Seeking Alpha α

Dividend Ideas

Preferred Market Weekly Review: Higher-Quality Yields Rise From The Dead

Feb. 05, 2022 2:36 AM ET | ARGO.PA, ECC, ECC.PD...

Summary

- We take a look at the action in preferreds and baby bonds through the fourth week of January and highlight some of the key themes we are watching.
- Unsurprisingly, the preferreds sector followed most other income sectors lower this week and remains around 2% down on the month.
- Higher-quality sectors like banks and insurance are now offering yields near 5% - we look at those that combine decent quality and a CMT fix/float structure to manage duration.
- Within our High Income Portfolio we are using our more stable preferreds allocation to opportunistically reallocate to CEFs that have suffered greater drawdowns.
- We are also taking the opportunity to improve the yield profile by rotating within securities of a given issuer such as the new Eagle Point Credit Co. notes, yielding 5.9%.

- I do much more than just articles at Systematic Income: Members get access to model portfolios, regular updates, a chat room, and more. Learn More »

da-kuk/E+ via Getty Images

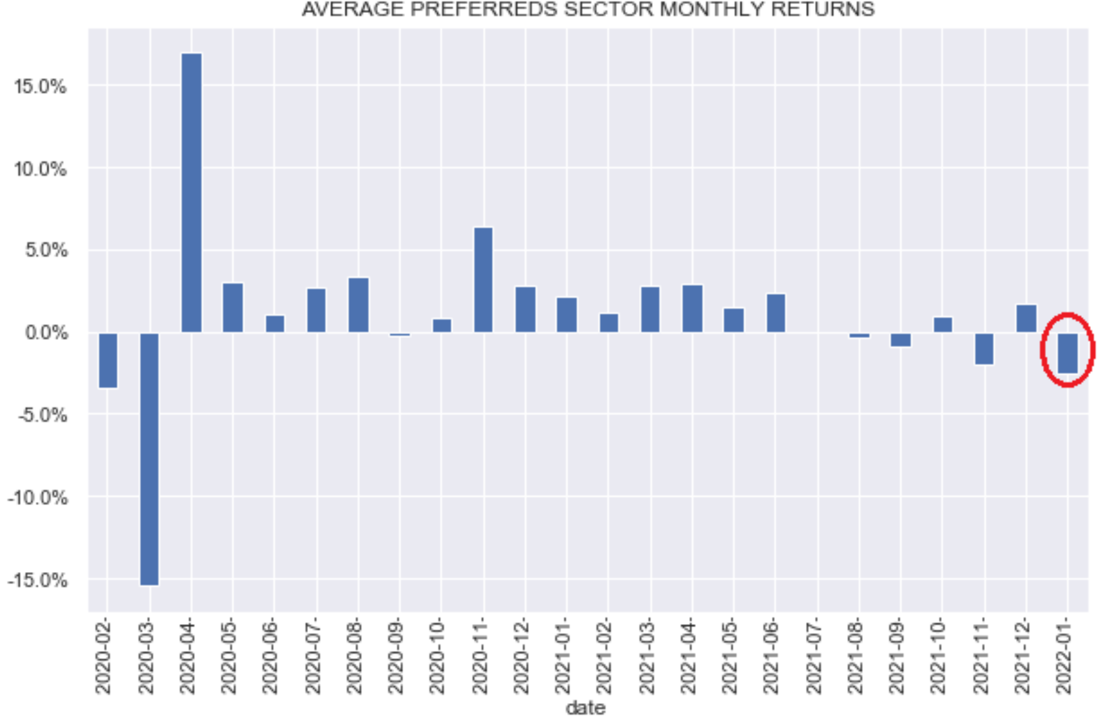
This article was first released to Systematic Income subscribers and free trials on Jan. 30.

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 fourth week of January.

Be sure to check out our other weekly updates covering the BDC as well as the CEF markets for perspectives across the broader income space.

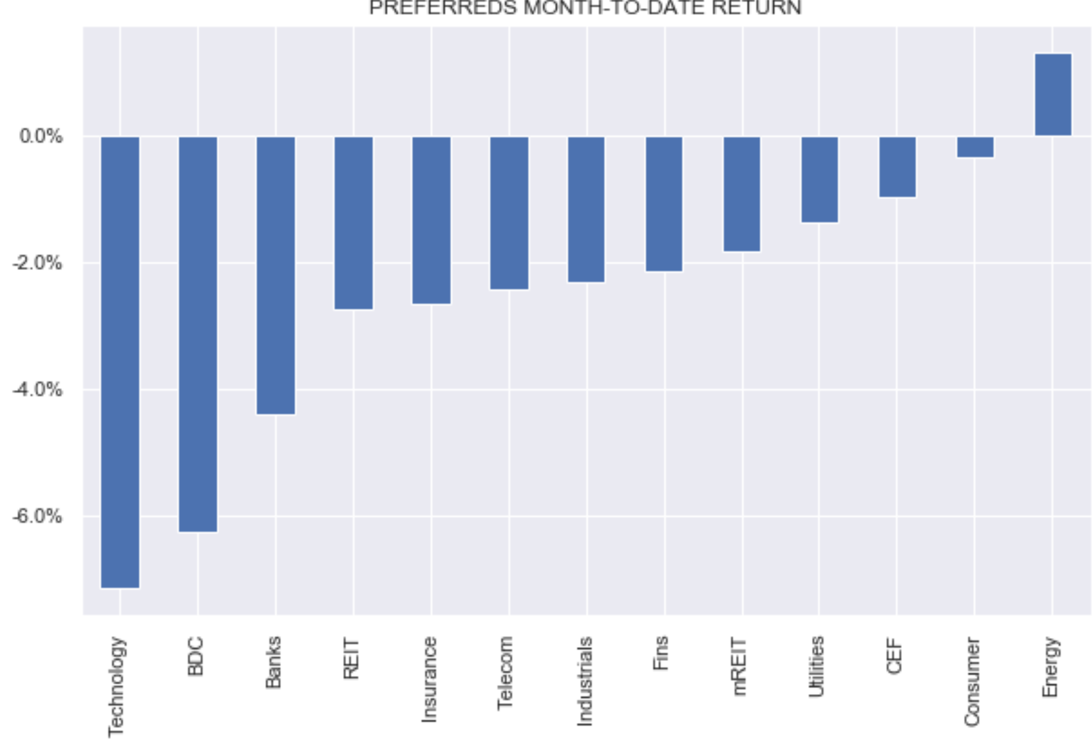
Market Action

Preferreds were down on the week along with most other income sectors. So far preferreds are down about 2% for the month which puts the sector on track for the worst monthly return since March of 2020. More broadly, the sector's drawdown is relatively mild relative to the CEF space which has moved lower more than 5% so far on the month.



Systematic Income

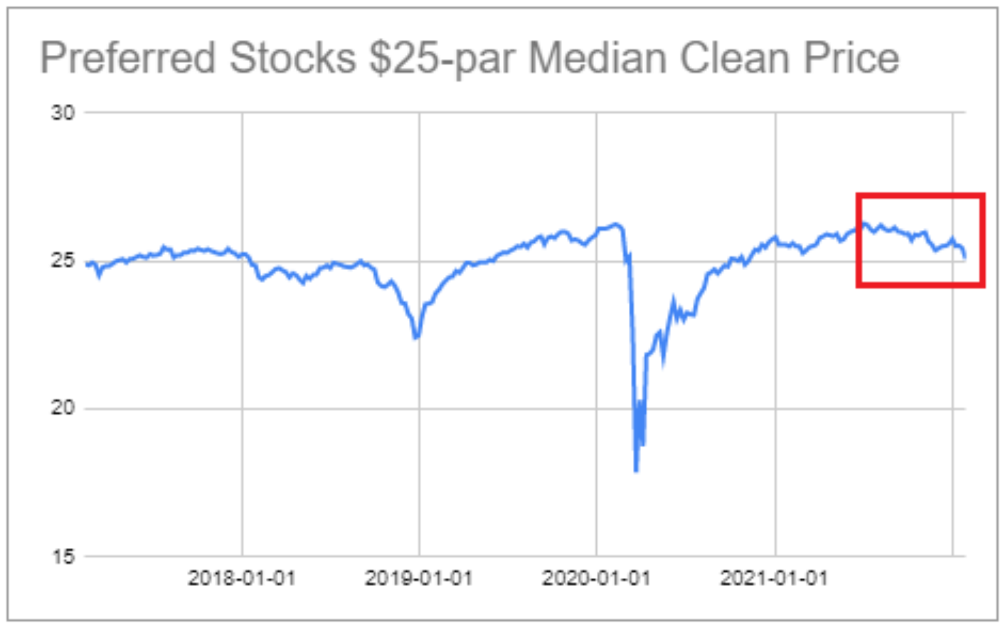
So far only one sector - Energy - remains in the green. We remain overweight CEF and mREIT sectors on the service which have outperformed so far in the current drawdown.



Systematic Income

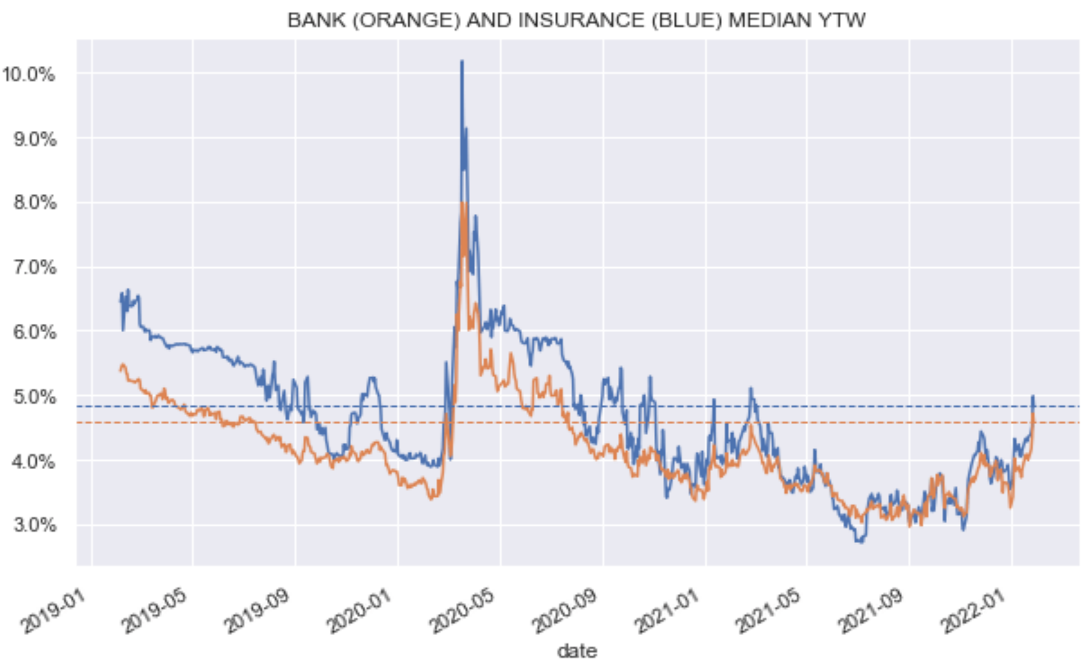
The recent back-up in Treasury yields, stock prices and credit spreads means many of the prices of higher-quality preferreds have moved below "par" which has pushed their yields significantly higher. What's interesting is that longer-term yields which tend to drive moves in higher-quality preferreds have been oddly well-behaved despite sharp moves higher at the front end of the Treasury yield curve.

The median $25-par preferred clean price has been on a downtrend over the second half of the year and is now only a touch above $25.



Systematic Income

Although this stability in longer-term yields does present the risk that long-term yields will start to rise as well, the preferreds sector has, in a sense, pre-adjusted for this move already with higher-quality sector yields moving up close to 2% as the chart below shows.



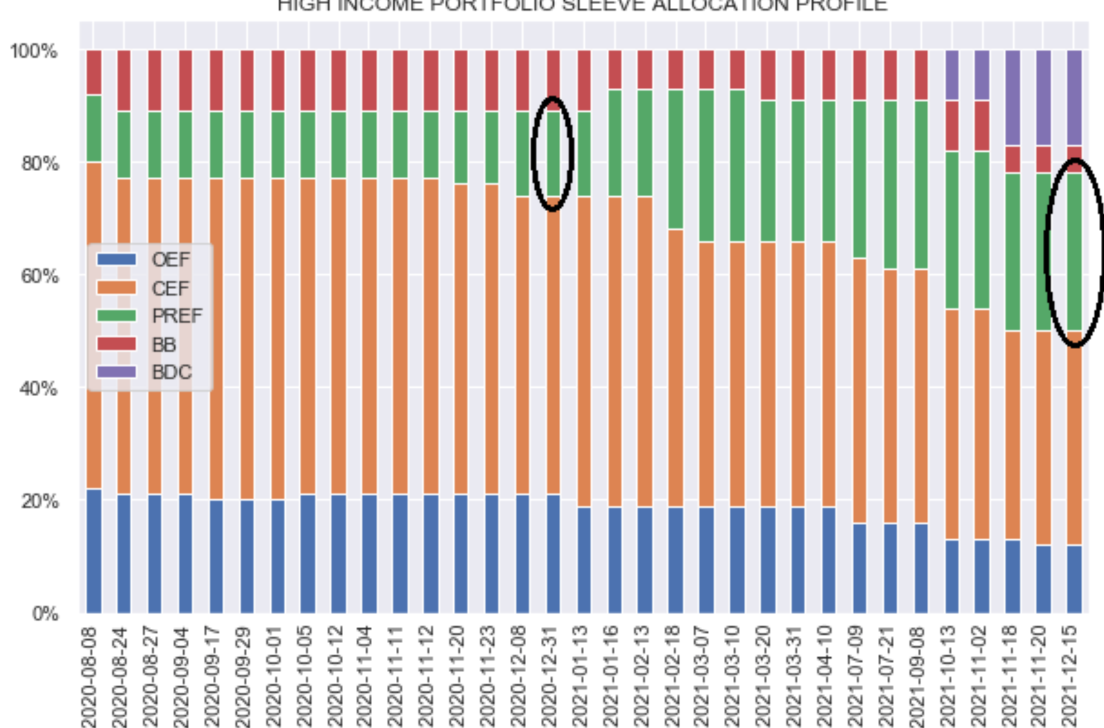
Systematic Income

Investors in preferreds have two broad risk to think about - credit and duration. For many investors neither one may be particularly attractive in the current environment. For these investors, higher-quality fix-to-float securities can be attractive, particularly after the recent rise in yields.

A few worth highlighting are the Argo Group Preferred (ARGO.PA), trading at a 5.7% yield-to-call with a 5Y Treasury Yield + 6.712% reset in 2025 if not redeemed earlier (the company can redeem prior to the first call date at $26) and the SiriusPoint 8% Series B (SPNT.PB), trading at a 5.89% yield-to-call with a 5Y Treasury Yield + 7.298% reset in 2026. The fix/float coupon structure of these two securities means they will participate in higher rates if not redeemed. And because the reset coupons of these stocks (i.e. current 5Y Treasury Yield + the relevant spread) are higher than their current fixed coupons (and the fact that both are trading above "par") suggests that both are fairly likely to be redeemed on the first call date which limits their current sensitivity to interest rates.

Stance & Takeaways

Over 2021 we have been increasing the allocation towards preferreds (and BDCs) in our High Income Portfolio, mostly at the expense of CEFs while maintaining its yield profile.



Systematic Income

The recent drawdown where CEFs have underperformed both preferreds and BDCs, provides a good opportunity to consider a partial rotation back to CEFs, particularly where discounts have moved to double-digit levels. This highlights the ability of preferreds to provide both yield and ballast to an income portfolio.

Apart from eyeing a potential rotation back to CEFs from more stable preferreds base we are rotating within securities of a given issuer, while picking up yield and, often, improving the duration profile. For instance, we have moved to the recently issued Eagle Point Credit Co. 5.375% 2029 Notes (ECCV) from the 6.75% 2031 Notes (ECCW) picking up around 0.55% in yield-to-worst. ECCV is trading at a 5.9% yield, has a 2029 maturity, asset coverage of around 450% and also has stringent asset coverage maintenance requirements that go above and beyond the 1940 Investment Act requirements.

Check out ***Systematic Income*** and explore our **Income Portfolios**, engineered with both yield and risk management considerations.

Use our powerful **Interactive Investor Tools** to navigate the BDC, CEF, OEF, preferred and baby bond markets.

Read our **Investor Guides:** to CEFs, Preferreds and PIMCO CEFs.

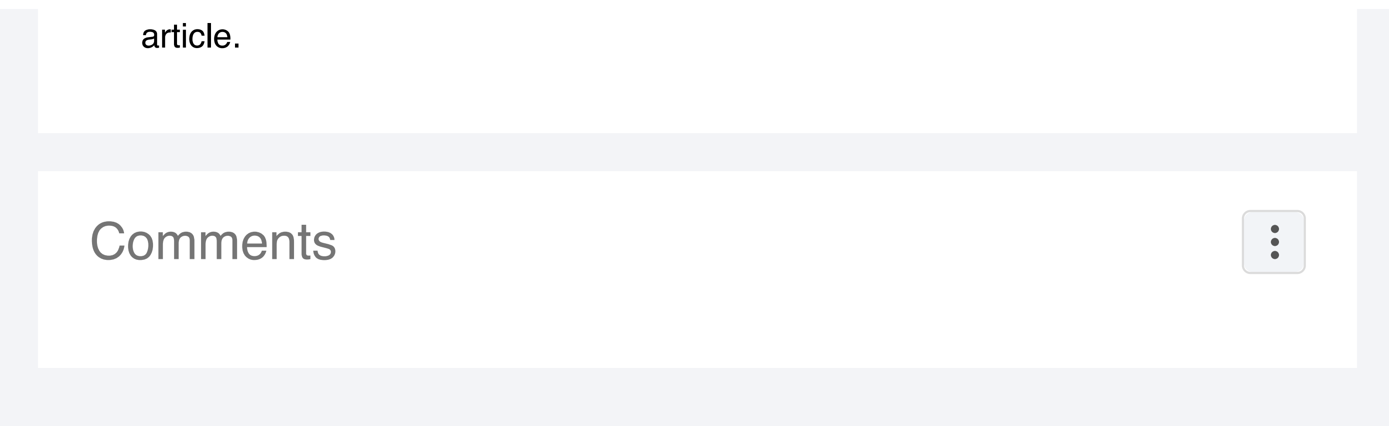
Check us out on a no-risk basis **- sign up for a 2-week free trial**!

This article was written by

Author of **Systematic Income**
Income investing across BDCs, CEFs, ETFs, preferreds, baby bonds and more.

Show More

Disclosure: I/we have a beneficial long position in the shares of SPNT.PB either through stock ownership, options, or other derivatives. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this


article.
Comments