

2 Undervalued 'Preferred Stocks' With Great Interest Rate Protection, Yields +7%

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Summary

- With the specter of higher interest rates from the Fed, we like the interest rate protection from these two preferred stocks.
- These undervalued preferreds provide the strongest protection against rising interest rates.
- With the highest "floating-rate" of their peer class, they secure a steady income despite inflation.
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Produced with: HDO's preferred stock expert "Preferred Stock Trader"

(This article was first published to HDO subscribers on January 27th, and all data is from that date.)

Summary

With inflation running very high, and the Fed threatening much higher short-term rates, I focus on two of our favorite interest rate protected preferred stocks.

1. **SPNT-B** is a “qualified” dividend-paying preferred stock from an investment-grade company that is quite under-valued. SPNT-B has a very high 8% coupon at par which will reset on its call date to 7.3% plus the interest rate on the 5-year Treasury Note (currently an 8.85% reset yield).
2. **NYMTM** is a LIBOR fixed-to-floating rate preferred stock with the highest floating rate in the mortgage REIT sector. NYMTM

has the best balance sheet in the sector and offers up an 8.1% stripped yield-to-call.



Dreamstime

Introduction

I know that investors are very nervous about inflation and rising interest rates. These are certainly totally valid concerns, especially with the Fed now talking about several short-term interest rate hikes and “running off” their balance sheet. Therefore, I looked to find the best and safest preferred stocks which provide the strongest protection against rising interest rates, and at the same time, are quite undervalued.

I queried all reset-rate and LIBOR fixed-to-floating rate preferred stocks and have come up with, what I believe are, the two most undervalued preferred stocks with the best protection against higher interest rates. Both have high fixed-rate coupons, and both convert to excellent floating/resettable yields once they pass their call date – yields that will move higher as interest rates move higher.



SiriusPoint

1) SiriusPoint Preferred Stock

SiriusPoint Ltd 8.0% Series B Cumulative Resettable Fixed Rate Preferred Shares ([SPNT.PB](#))

SiriusPoint Ltd. ([SPNT](#)) is a property/casualty insurance company. This is from the SPNT profile on Yahoo Finance:

SiriusPoint Ltd. provides specialty property and casualty reinsurance products to insurance and reinsurance companies worldwide. It underwrites homeowners' and commercial, workers' compensation, personal and commercial automobile, mortgage, and multi-line reinsurance products; professional, transactional, and general liability reinsurance products; and cyber, marine, travel, and extended warranty reinsurance products.

SiriusPoint came to be from a merger of Sirius Group and Third Point Re (a company backed by billionaire investor Dan Loeb). The preferred “B” shares, SPNT-B, were created as a result of the merger and are extremely generous in their terms – likely due to the fact that they were originally created for their shareholders and not for the public.

Documenting SPNT-B's Large Undervaluation

SPNT is an investment-grade company with a “BBB” rating from S&P. As is typical, the preferred stock is rated two notches lower than the company’s unsecured bond rating. Thus, SPNT-B has a credit rating of “BB+”.

Below is a chart of all “qualified dividend” paying, floating or reset-rate, preferred stocks with the same “BB+” rating plus those with a rating one notch below that at “BB”. **This database does not use stripped prices, which undervalues SPNT-B due to the fact that it will go ex-dividend 50 cents quite soon – February 10th. The current stripped yield is 7.5% and the current stripped yield-to-call is 6.0%.**

Symbol	Last Price	Call Date	S&P	t Rate Fixed	Annual Amount	CY	YTC2
SPNT-B	27.18	26 Feb 2026	BB+	7.30	2.00	7.36	5.62
ARGO-A	26.67	15 Sep 2025	BB	6.71	1.75	6.56	5.00
ESGRP	28.33	20 Sep 2028	BB+	4.01	1.75	6.18	4.69
AL-A	26.10	15 Mar 2024	BB+	3.65	1.54	5.89	4.01
RF-C	27.75	15 May 2029	BB+	3.15	1.43	5.14	3.97
AEL-B	27.36	01 Sep 2025	BB	6.30	1.66	6.05	3.82
VLYPO	25.20	30 Jun 2022	BB	3.58	1.38	5.46	3.63
PBCTP	27.52	15 Dec 2026	BB+	4.02	1.41	5.11	3.39
MS-K	28.00	15 Apr 2027	BB+	3.49	1.46	5.22	3.35
AEL-A	26.80	01 Dec 2024	BB	4.32	1.49	5.55	3.30
VLYPP	27.44	30 Jun 2025	BB	3.85	1.56	5.69	3.24
WFC-O	26.18	15 Sep 2023	BB+	3.09	1.46	5.59	2.90
MS-I	27.31	15 Oct 2024	BB+	3.71	1.59	5.84	2.85
CFG-D	26.95	06 Apr 2024	BB+	3.64	1.59	5.89	2.69
WFC-R	27.22	15 Mar 2024	BB+	3.69	1.66	6.08	2.36
MS-F	27.18	15 Jan 2024	BB+	3.94	1.72	6.32	2.35
C-J	27.05	30 Sep 2023	BB+	4.04	1.78	6.58	2.15
GS-J	26.07	10 May 2023	BB	3.64	1.38	5.27	2.13
KEY-I	29.72	15 Dec 2026	BB+	3.89	1.53	5.15	2.07
C-K	27.13	15 Nov 2023	BB+	4.13	1.72	6.34	2.06
MS-E	27.15	15 Oct 2023	BB+	4.32	1.78	6.56	2.04
GS-K	27.60	10 May 2024	BB	3.55	1.59	5.77	1.74
FITBI	27.74	31 Dec 2023	BB+	3.71	1.66	5.97	0.90
ZIONO	26.54	15 Mar 2023	BB+	4.24	1.57	5.93	0.84
AHL-C	26.91	01 Jul 2023	BB+	4.06	1.49	5.53	0.58
RF-B	28.82	15 Sep 2024	BB+	3.54	1.59	5.53	0.54

Source: Author

This comparison chart shows that SPNT-B is far-and-away the best preferred stock in its credit rating category, with its current yield ('CY') and yield-to-call ('YTC') way above even those preferred stocks with a lower credit rating. And using the stripped current yield of 7.5% and the 6% current stripped YTC, it's even more undervalued.

One important characteristic of preferred stocks is that their YTC falls dramatically as they get nearer and nearer to their call dates, at least in the current environment. A metric that I prefer over straight YTC, is “yield to one-year-from-a-call.” It's often best to sell a preferred stock one year or more before it is callable as the return in the last year is generally going to be quite low. For preferred stocks that sell above par, a large part of the drop in their prices tends to take place during the final year before it can be called. Thus, **YTC often greatly understates the return you can actually receive when purchasing a preferred stock with some years until its call date.**

You can see that a good number of preferred stocks in the list trade below a 2% YTC and some even with a YTC below 1%. ZIONO, for example, trades at a mere 0.75% YTC as it is callable in a little more than a year.

So let's say that SPNT-B will trade at a 1.5% YTC when it's one year away from its call date. That would put SPNT-B's price at \$26.90 one year before its call date creating a total return of 7.5% per year from now until 2/28/2025 (currently, SPNT-B has accrued 40 cents toward its next dividend, so its current stripped price is actually below \$26.90). 7.5% is an extremely high return in the current environment for a BB+ “qualified dividend” paying preferred stock, especially one with incredibly good interest rate protection given its very high reset rate.

SPNT-B's Excellent Reset Rate

If not called on its call date 2/26/2026, SPNT-B will have its dividend adjusted to 7.3% plus the 5-year Treasury Note, and then every five years the yield will be reset based on the then 5-year Note yield.

In the above chart, the column “fixed-rate” shows the fixed-portion of the floating rate. As can be seen, SPNT-B has far-and-away the best fixed-rate portion of its floating-rate formula. Thus, even if the 5-year Note goes to a zero yield, SPNT-B will still provide a 7.3% rate, while the other preferred stocks will float at much lower yields should LIBOR be at zero. So SPNT-B will be the best performer should rates stay low or fall further.

If rates stay the same, SPNT-B will have its dividend adjusted higher to 8.85% given the 5-year Note is at 1.55%. This, versus the other preferred stocks in this list which will see their yields drop significantly when they hit their call dates. This really sets SPNT-B apart from its peers.

And of course, if rates rise further, the 8.85% reset-rate will move even higher in lock-step with the yield of the 5-year Note.

The fact that **SPNT-B resets using the 5-year T-Note, which is currently at 1.55%, while all but one of the others in the above list float with LIBOR, which is only at .25%, just adds to the undervaluation of SPNT-B.** Historically, the 5-year T-Note generally yields more than 3-month LIBOR.

SPNT-B’s Excellent Entry Point

I believe we have an excellent entry point for two reasons.

1. SPNT-B traded above \$30.00 per share at the end of July, and has thus come down quite a bit in price for a preferred stock (current stripped price is now only \$26.78).
2. SPNT-B will soon go ex-dividend with a “qualified” 50 cent dividend on February 10th.

SPNT-B Summary

At its current price, and its stripped current yield of 7.5%, I believe that SPNT-B is extremely undervalued and by far the best preferred stock in its credit ratings category. Additionally, it should outperform all of its peers in a lower, flat, or higher interest rate environment. Its reset rate is incredibly generous as is its current \$2.00 per year annual dividend. It's difficult to see a reason that SPNT-B could trade lower in price due to interest rate changes given its large undervaluation, its quality, and its protection against all interest rate scenarios.



NYMT

2) New York Mortgage Trust Preferred Stock

New York Mortgage Trust 7.875% Fixed-to-Float Series E, Redeemable Cumulative Perpetual Preferred Stock ([NYMTM](#))

New York Mortgage Trust ([NYMT](#)) is a residential mortgage REIT (mREIT). It holds primarily non-agency residential mortgages.

NYMTM is the symbol of its Series "E" preferred stock which is a LIBOR fixed-to-floating rate preferred stock.

NYMT has gone from being the most leveraged mREIT, at the beginning of 2020, to the **least leveraged mREIT** now, but nobody has seemed to notice, causing NYMTM to be undervalued. NYMTM is certainly one of the top REIT preferred stocks for yield and for interest rate protection.

NYMTM Yield Metrics (*as of Jan. 26, 2022*)

- Current Price: \$24.95

- Current Stripped Yield: 7.9%
- Yield To Call: 8.1%
- Annual Dividend: \$1.97
- Call Date: 1/15/2025
- Yield After Call Date: 6.43% plus LIBOR
- Cumulative: Yes
- Taxation: As a REIT, only 80% of your dividends are taxed

Safety

At the start of 2020, NYMT had liabilities plus preferred stock that was 13 times its common stock equity. With that level of leverage, it is hard to believe they survived the COVID-induced stock market crash in 2020.

But that scare apparently brought religion to the management of NYMT. Since then, **NYMT has lowered its leverage from 13 to 1 to an extremely low 1.7 to 1, the lowest of any residential mREIT that I am aware of. In terms of just net debt, leverage is only 1 to 1.**

In terms of liquidity, NYMT has over \$400 million in cash, so with so much cash and a very lower leverage profile, NYMT is looking very safe.

And last but not least, the huge rise in home prices makes NYMT's mortgage loans quite safe, as the houses that provide collateral for their loans are almost certainly now worth much more than the mortgage loans. Thus, it's unlikely to see homeowners walk away from their mortgages when they could instead sell their homes, pay off their mortgage loan, and have money left over.

NYMTM's Undervaluation

Below is a chart of all mREIT LIBOR fixed-to-floating rate preferred stocks sorted by their floating rate yields (highest to lowest). The future yield of these preferred stocks will be "Float Rate Fixed" portion plus LIBOR.

Symbol	Last Price	Call	25.33	Date	Annual Amount	Float Rate	Fixed	CY	YTC2
					1.87		5.35	7.39	6.90
NYMTM	24.99	15	Jan	2025	1.97		6.43	7.88	7.89
PMT-B	26.50	15	Jun	2024	2.00		5.99	7.55	5.33
PMT-A	26.50	15	Mar	2024	2.03		5.83	7.66	5.16
NRZ-A	25.26	15	Aug	2024	1.88		5.80	7.42	7.06
CIM-B	25.07	30	Mar	2024	2.00		5.79	7.98	7.86
NYMTN	25.30	15	Oct	2027	2.00		5.70	7.91	7.74
TWO-A	25.71	27	Apr	2027	2.03		5.66	7.90	7.48
CHMI-B	25.07	15	Apr	2024	2.06		5.63	8.23	8.10
DX-C	25.95	15	Apr	2025	1.73		5.46	6.65	5.61
CIM-D	25.04	30	Mar	2024	2.00		5.38	7.99	7.92
TWO-B	25.00	27	Jul	2027	1.91		5.35	7.62	7.62
AGNCN	25.31	15	Oct	2022	1.75		5.11	6.91	5.25
NLY-F	24.96	30	Sep	2022	1.74		4.99	6.96	7.19
AGNCO	24.97	15	Oct	2024	1.62		4.99	6.51	6.55
NLY-I	25.27	30	Jun	2024	1.69		4.99	6.68	6.27
CIM-C	24.91	30	Sep	2025	1.94		4.74	7.78	7.86
AGNCM	25.11	15	Apr	2024	1.72		4.33	6.85	6.66
NLY-G	24.95	31	Mar	2023	1.62		4.17	6.51	6.68

Author

As can be seen from the chart, the fixed-part of NYMT's floating rate formula (column "Float Rate Fixed") is the best in the sector with a 6.43% fixed-rate portion of its floating rate formula. This floating rate floor (fixed-portion) is more than 50% better than the lowest yielding preferred stock NLY-G. Although NLY is an agency mREIT, and thus they hold mortgages backed by government-sponsored entities, given NYMT's much lower leverage than NLY, and given the strength of the housing market, I believe NYMTM is a far better preferred stock than those offered by the large "blue chip" agency mREITs.

Non-agency mREIT, Pennymac ([PMT](#)), has preferred stocks that make a good comparison to NYMTM. Although the PMT preferred stocks have the second-best floating rate in the above list, their \$26.50 price is much higher than NYMTM's price. Thus, NYMTM offers a much higher YTC than do the PMT preferred stocks. **So why shouldn't NYMTM also trade at \$26.50? After all, it has a better floating rate than PMT preferred stocks with much lower leverage.** While NYMT's leverage, as earlier stated, is 1.7 times, PMT's leverage is 6.2 times. Just more evidence of NYMTM's undervaluation.

NYMTM also is the best value among the four NYMT preferred stocks. NYMT just issued a fixed-rate preferred stock, ticker NYMTZ, with a 7% yield. NYMTM offers a current yield of close to 8% and NYMTZ provides no protection against higher interest rates. Therefore, relative to NYMTZ, NYMTM is rather mispriced/undervalued.

I believe that NYMTM should trade higher due to this relative undervaluation, especially due to its undervaluation relative to other mREIT preferred stocks. Trading closer to \$26.50, as the PMT preferred stocks do, would seem to be a more fair price for NYMTM given its higher floating rate and lower leverage than the PMT preferred stocks, and NYMTM would still have a higher YTC at \$26.50 than PMT preferreds have now.

NYMTM Summary

NYMTM's stripped 8.1% YTC and 7.9% current yield are very attractive relative to other mREIT preferred stocks, and very attractive vs. other relatively safe preferred stocks in general. Given the strength of the housing market, and the market incorrectly pricing NYMTM as if NYMT is still a highly leveraged company, I view NYMTM as mispriced and a bargain at its current price.

Not only is the market missing the huge balance sheet improvement at NYMTM, but also seems to be missing that it has a top-notch floating rate which provides more interest rate protection than any other preferred stock in its sector.

To get to fair value, NYMTM should at least trade back to its June high of \$26.30 which would provide a very nice annualized total return of over 18% should that target be hit over the next six months.

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