

## Portfolio Manager Commentary - December 31, 2023

### U.S. 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, the Fed Chair Jerome Powell signaled that the central bank was finished raising interest rates and is “just at beginning of discussion on policy easing”. Encouraged by the likely peak inflation and 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.

Investor sentiment improved during 2023. Despite uncertainties surrounding U.S. regional bank failures, slower China recovery, and 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 (IMF) 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 the Fed will keep short-term interest rates higher to ensure inflation is under control. Interest rates should come down from the elevated post-COVID levels, but the “last mile” to get closer to 2% inflation will be a slow grind. The U.S. should remain one of the strongest economies in the world, with high government deficit stimulus and 30-year term mortgages limiting the effects of the higher interest rates. We expect the Technology sector will continue to see superior earnings growth, but the performance gap between Technology and the other sectors should narrow.

Moreover, 2024 will be a U.S. election year. Equity market returns are typically positive for election years, but not as strong as for the third year of the election cycle.

## **Portfolio Review**

Brompton North American Low Volatility Dividend ETF (the “Fund”) focuses on lowering total portfolio volatility through investing in a diversified blend of North American equities with a minimum market cap of \$5 billion. During 2023, the Fund was down 1.1% versus the benchmark (MSCI Minimum Volatility USA) which was up 9.8%. Much of the performance gap can be explained by a strategy difference. The Fund does not force sector weights and, as such, it is more of a pure low volatility approach to investing than the benchmark, which keeps its sector weights within +/-5% of the weights in the underlying broad market index. As such, the benchmark had a relatively high weighting to technology, which was the best performing sector, and a relatively low weighting to consumer staples, which was the worst performing sector.

For the full year of 2023, the Low Volatility factor underperformed relative to the market. We note that the low volatility factor has generated a positive premium in every decade since 1929, with a higher level of statistical significance than the other factors (according to Blitz, van Vliet and Baltussen - The Volatility Effect Revisited).

During 2023, Consumer Staples remained the Fund’s largest weighting. Despite its negative return, the Fund’s holdings in this sector outperformed relative to the benchmark. Costco Wholesale was the top performer within the sector as well as the Fund (+50.0%). Information Technology and Consumer Discretionary posted double-digit returns and significantly outperformed relative to the benchmark, thanks to the inclusion of Garmin (+25.2%) and NXP Semiconductors (+48.4%). An overweight in Utilities and Materials resulted in positive returns and outperformance relative to the benchmark. No exposure to Real Estate benefited the Fund performance, as the sector was under pressure due to rapidly increasing interest rates.

Energy and Financials were underweight in the Fund, where they posted positive absolute returns but failed to beat the benchmark. The Fund was overweight Communication Services, which lagged the benchmark performance. In addition, Healthcare was market weight and Industrials was underweight in the Fund, both of which underperformed relative to the benchmark with negative absolute returns.

Annual Compound Returns <sup>1</sup>	1-YR	3-YR	Since Inception <sup>2</sup>
Brompton North American Low Volatility Dividend ETF	(1.1%)	3.4%	5.8%
MSCI USA Minimum Volatility Gross TR USD Index	9.8%	6.5%	9.3%
S&P/TSX Composite Index	11.8%	9.7%	12.5%

(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 MSCI USA Minimum Volatility Index ("MSCI Index") and the S&P/TSX Composite Index ("Composite Index" (together the "Indices"). The MSCI Index captures the investment results of an index composed of U.S. equities that, in the aggregate, have lower volatility characteristics relative to the broader U.S. equity market. 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 an actively managed portfolio consisting of equity securities of North American issuers with a market capitalization of at least \$5 billion. It is therefore not expected the Fund's performance will mirror that of the Indices. 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 April 30, 2020.

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#### Investor Relations

PHONE 416.642.6000  
TOLL FREE 1.866.642.6001  
FAX 416.642.6001  
EMAIL [info@bromptongroup.com](mailto:info@bromptongroup.com)

#### Website

[www.bromptongroup.com](http://www.bromptongroup.com)

#### Address

Bay Wellington Tower,  
Brookfield Place  
181 Bay Street  
Suite 2930, Box 793  
Toronto, Ontario M5J 2T3