Preferred Securities: Dominated by Financials Seeking to Support Bond Ratings

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When you think about the fixed income market, it's got several different buckets in the hybrid space. The first is high yield: these are the "dented" business plans, companies that have too much leverage, companies that have made a mistake—they're more value industries.

On the other spectrum, you've got the convertible market—it's about $300 billion, or so. The convertible market is made up of growth companies. They're companies that are expected to grow and they're looking for success-based capital.

Preferreds, though, are roughly the same size as the convertible market, so right around $300 billion, but here they're a little bit different. In general, preferreds should be thought of as highly junior debt or super senior equity.

They are generally issued by companies that need help supporting the senior parts of their capital structure. When companies have rating pressures, when the regulators or rating agencies come to them and say they need more capital to maintain investment grade ratings, they might hit the preferred market.

Who's doing that now? For the last 10 years it's been dominated by financials—banks, REITs, insurance companies—that need more capital to support their bond ratings. Prior to the last 10 years we saw a lot of MLPs issuing preferreds, because they needed help supporting their cap structure.

So, when you think about the market, you've got three broad buckets: the convert market is more "growthy," the high yield market is more value, and the preferred market today is more financials trying to support the senior parts of their capital structure.

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Fixed income securities entail interest rate risk. High yield securities are also subject to increased credit risk and liquidity risk.

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