FIRST ASSET
EXCHANGE TRADED FUNDS
A CI Financial Company

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

The Canadian preferred share market started the year with the second strongest quarterly return since the Global Financial Crisis. The continued positive tone for risky assets was the result of improving global growth and optimism that the Trump administration would be able to enact its pro-growth agenda. For the second quarter in a row, the Federal Open Market Committee felt the U.S. economy was growing strong enough to raise the overnight lending rate by 25bp. Most of the move higher in risky assets came in the first 2 months of the quarter before moving sideways in March due to the Trump administration's inability to pass a new Healthcare Act despite the fact that the Republicans control both the Senate and the House.

The BMO 50 Preferred Share Index rose in the first quarter of 2017, due to very strong performance from floating rate and rate reset preferred shares. Beside the global risk on trade, preferred shares benefitted from very strong retail and institutional demand including fixed income investors looking for a pickup over corporate bonds, lower issuance and fair steady redemptions. Issuance of 5 rate reset issues totaled $1.625B while redemptions totaled $500m across 3 issues for net increase of $1.1B. Preferred share ETFs continued to grow rapidly with approximately $700m flowing into the space. Thus, it didn't take much additional demand from traditional preferred share buyers to push the market higher. The strong move higher for floating rate and rate reset preferreds, are positively correlated to higher interest rates, made sense up to the middle of March as 5 year Canada government bonds rose from 1.11% to 1.31%. However, as the shine came off the Trump reflation trade, 5 year Canada government bonds fell back to 1.12% to close out the quarter essentially unchanged. However, preferred shares did not sell off, making the rate reset sector stretched on a valuation basis. Nonetheless, the market is starved for new issuance to meet the strong demand for preferred shares.

The U.S. Federal Reserve System (the "Fed") raised interest rates by 25 bps in March and indicated that 2 more increases were expected in 2017, and 3 more in 2018, due to near full employment and increasing inflation expectations. However, should the Trump administration be unable to move forward on key parts of its pro-growth plan the Fed would likely not raise rates as fast as the Dot Plot indicates. Unlike the Fed, the Bank of Canada (the "BoC") has remained on the sidelines over the period with the overnight rate remaining at 0.50%. The BoC has been concerned about the slack in the economy and with no signs of inflation, it continues to take a wait-and-see approach.

The BMO 50 Preferred Share Index posted a 9.98% total return for the first quarter of 2017, while the broader S&P/TSX Preferred Index returned 7.51%. The main difference between the indices comes from the floating rate constituents in January. Within the BMO 50 Preferred Share Index, rate Resets returned 11.3% and floating rate constituents posted 14.1%, while perpetual securities lagged with only a 5.0% return.

Our outlook for the preferred market was positive at the beginning of 2017. We remain positive but feel that rate resets issued in the past 15 months are fully priced with yield to redemptions in the low 3% area. At this juncture we believe the market needs higher interest rates to generate returns greater than the annual dividend yield of 4.6%, thus we expect more modest returns for the remainder of the year.

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.

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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.