

Try This Alternative Income Strategy

Description

Rising interest rates are putting pressure on stock, bond, and preferred share prices. As ultra-safe investments like GICs and savings account rates rise, higher-risk alternatives such as equities become less appealing. As a result, equities sold off over the past few months, leaving these investments with much higher yields than had been previously available.

Unfortunately, dividend stocks have become to regain some favour as market volatility increases. Stocks like **Fortis Inc.** ([TSX:FTS](#))([NYSE:FTS](#)) [have risen significantly](#) over the past few weeks, leaving higher yields behind as their shares gained in value. While the yields are no longer as attractive as they once were, preferred shares are still relatively suppressed, giving income investors an alternative to earning dividends from the common shares.

Take Fortis for example. While its common shares are only yielding 3.9%, its preferred shares (TSX:FTS.PR.F) have a yield of 5.7% at the current price. [Another company](#), **George Weston Ltd.** ([TSX:WN](#)), is even more extreme. At its current share price, George Weston pays a rather paltry yield of 2.2%. Its preferred shares (TSX:WN.PR.C), however, have a yield of 5.6%. In this case, you can gain a significant yield from extremely stable companies.

Another positive factor in owning preferred shares is that, unlike bonds, they benefit from the dividend tax credit. This makes them incredibly beneficial for people looking for steady, tax-advantaged income. In this way, preferred shares offer the same advantage as a common share dividend.

These equities also have the benefit that, like bonds, they are issued at a certain value and will likely be redeemed by the company at that par value at some future date. Preferred shares are usually issued at the value of \$25 per share.

At the moment, the Fortis preferred shares are trading at \$21.50 and George Weston preferred shares are trading around \$23. It is possible that the company may redeem these shares in the future at the issue price of \$25, building in a small potential capital gain along with the beneficial yield.

Of course, no investment is perfect, which holds true for preferred shares. There are a few drawbacks to owning preferred shares that investors should bear in mind. While it can be beneficial for investors to have their preferred shares redeemed at the issue price, it can also be frustrating if you have planned on the income. The redeemed shares will result in a capital gain tax, and you will have to find another investment to replace the lost income.

Preferred shares also do not benefit from dividend hikes. Companies like Fortis and George Weston have long histories of dividend increases, so over time, the yield on cost from the common shares may actually exceed the current yield on preferred shares. Last year, Fortis increased the dividend on its common shares by 6.25% last year and George Weston by 5% just this month. These increases amount to much larger yields over a long period of time.

As a preferred shareholder, your capital will most likely not fluctuate as much as common shares are likely to do. While this provides a sense of more stable capital, you won't benefit from a whole lot of

upside. If the shares were to appreciate over the issue price of \$25 and the company were to redeem the shares, the capital would be lost.

For this reason, it is highly unlikely that the preferred shares would gain too much in value beyond the \$25 issue price, whereas common shares have theoretically unlimited upside.

Preferred shares are a good alternative to common stock for investors who are looking for steady, tax-advantaged income with a smaller amount of risk. While it is probably a better choice to have a larger portion of your investment income in common stock, using preferred shares as a small, income-generating portion of your income can be very beneficial.

CATEGORY

1. Dividend Stocks
2. Investing
3. Stocks for Beginners

TICKERS GLOBAL

1. NYSE:FTS (Fortis Inc.)
2. TSX:FTS (Fortis Inc.)
3. TSX:WN (George Weston Limited)

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
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Date

2025/08/25

Date Created

2018/12/01

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