Retirement SIG

Scorecard on last year's 8 Income Ideas
Plus a Few Other Topics

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Jan 13, 2022

Caveat Emptor!

I am a Registered Investment Advisor Representative of Millstein Advisors, LLC, a Registered Investment Advisor.

This presentation <u>is not</u> a recommendation for any particular tactic, strategy, purchase, sale or other transaction. <u>This presentation is informational</u>.

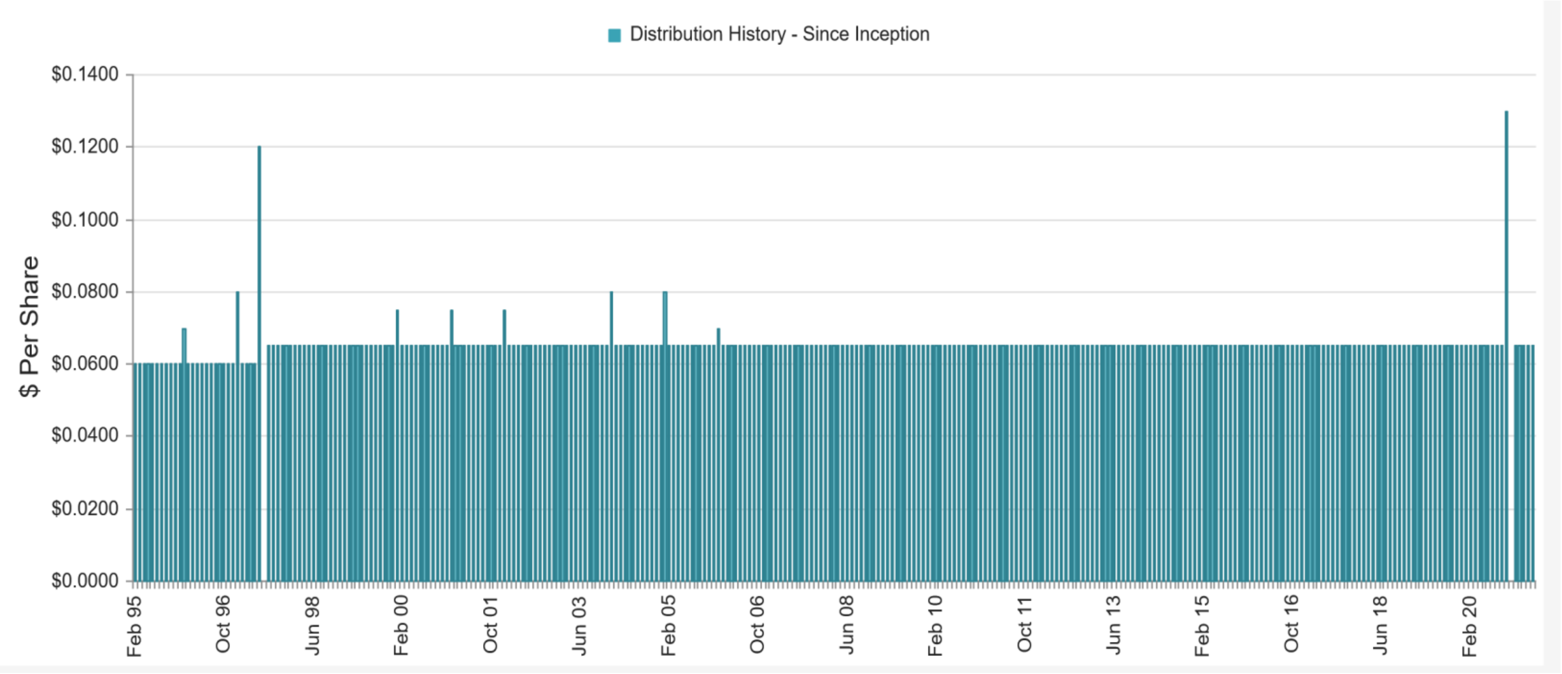
The following are some ideas you may find useful. It is impossible for me to know whether any of these ideas are appropriate for your particular situation. As Members of AAII, I fully expect that you will be able to make that judgment for yourself.

Agenda

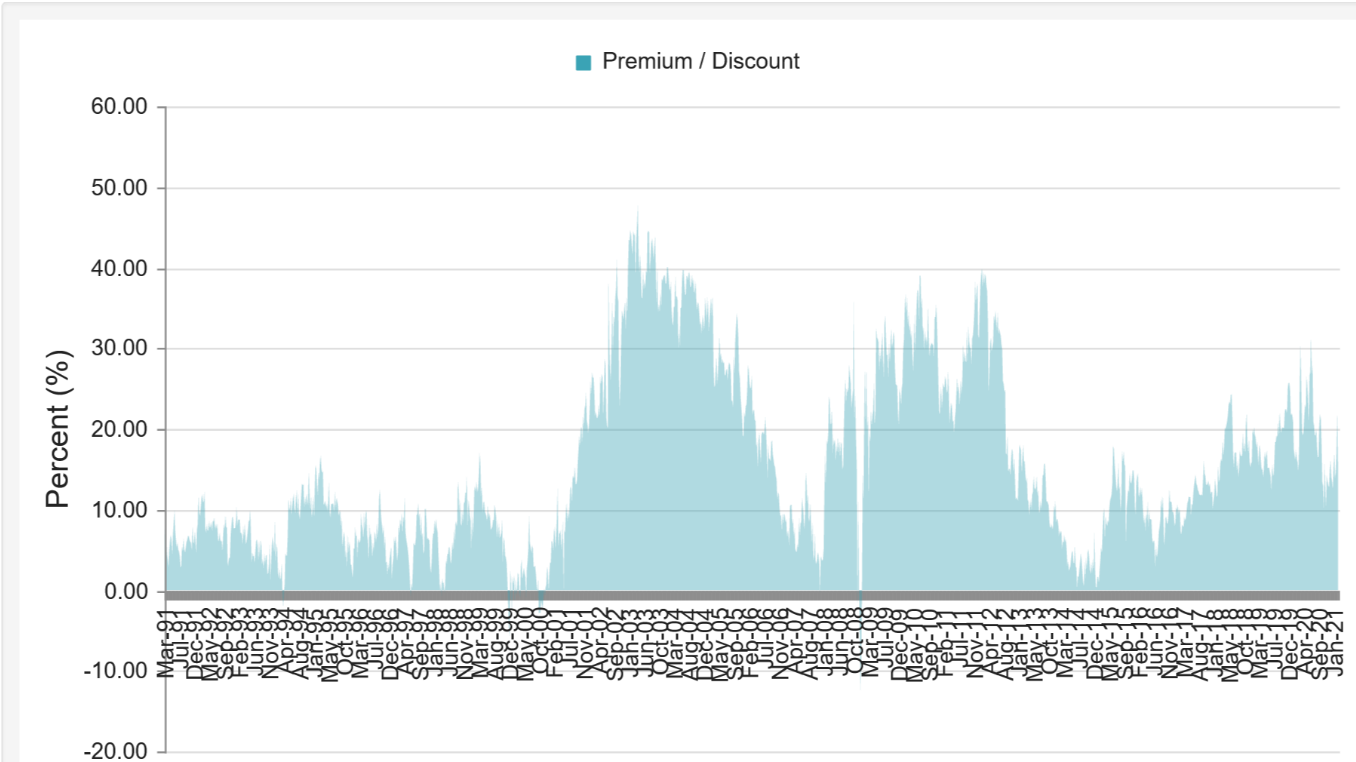
- Review of 8 Ideas for Generating Income from last March
  - The opening slide of that presentation noted
    - The challenge for today’s session:
      - Rates are low
      - And everyone believes they are going higher
  - Seems not much has changed
    - We’ll look at how these ideas worked out
- The Air II Fund
- The case against put writing / covered calls

Most Controversial Idea First

- DNP yielded ~7.6% last March; now 7.2%
  - Yield ↓ because price ↑ (10.90 vs 10.10)
- Dividend remains outrageously consistent



Here’s the Rub



- It trades at a persistent premium
- Yield is based on price, though. What premium, if any, would you pay??
  - 11% ($1.10) last Thursday
  - Bought some 4/8/21 at $0.48 ($9.94) and 4/20 at $0.45 ($10.18)
    - For these purchases, the premium is already covered….

And it will bounce Around

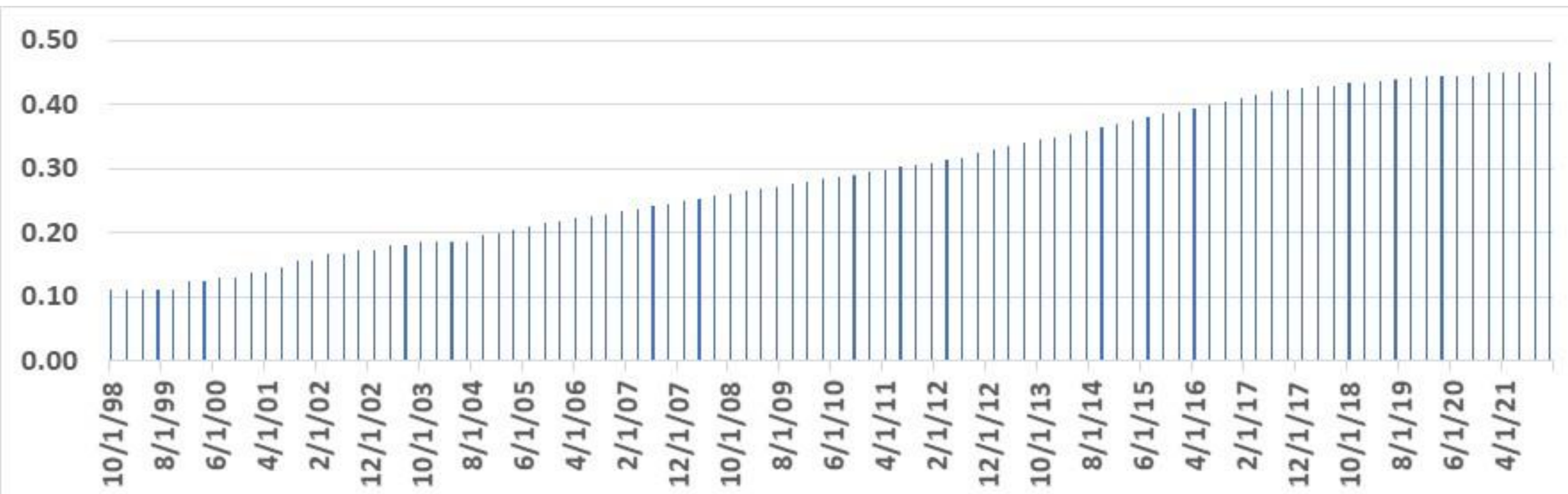
- You'll have drawdowns, but the dividends keep coming
- And total returns for 3, 5, 10 & 15 years are pretty similar
  - 7.9% (3), 8.5% (5), 8.7% (10) & 7.9% (15) last March
  - 9.3% (3), 9.0% (5), 8.0% (10) & 8.4% (15) as of Dec 2021
- Utilities, REITs, bonds, w/ annual turnover now 12% (vs 9%)

#2: Enterprise Products Partners

- We all know MLPs got creamed in 2015….

Total Return %	1-Month	3-Month	6-Month	YTD	1-Year	3-Year	5-Year	10-Year	15-Year
EPD	2.66	3.56	-5.26	21.29	21.29	3.54	2.56	5.01	7.56
Industry	1.59	0.29	-1.44	36.68	36.68	7.55	1.68	3.98	6.44

- Current yield = ~7.8% (3/21)--and rising (8.1%)
  - EPD raises dividend to .465 (was .45) for 1/28 ex-date



EPD, too, will bounce Around

- But this is a discussion about generating income
- Seems a reasonable enough place to take the plunge

The Updated Chart

- Turns out it was ok to take the plunge (close = 24.08 last night)
- As we discussed last year, for the UBTI/K-1 resistant, we can write puts instead of owning the stock

#3: Last year's Put Choices

- You can calibrate return & risk
  - Jan 2022 \$20 Put → 9.3% annualized
  - Jan 2022 \$18 Put → 6.0% annualized
    - With stock at \$23.18 last March
    - Stock at 23.27 last Thursday…both puts performed
  - Sep 21 puts, yielding 13.5% annualized
    - EPD was 22 on expiration day
  - Last March…

    Jan 2023 \$20 Put → 10.2% annualized

    Jan 2023 \$17 Put → 5.9% annualized
    - Now these yield 7.4% and 3.6%
    - That means yields for 10 months even higher

#3: Sidebar on Higher Yield

- EPD Jan 2024 $20 put = $2.90
  - 8.3% yield all the way to expiration
- EPD Jan 2023 $20 put = $1.43
  - 7.4% yield to expiration
- In 364 days, Jan 2024 becomes Jan 2023
  - Expected return for next 364 days on Jan'24…

    (2.90 – 1.43) / (20 – 2.90) * (365/364) = 8.6%
- Same exercise for Jan 2023 $20 to June 2022:

    (1.43 - .57) / (20 – 1.43) * (365/217) = 7.8%

Note: Stock at 23.27

#4: Rate Rise Defense

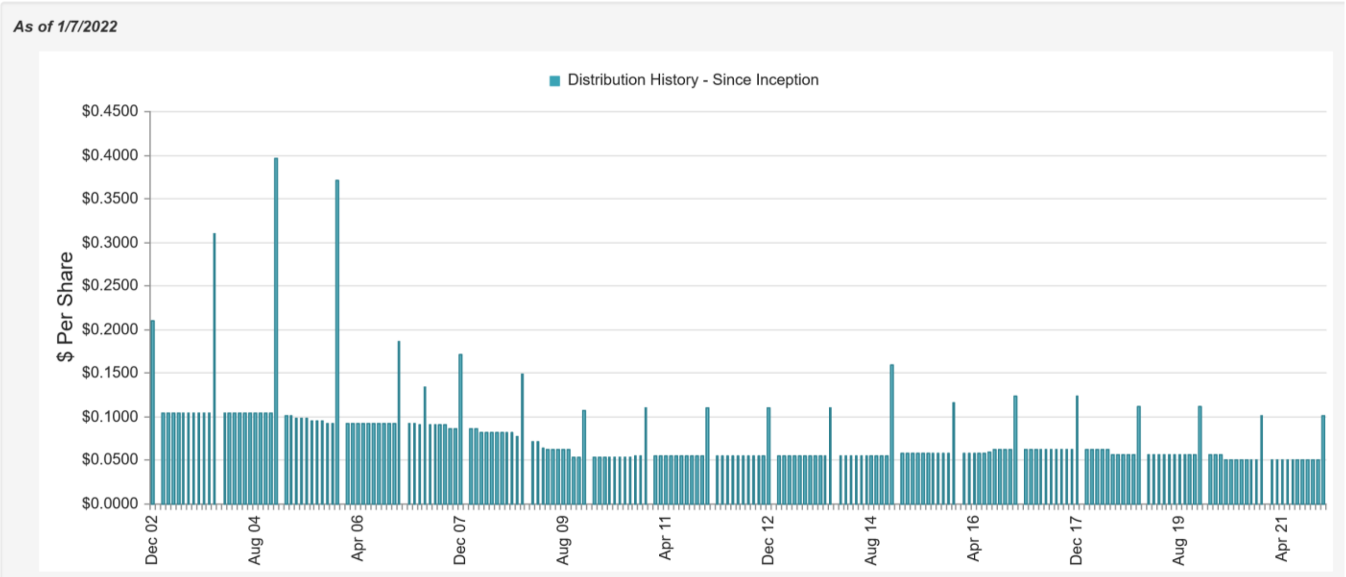
- QTS Pr A is a sort of 3.3% 2-year note
  - Where the effective yield will rise if rates rise
- QTS 7.125% Series A <u>Cumulative Redeemable</u>
  - Trades around $27.25
  - Callable 3/15/2023 at par plus accrued
  - Quarterly dividend = $0.4453125
    - Thus requires 5.05 dividends to cover premium
  - IRR to call = 3.3%
- Company Got Bought --- a big OOPS !!!

#4: QTS Pr A is Likely Reliable

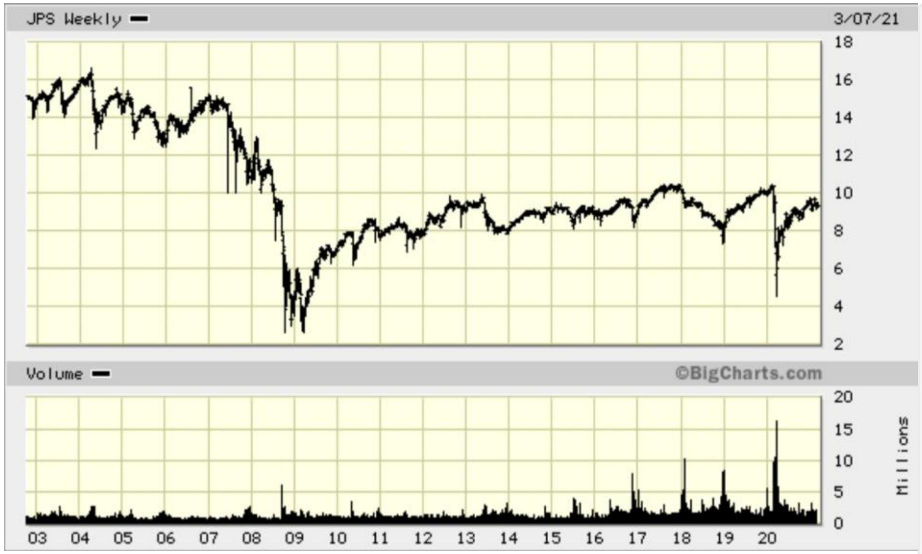
- Price is held down by call
  - If rates rise, you'll just hold it….
  - As an arbitrary outcome, consider that
    - If you held it for 6 years
    - Its price was $23 at the time
      - Translates to a current yield of 7.74%
    - And you sell at $23
      - The IRR for the 6 year holding period =~ 4.7%
- In actuality, we got called at $25 way before the call date and took a loss
  - Another reason to beware preferred premiums

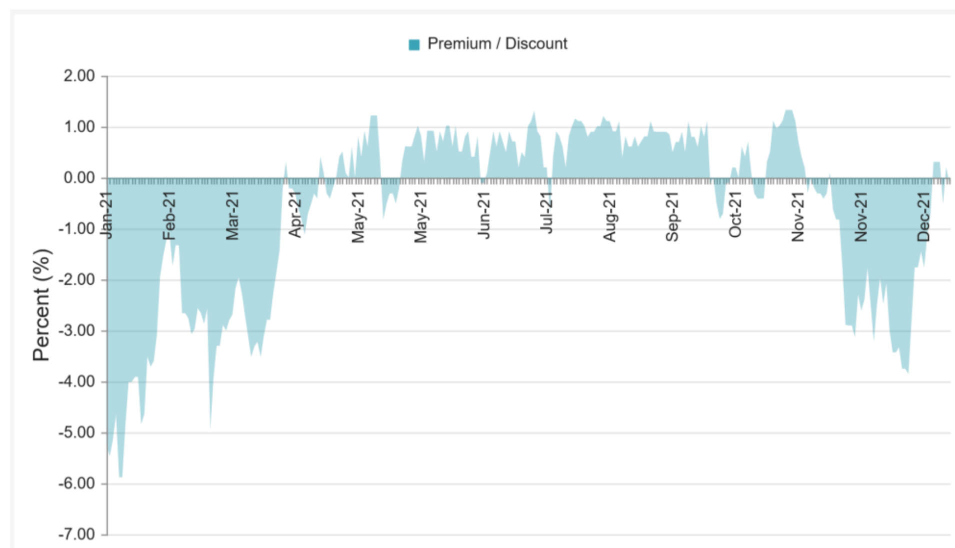
#5: Preferred Stock Fund

- JPS, Nuveen Pref & Income Securities
  - Yields 6.27% as of last Thursday’s close
- Distribution has decreased before
  - But is has not ever been skipped
  - No change this year – paying .0505/month



#5: JPS Since last March





#5: JPS Continued

- JPS Notes
  - Was creamed (~80%) during Great Recession
    - Effective leverage = 36.65%
    - Risk for many (most?) CEF in a financial crisis
  - Pref issuers lean heavily toward financials
  - Current discount only 0.10%
    - Not a good time to jump in
    - At same NAV w/ 3% discount, yield = 6.47%
      - Versus 6.27% at current discount
  - Liquid – average volume = 395,000 shares

#6: How about a Bond?

- In 2018 survey of AAII members,
  - 83% are Very Interested/Interested in Income Generation
  - Yet only 44% are VI/I in Bonds.
  - Why is that?
- BondSavvy has provided some nice ideas
  - Albertson's 7.45% of 8/1/29
    - Cusip = 013104AF1
    - YTM = 4.95% at $116.96 last March
      - Offered at Friday's close at Fidelity at 116.91.
    - Nice protection against rising yields because it's at a premium
    - Original recommendation, Feb 2018 is here:

      https://www.bondsavvy.com/fixed-income-investments-blog/albertsons-bonds

#6: What About Rates ?

- *The Price Will Vary !!*
  - It was around 106-108 in the summer
  - 96 at the end of March
  - (Can't find a good chart)
- Common Stock initiated a dividend Oct 23, 2020
  - Leaves the coupon looking awfully safe
- Last March, BondSavvy maintains its buy at 116.17
  - Current rating is Hold
- Take a look at www.BondSavvy.com
  - US Steel 6.65% of 6/1/37
    - Yields 5.575 at Fidelity's closing offer Friday, $111.00
    - Buy reiterated by BS on 12/3/21 at 107.50
    - Initial recommendation 9/9/21 at 109.75

#7: Ares Capital Corporation

- Talk about variable prices…

- But the yield is 8.44%
- Better yet….

#7: Ares Capital Corporation

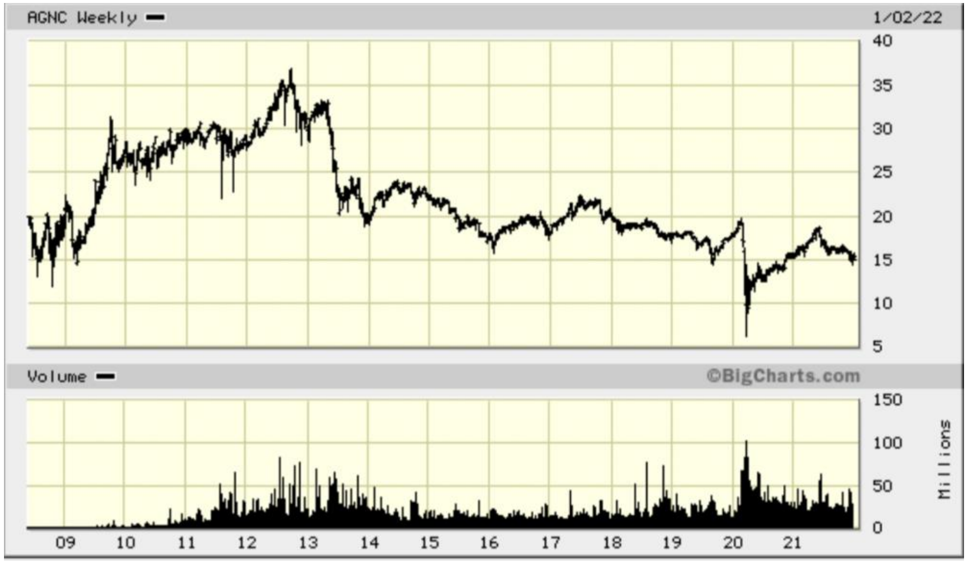
- Charts haven't changed much…but …

- Enough to drop yield to 7.73%
- Dividend raised a penny to 0.41

FYI, Ares has a 3.875 of Jan 15 '26
Yield = 2.52% at $106.05 offer last Mar
Yield now 2.66% at $104.50
Cusip = 04010LAZ6

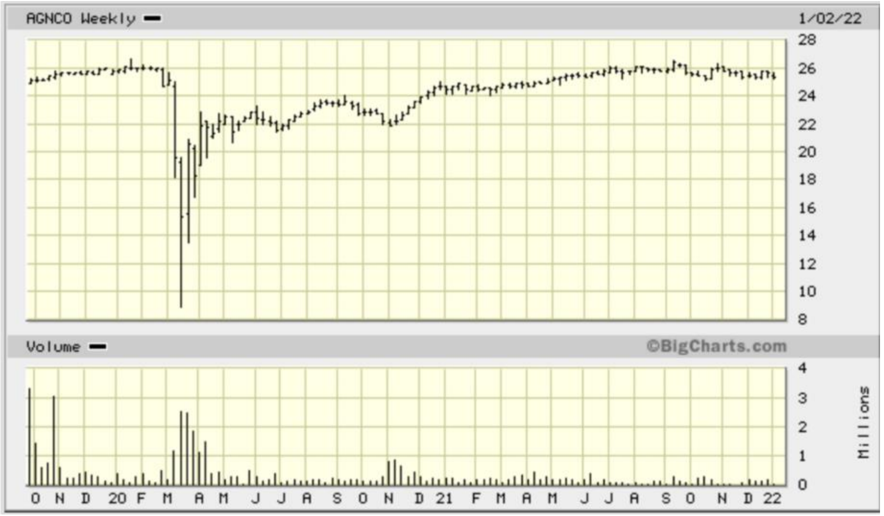
#8: AGNCO

- AGNC is one of many mortgage REITs, mREITs.
  - Juicy yield: About 9.4% lately (up from 9.1% last March)
- But the stock bounces around a lot
  - As has dividend, though it has held steady at 0.12/month since Apr’20



#8: AGNCO

- The preferred, issued Oct 2019
  - Yields less -- ~6.4% (Was ~6.6% last March)
  - Cumulative with a Fixed to Floating rate
    - Pays 6.5% now
    - From Oct 15, 2024, pays 3-month LIBOR + 4.993%
  - Callable Oct 15, 2024 at $25
- Pref dividend must be paid to pay common

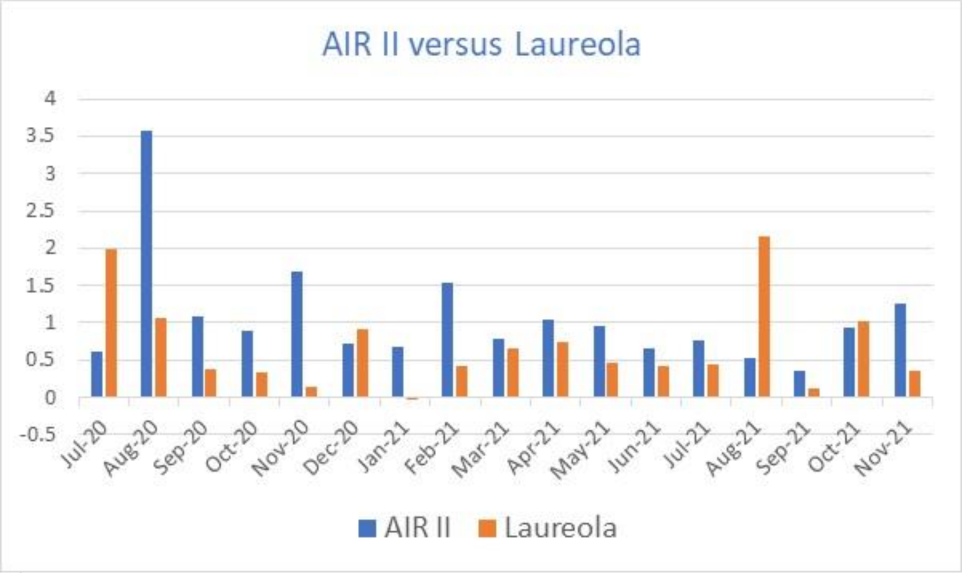


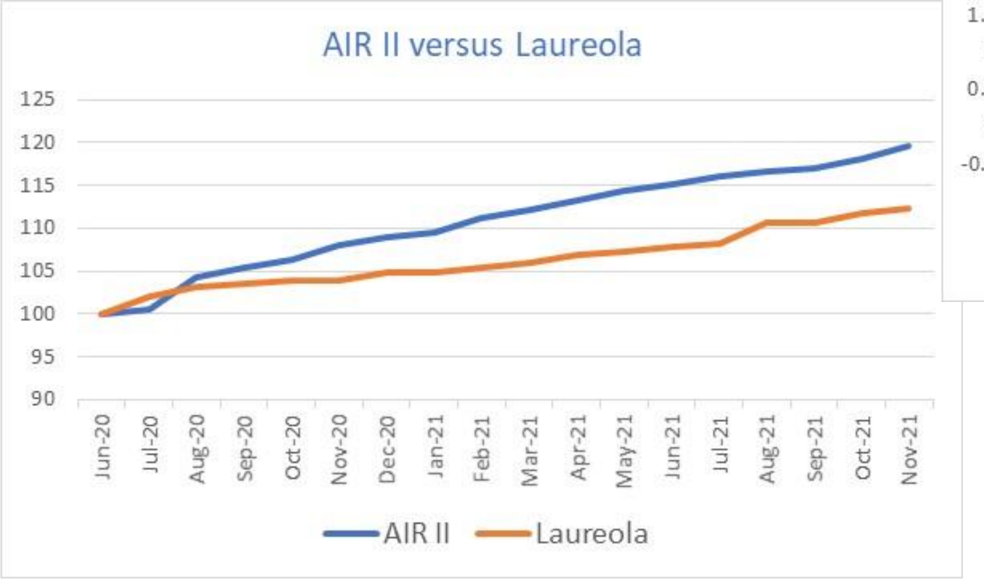
AIR Fund II

- Seeks log-term capital appreciation by investing in longevity-based products
  - Portfolio of longer dated policies targeting tertiary market
  - Portfolio of short-dated, small face policies
  - Portfolio of life-contingent structured settlements
    - Includes annuities and life insurance-backed lending
- Opened July 2020
  - Annualized return since = 13.5%
- Spoke w/ co-manager last week
  - Will Reduce 100k minimum to $50k for members of our Retirement SIG

AIR Fund II vs Laureola

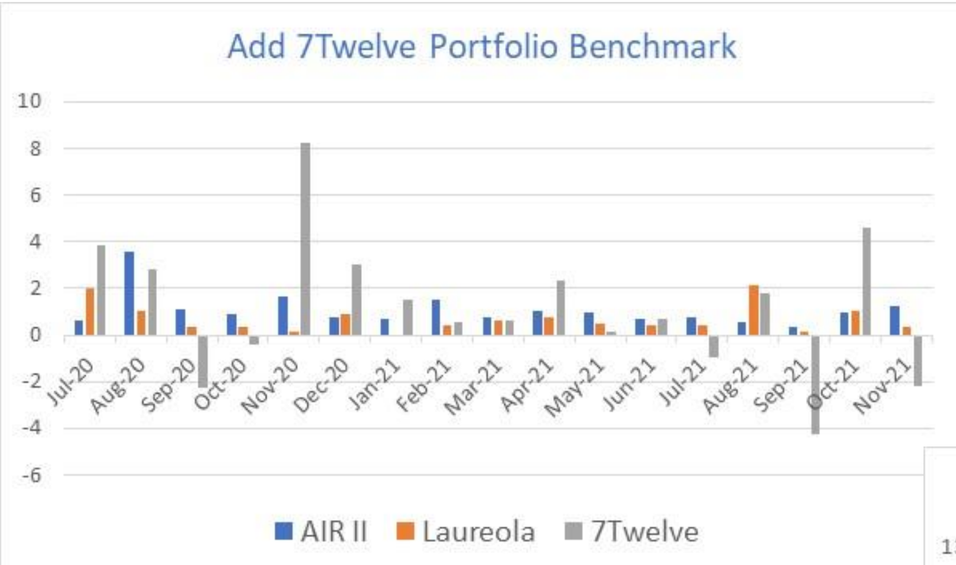
- Laureola
  - 15.3% annually since inception May 2013
  - 8.0% since Jan 2019 (both figures through Nov 2021)
  - Volatility to the upside is good:
    - STD AIR II = .73
    - STD Laureola = .64





Compared to 7Twelve

- 7Twelve BM up 14.6% annualized over same period
  - STD = 2.94 (!)



AIR Fund II - Thoughts

- Returns in the space are virtually always positive
  - Laureola had 2 down months in 8+ years
  - AIR Fund II, none yet
- Market potential huge
  - More players are lowering returns
    - But what's wrong with 7-10% ?
    - AIR Fund II deck still reports 13% target, net
      - We'll see
- Negatives
  - Liquidity is quarterly with 180 days notice!
  - Is there another material negative?

The Case Against Put Writing

- Many folks, including me, write puts for income
  - Imagine some stock at 100
    - It has \$90 puts selling for \$2 expiring in 3 months
      - Assuming stock stays above 90, you pocket the \$2
      - \$2 for 3 months ➔ \$8 for 12 months ➔ 8%/year
      - Nice return, and earned so long as stock doesn't fall 10%
- QVR Advisors asserts this is a logical fallacy
  - If the stock goes up, you still earn only \$2
  - If the stock goes down a lot, you lose a lot
  - This is "negative convexity" an "umabiguously bad thing"

But What If I Want to Own at $90

- The idea is often that one writes a put on a stock that they'd be happy to own
  - Buy it only if it goes down to $90
- What if it goes to $90 and bounces?
  - Put was not assigned early
    - That's virtually never rational
  - So stock went back up before expiration
    - No assignment, no purchase
    - Gain only $2 *even if* stock fell to $85 b4 rising to $105
    - Limit order at $90, however, is up $5

Selling Covered Calls in a Range Bound Market

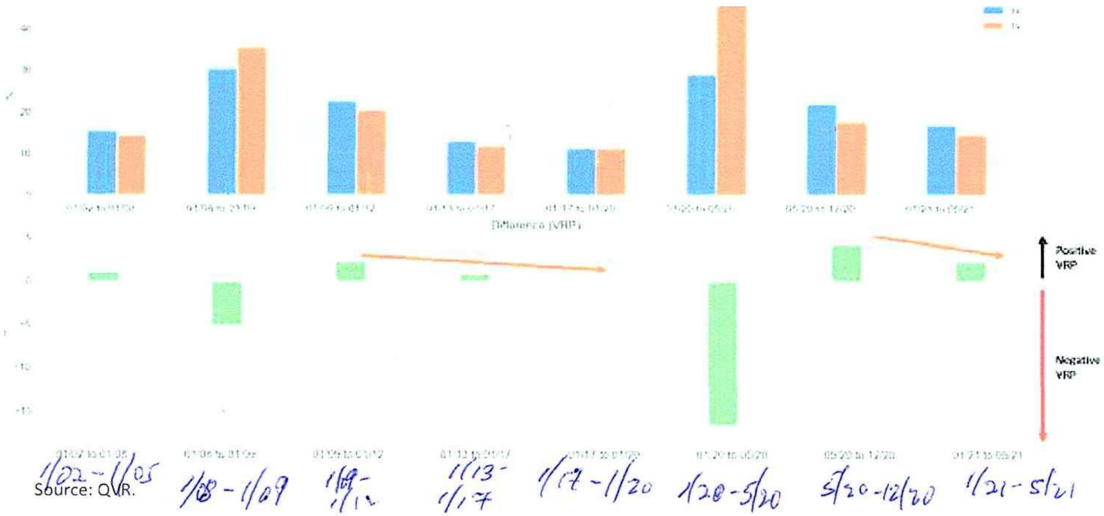
- Assume S&P 500 will go up 3% one month and give back that gain, a 2.913% drop, the next
- We sell ATM options each month for 1.3% of the price of the index
- Up months
  – We make 3% on the S&P, lose on the option
- Down months
  – We lose 2.913% on the S&P, make 1.3% on option
- After 12 months? (even including 2% divd)
  – This actually works out to a loss of .02%
- The S&P 500 buyer has the 2% dividend

Options are Overpriced – Sell Them !

- Volatility Risk Premium
  - The 1-month at-the-money implied volatility less the subsequent 1-month realized volatility
  - English translation:
    - Options are only expensive if they are priced such that they imply a higher level of volatility (risk) than actually obtains over the next month. That is, maybe that juicy premium is juicy only because the stock is going to bounce around like mad!

Volatility Risk Premium Charts

Different time-period view on S&P 500 Volatility Risk Premium



Blue = 1-month ATM implied volatility
Orange = Realized volatility of subsequent month.
Using S&P 500
Green = Difference
Note extraordinary premiums of market collapses were *not* sufficient to compensate for future volatility (risk)

"The point is that options are sometimes, but not always, expensive; and they have steadily become less expensive on average over time."

Source: QVR.

QVR Advisors Paper

- Full paper entitled “Common Volatility Risk Premium (“VRP”) Discussions” for Q2 2021
- https://www.qvradvisors.com/media
- Note that TastyTrade has long emphasized writing puts only when IV is at the high end of the range
  - Sosnoff, in a discussion with HIA noted that anyone using the same option trading strategy in all markets is taking too much risk
- Mandy Xu argues this is one of the good times

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