CORPORATE PARTICIPANTS

Raj Lala
President & Chief Executive Officer

Ryan Domsy
Foyston, Gordon & Payne Inc.

PRESENTATION

Operator

Good morning. My name is Jacqueline and I will be your conference operator today. At this time I would like to welcome everyone to the Evolve ETFs Canadian Preferred Share Update Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you.

Raj Lala, you may begin your conference.

Raj Lala, President & Chief Executive Officer

Thanks, operator. Thanks, everyone, for taking this time for a really quick update call on DIVS, the Canadian Preferred Share Fund that's of course run by or managed by Ryan Domsy at Foyston, Gordon & Payne.

As many of you know, we have experienced some volatility in the market, in the equity market, that has spread over to the preferred share market and we felt that it would be very timely for Ryan to talk a little bit about the overall state of affairs and also how this portfolio is positioned.
I will now turn it over to Ryan to provide that update.

Ryan Domsy, Foyston, Gordon & Payne Inc.

Thanks, Raj. As you've said, we've been receiving many calls about the volatility and some of the recent activity in the pref market, so we wanted to just take the chance to address a broad group, give you the answers you're looking for.

Now, one thing that's tough about prefs sometimes is that, unfortunately, many investors think of prefs like a common equity. So, as a result of that, when there is a risk-off tone in the equity markets it often spills over to prefs, although generally to a much lesser degree. And this really is done in an indiscriminate way, so you just see broad selling of the asset class because, you know, people are worried about the overall market.

Just to put this into context, as of yesterday when I was looking at the markets the U.S. S&P was down 7.8%, the EAFE was down 8%, the EM markets were down 9.3%, and Canadian equities were down 8.2% for the month of October. Now the pref index was only down about just over 3.5% for the month to date at that point.

Now the reason I point this out is because prefs are correlated with equities because of the view of much of the market that they are an equity security rather than treating it like it's linked to interest rates, which it is. So we generally see that impact but, as I've said before, it's often a story of value relative to those other market segments. It provides a nice kind of in-between between bonds and equities that can balance out your overall portfolio moves and obviously protect on the downside versus an equity selloff.

Now this was extra interesting yesterday and the reason that is because, well actually, first of all, I'll talk about just the market, the equity weakness. Really I don't expect the equity weakness to persist. I still view growth as quite strong and improving and inflation levels are finally picking up, especially including wage inflation, and this will really permit the equity markets to stabilize and actually see improvement. And I think that's what we saw beginning yesterday and what we appear to be seeing so far today in the markets that are actually open currently. So this should stabilize and see improvement and, as a result, I think that we'll see the pref market very much stabilize as a result.

The other thing that's really supporting preferreds over the next while is that they've actually experienced a capital loss over the past year, and this is notable because we've actually seen interest rates increasing quite dramatically. I mean just over the last kind of 24 hours we've seen the five-year interest rate spike by 10 basis points. And this increase directly drives higher dividend payments on the underlying preferred shares, although it's not always noticeable instantly because of the rate reset structure. The reset period is actually delayed, so over any one-year period you're only going to see about 20% of the market reset at higher levels. Now, because of that it will be delayed, but eventually it will be reflected. I think if you look at some of the larger, more liquid lines out there in the market, you're now seeing reset spreads for very high-quality product resetting at the 6.7% range, which is very dramatic, and then extreme yield pickup and spread pickup versus corporate bonds. So I think that's something to remember.

So, as these payments have increased, we've seen this decline, but that's what really creates the dislocation and the opportunity. This will eventually lead from a reallocation from bonds which are having much tighter spreads. Look at Enbridge as an example. Its spread on its bonds are 123 basis points as of this morning for a five-year whereas you're seeing their five-year rate resets have a spread of about 430 basis points. So it's a quite dramatic change and eventually we'll see a reallocation within the fixed income space from bonds to prefs to take advantage of it. Now the return outlook for prefs is very promising; however, this doesn't mean that it won't see periods of weakness because of contagion from the risk-off sentiment, but despite that the weakness is at least less than what you're going to see in the same equity market.

Now yesterday specifically was a unique scenario. It looked like, despite the equity markets turning positive and interest rates starting to rise again, what we saw out of the pref space was another leg down. And that was actually because of a specific technical factor. There's significant hedging done using the ZPR and there was a very large unwinding of a hedge yesterday, and because of the style of that product, given that it is index-based, when there's a redemption it has to sell every name in the underlying index. Traditionally, that's been very heavy-handed and I think yesterday the size of it was much larger than normal and then when this happens, it happens every couple of months, um, there's something like this that happens, and so the size of this one was much larger than normal, and then you combine that with the fact that the market had been seeing weakness in the previous days so I think it had everyone a bit more on edge and as a result, you know, you saw more excessive losses from that selling. But that's not something that will continue. I think they're likely done now, although it could spill over a little bit into today, depending on how much volume they got done. But that's something that's technical and usually works its way through the system within a couple days.

So, because of that, I think that we're actually at a very opportune time to allocate towards preferred shares from fixed income as they're providing that extremely high dividend now given the recent selloff and have the opportunity to actually regain quite a bit of capital that has been lost over the last few months. To give you an example of the capital loss over the last month, the BMO ZPR was actually down by 4.9% from a capital perspective, which is quite notable to happen within a month and really highlights what's been going on with their underlying product. But, unfortunately, they do have those hedges that do roll off from time to time.

So, we're overall very positive but we wanted to just give you that quick overview to know that we are still very constructive on the preferred share space, now more so than we were at the beginning of the month given the recent changes, but we wanted to give you all an opportunity to ask some questions and get some answers that you're looking for and that maybe some of your clients have also asked for.

Raj Lala, President & Chief Executive Officer

Thanks, Ryan. And before we open it up for a few questions I just want to make a couple of points here.

Right now DIVS is really the only pref fund in the country that still has a positive return for the year. We have gotten some inbound inquiries from some advisors contemplating doing some tax loss selling or tax selling, I guess, given that we're entering that time of year. So obviously for some of the other ETFs and for some of the single issues you have less gains this year than you did perhaps a few days ago or last month and in some cases deeper losses, so it may be an interesting time for you to take some of that and exchange in for units of DIVS, our pref fund. And if any of you are interested in that, reach out to us and we're happy to walk you through that process and how it works with your capital markets desks as well.

Operator

This concludes today's conference call. You may now disconnect.
