FIRST ASSET
EXCHANGE TRADED FUNDS
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FIRST ASSET PREFERRED SHARE ETF
MANAGER COMMENTARY
Second Quarter 2017
TSX: FPR

The Canadian preferred share market had a volatile second quarter, as the market fell in April and May before rebounding in June on the back of comments from the Bank of Canada governors that the emergency interest rate policy announced in January 2015 was no longer necessary. Global risky assets were generally positive but much more subdued in Q2-2017, as oil dropped 8% and global growth prospects were dampened. The shine came off the Trump administration's ability to follow through on its wish list of actions to make America Great Again, as it has yet to pass any major legislation. As the quarter passed, the market came to accept that maybe it will not be able to improve growth to the +3% level anytime soon.

The BMO 50 Preferred Share Index (the "Index") rose in the second quarter of 2017, due to higher rate expectations following the June 12th speech by Deputy Governor Carolyn Wilkins that questioned whether the Bank of Canada needed to continue providing significant monetary stimulus. The Index fell 2.31% over April and May on the back of heavy issuance before jumping 3.43% in June, as 5 year Government of Canada bonds moved 45 bps higher to 1.39%, on the back of expected higher overnight rates. The market has very quickly priced in two hikes in 2017. Preferred shares continue to benefit from very strong retail demand but institutional demand for new issues began to fade as yields and rate-reset preferred shares spreads moved lower.

Issuance picked up in Q2-2017 from the first quarter with 9 issues totaling $2.225b while redemptions totaled $850m across 5 issues, for a net increase of $1.375b. What was particularly interesting was the fact that 3 perpetual preferred share issues came to the market for $600m and institutional investors took roughly 50% of each deal. Institutional investors took only 28% of the 6 rate-reset share issues.

The U.S. Federal Reserve System ("Fed") raised rates by 25 bps in June (as anticipated) and indicated more increases should be expected, but toned down its hawkish comments as inflation remains stubbornly below its goal of 2%. Just as the Fed is likely decreasing its tightening pace, the Bank of Canada seems poised to remove its emergency 50 bps cut from 2015 over the next 6 months.

The Index posted a 1.04% total return for the quarter, while the broader S&P/TSX Preferred Share Index (the "Benchmark") returned 1.12%. Within the Index, floating rate preferred shares led the way for the second quarter in a row with a 2.66% return, while perpetual preferred shares returned 1.12% and rate-reset shares 0.79%. Another interesting point is that even as the market has been expecting rates to rise and floating rate shares have enjoyed the best returns this year, only one rate-reset issue up for conversion, out of 12 votes this year, has had enough votes to form a floating rate issue.

Our outlook for the preferred share market remains positive for the second half of 2017, as the interest rate outlook for Canada has certainly changed, which should finally lead to higher dividends from both new issues and rate-reset preferred shares up for reset. Following the sell-off in May and the change in interest rate outlook we are not as concerned with rate-reset shares as we were in March. Therefore, we could expect a 3% to 4% return for the remainder of the year coming mostly from the current annual yield of 4.57%.

John Shaw, CFA
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Signature Global Asset Management

Signature Global Asset Management manages a diverse range of equity, balanced and income funds, and is CI Investments' largest in-house portfolio management group. The team of over 40 investment professionals, led by Chief Investment Officer Eric Bushell, manages over $55 billion and has offices in Toronto and Hong Kong.

Investment Philosophy

The Signature investment philosophy is designed to deliver the best possible risk-adjusted returns in today's complex environment and is based on these key elements:

- The globalization of the world economy has resulted in increased complexity, requiring specialized knowledge.
- The increased interconnectivity of the global economy demands collaboration.

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First Asset - **Smart Solutions™**

First Asset, a CI Financial Company, is a Canadian investment firm delivering a comprehensive suite of smart ETF solutions. Rooted in strong fundamentals, First Asset's smart solutions strive to deliver better risk-adjusted returns than the broad market while helping investors achieve their personal financial goals.