

Investing In Preferred Stocks:  
A presentation to AAll's Sacramento Computerized Investing Group,  
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**Background**

Preferred stocks have more seniority than common stocks, but less seniority than bonds. They pay interest out of cash-flow instead of out of earnings. Companies use preferred stock to raise money. Preferred stock counts as a corporate asset, instead of a debt. "Retail" preferred stocks (those intended to trade primarily among individual investors) typically have a par value of \$25.00 and pay a quarterly dividend. Five years after it is issued, a preferred stock may be called at the discretion of the issuer. "Institutional" preferred stocks (those intended to be traded among institutional investors) are frequently given higher par values (\$100 and \$1000 per share). Preferred shares are investments in perpetuity, until called. The preferred shares of stock companies with long histories of steady dividend payments have low short-term volatility, usually trading in a limited range around their par value. They can be bought or sold at any time. There are about 900 preferred stocks currently trading in US financial markets.

Most preferred stocks are created with a par/liquidation value of \$25, a dividend premium amount, and a discretionary call date, which must be at least 5 years after issuance. These 3 elements do not change throughout the life of the preferred stock.

All other things being equal, preferred stock prices tend to peak on their ex-dividend dates. Investors want the dividends. Because of the dividend, there is a small quarterly wave in the preferred stock price.

As the call date approaches, the price of the preferred stock tends to converge with the call price, especially if a call is likely.

Under current financial market conditions, if an investor buys an investment grade preferred stock at 25\$, s/he is likely to receive about a 6% dividend. If the investor buys at 20\$, s/he may earn a 7% or 8% return. And if the investor sells at 27\$ or 28\$, s/he will also have a capital gain.

Convertible: some preferred stocks can be converted into common stock under conditions specified in the preferred stock prospectus.

Cumulative dividends: some preferred stocks pledge to make up for missed dividends, others do not.

Thorough review, and understanding, of the individual preferred stock prospectus is highly advisable before purchase of a preferred stock because of the wide variation in terms of issuance.

## **Preferred Stock Resources And Websites:**

Definition of “preferred stock:”

[https://en.wikipedia.org/wiki/Preferred\\_stock](https://en.wikipedia.org/wiki/Preferred_stock)

Information on Investing in Preferred Shares:

<http://www.quantumonline.com/>

[Quantumonline \(QOL\) is a good website for researching preferred stocks.](#) It is a free website. After required “registration,” users can make/not make voluntary contributions to the site. PDF copies of the following useful documents may be downloaded:

QOL Glossary of Investment Terms  
QOL Income Investing Basics  
QOL Preferred Shares Ticker Symbols

Free preferred stock newsletter: <http://www.preferredstockinvesting.com/> At this website, you can sign up for the free CDx3 Newsletter. This website is from Doug K. Le Du, who wrote (CDX3 income engine) “Preferred Stock Investing” now in its Fifth Edition.

## **Online Screening and Buying:**

Note: In the following section of the report, the pronouns “I” and “me” refer to Bernard Scoville.

The ticker symbols for preferred stocks are not standardized. Different brokerages and websites use different ticker symbol systems. The QOL Preferred Shares Ticker Symbols document listed above provides explanations of the ticker symbols used by major financial institutions and financial websites. To fully access these stocks, I stayed on the Schwab website - both screening and ordering.

At Schwab, click on Accounts, Research, Stocks, Screeners, Preferred Shares. Then step by step, you can screen and select the preferred shares suitable for you.

Screening is also available at Fidelity, but the Schwab program and criteria made sense to me for simple execution and use. I simply copy the selected preferred ticker symbol to the Schwab order page and complete and place an order.

There is a lot more to preferred stocks, but I already know enough to get started. I am moving some of our emergency money to preferred stocks. Because of low volatility, the money will be available in an emergency. And it will pay more than 6% interest.

## **Preferred Stock ETF's:**

There are many ETFs that invest in preferred shares. Investing in these ETFs may be a better strategy for individuals with little knowledge of the complexities of trading preferred shares, than direct investment in preferred shares. ETFs offer the advantages of diversification and, in many cases, expert selection of appropriate preferred shares. It should be noted that financial institutions are frequent issuers of preferred shares; so it may be difficult to mitigate the “industry” risks of financial institutions in “diversified” portfolios of preferred shares.

Investing in ETFs as a strategy/vehicle for exposure to preferred shares has the drawback that annual expense ratios for preferred stock ETFs range upward from one-half percent of the market value of the investment, even for passively-managed index funds.

The following preferred share ETFs are discussed at <https://www.investopedia.com/investing/preferred-stock-etfs/>:

iShares International Preferred Stock ([IPFF](#))

SPDR Wells Fargo Preferred Stock ETF ([PSK](#))

Invesco Preferred ETF ([PGX](#))

Invesco Financial Preferred ETF ([PGF](#))

### **Preferred Shares and the Individual Investor**

Two of the sources consulted during the research for this presentation suggest that individual investors should be cautious in their ownership of preferred shares. Short quotations from the two sources follow:

[https://en.wikipedia.org/wiki/Preferred\\_stock](https://en.wikipedia.org/wiki/Preferred_stock).

“But for individuals, a straight preferred stock, a hybrid between a bond and a stock, bears some disadvantages of each type of securities without enjoying the advantages of either. Like a bond, a straight preferred does not participate in future earnings and dividend growth of the company, or growth in the price of the common stock. However, a bond has greater security than the preferred and has a maturity date at which the principal is to be repaid. Like the common, the preferred has less security protection than the bond. However, the potential increase in the market price of the common (and its dividends, paid from future growth of the company) is lacking for the preferred.”

Note: The conclusions regarding risks and rewards expressed in the previous paragraph refer to “straight” preferred stock. Preferred shares that are convertible to common stock may mitigate the risks discussed here.

<https://www.cashcowcouple.com/preferred-stock-investing/>

“Because preferreds are issued in perpetuity, they are even more sensitive to interest rate changes than long-term bonds. When interest rates rise, the value of preferred stock will often plummet. When interest rates decline, preferreds don’t benefit like bonds because of their call provision (discussed below).

Thus, preferred stocks are subject to asymmetric interest rate risk, which ultimately makes them unattractive to many individual investors.

### 3) Call Provisions:

Almost all preferreds are callable at par value at the issuer’s discretion, normally following a specified amount of time past the issue date (often five years). This provision hurts preferred stockholders when interest rates decline.

If interest rates fall, the issuer will likely call the preferred stock and replace it with a new offering at a lower rate, thus lowering the company’s overall cost of capital.

Because of the asymmetric interest rate risk and call provisions, preferred stocks rarely trade above their issue price (at a premium).”

An interesting exception to the assertion “...preferred stocks rarely trade above their issue price (at a premium),” Wells Fargo Series L preferred shares, is discussed in Andrew Bary’s Oct. 21, 2018 article in Baron’s, “Opportunities Abound in Preferred Stock.” Wells Fargo series L, with a par value of \$1000, traded on Oct. 21, 2018 for approximately \$1260 per share. The \$260 premium price is based largely on specific terms of issuance that make this preferred share highly unlikely to be called. Trading at a premium price is an enduring feature of this particular preferred share.

### Summary Remarks:

Current US Federal Reserve Bank policy projections clearly portend an environment of rising interest rates, suggesting that individual investors should be cautious about investments in preferred shares at this time. Indeed, some sources seem to suggest that preferred shares are not likely to be a top priority for individual investors in any period of time, emphasizing the inherent difficulties arising from their “asymmetric interest rate risk and call provisions.”

This very brief presentation is not intended, and should not be construed, as investment advice to would-be investors. Every potential investor should determine for themselves whether these, or other, assets are appropriate investments for their particular objectives and circumstances.

Our suggested response to the apparent complexity of investing in preferred shares is to identify and discuss three possible methods/strategies that an individual might utilize to own preferred shares: (1) ownership of individual preferred stocks; (2) utilization of Doug K. Le Du's "CDx3 income engine" methods of selection of preferred shares; and (3) ownership of selected ETFs specialized in investment in preferred shares.

This report and several sources cited in this report are available from the website of AAll's Sacramento, CA Computerized Investing Special Interest Group:

<http://www.wonderfulwebwork.com/investment-info.html>

Article from Barron's on Preferred Stock Opportunities:

[http://www.wonderfulwebwork.com/documents/Opportunities\\_Abound\\_in\\_PREFERRED\\_Stock.pdf](http://www.wonderfulwebwork.com/documents/Opportunities_Abound_in_PREFERRED_Stock.pdf)

If links do not work, copy the web addresses into your browser.