Fixing your income

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WINNIPEG (GlobeinvestorGOLD) – James Hymas is among the few portfolio managers prepared to label a fixed-income fund “aggressive.” Hymas Investment Management’s Malachite Aggressive Preferred Fund, a tiny portfolio of $283,000 of fixed income securities established in March, 2001, returned 15.3 per cent for the 12 months ended June 30, 2002 compared with an average return of 3.0 per cent for Canadian dividend funds and the 9.8-per-cent loss by the benchmark S&P/TSX 60 index in the period. A pooled fund he started for sophisticated investors who can pony up $150,000 in Ontario, it was the top performer among all dividend funds for June with a gain of 1.7 per cent. Mr. Hymas, who sharpened his skills in a decade of work in pension fund management, said the results appear to confirm his view that preferred shares provide good returns for taxable investors. He’s a specialist in the details of preferreds, the prices of which depend on yield, date of redemption (when the issuer gives back the money), and retraction (when the holder can force the company to redeem). Unlike some dividend growth funds that hold common shares of blue chip corporations in hope of capturing rising earnings and dividends, Mr. Hymas’ fund is a pure dividend play on preferreds.

“Preferreds lack the glamour of growth stocks, but their virtue is that they pay a known and tax-advantaged dividend stream in which each buck of dividend is equal to $1.28 of straight interest,” Mr. Hymas said. “Today, preferreds, which are often too illiquid for institution to buy, have returns above what bonds of similar risk pay. Indeed, they represent money waiting to be taken off the table.”

BCE Inc. Cumulative Redeemable First Preferred Shares, Series R (BCE.PR.R - T), are 22 per cent of the portfolio. The shares, which were purchased at an average cost of $25.25, have slipped to $25 amid concern over BCE’s Teleglobe debt and other issues. Nevertheless, the security, with a Pfd-2 rating from the Dominion Bond Rating Service, pays $1.54 per year, a 6-per-cent return that’s the equivalent of an 8 per cent, high quality industrial bond. The issue gives BCE the option of giving $25 to holders on Dec. 1, 2005. If the holder keeps the issue, then the dividend will be reset at a rate that will not be less than 80 per cent of the rate on 5-year government bonds. If the rate is reset, the holder can take it or convert to BCE Preferred Series Q, which pays a floating rate based on the prime rate. Assuming that the bonds convert to Series Q and that the prime climbs by 2005 as business conditions improve, then the shares should outperform their peers for the next few years, Mr. Hymas said.

Power Financial Corp. 5.25 per cent, Non-Cumulative First Preferred Shares, Series E (PWF.PR.E - T), are 24 per cent of the portfolio. The securities were purchased at an average cost of $22.23 and now trade at $22.35. Rated Pfd-1 (low) by DBRS, the shares were picked up by Mr. Hymas at a substantial discount. With a $1.31 dividend, his bargain means the shares pay 5.9 per cent forever since the issue is a perpetual. The issuer may redeem in a period after Nov. 30, 2006 at $26 per share, declining to $25 after Nov. 30, 2010. There is a lot of risk in the issue, since a sustained increase in interest rates would hammer the shares' price. Nevertheless, he said, the issue pays the holder for that risk. Equivalent to a long bond, the issue is a good credit with a very strong financial services company, Mr. Hymas said. Under given conditions, the shares may rise to $26 under normal market conditions, he added.

The portfolio also includes TransAlta Corp. 8.15 per cent Redeemable Preferered Securities (TA.PR.B - T). Accounting for 18 per cent of the portfolio, the security is technically an interest bearing junior subordinated debenture. It resembles a bond that pays fully taxable interest but is nevertheless a preferred that it is redeemable after Dec. 31, 2004 at $25. Mr. Hymas bought the shares for $25.42 and has seen them climb to $25.70. With a coupon of $2.04 per year, equal to a yield of 8.15 per cent, the issue, rated Pfd 2 (low) by DBRS, is backed by the largest investor-owned electrical utility in Canada with deep pockets and abundant revenue.