

The Canadian preferred share market had a good quarter on the back of 5-year Canada bond yields rising to recent highs. Capital markets were concerned with U.S.-China trade tensions, as announced tariffs went into effect. Emerging market weakness led to some volatility in the quarter as tighter U.S. monetary policy and a stronger U.S. dollar had a negative impact on countries that rely on external funding. Global risky assets were volatile and mostly lower but the S&P 500 TR Index was up 7.7%, and West Texas Intermediate (WTI) oil ended the quarter down 1.2% to close at US\$73.25 per barrel.

The BMO 50 Preferred Share Index (the "BMO 50") posted a 1.33% total return for the third quarter, while the broader S&P/TSX Preferred Index was up 1.60%, due to security selection in fixed/floaters and perpetuals. Within the BMO 50, floaters led the index at 2.13% while rate re-sets returned 1.49% and perpetuals 0.30%. Supporting preferred shares was the five-year Government of Canada bond yield moving higher to 2.34% supported by market expectations that the Bank of Canada (BoC) would raise interest rates in October by 25 basis points.

Issuance of new preferred share offerings fell in the third quarter with four issues totalling \$1,350 million, while there were two redemptions announced of \$300 million for a net increase of \$1,050 million during the quarter. The four new issues all had very low re-set spreads and they did not initially trade well in the secondary market. Issuance is expected to pick up marginally as banks continue to redeem legacy preferred shares and additional tier 1 bonds that they must replace with new preferred shares.

Back-end spreads on new issues are again becoming too low, so we have been avoiding new issues and looking to pick up product in the secondary market at better prices.

The U.S. Federal Reserve (the "Fed") raised rates by 25 basis points at its September meeting, with the Fed's "Dot Plot" (The Dot Plot is published after each Fed meeting. It shows the projections of the 12 members of the Federal Open Market Committee) signalling one more increase in 2018 and three more in 2019. The BoC raised overnight rates by 25 basis points to 1.5% in July to continue removing its accommodative stance but acknowledged that it was concerned about NAFTA negotiations. The BoC feels that a neutral rate is in the 2.5% to 3.5% range.

The First Asset Preferred Share ETF (the "Fund") returned 1.67% this quarter while its benchmark, the BMO 50 Preferred Share Index returned 1.33% for the same period, as interest rates rose. The Fund's preferred shares outperformed mainly due to security selection within the fixed/floaters and perpetual sectors.

The main contributor to performance was positive security selection of fixed/floaters. Capital Power C and E, and TransAlta H were the largest contributors.

The main detractor was an underweight to the fixed/floater sector and security selection within the sector. The main underperformance came from holdings of AltaGas G and Semptra Energy A.

The outlook for the preferred share market remains positive as higher interest rates in Canada support the rate re-set and floating preferred shares that make up over 80% of the market. However, NAFTA negotiations, U.S. tariffs on aluminum, and global trade war talk is all bad for the Canadian economy and, thus, will moderate the rise of interest rates. Given the weak first half of 2018, we have lowered our annual expected returns in 2018 supported by the Bank of Canada raising rates a further 25 basis points.



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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 aims 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.

Fund Performance (%)

	1 Month	3 Month	6 Month	YTD	1 Year	2 Year	SI ¹
First Asset Preferred Share ETF	-0.41	1.67	2.36	2.57	5.23	8.49	9.74
BMO Capital Markets 50 Preferred Share Index	-0.39	1.33	2.54	3.10	6.46	12.77	12.50
S&P/TSX Preferred Share TR Index CAD	-0.33	1.60	2.46	2.31	5.10	10.64	11.27
S&P 500 TR Index USD	0.57	7.71	11.41	10.56	17.91	18.27	17.89

Source: First Asset as at September 30, 2018

¹Inception date: May 11, 2016

Use of Benchmark: The BMO Capital Markets 50 Preferred Share Index (the "BMO Index") is a market value weighted index that represents the Canadian preferred share market and includes 50 Canadian preferred share issues that are listed on the TSX which satisfy specific inclusion criteria. The Index is used as a benchmark to help you understand the Fund's performance relative to the general performance of Canadian preferred shares within the broader Canadian preferred shares market. The S&P/TSX Preferred Share Index is designed to track the performance of the Canadian preferred stock market. The Index is used as a benchmark to help you understand the Fund's performance relative to the general performance of the broader Canadian preferred shares market. The S&P 500 Total Return Index tracks 500 large-cap U.S. stocks representing all major industries. The Index is used as a benchmark to help you understand the Fund's performance relative to the general performance of the broader U.S. equity market.

Definitions:

Fixed Rate Preferred Shares (fixed): A type of preferred share that has a fixed dividend rate, similar to a fixed-income security.

Floating Rate Preferred Shares (floaters): A floating rate preferred share pays a quarterly (sometimes monthly) dividend that "floats" in relation to a reference rate, typically the prime rate.

Rate Reset Preferred Shares (re-sets): This kind of preferred share pays a fixed dividend rate until its reset date. Upon its reset date, if the preferred share is not called by the issuer, the holder has two options. A new fixed dividend rate reflecting the current interest rate environment can be locked-in until the next reset date; or at reset date, the holder can exchange the issue for a floating rate preferred share.

Perpetual Preferred Shares: This type of preferred share has no maturity date and pays a fixed dividend for as long as it remains outstanding. Due to its long duration, a perpetual preferred share can be very sensitive to credit spreads and interest rates.

Risky Assets: A risk asset is any asset that carries a degree of risk. Risk asset generally refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate and currencies.

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