

## Portfolio Manager Commentary - December 31, 2023

### Global Markets Review

Global equity markets had a strong rally in 2023, bolstered by a combination of better-than-expected corporate earnings and resilient economies. Investors entered the year expecting a recession by the second half of the year. However, it did not play out as consensus expected. Inflation has receded, while the U.S. Federal Reserve (the “Fed”) finished its aggressive rate hike campaign without collapsing the economy. Technology was the best performing sector across major developed market indices. The MSCI World Index gained 24.4%. In North America, the S&P 500 rose 26.3%, with Technology (+57.8%), Communication Services (+55.8%), and Consumer Discretionary (+42.3%) significantly outperforming other sectors. The S&P/TSX Composite was up 11.8%, also supported by Technology. In Europe, the STOXX 600 registered 16.6% for the year. Italy FTSE MIB and Spain IBEX 35 surged 34.3% and 28.1%, respectively. Germany, France, U.K., and Switzerland all finished the period in the positive territory, up 20.3%, 20.1%, 7.7% and 7.1%, respectively.

Inflation has continued to fall, and many central banks expect it to decline more rapidly. It became apparent that a peak in interest rates was on the horizon in Q4. November CPI came in at 3.1%, the second lowest reading since its peak in June 2022. The labour market remains tight, supported by the historically low unemployment rate (3.7% in November), despite an increase in the labour force participation rate. The most recent economic data releases suggest that the U.S. economy was on its way to fulfilling the Fed’s goals of low inflation and low unemployment. Meanwhile, manufacturing PMI entered November at 46.7, an indication of contraction when the number is below 50. The bond market was volatile during the year, with the U.S. 10-year treasury yield plummeting below 4% in December from nearly 5% in October. However, the yield did not move much on an annual basis. The spread between 10-year and 2-year treasury yields narrowed during the fourth quarter, while remaining negative. Other global bonds such as the U.K. Gilt and the German Bund also mirrored the U.S. treasury. When looking at value versus growth throughout 2023, growth outperformed value for both large cap and small cap, on the back of the AI hype and peak interest rates. The Technology sector was the clear winner.

During the fourth quarter, global central banks in developed economies gradually delivered more dovish stances of their monetary policy amid cooling inflation. The Fed left interest rates unchanged at 5.25%-5.5% range in November and December Federal Open Market Committee (“FOMC”) meetings. In the December FOMC meeting, Fed Chair Jerome Powell signaled that the central bank was likely finished raising interest rates and is “just at beginning of discussion on policy easing”. Encouraged by the likely peak inflation and potential rate cuts on the horizon, the Fed funds futures market is pricing in total rate cuts of 150 basis points in 2024 starting in May. In an optimistic sign heading into the new year, the Fed pivot saw a significant rise in equity flows. Current debates are focused on whether the Fed will cut rates as aggressively as the market anticipates and whether inflation will stay on its moderating path, resulting in a soft landing.

The Bank of Canada (“BoC”) kept the overnight policy rate at 5% in October and December meetings. The BoC communicated that policymakers will consider cutting interest rates when inflation is clearly on the path to a 2% target and it is still too early to consider easing. The central bank also acknowledged that the rate hikes are one of the main contributors to headline inflation in Canada. However, the Canadian economy appears to be downshifting, evidenced by consecutive months without posting a single month-over-month of economic growth. Also, activities in wholesale trade, manufacturing, and real estate were contracting so household debt should see temporary relief if inflation keeps moderating and rate cuts are in sight.

The European Central Bank (“ECB”) left the benchmark interest rate unchanged at 4.5% at the October and December meetings. The Governing Council was not yet convinced that the outlook for underlying inflation has improved sustainably and reiterated that policy rates “will be set at sufficiently restrictive levels for as long as necessary”. Recent inflation readings in the Euro Area suggest that Energy and food costs have dropped. However, price pressure remains elevated given ongoing strong labour cost growth. Furthermore, the Council also announced the plan to phase out the Pandemic Emergency Purchase Program (PEPP): the ECB will reduce PEPP holdings in the second half of 2024 and end reinvestments at year end. Meanwhile, the Bank of England (“BoE”) also held the policy rate unchanged at 5.25% and emphasized that rates need to remain restrictive for an extended period given its forecast. Like the Euro Area, core inflation in the U.K. has decelerated notably in recent months, but wage pressure showed sequential slowing, meaning that the BoE could shift to a more dovish direction faster than expected.

Investor sentiment improved during 2023. Despite uncertainties surrounding U.S. regional bank failures, slower China recovery, and the Israel-Hamas conflict, plenty of good news fueled the market rally, namely slowing inflation, peaked policy rates, and Artificial Intelligence hype. At the same time, U.S. corporate earnings appear to have bottomed in the second quarter of 2023. Powered by the solid performance of Magnificent Seven (Meta, Nvidia, Amazon, Apple, Alphabet, Microsoft, Tesla), which comprises more than 25% of the market value of the S&P 500, the index finished the year with robust returns. As U.S. equity valuations become even more expensive compared to major global equity markets, investors have sought opportunities in markets with low valuations. For instance, Japan's TOPIX Index posted 28.3% return in 2023 (in JPY terms). We have seen increasing global fund flow into this market, especially first-time Japanese equity investors overseas. According to the latest World Economic Outlook update issued by the International Monetary Fund in October 2023, the global economy is projected to grow 3.0% in 2023 and 2.9% in 2024, with the former unchanged and the latter revised down by 0.1 percentage point from the July forecast. Global inflation is forecast to decline to 6.9% in 2023 and further to 5.8% in 2024.

Looking forward to 2024, we believe global central banks will keep short-term interest rates higher to ensure inflation is under control. Markets are complacent about how quickly central banks, especially the Fed, will cut rates in 2024. But it is worth remembering that even if they did, policy would remain restrictive into 2025. We expect interest rates to come down from the elevated post-COVID levels, but the "last mile" to get closer to 2% inflation will be a slow grind. As a result, yields will continue to play an important role in dictating leadership between value and growth. Companies with long duration assets such as Telecommunications, Utilities, and Real Estate should benefit from the long-term rate decline thesis. Furthermore, geopolitical turmoil in the Gaza Strip and China's stimulus could also fuel market uncertainty. Stock picking will remain an important driver of alpha, and we continue favoring a barbell approach as our portfolio strategy. Brompton also expects volatility and believes that investors will be well-served by strategies that have historically demonstrated lower volatility than the market, such as dividend growth and covered call strategies.

## Portfolio Review

Brompton Global Dividend Growth ETF (the "Fund") was up 12.1% during 2023, outperforming the MSCI World High Dividend Yield Index, which was up 9.1%. The MSCI World Index was up 24.4% over the same period.

The Fund benefitted from stock selection within Consumer Staples and Healthcare and also from an overweight position in Consumer Discretionary. Our top contributors to return were Broadcom, Eli Lilly and Schneider Electric. Our portfolio was positioned to benefit from key themes this year, including the rise of generative AI, blockbuster weight loss drugs and government spending on infrastructure and de-carbonization. The consumer also remained resilient despite rising interest rates and increasing cost of living. This was largely thanks to them having a job with the unemployment rate at record low levels for most of the year. As a result, several consumer-related stocks in the Fund's portfolio also had a strong year.

Offsetting some of these gains were our underweight position in the Technology sector, while positions in Utilities and Materials also offset some of the gains. Tech was the strongest performer of the year, powered largely by the rise of generative AI. Most of the Magnificent 7 stocks do not pay dividends and would not be within the target universe for a dividend growth strategy. Tourmaline Oil, Corteva and Northrop Grumman were the biggest detractors from performance. Utilities suffered two-fold with higher interest rates. First, Utilities are often considered bond proxies due to their high dividend payout ratio. Those yields started to look unattractive with rising risk-free bond yields, leading to a selloff in these stocks. Secondly, higher interest rates made several projects (particularly in renewable energy) unprofitable, leading to further pressure on stock prices. Finally, Materials also had a tough year as economic activity in China was slower than anticipated at the start of the year.

During Q4 the Fund added to positions in Technology and Real Estate, funding them through sales in Energy. We believe the disruptive potential of AI is real and is currently still in the early stages. We believe that the initial winners will be the technology companies that can sell tools and services to enable AI. We also think that interest rate sensitive sectors such as Real Estate will rebound in 2024 as rates have likely peaked and we could see them come down through the year.

Laura Lau, CIO

Michael D. Clare, SVP & SPM

Annual Compound Returns <sup>1</sup>	1-YR	3-YR	5-YR	Since Inception <sup>2</sup>
Brompton Global Dividend Growth ETF	12.1%	4.3%	6.8%	4.9%
MSCI World High Dividend Yield Index	24.4%	7.8%	13.4%	10.7%
MSCI World Index	9.1%	6.4%	8.2%	6.6%

(1) Returns are for the periods ended December 31, 2023 and are unaudited. The table shows the Fund's compound return for each period indicated compared with the MSCI World Index ("MSCI Index") and the MSCI World High Dividend Yield Index ("MSCI High Dividend Index") (together, the "Indices"). The MSCI Index captures large and mid-cap representation across 23 developed markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country. The MSCI High Dividend Index targets companies from the MSCI Index (excluding Real Estate Investment Trusts) with high dividend income and quality characteristics and includes companies that have higher than average dividend yields that are expected to be both sustainable and persistent. The Fund invests in global dividend growth companies with market capitalization of at least \$10 billion. It is therefore not expected the Fund's performance will mirror that of the Indices which have more diversified portfolios. Further, the Indices are calculated without the deduction of management fees, fund expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on net asset value per unit and assumes that distributions made by the Fund on its units in the period shown were reinvested at net asset value per unit in additional units of the Fund.

(2) Inception Date October 17, 2018.

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