Brompton Flaherty & Crumrine Investment Grade Preferred ETF **BPRF**

Brompton Flaherty & Crumrine *Enhanced* Investment Grade Preferred ETF **BEPR**

Portfolio Manager Commentary - December 31, 2024

Market and Credit Environment

Despite a weaker fourth quarter, the preferred market experienced very strong performance in 2024, building on a recovery that began in late 2023. Interest rates remain well off the highs of late-2023 and, importantly, the yield curve has returned to a more normal shape with short-term interest rates once again below intermediate- and long-term rates. Although the Federal Reserve has struck a more cautious tone recently regarding additional rate cuts, it is difficult to look back at 2024 and be disappointed with performance.

One of the most impressive aspects of credit markets has been the resiliency of prices in the face of interest rate volatility. Interest rate volatility was elevated throughout the year as the 10-year Treasury traded in a range of over 100 basis points from peak to trough and reached peak and trough levels two separate times during the year. Credit markets rallied on lower Treasury rates and only sold off slightly on higher rates. Substantial spread tightening (vs Treasuries) across credit markets, including investment-grade (IG) corporate bonds, high-yield (HY), and preferreds, dampened the impact of interest rate volatility in Treasuries and resulted in consistently positive price performance. While we see only limited scope for narrower spreads from here, we do not expect significant widening either given solid credit metrics and ongoing demand from investors for income.

The preferred market is heavily concentrated in "financial" issuers, notably banks. Markets began 2024 with ongoing skepticism of the banking industry given several bank failures in the prior year. With each passing quarter, however, banks continued to show their resilience with strong earnings and healthy capital levels – demonstrating the worst ills of 2023 were limited to a handful of institutions. An economic "soft landing" should serve to extend this period of robust earnings and stable to improving credit metrics. Bank common stocks are up as much as 25% in 2024, and confidence in bank issuers of preferred stocks has similarly improved.

Bank preferred issuance has been very limited, and this year's net supply (issuance net of redemptions) is negative. The regional bank problems in 2023 widened spreads and dampened investor interest in the sector. In most cases, regional banks couldn't issue at economic levels, and many had other operational priorities to address during this time. Further, ongoing negotiations on Basel III Endgame regulations had caused larger banks to delay redemptions in favor of retaining additional capital to meet potentially higher capital requirements. It appears these regulations will be moderated significantly, and, therefore, larger banks have been actively redeeming callable preferreds (especially those with expensive floating-rate coupons). Bank spreads have tightened, however, offering attractive issuance levels for most banks – and the market is open once again to regional banks. Bank balance sheet growth remains tepid, so issuance should remain muted (mostly refinancing), but regulatory needs remain a possible catalyst for additional issuance when final Endgame rules are adopted and a timetable for implementation is known.

As we observed last quarter, one of the bigger developments of the year was a resurgence of issuance of taxable preferred securities from non-bank issuers – notably utility and energy companies. This structure has long been part of the broader preferred market, but issuance has been low for quite some time. Utilities have greatly expanded their capital expenditure budgets for coming years, largely due to expected demand from technology companies (i.e., AI data centers), and, therefore, have an increased need for capital. Issuance in 2024 was materially higher than previous years, and we expect this to continue in 2025 and 2026.

Outlook

Looking ahead, we think the U.S. will experience an economic "soft landing" with modest growth and gradually falling inflation. If so, the Federal Reserve should cut rates by another 50-75 bp in 2025, which is close to current market expectations. However, tariffs and/or fiscal policy could push inflation materially higher and prompt the Fed to keep rates on hold or even raise them. Intermediate- and long-term Treasury yields should fall modestly from current levels in the soft-landing scenario but likely would rise, perhaps significantly, if deficit projections worsen or inflation expectations become unanchored. While we view the latter scenarios as risks, we expect the more likely outcome to be a benign market environment for preferred investors that delivers attractive income and perhaps some modest price gains over the coming year—just expect some bumps along the way.

Overall, we remain constructive on the preferred market, although admittedly spreads have compressed throughout the year. Relative to IG and HY, however, preferreds continue to offer additional spread that is difficult to find in other sectors without also increasing credit or duration risk. Given relatively narrow spreads, lower interest rates may be required for total returns to exceed just coupon income this year. However, market technical factors remain strong, and credit markets could eventually attract some of the very large balances still held in money-market funds. While the Fed has delivered a total of 100 basis points of rate cuts so far, it remains unclear how the economy and inflation will progress in the near term and what impact they will have on the pace of an easing cycle. In the meantime, the preferred market provides much-needed income for investors.

Annual Compound Returns[1]	**1-YR**	**3-YR**	**5-YR**	**10-YR**	**S.I. BPRF[2]**	**S.I. BPRF.U[3]**
BPRF - Brompton Flaherty & Crumrine Investment Grade Preferred ETF (CAD-H)	10.7%	0.7%	2.2%	-	3.9%	-
BPRF.U - Brompton Flaherty & Crumrine Investment Grade Preferred ETF (USD)	11.0%	0.8%	2.9%	-	-	3.7%
ICE BofAML 8% Constrained Core West Preferred & Jr Subordinated Securities Index	9.6%	0.9%	2.8%	-	4.5%	3.4%

Annual Compound Returns[4]	**1-YR**	**3-YR**	**5-YR**	**10-YR**	**S.I. BEPR[5]**	**S.I. BEPR.U[6]**
BEPR - Brompton Flaherty & Crumrine *Enhanced* Investment Grade Preferred ETF (CAD)	13.5%	-0.7%	1.0%	4.3%	4.9%	-
BEPR - Brompton Flaherty & Crumrine *Enhanced* Investment Grade Preferred ETF (USD)	17.6%	-	-	-	-	1.6%
ICE BofA Indices	9.6%	0.9%	3.0%	4.7%	5.2%	2.1%

[1] Returns are for the periods ended December 31, 2024 and are unaudited. The table shows the Fund's compound return for each period indicated compared with the ICE BofA 8% Constrained Core West Preferred & Jr Subordinated Securities Index, (the "Index"). The Index tracks the performance of US dollar denominated high grade and high yield preferred securities and deeply subordinated corporate debt issued in the US domestic market. Qualifying securities must be rated at least B3, based on an average of Moody's, Standard & Poor's and Fitch and have a country of risk of either the U.S. or a Western European country. The Fund is actively managed; therefore, its performance is not expected to mirror that of the Index, which has a more diversified portfolio and includes a substantially larger number of companies. Furthermore, the Index 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 CAD and USD unit and assumes that cash distributions made by the Fund during the periods shown were reinvested at net asset value per CAD and USD unit in additional units of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future.

[2] BPRF inception date October 15, 2018.

[3] BPRF.U inception date August 8, 2019.

[4] Returns are for the periods ended December 31, 2024 and are unaudited. The table shows the Fund's compound return for each period indicated compared with the Fund's benchmark index ("ICE BofA Indices"). Effective December 1, 2022, the Ice BofA Indices is composed solely of the ICE BofA 8% Constrained Core West Preferred & Jr Subordinated Securities Index ("P8JC"), which took effect December 1, 2021. P8JC tracks the performance of US dollar denominated high grade and high yield preferred securities and deeply subordinated corporate debt issued in the US domestic market. Qualifying securities must be rated at least B3, based on an average of Moody's, Standard & Poor's and Fitch and have a country of risk of either the U.S. or a Western European country. For the period April 1, 2012 to November 30, 2021, the Fund used the benchmark ICE BofA 8% Constrained Non-DRD Eligible Core West Preferred & Jr Subordinated Securities Index ("P8JN"), while for the period since inception on December 15, 2004 to April 1, 2012, the Fund used a 50/50 split of the ICE BofA Hybrid Preferred Securities 8% Constrained Index ("P8HO") and the ICE BofA US Capital Securities US Issuers 8% Constrained Index ("C8CT"). P8JN is a subset of P8JC that includes only non- DRD eligible preferred securities. P8HO includes taxable, fixed rate, US dollar denominated, investment grade preferred securities listed on a US exchange and are structured for retail investors, while C8CT includes investment grade, fixed rate or fixed to floating rate $1,000 par securities that are structured for the institutional investors and receive some degree of equity credit from the rating agencies or their regulators. ICE BofA Indices are not leveraged, whereas the Fund employs leverage. The Fund is actively managed; therefore, its performance is not expected to mirror that of the Ice BofA Indices which have more diversified portfolios and include a substantially larger number of companies. Furthermore the Ice BofA Indices performance is calculated without the deduction of management fees, fund expenses and trading commissions, whereas the performance of the Fund includes the impact of leverage and is calculated after deducting such fees and expenses. The performance information shown is based on net asset value per CAD and USD unit and assumes that cash distributions made by the Fund during the periods shown were reinvested at net asset value per CAD and USD unit in additional units of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future.

[5] BEPR inception date December 15, 2004.

[6] BEPR.U inception date February 4, 2022.

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