

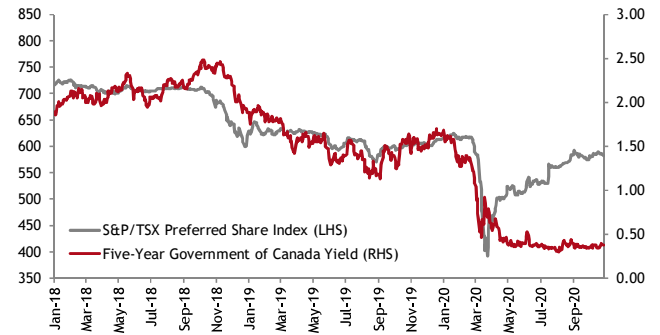


November 2020

PREFERRED SHARE MARKET - AN IMPROVING OUTLOOK

Since Q4/18, a combination of plunging sovereign interest rates and elevated levels of volatility has conspired to create a very challenging environment for preferred share investors. Contrary to traditional fixed income (where the price of the bond is inversely related to interest rates), the Canadian preferred share market tends to perform better in a rising-rate environment since more than 75% of the market comprises fixed rate-reset preferreds. For such securities, future cash flows are based on the five-year Government of Canada (GoC) yield. With the Bank of Canada (BoC) slashing the overnight rate to its effective lower bound of 0.25% in March this year in response to the COVID-19 pandemic, the outlook for preferred shares appeared challenging. However, the issuance of a new Canadian-dollar-denominated debt instrument called Limited Recourse Capital Notes (LRCN) by RBC in July helped to reinvigorate institutional investor interest.

S&P/TSX Preferred Share Index vs. Five-Year Government of Canada Yield



Source: Bloomberg; data is for the period between Jan 1, 2018 and Oct 26, 2020.

With benchmark yields at all-time lows, the relative cost for an issuer to raise preferred equity has become expensive (the last time a bank issued preferred shares in Canada was TD and CIBC in May 2019 at an average dividend rate of 5.1%). The advent of the LRCNs has provided banks with an alternate way to raise Additional Tier 1 (AT1) Capital in a relatively cost-effective manner since these securities have a tax-deductible structure. So far the banks have cumulatively raised \$5.68 billion of funding through the issuance of LRCNs, at an average coupon of 4.6% (or 3.8% after taking into account the tax deductibility for corporations). The Office of the Superintendent of Financial Institutions (OSFI) has capped LRCN issuance by the banks to 0.75% of their risk-weighted assets or 50% of their AT1 bucket, which could mean more than \$16 billion of issuance by the Big 6 Banks if they issue LRCNs up to the limit mandated by OSFI. As banks, and possibly life insurance companies, continue to come to the market with additional LRCN deals, we could see a limited supply of preferred shares being issued by the financial companies. This could cause a void in the preferred share market (since banks and insurers are some of the biggest issuers of preferred shares in the Canadian market), thus leading to a higher demand for their existing preferreds. This might especially be the case for retail investors since only institutional investors have access to LRCNs.

Most of the capital raised in these LRCN deals is expected to be used to redeem the outstanding higher-cost preferred shares (i.e. potentially those with reset spreads higher than 350 basis points based on the current five-year GoC yield). The wave of redemptions has already started with RBC redeeming its six series of non-NVCC (Non-Viability Contingent Capital) perpetual preferred shares and TD redeeming its only outstanding series of NVCC perpetual preferred shares. Apart from the banks, Element Fleet Management Corp. also redeemed one of its series of rate-reset shares. The non-financial issuers have tapped into the hybrid bond market in the past and could do so in the future, instead of issuing preferred equity, as it is a cheaper funding option compared to preferred shares for the firm. According to Fiera Capital, we could see total redemptions of \$11.05 billion or 17% of the preferred share market in the next two years! Higher rates of redemption, along with a lower supply of new preferred shares in the next two to three years, would create a pronounced scarcity effect, which might be supportive of the overall preferred share market.

In recent years, sovereign yields have slid lower, not only because of disinflationary pressures caused by technological innovation and automation but also partly due to exceptionally dovish global monetary policy. CIBC's Economics team is forecasting the five-year GoC yield to rise gradually to 1.25% from the current ultra-low level of 0.38% by December 2022. We expect this upward trajectory in interest rates to be an additional tailwind for preferred shares.

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Unless otherwise noted, all prices quoted in this report are as of the close of markets on October 26, 2020.

MARKET RETURN DATA

North American Indices		Price Performance (% Change)					Price Performance (% Change - Annualized)						
	Price	1 Month	3 Months	6 Months	YTD	1 Year	2 Years	3 Years	5 Years	10 Years	15 Years	20 Years	
S&P/TSX Composite	15,581	-3.4	-3.6	5.4	-8.7	-5.5	1.8	-0.9	2.9	2.1	2.7	2.4	
Total Return		-3.1	-2.9	7.1	-6.1	-2.3	5.2	2.2	6.1	5.2	5.8	5.2	
S&P/TSX Preferred Share Index	577	-1.0	2.9	10.1	-6.4	-3.7	-8.3	-7.0	-2.5	-3.9	-3.5	N/A	
Total Return		-0.4	4.3	13.3	-1.5	2.2	-2.9	-1.8	2.9	1.2	1.6	N/A	
S&P 500 Index	3,270	-2.8	-0.0	12.3	1.2	7.7	9.8	8.3	9.5	10.7	6.9	4.2	
Total Return		-2.7	0.4	13.3	2.8	9.7	12.0	10.4	11.7	13.0	9.1	6.3	
Dow Jones Industrial Average	26,502	-4.6	0.3	8.9	-7.1	-2.0	2.7	4.3	8.5	9.1	6.4	4.5	
Total Return		-4.5	0.8	10.1	-5.4	0.3	5.2	6.7	11.1	11.8	9.1	7.1	
Nasdaq Composite Index	10,912	-2.3	1.5	22.7	21.6	31.6	22.2	17.5	16.6	15.8	11.5	6.1	
International Indices		Price Performance (% Change)					Price Performance (% Change - Annualized)						
	Price	1 Month	3 Months	6 Months	YTD	1 Year	2 Years	3 Years	5 Years	10 Years	15 Years	20 Years	
Bloomberg Euro 500	227	-4.7	-3.8	0.8	-18.0	-14.0	-3.4	-5.2	-2.2	1.9	0.6	-1.0	
FTSE Eurotop 100	2,469	-5.9	-6.1	-3.7	-21.7	-18.4	-5.3	-6.6	-3.6	0.8	-0.4	-2.2	
FTSE 100 (England)	5,577	-4.9	-5.4	-5.5	-26.1	-23.1	-11.5	-9.4	-2.6	-0.2	0.3	-0.7	
Dax (Germany)	11,556	-9.4	-6.1	6.4	-12.8	-10.2	0.5	-4.4	1.3	5.8	5.8	2.5	
CAC 40 (France)	4,594	-4.4	-4.0	0.5	-23.1	-19.8	-5.0	-5.8	-1.3	1.8	0.2	-1.6	
MSCI World	2,293	-3.1	-0.5	11.7	-2.8	2.7	6.5	4.0	6.1	6.5	4.4	2.9	
MSCI Emerging Markets	1,103	2.0	2.3	19.3	-1.0	5.9	7.4	-0.5	5.4	-0.0	3.9	5.8	
Total Return	2,601	2.1	2.7	21.2	1.1	8.6	10.4	2.3	8.3	2.8	6.8	8.7	
MSCI EAFE	1,780	-4.1	-2.2	7.4	-12.6	-9.0	-1.0	-3.8	0.1	1.0	0.8	0.9	
Total Return	7,742	-4.0	-1.6	8.8	-10.4	-6.5	2.2	-0.8	3.3	4.3	4.1	4.0	
Nikkei 225 (Japan)	22,977	-0.9	5.8	13.8	-2.9	0.2	2.4	1.4	3.8	9.6	3.6	2.3	
Hang Seng (Hong Kong)	24,107	2.8	-2.0	-2.2	-14.5	-10.4	-1.8	-5.1	1.3	0.4	3.5	2.4	
ASX 200 (Australia)	5,928	1.9	-0.0	7.3	-11.3	-11.0	0.8	0.1	2.5	2.4	1.9	3.0	
Taiwan Weighted	12,546	0.2	-0.9	14.1	4.6	10.5	13.1	5.1	8.0	4.2	5.3	4.2	
Sensex 30 (India)	39,614	4.1	5.3	17.5	-4.0	-1.3	7.2	6.1	8.2	7.1	11.4	12.6	
Index Returns in Canadian Dollars		Price Performance (% Change)					Price Performance (% Change - Annualized)						
	Price	1 Month	3 Months	6 Months	YTD	1 Year	2 Years	3 Years	5 Years	10 Years	15 Years	20 Years	
S&P/TSX Composite	15,581	-3.4	-3.6	5.4	-8.7	-5.5	1.8	-0.9	2.9	2.1	2.7	2.4	
Total Return		-3.1	-2.9	7.1	-6.1	-2.3	5.2	2.2	6.1	5.2	5.8	5.2	
S&P 500 Index	4,362	-2.6	-0.6	7.5	4.0	9.1	10.6	9.5	9.9	13.7	7.7	3.5	
Total Return		-2.5	-0.2	8.5	5.6	11.2	12.8	11.7	12.2	16.1	10.0	5.6	
Dow Jones Industrial Average	35,350	-4.4	-0.3	4.2	-4.6	-0.7	3.4	5.4	8.9	12.1	7.3	3.8	
Total Return		-4.3	0.2	5.4	-2.8	1.7	5.9	7.9	11.6	14.9	10.0	6.4	
Russell 2000	2,052	2.3	3.3	12.4	-5.2	-0.2	1.6	1.9	6.2	11.1	6.8	5.1	
Nasdaq Composite Index	14,555	-2.1	1.0	17.5	25.0	33.4	23.0	18.8	17.1	19.0	12.4	5.3	
Bloomberg Euro 500	353	-5.1	-5.5	2.8	-12.6	-9.0	-1.2	-4.1	-0.7	2.9	1.2	-0.1	
EURO STOXX 50	4,595	-7.8	-8.5	3.0	-15.8	-13.1	-1.7	-5.9	-1.4	1.3	-0.2	-1.8	
Total Return		-7.7	-8.3	4.4	-14.1	-11.3	0.7	-3.5	1.2	4.3	2.8	0.9	
MSCI World	3,059	-2.9	-1.1	7.0	-0.1	4.0	7.2	5.2	6.5	9.4	5.3	2.3	
MSCI Emerging Markets	1,472	2.2	1.7	14.2	1.7	7.3	8.2	0.7	5.8	2.7	4.8	5.1	
Total Return		2.3	2.1	16.1	4.0	10.1	11.2	3.5	8.7	5.6	7.6	8.0	
MSCI EAFE	2,374	-3.9	-2.8	2.8	-10.2	-7.7	-0.3	-2.8	0.5	3.7	1.7	0.2	
Total Return		-3.8	-2.2	4.2	-7.9	-5.2	2.9	0.4	3.8	7.2	5.0	3.3	
MSCI Far East	4,570	-1.4	4.4	3.9	-3.5	-2.5	2.4	0.1	3.0	6.0	2.4	0.3	
Commodities		Price as of					Yields as of						
	30-Oct-20	-1 Month	-3 Months	-6 Months	-12 Months	YTD (%)		30-Oct-20	-1 Month	-3 Months	-6 Months	-12 Months	
Gold Spot (US\$/oz)	1,879	1,886	1,976	1,687	1,513	23.8%	Canada 3-month T-Bills	0.09	0.14	0.17	0.26	1.66	
Silver (US\$/oz)	23.66	23.24	24.39	14.97	18.11	32.5%	Canada 5yr Notes	0.40	0.36	0.32	0.39	1.42	
Brent Crude Oil	37.46	40.95	43.30	25.27	60.23	-43.2%	Canada 10yr Notes	0.66	0.56	0.47	0.55	1.41	
West Texas Intermediate Oil	35.79	40.22	40.27	18.84	54.18	-41.4%	Canada 30yr Bonds	1.25	1.11	0.93	1.13	1.58	
NYMEX Natural Gas	3.35	2.53	1.80	1.95	2.63	53.2%							
Spot Nat. Gas (AECO Hub - USD)	2.51	1.36	1.54	1.47	2.21	46.8%	U.S. 3-month T-Bills	0.09	0.09	0.08	0.08	1.52	
Lumber	495.60	612.20	585.80	319.70	396.20	22.3%	U.S. 5yr Notes	0.38	0.28	0.20	0.36	1.52	
Copper 3-month	3.05	3.03	2.91	2.35	2.63	8.8%	U.S. 10yr Notes	0.87	0.68	0.53	0.64	1.69	
Nickel 3-month	6.87	6.58	6.25	5.53	7.55	8.1%	U.S. 30yr Bonds	1.66	1.46	1.19	1.28	2.18	
Aluminum 3-month	0.84	0.80	0.78	0.68	0.80	2.1%							
Zinc 3-month	1.14	1.09	1.05	0.88	1.13	11.0%							
Currencies		Performance (% Change)					S&P/TSX Sectors						
	Price	1 Month	3 Months	6 Months	12 Months	YTD		1 Month	3 Months	6 Months	12 Months	YTD	Index Weight (%)
CAD/USD	0.7507	-0.0	0.7	4.7	-1.2	-2.5	Consumer Discret.	-0.3	3.3	18.1	-3.8	-5.3	3.6
EURO/CAD	1.5516	-0.6	-1.8	1.6	5.7	6.5	Consumer Staples	-7.5	-5.4	4.4	1.4	1.0	4.2
EURO/USD	1.1647	-0.6	-1.1	6.3	4.4	3.9	Energy	-4.7	-14.5	-16.3	-35.4	-41.7	10.5
USD/YEN	104.6600	-0.8	-1.1	-2.4	-3.1	-3.6	Integrated Oil & Gas	-6.4	-26.8	-34.5	-60.2	-63.7	1.5
Trade Weighted U.S. Dollar	94.0380	0.2	0.7	-5.0	-3.4	-2.4	Oil&Gas Expl. & Prod.	1.0	-6.6	-5.8	-36.3	-49.4	1.8
							Pipeline	-5.6	-13.7	-14.4	-26.0	-30.3	6.8
							Financials	-2.4	0.3	4.3	-17.7	-17.9	28.7
							Banks	-1.2	2.0	6.9	-17.9	-16.3	19.5
							Insurance	-1.8	2.7	8.4	-19.1	-23.6	4.2
							Real Estate	-0.9	-0.9	4.4	-21.1	-20.5	3.2
							Health Care	7.3	-9.2	-6.5	-37.8	-36.9	1.1
							Industrials	-3.4	3.5	13.2	8.4	4.3	12.6
							Information Tech.	-8.7	-10.9	23.0	71.3	53.0	9.8
							Materials	-2.1	-5.9	13.4	27.3	21.9	15.7
							Gold	-4.2	-11.5	7.9	40.4	36.3	11.0
							Base Metals	-1.4	25.5	53.0	0.1	-12.0	0.6
							Fertilizers	3.7	24.2	9.0	-14.0	-12.9	1.4
							Communication Serv.	-3.1	-3.6	-4.1	-12.0	-13.2	5.2
							Utilities	-1.3	2.4	7.4	6.6	4.4	5.4
Strategic Asset Allocation (in C\$)		Performance (% Change - Before Fees)					Total Return % Change						
(Global Equity/Cdn. Equity/Bonds/Cash)		1 Month	3 Months	6 Months	12 Months	YTD		1 Month	3 Months	6 Months	12 Months	YTD	
Capital Preservation (5/15/60/20)		-1.1%	-1.4%	2.5%	4.1%	3.7%	FTSE Canada Bond Universe Index	-0.8	-1.6	1.7	6.5	7.2	
Income (10/20/60/10)		-1.4%	-1.6%	3.3%	4.2%	3.4%	FTSE Canada Long Term Bond Index	-1.9	-4.4	1.6	7.6	8.9	
Income & Growth (20/25/50/5)		-1.7%	-1.6%	4.2%	4.0%	2.5%	FTSE Canada Mid Term Bond Index	-0.5	-0.4	2.0	7.8	8.9	
Growth (40/25/35/0)		-2.2%	-1.5%	5.6%	4.2%	1.7%	FTSE Canada Short Term Bond Index	0.0	0.3	1.5	4.7	4.8	
Aggressive Growth (60/25/15/0)		-2.6%	-1.3%	6.9%	4.2%	0.6%							

All data is sourced from Bloomberg unless otherwise noted. Data as of October 30, 2020.
Data source: Bloomberg

CIBC World Markets Interest Rate Outlook

Interest Rates (%) - End of Qtr.		Oct 26, 2020	Dec/20	Mar/21
3-month T-Bill	Canada	0.09	0.25	0.25
	U.S.	0.08	0.20	0.25
10-year Gov't Bond Yield	Canada	0.63	0.75	0.80
	U.S.	0.80	0.80	1.00
US\$/C\$		0.76	0.77	0.76

Source: CIBC World Markets Inc.

CIBC World Markets Economic Outlook

Economic Outlook		2019A	2020F	2021F
Real GDP Growth (% Chg)	Canada	1.7	-5.6	4.0
	U.S.	2.2	-3.9	3.5
Consumer Price Index (% Chg)	Canada	1.9	0.6	1.8
	U.S.	1.8	1.3	2.4

Source: CIBC World Markets Inc.

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