

# **PREFERRED STOCKS PRESENTATION**

**August 12, 2017**

## **DISCLAIMER**

This presentation is to help increase the investment knowledge of preferred stocks, enabling individuals to make their own personal research and investment decisions. This is my own personal findings and individuals must perform due diligence in their research and trading decisions.

## **INCOME GENERATING EQUITIES (EX BONDS)**

- \* Preferred stocks
- \* Utilities
- \* Telecommunications
- \* Oil and Gas
- \* Consumer Essential Stocks
- \* Healthcare and Pharmaceuticals
- \* Energy MLPS
- \* Preferred Real Estate REITS

- \* Mortgage REITS
- \* Closed End Funds (Will not cover.)

## **WHY INVESTORS OWN INCOME EQUITIES**

- \* Produces income and growth potential with some equities
- \* Conservative portion of a portfolio
- \* Generally greater price stability
- \* Fewer trades
- \* Can hold some of the equities during minor market corrections.

## **HELPFUL WEB SITES**

- \* [Morningstardividendinvestor.com](http://Morningstardividendinvestor.com)
- \* [Quantumonline.com](http://Quantumonline.com)
- \* [Dividendinvestor.com](http://Dividendinvestor.com)

## **WHY CORPORATIONS ISSUE PREFERRED STOCKS**

- \* Companies may issue preferred stock as an alternative form of financing because they may have already loaded their balance sheets with large amount of debt and risk a downgrade if adding more debt.
- \* Corporations with solid credit ratings generally do not issue preferred stock because preferred dividends are not tax deductible while bond interest is tax deductible.
- \* They may issue preferred stock for regulatory reasons; for example, regulators may limit the amount of outstanding debt.

## **PREFERRED STOCKS**

- \* Preferred stocks are often described as a hybrid investment since they share some characteristics with common stock and some with fixed income securities.
- \* Preferred stock tends to move with changing interest rates in the same way that bond prices do.
- \* They do not share in a corporation's potential for increased profits by having increased share prices and increased dividend payments.
- \* Preferred stocks might have a call provision. The call price is given at the time of issuance of the preferred stock. It is usually the same as the "par" price, \$25/share.
- \* Most preferred stocks pay a fixed dividend set at the time of issuance and paid at a regular schedule set when issued.

- \* Price tends to be less volatile than common stock prices.
- \* Dividends are paid before common stock dividends (senior).
- \* Preferred stock has a prior claim on capital over common stocks in the event of liquidation (senior).
- \* Share prices do not tend to appreciate as fast as common stock prices.
- \* Preferred stocks do not have voting rights.

## **TYPES OF PREFERRED STOCK**

- \* Cumulative preferred stock.
- \* Non-cumulative preferred stock.
- \* Participating preferred stock.
- \* Convertible preferred stock.

## **RISKS WITH PREFERRED STOCKS**

- \* As interest rates rise, preferred share prices will likely fall.
- \* If interest rates fall, the issuer of the preferred stock may call the preferred stock and issue a new preferred stock at a lower rate.

- \* Almost all callable preferred stocks called at par. If shares are above par, holder will have loss when called if holder purchased at above par.
- \* Preferred stocks seldom have a high credit rating. Of the preferred stocks in PFF (i shares U.S. preferred stock ETF) , only 13% of the preferred stocks in PFF have an A rating or higher.
- \* Changes in a corporation's credit rating. A low credit rating corporation with a high yield preferred stock likely will call the high yielding preferred stock if its credit status improves and possibly replace it with a conventional corporate bond (tax deductible).
- \* If a corporation's credit rating deteriorates, the share price of the preferred will fall due to the lower credit rating.

## **MOTIVATION ON OWNING PREFERRED STOCK**

- \* Individuals buy preferred stock because of the higher yield (possibly combined with fear of common stock investing).
- \* Individuals purchasing preferred with high yields need to factor in the greater risk associated with higher yields. Risk factors such as long maturity of the preferred, call features, low credit standing of the preferred, deferrable dividend, etc.
- \* Individuals may buy the preferred stock over other income equities if the yield is higher (risk may be different).

\* Corporations purchasing preferred stock of other companies have favorable tax treatment on the dividend of the preferred with vast majority of the dividend not subject to taxes. Individuals holding preferred stock get no such favorable tax treatment.

## **RULES FOR BUYING AND SELLING**

\* Develop rules for buying and selling that you are comfortable with.

\* My buying rule is that an entity needs to be within  $\pm 3\%$  of the 50 day SMA line.

\* My selling rule is when the share price crosses the 200 SMA line or the entity has an 8% loss.

## **SUMMARY AND SOME RECOMMENDATIONS**

\* In my opinion, as a general rule, preferred stocks have limited appeal for individual investors.

\* If investor wishes to have a portfolio with preferred stock exposure, it is recommended that PFF (i shares U.S. preferred stocks ETF) be bought. This will diversify the risks discussed above. The current yield on PFF is 5.70% (Was 6.4% in early June, 2017).

\* It should be noted that the Morning Star Dividend Investor portfolio does not include any preferred stocks! From Leigh

Anderson's previous presentations, it has performed excellently versus the S & P.

\* Here are two Preferred Stocks that I have owned for many years.

GWSVP –Glacier Water 9.0625% preferred (price on 8/11 was \$26.25/share. Was \$26.20 on June 1.)

HLMp--Hillman Group 11.6% preferred (price on 6/1 was \$34.3982/share, now on 8/11 was 33.20?share.)

