

# INCREASE YOUR FUTURE WEALTH POTENTIAL

J ZECHNER ASSOCIATES PREFERRED SHARE POOLED FUND



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For the last several months, the preferred share market has been trading in a fairly narrow range. During the summer months, the lack of new issue supply appeared to result in slightly higher prices, but in September a resumption of new issues led to a small retracement. The S&P/TSX Preferred Share Index returned -0.33% in September, as dividend income was not enough to fully offset the price declines. In a month when bond yields rose markedly, floating rate preferreds were the strongest performers while rate reset issues were the weakest. The weakness in rate resets was likely due to all of the new issues being that type. To date, the preferred share index has returned +2.31% in 2018, well ahead of the FTSE Canada Universe Bond index result of -0.35%.

The key economic news in September came on the final weekend after the markets were closed. Canada successfully concluded the renegotiation of NAFTA with the United States ending over a year of uncertainty. The direct impact of the NAFTA 2.0 deal (pardon our reluctance to call it by the Trumpian title the United States Mexico Canada Agreement) on preferred shares will be fairly minor. However, the deal reduces the risk of a recession in the next year or more, which would have been negative for preferred share values. In addition, the trade deal increases the likelihood of the Bank of Canada raising interest rates at its October 24th fixed announcement date, which should be positive for floating rate preferred shares. Should bond yields rise in conjunction with the Bank of Canada's rate increase, the new dividend rates for resetting issues will also be higher, which should be positive for their prices.

## J. Zechner Preferred Share Pooled Fund

The fund modestly outperformed the index in September. Security selection was generally favourable, although the Altgas announcement had a negative impact because the fund had an approximately 5% position in Altgas preferred shares. That was partially offset by the fund's relatively high cash position which did not follow preferred share prices lower.

Noteworthy transactions included the purchase of the new TD Bank and Bank of Montreal issues, as noted above. The purchases of attractively priced individual issues meant the ETF holding was no longer required and it was sold. The purchases of the bank shares resulted in lower cash levels, even after the sale of the temporary ETF holding. The RY.PR.W holding was also sold because it no longer represented good value.

## Outlook and Strategy

The news that NAFTA has been successfully renegotiated makes it much more likely that the Bank of Canada will raise rates on its October 24th fixed announcement date. Further rate increases, though, will be dependent on what the U.S. central bank does. While the Fed no longer describes its monetary stance as "accommodative", we believe it will continue to raise short term rates by at least another 100 basis points if the U.S. economy remains operating at full capacity. However, we expect that the pace of the Fed's moves may slow from the current quarterly cycle. Given the importance of the U.S. economy to the Canadian one, it is not surprising that our respective monetary policies are highly correlated and Canadian short-term rates should follow U.S. ones higher, although perhaps not as rapidly. Rising short term rates will, in turn, lead to higher bond yields.

So, what happens to preferred shares if interest rates and bond yields rise in the coming months? We believe most preferred shares will hold their values or even appreciate somewhat. Historically, there is no correlation between bond and preferred share returns, and we do not see any reason for that to change. Declining bond values will not necessarily cause preferred share prices to fall. The two markets are not linked, because the relatively limited liquidity of preferred shares makes it impossible for a large institutional investor to arbitrage between the two markets. The average yield of preferred shares is only slightly below their long term 5.00% average and that level compares very favourably with current bond yields. In addition, rising bond yields will result in some increases in dividend rates as issues reset in the next year or two, which may lead to price appreciation for those issues. As well, floating rate issues will benefit from any rate increases by the Bank of Canada.

| 29-June-2018                 | INVESTMENT RETURNS |        |         |
|------------------------------|--------------------|--------|---------|
|                              | Quarter            | 1 year | 2 year  |
| Preferred Share Fund         | +1.54%             | +4.26% | +17.24% |
| SP/TSX Preferred Share Index | +1.60%             | +5.10% | +10.64% |

### Notes:

Past performance is not indicative of future results

## Categorization: Canadian Preferred Share

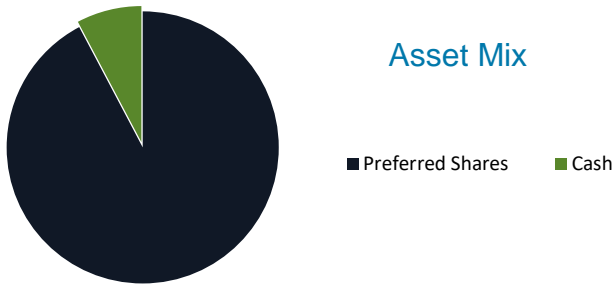
Funds have been categorized according to the Canadian Investment Funds Standards Committee criteria.

### 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                     |       |
|--------------------------------------|-------|
| BCE Inc. 4.812% Series AQ            | 4.89% |
| Algonquin Power 5% Series D          | 4.83% |
| TransCanada Pipelines 4.25% Series 9 | 4.78% |
| AllaGas Ltd. 4.75% Series G          | 3.87% |
| Pembina Pipeline 5.00% Series 5      | 3.76% |
| (as of September 28, 2018)           |       |
| Cash                                 | 1.52% |
| Current Portfolio Yield              | 4.90% |

### 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

Our Pooled Funds are held at CIBC Mellon, who acts as Trustee, Custodian, Valuation Agent and Unitholder Recordkeeper provider. Our commitment to integrity is behind our decision to partner with a leading Canadian custodian, reassuring our clients that their funds are safe and secure. Like J. Zechner Associates, CIBC Mellon is firmly committed to integrity, client service and exceptional results.

### 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”).

### For more information please contact:

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