

## Portfolio Manager Commentary - December 31, 2024

## U.S. Market Review

Global equity markets finished the year with another year of strong performance bolstered by a combination of moderating inflationary pressures, easing monetary policy, and resilient corporate earnings. Enthusiasm over the artificial intelligence (AI) theme drove significant gains in U.S. indices. Donald Trump's victory in the U.S. election also helped boost the domestic equity markets on the expectations of deregulation and a corporate tax cut despite uncertainties surrounding his proposed tariff and immigration policies. In global equity markets the MSCI World Total Return Index finished the full year with a 19.2% gain, while the S&P 500 rose 25.0%, climbing to all-time high in November. Communication Services (+40.2%) and Technology (+36.6%) were the best-performing sectors. Both sectors benefited from the development of AI themes. The S&P/TSX Composite Total Return Index was up 21.7% buoyed by Technology and Financials. In Europe, the STOXX 600 Total Return Index registered a 9.6% return for 2024. Spain, Italy, and Germany were the best-performing countries, gaining 20.0%, 18.9%, and 18.8%, respectively, while the U.K., Switzerland, and France all finished in positive territory, up 9.6%, 7.5%, and 0.9%, respectively.

Inflation continues to moderate, which has enabled global central banks to shift to accommodative monetary policies. In the U.S., inflation was 2.9% in 2024, while the unemployment rate remained relatively low at 4.1% as of the end of the year. The U.S. economy remains healthy and has managed to avoid a recession. However, the manufacturing PMI remained below 50 in the second half of 2024, which is an indicator of softness in the manufacturing sector. As the inflationary pressure meaningfully abated, the Federal Reserve started its long-awaited cutting cycle in September. The bond market was volatile in Q4 with the U.S. 10-year Treasury yield rising sharply from 3.6% in September (the lowest of the year) to approximately 4.6% by year end, which resulted in a steepening of the yield curve. The rebound in yields raised concerns over inflation returning due to President Trump's tariff and immigration policies, which has resulted in fewer rate cuts being priced into the market for 2025. Global bond markets, such as the U.K. Gilt and the German Bund, mirrored the sell off in U.S. Treasuries. In equities, growth outperformed value for both large cap and small cap, while large cap tech names were the primary contributors to the index performance even though they showed signs of losing momentum during the back half of the year. Strong performance was also seen from a broader group of stocks in 2024 relative to 2023, including strength Financials and Consumer Discretionary.

After kicking off the interest rate cutting cycle with a 50 bps cut in September, the Federal Reserve (Fed) cut interest rates by 25 bps each in the November and December meetings bringing the target range to 4.25%-4.5%. However, at the December meeting the Fed triggered a market sell-off after Fed Chair Jerome Powell emphasized a more cautious stance on the number of interest rate cuts expected in 2025. By the end of December, the Fed Funds Futures have priced in two additional 25 bps rate cuts in 2025, which was down from four cuts priced in as of September. Despite inflation coming down significantly, it remains slightly elevated relative to the Fed's 2% target. Therefore, we expect the Fed to tread lightly with interest rate cuts in 2025. On the political front, Donald Trump won the presidential election, and Republicans took control of Congress. The new administration's policies surrounding tariffs, immigration, regulation, and taxes will be the key to watch heading into 2025.

Artificial intelligence remained the year's dominant investment theme fueling market enthusiasm and a transformative industry shift. The "Magnificent Seven" mega cap tech stocks delivered outsized returns, boosting the S&P 500 Total Return Index. The seven names added about \$6 trillion of market cap in 2024. Meanwhile, broader market breadth, indicated by the advance/decline line for the S&P 500, suggests wider participation in the rally beyond large-cap tech. Consecutive Fed rate cuts, durability of the U.S. consumer, and optimism around pro-business policies from the Trump administration bolstered equity performance in sectors such as Financials. According to the latest World Economic Outlook update issued by the International Monetary Fund in October 2024, the global economy is projected to grow 3.3% in 2025, revised up by 0.1 percentage points from the July forecast. The outlook also highlights that persistent services inflation is impeding overall disinflation efforts, complicating the path to monetary policy normalization.

Looking forward to 2025, in our view, we expect to continue to see a widening of breadth in the market. Returns over the past 3 years have been dominated by the “Magnificent Seven” mega cap stocks. This trend peaked in mid-2024, and we have recently seen outperformance from a broader group of stocks, including mid-caps, particularly on the back of the U.S. election results in November. While we are still bullish on the Technology sector, broadening participation is positive for stock pickers and active management. In terms of the economy, we believe that a soft landing has been achieved and that we remain on a path back to normal in terms of both inflation and interest rates. The U.S. economy will continue to benefit from a strong consumer and continued growth in private sector capex, particularly around the themes of re-shoring, electrification, and artificial intelligence. The incoming policies under the new Trump administration will be the key to drive the market sentiment. Tax reform and deregulation would stimulate growth and benefit in particular domestic and cyclical sectors, while tariffs and trade policy uncertainties could create headline risks. We also expect increased volatility in 2025 and believe 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.

## **Financial Sector Review & Outlook**

The Financials sector delivered solid returns in 2024. It was the second-best performing sector in the S&P/TSX Composite and the third best performing sector in the S&P 500 during the year. Stocks in our portfolio are well positioned to capture the risk/reward opportunities across large cap banks, regional banks, consumer finance, investment banks, insurance, exchanges and financial technology.

In 2024, we saw signs of improvement across the banking sector. While still under pressure due to elevated deposit costs over most of the year, the pace of net interest margins (NIM) compression has moderated towards the end of the year. Overall loan growth has also improved. In particular, commercial and industrial loans were the primary growth drivers for the larger banks, while commercial real estate propelled growth for smaller banks. We expect NIM to trough in the coming quarters as interest rate cuts work their way through. Credit losses have begun to normalize with net charge-offs stabilizing, while we believe that lower rates will support the credit environment. Trading revenue was a major driver of growth for large banks, buoyed by elevated market volatility. Investment banking and wealth management were also bright spots on the back of robust equity market performance.

Banks continue to implement cost cutting measures while also making necessary investments in their digital transformation, which is a necessity given competitive dynamics and the attractive returns on invested capital over the long-term. On the consumer business front, banks continue to face increased competition from non-bank entities and financial technology players who operate at a lower cost structure and different regulatory environments. With an improvement in the revenue picture and waning inflation pressures, we expect operating leverage in banks to improve as we look out to 2025.

The regulatory environment is expected to become more favourable following the election of Donald Trump as the 47th President of the U.S. Trump’s administration is expected to continue its strong push for deregulation, consistent with his first term, with new appointments to key regulatory agencies including the Securities and Exchange Commission , the Federal Deposit Insurance Corporation (“FDIC”), the Office of the Comptroller of the Currency , and the Consumer Financial Protection Bureau . These personnel changes are anticipated to be more industry-friendly, leading to reduced oversight and regulation of banks. De-regulation efforts could include making changes to the Basel III Endgame re-proposal, which could allow banks to accelerate share buybacks as the industry is sitting on record levels of excess capital. We also believe the recent FDIC merger guidance issued in September 2024, which broadened the scope of transactions subject to FDIC approval, may be rescinded or modified, facilitating an end to the logjam of pent-up consolidation in the banking industry and creating a more favourable M&A environment. Accelerating capital markets revenue will be a major growth driver for large cap U.S. banks in 2025.

The Federal Reserve (the “Fed”) cut interest rates 3 times in 2024 by a total of 100 basis points (“bps”). The market is expecting 1-2 additional 25 bps cuts by the end of 2025. The impact on NIM is expected to be mixed. As the Fed interest rate continues to ease throughout 2025, deposit costs for banks are expected to drop further, and loan growth, which was sluggish in 2024 due to quantitative tightening, is anticipated to accelerate. At the same time, the yield curve is expected to steepen further, driving net interest margin improvements for banks.

## **Portfolio Review**

Brompton North American Financials Dividend ETF (the “Fund”) was up 33.9%, outperforming both the S&P/TSX Capped

Financials Total Return Index (+30.0%) and the S&P 500 Financials Total Return Index (+30.4%) in 2024.

Overweight positions in Life & Health Insurance, Consumer Finance and Investment Banking & Brokerage versus the S&P 500 Financials Total Return Index were major contributors to the Fund's outperformance. Top holdings include Synchrony Financial (up 74.0%), Manulife (up 44.4%), iA Financial Corp (up 39.9%), and Raymond James Financial (up 40.8%). Our outlook on life insurance companies remains favourable, primarily due to their diversified product offerings and business mixes, which make them relatively resilient through economic cycles; however, we remain selective within the sector. Given its strong performance year-to-date, the sector is currently trading at elevated multiples compared to the last 5 years. We continue to identify opportunities that offer optimal risk-adjusted returns.

Underweight exposures in Diversified Banks detracted from the Fund's performance, with holdings of KeyCorp and JP Morgan offsetting some of the Fund's gains.

We have a constructive view on Investment Banking & Brokerage and Diversified Banks and hold overweight positions in both sectors on the back of a steeping yield curve and prospects of strong capital market activity heading into 2025.

| Annual Compound Returns <sup>1</sup>                         | 1-YR  | 3-YR  | 5-YR  | Since Inception <sup>2</sup> | Since Inception <sup>3</sup> |
|--|-------|-------|-------|------------------------------|------------------------------|
| Brompton North American Financials Dividend ETF (CAD Hedged) | 33.9% | 5.3%  | 8.9%  | 9.1%                         | -                            |
| Brompton North American Financials Dividend ETF (USD)        | 32.9% | 5.3%  | 9.6%  | -                            | 11.1%                        |
| S&P/TSX Capped Financials Total Return Index                 | 30.0% | 10.3% | 13.2% | 12.7%                        | 13.8%                        |
| S&P 500 Financials Total Return Index                        | 30.4% | 9.4%  | 11.6% | 12.3%                        | 13.8%                        |
| S&P/TSX Composite Total Return Index                         | 21.6% | 8.6%  | 11.1% | 11.2%                        | 11.5%                        |

(1) Returns are for the periods ended December 31, 2024 and are unaudited. The table shows the Fund's compound returns for each period indicated compared with the S&P/TSX Capped Financials Total Return Index ("Financials Index"), the S&P 500 Financials Total Return Index ("S&P Index") and the S&P/TSX Composite Total Return Index ("Composite Index") (together the "Indices"). The Financials Index is comprised of constituents of the Composite Index that are classified as members of the financial sector with individual constituents capped at 25% weight. The S&P Index is comprised of constituents of the S&P Index that are classified as members of the financial sector with individual constituents capped at 25% weight. The Composite Index tracks the performance, on a market-weight basis and total return basis, of a broad index of large-capitalization issuers listed on the Toronto Stock Exchange. The Fund is actively managed; therefore, its performance is not expected to mirror that of the Indices, which have more diversified portfolios and include a substantially larger number of companies. Furthermore, the Indices performance is 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. The performance information shown is based on net asset value per CAD and USD unit and assumes that cash distributions made by the Fund during the periods shown were reinvested at net asset value per CAD or USD unit in additional units of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future.

(2) Inception Date October 17, 2018

(3) Inception Date August 8, 2019.

This document is for information purposes only and does not constitute an offer to sell or a solicitation to buy the securities referred to herein. The opinions contained in this report are solely those of Brompton Funds Limited ("BFL") and are subject to change without notice. BFL makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, BFL assumes no responsibility for any losses or damages, whether direct or indirect which arise from the use of this information. BFL is under no obligation to update the information contained herein. The information should not be regarded as a substitute for the exercise of your own judgment. Please read the prospectus before investing.

Commissions, trailing commissions, management fees and expenses all may be associated with exchange-traded fund investments. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Exchange-traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

Information contained in this document was published at a specific point in time. Upon publication, it is believed to be accurate and reliable, however, we cannot guarantee that it is complete or current at all times. Certain statements contained in this document constitute forward-looking information within the meaning of Canadian securities laws. Forward-looking information may relate to matters disclosed in this document and to other matters identified in public filings relating to the Fund, to the future outlook of the Fund and anticipated events or results and may include statements regarding the future financial performance of the Fund. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Actual results may vary from such forward-looking information. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.