Parametric

Preferred Securities Market Insight | January 2026

Positioned for Another Solid Year in 2026

Key takeaways

» **Constructive macro and credit backdrop:** Robust earnings, mid-cycle fundamentals and anticipated Fed cuts seem to support continued preferred performance in 2026.

» **Valuations remain reasonable** relative to alternatives in fixed income, with institutional preferred spreads largely unchanged over the past year.

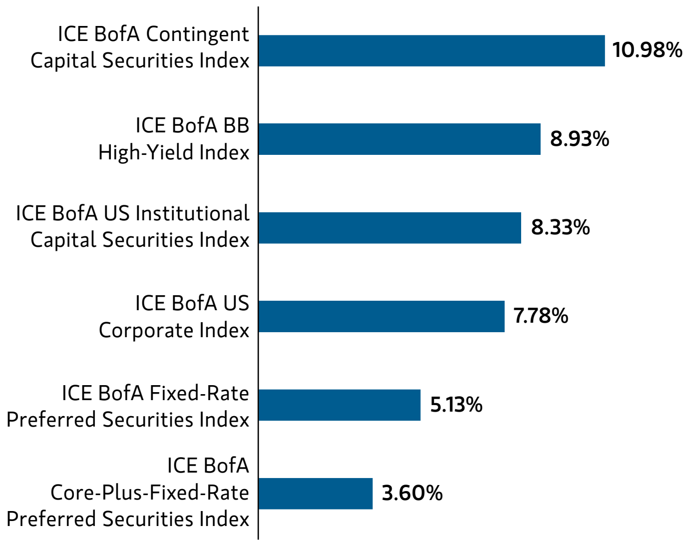
» **Bank supply should stay limited**, as evolving regulatory requirements temper issuance, while financial sector fundamentals remain strong heading into 2026.

» **Hybrid and preferred structures offer compelling relative value**, allowing investors to move down the capital structure to seek incremental yield.

2026 outlook for the preferred securities market

Preferreds delivered another year of attractive performance in 2025, with the ICE BofA Fixed Rate Preferred Index returning 5.13% at year-end. Looking ahead, a supportive macro backdrop characterized by healthy corporate earnings, mid-cycle credit fundamentals and the prospect of additional Fed easing positions the asset class for potential continued resilience. Valuations in the institutional preferred market remain similar to those of a year ago, while regulatory changes are likely to limit net bank supply. Together, these conditions suggest another year of positive returns in 2026.

FIGURE 1: 2025 INDEX TOTAL RETURN



Source: Bloomberg, as of 12/31/2025. For illustrative purposes only. It is not possible to invest directly in an index. Indexes are unmanaged and do not reflect the deduction of fees or expenses. All investments are subject to risk, including the risk of loss.

Valuations remain attractive relative to other risk assets

Despite a strong year for risk markets, with equities near all-time highs and investment-grade credit spreads near historic tights, preferred valuations have been largely range-bound. Total returns in 2025 have been driven primarily by coupon income, with a tailwind from rates as the two-year Treasury yield fell from 4.24% at the start of the year to roughly 3.47% at year-end.

The ICE US Institutional Capital Securities Index spread stands at 185 basis points (bps), four bps wider than during 2025 and essentially unchanged since mid-2024. In contrast to other markets, where stretched valuations may warrant caution, preferreds continue to offer a reasonable entry point for investors seeking incremental tax advantaged income.

Bank supply dynamics: Regulatory shifts limiting issuance in 2026

US money-center banks returned to positive net supply in 2025, as clarity around regulatory requirements improved. This issuance helped anchor valuations and was met with healthy investor demand. Notably, a major money-center bank priced a preferred security in December at a reset spread of 300 bps—43 bps wider than comparable issuance in November 2024—as many banks traded wider year over year (YoY).

Looking to 2026, changes to the supplementary leverage ratio (SLR) rules could enable previously constrained banks to let portions of their Additional Tier 1 (AT1) capital decline. As a result, while some institutions still have capacity to issue, we expect overall net supply to be modest, providing ongoing technical support for the asset class.

In Europe, we anticipate bank AT1 supply to drop after a very active 2025. Fewer upcoming calls, elevated opportunistic pre-funding in the current year and only modest growth in bank balance sheets should lead to a decline in issuance. While this should support the asset class, we prefer older vintage structures to more recently issued securities in this segment.

Retail $25-par market: Improving relative value but limited catalysts

The $25-par retail preferred market lagged institutional securities in 2025, with the ICE BofA Core Plus Fixed Rate Preferred Index rising only 3.6% as spreads drifted wider amid a steepening yield curve.

Relative value compared with the institutional market is now as favorable as it's been in three years, matching mid-2025 levels, but retail preferreds remain more expensive. A sustained period of flatter curves and lower long-end rates—conditions that would typically support this segment—appears less likely in 2026. Additional Fed cuts may further steepen the curve, and long-end rates may remain anchored by nominal GDP growth above 4%. Together, this could limit the potential for retail preferreds outperforming institutional securities in the near term.

Sector outlook: Financials standing out amid diverging sector performance

Within investment-grade credit, some sectors may see modest spread widening next year, driven by elevated capital-expenditure needs related to AI infrastructure and increased merger and acquisition (M&A) activity. But these pressures are uneven across sectors. Financials, representing the majority of the preferred market, continue to demonstrate a compelling mix of strong fundamentals, reasonable valuations and limited supply.

US banks posted record net interest income in 2025, further supported by a rebound in corporate dealmaking that boosted fee-based revenue. A steepening yield curve and continued economic expansion should support moderate loan growth and modest improvement in net interest margins in 2026. M&A activity also appears poised to grow toward levels last seen between 2016 and 2019.

Credit quality across the sector remains robust. Despite isolated concerns around lower-income consumers and risks emerging from nonbank financial institutions, charge-offs and delinquencies in consumer lending improved YoY. On balance, the sector enters 2026 with high capitalization, strong revenue growth, and stable asset quality—a solid foundation for preferred investors.

Yankee AT1: Attractive yield but less room for compression

Total return on the ICE USD Contingent Capital Index topped 10% last year, outperforming US preferreds as spreads compressed for European banks. While the sector has richened compared with US counterparts, we see value amid strong fundamentals and attractive yield differential.

Further tightening could be limited by ongoing regulatory noise in Europe next year. However, European bank earnings have rebounded relative to US peers, and the outlook is bright with positive net interest and fee income trends. Capital is elevated and supported by strong earnings generation, while asset quality is less exposed to problem sectors over the past year, in our view.

Corporate hybrids: Expanding market with attractive structures

Outside the qualified dividend income preferred space, the corporate hybrid market continues to expand. Rating-agency methodology changes allowing 50% equity credit for hybrids, combined with intensifying capital needs—particularly for utilities amid rising energy demand—have supported increased issuance.

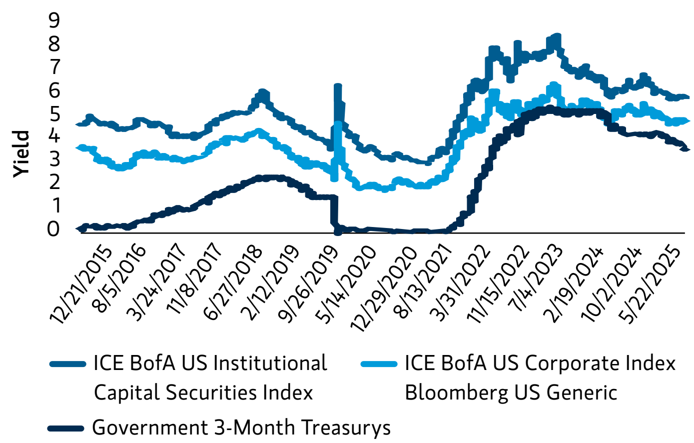
Structures evolved in 2025, with investors favoring securities featuring 10-year calls, 30-year maturities and protective features such as coupon floors. Strong demand has compressed subordinated-to-senior ratios, but hybrids still offer appealing compensation for subordination and attractive relative value compared with BB-rated high yield.

In addition, hybrid issuance broadened beyond utilities in 2025, with Canadian telecom, healthcare and refining companies entering the market. We expect this trend to continue as corporates seek rating support and financing flexibility in an active M&A environment.

Conclusion: Another income-driven year ahead

Bringing these elements together, we believe preferred securities could deliver returns consistent with long-term historical averages—approximately 6%—with income providing the majority of performance. Given robust corporate earnings, a supportive macro backdrop and solid financial-sector fundamentals, we remain comfortable moving down the capital structure to capture the additional yield available in preferred and hybrid securities.

DISPLAY 2: YIELD TO WORST



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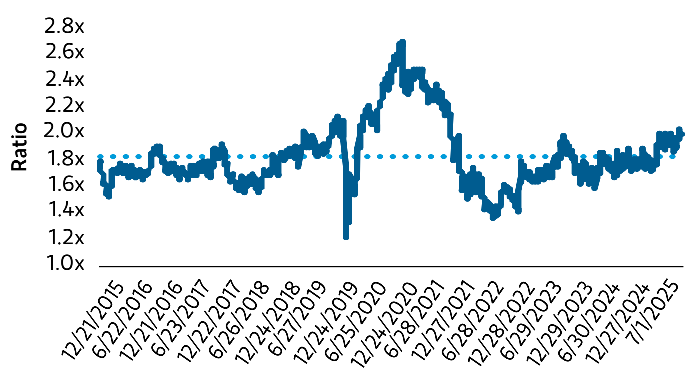
DISPLAY 3: INSTITUTIONAL PREFERRED TO SENIOR FINANCIALS SPREAD RATIO



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