

30 September 2013

Dear Investor

PREFERENCE SHARES: A HIGH YIELDING ALTERNATIVE.

With equity markets up 12.02% (Year to date) and touching new highs every other day, one could be forgiven for looking to take some money off the table. But where do you take your profits to? Cash returns are at an historical low and other yield assets (fixed rate bonds and property) face some downside capital risk if yields trend upwards from here.

A solid option, in our view, over the next 12 – 24 months is the listed preference share market. In contrast to other asset classes the pref market is trading near historical lows. To our minds there is no fundamental reason for this weakness, and given the search for yield, preference shares stand out from the crowd. The preference share index is currently yielding 7.7% forward (as a dividend).

FTSE/JSE Preference Share Index

Weekly 20/07/2008–29/09/2013



Moreover the preference share market is geared to the upside if cash yields move up as the contracted yields are linked to the interest rate market. For example the Standard Bank Preference Share (SBPP), the largest listed pref by market cap, is currently yielding 87.25% of Prime (8.5%) or 7.42%. If Prime moves up by 1%, the pref yield will increase by 0.87% to 8.29%. Looking at comparative data the Standard Bank 3 year floating rate bonds (e.g SBS22) are yielding around 5.9%.

Despite the changes induced by the introduction of Dividends Withholdings Tax (DWT) last year, preference shares remain very tax efficient. The current yield generated by the index at 7.7% would be taxable at 15% for individuals which amounts to 6.55% after tax. If converted to a pre-tax (@ 40%) yield to compare with cash, this equates to 10.9%. Importantly, the DWT only relates to individuals and family trusts and DWT does not relate to companies and retirement funds.

The recent slump in capital values can most likely be attributed to simple demand and supply dynamics – probably one or two larger sellers offloading their holdings in an illiquid market. The fear factor has then played its hand as disgruntled investors sell on the back of the weak markets and so the market becomes weaker still.

In conclusion, the preference share market is trading at near historical lows. It is significantly less volatile than the conventional equity market and offers an attractive yield of nearly 8%. Grindrod offers two points of entry, the Grindrod Diversified Preference Share Fund, a unit trust managed by Grindrod Asset Management and PREFEX the only preference share ETF to trade on the JSE and originated by Grindrod Bank Limited.

Regards

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