

Canadian Preferred Shares Report

Getting Paid to Wait

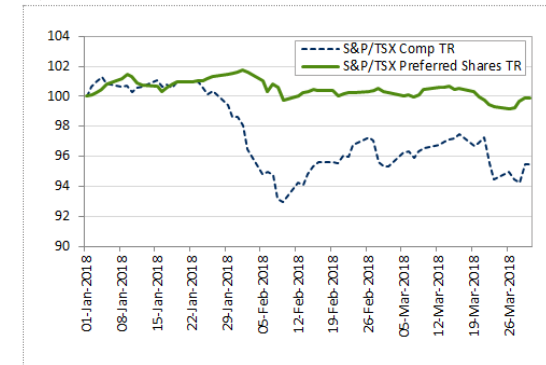
After nearly two years of great performance, Canadian preferred shares took a breather in the first quarter of 2018. They posted a total return of -0.15%, beating out the S&P/TSX Composite TR and the FTSE/TMX Universe Bond TR at -4.52% and -0.51%, respectively. Equity markets have been on edge since hitting record highs at the end of January, as headlines from trade wars to data privacy issues at Facebook (FB-US) pressured equities into correction territory during the first quarter.

Preferred share new issues were more abundant in Q1. There were several bank and insurance issues, which investors were starving for after not seeing any issued in the last quarter. However, with reset spreads continuing to tighten, the issue sizes were not as monstrous as we saw a couple of years ago and institutional involvement also declined.

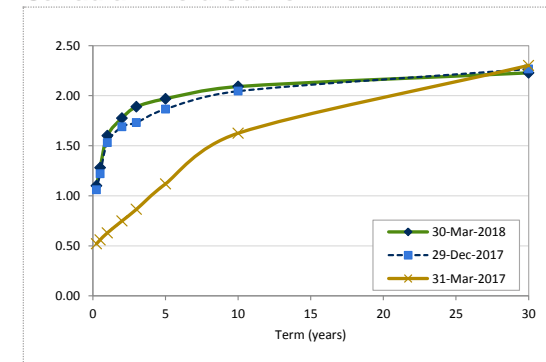
On the central bank front, the Bank of Canada (BoC) followed up two hikes in the third quarter of 2017 with another on January 17 bringing the overnight rate up to 1.25%. The Fed also hiked at the end of March 2018 to 1.75%. This was the sixth raise in about 2¼ years for our US counterpart. Currently, interest rate markets are pricing in at least one more hike by the BoC, whereas the Fed is looking to tighten two to three more times by year end.

Though we see continued volatility throughout the remainder of the year, we remain constructive on preferred shares with rates looking to go higher. We believe that the key drivers (higher rates, lack of new issues, and mutual fund/ETF participation) we outlined at the beginning of 2018 still remain and continue to recommend using preferred shares in addition to a laddered bond portfolio and other fixed income instruments to enhance yield.

Q1-2018 Performance



Canadian Yield Curve



Source: Bloomberg, Raymond James Ltd.

Phil Kwon
Fixed Income

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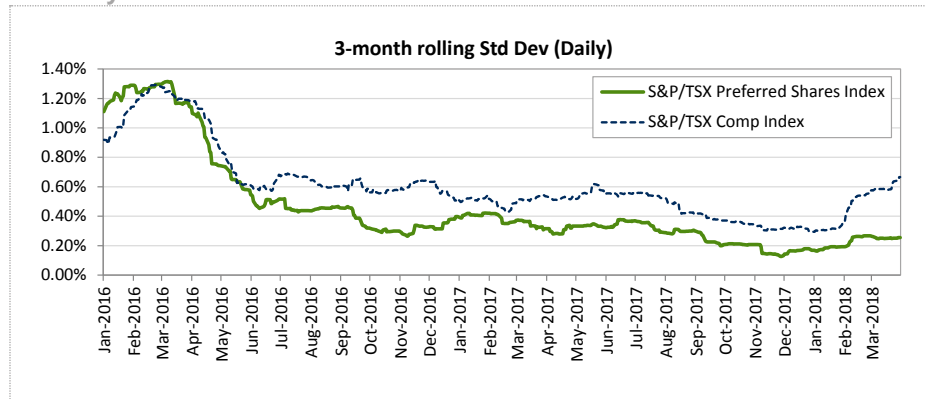
Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2. 2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

Volatility Will Likely Remain

In the most recent announcement (April 18), the BoC kept rates unchanged and stated that despite some weakness in the first quarter, GDP growth is looking to rebound in the second quarter resulting in 2% average growth for the first half of this year. Inflation is near 2% as “temporary factors that have been weighing on inflation have largely dissipated, as expected.” Most importantly, “some monetary policy accommodation will still be needed to keep inflation on target...the Governing Council will remain cautious with respect to future policy adjustments, guided by incoming data.” South of the border, the Fed increased its benchmark rate by 0.25% to 1.75% at their last meeting on March 21, 2018 and raised its forecasts for hikes in 2019 and 2020 due to a stronger outlook on the economy.

In both Canada and the US, despite central banks in tightening modes, equity markets had performed very well and we’ve seen record highs set in the first quarter of this year. However, over the past several months the markets have run into some unexpected headwinds including trade war tensions, privacy issues and data breaches at Facebook, and stalled NAFTA negotiations, just to name a few. We do not believe these negative headlines will disappear over the near term but slowly resolve throughout the year.

Volatility Back in the Markets

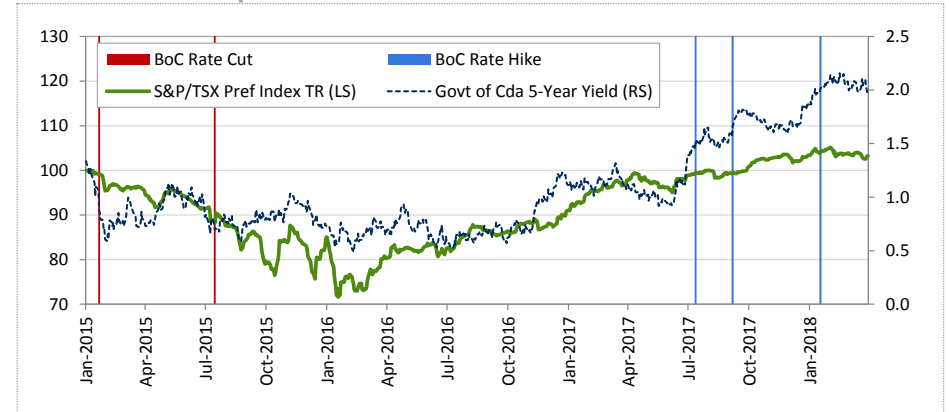


Source: Bloomberg, Raymond James Ltd.

Despite detractors, interest rate markets are still pricing in 1-2 rate hikes in Canada, and nearly 3 more raises by the Fed for the remainder of 2018. Because of this, we

remain constructive on preferred shares as the increase in yields, in particular the Government of Canada (GoC) 5-year, will be positive for fixed-resets.

Good Relationship Between Prefs and Yields



Source: Bloomberg, Raymond James Ltd.

Getting Paid to Wait

With volatility spiking over the past couple of months, equity markets have been on a roller coaster ride and even flirting with correction territory. As markets roiled with every headline and Trump tweet, preferred shares have also had the wind taken out of their sails in what had been a great two year performance run. Despite the slight negative performance this quarter, prefs did manage to outperform both bonds and equities.

Fixed-Resets: Place to Be for Rising Rates

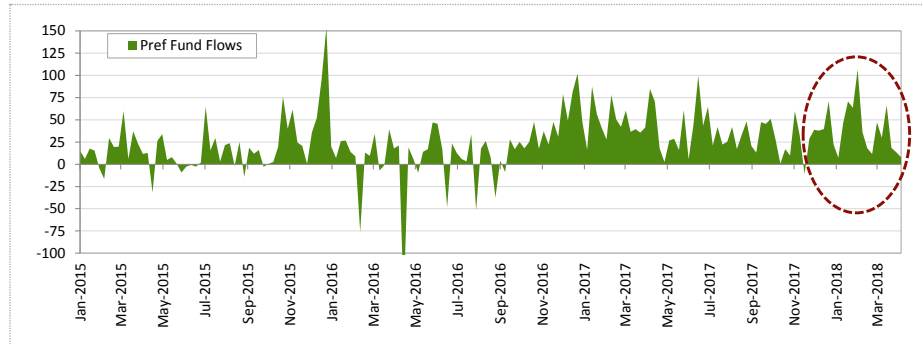
Resetting In	% Increasing Div with GoC 5-Yr at			Avg Div Increase with GoC 5-Yr at		
	2.00	2.10	2.20	2.00	2.10	2.20
In 12 months	93.9%	97.0%	100.0%	7.1%	9.5%	11.8%
1-2 years	96.7%	97.8%	97.8%	20.6%	23.3%	25.9%
3+ Years	82.3%	89.6%	91.7%	15.1%	17.4%	19.8%

Source: Bloomberg, Raymond James Ltd. The assumption is that the fixed-reset will not be called and the dividend will be re-calculated on the reset date.

In our previous quarterly report, we noted three key drivers for prefs in 2018 being: additional rate hikes; lack of new issue product; and continued demand (appetite)

from ETFs. Out of the three, the prospect of higher future rates is the most important for preferred shares, in particular fixed-resets which make up 70% of the universe. The recent volatility has provided investors with good buying opportunities in prefs, allowing them to get paid to wait until interest rates rise. In the table above we have summarized the percentage of fixed-resets that would have their dividends increased at their next reset dates at given GoC 5-year yields. Fund flows into preferred share ETFs also remain very positive through the first quarter with many options to choose from including passive and active management. Our preferred ETF is Horizons Active Preferred Share ETF (HPR-T).

Positive Preferred Shares ETF Fund Flows Continue



Source: Bloomberg, Raymond James Ltd.

Conclusion: Portfolio Positioning

Since our stance has not changed since last quarter's report we believe that investors should continue to use these guidelines to position preferred shares portfolios.

- **Overweight fixed-resets, underweight perpetuals:** Rising rates are not good for interest-rate sensitive perpetuals, but better for fixed-reset whose dividends are reset off a benchmark yield. Higher yields lead to higher dividends on the products.
- **Underweight high-reset preferreds:** Most high reset preferreds are now trading at premiums due to the high likelihood of being called at their next reset date. Despite paying a nice dividend, you may encounter a capital loss (if

purchased at premiums) if they do get called making the total return mediocre.

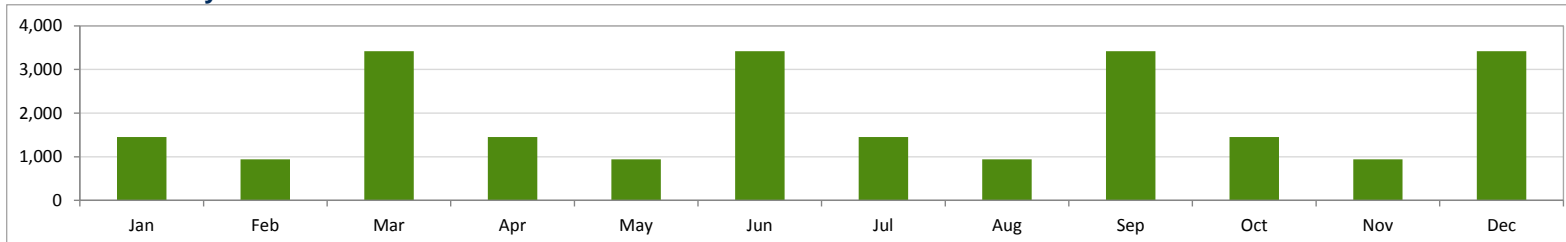
- **Buy issues with near-term reset dates looking to increase the dividend:** There may be a little bit of math involved but unlike 2015 when a lot of dividends were being reduced, we are now in an environment where dividends will likely go higher for fixed-resets.
- **Increase weighting of lower reset preferreds:** As higher reset prefs are called, ones with lower reset spreads become more attractive in a rising rate environment. This is because when new issue reset spreads are tightening, the potential for these discounted issues to get called moves higher. As the probability of a fixed-reset preferred share being called increases, the call date becomes more like a maturity date. It is this increase in predictability which was one of the main drivers of price increases in 2017 for fixed-reset preferreds. The returns came more from price appreciation as opposed to dividends, which preferreds are usually known for. Keep in mind that from an issuer perspective, they want to issue at the lowest reset spread possible and call in those issues with high reset spreads.

Highlights: Sample Portfolio

Issuer	General Information		Rating	Pricing			Dividend		Possible Calls			Shares	Value	Weight
	Series	Symbol	DBRS	Par	Last	Current Yield	Annual	MMMM-DD	Date	Price	YTC			
Fixed Reset														
BCE INC	AQ	BCE.PR.Q	Pfd-3	\$25.00	\$24.29	4.37%	\$1.06	MJSD-31	30-Sep-2018	\$25.00	11.57	2,000	\$48,580	9.8%
BROOKFIELD OFFICE PROP	T	BPO.PR.T	Pfd-3	\$25.00	\$22.85	5.03%	\$1.15	MJSD-31	31-Dec-2018	\$25.00	18.03	2,100	\$47,985	9.6%
FAIRFAX FINL HLDGS LTD	K	FFH.PR.K	Pfd-3H	\$25.00	\$23.62	4.94%	\$1.17	MJSD-31	31-Mar-2022	\$25.00	6.40	2,100	\$49,602	10.0%
HUSKY ENERGY INC	3	HSE.PR.C	Pfd-2L	\$25.00	\$24.52	4.59%	\$1.13	MJSD-31	31-Dec-2019	\$25.00	5.58	2,000	\$49,040	9.8%
PEMBINA PIPELINE CORP	17	PPL.PR.Q	Pfd-3	\$25.00	\$23.99	5.21%	\$1.25	MJSD-31	31-Mar-2019	\$25.00	9.33	2,000	\$47,980	9.6%
ROYAL BANK OF CANADA	BD	RY.PR.J	Pfd-2	\$25.00	\$24.37	3.69%	\$0.90	FMAN-24	24-May-2020	\$25.00	5.02	2,000	\$48,740	9.8%
TORONTO-DOMINION BANK	5	TD.PF.C	Pfd-2	\$25.00	\$22.59	4.15%	\$0.94	JAJO-31	31-Jan-2020	\$25.00	9.70	2,100	\$47,439	9.5%
TRANSCANADA CORP	11	TRP.PR.G	Pfd-2L	\$25.00	\$23.75	4.00%	\$0.95	JAJO-30	30-Nov-2020	\$25.00	6.08	2,000	\$47,500	9.5%
Perpetuals														
GREAT-WEST LIFECO INC	T	GWO.PR.T	Pfd-2H	\$25.00	\$24.62	5.23%	\$1.29	MJSD-31	30-Jun-2022	\$26.00	6.37	1,500	\$36,930	7.4%
POWER FINANCIAL CORP	V	PWF.PR.Z	Pfd-2H	\$25.00	\$23.90	5.39%	\$1.29	JAJO-31	31-Jul-2022	\$26.00	7.17	1,500	\$35,850	7.2%
ROYAL BANK OF CANADA	BJ	RY.PR.P	Pfd-2	\$25.00	\$25.57	5.13%	\$1.31	FMAN-24	31-Oct-2020	\$26.00	7.20	1,500	\$38,355	7.7%
TOTAL														
											4.67%		\$498,001	

Issuer	General Information		Quarterly Income	Annual Income	
	Series	Symbol			
Fixed Reset					
BCE INC	AQ	BCE.PR.Q	\$531	\$2,125	5yr GoC +2.64%
BROOKFIELD OFFICE PROP	T	BPO.PR.T	\$604	\$2,415	5yr GoC +3.16%
FAIRFAX FINL HLDGS LTD	K	FFH.PR.K	\$613	\$2,452	5yr GoC +3.51%
HUSKY ENERGY INC	3	HSE.PR.C	\$563	\$2,250	5yr GoC +3.13%
PEMBINA PIPELINE CORP	17	PPL.PR.Q	\$625	\$2,500	5yr GoC +3.01%
ROYAL BANK OF CANADA	BD	RY.PR.J	\$450	\$1,800	5yr GoC +2.74%
TORONTO-DOMINION BANK	5	TD.PF.C	\$492	\$1,969	5yr GoC +2.25%
TRANSCANADA CORP	11	TRP.PR.G	\$475	\$1,900	5yr GoC +2.96%
Perpetuals					
GREAT-WEST LIFECO INC	T	GWO.PR.T	\$483	\$1,931	Par call at \$25 on June 30, 2023
POWER FINANCIAL CORP	V	PWF.PR.Z	\$483	\$1,931	Par call at \$25 on July 31, 2024
ROYAL BANK OF CANADA	BJ	RY.PR.P	\$492	\$1,969	Par call at \$25 on February 24, 2025
TOTAL			\$5,811	\$23,242	

Cash Flow Analysis



Source: Bloomberg, Raymond James Ltd., Prices as at April 19, 2018.

Most Actively Traded

Trading volume data as at April 19, 2018. 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
BANK OF NOVA SCOTIA	19	BNS.PR.A	18,697	409
BCE INC	AE	BCE.PR.E	8,695	22,395
TORONTO-DOMINION BANK	T	TD.PR.T	8,605	977
BROOKFIELD ASSET MAN INC	2	BAM.PR.B	7,371	3,907
BROOKFIELD ASSET MGMT	13	BAM.PR.K	7,260	6,375
BCE INC	AH	BCE.PR.H	5,915	3,386
TRANSCANADA CORP	2	TRP.PR.F	5,087	3,085
ALTAGAS LTD	B	ALA.PR.B	4,977	300
BCE INC	Y	BCE.PR.Y	4,882	2,010
THOMSON REUTERS CORP	B	TRI.PR.B	4,700	10,161

Retractable

Issuer	Series	Symbol	30-Day	5-Day
CANOE EIT INCOME FUND	1	EIT.PR.A	3,592	2,632
BIRCHCLIFF ENERGY LTD	C	BIR.PR.C	810	1,100
CANADIAN GENL INVESTMENT	4	CGI.PR.D	689	720
BROOKFIELD INVESTMENTS	A	BRN.PR.A	454	200

Perpetual

Issuer	Series	Symbol	30-Day	5-Day
WESTCOAST ENERGY INC	8	W.PR.J	12,939	1,493
MANULIFE FINANCIAL	2	MFC.PR.B	11,765	5,340
SUN LIFE FINANCIAL INC	1	SLF.PR.A	11,542	6,526
MANULIFE FINANCIAL CORP	3	MFC.PR.C	11,154	5,262
POWER FINANCIAL CORP	K	PWF.PR.K	11,122	2,087
SUN LIFE FINANCIAL INC	4	SLF.PR.D	10,917	2,626
GREAT-WEST LIFECO INC	G	GWO.PR.G	10,908	6,939
ATLANTIC PWR PFD EQUITY	1	AZP.PR.A	10,277	874
POWER FINANCIAL CORP	S	PWF.PR.S	9,476	7,793
POWER CORPORATION CANADA	D	POW.PR.D	8,987	2,867

Fixed-Reset

Issuer	Series	Symbol	30-Day	5-Day
ENBRIDGE INC	19	ENB.PF.K	47,817	72,104
ROYAL BANK OF CANADA	BB	RY.PR.H	36,390	20,079
CANADIAN IMPERIAL BANK	45	CM.PR.R	34,064	19,351
TORONTO-DOMINION BANK	12	TD.PF.G	33,602	35,404
CANADIAN IMPERIAL BANK	47	CM.PR.S	31,286	36,787
BANK OF NOVA SCOTIA	38	BNS.PR.H	30,920	8,443
INDUSTRIAL ALLIANCE	I	IAG.PR.I	29,756	10,823
ENBRIDGE INC	N	ENB.PR.N	29,074	4,798
TRANSCANADA CORP	13	TRP.PR.J	27,683	101,024
ENBRIDGE INC	D	ENB.PR.D	26,423	46,080

New Issues

Artis REIT, Series I

- **Symbol:** AX.PR.I
- **Type:** Fixed-Reset, Cumulative
- **Issue:** \$25.00 | 5.0 million shares | January 31, 2018
- **Rating:** Pfd-3L (DBRS)
- **Dividend:** 6.00% | JAJ0-31
- **Notes:** Coupon is 6.00% until April 30, 2023, thereafter resets every 5 years @+3.93% over 5-year GoC bond yield. The minimum coupon is 6.00%.

CIBC, Series 47

- **Symbol:** CM.PR.S
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 18.0 million shares | January 18, 2018
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.50% | JAJ0-31
- **Notes:** Coupon is 4.50% until January 31, 2023, thereafter resets every 5 years @+2.45% over 5-year GoC bond yield.

Industrial Alliance, Series I

- **Symbol:** IAG.PR.I
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 6.0 million shares | March 7, 2018
- **Rating:** Pfd-2H (DBRS)
- **Dividend:** 4.80% | MJSD-31
- **Notes:** Coupon is 4.80% until March 31, 2023, thereafter resets every 5 years @+2.75% over 5-year GoC bond yield.

Manulife Financial, Series 25

- **Symbol:** MFC.PR.Q
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 10.0 million shares | February 20, 2018
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.70% | MJSD-19
- **Notes:** Coupon is 4.70% until March 31, 2023, thereafter resets every 5 years @+2.55% over 5-year GoC bond yield.

National Bank, Series 40

- **Symbol:** NA.PR.E
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 12.0 million shares | January 22, 2018
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.60% | MJSD-19
- **Notes:** Coupon is 4.60% until March 31, 2023, thereafter resets every 5 years @+2.58% over 5-year GoC bond yield.

TD Bank, Series 18

- **Symbol:** TD.PR.J
- **Type:** Fixed-Reset, Non-Cumulative
- **Issue:** \$25.00 | 14.0 million shares | March 14, 2018
- **Rating:** Pfd-2 (DBRS)
- **Dividend:** 4.70% | JAJ0-31
- **Notes:** Coupon is 4.70% until March 31, 2023, thereafter resets every 5 years @+2.70% over 5-year GoC bond yield.

Credit Rating Changes

Company Name	Date	Agency	Curr Rtg	Last Rtg
Allbanc Split Corp	03/14/2018	DBRS	WR	Pfd-2

Source: Bloomberg, WR = Withdrawn Rating, NR = No rating has been requested. March 31, 2018.

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	Superior: 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+	Satisfactory: 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-	
Investment Grade Cut-Off			
Pfd-3 (high)	P-3 (high)	BB+	Adequate: 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+	Speculative: 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+	Highly Speculative: 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	
			In Arrears: 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"> ▪ No deemed dividend ▪ Deemed proceeds of disposition is the paid-up capital
Redemption When Paid-Up Capital Is Less Than Par	<ul style="list-style-type: none"> ▪ Can result in a significant deemed dividend ▪ Deemed proceeds of disposition well below par resulting in the realization of a significant capital loss on the redemption
Purchase price above par value & Redemption at Par	<ul style="list-style-type: none"> ▪ Capital loss, can offset any capital gains realized in calendar year of redemption or carry back 3 yrs or carried forward indefinitely
Redemption Price Above Par	<ul style="list-style-type: none"> ▪ Paid-up capital rarely greater than par, thus, this results in deemed dividend ▪ Deemed proceeds of disposition is the paid-up capital

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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