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Can hybrid securities “fill the gap” between equities and bonds?

Tight bond spreads and stretched equity valuations pose a challenge for many portfolios. Hybrid securities – combining characteristics of both debt and equity – may offer a potential “gap filler” between bonds and equities, allowing investors focused on income and growth in their portfolios to boost returns without taking on disproportionate risk. We identify three benefits hybrid securities can bring to a multi asset portfolio.



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The classic 50/50 equity-bond mix (50% weighted in bonds and 50% in equities) is the backbone of many investment portfolios, offering the growth of equities and the stability of fixed income.

But what if income and growth-focused portfolios could be enhanced further?

Our analysis shows adding hybrid securities to such portfolios can have a positive impact on their overall risk-return, “filling the gap” between equities and bonds and potentially enhancing returns without taking on disproportionate risk.

Key takeaways

- Potentially offering yields in the 5-6% range¹, with higher credit quality than high yield bonds, hybrids have grown globally as a key asset class for many investors.
- While hybrid securities are subject to interest rate risks, investors can manage these risks through an active approach to portfolio management.
- Hybrids offer diversification benefits due to their low correlation with equities, while also enhancing yield, strengthening risk-adjusted performance and building portfolio resilience when drawdowns are actively managed.

1. The ICE Global Hybrid Corporate & High Yield Index that we are using for our analysis has a yield to maturity of 5.6% in US dollars, according to Bloomberg data.

Introducing hybrids: a blend of debt and equity features

Hybrid securities blend features of both debt and equity and typically offer fixed or floating rates of return, paying out in the form of either interest or dividends. Typically, hybrid securities are traded through an exchange such as the ICE Exchange-Listed Preferred & Hybrid Securities Index, which tracks US dollar-denominated hybrid and preferred (a form of hybrid) securities.

Hybrids potentially offer yields in the 5-6% range with average credit ratings around BBB.

Investing in hybrid securities offers the opportunity to gain exposure to a range of instruments:

- **Corporate hybrids:** issued by non-financial firms, these instruments tend to feature long maturities or are perpetual, with call options (giving the bond issuer the right to buy the instrument at a certain price by a specific time).
- **AT1s (additional tier 1):** issued by banks as part of regulatory capital, AT1s carry higher yield but also greater risk, including potential write-downs or conversion to equity under stress.
- **Preferred stocks:** usually issued by financial and utility firms, preferred stocks tend to offer stable income, but their sensitivity to interest rate cycles must be actively managed.

Improving the risk-return profile of traditional portfolios

In our view, with agile management, hybrids can improve the risk-return profile of traditional 50/50 MSCI World/Global Aggregate Corporate portfolios.

They can do this by helping to address one of the persistent challenges many such portfolios face today: compressed fixed income spreads and stretched equity valuations that can result in limited income generation and an over-reliance on equities for returns. By combining the stability of bonds with the upside potential of equities, hybrids can offer enhanced yield and meaningful diversification, improving overall portfolio efficiency.

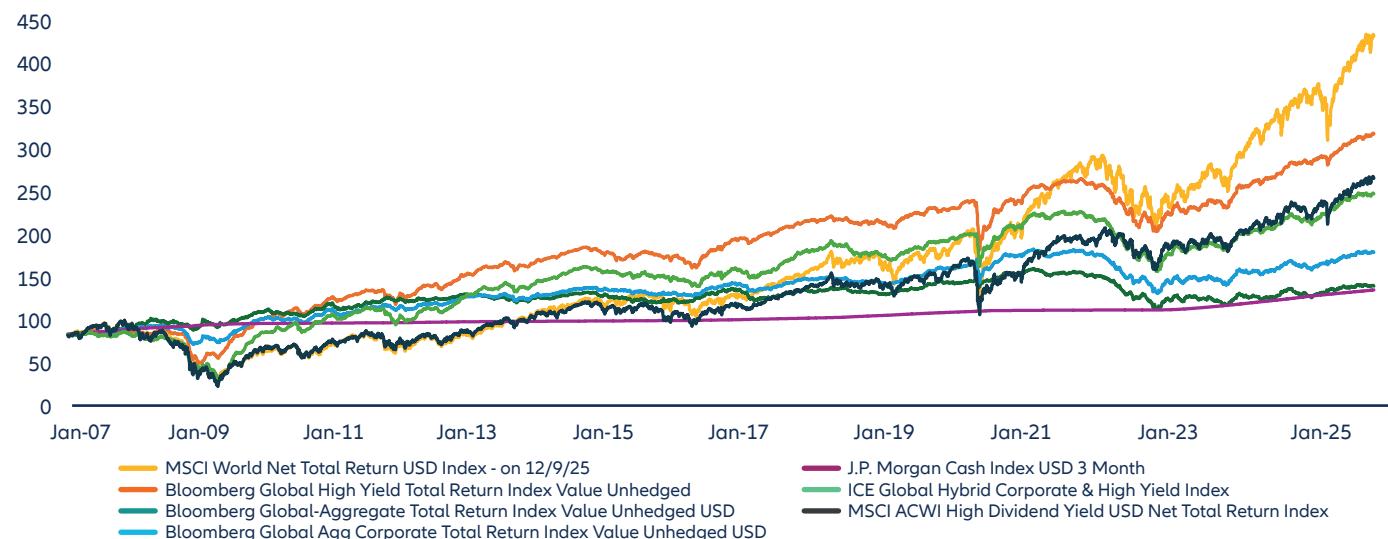
Investing in a range of hybrids can bring three key benefits to an income and growth-focused portfolio, in our view:

Benefit 1: Creating yield without sacrificing credit quality or massively increasing volatility

Hybrid securities typically deliver higher yields than investment grade bonds and rival those of high yield (see Exhibit 1), while maintaining superior credit quality. Positioned between high yield and corporate bonds on the risk spectrum, hybrids offer competitive Sharpe ratios (risk-adjusted return) and medium volatility. They are susceptible to significant drawdowns during market crises. But their risk profile is distinctly “middle ground” – less volatile than equities, but more dynamic than core bonds (see Exhibit 2).

Exhibit 1: Hybrid securities generally deliver higher yields than investment grade bonds

Cumulative returns since 2007



Source: AllianzGI analysis.

CAN HYBRID SECURITIES “FILL THE GAP” BETWEEN EQUITIES AND BONDS?

Exhibit 2: Hybrids offer competitive risk-adjusted return and medium volatility, but are susceptible to significant drawdowns

Index	Total return per annum	Annual standard deviation	Sharpe ratio	Max drawdown	Skewness*	Value at Risk 95%	Correlation to MSCI World
MSCI World Net Total Return USD Index	6.20%	16.80%	0.34	-60%	-0.49	-1.60%	1.00
Bloomberg Global High Yield Total Return Index Value Unhedged	4.60%	5.40%	0.75	-38.8%	-1.66	-0.50%	0.60
Bloomberg Global-Aggregate Total Return Index Value Unhedged USD	1.20%	5.30%	0.03	-27.4%	0.09	-0.50%	0.11
Bloomberg Global Agg Corporate Total Return Index Value Unhedged USD	2.40%	5.40%	0.24	-25.2%	-0.39	-0.50%	0.19
ICE Global Hybrid Corporate & High Yield Index	3.90%	6.80%	0.42	-55%	-0.99	-0.60%	0.36
MSCI ACWI High Dividend Yield USD Net Total Return Index	4.30%	16.00%	0.20	-63.9%	-0.29	-1.40%	0.92

*Skewness refers to the asymmetry of return outcomes for a bond or bond portfolio (the extent to which upside and downside returns are unevenly distributed).

Note: Results are based on cumulative returns derived from a portfolio optimisation we conducted for the period between 1 January 2017 and 10 December 2025.

Source: AllianzGI analysis.

Benefit 2: Improving returns without disproportionate risk

Hybrids can allow investors to boost returns without taking on disproportionate risk. As shown in Exhibit 3, each incremental allocation within a base portfolio of

50/50 MSCI World/Global Aggregate Corporate from global corporate bonds to hybrids delivers historically higher returns for only modest increases in volatility. The most efficient improvements are achieved with moderate allocations, as aggressive shifts tend to flatten the marginal benefit.

Exhibit 3: Gradually increasing allocations to hybrids can deliver higher returns for only modest increases in volatility

Hybrids in an efficient frontier of return to risk optimisation, representing the historical portfolio excess return (over cash) for a given risk level



Source: AllianzGI analysis.

Benefit 3: Delivering diversification benefits to an income and growth-focused portfolio

Global hybrids bring diversification benefits to an income and growth-focused portfolio as they tend to have a moderate correlation with other asset classes (see Exhibit 4). Combining hybrids with equities in a portfolio can help reduce volatility and smooth returns under normal conditions. However, in periods of severe stress, hybrids often decline alongside equities, limiting their protective value. Allocations to core government bonds or cash may be the most effective way to build resilience to a crisis.

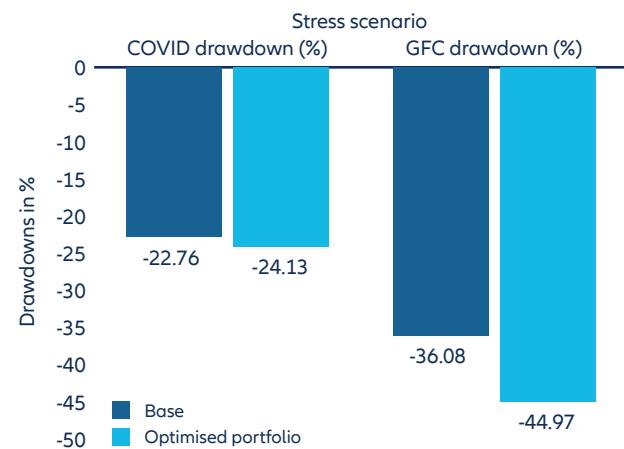
Overall, hybrids do not move in lockstep with global equities and their correlation remains meaningfully lower than that of high yield bonds, supporting their role as a diversifying allocation in portfolios, particularly for investors seeking a balance between income and risk.

Hands-on approach to balance higher return and risk potential

Investors still need to be aware of potential risks when investing in hybrids. One is drawdowns, the peak-to-trough decline in an investment’s value, that can disrupt long-term investment objectives. Hybrids enhance income, but they also increase vulnerability to deeper drawdowns during systemic crises such as Covid-19 and the global financial crisis (see Exhibit 5). Core bonds play a stabilising role within a portfolio and reducing their allocation in favour of hybrids may raise both return potential and risk.

The optimal portfolio construction must balance the pursuit of higher returns with the need for crisis resilience, especially for investors with lower risk tolerance or a focus on capital preservation. Active management becomes especially important when allocating to hybrids, as it enables a timely response to any market stress. Managers can help cushion the impact of deeper drawdowns by closely monitoring portfolio exposure and performing active selection. Ultimately, a hands-on approach is key to balancing the higher return potential of hybrids with their higher potential risk.

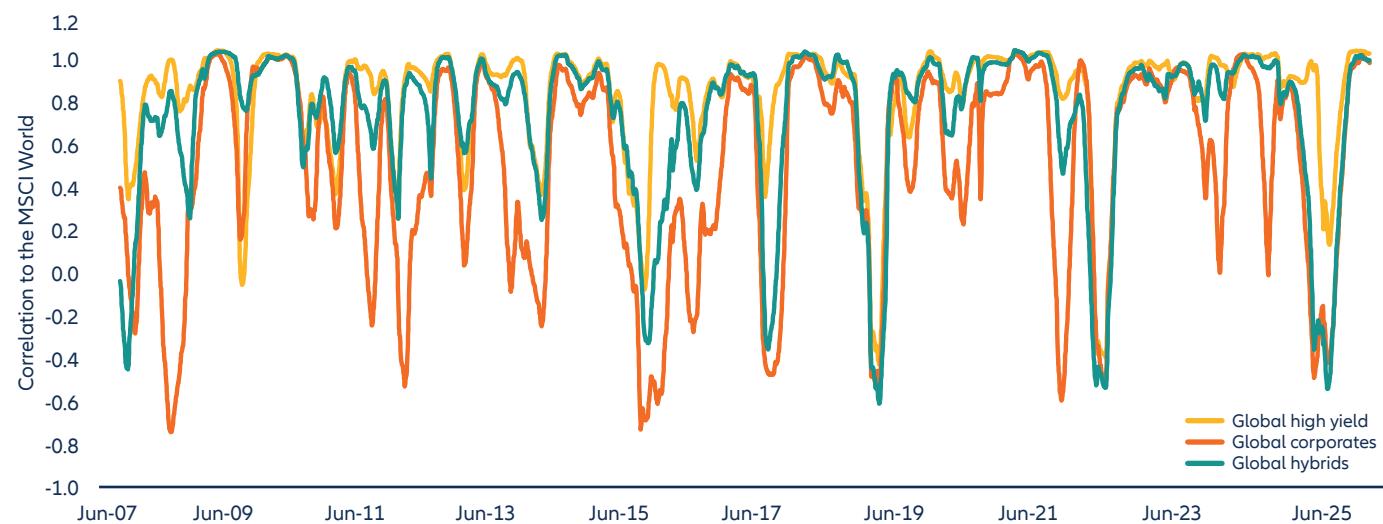
Exhibit 5: Adding hybrids to portfolios can increase vulnerability to deeper drawdowns during crises



Note: the optimised portfolio in the chart above is allocated 50% to MSCI World, 25% to Global Aggregate Corporate and 25% to hybrids. The base portfolio is 50% MSCI World and 50% Global Aggregate Corporate. Source: AllianzGI analysis.

Exhibit 4: Global hybrids tend to have moderate correlations with other asset classes

Rolling six-month correlations since 2007



Source: AllianzGI analysis.

Managing risks through active management

Hybrid securities are also subject to unique interest rate risks that can impact both how long it takes to get back an initial investment (the principal return) and reinvestment opportunities:

- **Extension risks** emerge when interest rates rise as issuers seek to avoid refinancing at higher costs. The result can be a rise in a portfolio's effective duration, slower principal repayments and an increase in investors' interest rate sensitivity, potentially lowering total returns.
- **Contraction risks** occur when interest rates fall as issuers are incentivised to redeem hybrids sooner to take advantage of lower interest payments. While earlier redemption can benefit investors by reducing duration, it can also create reinvestment risk as principal is returned when yields are lower.

Investors can counter these risks through an active approach. An effective way to manage extension and contraction risk is by monitoring a bond issuer's behaviour (for example, monitoring for any signs of moves to make earlier payment of the principal amount plus interest before the scheduled maturity date), call schedules (the dates and prices at which they can redeem the bond before its maturity) and the outlook for interest rates.

Hybrids' role within an income and growth portfolio

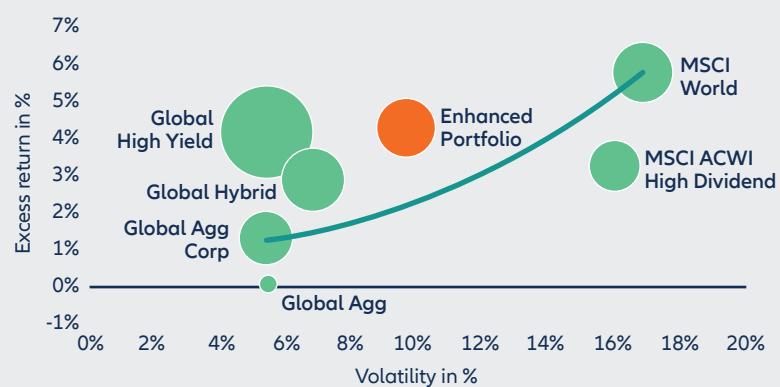
When comparing the risk-return trade-off for major asset classes, a portfolio comprising 50% MSCI World, 25% Global Aggregate Corporate and 25% hybrids stands out for its superior risk-adjusted historical excess returns (see Exhibit 6). This blend captures much of the equity risk premium while substantially reducing volatility and drawdown risk, thanks to the stabilising effect of bonds and the return-enhancing role of hybrids.

Adding 25% hybrids to a 50/50 portfolio (50% MSCI World, 25% Global Aggregate Corp) can raise income by approximately 70 basis points per annum and improve the Sharpe ratio.² But such a portfolio would require active management to mitigate drawdown risk.

Our analysis supports a strategic allocation to hybrids, blending them with equities and bonds to optimise the risk-return profile for long-term income investors.

Exhibit 6: A portfolio incorporating hybrids may offer superior risk-adjusted historical excess returns

Mapping asset returns to risk since 2007



Source: AllianzGI analysis.

Hybrids: enhancing income-focused portfolios

Hybrid securities are a powerful addition to income and growth-focused portfolios. They improve returns without adding disproportionate risk, enhance yield without sacrificing credit quality and deliver diversification benefits by reducing volatility and smoothing returns. As outlined above, the evidence supports their inclusion as a strategic allocation, blended with equities and bonds for efficient, resilient portfolio construction.

² Based on data derived from a portfolio optimisation we conducted for the period between 1 January 2017 and 10 December 2025.

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