CANADA TIP SHEET: Hymas Seeks Out Preferred Shares
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TORONTO -(Dow Jones)- Preferred shares and preferred securities don't get much investor attention and that suits James Hymas just fine.

Hymas manages the Malachite Aggressive Preferred fund, with an objective of generating a relatively high level of after-tax income and long-term capital growth by investing primarily in preferred securities and preferred shares listed on the Toronto Stock Exchange. Preferred securities pay holders interest income, while preferred shares generate dividend income.

"The objective is to achieve a good normal base-rate return (which is derived by the regular coupon, or dividend stream), and on top of that I try to take advantage of mispricing in the market to add some capital gain," Hymas said.

In identifying picks, Hymas limits his choices to preferred securities and shares with a minimum rating by Dominion Bond Rating Service Ltd. of Preferred 2, the rating agency's second-highest rating for preferred shares. Within this universe, Hymas looks for the cheapest cash flow packaging implicit in a preferred share or security to make his picks. Cash flows implicit in preferred shares comprise the quarterly dividend, the potential for redemptions or retractions on the preferred shares, the potential for capital gains and applicable taxes.

The potential for capital gains stems from mispricing in the market for a preferred security that can result from the market's lack of liquidity.

"Essentially I'm trying to exploit the lack of liquidity" in order to buy preferred shares and securities at discounted prices, Hymas said.

Mispricing can result from the price of a company's preferred shares unjustifyably coming under pressure in response to the firm's common shares falling out of favor. For instance, towards the end of 1999, TransCanada Pipelines Ltd.'s (TRP) preferred shares "tanked" after the company cut the dividend on its common shares, triggering a big sell-off in the common stock. But "I can't really see that the (preferred shares) were ever in any danger," Hymas said.

The Malachite Aggressive Preferred fund, which was founded in March 2001, is small with less than C$1 million in assets. However, the company's track record, albeit a short one, stands out.

One-Year Track Record Stands Out

As of May 31, the fund had returned 16.3% on a one-year basis, according to Globefund.com. By comparison, the comparable group posted an average gain of 5.0% while the relevant index declined 8.90% over the same period, according to Globefund.com.

As a general rule, Hymas is focused on identifying so-called non-retractable preferred shares. These securities are redeemable by the company, but the holder can't force the firm to take back the shares at any time in the future.

Within this group, Hymas holds TransAlta Corp. (TAC) Preferred B securities and Power Financial Corp. (T.PWF) Preferred F shares.

Another holding is BCE Inc. (BCE) Preferred R shares. These shares are convertible into another series of shares but that series is non-retractable, making the Preferred R shares essentially non-retractable, Hymas said.

Hymas favors the non-retractable group believing he can identify securities and shares offering cheaper packages of cash flows.

In addition, the non-retractable market is less liquid, enhancing the possibility of identifying mispriced securities.

Most investors favor retractable securities because of the flexibility holders have in forcing the company to buy them back, Furthermore, it can be difficult and time-consuming to analyze the various put and and call options embedded in preferred shares and securities, so some investors focus on investing in the safer retractable preferred securities as a way of doing less analysis, Hymas said.

That said, Hymas also holds retractable preferred securities in the fund, including Mulvihill Pro-Ams RSP Split Share Corp. (SPL.A) and Brascan Corp. (BNN) Preferred T securities.

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