

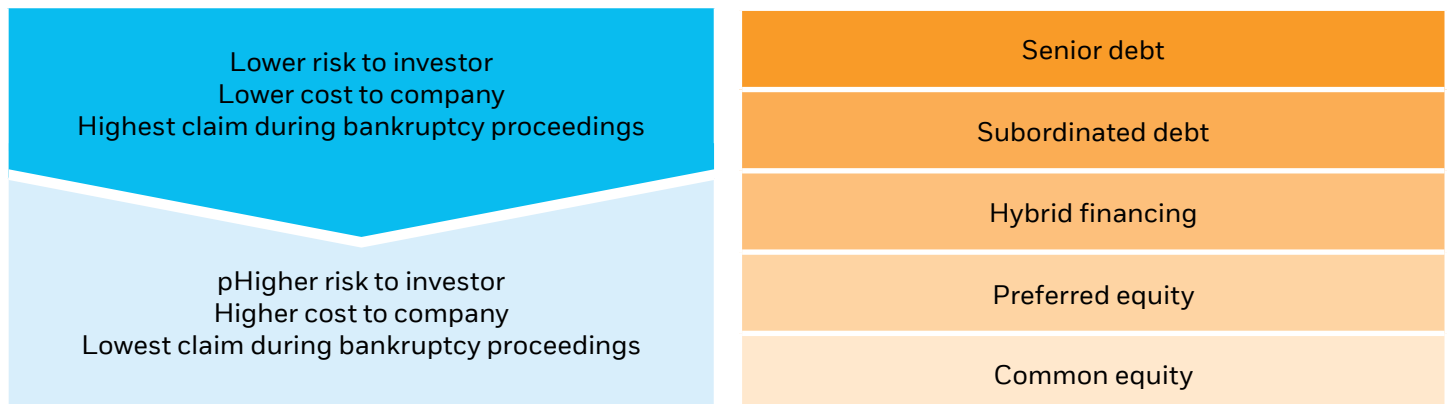


Preferred shares are a unique investment vehicle that sit between debt and common equity. They blend the characteristics of equity and fixed-income securities, with some distinct qualities of their own.

	Preferred Shares	Common Shares	Bonds
Ownership in company	Yes	Yes	No
Ranking in company capital structure	Senior to equity but subordinate to bonds	Subordinated to bonds and preferreds	Senior to equity and preferreds
Voting rights	No	Generally yes	No
Payouts	<ul style="list-style-type: none"> •Tax-advantaged dividends •Rates set at issue •Not a legal obligation •Cumulative 	<ul style="list-style-type: none"> •Tax-advantaged dividends •At company discretion •Not a legal obligation 	<ul style="list-style-type: none"> •Fully taxable interest income •Amount set at issue •Legal obligation
Interest rate sensitivity	Yes, especially for straight perpetuals	No	Yes
Par value	Yes	No	Yes
Credit rating	Yes (distinct from bonds)	No	Yes

Where do preferred shares fit within a company’s capital structure?

Preferred shares are subordinated to bonds but senior to common shares. In the event that a company declared bankruptcy, bondholders would be paid out first, followed by preferred shareholders, then common equity shareholders. Preferred share dividends are “protected by” common share dividends in that equity dividends cannot be paid while a preferred dividend is outstanding. Outside the financial sector, dividends on preferred shares are



Preferred shares

cumulative – if a dividend isn't paid out in one quarter, it is added to the dividend payment due in the next quarter.

Types of preferred shares

- **Straight perpetuals:** Perpetual preferreds have no set maturity date and pay a fixed dividend indefinitely, with no option for shareholders to put the issue back to the issuer (not retractable). They are generally callable by the issuer at its own discretion based on predetermined date and prices. Similar to long-duration bonds, perpetuals tend to be more sensitive to credit spreads and interest rates.
- **Fixed-reset or rate-resets:** Rate-reset preferreds are issued at a set spread to an interest-rate benchmark (generally the Government of Canada five-year rate). The dividend is fixed at this rate for five years, at which point the dividend resets to the new prevailing five-year rate. The issuer has the option to either call or extend the issue at each five-year mark. Shareholders have the option to convert rate-reset preferreds into floating-rate preferreds at each reset date.
- **Floating-rate:** Floating-rate preferreds pay a dividend that "floats" alongside a reference rate (generally the Bank of Canada prime rate). Shareholders have no option to put the issue back to the issuer (not retractable).
- **Retractables:** Similar to perpetual preferreds, retractable preferreds pay a fixed dividend in perpetuity. These issues are callable by the issuer, but they are also retractable by the shareholder (shareholders can put them back to the issuer) at a set par value on the specific date(s).

Why invest in preferred shares?

- Alternative source of stable income in a low-yield environment – dividend rates are set at issue and take priority over common stock dividends.
- Generally offer a higher yield compared with bonds of the same issuer.
- Favourable tax treatment – income from Canadian preferred shares is eligible for the federal dividend tax credit.
- Portfolio diversification – Preferred shares generally have low correlation with Canadian bonds and equities.

Preferred share correlation to other asset classes

	Correlation
Canadian Bonds	-0.09
Canadian Equities	0.65
US Equities	0.42
Developed Markets ex North American Equities	0.49
Emerging Market Equities	0.42

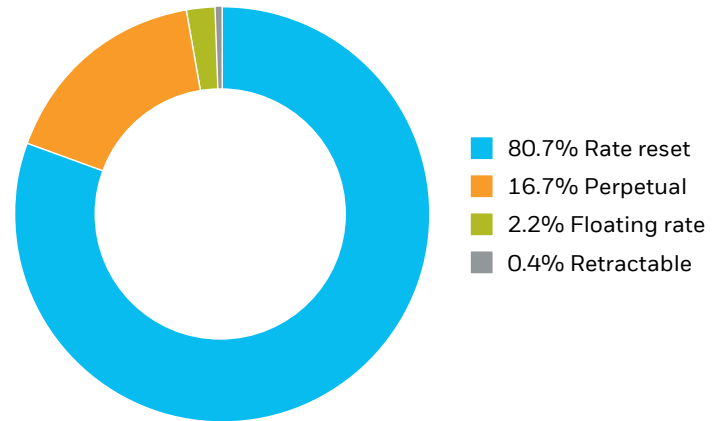
Source: Morningstar, Bloomberg, RBC GAM. 5 year correlation. As of December 31, 2021. Correlation of daily returns relative to the S&P/TSX Preferred Share Index. All in CAD. Canadian Bonds: FTSE Canada Universe Bond Index, Canadian Equities: S&P/TSX Composite Total Return Index, US Equities: S&P 500 Total Return Index (CAD), Developed Markets ex. North America: MSCI EAFE Net Return Index (CAD), Emerging Market Equities: MSCI Emerging Markets Net Return Index (CAD).

Preferred shares

Canadian preferred shares

As of December 31, 2021 Canada's preferred share market had a market capitalization of \$76.2 billion. More than 80% of the preferred shares market is in rate-reset notes with perpetual shares making up another 17%.

Types of preferred shares



Source: RBC GAM, Blackrock. Data as of December 31, 2021.
As reflected by the S&P/TSX Canadian Preferred Share Index.

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