

PORTER & CO.
Distressed Investing

Income Streams

*The Porter & Co. Guide To
Investing For Income*

Income Streams: The Porter & Co. Guide To Investing For Income

Who doesn't want to earn some extra cash?

This special report – *Income Streams: The Porter & Co. Guide To Investing For Income* – describes the major instruments you can use individually or in combination with one another to generate various streams of income from your investments in addition to the value gained from their price appreciation.

You can earn consistently decent overall returns from an income investment just as you can from simply owning shares of a company – but with income investments, most of the returns come from dividends, interest payments, or other cash disbursements and not from the appreciation of the share price. We'll discuss the advantages – such as providing living expenses and reducing volatility – below.

Here are some of the investment-class opportunities we will be exploring later in the report:

- **Closed-End Funds** diversify risk over a large number of securities and able to use leverage to juice upside
- **Master Limited Partnerships** strong tax advantages and relatively liquid
- **Real Estate Investment Trusts** combines the advantages of a liquid investment and escapes double taxation
- **Dividend Growth Stocks** performance of price returns with the benefit of added cash
- **Preferred Securities** protected dividends and more senior than common stock
- **Corporate Bonds** strong downside protection with contractually obligated future payments
- **Utility Stocks** juicy dividends and steady returns

We also share the names of eight specific exchange-traded funds (“ETF”) to expose readers to the real-time performance of these various asset classes. While they are not formal recommendations, we believe these ETFs best represent each of the income categories.

But first let's talk about setting appropriate objectives.

Objectives in income investing are different from the results you'd seek with a portfolio focused on equities or distressed debt. To help explain the various types of income investments, we'll first go over some essential terms and concepts.

It's important to point out that we refer throughout this document to “income investments” rather than “fixed income investments.” That's because the securities we discuss include some for which the income paid to holders is not fixed. Rather, it either adjusts with changes in prevailing interest rates, has the capacity to increase over time, or can be reduced or suspended by the issuer's board of directors.

Why Own Income Investments?

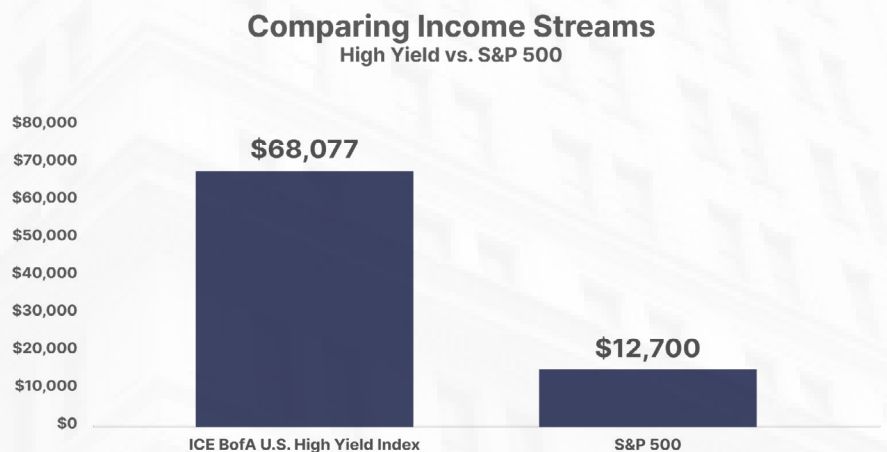
The primary purpose of investing in income assets is not, as is the case with common stocks, to build long-term wealth through capital appreciation – meaning we don't anticipate huge returns on the value of the underlying asset, like you would with a stock increasing in price from \$100 to \$150. Income investors should instead expect to earn a sizable majority of their return from the cash payments they receive on a quarterly, semiannual, or annual basis.

For example, in the 40 years ending December 31, 1984, an index of high-quality bonds known as the ICE BofA U.S. Corporate Index produced an annualized total return of 6.78%, and 96% of that performance was attributable to interest payments received (and income earned by reinvesting those interest payments). Only 4% came from price appreciation.

In sharp contrast, dividend income and reinvestment income contributed just 21% of the S&P 500 stock index's 11.76% annualized return over the same period. By far the larger portion of the S&P 500's return – 79% – came from the index's constituent stocks growing more valuable over time.

These facts raise a question: Why would anyone want to invest in something that went four decades with only a small uptick in value? And which, by the way, returned five percentage points a year less than stock investors earned if they merely matched the market average. The answer lies in the two most common purposes of an income portfolio.

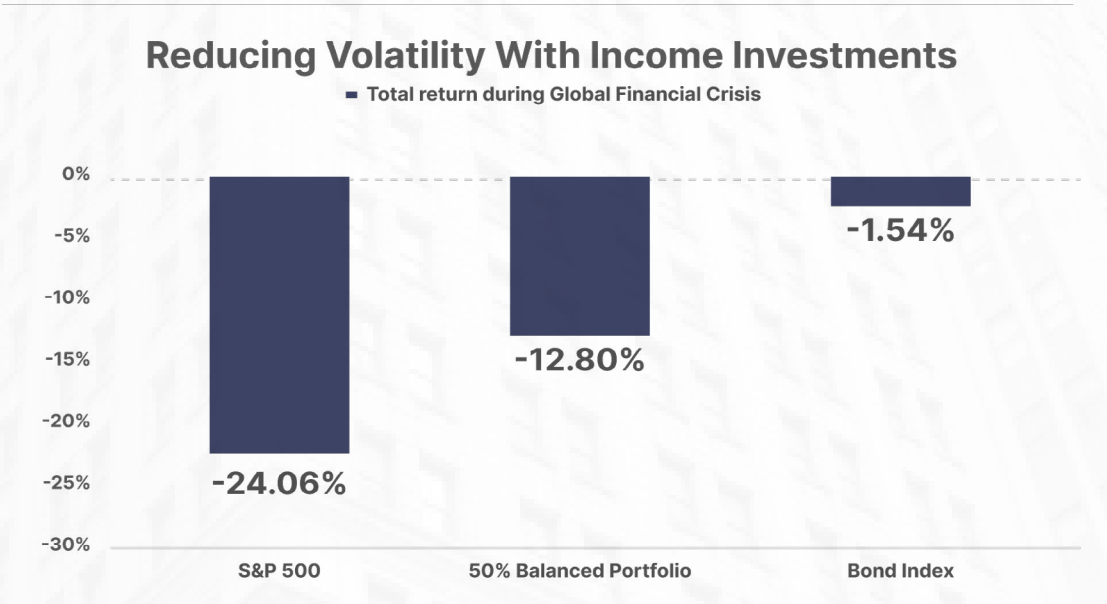
- 1. Generating cash for current living expenses.** As of December 31, 2024, an investment of \$1 million in the ICE BofA U.S. High Yield Index of lower-quality bonds provided an annual pretax cash income of \$68,077. The comparable figure for the S&P 500, based on the level of dividend payments on that date, was \$12,700 per year. A retired couple who built their net worth through smart investing over the previous four decades might reasonably have been less concerned at that point with building it further in order to leave a bigger estate to their heirs than with maintaining a comfortable lifestyle to explore hobbies and travel. Shifting their primary focus from stocks to bonds and other income vehicles would make sense for them.



As of December 31, 2024. Income of an investment of \$1 million.

2. Reducing overall portfolio volatility. It's exciting to talk about being a Warren Buffett who focuses solely on the long-term and ignores interim market fluctuations. But in practice, for many investors, seeing a large portion of their wealth, built up over decades, wiped out – even if only temporarily – is awfully hard to swallow. Incorporating an income component into your overall portfolio can greatly reduce that risk and wipe away those fears.

During the 2008-2009 Global Financial Crisis, the change in market value of a portfolio invested entirely in the S&P 500 was negative 24.06%. Now suppose that instead of being all in equities, you had held a *balanced portfolio* during that period. A rule of thumb that many investors follow is to allocate to stocks a percentage equivalent to 100 minus your age. Since $100 - 50 = 50$, a 50-year-old couple following this rule would have divided its portfolio equally between bonds and stocks. If that couple had merely matched the average returns of the two categories, it would have done much better than a pure equity investor during 2008-2009. Factoring in the bond index's negative 1.54% market value change, the couple's portfolio-wide change would have been a less devastating negative 12.80%. (That rule of thumb formula isn't appropriate for all investors – consult your financial advisor to determine what allocation best fits your specific financial circumstances.)



As of December 31, 2024. Income of an investment of \$1 million.

Yield And Return

Once you've determined that there's a place for income investments in your portfolio, you'll want to familiarize yourself with the methods for measuring the expected and actual investment performance of your holdings.

The discussion below on bonds will elaborate on the definition of yield, but at the most basic level it's the expected annual income on an investment, expressed as a percentage of its price. Suppose, for example, you pay \$24 (a \$1 discount) for Acme Corporation preferred stock with a face value of \$25. Its dividend rate is 6% of face value, meaning that your expected income for the year is \$1.50.

The issue's current yield is $\$1.50 \div \$24 = 6.25\%$.

You can compare that yield with yields on other preferred stocks of similar quality to determine whether it offers good relative value. But your actual return won't be equal to the yield unless its price remains equivalent to the price you paid for it. Suppose that in the 12 months following your purchase the security's price rises to \$25.25. Your percentage price gain is the increase (or decrease) in price divided by the purchase price:

$$(\$25.25 - \$24) \div \$24 = 5.21\%.$$

For the 12-month period your total return includes both the current yield (6.25%) and the percentage price gain (5.21%):

$$6.25\% + 5.21\% = 11.46\%$$

As mentioned above, long-run returns in income investments derive overwhelmingly from the income reflected in the yield calculation. Price gains – or losses – can cause an income security's shorter-term total return to diverge widely from its yield, however.

And not everyone plans to take the income that an investment throws off – they prefer to plow it back into their portfolio. To that end, a more precise total return calculation than we show in this example incorporates income you would have earned if you did just that... reinvested the income received in quarterly or semiannual installments. (The frequency of dividend payments depends on the terms of the particular preferred stock that you buy. Bonds are more standardized, with semiannual payments the rule except for zero-coupon bonds, mentioned below.)

Income earned on reinvestment is highly important to those people who don't plan to spend the cash generated by income-generating assets, but instead own them in order to limit the volatility of an overall portfolio. Thanks to the power of compound interest, the income component's value can increase dramatically over a period of many years

Risks

As with stocks and other asset classes, smart income investing involves tradeoffs between risk and reward. We'd all like to earn the highest possible return, but we have to weigh that aspiration against the danger of a loss of market value or even a permanent loss of principal. The market uses yield to quantify the risk-reward tradeoff – the greater is the risk of a security, the higher is its yield. Here are the main risk categories that income investors need to consider:

Interest Rate Risk

If you buy a fixed-rate income security, you take the risk that the value of your investment may fall because prevailing interest rates rise. To understand why, let's return to the example shown above in Yield and Return.

You paid \$24 for the Acme Corporation 6% preferred stock that pays dividends of \$1.50 per year. The current yield is:

$$\$1.50 \div \$24 = 6.25\%$$

Suppose that five years later Acme Corporation decides to raise additional capital through a new preferred stock offering. U.S. interest rates have risen since you made your purchase, so Acme Corporation has to put an 8% dividend rate on the new issue to induce investors to buy it. The annual dividend payment from the company on the company's new \$25 preferred stock is \$2 (up from the previous \$1.50).

Now suppose you decide to sell your 6% preferred stock. The potential buyers won't accept a 6.25% yield when they can buy a new issue of the same company and obtain an 8% yield. Instead, they'll be willing to pay only the price (p) that equates the yield on your preferred stock to the yield available on the new Acme issue:

$$\$1.50 \div p = 8\%$$

To solve for p, divide \$1.50 by .08 to find that the price at which you can sell your Acme Corporation preferred stock is \$18.75. That represents a \$5.25, or 22% loss from the \$24 price that you paid. There's some consolation in the fact that in the intervening five years you've received total dividends of \$7.50.

Of course, interest-rate fluctuations are a two-edged sword. If interest rates fall rather than rise following your purchase of the Acme Corporation preferred, you'll enjoy a price gain rather than a price loss.

Note that in the Preferred Stocks section below we point out that interest-rate risk is mitigated on issues that have *adjustable-rate dividends*.

One other point to keep in mind about interest-rate risk is that it's magnified by buying a bond or preferred stock with a very long maturity. You can limit price swings by sticking to shorter-maturity issues. At most times, that will mean accepting a lower yield than you could obtain by holding longer-maturity issues, again demonstrating the tradeoff between risk and reward.

Default Risk

When you buy a corporate bond, you take the risk that the issuer's finances will subsequently become severely strained. The company may falter financially and become unable to continue to make promised interest payments or to repay the principal, with the issuer possibly filing for bankruptcy. If this happens, the bond's price drops far below its face value. Investors who continue to hold the security could face a lengthy period of receiving no income from their investment and ultimately wind up with a new bond, or some combination of cash and securities, worth far less than the original bond's face value.

Downgrade Risk

Even if a bond's financial condition doesn't deteriorate to the point of default, the market will raise its yield, by reducing its price, if the likelihood of an eventual default increases, for example, from "extremely unlikely" to "somewhat unlikely." This kind of increased risk is signaled by financial data such as a decline in cash flow, from which the company aims to make interest payments on its debt, and an increase in the amount of the company's debt relative to the total value of its assets. The credit rating agencies will signal the deterioration by lowering their ratings (see "Role of Credit Ratings," below) on the bond.

Risk Of Missed Income

Scheduled interest payments on bonds are contractual obligations. The following list of payments are not contractual. The issuer's board of directors can reduce the amount of payment or even suspend it, without triggering a default:

- payments of dividends on common and preferred stocks
- distributions on closed-end funds
- distributions on Real Estate Investment Trusts
- distributions on Master Limited Partnerships.

Holders of the affected security will consequently receive less income than they expected when they bought it.

Call Risk

Many bonds and preferred stocks are subject to redemption (or "call") prior to their stated maturity. If interest rates decline after the security is issued, the issuer may call it and replace it with a bond that carries a lower interest rate or a preferred with a lower dividend rate. The security may have previously been trading above the price at which the issuer was permitted to call it, resulting in a loss of market value for holders. Furthermore, the holders of the bond that was called away who want to put the proceeds of the call back to work in an issue of similar quality must now invest at a lower interest rate than they previously enjoyed.

Illiquidity Risk

Some types of income investments trade more or less continuously, meaning that a holder who decides to sell can usually execute the transaction promptly and at a price close to the previous trade. But many corporate bonds trade infrequently, sometimes not trading at all on a given day. The bond an investor wishes to buy may not be in the broker's inventory when looking to buy it, making it necessary for the broker to find an offering from another firm. And if the investor later decides to sell the bond in a falling market, there may be a costly delay until the trade gets executed.

Inflation Risk

If you invest in a fixed-rate bond or preferred stock, the income from the investment will remain unchanged throughout your holding period. The consumer price index ("CPI") will not. Inflation will erode the purchasing power of that income. This is why it's essential to include in any income portfolio assets other than fixed-rate ones. Investors need securities that can increase their payouts over time and ideally can show a long historical record of having done so. Increases over time in the amount of income generated by a portfolio can address the problem of each dollar buying less and less as time goes on.

Role Of Credit Ratings

Credit ratings are tools that can be useful in assessing the tradeoff between risk and return for bonds and preferred stocks. Other types of income investments don't have credit ratings, but information about the ratings of bonds held by closed-end funds that specialize in that asset class can be helpful. Note that the research firm Morningstar rates closed-end funds and exchange-traded funds ("ETF") on a five-star scale based on their risk-adjusted returns relative to peer-group funds.

It's important to know that credit ratings address only one of the risk categories described above, namely default risk. That includes both the probability that the issue will default and the expected percentage of face value that the holder will ultimately recover if it does default. Because the yields assigned by the market also depend on factors other than default risk, such as liquidity and industry sector, don't expect to see all issues of a given rating carrying the same – or even close to the same – yield. Still, ratings are helpful, in conjunction with other analysis, in identifying good values in income investments.

The table below shows the rating scales employed by the most prominent credit-rating agencies. Default risk increases with each step down. Ratings of Baa3 or higher on the Moody's Investors Service scale, and BBB- or higher on the Standard & Poor's and Fitch Ratings scales, are called "investment grade." The terms "speculative grade," "high yield," and more disparagingly, "junk" apply to ratings of Ba1 or lower or BB+ or lower. A rating of D indicates that the issue is in default.

Credit Rating Scales

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-
B1	B+	B+
B2	B	B
B3	B-	B-
Caa1	CCC+	
Caa2	CCC	CCC
Caa3	CCC-	
Ca	CC	CC
C	C	C
	D	D

Sources: Moody's Investors Service, Standard & Poor's, Fitch Ratings

Tax Considerations

Tax treatment varies across asset classes – and even within an asset class. For example, interest payments on corporate bonds are taxed as ordinary income – meaning holders pay their regular tax rate on them. In contrast, some dividends – known as qualified dividends, on common stocks and preferred securities are taxed at the capital gains rate, typically lower than the income-tax rate.

State, county, and city governments and government-related entities can issue municipal bonds for which interest payments are exempt from federal income tax. For residents within their jurisdictions, the interest payments can also be exempt from state and local taxes. These issuers may also issue taxable bonds for certain purposes. U.S. government obligations are exempt from state and local income taxes. Bonds of some but not all U.S. government agencies are exempt from state and local income taxes. Portions of the distributions from REITs can be taxed as income, capital gains, or a tax-deferred return of capital. Complex rules govern the taxation on distributions of Master Limited Partnerships.

Differences among the asset classes in tax treatment can help determine where best to locate particular investments. For instance, suppose an investor has both a tax-deferred IRA account and a taxable investment account. Let's assume for this illustration that the plan is not to draw income from the investments for living expenses. Placing taxable corporate bonds in the IRA can make sense in that situation, while tax-exempt municipal bonds would normally fit better in a taxable account.

Porter & Co. does not offer tax advice. Consult a tax advisor before investing in income-generating assets. The consultation can help estimate what after-tax return will be and also to time the realization of capital gains and losses most optimally from a tax perspective.

What Income Asset Classes To Invest In

The following sections of this Guide to Income Investing describe the asset classes on which *Porter & Company Income Investing focuses*. They differ from one another in the risk factors that drive their yields and total returns. To advance the objective discussed above of limiting interim swings in portfolio value, it's advisable to spread your income portfolio across multiple asset classes. Definitions of italicized words can be found in the Glossary at the end of this document.

Corporate Bonds

A corporate bond is essentially a company's IOU. It has a contractually promised interest rate (*the coupon*) and a specified date (*maturity*) on which your principal will be returned to you along with the final interest payment. Some have provisions (*call features*) that permit the issuer to redeem the issue prior to its maturity. Annual interest is typically paid in two equally sized semiannual installments. Bonds with maturities of ten years or less are commonly called *notes*.

Coupons are generally at *fixed rates*. If the general level of interest rates rises subsequent to a bond's issuance, it will likely trade at a *discount* to its face *value*. A decline in interest rates, on the other hand, is likely to drive the bond's price to a *premium*. The upside from face value, or par, is limited, however, by the knowledge that the bond will be worth only par at maturity. Call features can also limit the upside.

A price movement to a discount or to a premium can also result from a change in the issuer's perceived default risk. In addition, a bond can lose liquidity and consequently trade down in price if the issuer makes a *tender offer* that is accepted by holders of a large portion, but not 100%, of the outstanding amount. The bonds that remain outstanding will trade sporadically, if at all.

Bonds generally have a face value of \$1,000, but price quotations treat the face value as 100. So a bond quoted at 96.75 is actually priced at \$967.50. Some bonds are listed on the New York Stock Exchange, but many instead trade over-the-counter by *CUSIP* number.

A *zero-coupon* bond pays no cash interest. It's issued at a discount to face value. Holders earn a return through the bond's appreciation to par at maturity.

See Glossary for explanations of varieties of yields commonly quoted on bonds – *current yield*, *yield-to-maturity*, *yield-to-call*, and *yield-to-worst*. Whether a corporate bond offers good value also depends on its *spread*. That's the amount, in *basis points*, by which the bond's yield exceeds the yield on comparable-maturity U.S. Treasury bonds. The spread compensates investors for taking credit and liquidity risk, neither of which is conventionally considered a characteristic of Treasuries.

Convertible bonds are a subcategory of the corporate bond universe. They enable bondholders to participate in the upside of the issuer's common stock. At issuance, a convertible bond yields less than a nonconvertible ("straight") bond of the same issuer. A *busted convertible* is one in which the embedded option on the issuer's stock is *out of the money*, meaning that the stock is too far below the *conversion price* for it to be likely that the holder's option to convert will become attractive. Busted convertibles trade at substantial discounts to face value, often making their yields competitive with yields on nonconvertible bonds.

Downside protection is a basic attraction of a corporate bond. A bond has *seniority* over the company's preferred stock and common stock with respect to recovery of principal in the event of bankruptcy. Note as well that a company may issue bonds of more than one seniority class. Expected recovery rates in the event of bankruptcy decline from secured to *senior unsecured* to *subordinated bonds*. Secured bonds include issues *collateralized* by specific corporate assets. Debentures are unsecured bonds; investors must look to the issuer's overall pool of assets for their recovery in the event of bankruptcy.

Preferred Securities

This category includes several distinct types of securities. They share the characteristic of paying dividends (as opposed to interest), which can be either *fixed-rate* or *adjustable-rate*. If finances are tight, the issuer's board of directors may decide to omit payment of the dividend for some period of time. Doing so, unlike failing to make an interest payment on a bond, does not constitute an act of default. Some preferred dividends are cumulative, meaning that the company must eventually pay all arrearages – that is, reimburse holders for all of the skipped dividends. Preferred securities are most often issued in denominations of \$25 and pay dividends quarterly or semi-annually.

The most familiar type of preferred for most investors is preferred stock. It's a corporate obligation that ranks in-between bonds and common stock in seniority. Unlike common shareholders, preferred shareholders do not have voting rights with respect to election of the company's board of directors. Yields on a company's preferred shares are generally higher than the dividend yield on its common stock.

A preferred exchange-traded ("PET") note is a debt instrument with a par value of \$25 or \$50 that trades on the Nasdaq exchange or NYSE, much like a preferred stock. Also called "baby bonds," they're typically issued by holding companies of regulated entities (banks, insurance companies, and utilities) to obtain favorable treatment from regulators or credit rating agencies. Unlike conventional corporate bonds, most PET notes' terms permit the issuer to skip interest payments for a defined period of time without constituting an event of default. The skipped interest payments are cumulative and must be paid up before maturity.

Convertible preferred shares, like convertible bonds, can be converted at the holder's option into the issuer's common shares, providing an opportunity to participate in those securities' upside. A variation is the *mandatory convertible preferred*, which assigns the power to convert the security to the issuer rather than the holder. The issuer's conversion option is set at a specified date, typically two to three years post-issuance.

Note that securities carrying the preferred label issued in \$1,000 denominations trade over-the-counter and resemble corporate bonds more than preferred securities.

Closed-End Funds

Closed-end funds ("CEF") are actively managed vehicles that hold portfolios of underlying assets. Among the kinds of assets a CEF may hold are corporate bonds, municipal bonds, mortgage-backed securities, common stocks, and preferred stocks. Some CEFs seek to supplement their income by writing options on the underlying assets.

Like their better-known cousins, the open-end mutual funds, closed-end funds enable an investor to diversify risk over a large number of securities. But CEFs differ in a fundamental way from open-end mutual funds. When you buy an open-end mutual fund,

the company that runs it creates new shares at that day's *net asset value* ("NAV") – the total value of the fund's assets minus its liabilities. When you decide to sell, the fund company redeems your shares, again at that day's NAV.

In contrast, a CEF's shares trade on an exchange, meaning that the counterparty to your trade is another investor. Your purchase or sale doesn't increase or decrease the number of shares outstanding. An important consequence is that a CEF may trade at a discount or premium to its NAV, which is not ordinarily possible for an open-end fund's shares.

In another difference from open-end funds, CEFs are permitted to use leverage. That can heighten returns to investors, but it also increases the CEFs' price volatility. Returns to investors are reduced from the underlying portfolio's return by the management fee charged by the company that operates the CEF.

CEFs make distributions monthly, quarterly, or annually. Distributions are derived from dividends, interest, or capital gains. Some CEFs' distributions vary materially from period to period based on the performance of the underlying assets. Others strive to make steady distributions, which may result in a portion of the distribution consisting of *return of capital*. That results in a reduction of the holder's cost basis in the fund.

Exchange-Traded Funds

An income-focused exchange-traded fund ("ETF"), like a closed-end fund, enables investors to diversify across a large number of issues and trades on an exchange. Unlike a CEF, it continuously creates and redeems shares, which keeps its price in line with its NAV. Also unlike CEFs, ETFs aren't allowed to use leverage. Many ETFs are passively managed with an objective of tracking an index, but there are also actively managed ETFs.

Master Limited Partnerships

A Master Limited Partnerships ("MLP") enjoys the advantage of being taxed like a partnership while also being a liquid investment. As long as it derives at least 90% of its income from qualifying sources, the MLP is not taxed at the company level. That's in contrast to the double taxation of corporations – which pay income tax on profits and the dividends (derived from their remaining post-tax income) are taxable to their shareholders. Qualifying sources of income for MLPs to avoid *double taxation* include activities such as production, processing, storage, and transportation of depletable natural resources (such as oil and natural gas), as well as rents on real properties.

MLP unitholders receive a Schedule K1 form instead of a Form 1099, which is sent to holders of other kinds of investments. Unitholders are allocated a share not only of the MLP's income, but also of its deductions, losses, and credits. Owing to the K1's resulting complexity, investors who rely on professional tax return preparers commonly incur additional expenses for filing their taxes. Further cost increases can arise from the requirement to pay state income taxes on an allocated portion of the income in each state in which the MLP operates.

Real Estate Investment Trusts

A publicly traded Real Estate Investment Trust (“REIT”), like an MLP, combines the advantages of a liquid investment that escapes double taxation. There are also public non-traded REITs and private REITs, but we at *Porter & Co. Distressed Investing* only recommend public REITs.

To qualify for taxation only at the shareholder (if set up as a corporation) or unitholder (if set up as a trust) level, a REIT must invest at least 75% of its total assets in real estate, cash, or U.S. Treasury securities and derive at least 75% of its gross income from rent, interest on mortgages that finance real estate, or sales of real estate. In addition, the REIT must distribute at least 90% of its taxable income to investors. A REIT holder receives a Form 1099-DIV, which breaks down dividends into the differently taxed categories of ordinary income, capital gains, and return of capital.

Dividend Stocks

The goal of an investment in common stocks is most often generating a return mainly through price appreciation – buy a share for \$10, watch it grow to \$15, sell for 50% return. Stocks that issue dividends can play a role in a portfolio designed primarily for generating current income.

Stocks of certain industries – particularly Utilities and Real Estate – have higher-than-average dividend yields, leading them sometimes to be characterized as “bond substitutes.” These high-dividend stocks have some appeal simply for the level of current income they generate.

Other stocks have more modest dividend yields, but long records of regularly increasing their dividends. Provided that their *dividend payout ratios* are not already very high, they have the capacity to continue that practice. These *dividend growth stocks* can help provide the growth in income needed to combat loss of purchasing power over time, as discussed above in “Inflation Risk.” Investors should think about these securities in terms of *yield on cost*. Down the road, the dividends being paid on a dividend growth stock, as a percentage of the price you paid for it, will compare very favorably with yields on other income assets.

How We Generate Asset Class Recommendations

It’s not advisable to actively trade an income portfolio in an effort to time the market or to pivot frequently from one asset class to another. But when putting new money into the market, it makes sense to aim for the best value available at the time. We offer quarterly guidance on that effort through our Relative Value analysis of major income asset classes. We have also included a relevant ETF for each asset class to track performance in the real world – since you can’t invest directly in the category indexes. We will track the performance of those ETFs in our quarterly Income Streams updates.

Technical details on the calculations behind our rankings appear in the Appendix at the end of this document. The key point is that we put disparate asset classes on a common scale – using either its mean spread versus U.S. Treasuries, its mean price-to-earnings ratio (P/E), or mean index price as its benchmark. An index that falls below that mean of 0 is considered cheap, and so we give it a green checkmark for every 0.20 deviation below the mean. Conversely, an index that is above the mean of 0 earns a red x for every 0.2 deviation above 0. So, for example, Closed-End Funds fall 0.98 below the 0 mean and therefore earn five green check marks – one for each 0.2 move (rounded to 1). In theory, the cheaper the asset class, the better it should perform going forward.

Relative Value: Income Asset Classes

September 30, 2025			
Rank	Asset Class	Value Scale	ETF Investment Opportunity
1	Closed-End Funds	✓✓✓✓✓	Invesco CEF Income Composite ETF (PCEF)
2	Master Limited Partnerships	✓✓	Alerian MLP ETF (AMLP)
3	Real Estate Investment Trusts	✓✓	Schwab U.S. REIT ETF (SCHH)
4	Dividend Growth Stocks	✗✗	ProShares S&P 500 Dividend Aristocrats ETF (NOBL)
5	Preferred Stocks	✗✗	Invesco Preferred ETF (PGX)
6	High-Yield Corporate Bonds	✗✗✗✗✗	VanEck Moody's Analytics BBB Corporate Bond ETF (MBBB)
7	Investment-Grade Corporate Bonds	✗✗✗✗✗	iShares iBoxx High-Yield Corporate Bond ETF (HYG)
8	Utility Stocks	✗✗✗✗✗	Vanguard Utility Index Fund ETF (HYG)

✓ = 0.2 price deviation below the mean, ✗ = 0.2 price deviation above the mean

Sources: Bloomberg; ICE Indices, LLC; Porter & Co. Research Calculations

Glossary

Definitions of technical terms used within a definition can be found elsewhere within this Glossary. Nothing in the Glossary should be construed as tax advice. Consult your tax advisor when making investment decisions that may affect your tax liability.

Adjustable Rate

An interest rate or dividend rate that's not fixed over the life of the security, but instead changes at set intervals based on a reference rate such as the Secure Overnight Financing Rate.

Arrearages

The amount by which an issuer has fallen behind on scheduled payments. For example, if a \$25 preferred stock's fixed dividend rate is \$0.30 per quarter and the issuer has omitted the past three scheduled payments, the arrearages total \$0.90 per share.

Balanced Portfolio

An investment strategy that combines asset classes, typically stocks and bonds, with the aim of balancing risk and return. A frequently used mixture is 60% stocks and 40% bonds. Some cash may also be included to provide liquidity.

Basis Point

A unit of measurement for yields and spreads defined as 1/100 of a percentage point. For instance, if a bond's yield rises from 4.50% to 4.65%, the increase is 15 basis points.

Busted Convertible

A convertible bond or preferred security that is trading so far below its conversion price that conversion is very unlikely to become attractive. A busted convertible's market price will approximate the price at which a nonconvertible with an equivalent coupon, maturity, and seniority would trade, given prevailing yields on comparable issues.

Call Feature

Also known as an "early redemption provision," a call feature in a bond or preferred security's terms permits the issuer to retire the issue prior to its maturity date. A call feature enables the issuer to take advantage of a drop in interest rates rather than be locked in, for the full period to maturity, at a rate obtained in a high-interest-rate environment. At least initially, the call typically must be made at a premium to par. A call feature may allow the issuer to redeem the issue in whole or in part. If in part, the call is executed on securities selected by lottery.

Capital Gain

An investor realizes a capital gain for tax purposes when selling a security in a taxable account at a price higher than the purchase price. As of 2025, capital gains are taxed at lower rates than ordinary income. The tax rate on a capital gain depends on whether it is short-term, meaning the investment was sold within one year of its purchase, or long-term, meaning the investor's holding period was longer than one year.

Collateral

Assets that back a claim for secured bondholders in the event that the issuer defaults. Secured corporate bondholders have collateral such as real estate, equipment, and inventory.

Conversion Price

The fixed price per share at which holders of a convertible security can convert their bonds or preferred shares to the issuer's common stock. The conversion price is set at the time of the convertible's issuance, ordinarily at a premium to the stock's then-prevailing market price.

Cost Basis

The purchase price of a security for tax purposes. Dividends reinvested in a stock become part of its cost basis. Cost basis becomes crucial at tax time, when an investor has sold a security and needs to determine whether and how much money was made or lost on the investment.

Coupon

The contractual interest rate payable on a bond. For example, a bond with a face value of \$1,000 might be required to make two annual payments of \$22.50 each for an annual coupon rate of $\$45 \div \$1,000 = 4.50\%$. If the bond is trading at par (= face value, typically \$1,000), its yield-to-maturity is equivalent to the coupon rate. If the bond trades at a discount, the yield will exceed the coupon rate and if the bond trades at a premium, the yield will be less than the coupon rate.

Credit Rating Agency

A company that provides opinions regarding the creditworthiness, or likelihood of repayment, of various debt instruments and preferred securities. Credit ratings are not investment recommendations, as yields and spreads on the rated securities reflect factors other than likelihood of repayment, such as maturity and tradability, as well as prevailing supply/demand conditions. The leading U.S.-based credit rating agencies are Moody's Investors Service, Standard & Poor's, and Fitch Ratings.

Cumulative

With reference to preferred securities, a provision of an issue's terms that requires the issuer to pay all arrearages, upon resuming payment of the preferred dividend following a suspension, before dividends may once again be paid to common shareholders.

Current Yield

A yield calculated as the coupon rate (for a bond) or dividend rate (for a preferred security) divided by the security's prevailing market price. For a low-coupon bond trading at a discount, its current yield will be lower than its yield-to-maturity, which also takes into account the expected appreciation to par at maturity.

CUSIP

A nine-digit code made up of letters and numbers that is used to identify securities. Pronounced "cue-sip," CUSIP is an acronym for the Committee On Uniform Security Identification Procedures. When buying a bond that trades over-the-counter, an investor needs to provide the CUSIP to the broker.

Default

Failure by a bond issuer to make a scheduled interest or principal payment in full and on schedule.

Discount

A bond or preferred security is said to be trading at a discount when its market price is below its face value. A closed-end fund is said to be trading at a discount when its market price is below its Net Asset Value.

Dividend Growth Stock

A common stock that attracts income investors not by virtue of a particularly high dividend yield but instead because of the issuer's record of steadily increasing its dividend over time and its perceived capacity to continue doing so.

Dividend Payout Rate

For a common stock, a percentage calculated as the annual dividend divided by earnings per share. An unusually high payout rate may raise questions about the issuer's ability to increase or even to maintain the dividend at its current level.

Dividend Yield

A percentage yield calculated by dividing the annual dividend by the security's market price. For example, a common stock priced at \$32.40 that pays a \$0.46 annual dividend has a dividend yield of $\$0.46 \div \$32.40 = 1.42\%$. For a preferred security with a face value of \$25, a 4.88% dividend rate, and a market price of \$23.875, the dividend yield is $(\$4.88 \div 4) / \$23.875 = 5.11\%$.

Double Taxation

Double taxation occurs when income is taxed at both the corporate and personal level. MLPs and REITs are structured to escape double taxation. Their income earned at the issuer level is passed through, without being taxed, to the unitholders.

Face Value

The amount due to be paid to a security holder at maturity, generally \$1,000 for a bond and most often \$25 for a preferred security. Face value is generally equivalent to par value.

Fixed Rate

An interest rate or dividend rate does not vary over the life of the security. This is in contrast to an adjustable rate dividend.

Leverage

The use of borrowed funds to increase the rate of return. Many closed-end funds employ leverage. Leverage magnifies both upswings and downswings in price.

Maturity

The date on which principal becomes due for repayment on a bond or preferred security. Note that some preferred securities are perpetuals, meaning they have no maturity date. A perpetual remains outstanding unless and until the issuer exercises its right to call the security or repurchases the entire issue.

Mean

Also known as “simple average,” the mean of a sample is calculated by summing the values and dividing by the number in the sample. For example, if the prices of the ICE BofA Fixed Rate Preferred Securities Index in five consecutive months were 97.98, 96.83, 91.23, 92.31, and 88.08, the index’s mean price over that period was $466.43 \div 5 = 93.29$.

Net Asset Value (“NAV”)

For a closed-end mutual fund (“CEF”) and certain other types of investments, NAV is calculated as the total value of assets minus the total value of liabilities. Dividing this amount by the number of fund shares produces a number that investors can compare with a CEF’s market price to determine whether it is trading at a premium or a discount to NAV.

Ordinary Income

Income that is taxed at the taxpayer’s marginal tax rate rather than the lower capital gains rate. The category includes interest income, short-term capital gains, and dividends that do not satisfy the requirements for being classified as qualified dividends.

Out Of The Money

An option (such as a convertible bondholder’s option to convert the bond to shares of the issuer’s common stock) is out of the money if it cannot currently be exercised at a profit. The option can still have value, based on the possibility that the stock price will rise to the level that will provide a profit to the holder. If the stock price is far below that level, the conversion option is said to be “deep out of the money,” with little likelihood of becoming profitable to exercise, resulting in the option having little or no value.

Over-The-Counter (“OTC”)

OTC trading of securities occurs either directly between investors or through broker-dealer networks, rather than on a securities exchange. Many corporate bonds are not listed on an exchange and therefore must be traded over-the-counter, using a CUSIP number.

Par Value

Generally equivalent to face value. For a \$1,000-face-value bond, par is conventionally quoted as 100, so a bond quoted at 82.875 has a market value of \$828.75.

Premium

A bond or preferred security is said to be trading at a premium when its market price exceeds its face value. A closed-end fund is said to be trading at a premium when its market price exceeds its NAV.

Qualified Dividend

A qualified dividend is one that satisfies certain Internal Revenue Service requirements to be taxed at the capital gains rate rather than the higher ordinary income rate.

Return of Capital ("ROC")

ROC is a payment on an investment that is not taxed as either income or a capital gain. ROC reduces the security holder's cost basis. If ROC payments over time add up sufficiently to reduce the holder's cost basis to zero, any subsequent return of capital becomes taxable as a capital gain.

Secure Overnight Financing Rate ("SOFR")

The Secure Overnight Financing Rate is a nearly risk-free benchmark rate used in setting interest and dividend rates on adjustable-rate securities. SOFR reflects the cost of borrowing overnight in the market for repurchase agreements backed by U.S. Treasury securities. It replaced the London Inter-Bank Offered Rate (LIBOR) as the primary U.S. dollar benchmark rate after LIBOR was phased out in June 2023.

Secured

A secured bond is backed by specific collateral. An unsecured bond, in contrast, is backed only by the issuer's creditworthiness. In the event of bankruptcy, the senior secured bond ranks above unsecured bonds in priority for recovery of principal. An issuer's secured bonds are therefore generally considered less risky than its unsecured bonds and will consequently carry lower yields.

Senior Unsecured

A senior unsecured bond is backed only by the issuer's creditworthiness, not by specific collateral. In the event of bankruptcy, the senior unsecured bond ranks below secured bonds in priority for recovery of principal and ahead of subordinated bonds.

Seniority

For debt instruments, seniority refers to priority for recovery of principal in the event of bankruptcy. In principle, the claim of a given priority class must be satisfied in full before any of the bankrupt company's value can be used to satisfy, either fully or partially, the claim of the next most senior class. Ranked from most to least senior, the instruments discussed in this Porter & Co. Guide to Income Investing are secured bonds, senior unsecured bonds, subordinated bonds, preferred stocks, and common stocks.

Standard Deviation

Standard deviation measures the dispersion of a set of financial data points, such as asset prices or returns, around their mean. In investing, it quantifies volatility; a higher standard deviation indicates greater price swings and therefore higher risk.

Subordinated

A subordinated bond is backed only by the issuer's creditworthiness, not by specific collateral. In the event of bankruptcy, the subordinated bond ranks below senior unsecured bonds in priority for recovery of principal.

Tender Offer

A public offer by an issuer either to buy back its securities for cash or to exchange them for new securities. The issuer generally makes the tender offer at a price above the prevailing market price.

Total Return

A measure of an investor's return during a stated period that takes into account price change, interest or dividends, and income earned by reinvesting the interest or dividends.

Yield On Cost ("YOC")

YOC is a measure of a stock's dividend yield based on the stock's original purchase price rather than its current market price. The calculation formula is the annual dividend per share divided by the cost basis per share.

Yield-To-Call ("YTC")

A yield calculation that assumes a bond or preferred security is purchased at the market price as of the calculation date, is held until the earliest permitted call date, and is called on that date at the applicable call price.

Yield-To-Maturity ("YTM")

YTM is a yield calculation that assumes a bond or non-perpetual preferred security is purchased at the current market price and held to maturity, that the issue is not called prior to maturity, and that all scheduled coupon and principal payments are made in full and on schedule. Another key assumption is that all coupon payments are reinvested at the same rate as the issue's YTM. Because in reality interest rates fluctuate, the security's total return over the investor's holding period will most likely vary from its YTM at the time of purchase.

Yield-To-Worst ("YTW")

YTW is a yield measure that represents the lowest possible yield that can be calculated for a callable bond or preferred security, taking into account all of the issuer's call date and call price options.

Zero-Coupon Bond

A bond that pays no cash interest. It is initially sold at a discount to face value, so the investor's return comes entirely in the form of price appreciation to par at maturity. The price appreciation on a zero-coupon corporate bond is taxed as ordinary income, not as a capital gain.

Appendix: Calculation Of Rich/Cheap Asset Class Scores

For each of the asset class valuation metrics listed below we calculate a *mean* and *standard deviation* for all months from December 2005 to December 2024.^[1] In our quarterly updates, each asset class is assigned a score calculated by subtracting the mean from its current number and then translating the result into how many standard deviations it represents. For asset classes measured by spread or price/earnings ratio, a positive value indicates that the asset class is cheap by so many standard deviations, while a negative value indicates that the asset class is rich by so many standard deviations. For asset classes measured by price, a positive value indicates that the asset class is rich by so many standard deviations, while a negative value indicates that the asset class is cheap by so many standard deviations.

Data Used In Income Asset Class Rankings

Asset Class	Index	Metric
Closed-End Funds	S-NetWork Composite Closed-End Fund Index	Price
Dividend Growth Stocks	S&P 500 Dividend Aristocrats Price Index	P/E Ratio
High Yield Corporate Bonds	ICE BofA US High Yield Index	Spread
Investment Grade Corporate Bonds	ICE BofA U.S. Corporate BBB Index	Spread
Preferred Stocks	ICE BofA Core Plus Fixed Rate Preferred Securities Index	Spread
Master Limited Partnerships	Alerian MLP Index	P/E Ratio
Real Estate Investment Trusts	MSCI US REIT Index	P/E Ratio
Utility Stocks	S&P 500 Utilities Sector GICS Level 1 Index	P/E Ratio

Below are the indexes used for the asset classes that we track and the metric for each. Asset classes mentioned in the *Guide to Income Investing* but not included in the rankings due to lack of required data or a workable metric are Adjustable Rate Preferred Stocks, Convertible Bonds, Convertible Preferred Stocks, and Speculative Grade Preferred Stocks. Because of its large overlap of securities with the MSCI US REIT Index, the S&P 500 Real Estate Sector GICS Level 1 Index is also excluded from the rankings.

^[1] Calculations for the ICE BofA Core Plus Fixed Rate Preferred Securities Index are from March 31, 2012, forward.

The Income Streams ETF Portfolio

Asset Category	Investment Opportunity
Closed-End Funds	Invesco CEF Income Composite ETF (PCEF)
High Yield Bonds	iShares iBox High-Yield Corporate Bond ETF (HYG)
Master Limited Partnerships	Alerian MLP ETF (AMLP)
Real Estate Investment Trusts	Schwab U.S. REIT ETF (SCHH)
Utility Stocks	Vanguard Utility Index Fund ETF (VPU)
Dividend Growth Stocks	ProShares S&P 500 Dividend Aristocrats ETF (NOBL)
Preferred Stocks	Invesco Preferred Stocks ETF (PGX)
High-Yield Corporate Bonds	VanEck Moody's Analytics BBB Corporate Bond ETF (MBBB)

For the latest updates and research on our *Income Streams* Portfolio, [click here](#)



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P.S. If you'd like to learn more about the Porter & Co. team, you can get acquainted with us [here](#). You can follow me (Porter) on **X** here: [@porterstansb](#)