



# How Did Preferred Yields React During the Recent Equity Market Selloff?

*A fresh look at the market data that drives preferred distribution yields.*

February 2018

## Executive Summary

MPI is often called upon by clients and wealth advisors to provide expert opinions in the context of establishing preferred stock and preferred freeze partnership structures, or simply valuing existing preferred equity. Given relevant federal tax rules and regulations, including the provisions of Internal Revenue Code Section 2701, it is critical that clients have a qualified team of professionals providing the appropriate support in these matters. MPI has the experience and expertise necessary to assist clients with preferred equity structures and leans on its proprietary databases and models to support its opinions.

## MPI Preferred Stock Model

With the recent equity market selloff in February 2018, clients and advisors are curious about the impact on preferred stock. According to business news outlets, the selloff was triggered, in part, by increases in interest rates. Since there is an inverse relationship between asset values and interest rates, it is possible that the rapid increases in interest rates in recent weeks, as evidenced by movement in the 10-year Treasury Yield, drove the selloff.

Preferred stock is often viewed as a debt-like instrument due to its fixed dividend rate. This implies that preferred stock is valued and trades like debt, meaning increases in market interest rates may push preferred yields higher and preferred stock prices lower.

MPI conducted an update of its preferred stock database as of February 12, 2018, and compared general levels of interest rates to those observed on December 31, 2017. Interest rates and preferred stock yields have been low by historical standards, but may be headed higher. As shown below, the median preferred stock yield rose 80 basis points during this short period.

As of February 12, 2018, the median yield of the 199 publicly traded preferred stock issues that met MPI's criteria for inclusion in its latest model was 5.8% using the yield-to-worst convention. The yields ranged from 4.4% to 8.1% for the middle 80% of the observations. The database includes preferred stocks from issuers in a variety of industry categories, including asset management, banking, capital markets, hospitality, insurance, media, oil and gas, real estate, telecommunications and utilities.

Prices of preferred stock for the most highly leveraged issuers generally traded at yields of between 6.0% and 8.0%. For clients considering various estate and corporate planning alternatives, these capital market conditions might warrant consideration of a preferred freeze structure. At other points in history, highly leveraged preferred stock traded at significantly higher yields.

Factors that seem to drive investors to demand higher or lower yields in today's market include asset coverage, earnings coverage, the issuer's total leverage, and the size of the issuing company. Weaker issues, such as those with lower asset and earnings coverage ratios, tended to trade at yields between 6.5% and 8.0%. Preferred stocks of smaller sized companies tended to trade at yields between 6.5% and 8.0%.

**In comparison, as of December 31, 2017, the median yield of the 190 publicly traded preferred stock issues that met MPI's criteria for inclusion in the model on that date was 5.0%, or 80 basis points lower than at February 12, 2018.** The yields ranged from 2.8% to 7.2% for the middle 80% of the observations.

Further comparisons are contained in the following table:

MPI Preferred Stock Model: Summary of Recent Data							
Model Date	# of Issues	Median Yield	Percentile		High Leverage	Low Coverage	Small Size
			10th	90th			
12/31/2017	190	5.0%	2.8%	7.2%	6.1%	6.6%	6.5%
2/12/2018	199	5.8%	4.4%	8.1%	7.1%	7.5%	7.2%
Basis Point Chg. =>		80	150	90	100	90	70

MPI regularly provides opinions to clients that are establishing terms for preferred stock and preferred freeze partnerships, or valuing preferred stock for transfer tax, income tax or corporate purposes. If you have any questions about the MPI Preferred Stock Model or our valuation and advisory services, please contact your local MPI professional.

**For Information Please Contact:**

**Todd G. Povlich, ASA**

Partner

Phone: (212) 390-8310

**[tpovlich@mpival.com](mailto:tpovlich@mpival.com)**

**About MPI**

*MPI, a prestigious national consulting firm founded in 1939, specializes in business valuation, forensic accounting, litigation support and corporate advisory work. MPI provides fairness opinions, sell-side and buy-side advisory services through its investment banking affiliate MPI Securities, Inc. MPI conducts every project as if it is going to face the highest level of scrutiny, and its senior professionals have extensive experience presenting and defending work product in front of financial statement auditors, management teams, corporate boards and fiduciaries, the IRS, other government agencies, and in various courts.*

Please visit [www.mpival.com](http://www.mpival.com) for more information on our valuation and advisory services.