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Banking on yield

Harrison Waddill writes:

It's no front-page news that bank stocks are on the outs (a quoted authority in the Aug. 19 *Wall Street Journal* called them "un-investable") or that the bond market is a yield desert. Despite the first fact and because of the second, we return to the opportunity in fixed-to-floating bank preferred shares.

Incorporated by reference (see the issue of *Grant's* dated Jan. 10) are the salient facts about these securities—that they pay a fixed-rate dividend until the call date, after which, if not called, the dividend floats at a spread to Libor or a succeeding benchmark interest rate. For example, if uncalled by Nov. 10, 2022, the payout on the Goldman Sachs 5s would reset quarterly to a rate equal to three-month U.S. dollar Libor plus 2.874%—to 3.11%, if today were the day.

The shares are undated—perpetual—and the dividends, which the issuing bank may suspend at its convenience (in keeping with the specifications for loss-absorbing Tier 1 capital), are noncumulative. On a brighter note, the dividends receive qualified tax treatment, meaning that they are taxable at a maximum federal preferential rate of 20%. New Yorkers, Californians and other blue-state fiscal martyrs may approve.

Featured here again, as in January, are the fixed-to-floating, non-cumulative preferred stocks of Goldman Sachs Group, Inc., Citigroup, Inc. and JPMorgan Chase & Co.

Up first are the Goldman Sachs 5% Series P preferred shares (CUSIP: 38148BAD0), of which $1.5 billion are outstanding. Rated Ba1/BB, they change hands at 97.4 to yield 6.3% to the November 2022 call date (an increase of 190 basis points since we wrote in January), or 581 basis points over Treasurys. For a maximally taxed New York City–based investor, the after-tax yield would amount to 4%.

Goldman showed a common-equity Tier 1 capital ratio (that being the highest grade of regulatory capital) of 13.3% at the end of the second quarter. Return on equity had dwindled to 6.1% over the past 12 months compared with a 10-year average of roughly 10%. At last report, reserves for loan losses covered 98.3% of nonperformers, which amounted to 3.28% of total loans.

Citigroup, Inc.'s 6.3% Series M preferred shares (CUSIP: 172967HQ7; $1.75 billion outstanding; rated Ba1/BB+) change hands at 107 to yield 4.23% to the May 2024 call. Citi showed a Tier 1 capital ratio of 11.59% at the close of the second quarter while its 12-month trailing return on equity drooped to 7.1% versus a 10-year average of 4%. Reserves covered 452% of nonperformers, which weighed in at 0.79% of total loans.

Pitched higher on the credit-rating scale are the JP Morgan Chase & Co. Series X preferred shares (CUSIP: 48126HAC4; $1.6 billion outstanding; rated Baa2/BBB-), which trade at 107.1

Bank preferred income sampler

	Cusip	price	percent change in price*	yield to call (in %)	yield increase/ decrease (in bps*)	date of first call	credit rating	amount outstanding (in $ bns)
Goldman Sachs 5 Perp	38148BAD0	97.4	-4.1%	6.30%	190.1	11/20/22	Ba1/BB	1.5
Citigroup 6.3 Perp	172967HQ7	107.0	-1.6	4.23	15.1	5/15/24	Ba1/BB+	1.75
JPM 6.1 Perp	48126HAC4	107.1	-2.5	4.18	38.9	10/1/24	Baa2/BBB-	1.6

* Since the Jan. 10, 2020 issue of *Grant's*.

source: company reports

to yield 4.18% to the October 2024 call date. On June 30, JPM showed a CET1 ratio of 12.4%. Morgan's trailing 12-month ROE, too, betrayed the ravages of Covid-19, with a dip to 10%, which, however, happened exactly to match the 10-year average of 10%. Reserves covered 399% of non-performers, which ticked up to 0.82% of total loans, from 0.52% in January.

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