FIRST ASSET
EXCHANGE TRADED FUNDS
A CI Financial Company

FIRST ASSET PREFERRED SHARE ETF
MANAGER COMMENTARY
Third Quarter 2017
TSX: FPR

Income Generation

The Canadian preferred share market, as well as the the global market for risky assets, had a volatile third quarter. Canadian interest rates moved higher in the quarter as the Bank of Canada ("BoC") removed its emergency interest rate policy of 2015, due to the economy performing very well this year. Global risky assets were positive as the S&P500 Index rose 4.5% and oil recovered from last quarter's drop gaining 12%, to close at $51.60.

The BMO 50 Preferred Share Index (the "Index") rose 2.34% in Q3-2017, due to higher interest rates as a result of the BoC increasing rates 50 bps in 2 hikes over the quarter. 5 year Government of Canada bonds moved 36 bps higher to 1.75%, on the back of the BoC increases and the expectations of more to come. Preferred shares continue to benefit from very strong retail demand and institutional demand improved on the higher rates.

New issuance fell in Q3 compared to Q2, with 5 preferred share issues totaling $1.25b, while redemptions totaled $500m across 2 issues for a net increase of only $0.750b. Issuance is lower, and likely to remain lower, due to two developments in the bond market. First, both TransCanada and Enbridge issued their inaugural CAD denominated hybrid corporate bonds (junior subordinated debt) that supports their senior bond credit ratings. This is less costly funding than preferred shares, which had filled the same role. Second, Bank of Nova Scotia announced plans to issue the first Additional Tier 1 bond from a Canadian bank in USD, as the quarter drew to a close. Both of these structures can raise larger amounts of debt at lower costs for the issuer, thus taking substantial issuance away from the Canadian preferred share market.

The U.S. Federal Reserve left rates on hold in Q3, although it has signaled that more increases are likely, but at a more gradual pace than the previous 6 months. On the Canadian side, as a result of the aforementioned rate increases by the BoC, the Canadian bond market priced in further rate increases over the next year at a faster pace than the preferred share market is pricing. As a result, valuations of rate re-set are attractive to fair.

The Index posted a 2.34% total return for Q3-2017, while the broader S&P/TSX Preferred Share Index (the "Benchmark") returned 1.73%, due to its lower weight in floating rate preferred shares. Within the BMO 50 Preferred Share Index, floating rate prefered shares led the Index for the third quarter in a row with an 8.33% return, while rate re-set shares retuned 2.84% and perpetual preferred shares -1.45%, respectively.

Our outlook for the preferred share market remains positive, as the higher interest rates in Canada supports the rate re-set and floating rate preferred shares that make up the vast majority of the market. Additionally, Canadian banks and utilities taking advantage of lower cost bond structures will decrease future issuance, and thus preferred shares will remain well bid. We would expect preferred shares to gain 5% to 6% over the next year with only a modest increase in rates.

John Shaw, CFA
Vice-President, Portfolio Management and Portfolio Manager
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.

1 (877) 642-1289 | www.firstasset.com | info@firstasset.com

FIRST ASSET

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.