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Preferreds Market Weekly Review: Rising Yields Deliver A Positive Side-Effect

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Summary

- We take a look at the action in preferreds and baby bonds through the first full week of October and highlight some of the key themes we are watching.
- So far, October is shaping up to be another down month in the exchange-traded preferreds sector as the continued rise in Treasury yields is taking its toll.
- One advantage of this rise in yields is that higher-quality preferreds have started to look much more attractive than they have been over the previous few months.
- We also highlight new issuance from Gabelli Dividend & Income Trust, Healthcare Trust and Arbor Realty.
- I do much more than just articles at Systematic Income: Members get access to model portfolios, regular updates, a

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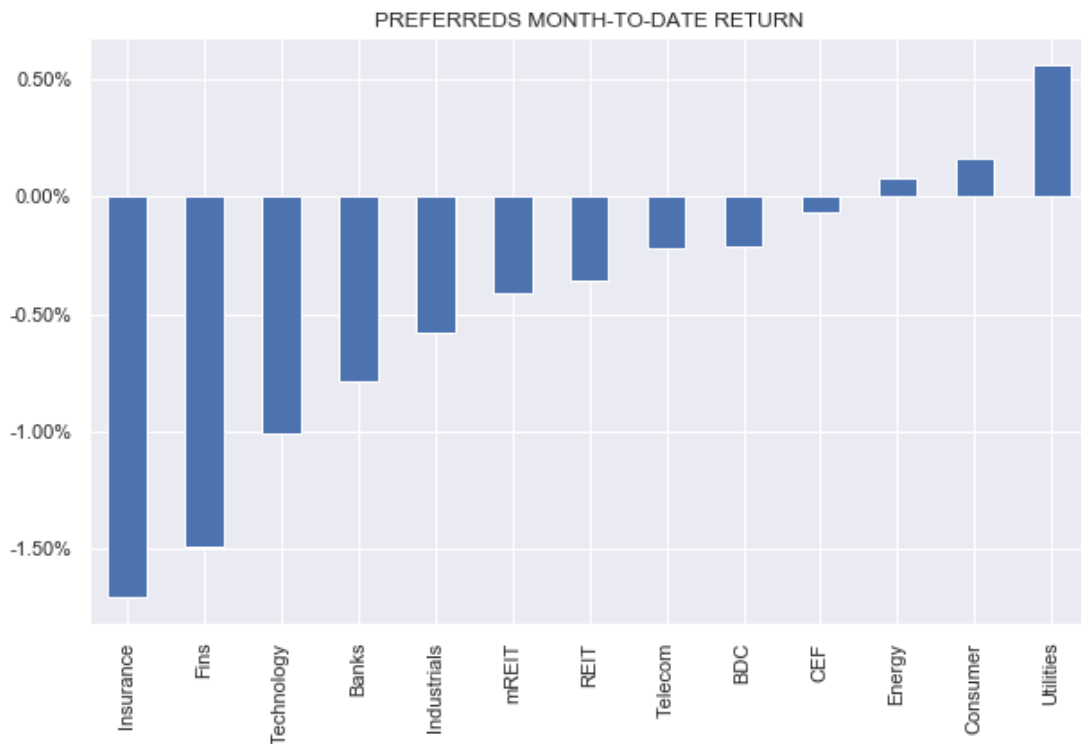
This article was first released to Systematic Income subscribers and free trials on Oct. 10.

Welcome to another installment of our Preferreds Market Weekly Review where we discuss preferreds and baby bond market activity from both the bottom-up - highlighting individual news and events - as well as top-down - providing an overview of the broader market. We also try to add some historical context as well as relevant themes that look to be driving markets or that investors ought to be mindful of. This update covers the period through the first full week of October. Be sure to check out our other [Weeklies](#) - covering the CEF as well as the BDC markets for perspectives across the broader income space.

Market Overview

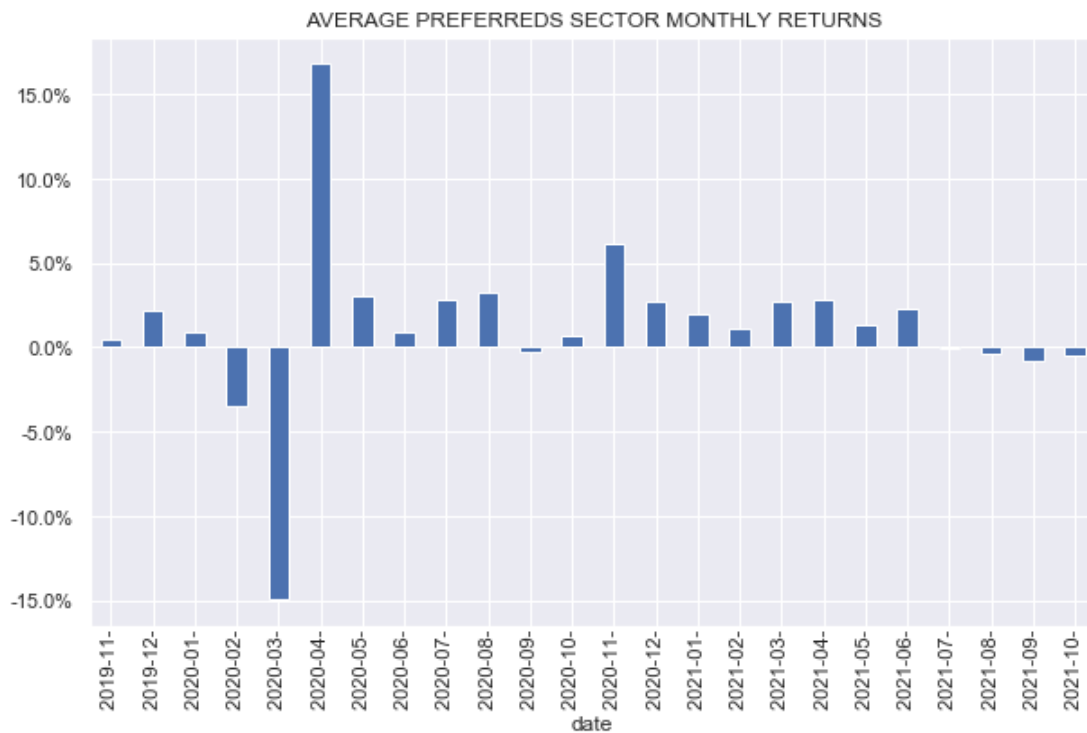
The first full week of October was not able to turn around the direction of the preferreds market which has been moving lower for the last few months.

Month-to-date, most sectors remain in the red with only a handful of sectors like Energy and Utilities eking out a positive return.



Source: Systematic Income

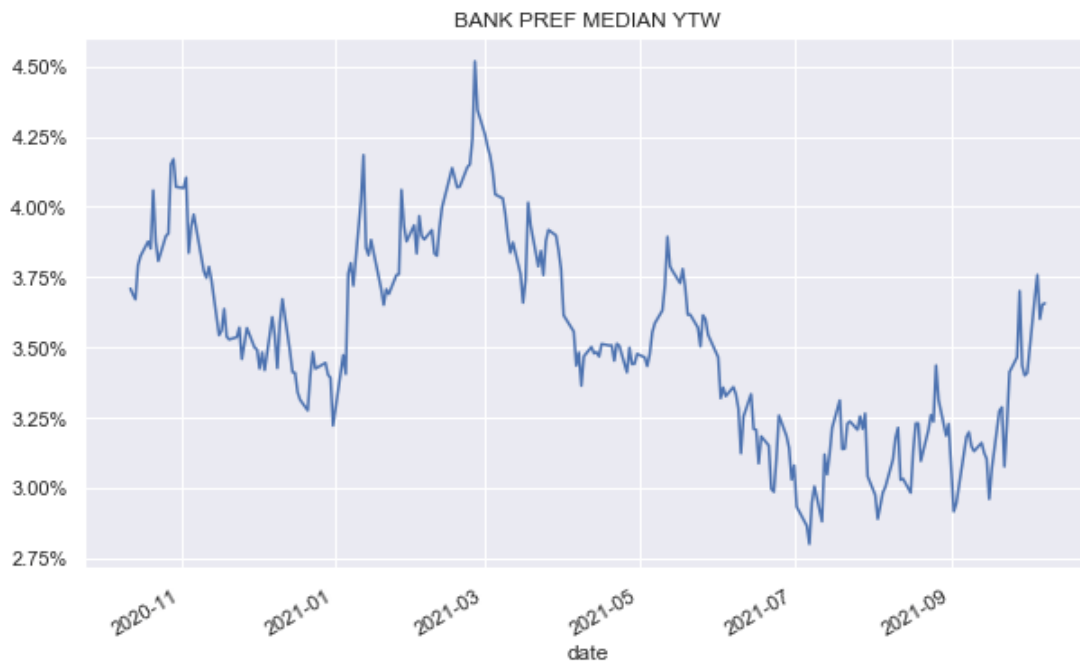
So far, October is shaping up to be the fourth down month in a row, measured by average sector performance after a long string of positive return months.



Source: Systematic Income

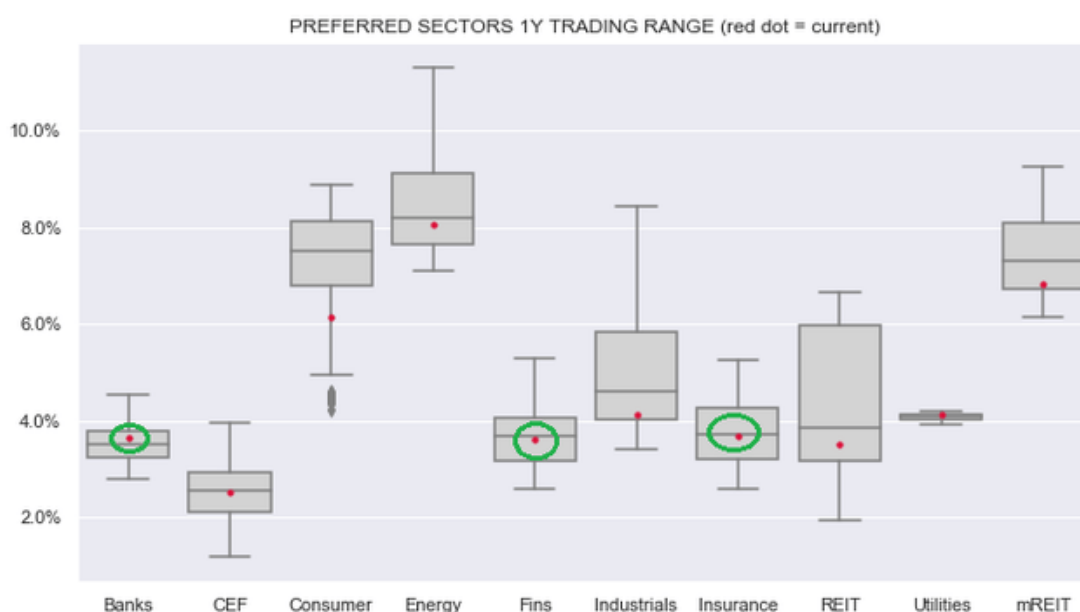
Market Themes

One of the side benefits of the recent rise in Treasury yields is the associated back-up in yields of higher-quality preferreds. The chart below shows the recent trend of the median yield-to-worst of the bank preferreds sector where yields have risen around 0.85%.



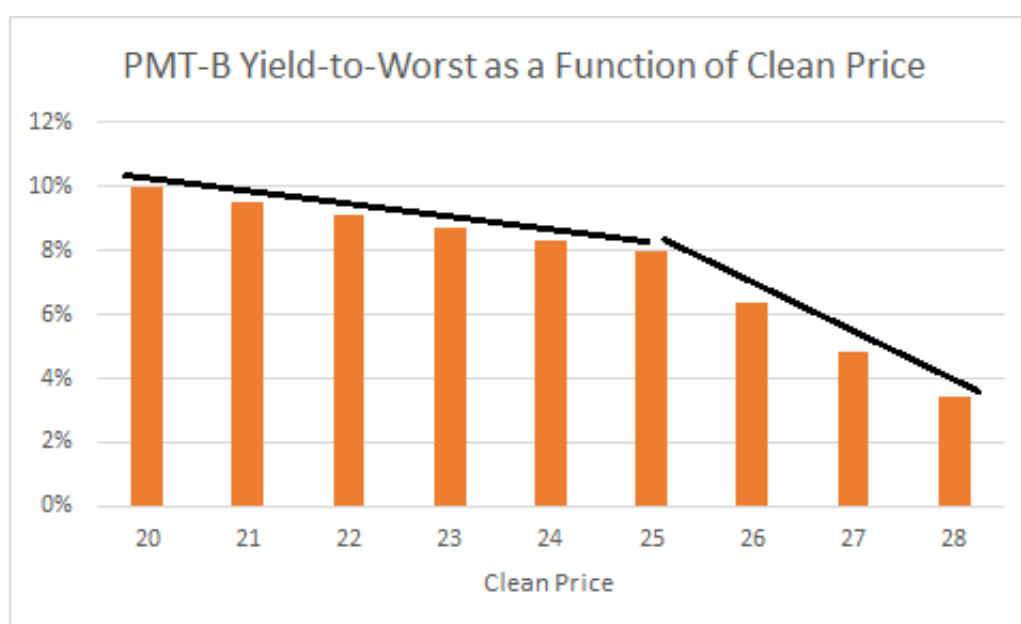
Source: Systematic Income

The chart below shows the 1-year yield range of various preferreds sectors and shows that bank, insurance and financials sectors, which tend to be higher-quality, are currently trading at or above the median level of their 1-year range while other sectors are mostly still below their 1-year median level. The horizontal bar in the box plots shows the median level of the past 1-year range.



Source: *Systematic Income*

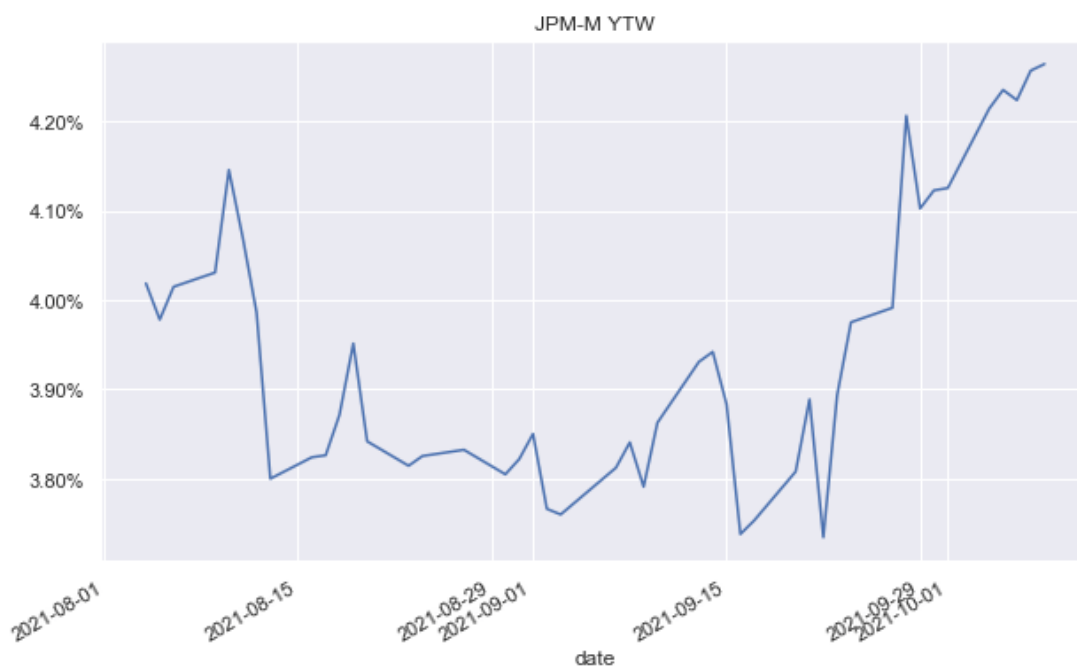
The yields of higher-quality preferreds have risen sharply for a couple of reasons. First, higher-quality preferreds tend to have a longer duration due to their lower coupons - a simple mathematical result of the duration formula of a perpetual security. And the second reason why high-quality preferreds yield have backed up sharply is due to the non-linear behavior of yields when they cross "par" which is described in more detail [here](#). The chart below shows how this works in practice.



Source: *Systematic Income*

As many higher-quality preferreds have been trading well above "par", their descent back towards par has pushed up their yields more than the stocks of other sectors.

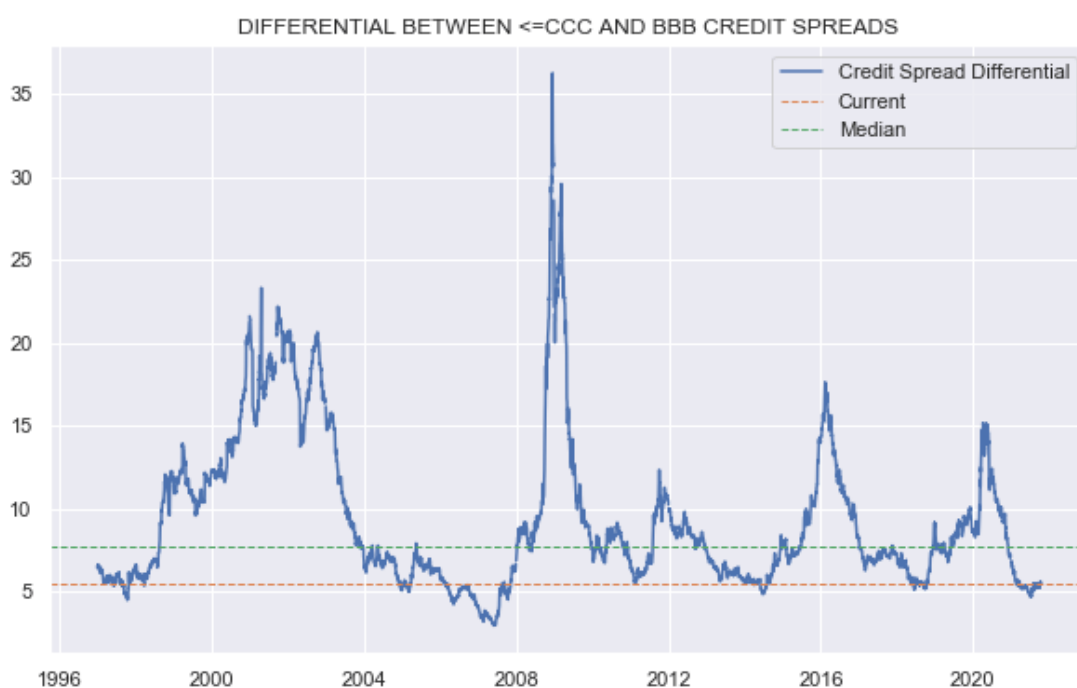
This has resulted in a number of high-quality financial preferreds trading at levels we haven't seen in some time. A few stocks that stand out on this front are the BBB- rated JPM 4.2% Series MM ([JPM.PM](#)) trading at a 4.26% yield which has risen from a yield trough of around 3.75% as the chart below shows. The series is also attractive in the JPM preferreds suite whose other series yields range from 2.12% to 3.98%.



Source: *Systematic Income*

We also like the split-IG rated Huntington Bancshares 4.5% Series H ([HBANP](#)) trading at a 4.33% yield, BB+ rated Regions Financial 4.45% Series E ([OTCPK:RFPEL](#)), trading at a 4.25% yield, BB+ rated SiriusPoint 8% with an attractive 5y CMT + 7.298% reset in 2026, trading at a 4.92% yield.

Although these yields aren't going to blow anyone's socks off they do offer up-in-quality alternatives for investors who don't see much value in being in cash which offers negative real yields but who are also looking to take some chips off the table. The advantage for doing this now is that the yield compression we are seeing across various quality levels means that being up-in-quality now has a near-record low opportunity cost. The chart below shows that the differential between credit spreads of corporate debt rated BBB and that rated CCC and worse is not far from a 25-year low.



Source: *Systematic Income, FRED*

Market Commentary

The Gabelli Dividend & Income Trust ([GDV](#)) has issued the 4.25% Series K ([GDV.KP](#)) to redeem the 5.25% Series G ([GDV.PG](#)). There is also a Series H ([GDV.PH](#)) trading at a 2.24% yield so it's odd they are issuing at such a high coupon especially for a Aa3 (AA- equivalent) rated preferred.

As we suspected the stock has quickly rallied to trade close to 1% above par and a 4.08% yield. That said, it's not a bad choice for a high-quality option. To give an idea of the risk of the preferred - the GDV CEF has \$2.9bn of total assets versus \$300m of preferreds which will likely rise to \$350m after the refinancing as Series K is \$50m larger than G. This means that the fund's assets have to drop more than 88% before they are lower than the liquidation preference of the preferreds which feels like a pretty good margin of safety. Viewed a different way, the equity coverage of the preferreds is 7.4x. The fund has no debt ahead of the preferreds.

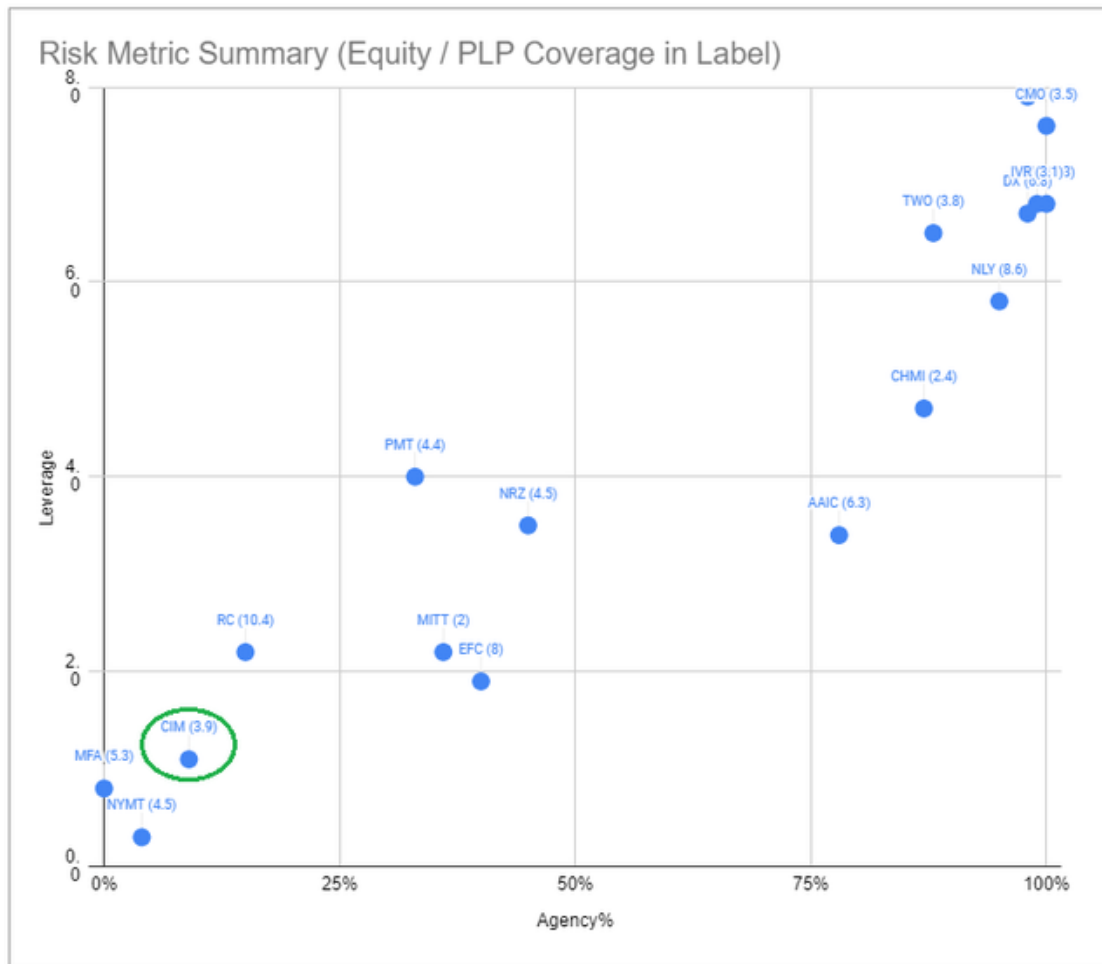
It is curious that Gabelli is the only manager of equity CEFs that persists in issuing preferreds. The combination of low-yielding assets (primarily common stocks) and high-yielding liabilities means the fund's net investment income is very low - 0.37% by out count. This accentuates our general point that investors shouldn't think of equity CEFs as income products for the simple reason that they don't generate much underlying income.

In addition to GDV KP we added two other preferreds to our Preferreds Tool on the service which investors can use to follow the market. One is the REIT Healthcare Trust 7.125% Series B (HLTCP), trading at a 7.04% yield which looks more appealing than the 6.26% yield of its Series A ([HTIA](#)) counterpart. The new mREIT Arbor Realty Trust 6.25% Series F (ABRFV) does not look as attractive as the two other series with the 6.25% Series E ([ABR.PE](#)) more attractive at a 6.28% yield.

Given our focus on the pinned-to-par sub-sector which has remained very resilient over the recent rise in Treasury yields, it is worth mentioning that the mREIT Chimera Investment Corp 8% Series A ([CIM.PA](#)) has begun to trade as a pinned-to-par stock as its first call date is approaching at the end of the month. The stock could very well be redeemed as the other series are trading at a lower yield, recent hybrid mREIT issuance has been below 7% and the proportion of CIM financing from preferreds has risen since Dec-19 as the company's leverage and equity has decreased while its preferred liquidation preference has remained the same.

However, at the current price (clean price is \$25.05) CIM.PA has essentially no call price risk. And if the stock is not redeemed, its 7.98% yield is very attractive in the sector being below only 3 other mREIT preferreds, two from MITT (whose portfolio metrics look much worse) and AAIC.PC which remains the most attractive hybrid mREIT preferred.

The company's risk profile is attractive in the hybrid mREIT sub-sector as shown below. Its leverage is very low at 1.1x with a decent agency allocation of 9% and decent equity coverage of 3.9x. The other preferreds in the sector with a similar risk profile have yields around 0.5% below CIM.PA.



Source: *Systematic Income Preferreds Tool*

Check out [Systematic Income](#) and explore our **Income Portfolios**, engineered with both yield and risk management considerations.

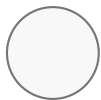
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This article was written by



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