

# INCREASE YOUR FUTURE WEALTH POTENTIAL

## J ZECHNER ASSOCIATES PREFERRED SHARE POOLED FUND



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In September, the preferred share market traded down for most of the month as increasing bond yields put pressure on both common and preferred share markets. Bond investors seemed to abandon the hope that central banks would cut interest rates this year and pared expectations for rate reductions in 2024. Catalysts for the shift in expectations included a reacceleration in inflation, an extension of the rally in oil prices to above \$90 per barrel and continued resilient economic activity despite the sharp rise in interest rates in the last 18 months. However, in the last week of the month, the preferred share market was taken by surprise when TD Bank redeemed a rate reset issue and preferred shares rallied, particularly bank rate reset issues. The S&P/TSX Preferred Share index ended the month with a return of 1.44%.

In Canada, the economic data released in September suggested activity was decelerating, but still growing. However, to some extent, interpreting the underlying strength of the economy was made more difficult by the record wildfire season, labour strikes, and harsh weather events. The key data point in the month was CPI inflation that rose to 4.0% from 3.3%, on strength in gasoline prices, mortgage interest costs and rents. Additionally, core measures of inflation that are closely followed by the Bank of Canada rose for the first time in almost a year. The jump in inflation was larger than expected and reinforced the view that the Bank of Canada was not finished with its struggles to bring inflation back to 2%.

As mentioned above, the most significant news in September was TD Bank taking the market by surprise when it announced, after the market closed on September 22<sup>nd</sup>, that it would redeem the TD.PF.K issue which had closed that day at a price of \$21.79. TD.PF.K has a reset spread of 259 bps and the company had not redeemed its previous two resetting issues, TD.PF.I and TD.PF.J, with reset spreads of 301 and 270 basis points respectively.

In contrast, prior to TD Bank's announcement, National Bank chose to extend its NA.PR.G issue with a reset spread of 277 basis points. The new dividend rate will be announced on October 17<sup>th</sup>. Market participants are keenly looking at the possible redemption of Bank of Montreal's BMO.PR.E issue, which is due to reset on November 25<sup>th</sup> with a spread of 268 basis points. However, current market pricing suggests that it will not be redeemed because Bank of Montreal does not have capital levels as high as TD Bank.

### J Zechner Associates Preferred Share Pooled Fund

The fund earned 1.10% in September, which was somewhat less than the S&P/TSX Preferred Share index return. After the TD Bank redemption announcement, the best performing issues in the market were bank rate reset issues. Fund performance was hurt by its underweight in these types of issues, and the approximate 13% allocation to bank institutional preferred shares and LRCNs that are not in the S&P/TSX Preferred Share index and which underperformed traditional \$25 par value issues in the month.

### Outlook & Strategy

As noted above, bond investors pushed yields higher in September and the yield of the 5-year Canada bond continues to be substantially higher than five years ago resulting in substantial increases in dividend rates on resetting issues. With bond investors seemingly anticipating rates staying higher for longer, reset issues will continue to benefit from sharply higher dividend rates when they reset, particularly those with reset dates in the next few months and potentially further in the future.

Some months ago, we noted that the fight against inflation resembled the carnival game of Whack-a-Mole. No sooner have price increases in one area of the economy subsided then another sector experiences sharply higher prices. For example, recall the surge in goods prices early in the pandemic, the shift to services such as travel once the economy reopened, and now labour strikes resolved with large wage gains. For a central bank, such as the Bank of Canada, trying to rein in inflation, the problem is that it only has one lever to pull, interest rates. Because different sectors of the economy respond differently in terms of speed and magnitude to higher interest rates, the Bank of Canada will need to keep interest rates at a restrictive level for an extended period to bring inflation back to the desired 2% pace.

Only a widespread slowing of the economy is likely to result in the Bank achieving its objective. While a so-called soft landing might be sufficient, we believe a recession is much more likely to occur because of the difficulty assessing economic activity and inflationary pressures in real time. The Bank will want to avoid tightening to a degree that halts economic growth but does not control inflation, also known as stagflation. Instead, the Bank will need to ensure that inflation is well and truly under control before it can consider easing monetary policy. At this point, it is not clear that the Bank has raised interest rates high enough to accomplish its goal. While some observers are describing the current level of rates as "high", that is true only if your perspective is limited to the period since the Great Financial Crisis. If we look at the period from 1992 to 2007, when inflation was fluctuating around 2%, it was not uncommon to see the Bank's interest rates and bond yields at or above current levels while economic growth remained satisfactory. We believe the recent adjustment of the bond market to rates staying higher for longer may extend somewhat further.

Notwithstanding the growing risk of a recession, we continue to remain confident in the creditworthiness of the issuers in the portfolio, as these companies have successfully weathered previous economic downturns without impacting their ability to pay the dividends on their preferred shares.

29 <sup>th</sup> September 2023	INVESTMENT RETURNS		
	Quarter	1 year	2 year
Preferred Share Fund	-0.68%	-0.82%	-6.79%
S&P/TSX Preferred Share Index *	-1.42%	-4.47%	-9.35%

**Notes:**

See Performance Disclosure on Page 2

## Categorization: Canadian Preferred Share

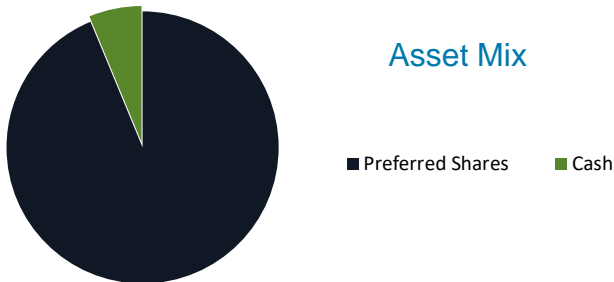
Funds have been categorized according to the Canadian Investment Funds Standards Committee criteria.

### Fund Objective:

The fund's investment objective is to provide a combination of current income and long-term capital growth. The Fund will seek to achieve its investment objective primarily by investment in a diversified portfolio of mainly preferred shares of Canadian issuers, Canadian money market securities and debt securities.

### Investment Strategy:

The goal of the Fund is to add value of 75 bps per annum over and above the S&P/TSX Preferred Share Index. We will build a well-diversified portfolio of thirty to forty preferred share issues that is actively managed, emphasizing the sectors that offer the best value proposition, we believe that active management can substantially outperform passive investing. Selectivity of securities is key as we believe, for example, that we should own the cheapest Royal Bank preferred share issue rather than all 22 Royal bank issues. We avoid overvalued sectors and focus on those sectors that offer the best value on a risk / return basis. We will provide superior credit analysis as we apply the same rigorous credit analysis to Preferred share issues as we do to bonds. We believe that the index is not a prescription of how to invest but rather a proxy of the whole market. Execution of trades and price discipline are essential in a market that can be less liquid.



### Top 5 Holdings:

Preferred Shares	
Manulife Financial 5.942% Series 25	4.91%
Bank of Montreal 7.373% Series 50	4.45%
Enbridge Inc. 5.086% Series N	3.80%
Fairfax Financial 5.0% Series K	3.46%
BCE Inc. 4.812% Series AQ	3.37%
(as of September 29, 2023)	
Cash	1.28%
Current Portfolio Yield	7.16%

### Benefits of our Pooled Funds

The J Zechner Associates Pooled Funds offer professional money management, varied investment choices, the potential for above average returns and lower management fees so you keep more of your accumulated wealth.

A pooled fund is a unit trust that operates like a mutual fund but is not required to have a prospectus under securities law.

A pooled fund is sold through an Offering Memorandum.

J Zechner Pooled Funds are available only to Canadian investors and require a minimum investment of \$150,000; unless the investor is an Accredited Investor. Units of the Funds are qualified investments for certain registered plans.

### Solid Partnership Foundation

#### Eligibility for Investment

The Fund will only invest in securities that will be qualified investments under the Income Tax Act (Canada) for a trust governed by a registered retirement savings plan (an "RRSP"), registered retirement income fund (a "RRIF), or tax-free savings account (a "TFSA").

#### Performance Disclosures

Performance data quoted represents past performance and does not guarantee future results. Investment returns and principal value will fluctuate so that when withdrawals are made by the investor the shares or units may be worth less than their original cost. Unless specified, all performance quoted is gross of fees and expenses.

Benchmarks: Index returns are provided for comparative purposes only to show how the companies returns compare to a broad-based index of securities. As the indices do not have costs, fees or other expenses associated with their performance. In addition, securities held in the indices may not be similar to securities held in the composite's accounts. All returns are expressed in CAD

#### Notes:

\*Returns are Net of Fees.

\*All indices are total return.

\*Past performance is not indicative of future results.

\*Index returns are shown for comparative purposes only.

Securities held in the portfolio do not replicate the index.

No guarantee is given that performance will match the index indicated.

### For more information please contact:

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