



First Asset Preferred Share ETF First Quarter 2019

Market Overview

- The Canadian preferred share market moved sideways over the first quarter of 2019, unlike other global risk assets that bounced back from the sell-off in the fourth quarter of 2018. Global risk asset valuations were cheap across the board to start the year and received a big boost from the U.S. Federal Reserve (the “Fed”) throughout the quarter. The Canadian preferred share market was held back due to the continuing fall in five-year interest rates. Capital markets continue to deal with several concerns including slowing global economic growth and geopolitical issues related to Brexit and Chinese/U.S. trade tensions. However, the markets were coming to terms with these issues, believing they may reach a satisfactory conclusion shortly. Global risk assets were higher, as the S&P 500 Index rose 13.6% over the quarter and West Texas Intermediate crude oil rose 32% to close the period at US\$60.14 per barrel.
- The BMO Capital Markets 50 Preferred Share Index (“BMO 50”) fell 0.2% over the quarter, while the broader S&P/TSX Preferred Share Index was up 1.1% due to the strong tone in global risk assets being balanced by the fall in five-year Canada interest rates from 1.89% to 1.62%. Within the BMO 50, perpetuals were the best-performing sector for the second quarter in a row, up 6.16%, while rate re-sets fell 2.47% and floaters plunged 12.47%. Perpetuals did better due to falling interest rates and a better overall tone for credit spreads.
- Gross issuance was muted during the quarter, with only \$1.1 billion issued across five issues, while over \$1.3 billion was redeemed, for a net reduction of \$300 million. Inter Pipeline Ltd. issued a well-received hybrid bond that is structurally akin to that of a preferred share, but with the company being able to expense the interest costs. We expect more energy infrastructure companies to seek capital in the bond market instead of the preferred share market. That said, we do believe that preferred share issuance by Canadian banks is going to pick up over the next two quarters due to the maturity of Tier 1 bonds and non-capital-compliant preferred shares. We estimate issuance of more than \$3 billion from the banks for the remainder of the year, which will temper price increases. New issuance by banks is expected to come with good yields and very good re-set spreads, which should be well-received by the market.



- The biggest influence on global risk assets during the quarter was the Fed. Simply put, the Fed has relented to the wishes of the market. Following the terrible fourth quarter of 2018, the U.S. Federal Open Market Committee has taken a number of steps, in fairly rapid succession, to reassure markets that it would not continue raising interest rates in a slowing U.S. or global economy. The market now assumes Fed interest rate hikes are on hold for the remainder of the year, with the dot plot showing only one hike in 2020. The Bank of Canada was also on hold for the first quarter of 2019 due to the slowing Canadian and global economies, and it is expected to remain so unless the Canadian economy weakens further and forces the central bank to cut interest rates.

Performance Summary

- Over the first quarter of 2019, First Asset Preferred Share ETF (TSX:FPR) (the “Fund”) returned 1.3% while its benchmark, the SPX/TSX Preferred Share Index, returned 1.1% as interest rates fell but risk assets rallied. The Fund’s preferred shares outperformed those of the benchmark by 0.15 percentage points mainly due to security selection within the fixed/floater and floater sectors.

Contributors to Performance

- The main contributor to Fund performance during the quarter was sector allocation, with a modest overweight position in the perpetuials sector, which was the best-performing structure of preferred shares, and an underweight position in the fixed/floater sector. The Fund’s underweight positioning and selection of securities in the fixed/floater sector was the main driver of performance. The top-performing securities came from positions in TransAlta Corp.’s Series H and F preferred shares, which bounced back strongly on news that Brookfield Renewable Partners L.P. was increasing its investment in the company. Series A preferred shares of Sempra Energy was another top performer that did well due to its parent company’s outlook improving during the quarter.
- Additionally, very strong security selection within the floating-rate structure contributed to the Fund’s performance. The best-performing floating-rate preferred shares were those of Citigroup Capital XIII (Series N), which benefited from investors seeking carry assets, plus The Bank of Nova Scotia (Series D and F), which benefited from the bank calling other preferred shares.



Detractors from Performance

- The main detractors from Fund performance came from individual security selections within the fixed/floater and floating-rate sectors. As interest rates fell in the first quarter of 2019 and the market priced in a potential interest rate cut, the floating-rate and soon to be re-set fixed/floater preferred shares were the hardest hit. The main underperformers were floater and fixed/floaters from BCE Inc. due to rate concerns. Power Financial Corp. (Series A preferred shares) and Pembina Pipeline Corp. (Series E preferred shares) were also major detractors from performance.

Outlook

- We remain positive on Canadian preferred shares for the second quarter of 2019, even as five-year yields have fallen during the first quarter. Preferred shares were very weak to end the year, as were all risk asset classes, and therefore had room to bounce back and/or absorb lower rates without falling in price. Valuations remain attractive compared to the past number of years, as measured by both the current and expected yield on re-set preferred shares. Overall, we believe the Canadian preferred share market is attractively priced and will return around its dividend rate of 5% to 6% for the year.

Performance (in %)	Year-to-date	1 year	3 year	5 year	Since inception (5/11/2016)
First Asset Preferred Share ETF	1.3	-4.9	–	–	5.3
S&P/TSX Preferred Share Index	1.1	-6.8	–	–	5.7

Source: First Asset, as at March 31, 2019.

The indicated rates of return are the historical annual compounded total returns, including changes in unit value, and do not take into account sales, redemption or optional charges or income taxes payable by a security holder that would have reduced returns.

Use of Benchmark: S&P/TSX Preferred Share Index is a capitalization-weighted index designed to measure market activity of Canadian preferred stock listed on the Toronto Stock Exchange. This index is used as a benchmark to help you understand the Fund's performance relative to the general performance of Canadian preferred shares.

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