

A case for hybrid securities in client portfolios

Speaking at Hubbis' Investment Solutions Forum 2017 in Singapore in June – Matthew Byer of Spectrum Asset Management explains the features and benefits of preferred securities in investor portfolios, especially in rising rate cycles.

As structurally subordinated fixed income instruments, there is a good case for preferred securities in investor portfolios, says Matthew Byer, chief operating officer of Spectrum Asset Management.

He explains that there are both strategic and tactical reasons to buy preferred securities.

From a strategic perspective, they have moderate correlations to other asset classes and other fixed income categories. They also offer a yield premium over senior debt that may over-compensate investors compared with the incremental risks of subordination and deferrals. This is in line with the objective of increasing total returns and reducing total volatility.

Tactically, meanwhile, preferred securities capture income opportunities of bonds with some of the capital characteristics of equity. Also, there is a continuing attractive subordination premium relative to corporate senior

debt, which may offset potentially rising interest rates.

In addition, allocation to defensive coupon structures, namely fixed-to-floating USD1,000 par preferred securities and fixed-to-variable CoCos, may offer investors an attractive current yield with a potentially supportive back-end yield in a rising rate environment.

He says some of the features of these instruments that potentially create value support through rising rate cycles.

This has come from the evolution of the market from fixed-for-life to fixed-tofloat and fixed-to-variable rate coupon structures. So rather than it converting to a floating rate instrument at (generally) LIBOR plus the initial funding spread in the case of there not being a call, the fixed-to-variable option means a no-call situation leads to the instrument resetting at another like term at mid-swaps plus initial funding spread. ■



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