Income Seekers: This Forgotten Asset Class Can Make You Rich

Description

Dovishness by the world's central banks have pressured yields to the lowest levels we've seen in years, while leading to a rally in pretty much everything from stocks to bonds and precious metals. However, preferred shares, particularly those with floating rate and rate reset features, have underperformed bonds and equities, as their future cash flows are tied to key interest levels such as the five-year bond yield.

With little inflation on the horizon and chances of rising interest rates in Canada and the U.S., preferred shares have been sold off by income investors in anticipation of lower future dividends. That being said, I believe the market's reaction has been a case of "Throwing the baby out with the bath water," and there are certainly bargains to be had in the preferred space.

The sweet spot when it comes to preferred shares then is to focus on names whose dividends will not be resetting within the next six months, preferably with a minimum interest rate feature and trading below their par value. The last point is particularly important, as many preferred shares have embedded call features, and you certainly do not want to be called away at $25 on a share which you paid $25.50 for.

Below are a few names that caught my eye.

The first is **Brookfield Renewable Partners** (TSX:BEP.UN)(NYSE:BEP) Series 7 (BEP.PR.G). Many income investors should already be familiar with the Brookfield name, which has a ubiquitous presence in the Canadian and international real estate, renewable power, infrastructure and private equity space. With approximately $300 billion under management, Brookfield presents a stable brand name with staying power.

Moreover, through Renewable Partners, Brookfield operates 882 generating facilities in North and South America, Europe, and Asia, while delivering 17,500 megawatts of capacity. Financially, the company is very sound with last quarter's funds from operations came in at $230 million, up from $172 million in the year prior, while revenues were $553 million versus $473 million, as the business benefited from recent acquisitions and operational improvements. Although Brookfield is tied to the five-year CDN bond yield, the preferred share has a minimum rate floor of 5.5% (set to reset in February 2021), which is certainly higher than anything available on the bond market.

The second preferred share on my radar is the **Brookfield Infrastructure Partners** Series 5 (BIP.PR.C). Much like Renewable Partners, this preferred share also has a minimum rate feature of 5.35%. Furthermore, with $66 billion of infrastructure assets, this is another Brookfield brand that features safety and stability. Financially, Infrastructure Partners delivered revenues of $1.69 billion, up from $1.04 billion and FFO of $337 million in the last quarter, up 58% from the year prior, primarily driven by investments made in the global data centre portfolio.

The bottom line

With bond yields so low, investors have crowded into high-dividend-paying stocks in their pursuit of income. However, with stocks and bonds having rallied so far over the past few months, there is tremendous risk of downside capture if the interest rate outlook were to reverse. Fortunately, preferred shares present a safer bet, and with the recent selloff, you’re going to get some great names — like the above two — at a bargain.

CATEGORY

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TICKERS GLOBAL

1. NYSE:BEP (Brookfield Renewable Partners L.P.)
2. TSX:BEP.UN (Brookfield Renewable Partners L.P.)

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Date
2025/07/20
Date Created
2019/09/09
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