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Brompton North American Low Volatility Dividend ETF

Portfolio Manager Commentary - March 31, 2025

Global Markets Review

It was a turbulent first quarter for Global equity markets, marked by a sharp divergence between the U.S. and international indices. Tariff fears have introduced significant uncertainty into global markets. U.S. tech stocks, especially mega-cap AI names, sank after a Chinese AI developer released DeepSeek, which raised questions on capital investments into AI infrastructure. Overall, the MSCI World Index was down 1.7%, with Energy being the best performing sector. In North America, the S&P 500 declined 4.3%, with Consumer Discretionary and Information Technology underperforming, while Energy was the best performing sector. The S&P/TSX Composite gained 1.5%, buoyed by the Materials sector on the back of gold rally. Conversely, Europe was one of the better performers among major equity markets, with the STOXX 600 up 5.9%. Spain, Italy, and Germany were the main contributors, gaining 14.0%, 11.8%, 11.3%, respectively, while Switzerland, the U.K., and France all finished the quarter in positive territory, up 10.0%, 6.1%, 5.8%, respectively.

As inflation continued to moderate, global central banks have slowed the pace of easing during the quarter. However, Trump's aggressive tariff policies are likely to raise uncertainty around inflation expectations and overshadow the trajectory of rate cuts. In the U.S., inflation came in at 2.8%, while the unemployment rate remained relatively low at 4.1% as of February. Meanwhile, manufacturing PMI entered March at 49, a sign of contraction, after being above 50 for only two consecutive months. In bond markets, the U.S. 10-year Treasury yield fell from 4.57% to 4.21% for the 3-month period, while the Canadian 10-year and most European 10-year yields largely mirrored U.S. Treasuries. The exception was Germany, where the country's 10-year yield spiked in early March after the new government proposed a sizeable infrastructure and defense spending plan that surprised the market. In equities, value outperformed growth for both large caps and small caps, as investors rotated out of sectors such as Information Technology and Consumer Discretionary and into defensive sectors such as Consumer Staples and Utilities. We have also seen bifurcation of performance among regions, where Europe outperformed the U.S.

The Federal Reserve (Fed) kept interest rates unchanged at 4.25-4.50% range in both January and March, while Fed Chair Jerome Powell highlighted elevated uncertainty due to President Trump's tariffs on imports, which are expected to lift inflation and slow economic growth. The Fed downgraded their projections for 2025 economic growth to 1.7% (down 0.4 percentage points from their previous projection), while inflation expectations rose to 2.8% (up 0.3 percentage points from their previous estimate). Powell also stressed the need for patience as tariffs could delay progress toward the 2% inflation target. By the end of March, the Fed Funds Futures have priced in three additional 25 bps rate cuts in 2025. Nevertheless, it would be challenging for the Fed to resume rate cuts until there is more visibility on tariffs and their impacts on inflation and unemployment.

The Bank of Canada (BoC) reduced its overnight policy rate to 2.75% after two 25bps cuts in in the first quarter. Governor Tiff Macklem warned that tariffs would reduce economic efficiency, hurt GDP growth, and increase costs for imported goods. He also emphasized that monetary policy could not fully offset the negative effects of a trade war but noted that past rate cuts had supported housing and consumption. Due to trade tensions and tariff threats, job growth in Canada stalled in February as businesses reduced hiring plans. Investment activities remained muted, particularly in the manufacturing sector. Rising import costs and excess supply pressures from reduced U.S. demand for Canadian goods continue to weigh on the already fragile economic fundamentals.

The European Central Bank (ECB) cut its benchmark interest rate by 25 bps at both the January and March meetings, bringing the rate to 2.65%. President Christine Lagarde indicated that monetary policy was becoming "meaningfully less restrictive" in March. This tone change means policymakers will become more cautious about further rate cuts. Recent credit data indicates that bank lending to corporates and households shows promising signs of acceleration. Unsurprisingly, the central bank raised the concern that escalation of a trade war would dampen European exports and drag down investments. Meanwhile in Germany, the new government proposed a momentous defense and infrastructure spending plan, which has been approved by both houses of parliament. This fiscal package allows defense spending above 1% of GDP to be exempted from the debt brake and offers greater borrowing flexibility at both federal and state levels. Additionally, the plan includes €500 billion infrastructure spending over 12 years. In response, the Germany's DAX index rallied, buoyed by aerospace and defense stocks.

The first quarter of 2025 started with a continuation of market complacency we observed in 2024. However, mega-cap tech names, especially AI stocks, sold off following the release of DeepSeek's lower-cost open-source AI model. This development disrupted the competitive landscape of the AI industry and shifted investor sentiment. Soon after, concerns over tariffs and escalating trade tensions dominated market headlines, further dampening sentiment. Unlike the tariff policies during Donald Trump's first term as president, the current measures are broader in scope and target a wider range of industries and countries. Allies such as Canada and Mexico, who were not targeted with broad-based tariffs during Trump's first term, were initially hit with 25% tariffs on all goods except certain Canadian Energy imports, which were to be taxed at 10%. Later, all goods that are USMCA-compliant were exempted from the tariffs. Beyond North America, the Trump administration also introduced 25% tariffs on global imports of certain products such as steel & aluminum and was evaluating adding them on copper, semiconductors, pharmaceuticals, and automobiles. As of March 31, President Trump has issued tariffs against Canada, Mexico, China and the European Union. While some of these tariffs have been delayed for a negotiating period, the outlook for global manufacturing activities and consumer confidence are deteriorating.

Looking forward to the rest of 2025, in our view, the tariff fears will continue to weigh on the global economic outlook, as these policies complicate central banks' monetary decisions, overshadow corporate earnings, and erode consumer confidence. Equity valuations are at risk of contraction, but this also means some stocks could present attractive investment opportunities, as they trade at even more compelling valuations while their fundamental business strengths remain intact. From a portfolio construction perspective, the prevailing market uncertainty underscores the importance of maintaining a well-diversified portfolio that spans multiple sectors and geographies. In this climate, we favour a more defensive portfolio and prefer companies that are less exposed to tariffs and demonstrate resilience during economic turbulence.

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 Q1 2025, the Fund was up 8.3%, outperforming the benchmark (MSCI USA Minimum Volatility Total Return Index) which was up 5.9%.

For the quarter, the Low Volatility factor outperformed 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 (August 26, 2019)).

The portfolio's performance was notably enhanced by our picks in Consumer Staples, Industrials and Financials. Amid rising economic uncertainty and recession risk, we have observed a notable investor rotation towards more defensive sectors, such as Consumer Staples. Within Staples, we remain overweight in grocery retailers, supported by the tailwinds of declining inflation and lower interest rates. In Industrials, we maintain a significant allocation to waste management companies, which are considered defensive due to their ability to perform well across economic cycles, benefiting from inflation-plus pricing and strong cash flow generation. Within Financials, our positions in exchanges have delivered strong results as heightened market volatility drove increased trading volumes, while our insurance holdings outperformed thanks to firmer pricing and their relative insulation from tariffs, prompting further investor rotation into these names.

The portfolio was negatively impacted by our picks in Technology, as investors rotated out of this higher beta sector. This shift was initially triggered by the emergence of DeepSeek, a Chinese AI model that significantly reduced computing costs, leading to sharp declines in stocks tied to AI and data centers. Compounding this was a broader sell-off in high-performing equities as President Trump started to unveil his tariff plans, heightening recession fears and prompting investors to pivot toward defensive sectors.

Annual Compound Returns[1]	YTD	1-YR	3-YR	Since Inception[2]
Brompton North American Low Volatility Dividend ETF	8.3%	11.1%	3.6%	8.3%
MSCI USA Minimum Volatility Gross Total Return Index	5.9%	14.0%	8.3%	11.4%
S&P/TSX Composite Total Return Index	1.5%	15.8%	7.8%	14.0%

(1) Returns are for the periods ended March 31, 2025 and are unaudited. The table shows the Fund's compound returns for each period indicated compared with the MSCI USA Minimum Volatility Total Return Index ("MSCI Index") and the S&P/TSX Composite Total Return 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 and total return business, 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 unit and assumes that cash distributions made by the Fund during the periods shown were reinvested at net asset value per unit in additional units of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future.

(2) Inception date April 30, 2020

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