Brompton North American Low Volatility Dividend ETF

BROMPTON FUNDS

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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.

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. In Q1, BLOV was down 0.6% versus the benchmark (MSCI Minimum Volatility USA) which was up 2.3%.

The Fund was significantly overweight the Consumer Staples sector relative to the benchmark, which did not overly detract from performance. Top performing holdings include Loblaw (+14%), Archer Daniels Midland (+14%) and Hormel (+4%). The Fund also benefited from an overweight position in Consumer Discretionary, which contributed to performance though lagged the benchmark. Top performing holdings include Target (+12.6%). A market weight position in Communication Services also contributed to Fund's performance versus the benchmark. Top performing holdings include BCE (+7.3%) and Telus (+1.8%).

The Fund was overweight Utilities, which contributed to outperformance relative to the benchmark. Top performers include Brookfield Infrastructure (+9.1%). An underweight position in Information Technology detracted from the Fund's performance relative to the benchmark with its holding in Apple down 7.8% given factor rotation away from growth momentum. The Fund was underweight Healthcare, which contributed to outperformance relative to the benchmark. Top holdings include Johnson & Johnson (+5%) and Amgen (+3%). An overweight position in Materials through holdings in Franco Nevada underperformed the benchmark.

For the first time in over a decade, the low volatility factor underperformed all other factors except for value. In Q1, the Low Volatility factor continue to underperform though the momentum factor lagged behind given extreme factor rotation in the quarter. In our view, this short-term data point does not signify a trend neither an inflection point given the historic performance of Low Volatility. 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). We expect the Low Volatility factor to mean revert to its historical premia over time as excessive risk taking by investors makes Low Volatility equities underpriced, which bodes well for long-term risk-adjusted returns.

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