

## Portfolio Manager Commentary - December 31, 2023

### Financial Sector Review & Outlook

The Financial sector underperformed the broader market in 2023 given US and European bank failures earlier in the year. While we believe the market is pricing in a soft-landing scenario, we remain cognizant of macroeconomic and geopolitical risks that could become a headwind. Banks are trading at 11.2x forward P/E, relatively in-line with the 10-year average which is a 43% discount to the broader market (versus a historic 38% discount). We believe that the discount to the market is warranted given the uncertainty of Net Interest Income (“NII”) trajectory (on the back of expected Fed rate cuts), credit outlook and regulatory headwinds. We note that an analysis by Goldman Sachs on January 4, 2024, revealed banks forward P/E valuations fell 20% on average over the last 3 rate cutting cycles.

We expect NII to decline modestly in 2024 given the forward path of interest rates. Credit losses have begun to normalize; however, the banks have already built loan loss reserves to reflect continued normalization of credit losses from historically low levels. We note an uptick in delinquencies in commercial office real estate, auto and credit card lending. Bank’s credit quality continues to be strong given the industry’s high underwriting standards. In the fee-based business, we expect growth will be driven by the continued recovery in investment banking, modest growth in wealth management and credit card activity given strong spending trends.

Banks continue to embark on cost cutting measures through a variety of levers. However, with investments in digital transformation along with the expected decline in NII we expect operating leverage will be subdued. Investments in digital transformation are a necessity, given competitive dynamics and the attractive returns on invested capital over the long-term. We note on the consumer business front, banks continue to face increased competition from non-bank entities and fintech players who operate with a lower cost structure and different regulatory environments.

The Basel III Endgame proposal released by US bank regulators seeks to provide consistency and transparency in the regulatory capital framework and improve the strength in the banking industry. The proposal is focused on four main areas including credit risk, market risk, operational risk, and credit valuation adjustment risk. Under the proposal, banks will face increasing capital requirements over the next five years, with larger banks facing higher requirements. Many banks have responded that these new rules could result in significant mitigation in terms of selling assets or otherwise reducing risk-weighted assets, as well as slowing share buybacks for a period of time.

Overall, banks are attractively valued and remain well capitalized. Investors who believe in the soft-landing narrative should have exposure to financials in our view. Stocks in our portfolio are well positioned to capture the idiosyncratic risk/reward opportunities across large cap banks, regionals, consumer finance, investment banks, insurance, exchanges and fintech.

### Portfolio Review

Brompton North American Financials Dividend ETF (the “Fund”) was up 8% versus the S&P/TSX Capped Financials Index, 13.9% and the S&P 500 Financials 12.1% in 2023.

Compared to the S&P 500 Financials Index, the Fund was overweight Diversified Banks which resulted in performance lagging the benchmark. Top holdings include JP Morgan (up 24%), TD Bank (up 16.5%) and Royal Bank (up 12.9%).

An overweight position in Investment Banks contributed to our underperformance relative to the benchmark. Top holdings include Morgan Stanley (up 13.9%) and Raymond James (up 6.1%).

The Fund’s overweight exposure in Asset Managers contributed to performance which was well ahead of the benchmark. Top holdings include Brookfield Asset Management (up 31.1%), Brookfield Corp (up 29.4%) and Blackstone (up 29.4%).

An overweight position in Regional Banks negatively impacted performance which was ahead of the benchmark. M & T Bank (up 32.6%) was our only top performer.

The Fund was market weight Property & Casualty Insurance which contributed to performance ahead of benchmark holdings. Top performers include Progressive (up 23.1%) and Intact Financial (up 10%).

The Fund’s overweight exposure in Life Insurance contributed to performance well ahead of benchmark holdings. Top holdings include IA Financial (up 21.3%), Aflac (up 17.4%) and Manulife (up 6.4%).

An underweight exposure in Financial Exchanges contributed to performance which lagged the benchmark. The top performers were CBOE (up 21.2%) and Factset (up 2%).

The Fund's only position in Insurance Brokers (market weight) and Multi-Sector (underweight) contributed to performance relatively in-line with the benchmark with Arthur J Gallagher (up 20.5%) and Berkshire Hathaway (up 15.5%) respectively.

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)	8.0%	4.4%	8.3%	4.9%	-
Brompton North American Financials Dividend ETF (USD)	9.3%	4.9%	-	-	6.7%
S&P/TSX Capped Financials Index	13.9%	12.1%	11.7%	9.7%	10.4%
S&P 500 Financials Index	12.1%	10.6%	11.9%	9.1%	10.4%
S&P/TSX Composite Index	11.8%	9.7%	11.3%	9.3%	9.3%

(1) Returns are for the periods ended December 31, 2023 and are unaudited. The table shows the Fund's compound returns for each period indicated compared with the S&P/TSX Capped Financials Index ("TSX Financials Index"), the S&P 500 Financials Index ("S&P Financials Index") and the S&P/TSX Composite Index ("Composite Index") (together the "Indices"). The Financials Index is comprised of constituents of the S&P/TSX 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 500 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, of a broad index of large-capitalization issuers listed on the Toronto Stock Exchange. The Fund invests in at least 15 North American Financial Services companies with market capitalization of at least \$5 billion. It is therefore not expected the Fund's performance will mirror that of the Indices which have more diversified portfolios. Furthermore, 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

(3) Inception Date August 8, 2019.

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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.

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