Nuveen’s Langenfeld: ‘A Timely Opportunity’ To Invest In Preferred Securities

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Brenda Langenfeld, lead portfolio manager for the Nuveen Preferred and Income Opportunities Fund and the Nuveen Variable Rate Preferred and Income Fund. Read the Q&A below as Brenda says that conditions are favorable on a number of different levels, setting up preferred securities for a potentially strong year ahead. She noted that heightened banking regulatory oversight will be favorable for credit investors, that positive fundamentals suggest stability and growth, and that valuations are at levels "that present a capital appreciation opportunity over the next year."

Brenda Langenfeld

The podcast can be found on AICA’s website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Brenda Langenfeld, portfolio manager at Nuveen is here, we’re talking preferred securities now on The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you’re looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today it’s pointing us towards preferred securities with Brenda Langenfeld, she’s portfolio manager at Nuveen, lead portfolio manager for the Nuveen Preferred and Income Opportunities Fund, ticker JPC, and the Nuveen Variable Rate Preferred and Income Fund, ticker NPFD. You can learn more about those funds at Nuveen.com, and I'll tell you, check out their "Opportunity for Income and Preferred Securities" page because it's worth a look. And if you want to learn more about closed-end funds, interval funds, and business-development companies generally, then AICAlliance.org, the website for the Active Investment Company Alliance is also worth a look. Brenda Langenfeld, thanks for joining me on The NAVigator.

BRENDA LANGENFELD: Hello Chuck, it's a pleasure to be here, thank you.

CHUCK JAFFE: So let's start with preferreds generally in this market. Preferreds is a very specific asset class that truthfully average investors don't necessarily always know much about. Folks who love them or know them tend to love them or hate them, but these have been interesting market conditions because of course the rate picture has been so fluid.

BRENDA LANGENFELD: Yes, certainly fluid is a mild way to characterize 2023. Preferred securities can be classified as either debt or equity securities depending on the security features, but most have attributes of both, and they reside between debt and common equity in the corporate capital stack, which means that they have a higher priority of claims than common stock but a lower priority than senior debt. Financial institutions are the largest sector within this asset class, and preferred securities and contingent capital securities or CoCos are considered regulatory capital, which helps explain why banks make up almost 70% of this asset class. Other highly regulated sectors such as insurance and utilities, they are additional capital intensive industries such as midstream energy, that really rounds out what you find within the preferred securities universe, but really the combination of debt and equity characteristics does make it a little bit undiscovered.

CHUCK JAFFE: When you look at preferreds now, given what we saw with action in the banking sector, et cetera, given where we are with rates, what's your outlook? Again, been a rough rate environment and a bit of a rough picture, so what is the outlook for you on preferreds as we head into 2024?

BRENDA LANGENFELD: Certainly, let's start with fundamentals. We expect this heightened regulatory oversight to continue, particularly in that bank sector, but that's really favorable for credit investors such as ourselves. Certainly we've likely seen a peak in metrics such as net interest margins at this point in the cycle which is as expected, but again, that's really more of a focus for equity investors rather than credit investors. Really bank balance sheets continue to remain resilient, so it's a very positive fundamental outlook for the asset class. Turning to valuations, as of December 15th of this year, looking only at index data and the three major segments of the asset class, which is $25 par securities, $1,000 par securities, and those CoCos, we're looking at option-adjusted spreads that are wide to the tights within a trailing 12-month period. On the flip side, investment grade and high yield, corporate markets, and even leveraged loans, they're either at or near the tights during that same time period. So the preferreds security asset class is poised for some spread tightening, which presents a capital appreciation opportunity in this coming year. Finally technicals, over the past couple of years banks have really optimized their capital structure, so we're not expecting material net new issue supply, that's a theme that we've since the end of 2021. We would welcome some rate stability or even modestly lower rates, that should open the door for refinancing activity, another theme we've seen persist in recent years. This technical tailwind should be supportive of good performance within the asset class in 2024, so we feel that this current environment presents a timely opportunity to invest in the asset class.

CHUCK JAFFE: Help us understand preferreds and interest rate sensitivity. I think everybody understands that you see bond rights come down, you see interest rates come down, you're going to see bond prices change and fluctuate, et cetera. But what are we looking at in terms of what happens to preferreds as we watch the environment change from rising rate to first static and then presumably falling rate?

BRENDA LANGENFELD: Right. Even though generally speaking most of the securities are perpetual in nature, they do have call features. So while it may be intuitive to think that there is a lot of duration in the asset class, so a lot of interest rate sensitivity, with those call features it is challenging to find really long duration like you do more in munis or investment-grade credit. But it still exists and it's really more pronounced in that $25 par segment of the market, and the reason is that those securities tend to be fixed rate for the life of the security, so the upfront rate does not change even as you roll through those calls. So where we find the most duration in the current environment is those below-market coupon fixed-rate for life securities in the $25 par segment of the market, and the reason is that those call features are so out of the money. To no surprise then, as we've seen interest rates move lower in the last month and a half, we've seen that segment of the market outperform, but also as rates move lower the interest rate sensitivity of those securities actually decreases. So we've seen that compress as rates have moved lower during, again the last month and a half. One of the reasons why we don't have a material exposure to that segment of the asset class is going back to the spreads that I talked to in the valuation segment. It actually is the lowest spread within the investment universe of preferred securities, so if you're looking for spread, that is not where you would find it, if you're looking for duration, you may be able to have it but it may shorten as interest rates move lower.

CHUCK JAFFE: I mentioned your funds, Nuveen Preferred Income Opportunities, JPC, and Nuveen Variable Rate Preferred and Income Fund, NPFD, and while we have talked about the outlook and where preferreds are right now, let's just talk a little bit about the fact that there are tax advantages. And we're coming off a year, well, we came off a really bad year in 2022 for a better year in 2023 for the market generally, but tax advantage is always something that folks are looking for. Particular tax advantages to these funds now?

BRENDA LANGENFELD: Yes, given that most of those securities again are perpetual and non-cumulative, which means that most of them are qualified dividend income or QDI eligible, which means that they're taxed at a lower rate than interest and ordinary dividend income. We pass that QDI onto fund shareholders, so it does offer a high-tax advantage potential by investing in these funds.

CHUCK JAFFE: Everybody likes to have tax advantages when they can get it, but also preferred securities, if you didn't understand it before maybe you understand it a lot better and where they're headed now. Brenda Langenfeld, thanks so much for joining me on The NAVigator to talk about it.

BRENDA LANGENFELD: Thank you, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. Yep, that's me, and you can check out my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more generally about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, that's the website for the Active Investment Company Alliance, which is also on Facebook and LinkedIn @AICAlliance. Thanks to my guest Brenda Langenfeld, portfolio manager at Nuveen, the lead manager for the Nuveen Preferred and Income Opportunities Fund, ticker JPC, and the Nuveen Variable Rate Preferred and Income

Fund, ticker NPFD. You can learn more about those funds at Nuveen.com. The NAVigator podcast is new every Friday, we hope you won't miss an episode by subscribing or following along on your favorite podcast app. We'll be back next week and throughout the holidays, so make sure you don't miss those as well. Happy investing and happy holidays everybody, we'll see you again next week.

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