Preferreds Still Attractive On A Relative Basis

View from the Observation Deck

1. The yield to maturity on the BofA Merrill Lynch U.S. Preferred Stock Fixed Rate Index closed January 2013 at 6.14%, the lowest it has been on the last day of January since 2004, when it stood at 6.10%.

2. In January 2004, the index posted a yield spread of 197 basis points over the yield on the 10-Year T-Note (see chart), less than half the 415 basis point spread on January 31, 2013.

3. Inflation, as measured by the Consumer Price Index, stood at 1.9% in January 2004, compared to 1.7% in December 2012. So that doesn't explain the difference.

4. The difference between the two climates is the fallout from the financial crisis of 2008-2009. Approximately 80% of all preferred securities are issued by financial firms.

5. The yield to maturity on the BofA Merrill Lynch U.S. Preferred Stock Fixed Rate Index closed January 2009 at 12.12%, while the 10-Year T-Note slid to 2.84% as investors flocked to safe havens.

6. With the aid of the Federal Reserve’s quantitative easing initiatives, the yield on the 10-Year T-Note was driven down as low as 1.39% in July 2012. It stood at 1.99% on January 31, 2013.

7. There are not many opportunities for investors to get a 6.0% yield in this climate, let alone from an investment grade security.

8. Preferreds still measure up, and with a generous yield spread to boot.

Source: Bloomberg. Note: Fixed rate preferred yields taken from the BofA Merrill Lynch U.S. Preferred Stock Fixed Rate Index.

This chart is for illustrative purposes only and not indicative of any actual investment. The illustration excludes the effects of taxes and brokerage commissions or other expenses incurred when investing. Investors cannot invest directly in an index. The BofA Merrill Lynch U.S. Preferred Stock Fixed Rate Index ($25 par) consists of investment grade, fixed and fixed-to-floating rate U.S. dollar denominated preferred securities.