.

Looking at preferred securities returns, it was a “tale of two markets,” as an index that captures investment-grade exchange-listed securities returned -3.7%, while a similar index for OTC securities posted a positive total return of 4.9%, or about 860 basis points higher.

What caused this gaping difference? Structure was perhaps the biggest driver, as most OTC issues are simply built to be far less rate sensitive. The OTC index is dominated by fixed-to-float securities. Instead of a coupon that is fixed in perpetuity, these issues offer a period of fixed payments followed by a period of floating rate payments. Interest rate risk is not obviated by this structure, but it can be materially reduced.

What other characteristics can make preferreds defensive? Income is another form of defense against rates, and preferreds continue to generate the highest income within the investment-grade fixed-income universe. In fact, investment-grade preferreds currently offer almost double the income provided by investment-grade corporate bonds of similar duration. Importantly, since total return is a combination of income and price return, the significant income advantage of preferreds provides a cushion that enhances returns and dampens total return volatility over time.

Credit spreads can also act as a shock absorber to rising Treasury yields, making preferreds’ abnormally wide credit spreads an important line of defense against rising interest rates. We observed this trend in 2013, when credit spread contraction helped preferreds generally outperform corporates, Treasuries and other areas of fixed income. While spreads contracted for most issues, below-investment-grade issues with wide spreads generally fared best due to more significant spread contraction. Given the rapidly improving fundamentals of the financial issuers that dominate the preferred market, we see good scope for further spread compression ahead.

As professional managers who invest globally, we can also alter portfolio rate risk by investing in preferreds denominated in foreign currencies. These will react to the rate environment governing the foreign currencies rather than to factors influencing U.S. Treasuries. In this regard, we point to Europe, where, due to much slower growth, the European Central Bank will be embarking upon quantitative easing measures even as the U.S. exits that form of stimulus.

In sum, the factors above do not fully mitigate the risk of rising rates. However, along with active management, we believe they can help to protect investors.
When Interest Rates Rise

**Preferreds and Rising Interest Rates**

**A Look at Outperformance in 2013**

Taken as a whole, including both OTC and exchange-traded market components, preferred securities generally outperformed other fixed income assets in 2013, as shown in Exhibit 1 below. Important drivers of this performance were high income, wide credit spreads and lower duration security structures. This report explores each of these drivers in more detail and drills down on preferred market segments to better understand sources of performance.

Highlighted in Exhibit 1 is the importance of income to total returns. The income advantage of preferred securities is one reason why the asset class has historically delivered more consistent returns over time than many other fixed-income investments. It is important to remember that price change, by itself, ignores the potential income and reinvestment that could buoy total return over time. To illustrate, in 2013, investment-grade preferreds as a whole offered 6.2% income, which was substantially more than that of investment-grade corporate bonds. So while prices of the blended investment-grade preferred index declined 5.6%, the addition of 6.2% annualized income resulted in a positive total return of 0.6% for the investment grade preferred market. An environment of rising interest rates (or yields) could cause the prices of existing investments to drop, but the loss would be at least partially offset over time through coupon payments and higher-yielding reinvestment opportunities.

Income can have a big impact on total returns over time.

**Exhibit 1: Preferred Securities Performance vs. Other Investment-Grade Fixed Income Classes in 2013**

<table>
<thead>
<tr>
<th></th>
<th>Total Return</th>
<th>Price Return</th>
<th>Income Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>At December 31, 2013.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50/50 Blend(a)</td>
<td>0.6</td>
<td>-5.6</td>
<td>6.2</td>
</tr>
<tr>
<td>Corporate Bonds(b)</td>
<td>-1.5</td>
<td>-5.7</td>
<td>-5.7</td>
</tr>
<tr>
<td>Municipal Bonds(c)</td>
<td>-2.9</td>
<td>-7.2</td>
<td>-7.2</td>
</tr>
<tr>
<td>10-Year Treasury</td>
<td>-7.8</td>
<td>-9.8</td>
<td>-9.8</td>
</tr>
<tr>
<td>TIPS(d)</td>
<td>-9.4</td>
<td>-10.5</td>
<td>-10.5</td>
</tr>
</tbody>
</table>


Performance data quoted represents past performance. Past performance is no guarantee of future results.

(a) 50/50 blend of BofA Merrill Lynch Capital Securities Index and BofA Merrill Lynch Fixed Rate Preferred Securities Index. (b) BofA Merrill Lynch Corporate Master Index. (c) BofA Merrill Lynch Municipal Master Index. (d) BofA Merrill Lynch U.S. Inflation-Linked Treasury Index. See page 11 for index definitions and additional disclosure.
Wide credit spreads can also offer enhanced total-return potential and protection against rising interest rates.

Since the financial crisis, we have observed that preferred securities have become much more credit sensitive. One reason is that the asset class is heavily dominated by financial issuers—particularly banks and insurance companies—which receive beneficial regulatory capital treatment from issuing preferred securities. As highlighted in the chart below, the credit spreads of these issues, which widened materially during the financial crisis, have remained disproportionately wide relative to historical pre-crisis levels, despite drastic fundamental credit improvements spurred largely by far stricter regulatory requirements that improve capital and reduce operating risks. Today, the credit compensation over 10-year Treasuries remains wide, at 320 basis points, compared to the longer-term pre-crisis average of 227 basis points, as shown in the chart below.

Wide credit spreads are a first line of defense relative to rising interest rates—and the wider the credit spread, the stronger the defense potential. Since credit risk has historically diminished in an improving economic climate, wide spreads can help cushion returns as this spread contraction helps to offset some or all of the higher Treasury yields. Potentially, the demanded yield on the credit instrument may not rise as much as that of a Treasury benchmark. It is worth pointing out that spread compression does not always occur, or it may occur over time or in an uneven fashion. For example, in 2013 outflows from preferred exchange-traded funds (ETFs), as well as tax-loss selling, kept pressure on the investment-grade exchange-traded market in the second half of the year, preventing a material spread narrowing as Treasury yields rose. In this case, market technicals overpowered the impact of steady fundamental issuer improvements. But the picture was a bit different in below-investment-grade prefers, in both the exchange-traded and OTC markets. The wide spreads these securities offered did compress in the second half of 2013, providing somewhat of a cushion.
Structure Matters

Understanding the Lower Interest-Rate Sensitivity of the Over-the-Counter Preferred Securities Market

Diving deeper into the asset class, there are two distinct trading markets for preferred securities: defined earlier as exchange-traded and OTC. Many securities in the OTC preferred market have a “fixed-to-float” structure, through which payments begin at a fixed rate for a specified period, for instance for 10 years, and then convert to a floating rate, for instance, at a rate that resets every quarter over a short-term rate benchmark, like LIBOR. Since the rate can reset in the future, fixed-to-float issues have the potential to offer relatively modest interest rate risk. The durations of such issues—duration being a measure of price sensitivity with respect to changing yields—is based almost entirely on the length of the fixed-rate payment period. By contrast, many exchange-traded preferred securities offer a fixed-payment rate in perpetuity and thus carry very high durations and price sensitivities relative to changes in demanded rates. For a more detailed explanation of these security structures, please see “Case Study: Understanding Security Structure” on page 7.

Some preferred securities offer superior risk-reward characteristics based on structure and credit spreads.

Exhibit 3: Preferred Securities—Tale of Two Markets

<table>
<thead>
<tr>
<th>Preferred Securities</th>
<th>2014 YTD Total Return</th>
<th>2013 Total Return</th>
<th>2013 Price Return</th>
<th>2014 YTD Modified Duration (years)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over-the-Counter Preferred</td>
<td>8.3%</td>
<td>4.9%</td>
<td>-1.3%</td>
<td>5.7</td>
</tr>
<tr>
<td>50/50 OTC/Exchange-Traded Preferred Blend</td>
<td>10.3%</td>
<td>0.6%</td>
<td>-5.6%</td>
<td>6.8</td>
</tr>
<tr>
<td>Exchange-Traded Preferred</td>
<td>12.4%</td>
<td>-3.7%</td>
<td>-9.7%</td>
<td>7.9</td>
</tr>
<tr>
<td>Other Fixed Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Bonds</td>
<td>6.0%</td>
<td>-1.5%</td>
<td>-5.7%</td>
<td>6.7</td>
</tr>
<tr>
<td>Municipal Bonds</td>
<td>8.3%</td>
<td>-2.9%</td>
<td>-7.2%</td>
<td>4.7</td>
</tr>
<tr>
<td>10-Year Treasury</td>
<td>6.9%</td>
<td>-7.8%</td>
<td>-9.8%</td>
<td>8.7</td>
</tr>
<tr>
<td>TIPS</td>
<td>4.2%</td>
<td>-9.4%</td>
<td>-10.5%</td>
<td>8.4</td>
</tr>
<tr>
<td>High-Yield (Junk) Bonds</td>
<td>3.6%</td>
<td>7.4%</td>
<td>0.0%</td>
<td>4.1</td>
</tr>
</tbody>
</table>


(a) Modified Duration measures the effect that a 100 basis point change in interest rates will have on the price of a bond. (b) BofA Merrill Lynch Capital Securities Index. (c) 50/50 blend of BofA Merrill Lynch Capital Securities Index and BofA Merrill Lynch Fixed Rate Preferred Securities Index. (d) BofA Merrill Lynch Fixed Rate Preferred Securities Index. (e) BofA Merrill Lynch Corporate Master Index. (f) BofA Merrill Lynch Municipal Master Index. (g) BofA Merrill Lynch U.S. Inflation-Linked Treasury Index. (h) BofA Merrill Lynch High Yield Master Index. See page 11 for index definitions and additional disclosure.

As highlighted on page 3 and shown in the 50/50 blend in Exhibit 3 above, the investment-grade preferred market posted a positive total return of 0.6% and outperformed many other fixed income asset classes in 2013. But the positive total return performance was attributable to the OTC preferred securities market. As shown above, the OTC market, evidenced by the BofA Merrill Lynch Capital Securities Index, posted a positive total return of 4.9% and outperformed the smaller exchange-traded preferred market by 860 basis points. In comparison, the investment-grade exchange-traded preferred market measured by the BofA Merrill Lynch Fixed Rate Preferred Securities Index generated a -3.7% total return. A very important difference is that the OTC index is largely composed of fixed-to-floating-rate securities, whereas the exchange-listed market is primarily a fixed-rate market. We do note, however, that in recent quarters there has been a growing opportunity to own fixed-to-float securities in the exchange-listed market as well.

(1) LIBOR is the London Interbank Offered Rate.
When Interest Rates Rise

In 2013, the OTC market for preferred securities outperformed the exchange-traded market by 860 basis points.

The exhibit on the previous page also indicates that the duration on the OTC preferred index is currently 5.7 years, which is lower than that of exchange-traded preferreds (7.9 years), corporate bonds (6.7 years) and 10-year U.S. Treasuries (8.7 years). Perhaps just as important is that the durations of many OTC preferred securities do not “extend” like that of most exchange-traded preferred securities. Hence, a duration of 5.7 years would be accurate whether the security is priced at a premium or below par. Conversely, duration measures of exchange-traded fixed-for-life preferreds can be misleading; duration could extend if the market environment changes and it is no longer advantageous for that issuer to redeem the security at its first call date.

A Closer Look at Below-Investment-Grade Preferreds

Looking more closely at the performance in 2013, below-investment-grade preferred securities performed particularly well, given that i) their credit spreads were wider than those of investment-grade preferreds and ii) the improving credit fundamental backdrop supported credit spread compression. As highlighted in Exhibit 4 below, in both the exchange-traded and OTC preferred markets, these securities provided better relative price returns than investment-grade preferreds. Below-investment-grade OTC preferreds generated positive total returns of 14.3% (935 bps higher than those of investment-grade OTC preferreds). Similarly, below investment-grade exchange-listed preferreds generated a 2.7% total return, 639 basis points more than comparable investment-grade preferreds. We note again that spread compression does not always occur, but it can be powerful.

Greater Volatility of Exchange-Listed Fixed-for-Life Preferreds

The dispersion in returns—both when interest rates were rising (as they did in 2013) and when they were falling (such as in the first nine months of 2014, when exchange-traded preferreds led OTC preferreds by 410 basis points)—reflects the higher inherent volatility profile of the exchange-traded preferred market.
In our view, investors may be best served by focusing on the better risk-adjusted returns and larger investment universe offered in the OTC market. Even better, investors could take a tactical approach to owning the best securities in both markets, as we do. The characteristics of these two types of preferred securities are explored further in the Case Study below.

Case Study: Understanding Security Structure

Security 1: Fixed-Rate Securities
Exchange-Traded Market

Typically, exchange-traded perpetual preferred securities offer a fixed rate of income into perpetuity. As shown to the right, the duration of this structure is very high. Thanks to the potential for credit-spread tightening, the demanded yield on the security does not have to move in tandem with Treasury yields. But these securities’ price sensitivity to rising rates tends to be quite high.

Security 2: Fixed-to-Floating Rate Securities
Over-the-Counter Market

Generally, over-the-counter preferred securities include a rate reset, as shown in the example to the right that highlights fixed-to-float securities. These issues make fixed-rate payments for a specified period of time—most typically 10 years—after which they can be redeemed or switched to a floating rate. Since payments reset with the rate environment, the floating-rate portion offers near-zero interest-rate risk. As a result, the security acts like a much shorter-term issue, with a far lower duration. Given the same change in demanded yield for this security, the price volatility would be far less than one with a fixed rate into perpetuity.

Security 3: Floating-Rate Securities
Over-the-Counter Market

Floating-rate issues, which typically pay a floating rate into perpetuity, are the most defensive preferred securities relative to rate risk. Payments are usually benchmarked to a short-term benchmark, such as LIBOR, though some securities will pay a spread over longer-term benchmarks, such as the 10-year Treasury. Given the long-term nature of the cash flows associated with these issues, and since the income of these securities will reset with higher benchmark rates, securities of this nature may actually rise in price if markets begin to price in higher-than-expected rates in the future.
The Evolution of CoCos

How This New Form of Preferred Securities Can Help Diversify Interest-Rate Risk (and a Case for Active Management)

The OTC market offers a much broader opportunity set to active managers than the much smaller exchange-traded market. This larger investment universe includes a wide diversity of securities of foreign companies (both USD and non-USD) not found in the exchange-traded market, as well as securities of U.S. domiciled issuers. Of particular note, within this over-the-counter universe, is an emerging subset of the preferred securities market called Contingent Capital Securities, or CoCos.

Currently CoCos offer rates that compare favorably with global investment-grade and even global high-yield bonds.

As we further detail in our whitepaper titled “Investing in CoCos,” available at cohenandsteers.com, this new asset class presents new opportunities and high income as well as risks. CoCos may carry higher credit risk than comparable preferreds in the U.S., so CoCos require wide credit spreads commensurate with this credit risk. This may make these securities more sensitive to the credit quality of the issuer and less sensitive to interest rates. While most issuers are large, high-quality institutions, we believe that the analysis of the credit risk within this emerging asset class is geared to active managers.

Similar to other types of preferreds in the OTC market, CoCos have characteristics that help manage interest-rate risk. Nearly all CoCos in the current market trade with coupon reset features. Many of these resets occur within 5–10 years, which limits the securities’ price sensitivity to interest rates.

Additionally, CoCos, which are only issued by foreign companies, are frequently denominated in foreign currencies. Foreign currencies can provide another tool for mitigating interest-rate risk, because the economies of other countries can be at different points in their interest-rate cycles.

A Credit Spread Scenario for the Next Fed-Tightening Cycle

While the period of rising interest rates in 2013 provided valuable insight into how various types of preferred securities performed relative to other fixed income asset classes, we believe it is also important to look at full Fed tightening cycles. Since the inception of the preferred securities market in the early 1990s, there have been three such periods: 1994, 1999 and 2004. In each of these cycles, preferred security yields rose less than Treasury yields. This credit-spread contraction helped buffer the impact on prices. Today, the yield spreads of preferred securities are far wider than they were in those periods, and they remain significantly above long-term averages. For this reason, we believe they have more room to contract should rates move higher.
The chart below illustrates this point with key data from the last three Fed tightening cycles. As of August 31, 2014, the difference in the yield to maturity between investment-grade preferred securities and 10-year Treasuries was 330 basis points, far wider than the credit spreads at the beginning of previous rate hike cycles—all in the low 200-basis-point range. An important difference today is that gross yields on preferreds are lower, as shown below. Nevertheless, while we cannot be certain whether or how far the spread would contract, we believe that the exceptionally wide spread existing today may provide a good degree of cushion against rising Treasury yields, compared with prior periods.

### Exhibit 5: Fixed-Income Performance in Earlier Fed-Tightening Cycles

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>10-Year Treasury Yield&lt;sup&gt;a&lt;/sup&gt;</td>
<td>5.75%</td>
<td>5.90%</td>
<td>4.73%</td>
<td>2.35%</td>
</tr>
<tr>
<td>Preferred Securities Yield&lt;sup&gt;b&lt;/sup&gt;</td>
<td>7.84%</td>
<td>8.19%</td>
<td>7.00%</td>
<td>5.65%</td>
</tr>
<tr>
<td>Credit Spread&lt;sup&gt;c&lt;/sup&gt; (basis points)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning of Period</td>
<td>209</td>
<td>229</td>
<td>227</td>
<td>330</td>
</tr>
<tr>
<td>End of Period</td>
<td>108</td>
<td>266</td>
<td>181</td>
<td></td>
</tr>
<tr>
<td>Long-term Average&lt;sup&gt;d&lt;/sup&gt;</td>
<td>238</td>
<td>155</td>
<td>206</td>
<td>227</td>
</tr>
<tr>
<td>Federal Reserve Rate Hikes</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>7</td>
<td>6</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>Magnitude</td>
<td>3.00%</td>
<td>1.75%</td>
<td>4.25%</td>
<td></td>
</tr>
<tr>
<td>Duration&lt;sup&gt;e&lt;/sup&gt;</td>
<td>12 months</td>
<td>11 months</td>
<td>24 months</td>
<td></td>
</tr>
</tbody>
</table>


Performance data quoted represents past performance. Past performance is no guarantee of future results.

(a) Absolute yield of the 10-year U.S. Treasury note at the beginning of each period. (b) Represented by the BofA Merrill Lynch Fixed-Rate Preferred Securities Index (credit quality: BBB) at the beginning of each period. (c) Yield difference between BofA Merrill Lynch Fixed-Rate Preferred Securities Index (credit quality: BBB) and the yield of the 10-year Treasury note. (d) Average spread starting December 1992 through the month before each period begins. BofA Merrill Lynch Fixed-Rate Preferred Securities Index (credit quality: BBB). (e) Assumes month-end data. See page 11 for index definitions and additional disclosure.

### Our Closing Perspective

As we learned from the rising rate period in 2013, preferred securities are not all alike, and some can vastly outperform others when these conditions reappear. Diversification is important, but we believe the key to taking advantage of the higher income that preferred securities offer today—and navigating the potential for higher rates tomorrow—is active management, backed by in-depth research focused on credit and structure selection. Some of the tools and strategies we find useful are summarized in the Quick Reference section on the following page.
Quick Reference: Managing Interest-Rate Risk
The Portfolio Manager’s Toolkit

Increase allocations to preferred securities with lower credit quality and wider credit spreads. In today’s market, high credit spreads are a first line of defense relative to rising interest rates—and the wider the credit spread, the stronger the defense potential. Since credit risk typically diminishes in an improving economic climate, wide spreads can provide a cushion. In a rising-rate environment, below-investment-grade and non-rated preferred securities with wide credit spreads tend to provide better relative price returns as well as higher income rates, both of which tend to protect investors when interest rates rise.

Employ more fixed-to-float or more floating-rate structures that are less sensitive to interest rates. Preferred securities that trade on stock exchanges typically pay a fixed rate forever, potentially making them highly sensitive to changes in demanded yields. By contrast, the standard structure for OTC perpetual preferred securities is a fixed-to-float instrument. Many have only a few years left until they convert to floating rates, giving them quite short durations. Moreover, floating-rate preferred issues with income rates that reset most typically with changes in short rates, like LIBOR, have almost no interest-rate risk.

Favor higher-coupon/higher-income securities. Securities that pay higher coupons or trade at a premium tend to perform better than lower-coupon issues in a rising-rate environment, benefiting from high current income rates. Income in and of itself also provides a total return defense over time. Additionally, high coupon securities that are callable in the near-term tend to trade very close to par as the market prices in a high probability of redemption at par.

Invest in foreign currency-denominated securities Interest-rate cycles in other areas of the world may not be in sync with those in the United States. For instance, due to a much weaker economy, Europe is far less likely to see rising rates in the near future. In fact, they may be embarking upon quantitative easing even as the U.S. is exiting that form of economic stimulus. By investing in preferred securities denominated in foreign currencies, we are able to take advantage of yield environments that may remain low for a longer period of time.

Use derivatives to hedge interest rates directly. For many strategies, a last and important line of defense is the direct hedging through options, interest rate swaps and futures based on the manager’s view of when and by how much yields will rise.
Index Definitions

An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes.

BoFA Merrill Lynch Corporate Master Index tracks the performance of U.S. dollar-denominated investment-grade corporate debt publicly issued in the U.S. domestic market.

BoFA Merrill Lynch Current 5-Year U.S. Treasury Index is a one-security index composed of the most recently issued 5-year U.S. Treasury note. The index is rebalanced monthly. In order to qualify for inclusion, a 5-year note must be auctioned on or before the third business day before the last business day of the month.

BoFA Merrill Lynch Current 10-Year U.S. Treasury Index is a one-security index composed of the most recently issued 10-year U.S. Treasury note. The index is rebalanced monthly. In order to qualify for inclusion, a 10-year note must be auctioned on or before the third business day before the last business day of the month.

BoFA Merrill Lynch Fixed-Rate Preferred Securities Index tracks the performance of fixed-rate U.S. dollar-denominated preferred securities issued in the U.S. domestic market.


BoFA Merrill Lynch U.S. Capital Securities Index is a subset of the BoFA Merrill Lynch U.S. Corporate Index including all fixed-to-floating rate, perpetual callable and capital securities.

BoFA Merrill Lynch U.S. Inflation-Linked Treasury Index tracks the performance of U.S. Treasury Inflation Protected Securities with at least $1 billion in outstanding face value and a remaining term to maturity greater than one year.

S&P 500 Index is an unmanaged index of 500 large-capitalization, publicly traded stocks representing a variety of industries.

Performance data quoted represents past performance. Past performance is no guarantee of future results. The information presented in this commentary does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers and there is no guarantee that any historical trend presented in this commentary will be repeated in the future, and no way to predict precisely when such a trend will begin. There is no guarantee that any market forecast set forth in this document will be realized.

The views and opinions in the preceding commentary are as of the date of publication and are subject to change without notice. This material represents an assessment of the market environment at a specific point in time, should not be relied upon as investment advice, is not intended to predict or depict performance of any investment and does not constitute a recommendation or an offer for a particular security. We consider the information in this document to be accurate, but we do not represent that it is complete or should be relied upon as the sole source of suitability for investment. Investors should consult their own advisors with respect to their individual circumstances.

Risks of Investing in Preferred Securities

Investing in any market exposes investors to risks. In general, the risks of investing in preferred securities are similar to those of investing in bonds, including credit risk and interest-rate risk. As nearly all preferred securities have issuer call options, call risk, reinvestment risk and income risk are also important considerations. In addition, investors face equity-like risks, such as deferral or omission of distributions, subordination to bonds and other more senior debt, and higher corporate governance risks with limited voting rights.

Preferred funds may invest in below investment-grade securities and unrated securities judged to be below investment-grade by the Advisor. Below investment-grade securities or equivalent unrated securities generally involve greater volatility of price and risk of loss of income and principal, and may be more susceptible to real or perceived adverse economic and competitive industry conditions than higher grade securities. The benchmarks do not contain below investment-grade securities.

Risks associated with preferred securities differ from risks inherent with other investments. In the event of bankruptcy, a company’s preferred securities are senior to common stock but subordinated to all other types of corporate debt. Corporate bonds sit higher in the capital structure therefore in the event of bankruptcy will be senior to preferred securities. High-yield bonds, although typically issued by different types of issuers than those that issue preferred securities and rated below investment grade, also would sit higher in a firm’s capital structure than preferred securities if the issuer did employ both forms of issuance. 10-Year Treasury notes are issued by the U.S. government and are considered the safest of all bonds since they are backed by the full faith and credit of the U.S. government as to the timely payment of principal and interest.

This commentary must be accompanied by the most recent Cohen & Steers Fund fact sheet(s) if used in connection with the sale of mutual fund shares.
We believe accessing investment opportunities around the world requires local knowledge and insight into specialized and regional markets. Cohen & Steers maintains a global presence through the following offices:

**Americas**

NEW YORK

Corporate Headquarters  
280 Park Avenue, 10th Floor  
New York, New York 10017

Phone  212 832 3232  
Fax  212 832 3622

SEATTLE

Cohen & Steers Capital Management, Inc.  
1201 Third Avenue, Suite 3810  
Seattle, Washington 98101

Phone  206 788 4240

**Europe**

LONDON

Cohen & Steers UK Limited  
21 Sackville Street, 4th Floor  
London W1S 3DN  
United Kingdom

Phone  +44 0 20 7460 6350

**Asia Pacific**

HONG KONG

Cohen & Steers Asia Limited  
Suites 1201-02, Citibank Tower  
Citibank Plaza, 3 Garden Road  
Central, Hong Kong

Phone  +852 3667 0080

TOKYO

Cohen & Steers Japan, LLC  
Pacific Century Place, 8F  
1-11-1 Marunouchi Chiyoda-ku  
Tokyo 100-6208 Japan

Phone  +81 3 6860 9398

Cohen & Steers UK Limited is authorized and regulated by the Financial Conduct Authority with FRN 458459.