Brompton North American Financials Dividend ETF (TSX:BFIN; BFIN.U)

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - DECEMBER 31, 2020

US Markets Review

2020 was a tumultuous year and surely a year for the history books. The 2020 stock market crash marked the fastest correction in market history; yet numerous stock markets defied expectations and closed at all-time highs. All in all, global markets finished the year with stellar performance, especially when taking into account the major correction that took place in March. The MSCI World Index gained 16.5% with the Information Technology sector as the best performing sector, gaining 44.3% during the year; Consumer Discretionary was the second-best performing sector, outperforming the MSCI World Index by 20.5%. In North America, the S&P 500 was up 18.4%, while the S&P/TSX Composite was up 5.6%, both of which were led by strong performance from the Information Technology sector. In Europe, the STOXX 600 was down 1.4% for the year. Germany and Switzerland had the best performance, where the DAX and SMI were up 3.5% and 4.3%, respectively. France's CAC 40 Index declined 5.0%. Spain and U.K. also finished the year in negative territory as the IBEX 35 and FTSE 100 declined 12.7% and 11.4%, respectively.

During the fourth quarter, global economies continued the path to recovery while certain parts of the world combated a resurgence of COVID-19. In general, Asian countries have been able to control the spread of COVID-19 much better than North America and Europe. In November, Significant progress was made with the development and the rollout of COVID-19 vaccines. Pfizer and Moderna's vaccines both showed efficacy rates above 90%. AstraZeneca's vaccine also showed efficacy rate above the 50% threshold set by the World Health Organization. Several countries have granted emergency approval for these vaccines and are undergoing the inoculation process. At the same time, we saw sequential improvement in manufacturing production and sequential declines in the unemployment rate after peaking out in April. In the U.S., Democratic presidential nominee Joe Biden was elected the 45th president of the United States and was inaugurated on January 20, 2021. The two Georgia Senate runoff elections in January 2021 resulted in Democratic control of the Senate. Democrats gained control of both the Congress and the White House for the first time since 2011 by the slimmest of margins. A Democratic win in combination with vaccine news pushed stock markets to new highs in November. The more cyclical parts of the economy benefited the most, including Energy, Financials, Materials and Industrials. Performance of Information Technology stocks remained robust, as the work from home theme continue to be a secular tailwind for the sector. In December, equity markets rallied further despite the implementation of lockdown measures in certain countries. Risk appetites continue to favor pro-cyclical stocks as additional coronavirus relief get passes by the U.S. congress.

Effective central bank policies played an essential role in the recovery of global equities. In the U.S., the Federal Reserve remained highly accommodative in the fourth quarter and kept policy rates at 0%-0.25% throughout the period. The latest dot plot suggests that the Federal Reserve sees rates at the zero lower bound through to and including 2023. In December, President Trump has signed another coronavirus relief package in the amount of approximately US$900 billion, the stimulus package encompasses areas like unemployment support, vaccine distribution and rental relief. During the most recent FOMC meeting in December, the Fed saw continued recovery in the fourth quarter led by improvements in labour market conditions and industrial productions. The U.S. economy continued to show resilience in the face of the pandemic. The take-up of labor and production market slack is expected to lead to a gradual increase in inflation. Inflation is expected to overshoot 2% beyond 2023 under the Fed's new flexible form average inflation targeting framework.

At the end of 2020, the number of confirmed infections worldwide exceeded 84 million, with cumulative deaths approaching 2 million- more than double the number of infections at the end of the third quarter. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in October 2020, global gross domestic product is projected to contract 4.4% this year, a less severe contraction than the previous forecast in June as activity began to improve sooner than expected after lockdowns were scaled back in May and June. The IMF projected the global growth rate for 2021 to be 5.2%. The path to recovery will follow a choppy trajectory as it is predicated upon a confluence of factors including public health response, progress with vaccines rollouts and the size and effectiveness of the policy response.

Looking forward to 2021, the rollout of COVID-19 vaccines should allow societies to gradually normalize in the coming year and thus push equity prices higher. Government policies under the Biden administration will be an area of focus. We expect additional stimulus in the U.S. and see increases in the federal corporate income taxes in the short term to be unlikely. Tensions with China should abate to some extent under the Biden administration. Pro-cyclical sectors should extend their leadership that we saw since November into 2021.

Financial Sector Review & Outlook

The increasing optimism around reopening of the economy given positive vaccine news coupled with fiscal stimulus and proposed infrastructure spending are positive tailwinds for the financial sector. Heading into 2021 there is increased confidence that bank earnings will rebound given the prospects for lower loan loss provision as this was the primary factor in driving the earnings decline in 2020. Lower rates and slowing deposit-balance growth are pressuring interest income, slightly offset by a steeper yield curve. A second shutdown may have negative consequences for credit quality; however, this is expected to improve steadily in the second half of 2021 as economic recovery hits a cadence.

The pandemic has accelerated digitization trends that have been reshaping the financial sector. We note that pandemic-driven costs incurred through activities, such as retrofitting branches and moving employees to a work from home environment are expected to roll off in 2021. In the near-term digital transformation expenses continue to be a fast-growing cost item however we believe banks would unlikely pare technology expenses. Over time, investment in digital technologies is expected to lower banks' cost structure and improve efficiency gains.

Banks benefited from robust capital markets activity in 2020, as issuance picked up in the second half of 2020, with investment banking fees up 15% to 20% amongst global banks, according to Bloomberg. Trading revenue was robust given market volatility with fixed income gains of 40% and equities up 5% to 10%. Trading may be the most since 2009-10, with profitability also benefiting from slimming of cost bases in recent years, according to Bloomberg. We expect trading revenue to normalize in 2021 with the potential of lower investment banking fees after a solid underwriting year.

In the Comprehensive Capital Analysis and Review (CCAR) the Federal Reserve imposed a moratorium on dividend increases and on buybacks, and a payout ratio cap for banks' quarterly common dividends at 100% of the average of the prior four quarters' net income. In December, the dividend increase moratorium was extended but beginning in Q1 2021, banks may recommence buybacks with limitations. There are a number of banks that either have significant excess capital and do not have significant risk of higher credit reserve builds and as a result will likely restart buybacks given the certainty around the capital return framework for Q1 2021. While the Federal Reserve did not state whether it would maintain the payout restrictions after Q1, in our view an extension is more likely given the uncertain macro-economic backdrop.

Portfolio Review

Brompton North American Financials Dividend ETF (the "Fund") was up 0.6% in 2020 versus the S&P/TSX Capped Financials Index, which was up 1.6% and the S&P 500 Financials Index down 1.8%.

The Fund benefitted from an overweight position in Investment Banking and Brokerage which contributed to outperformance relative to benchmark holdings. Top performers include Morgan Stanley (+38%) and Goldman Sachs (+17.5%).

The Fund's overweight position in Data Processing and Outsourced Services contributed favorably to outperformance relative to the benchmark. Top performers include Broadridge (+26%), Mastercard (+20%) and Fidelity National (+19%).

A slight overweight exposure to Financial exchanges contributed to the Fund's performance through holdings in S&P Global (+21%) partially offset by weakness in CME Group.

The Fund also benefitted from an overweight exposure to Regional banks with our holdings in First Republic up 26%, partially offset by weakness in PNC.

An underweight exposure to Diversified Banks negatively impacted the Fund's performance relative to the benchmark. Top holdings include Royal Bank (+8%), National Bank (+6%) and TD (5.6%). We continue to have a positive outlook on the banks in 2021 given the propensity for earnings growth as the economy recovers.

Laura Lau, SVP & CIO

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Annual Compound Returns[1]	1-YR	Since Inception[2]	Since Inception[3]
Brompton North American Financials Dividend ETF (CAD Hedged)	0.6%	5.5%	-
Brompton North American Financials Dividend ETF (USD)	3.1%	-	10.8%
S&P/TSX Capped Financials Index	1.6%	6.2%	6.6%
S&P 500 Financials Index	(1.8%)	6.6%	8.8%

(1) Returns are for the periods ended December 31, 2020. The table shows the Fund's compound returns for each period indicated compared with the S&P/TSX Capped Financials Index ("Financials Index") and the S&P 500 Financials Index ("S&P 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 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. 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.

(2) Inception Date October 17, 2018

(3) Inception Date August 12, 2019.

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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.

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EXCHANGE TRADED FUNDS

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