FIRST QUARTER 2023

Preferred and Income Securities Commentary

March 31, 2023

PERFORMANCE

The Preferred and Income Securities Composite (Composite) returned 0.15%, net of fees on the quarter, outperforming its benchmark* by 84 basis points (bps) during the first quarter of 2023. This brings the 14-month inception-to-date performance (February 1, 2022–March 31, 2023) to +250 bps, net of fees, relative to the benchmark.

COMPOSITE	Composite Gross (%)	Composite Net (%)	Index* (%)	Outperformance** (%)
1Q23	0.25	0.15	-0.69	0.84
ITD†	-7.25	-7.60	-10.10	2.50

*Custom Benchmark (60% CIPS, 20% PoP4, 20% CDLR)
**Outperformance=Composite Net-Index
†Performance calculated from inception date 2/1/2022

Periods greater than 12 months are annualized
Source: Bloomberg, Clearwater Analytics

PREFERRED, HYBRID, AND AT1 MARKET OVERVIEW

Q1 2023 was by far the most consequential month for the preferred, hybrid, and AT1 asset class since at least 2008/2009. In the 15 years since the Global Financial Crisis, there have been few defaults in the space and amongst those few defaults even fewer were noteworthy. Then, in a little under three weeks in mid-March 2023, we had two of the three largest bank failures in the history of the United States followed by the failure of Credit Suisse (CS), a 167-year-old Global Systemically Important Bank (G-SIB). This culminated in the write-off of $16bn of AT1 notes or 6% of the ICE BofA Contingent Capital (COCO) Index. A full recap of what transpired is beyond the scope of this commentary, instead we will focus on where those events leave us.

At the start of Q2 2023, from both a carry and capital appreciation standpoint, valuations in the space have rarely looked better. At the custom benchmark level, spreads are at or above the 90th percentile[1] with a 10-year look back. This is a carry asset class. All the instruments that we invest in are callable at par, at the issuer's option, which means that capital appreciation is typically limited. However, after the recent sell-off, the benchmark indices are all trading at deep discounts to par, which means the asset-class in general – which is notoriously negatively convex – is in the best convexity position of the last 10 years.

INDEX	Description	Price ($)	YTW (%)	Duration	Current Spread	Spread (%)
CIPS	IG Institutional Prefs	91.19	7.34	3.86	+359	92
POP4	$25 Retail Prefs (IG & HY)	84.14	6.82	13.75	+310	88
CDLR	U.S. $ COCO	87.46	8.62	2.77	+495	94

While we are bullish regarding valuations, we are cognizant that technicals and trust in the space are currently negative given the recent defaults. Major ETFs dedicated to the space are experiencing outflows and it is not entirely clear to us when the flows will slow, let alone reverse. On the AT1 side in particular, it would appear that some of the investor base couldn't imagine that an issuer would even miss a call let alone default. It's unclear when those investors who took losses on the CS bail-in will return, if ever.[2]

Furthermore, it seems likely that regulations, as they relate to U.S. regional banks, are set to change with a very strong probability of increased total loss absorbing capital (TLAC) requirements (among other changes). Even if these new regulations do not require additional issuance of preferred securities the increased supply of senior bail-in debt should still weigh on spread levels.

From a fundamental standpoint, we believe that we are in a much better place than we were only a month ago. For starters, the weakest banks in both Europe and North America have been resolved. Secondly, major policy tools have been created and remain in place in the U.S. in the form of an implicit guarantee on all bank deposits and the Bank Term Funding Program. These policy tools prevent the need for a run on a bank (implicit insurance) and provides for

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[1] 90th percentile is based on the lookback period 12/31/2013–3/31/2023, with 12/31/2013 being its inception date.
[2] We suspect it will be sooner than most expect as the market has a notoriously short memory when it comes to these kinds of things.

PORTFOLIO MANAGEMENT TEAM

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QUALITY RATINGS	Strategy (%)
A & above	3.5
BBB	68.8
BB	26.8
B	0.0
Cash & Equivalent	0.8

SECURITY TYPE	Strategy (%)
Institutional Preferreds	21.1
Corporate Hybrids	25.7
Retail Preferreds	0.0
AT1s	52.5
Traditional Corporate	0.0
Cash & Equivalent	0.8

government funding at advantageous terms for a year, which ensures that even if a bank run occurs, the bank will remain liquid. While these policy tools have been framed as temporary, we can't help but be reminded of the old quip by Milton Friedman, "Nothing so permanent, as a temporary government program."

Meanwhile on the other side of the pond, the Swiss National Bank was able to successfully resolve a G-SIB failure, preventing nearly all financial contagion, and limiting taxpayer funds in the process. The fact that CS was "resolved" in as clean a matter as it was might be the most underappreciated aspect of the quarter. Sure, common equity holders (inexplicably) had a small recovery at the expense of AT1 holders but no debtors other than the AT1 holders took a loss, missed a coupon, or were harmed in any way. If the resolution of CS sets precedent (and we think it does) in terms of the lack of financial contagion in the face of the resolution of a G-SIB, then a seriously fat left tail has been removed.

PREFERRED AND INCOME SECURITIES REVIEW

The Composite outperformed its benchmark by 84 bps on the quarter primarily due to security selection as it avoided all four defaults during the quarter: CS, SVB Financial Group, Signature Bank, and Silvergate Capital Corporation. All four of these banks were represented in our custom benchmark, with CS and SIVB being the most prominent. Relative outperformance was further enhanced by our underweight (UW) positioning in AT1s, which we maintained until the day's immediately following the CS failure.

Relative underperformance was due to the portfolio's duration position, which was and remains materially UW. As discussed in our 4Q commentary, despite valuations being in the 90th percentile, the Composite was defensively positioned away from the $25 retail market, where the likes of SBNY, SI, and First Republic Bank were notable issuers, and was also cautiously UW AT1s due to the idiosyncratic issues with Credit Suisse that we feared would spill over to the rest of the AT1 market. Those themes largely played out in the last three weeks of March, and since the Credit Suisse/UBS merger, we have rapidly re-positioned the Composite by overweighting (OW) AT1s to take advantage of historically cheap valuations. Lastly, relative underperformance was caused by transaction costs owing to the rather large repositioning of the portfolio that took place in the final two weeks of the quarter (turnover of 64%) discussed in more detail below.

PORTFOLIO OUTLOOK AND POSITIONING

We believe that issuers - and just as importantly, regulators - have large incentives to keep the AT1 asset class viable and healthy in the wake of the CS bail-in. Therefore, it appears entirely plausible (if not likely) that European banks are going to start to call AT1s at first call dates to assuage investor concerns after the CS bail-in. In fact, Unicredit (UCG) has already signaled to the market that it will do just that when its €1.25bn 6-5/8ths AT1s reach their first call date in June. These bonds were trading at a yield to call (YTC) of 25%+ just days before the end of the quarter before rallying to near par and still offer a YTC of 14%. Additionally, on the first day of the second quarter, HSBC announced that it was calling several legacy perpetuals that were trading in the 70's prior to the call announcement.

Despite this, nearly the entire AT1 asset class is trading on a yield to perpetuity (YTP) basis including the UCGs.[3] Even if these bonds don't get called and remain outstanding in perpetuity, investors are still getting paid 8-10%, which is historically the cheapest the asset class has ever been. And that's before you consider the potential for large capital appreciation in the event the asset class once again begins to trade on a YTC basis. And let's not forget that since the inception of the COCO index in 2013, 92% of all AT1s have been called on their first call date.

It is for these reasons that RCIM acted swiftly after the CS bail-in to quickly bring its AT1 exposure from 13% outright and 7% UW relative to the benchmark to 52% outright and 32% OW relative, by quarter end. To be sure, we are still laser focused on credit quality and own no peripheral bank paper (Italy/Spain) and no German bank paper (e.g., Deutche/Commerz) at quarter end.

We remain UW the fixed-for-life, exchange-traded preferreds with an exposure of 0% versus the benchmark at 20%. This UW was the biggest source of relative underperformance over the last three months, but we think that story has played out and is likely to reverse in the coming weeks and months. Our exposure to regional banks totals 6.25% and comes in the form of a two issuers (M&T Bank and Huntington Bancshares) for which we are entirely comfortable with from a credit standpoint.[4] Lastly, we remain OW floating and/or soon to be floating securities as the yields of 8-9% represent attractive carry, and to the extent that rates stay higher for longer, as the Federal Reserve contends, they should continue to perform well through 2023.

COUNTRY	Weight (%)
United States	44.9
United Kingdom	16.8
France	10.4
Netherlands	9.7
Belgium	3.7
Sweden	3.5
Denmark	3.5
Canada	3.3
Switzerland	3.3
Germany	0.0
Spain	0.0
Italy	0.0
Cash & Equivalents	1.0

[3] For the avoidance of doubt, we do not own and have never owned the AT1s of Unicredit for credit reasons. It is referenced above only since it has an upcoming call in June and the economics of the bond are illustrative of the YTC/YTP dynamic for which we have taken a large OW position in other AT1s.

[4] The differences in funding profiles between these banks and the "regional" banks that failed and/or are under tremendous strain couldn't be starker.

DISCLOSURES

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All information and performance are reported in U.S. dollars.

The "Net" returns presented are net of fees. Investing involves the risk of loss and investors should be prepared to bear potential losses. Past performance is not indicative of future results.

The "Gross" returns presented are gross of fees. The results do not reflect the deduction of investment management fees. The client's return will be reduced by the management fees and any other expenses incurred in the management of the account. For example, a U.S. $100 million account, paying a 0.50% annual fee, with a given rate of 10% compounded over a 10-year period would result in a net of fee return of 9.5%. Management fees are described in Part 2A of RCIM's Form ADV Part 2A. Investing involves the risk of loss and investors should be prepared to bear potential losses. Past performance is not indicative of future results.

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The Preferred and Income Securities Composite includes a broad distribution pooled fund (North Square Preferred and Income Securities Fund) that invests in preferred securities, Treasury and agency bonds, investment grade and non-investment grade corporate bonds, asset-backed securities, agency and non-agency mortgage-backed securities, collateralized mortgage obligations, and REITS. The strategy may use derivatives, including forward contracts, futures contracts, swap contracts and options in implementing its strategy. The use of derivative instruments allows the strategy to achieve its investment objectives, reduce risks, or manage the strategy more efficiently. The strategy also invests in international securities, foreign exchange, and non-U.S. dollar denominated securities. Under normal market conditions, the portfolio invests at least 80% of its net assets (plus any borrowings for investment purposes) in a portfolio of preferred and debt securities issued by U.S. and non-U.S. companies. The Preferred and Income Securities Composite was created 2/1/2022. The inception date of the Composite was 1/14/2022.

Benchmark Definition:

The benchmark is a Custom Benchmark. The Custom Benchmark is a combination of 60% ICE BofA U.S. Investment Grade Institutional Capital Securities Index (CIPS), 20% ICE BofA Core Plus Fixed-Rate Preferred Securities Index (PoP4), and 20% ICE BofA Contingent Capital Index (COCO), calculated by weighting the respective index returns monthly. The CIPS index tracks the performance of the U.S. dollar-denominated investment-grade hybrid capital corporate and preferred securities issued in the U.S. domestic market. The PoP4 index tracks the performance of fixed rate US dollar denominated preferred securities issued in the US domestic market. The index includes preference shares (perpetual preferred securities), both DRD-eligible and non-DRD eligible preferred stock and senior and subordinated debt issued in $25, $50 or $100 par/liquidation increments. The COCO index tracks the performance of investment grade and below investment grade contingent capital debt publicly issued in the major domestic and Eurobond markets. The Custom Benchmark returns are calculated by using the monthly returns of the indices listed above during each period. At the beginning of each month the indices are rebalanced to a 60/20/20 ratio to account for divergence from that ratio that occurred during each month. The monthly returns are the compounded for each period, giving the performance for the Custom Benchmark. An index is an unmanaged portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown.

PoP4: ICE Preferred Securities Index for $25 retail prefs including investment grade and high yield securities.

CIPS: ICE Investment Grade Institutional Capital Securities Index that tracks U.S. dollar-denominated investment grade hybrid capital corporate and preferred securities.

CDLR: ICE Contingent Capital Index is a subset of the COCO Index that includes only U.S. dollar-denominated securities.

COCO: ICE Contingent Capital Index that tracks investment grade and high yield contingent capital issued in major domestic and Eurobond markets.

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