

# Canadian Preferred Shares Report

July 19, 2017

Fixed Income Group

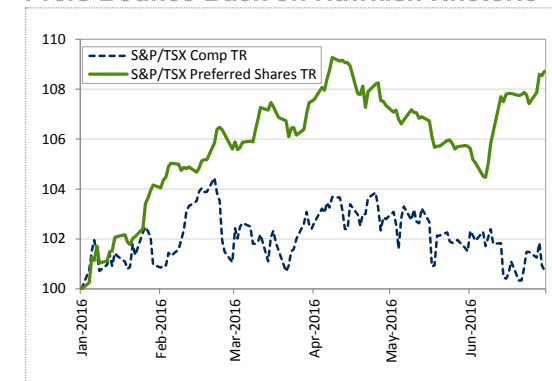
## Rising Rates and Preferred Shares

The Canadian preferred shares market squeaked out a positive total return for the second quarter of 1.12%, matching the performance of the Canadian bond universe, and handily outperforming the S&P/TSX which posted a total return of -1.64%. Through half a year, prefs have returned 8.72%, thanks to a great first quarter in 2017.

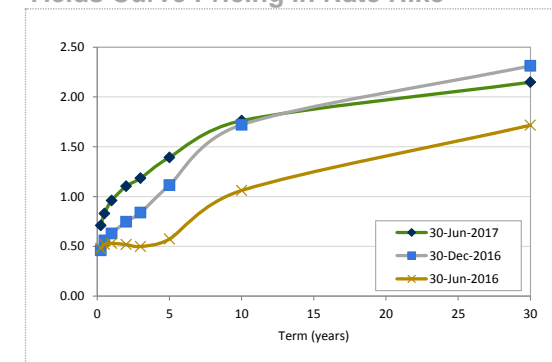
Preferred shares took a step back early in the second quarter. After a great start to the year, prefs continued to rally until mid-April then retreated dramatically until early June as the Government of Canada (GoC) 5-year yield fell. The yield which was as high as 1.30% in mid-March continued to drift lower to below 1.0% in May. It was not until there were rumblings that the Bank of Canada (BoC) may raise rates at their next policy announcement that we saw the GoC 5-year yield jump nearly 45 bps by the end of June. The BoC ended up hiking their key policy rate by 25 bps on July 12, the first time in 7 years. BoC Governor Poloz did not commit to a path for interest rate policy and the communique stated that “the output gap is now projected to close around the end of 2017, earlier than the Bank anticipated in its April Monetary Policy Report (MPR).”

Fixed-reset preferreds react favourably to a rising rate environment and with resets making up nearly 70% of the universe, the pref market bounced back at the end of the second quarter. With the market pricing in a further rate hike in Canada for 2017 we move to an overweight position for fixed-resets. We recommend continuing to allocate a portion of your portfolio to higher paying perpetuals from a portfolio management perspective.

Prefs Bounce Back on Hawkish Rhetoric



Yields Curve Pricing in Rate Hike



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Source: Bloomberg, Raymond James Ltd.

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Please read domestic and foreign disclosure/risk information beginning on page 11.

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**Rising Rates and Preferred Shares**

We started 2017 with the anticipation that the policy rate would likely remain unchanged. In January, the likelihood of rate hike was higher than that of cut, but still sat at only 20%. We maintained a “getting paid to wait” strategy as an improving Canadian economy was playing tug-o-war with oil price volatility. The wait, in the short-term, is now over with the first hike in 7 years occurring. The markets are also pricing in a second hike in the fall, with the BoC looking to reverse the two cuts which happened in 2015. The US, on the other hand, have already been tightening for over a year, having raised rates four times since the financial crisis (once at the end of 2015, and three times over the past seven months). Currently, the market seems split on whether the Fed will raise again this year. As we enter a rising rate environment, we think it would be prudent to refresh ourselves on how rising rates and preferred shares are related.

■ **As Reset Spreads Tighten, Redemption Probability Goes Higher**

When there is high demand for fixed-reset preferred shares, reset spreads will tighten. This in turn will cause current issues that have higher reset spreads to trade higher (closer to par), since the likelihood of them being redeemed increases. A company would like to re-issue at a lower reset spread and call in a higher one since it would decrease their dividend payouts.

**New Issues Yields Declining and Reset Spreads Tightening**

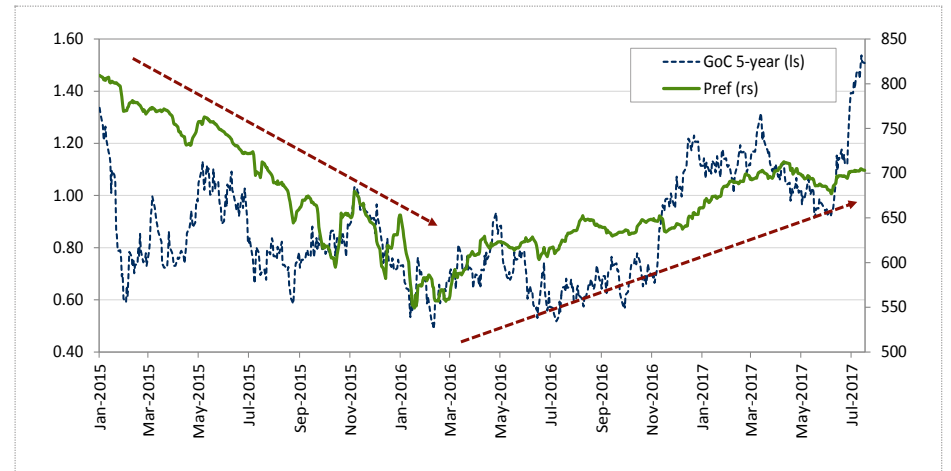


Source: Bloomberg, Raymond James Ltd.

■ **Fixed-Reset Dividends/Yields are Benchmarked to the GoC 5-Year Yield**

Generally, the yield on fixed-resets are determined every five years by a spread above the GoC 5-year yield and therefore when the GoC yield rises so can the preferred dividend. Though investor prefer increasing dividends, they can be reset lower as we saw in 2014-15. The 12-month correlation of the pref market to the GoC 5-year yield is currently at 80% and has been there for most of the second quarter.

**Fixed-Resets Moves In Tandem**



Source: Bloomberg, Raymond James Ltd.

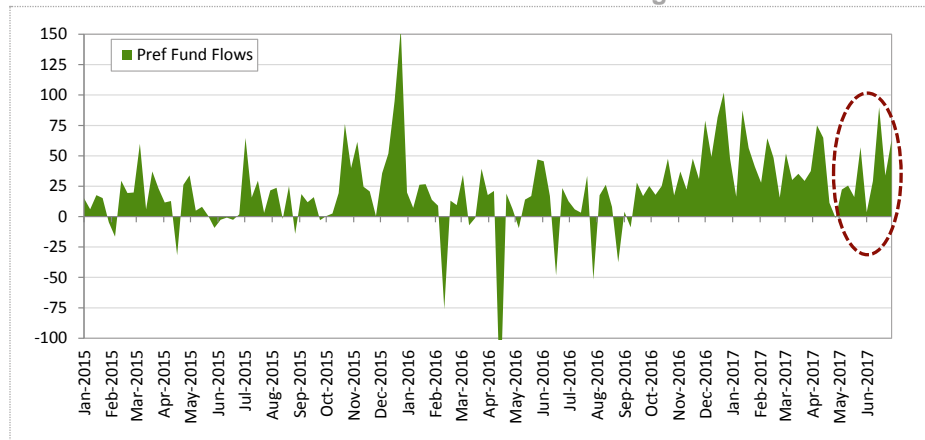
■ **Straight Perpetuals are Negatively Correlated to Yields**

Perpetuals act very differently to fixed-resets when it comes to yields. Since they are more like long-dated bonds, prices are inversely related to yield. So in a rising rate environment, perpetuals tend to go lower and move opposite to fixed-resets, since they have no maturity and their dividends are fixed in perpetuity until they are called by the company. Keep in mind that the preferred shares market is about 20% perpetuals (the rest is mainly fixed-resets) and the majority of the trading volume, especially these days, are dominated by fixed-resets. So the direction of the market itself is not determined by moves in perpetuals. Of note, this past quarter there were three new perpetual issues (Great-West Lifeco, Power Financial, and Intact Financial), the likes of which we haven’t seen since September 2015.

▪ **ETF and Institutional Demand Remains High**

Historically, preferred shares have been a retail product. However, over the past couple of years we have seen major growth in the number of preferred shares ETF offerings, as well as significant institutional involvement in new issues, in particular for bank fixed-resets. Though institutional involvement has declined somewhat, it was still about 50-60% for the past two bank issues, which is still significant. Fund flows into preferred share ETFs has been positive for the past 10 months, with the latest surge coming in the past couple of months with news that the BoC would raise rates.

**Preferred Shares Fund Flows Continue to be Strong**



Source: Bloomberg, Raymond James Ltd.

**Conclusion: Positioning Your Portfolio**

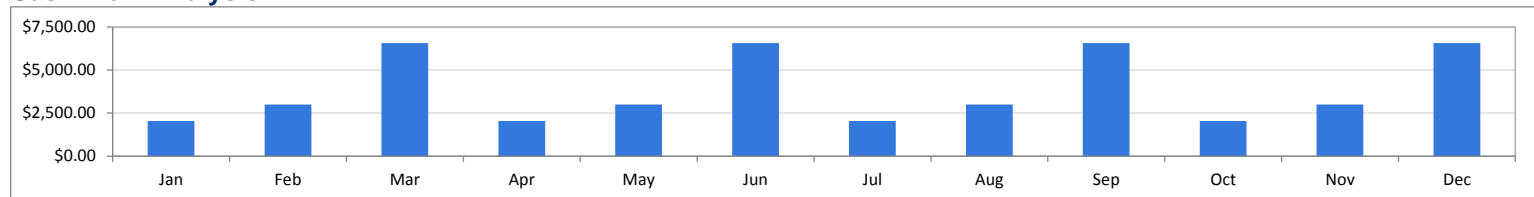
As we move into the second half of 2017, the interest rate environment has completely changed than when we first started the year. With one rate hike under their belt, and the markets anticipating a second by the BoC in the fall, we have moved to an overweight position in fixed-resets versus perpetuials. Despite being in a rising rate environment we remain cautiously optimistic with oil volatility and the frothy Canadian housing market still weighing on the economy. Only time will tell whether there will be consequences of the rate hike(s) on the Canadian consumer and economy. In the meantime, the environment for fixed-reset preferred shares is positive as long as the tightening bias remains for the BoC.

Highlights: Sample Portfolio

General Information			Rating	Pricing			Dividend		Possible Calls			Shares	Value	Weight
Issuer	Ser	Symbol	DBRS	Par	Last	Current Yield	Annual	MMMM-DD	Date	Price	YTC			
<b>Fixed-Resets</b>														<b>74.2%</b>
BANK OF MONTREAL	33	BMO.PR.Y	Pfd-2	\$25.00	\$23.92	3.97%	\$0.950	FMAN-25	25-Aug-2020	\$25.00	5.45	4,000	\$95,680	9.3%
BCE INC	AO	BCE.PR.O	Pfd-3	\$25.00	\$24.81	4.29%	\$1.065	MJSD-31	31-Mar-2022	\$25.00	4.44	4,000	\$99,240	9.6%
BROOKFIELD OFFICE PROP	GG	BPO.PR.G	Pfd-3	\$25.00	\$24.80	4.89%	\$1.213	MJSD-31	30-Jun-2022	\$25.00	5.08	4,000	\$99,200	9.6%
FAIRFAX FINL HLDGS LTD	K	FFH.PR.K	Pfd-3	\$25.00	\$23.30	5.01%	\$1.168	MJSD-31	31-Mar-2022	\$25.00	6.41	4,000	\$93,200	9.0%
INDUSTRIAL ALLIANCE	G	IAG.PR.G	Pfd-2H	\$25.00	\$23.06	4.09%	\$0.943	MJSD-20	30-Jun-2022	\$25.00	5.42	4,000	\$92,240	8.9%
MANULIFE FINANCIAL CORP	5	MFC.PR.G	Pfd-2	\$25.00	\$23.80	4.09%	\$0.973	MJSD-19	19-Dec-2021	\$25.00	5.08	4,000	\$95,200	9.2%
ROYAL BANK OF CANADA	BD	RY.PR.J	Pfd-2	\$25.00	\$23.86	3.77%	\$0.900	FMAN-24	24-May-2020	\$25.00	5.29	4,000	\$95,440	9.3%
TORONTO-DOMINION BANK	7	TD.PF.D	Pfd-2	\$25.00	\$23.83	3.78%	\$0.900	JAJO-31	31-Jul-2020	\$25.00	5.01	4,000	\$95,320	9.2%
<b>Perpetuals</b>														<b>25.8%</b>
INTACT FINANCIAL CORP	5	IFC.PR.E	Pfd-2	\$25.00	\$25.07	5.19%	\$1.30	JAJO-31	30-Jun-2026	\$25.00	5.15	3,500	\$87,745	8.5%
POWER FINANCIAL CORP	R	PWF.PR.R	Pfd-2H	\$25.00	\$25.03	5.49%	\$1.38	MJSD-1	30-Apr-2021	\$25.00	5.43	3,500	\$87,605	8.5%
ROYAL BANK OF CANADA	BJ	RY.PR.P	Pfd-2	\$25.00	\$25.81	5.09%	\$1.31	FMAN-24	24-Feb-2025	\$25.00	4.87	3,500	\$90,335	8.8%
<b>TOTALS</b>						<b>4.50%</b>							<b>\$1,031,205</b>	

General Information			Quarterly Income	Annual Income	Notes
Issuer	Ser	Symbol			
<b>Fixed-Resets</b>					
BANK OF MONTREAL	33	BMO.PR.Y	\$950	\$3,800	May be reset to GoC 5-year yield + 2.71% on August 25, 2020 or redeemed.
BCE INC	AO	BCE.PR.O	\$1,065	\$4,260	May be reset to GoC 5-year yield + 3.09% on March 31, 2022 or redeemed.
BROOKFIELD OFFICE PROP	GG	BPO.PR.G	\$1,213	\$4,850	May be reset to GoC 5-year yield + 3.74% on June 30, 2022 or redeemed. Minimum/floor yield of 4.85%.
FAIRFAX FINL HLDGS LTD	K	FFH.PR.K	\$1,168	\$4,671	May be reset to GoC 5-year yield + 3.51% on March 31, 2022 or redeemed.
INDUSTRIAL ALLIANCE	G	IAG.PR.G	\$943	\$3,770	May be reset to GoC 5-year yield + 2.85% on June 30, 2022 or redeemed.
MANULIFE FINANCIAL CORP	5	MFC.PR.G	\$973	\$3,891	May be reset to GoC 5-year yield + 2.90% on December 19, 2021 or redeemed.
ROYAL BANK OF CANADA	BD	RY.PR.J	\$900	\$3,600	May be reset to GoC 5-year yield + 2.74% on May 24, 2020 or redeemed.
TORONTO-DOMINION BANK	7	TD.PF.D	\$900	\$3,600	May be reset to GoC 5-year yield + 2.79% on July 31, 2020 or redeemed.
<b>Perpetuals</b>					
CANADIAN UTILITIES LTD	AA	CU.PR.D	\$1,138	\$4,550	Next par call is June 30, 2026 at \$25.
POWER CORPORATION CANADA	G	POW.PR.G	\$1,203	\$4,813	Next par call is April 30, 2021 at \$25.
ROYAL BANK OF CANADA	BJ	RY.PR.P	\$1,148	\$4,594	Next par call is February 24, 2025 at \$25.
<b>TOTALS</b>			<b>\$11,600</b>	<b>\$46,398.25</b>	

Cash Flow Analysis



Source: Bloomberg, Raymond James Ltd., Prices as at July 19, 2017. Settlement date July 24, 2017.

## Most Actively Traded

Trading volume data as at July 19, 2017. 30-Day = Average volume over past 30 days. 5-Day = Average volume over past 5 days

### Floating-Rate

Issuer	Series	Symbol	30-Day	5-Day
MANULIFE FINANCIAL CORP	4	MFC.PR.P	12,385	81,188
THOMSON REUTERS CORP	B	TRI.PR.B	6,716	14,886
TRANSCANADA CORP	2	TRP.PR.F	6,072	2,520
TORONTO-DOMINION BANK	T	TD.PR.T	5,901	2,542
SHAW COMMUNICATIONS INC	B	SJR.PR.B	5,777	1,520
FORTIS INC	I	FTS.PR.I	4,643	1,680
SUN LIFE FINANCIAL INC	9QR	SLF.PR.J	4,264	2,415
TORONTO-DOMINION BANK	Z	TD.PR.Z	2,798	589
TRANSCANADA CORP	4	TRP.PR.H	2,313	1,020
TRANSALTA CORP	B	TA.PR.E	1,663	2,800

### Retractable

Issuer	Series	Symbol	30-Day	5-Day
CANOE EIT INCOME FUND	1	EIT.PR.A	6,902	2,574
BIRCHCLIFF ENERGY LTD	C	BIR.PR.C	858	817
BROOKFIELD INVESTMENTS	A	BRN.PR.A	768	500
CANADIAN GENL INVESTMENT	4	CGI.PR.D	495	620

### Perpetual

Issuer	Series	Symbol	30-Day	5-Day
POWER FINANCIAL CORP	V	PWF.PR.Z	30,063	4,177
INTACT FINANCIAL CORP	5	IFC.PR.E	23,021	5,561
ROYAL BANK OF CANADA	AC	RY.PR.C	20,973	12,250
ROYAL BK CANADA	AF	RY.PR.F	17,035	5,634
GREAT-WEST LIFECO INC	T	GWO.PR.T	13,415	7,851
ROYAL BANK OF CANADA	AB	RY.PR.B	10,760	6,789
POWER FINANCIAL CORP	I	PWF.PR.I	10,552	7,305
BOMBARDIER INC	4	BBD.PR.C	9,611	12,778
GREAT-WEST LIFECO INC	I	GWO.PR.I	9,388	10,384
BROOKFIELD ASSET MAN INC	17	BAM.PR.M	8,774	12,085

### Fixed-Reset

Issuer	Series	Symbol	30-Day	5-Day
CANADIAN IMPERIAL BANK	45	CM.PR.R	251,653	147,134
AIMIA INC	3	AIM.PR.C	53,833	11,867
BANK OF MONTREAL	40	BMO.PR.C	49,701	34,450
TORONTO-DOMINION BANK	14	TD.PF.H	48,309	16,280
TORONTO-DOMINION BANK	5	TD.PF.C	43,862	49,754
ENBRIDGE INC	N	ENB.PR.N	36,211	26,112
MANULIFE FINANCIAL CORP	21	MFC.PR.O	35,999	86,370
TORONTO-DOMINION BANK	9	TD.PF.E	33,888	18,358
ENBRIDGE INC	3	ENB.PR.Y	33,259	35,510
ENBRIDGE INC	B	ENB.PR.B	32,871	65,821

## New Issues

### Bank of Montreal, Series 42

- **Symbol:** BMO.PR.D
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 16.0 million shares | June 29, 2017
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.40% | FMAN-25
- **Notes:** Coupon is 4.40% until August 25, 2022, thereafter resets every 5 years @+3.17% over 5-year GoC bond yield.

### Brookfield Office Properties, Series GG

- **Symbol:** BPO.PR.G
- **Type:** Fixed-Reset, Cumulative
- **Issue:** \$25.00 | 11.0 million shares | May 4, 2017
- **Rating:** Pfd-3 (DBRS)
- **Dividend:** 4.85% | MJSD-31
- **Notes:** Coupon is 4.85% until June 30, 2022, thereafter resets every 5 years @+3.74% over 5-year GoC bond yield. The minimum coupon is 4.85%.

### CIBC, Series 45

- **Symbol:** CM.PR.R
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 32.0 million shares | June 2, 2017
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.40% | JAJ0-28
- **Notes:** Coupon is 4.40% until July 21, 2022, thereafter resets every 5 years @+3.38% over 5-year GoC bond yield.

### ECN Capital, Series C

- **Symbol:** ECN.PR.C
- **Type:** Fixed-Reset, Cumulative
- **Issue:** \$25.00 | 4.0 million shares | May 25, 2017
- **Rating:** Pfd-3L (DBRS)
- **Dividend:** 6.25% | MJSD-31
- **Notes:** Coupon is 6.25% until June 30, 2022, thereafter resets every 5 years @+5.19% over 5-year GoC bond yield. The minimum coupon is 6.25%.

### Element Fleet Management, Series I

- **Symbol:** EFN.PR.I
- **Type:** Fixed-Reset, Cumulative
- **Issue:** \$25.00 | 6.0 million shares | May 5, 2017
- **Rating:** Pfd-3H (DBRS)
- **Dividend:** 5.75% | MJSD-31
- **Notes:** Coupon is 5.75% until June 30, 2022, thereafter resets every 5 years @+3.96% over 5-year GoC bond yield. The minimum coupon is 5.75%.

### Great-West Lifeco, Series T

- **Symbol:** GWO.PR.T
- **Type:** Perpetual, Non-Cumulative
- **Issue:** \$25.00 | 8.0 million shares | May 18, 2017
- **Rating:** Pfd-2H (DBRS)
- **Dividend:** 5.15% | MJSD-31
- **Notes:** Coupon is 5.15%. Call schedule: June 30, 2022 at \$26.00; June 30, 2023 at \$25.75; June 30, 2024 at \$25.50; June 30, 2025 at \$25.25; and June 30, 2026 at \$25.00

### Intact Financial, Series 5

- **Symbol:** IFC.PR.E
- **Type:** Perpetual, Non-Cumulative
- **Issue:** \$25.00 | 6.0 million shares | May 24, 2017
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 5.20% | JAJ0-31
- **Notes:** Coupon is 5.20%. Call schedule: June 30, 2022 at \$26.00; June 30, 2023 at \$25.75; June 30, 2024 at \$25.50; June 30, 2025 at \$25.25; and June 30, 2026 at \$25.00

### National Bank of Canada, Series 38

- **Symbol:** NA.PR.C
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 16.0 million shares | March 9, 2017
- **Rating:** Pfd-2L (DBRS)
- **Dividend:** 4.45% | FMAN-15
- **Notes:** Coupon is 4.45% until May 25, 2022, thereafter resets every 5 years @+3.43% over 5-year GoC bond yield.

**Power Financial, Series V**

- **Symbol:** PWF.PR.Z
- **Type:** Perpetual, Non-Cumulative
- **Issue:** \$25.00 | 10.0 million shares | May 26, 2017
- **Rating:** Pfd-2H (DBRS)
- **Dividend:** 5.15% | JAJ0-31
- **Notes:** Coupon is 5.15%. Call schedule: July 31, 2022 at \$26.00; July 31, 2023 at \$25.75; July 31, 2024 at \$25.50; July 31, 2025 at \$25.25; and July 31, 2026 at \$25.00

**Credit Rating Changes**

Company Name	Date	Agency	Curr Rtg	Last Rtg
TransCanada Corp	09-Jun-2017	DBRS	Pfd-2L	Pfd-2L *
R Split III Corp	01-Jun-2017	DBRS	NR	Pfd-2
Aimia Inc	11-May-2017	DBRS	Pfd-3L *-	Pfd-3L
North American Finl 15 Split Corp	28-Apr-2017	DBRS	Pfd-3L	Pfd-4H
TransAlta Corp	03-Apr-2017	DBRS	Pfd-3L	Pfd-3

Source: Bloomberg, WR = Withdrawn Rating, NR = No rating has been requested. July 11, 2017

## Appendix A: Yield Tables

Yields tables are included as a separate report/attachment, and are also available on a daily basis from the Fixed Income Group of Raymond James Ltd.

## Appendix B: Credit Ratings Comparisons

DBRS	S&P	S&P Global	Description
Pfd-1 (high)	P-1 (high)	AA	<b>Superior:</b> High quality with minimal credit risk. Such a rating is back by strong earnings and balance sheet.
Pfd-1	P-1	AA-	
Pfd-1	P-1	A+	
Pfd-1 (low)	P-1 (low)	A	
Pfd-1 (low)	P-1 (low)	A-	
Pfd-2 (high)	P-2 (high)	BBB+	<b>Satisfactory:</b> Upper-medium grade and comes with moderate credit risk. There is substantial protection of dividend and principal.
Pfd-2	P-2	BBB	
Pfd-2 (low)	P-2 (low)	BBB-	
<b>Investment Grade Cut-Off</b>			
Pfd-3 (high)	P-3 (high)	BB+	<b>Adequate:</b> Medium grade and comes with moderate credit risk. There may be speculative characteristics.
Pfd-3	P-3	BB	
Pfd-3 (low)	P-3 (low)	BB-	
Pfd-4 (high)	P-4 (high)	B+	<b>Speculative:</b> substantial credit risk, and are speculative in nature. The protection of dividend and principal is uncertain, but especially so during times of economic adversity.
Pfd-4	P-4	B	
Pfd-4 (low)	P-4 (low)	B-	
Pfd-5 (high)	P-5 (high)	CCC+	<b>Highly Speculative:</b> Very high credit risk due to chance of default. The protection of dividend and principal is uncertain.
Pfd-5	P-5	CCC	
Pfd-5 (low)	P-5 (low)	CCC-	
Pfd-5 (low)	CC	CC	
Pfd-5 (low)	C	C+	
Pfd-5 (low)	C	C	
Pfd-5 (low)	C	C-	
D	D	D	<b>In Arrears:</b> The lowest rated class. Low prospect for recovery of principal and interest.



## Appendix C: Education and Glossary

### What are Preferred Shares?

Preferred shares are equity securities that provide investors a fixed dividend which must be paid out before common share dividends are paid. Preferred shares have characteristics of both equity and debt instruments. The fixed dividend is stated by a coupon rate and is commonly paid out quarterly. In the event of a dissolution or liquidation of the issuer, preferred shareholders' claims on assets are senior to common shareholders but behind debt holders.

### Preferred vs Common

- Like most common shares, these are equity instruments which pay dividends
- Potential for price appreciation but price is less volatile than common shares
- Not able to participate in the upside profits from ownership of the company and usually have no voting rights unlike common shares

### Preferreds vs Debt Securities

- React similarly to interest rates as bond instruments
- Many preferred shares are issued at a fixed par value
- Rated by the major credit rating agencies
- Redeemable for a set amount at the end of a fixed term
- Typically pay a fixed dividend

### What are the Benefits?

- **Favourable tax treatment:** Better after-tax return for preferred share distributions from Canadian corporations; preferred dividends are less heavily taxed due to the dividend tax credit compared to interest which is fully taxable as income under Canadian federal and provincial legislation.
- **Higher yield than other fixed income products:** Preferreds tend to have higher yields than other fixed income products such as bonds since distributions are less assured. Yields are not guaranteed but many major public companies will meet preferred share obligations even in times of losses. However, some issuers have the right to defer (or suspend) payment of dividends upon financial hardship.
- **Price stability compared to common shares:** Less volatility in price of preferreds.

- **Addresses reinvestment risk:** available in longer terms unlike money market products such as GICs

### What are the Drawbacks?

- **Interest Rate Risk:** Many preferreds pay a fixed rate distribution similar to fixed income securities; there is an inverse relationship between changes in interest rates and the price of the preferred shares. Price sensitivity of the preferreds is greater for longer terms and for lower coupon rates. Preferreds are less price sensitive to interest rate fluctuations than bonds.
- **Call Risk:** Callable preferreds tend to have higher yield to maturities given the call risk. However, the call risk is a disadvantage to the investor for the following reasons: future dividend income stream is uncertain, reinvestment risk for the investor since the issuer often exercises the call provision when interest rates have fallen in order to refinance at lower rates. Callable issues are unlikely to appreciate in price when interest rates fall and possibly decline below the call price given a significant rise in rates.
- **Credit Risk:** Independent agencies such as the Dominion Bond Rating Service (DBRS), and Standard & Poor's (S&P), assess an issuer's ability to fulfill its obligations and assign a credit rating. A decline in credit quality can negatively impact the price of preferreds and the dividend policy of the issuer.
- **Liquidity Risk:** Preferreds often have light trading volumes, i.e. "thin" markets. This lack of liquidity can cause exaggerated swings in price when buy or sell volumes pick up from normal levels.

### What to Look for in Buying Preferreds?

- **Credit Quality:** Higher quality preferreds provide higher assurance of a dependable income stream. The price of preferred shares is likely to erode much more upon the issuer facing financial difficulty than from a shift in rates. High credit quality preferreds are rated P1 and P2 by DBRS.
- **Yield to Call/Redemption:** This is the yield shown to a call date or reset date.
- **Liquidity:** - Certain issuers are more easily purchased or sold on the market due to higher liquidity. The size of the initial preferred offering can influence liquidity. In general, the larger the issuance size, the better the liquidity.
- **Diversification:** Selecting preferreds in different industries and with different features can help provide balance and flexibility to an investor.

## Types of Preferred Shares

Preferreds can be structured in a variety of ways based on a combination of features related to the 1) term or maturity (fixed or no maturity date), 2) payment provision (fixed or floating rate), 3) dividend policy (cumulative or non-cumulative), and 4) other unique qualities. It is easy to see that there can be a number of different combinations of the different features for preferred shares which give the holder/issuer different rights. Therefore, prior to investing in preferred shares, it is important to understand the specific features of the particular preferred share issuance. The following is a description of the different types of preferred shares.

### 1. Term to Maturity

- Perpetual/straight preferreds have no fixed maturity date, the stated dividend rate is paid in perpetuity. Although the issuer does have redemption rights.
- (Hard) Retractable/term preferreds have a set maturity date at the time of issue, the investor would get back his capital investment at the end of the specified period.
- Soft Retractable preferreds pay out the retraction amount either as cash or an equivalent amount in common shares of the issuer, at the option of the issuer. Typically, the stock price used to calculate the number of common shares is 95% of the average price of the common shares in a time period before the retraction occurs.

### 2. Payment Provision

- Fixed Rate preferreds have a fixed dividend at issue date, can be a fixed dollar value of a stated percentage of par value, normally paid quarterly
- Floating Rate preferreds offer a floating dividend tied to a benchmark, typically as a percentage of the bank prime rate
- Resettables pay a fixed dividend rate for a specified period, usually for five years after their date of issue. On and after that date and on every fifth anniversary, if the issue is not redeemed by the issuer, the holder has the option to either receive a floating-rate dividend, or exchange the series for a further series of a fixed-rate preferred.

### 3. Dividend Policy

- Cumulative means any missed dividends are accumulated and paid in full before common dividends are paid or preferred shares are redeemed.
- Non-cumulative means dividends are paid only when declared and to do not accumulate if missed. The trend in the marketplace has been issuances with non-cumulative preferred shares.

### 4. Other Features

- Convertible preferreds allow the holder to convert the preferreds into common shares based on a specified conversion formula, there are not many of these in the market nowadays.
- Redeemable or Callable features allow the issuer to reserve the right to redeem or “buy back” shares at a predetermined price after a specific date. A small premium above the par value per share is often paid as compensation to the investor when the shares are called. Non-callables, which are rare, cannot be called or redeemed as long as the issuing company is in existence.

There are a couple of other types of preferred shares which have characteristics which are quite different from conventional preferred shares and are described below.

- Deferred Preferred Shares are non-dividend-paying preferred shares, similar to strip bonds, the shares are redeemed at a set par value on a set date in the future. However, unlike strip bonds, the accrued dividends (the dividend premium) on a deferred preferred share are not subject to yearly tax. When the holder is an individual, such dividends do not qualify for the gross-up and dividend tax credit rules normally applicable to dividends received by individuals from taxable Canadian corporations. If the preferred is held to redemption, the accrued dividends are fully taxable as interest income.
- Synthetic Preferreds (Split Shares, Structured, Equity Dividend Shares) are preferreds where holders give up the right to all capital gains to common shareholders while receiving all the dividends on the common shares. The maturity values of such structured shares are dependent upon the value of the underlying common. Another feature of many Split Shares is a possible early redemption date.

## Tax Consequences

For tax purposes, there is usually a disposition when preferred shares are redeemed or called. Here is a list of tax related terminology related to such an event.

- **Deemed Dividend:** The difference between the redemption price and the shares' paid up capital
- **Deemed Proceeds of Disposition:** The deemed dividend deducted from the redemption price
- **Adjusted Cost Base (ACB):** This is generally the purchase price plus sales commissions
- **Capital Gain/Loss on the Disposition:** The amount the deemed proceeds of disposition exceeds (or is less than) the adjusted cost base

The table below provides a few illustrative examples of the tax consequences upon redemption of preferred shares.

### Tax Consequences

Redemption	Tax Consequence
Redemption Price Equals Paid-up Capital	<ul style="list-style-type: none"> <li>▪ No deemed dividend</li> <li>▪ Deemed proceeds of disposition is the paid-up capital</li> </ul>
Redemption When Paid-Up Capital Is Less Than Par	<ul style="list-style-type: none"> <li>▪ Can result in a significant deemed dividend</li> <li>▪ Deemed proceeds of disposition well below par resulting in the realization of a significant capital loss on the redemption</li> </ul>
Purchase price above par value & Redemption at Par	<ul style="list-style-type: none"> <li>▪ Capital loss, can offset any capital gains realized in calendar year of redemption or carry back 3 yrs or carried forward indefinitely</li> </ul>
Redemption Price Above Par	<ul style="list-style-type: none"> <li>▪ Paid-up capital rarely greater than par, thus, this results in deemed dividend</li> <li>▪ Deemed proceeds of disposition is the paid-up capital</li> </ul>

*Please note that the tax implications in the examples are for illustrative purposes only, and should not be considered an interpretation of the Income Tax Act; nor do they purport to constitute specific tax advice. Clients should seek independent advice on tax-related matters from qualified professionals licensed to practice in that area.*

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