Three themes in hybrid credit securities today

Rapidly shifting narratives and geopolitical disruption highlight hybrid credit's role as a high-quality, stable source of income

2Q 2026

The first quarter reminded investors just how quickly market narratives can change. Early in the year, economic conditions were generally supportive of credit. Growth was holding up, inflation was still elevated but trending toward central banks' targets, and risk assets were performing well.

That changed in late February with the onset of the U.S.–Iran conflict. Disruptions to global energy production and transportation raised concerns about an energy driven inflation shock that could keep monetary policy tighter for longer, even as growth expectations softened.

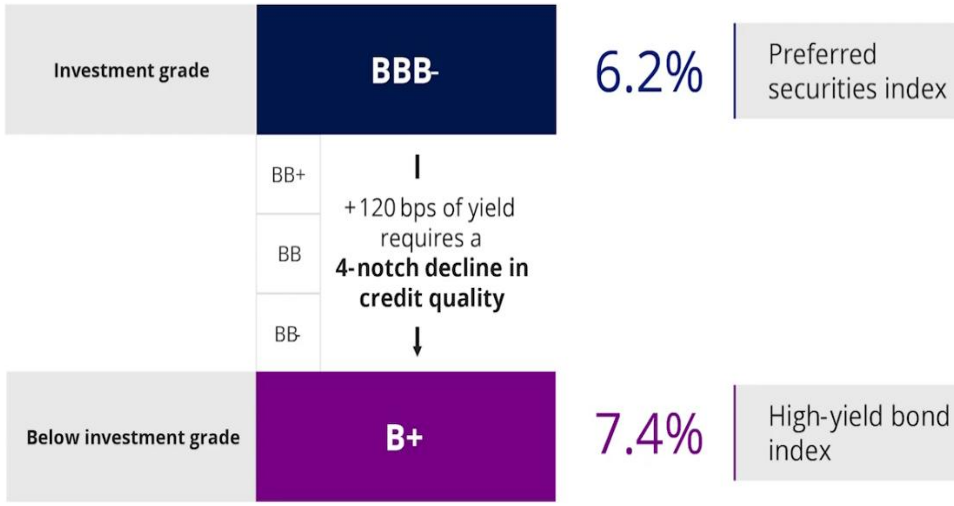
Markets turned volatile, and both equities and fixed income pulled back, erasing earlier gains. Within hybrid credit, longer duration, exchange listed securities were most affected by the rate driven sell off.

In environments like this, where rate expectations are shifting and volatility is elevated, income becomes an increasingly important driver of fixed income returns. When forward visibility is limited, returns are less about timing rate moves and more about the durability and level of income you're earning along the way.

Hybrid credit securities continue to offer attractive income, backed by high quality issuers, which can help cushion portfolios during periods of market stress and policy uncertainty. Investors would have to take on significantly more risk to achieve higher yields in today's market.

Achieving a slightly higher yield requires taking significantly more risk

Income gains are incremental—but risk increases are exponential



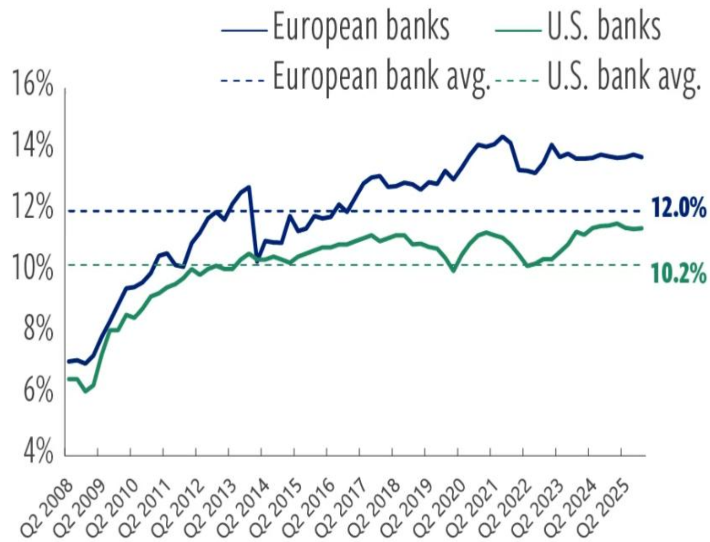
At 13 March 2026. Source: ICE BofA.
Yields shown on a yield-to-worst basis. Credit ratings represented by the weighted-average ICE Composite credit rating of total indexes. Sub-index values derived from ICE BofA High-Yield Master main index, which tracks the performance of U.S. dollar-denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. As of 3/31/2026, the High-Yield Bond Sub-Index (BB) represents 59% of the main index; High-Yield Bond Sub-Index (B) represents 32% of the main index, and High-Yield Bond Sub-Index (CCC) represents 9% of the main index. Below investment grade is represented by the B+ sub-component of the High-Yield Bond Sub-Index in the ICE BofA High-Yield Master Index.

We also saw modest widening in credit spreads during the quarter, as higher inflation and weaker growth prospects unsettled markets. However, the move was contained—reflecting strong underlying credit fundamentals and expectations that the conflict would remain limited.

Importantly, hybrid credit has relatively little exposure to the areas of credit where stress is building, particularly parts of private credit. Banks and insurance companies—the primary issuers of hybrid credit—entered this period with strong balance sheets, robust capital, and regulatory frameworks that have pushed higher risk lending outside the banking system. That insulation has helped hybrid credit weather credit volatility better than many investors might expect.

Bank fundamentals remain healthy

Core capital ratios of major U.S. and European banks



Capital ratios remain at historically high levels

Strong capital and reserves provide cushion against future loan losses

Bank earnings expectations and profitability remain elevated, supporting issuer fundamentals

At 31 December 2025. Source: Bloomberg, Cohen & Steers.
Core capital ratio is the ratio of core (common equity) capital to total risk-weighted assets. Banks must meet a minimum core capital requirement as dictated by local banking laws and regulations. Higher core capital ratios have helped to strengthen banks' balance sheets and to improve their credit quality. Core Capital ratios are based on the largest U.S. and European banks, respectively.

A third theme shaping the hybrid credit market, we have seen increased issuance by non-financials, such as utilities and pipelines, adding diversification to the hybrid credit market. This issuance is often directly tied to rising capital needs driven by AI adoption, data center expansion, and the growing importance of reliable energy infrastructure. While AI increases investment demands and near term costs, the sectors benefit from scale, regulation, and embedded infrastructure that helps protect earnings durability and mitigate disruption risk.

At the same time, the hybrid credit market remains diverse and liquid, allowing investors to manage duration, adapt positioning, and maintain flexibility during periods of market dislocation—particularly as lower coupon and longer duration securities reprice in a higher rate environment.

In a quarter marked by geopolitical shocks and shifting policy expectations, hybrid credit securities continue to offer a compelling mix of income, resilience, and flexibility—making them an important component of income focused portfolios today.

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Contingent capital securities (CoCos). CoCos are debt or preferred securities with loss absorption characteristics built into the terms of the security, for example a mandatory conversion into common stock of the issuer under certain circumstances, such as the issuer’s capital ratio falling below a certain level. Since the common stock of the issuer may not pay a dividend, investors in these instruments could experience a reduced income rate, potentially to zero, and conversion would deepen the subordination of the investor, hence worsening the investor’s standing in a bankruptcy. Some CoCos provide for a reduction in the value or principal amount of the security under such circumstances. In addition, most CoCos are considered to be high yield securities and are therefore subject to the risks of investing in below-investment-grade securities.

Duration risk. Duration is a mathematical calculation of the average life of a fixed-income or preferred security that serves as a measure of the security's price risk to changes in interest rates (or yields). Securities with longer durations tend to be more sensitive to interest rate (or yield) changes than securities with shorter durations. Duration differs from maturity in that it considers potential changes to interest rates, and a security's coupon payments, yield, price and par value and call features, in addition to the amount of time until the security matures. Various techniques may be used to shorten or lengthen a portfolio's duration. The duration of a security will be expected to change over time with changes in market factors and time to maturity.

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