TSX **DIVS**

MONTHLY COMMENTARY

Evolve Active Canadian Preferred Share Fund

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 August 30, 2019

ETF TICKER: DIVS (Unhedged)
MUTUAL FUND FUNDSERV CODE: EVF100 (Class F); EVF101 (Class A)
SUB-ADVISOR: Foyston, Gordon & Payne, Inc.

FOYSTON, GORDON & PAYNE INC.
INVESTMENT COUNSEL

Active management in Canadian Preferred Shares continue to be an attractive investment opportunity. Foyston, Gordon & Payne Inc. has managed Canadian Preferred Shares since 2012 and the FGP Preferred Share Fund since November 22, 2015.

OVERVIEW:

The Canadian preferred share market has experienced a tumultuous period dating back to the beginning of the fourth quarter of last year. The implementation of U.S.-China trade tariffs, and public attacks on Federal Reserve policy by the U.S. administration, sparked a severe risk-off tone in financial markets. The pressure on markets abated to begin the year and most large risk asset markets had some form of recovery. However, as the year has progressed the trade war has intensified, resulting in elevated uncertainty, and stoking fears that decreased business confidence will bring about decreased investment, which in turn, will bring about a recession.

ECONOMIC UPDATE:

The U.S., China and the Euro-zone – which account for half the world's GDP – are disappointing on both the economic and inflation fronts according to Citigroup's surprise indices. Although this should come as no shock given another month of unproductive trade dialogue between the U.S. and China, and weak economic data from the driver of the European economy, Germany. Canada, however, continues to show some resiliency. The domestic economy may end up registering the strongest second quarter growth rate among the G7 countries, as job creation is the best it's been since 2011 and core inflation is right at the Bank of Canada's (BoC) target. Furthermore, the risks to the housing sector have eased as sales bounced back strongly in recent months due to the decline in mortgage rates. As expected, the BoC kept interest rates on hold in early-September, however markets are pricing in up to three interest rate cuts by the end of 2020. Unless the trade conflict between the U.S and China escalates further, monetary stimulus in Canada does not appear to be necessary. In the U.S., the Federal Reserve (Fed) tried to assure market participants that fundamentals do not warrant reductions in rates and that the 0.25% interest rate cut in July was not the start of a protracted easing cycle, but rather a "mid-cycle adjustment to policy." However, the eventual impact on the economy should the trade war deepen or persist would likely lead to additional easing by the Fed.

MARKET INSIGHTS:

Preferred shares have continued to suffer from a general aversion to the asset class despite a material yield advantage over other income producing assets. Investors should take some comfort in the fact that corrections of this magnitude are not unprecedented, and that prior periods of underperformance for the Canadian preferred share market have been followed by a return to outperformance relative to more widely followed asset classes.

The TSX Preferred Share Index is now trading at levels below those seen during the 2008 Global Financial Crisis and is only 5% off the all-time low set in February 2016. Looking back to February 2016, the general view was that we were in the midst of what was expected to be an extended global recession. Europe was a mess, global growth and inflation were much weaker than today, and global interest rates were near zero or negative. While some of these same problems exist today, fundamentally as a whole we are in a better position. Consumers in North America are doing quite well: employment is strong, consumer spending is robust, and there is even some wage growth. However, the trade dispute remains an overhang.

There were several interesting company transactions in August. As further indication that the preferred share market is undervalued, Brookfield Asset Management Inc. announced that they would buyback 10% of all their outstanding preferred shares from investors. This purchase is valued at approximately $330 million and generally signals management confidence in the embedded value of their shares. Brookfield also announced a deal in which their private equity arm will acquire Genworth MI Canada. Given Brookfield's history of levering up its balance sheet, we'll be watching to see what impact, if any, the acquisition has on the Genworth's existing debt structure. Lastly, Pembina Pipeline Corp. announced a deal to buy Kinder Morgan Canada Ltd. and the U.S. portion of the Cochin Pipeline System. Under the terms of the deal, Pembina will assume Kinder Morgan Canada's preferred shares and outstanding debt.

OUTLOOK AND PORTFOLIO STRATEGY:

Our portfolio currently offers an attractive gross yield of 6.4%. This yield will *increase* slightly over time, *even in the absence of an upward move in key interest rates.* This is because the reference interest rate today remains well above the ultra-low levels seen in 2015, 2016 and the first half of 2017. During this time, the average yield on the 5-year Government of Canada bond was 0.75%. Approximately 80% of our portfolio is invested in rate-reset preferred shares. As long as the reference interest rate remains above the levels seen from 2015 to mid-2017, this will be supportive of dividend levels on preferred share securities with rates resetting 5-years from 2015 to mid-2017 (i.e. 2020 to mid-2022). Despite this, the preferred share market is trading at historically low levels, and currently offers yields and spreads that are exceptionally wide versus other income producing assets. Additionally, flows within preferred share space have been focused on the type of preferred share or the reference rates, despite significant credit spread dislocation.

Our outlook for preferred shares continues to be positive, largely driven by the significant yield advantage preferred shares offer relative to other fixed income options available in the market today. With a 6.4% dividend yield as a starting point, the cumulative return from dividends alone over the next 5 years is 31%. Furthermore, the primary driver of performance through a cycle for this strategy is security selection, not interest rate anticipation. Our portfolio is constructed based on thorough credit research and associated valuation methodologies to identify undervalued securities relative to the market. The portfolio's strategy continues to focus on lower risk companies and credit risk-adjusted returns. We expect this asset class to revert to a more properly priced environment as sentiment improves towards the space from stability in the economic data.

We see meaningful upside in our portfolio however, in the short term, the market is a mechanism that reflects sentiment, not value. At its present level, the preferred share market implies an incredible opportunity for investment gains. These types of opportunities for outsized returns over the medium term from investing in low-risk companies are rare. In the two years following the last correction which bottomed in February 2016, the broader preferred share market saw returns of 39%. During that period, our strategy provided investors with a value-added return (in excess of the benchmark) of over 20%. We see similar opportunities for outsized returns in the preferred share market today and believe investors who take a long-term view will be rewarded.

Disclosures:
Securities mentioned herein are not to be construed as recommendations to buy or sell and are not representative of Foyston, Gordon & Payne Inc. accounts/portfolios as a whole. All figures stated in Canadian Dollars unless otherwise noted.

Any projections in this investment presentation are estimates only and may not be realized in the future.

Commissions, management fees and expenses all may be associated with an investment in the exchange traded funds managed by Evolve ETFs (the "ETFs"). The prospectus contains important detailed information about the ETFs. Please read the prospectus before investing. This communication is intended for informational purposes only and is not, and should not be construed as, investment and/or tax advice to any individual.

Investment returns and assets under management are expressed in Canadian dollars unless otherwise noted. Investment returns are gross of investment management fees, net of fund expenses for FGP pooled funds, and include reinvestment of dividends and income. Returns are time weighted and annualized for periods greater than one year. Values change frequently and past investment performance may not be repeated. Securities mentioned herein are not to be construed as recommendations to buy or sell and are not representative of Foyston, Gordon & Payne Inc. accounts/portfolios as a whole. Any projections in this investment presentation are estimates only and may not be realized in the future. Any information herein describing FGP's pooled funds is for illustration purposes only.