Market Commentary
Third Quarter 2018

Signature Preferred Share Pool

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 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 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 fell in the third quarter with four issues totalling $1,350 million while there were two redemptions announced for $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 the issues 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 the issues and looking to pick up product in the secondary market at better prices.

The U.S. Federal Reserve raised rates by 25 basis points at its September meeting, with the Fed's Dot Plot 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 potential NAFTA negotiations. The BoC feels that a neutral rate is in the 2.5% to 3.5% range.

The Signature Preferred Share Pool (Class F) returned 1.6% 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.

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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 Sempra Energy A.

The outlook for the preferred 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.

Class F Returns (in %) as at September 30, 2018	Year-to-date	1 year	3 year	5 year	Since inception (12/21/2015)
Signature Preferred Share Pool	2.3	5.2	N/A	N/A	9.0

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