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

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - MARCH 31, 2021

Global Markets Review

It has been one year since COVID-19 was declared a global pandemic. Global stock markets extended the recovery seen since November last year to close at all-time highs during the first quarter of 2021. All in all, global markets finished the quarter with solid performance, especially for pro-cyclical sectors, as several of them enjoyed double digit returns. The MSCI World Index gained 5.0% with the Energy sector the best performing sector, gaining 22.2% during the quarter; Financials was the second-best performing sector, outperforming the MSCI World Index by 8.3%. In North America, the S&P 500 was up 6.2% led by gains from the Energy sector, while the S&P/TSX Composite was up 8.1%, with Heath Care and Energy as the top performing sectors. In Europe, the STOXX 600 was up 8.4% for the quarter. Italy and France had the best performance, where the FTSE MIB and CAC 40 were up 11.3% and 9.6%, respectively. Germany's DAX gained 9.4%. Spain and U.K. also finished the quarter with solid returns as the IBEX 35 and FTSE 100 increased 6.7% and 5.0%, respectively.

During the quarter, global economies continued the path to recovery while certain parts of the world combated a third wave of COVID-19. We saw sequential improvement in manufacturing production as the March PMI reached a record high of 64.7 in the U.S., the unemployment rate continued declining during the first quarter. In the U.S., Democrats gained control of both the Congress and the White House for the first time since 2011. Election of Joe Biden as the 45th president of the United States paved the way for further fiscal stimulus. Biden's sharp focus on immunization efforts in combination with unprecedented fiscal stimulus pushed stock markets to new highs in March. At the same time, as a reflection of the improved growth outlook, global yield curves steepened and the U.S. 10-year treasury yield recovered to above 1.7%. Cyclical parts of the economy led the equity market rally, with Energy, Financials, Industrials and Materials gaining the most, while defensive sectors such as Consumer Staples and Utilities lagged. Performance of Information Technology stocks was lackluster overall due to investor sentiment shifting away from large capitalization growth names during the quarter. Risk appetites continue to favor pro-cyclical stocks as global economies pick up its pace.

Effective central bank and government policies played an essential role in the recovery of global equities. In North America, both the Federal Reserve and the Bank of Canada (BoC) remained highly accommodative and kept interest rate unchanged during the first quarter. In March, President Biden signed a US$1.9 trillion pandemic relief bill, titled the American Rescue Plan, into law. The plan includes additional stimulus cheques, enhanced unemployment aids, rental assistance and childcare support among other assistance. During the most recent FOMC meeting in March, the Fed saw Q1 2021 GDP expanding at a faster pace than Q4 of 2020 as well as improvement in labor market conditions. Consumer spending also fared better than Q4 of last year. In Canada, GDP growth in Q1 of 2021 is expected to be positive rather than the contraction projected back in January. While higher commodity prices and improvement in demand brightened the prospect of a recovery, employment levels remain well below pre-COVID levels. As such, the BoC expect to hold policy interest rates at the current level until at least 2023.

In Europe, the European Central Bank (ECB) kept the benchmark interest rate unchanged at -0.50%. ECB's president Christine Lagarde noted the uncertainty surrounding Europe's economic outlook due to the ambiguous dynamics of the pandemic and the unpredictable speed of inoculation campaigns. The Governing Council is continuing the current pace of purchase under the pandemic emergency purchase programme (PEPP) in the amount of EUR1,850 billion until at least the end of March 2022. Purchases under the asset purchase programme (APP) will continue at a monthly pace of EUR20 billion. The ECB projects an annual real GDP growth of 4% and an annual inflation rate of 1.5% in 2021.

At the end of the first quarter, the number of confirmed infections worldwide exceeded 134 million, about one and a half times greater than the number of infections at the end of 2020. On the other hand, global vaccination efforts are well underway, with the U.S. having administered 171 million doses of the vaccine as of the first week of April. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in April 2021, the global economy is projected to grow 6% in 2021, up from the previous forecast of 5.2%. The contraction of 2020 was also smaller than the previous projection due to outsized growth in the second half of 2020 driven by easing of lock-down measures. However, there still remains a high degree of uncertainty surrounding the global economic outlook; such as whether the new COVID-19 strains are susceptible to current vaccines, capacity adjustments in the economy and effectiveness of global policies.

Looking forward to the rest of 2021, we believe the rotation into pro-cyclical sectors is set to continue. First, wide COVID-19 vaccine coverage should allow societies to gradually normalize over the course of the year. Second, the Biden administration is laser-focused on boosting the economy through the American Rescue Plan and the proposed US$2.25 trillion infrastructure plan since his election, which should be supportive of further economic recovery. Third, the personal savings rate is sitting at the highest rate in the past decade. Consumers have a strong propensity to spend, which in turn should fuel economic growth. Overall, we are optimistic about equity performance heading the upcoming quarter.

U.S. large capitalization stocks are likely to participate in the market rally but not necessarily lead the performance. Pro-cyclical sectors should extend their leadership that we saw since November into the upcoming quarters.

Financial Sector Review & Outlook

We are optimistic on the financial sector given the line-of sight in reopening of the economy as COVID-19 vaccinations hit a crescendo coupled with fiscal stimulus and proposed infrastructure spending which are positive tailwinds. 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 earnings decline in 2020. As the economy rebounds, we expect strong reserve releases will continue and contribute to an ongoing strong excess capital return story. In addition, the net interest income trajectory remains constructive as rates continue to rise and banks remix cash into higher yielding assets. While bank valuations are slightly more expensive than historic levels, the sector is trading in-line with its spread to the S&P 500. On a forward basis (2022), valuations appear more reasonable and in-line with historic averages.

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.

During the quarter the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) announced that the temporary relief they granted last year for the Supplementary Leverage Ratio will expire as scheduled. Recall in May 2020, in response to the impact of the COVID-19 pandemic, the Fed, FDIC, and OCC adopted a temporary amendment to the SLR rule that would permit firms to exclude US Treasury securities and deposits at Federal Reserve Banks from the denominator in the calculation of the ratio. Global Systemically Important Banks will need to consider one or more of the following strategies to ensure that they maintain a fully buffered SLR in line with their targets: (1) issue preferred stock; (2) recalibrate capital return plans; (3) scale back deposits (e.g., disincentivize new deposits and/or deposit retention); (4) address other aspects of their business that are impacted by US Treasury holdings.

The Federal Reserve also announced the temporary and additional restrictions on bank holding company dividends and share repurchases that are currently in place will end for most firms after June 30, following the completion of the upcoming stress tests. Firms with capital levels above required minimums will no longer be subject to the additional restrictions, as of that date. Firms with capital levels below required minimums will remain subject to current restrictions. As a result of the Fed's announcement, the large banks will be permitted to increase their dividends after June 30.

Portfolio Review

Brompton North American Financials Dividend ETF - CAD Hedged (the "Fund") was up 13% in Q1 2021 versus the S&P/TSX Capped Financials Index, which up 13.9% and the S&P 500 Financials, which was up 15.9%.

The Fund benefitted from an overweight position in Diversified Banks, which contributed to performance though slightly lagging the benchmark. Top performers include Bank of America (+28.3%), National Bank of Canada (+21.8%) and JP Morgan (+20.7%).

An overweight position in Investment Banks did not overly detract from performance relative to the benchmark. Top performers include Goldman Sachs (+24.5%), Morgan Stanley (+14%) and Raymond James (+14%).

The Fund's overweight position in Life Insurers contributed to outperformance relative to the benchmark. Top holdings include Manulife (+22.4%), Metlife (+17%) and Sunlife (7%).

A market weight position in Financial Exchanges contributed to performance which was ahead of the benchmark. Top performers include CME (+12.7%), S&P Global (+7.6%) and NASDAQ (+3%).

The Fund benefitted from a market weight exposure to Regional Banks, though performance lagged the benchmark. Top holdings include Fifth Third Bancorp (+17.5%), First Republic (+13.6%) and PNC (+6%).

The Fund's overweight position in Data Processing and Outsourced Services had a neutral impact to performance as strength in our holdings in Broadridge was offset by weakness in Mastercard and Fidelity National.

Laura Lau, SVP & CIO

Michael D. Clare, VP & PM

Annual Compound Returns[1]	1-YR	Since Inception[2]	Since Inception[3]
Brompton North American Financials Dividend ETF (CAD Hedged)	60.4%	10.2%	-
Brompton North American Financials Dividend ETF (USD)	67.2%	-	17.7%
S&P/TSX Capped Financials Index	46.7%	11.5%	14.5%
S&P 500 Financials Index	67.3%	12.9%	18.5%

(1) Returns are for the periods ended March 31, 2021. 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 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 8, 2019.

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