Market Commentary
First Quarter 2018

SIGNATURE GLOBAL ASSET MANAGEMENT™

Signature Preferred Share Pool

Canada's preferred share market had a volatile first quarter following the broader risky asset market run-up in January and subsequent sell-off in February and March. Rising interest rates and growing concerns about a trade war, on top of high equity valuations, caused risky asset markets to fall and volatility to rise. The Canadian economy continued to perform well in the first quarter which may prompt the Bank of Canada to raise rates slowly this year. Global risky assets were volatile as the S&P 500 Index fell 0.76%; however, West Texas Intermediate (WTI) crude continued to climb, rising 7% to close at $64.94 a barrel.

The BMO Capital Markets 50 Preferred Share index posted a 0.54% total return for the first quarter, while the broader S&P/TSX Preferred Share Index was down 0.15%, again due to its lower weighting in floating rate preferred shares. Within the BMO 50, floating stocks led the index for a fifth consecutive quarter with a 6.13% return. In contrast, rate reset preferred shares retuned 0.22% and perpetual preferred stocks generated -1.18%. Supporting preferred shares was the Bank of Canada's 25-basis-point overnight rate increase to 1.25%, and 5-year Canadas, which moved 11 basis points higher to 1.97%. Preferred shares continued to benefit from strong retail demand in January; however, demand fell off along with the equity sell-off. The sell-off in preferred shares from January highs was the result of higher issuance, as well as retail investors disposing of these assets after two years of strong returns and institutional investors seeking better levels before buying.

Issuance picked up with eight issues totaling $2.075 billion. There were only three redemptions announced, totalling $420 million, for a net increase of $1.65 billion during the quarter. Issuance is expected to be manageable in 2018 but higher than in 2017 as AltaGas will likely issue to help fund its acquisition of WGL Holdings, and as Canadian banks refinance legacy additional tier-1 bonds.

The U.S. Federal Reserve raised rates by 25 basis points at its March meeting, with its "dot plot" signaling two more increases in 2018 and continued hikes in 2019. The Bank of Canada raised rates in January amid strong employment growth but also noted that ongoing NAFTA negotiations may reduce growth. Still, with Canada's unemployment rate at 5.8% for two consecutive months, the market expects further rate hikes.

Performance

The fund (Class F) returned 0.1% for the quarter. The main contributor to performance was the overweight to the floating rate sector, which was the best-performing sector in the market.

Citigroup N benefited from rising Libor yields and the Fed's rate hike, while holdings of Power Financial A benefitted from the increase in the prime rate by Canadian banks.

Security selection within the fixed/floater sector added to performance. Capital Power C, E and BCE A, C were the top-performing holdings in the sector.

Security selection within the floating rate sector – which included holdings of Bank of Nova Scotia D,F – detracted from performance. Both of these securities are high-conviction holdings that we believe will perform well in the future.

Outlook

The outlook for the preferred market remains positive as higher interest rates in Canada supports the rate reset and floating preferred shares that make up over 80% of the market. Retail demand has waned recently, but we believe it will return and that institutional demand for preferred shares will continue due to expected better returns than fixed-income markets. Given the weak first quarter, we have lowered our annual expected returns for 2018 based on expectations of a further 25-basis-point rate hike by the Bank of Canada.

Class F Returns (in %) as at March 31, 2018	Year-to-date	1 year	3 year	5 year	10 year
Signature Preferred Share Pool	0.1	5.7	N/A	N/A	N/A