TSX **DIVS**

QUARTERLY COMMENTARY - Q1

Evolve Active Canadian Preferred Share ETF

DIVS seeks to provide holders of Units with stable income and long-term capital appreciation by investing primarily in a diversified mix of preferred shares of primarily Canadian issuers, in addition to U.S. and international issuers.

For the month ending March 29, 2018

TICKER: DIVS
CURRENT YIELD: 4.63%*
SUB-ADVISOR: Foyston, Gordon and Payne, Inc.

FOYSTON, GORDON & PAYNE INC.
INVESTMENT COUNSEL

Preferred shares are hybrid securities with both equity and fixed income characteristics.

QUARTERLY COMMENTARY:

The broad positive economic trends from 2017 continued into the first quarter of 2018 although interesting developments have emerged that increased volatility and general risk aversion. Global economic performance continues to be strong and performance of global equity markets is positive despite the continued heightened political uncertainty and the growing fear that equity market valuations are stretched. The uncertainty combined with the valuation fears have started to seep into investor confidence and it appears that investors are broadly becoming more risk averse which has been revealed through market volatility and severe single day corrections.

In Canada, we continue to have a healthy labour market, reasonable inflation, and sound growth, however, headwinds from tightening monetary policy, new mortgage rules aimed at slowing the housing market and increasing worry from protectionism rhetoric in the US have dragged down the Canadian equity market and constrained longer-term interest rates.

The 5-year interest rate was up about 10 basis points from the end of the year but notably lower than its peak in February. The preferred share market did rally slightly as rates trended higher, which was eventually offset by increased risk aversion and the unwinding of certain structured products that pressured the preferred share market to a loss for the quarter. Given the temporary nature of these factors and the trend of higher 5-year rates we are seeing better value now in preferred shares than we did at the start of Q1.

The portfolio continued to generate value added performance during the quarter. The underweight exposure to financials provided significant value in January. Security selection also contributed to the outperformance in the energy sector and telecommunications sector through exposure to Enbridge Inc and BCE Inc.

As the quarter progressed, we reduced our exposure to Enbridge to an underweight position relative to the index. This allocation contributed to performance as Enbridge lagged the market during the second half of the quarter.

* Gross of MER

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An additional driver of performance was avoiding losses associated with Element Fleet Management (~1% of pref market). FGP did not hold Element as we viewed it as a highly risky investment that was inconsistent with its P3 rating and overpriced. At the beginning of February Element abruptly announced the departure of its CEO, integration issues from recent acquisitions, declining revenue forecasts, and lost clients. Our view is that Element's risk profile is still elevated and that the decline in market price and increasing yield still does not properly compensate investors for the associated risk. This is an example of FGP's rigorous security selection process.

PORTFOLIO STRATEGY:

The portfolio strategy remains mostly consistent with last quarter. The portfolio began reducing its overweight to certain rate resets as the valuations appeared extended. This provided an opportunity to increase exposure to a subset of rate resets that had lagged the market and had exhibited less correlation with interest rates.

OUTLOOK:

Canada's economic data has softened since the BoC hiked the policy rate in January. Additionally, protectionism/trade headlines have made the market uneasy with the growing uncertainty of its exact impact on the Canadian economy. This has tempered expectations for the pace of rate hikes in Canada. While we expect to continue to see periodic uncertainty in the market that is driven by political headlines, we still view the underlying economic data in North America as strong and sufficient to warrant additional hikes in 2018 by the both the Fed and the BoC. This outlook for short-term rates should continue the trend of higher 5-year rates and provide additional stability to market prices for preferred shares while allowing for modest capital appreciation.

At current interest rate levels there appears to be modest value in certain rate-reset and floating rate securities that react favourably to rising rates and offer an attractive risk/reward balance. These securities will continue to have an overweight position and when combined with a higher yield than the index should provide additional support in the portfolio even if the market expectations for interest rates are not fully realized.

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