Brompton European Dividend Growth ETF (TSX: EDGF)

BROMPTON FUNDS

Portfolio Manager Commentary - March 31, 2024

Global Markets Review

Global Equity markets started the first quarter of 2024 with strong performance, robust corporate earnings and a surge in artificial intelligence investment sending major indices to all-time highs. Meanwhile, the economic backdrop remains resilient, as inflation eased from pandemic levels. Central banks in major developed economies kept their policy rates unchanged waiting for more data to confirm low inflation readings before starting rate cuts. All in all, the MSCI World Index gained 9.0%. In North America, the S&P 500 rose 10.6%, as Communication Services (+15.8%) and Energy (+13.7%) were the best-performing sectors in the quarter. The S&P/TSX Composite Index was up 6.6%, buoyed by Healthcare and Energy. In Europe, the STOXX 600 registered a 7.8% return for the first quarter. Italy FTSE MIB and Spain IBEX 35 gained 15.1% and 10.6%, respectively. Germany, France, Switzerland, and the U.K. all finished the period in the positive territory, up 10.4%, 9.0%, 6.8% and 4.0%, respectively.

Global economic data suggests the trajectory of inflation should continue dominating the timeline of monetary easing. U.S. inflation has materially come off the peak since mid-2022 to 3.2% for the February 2024 reading. However, it has remained stubbornly high above 3% over the past 9 months, further evidence of inflation's nonlinear downward trend. The labour market remains tight, supported by the historically low unemployment rate (3.9% in February). In this sense, the U.S. economy is on its way to heading towards low inflation without imminent recession. Meanwhile, manufacturing PMI entered February at 47.8, an indication of contraction when the number is below 50. The bond markets finished slightly down in the first quarter. The U.S. 10-year treasury yield started the year below 4% and finished the quarter over 4.2%, as uncertainties surrounding the inflation outlook led to a delay in immediate rate cuts. The spread between 10-year and 2-year treasury yields widened during the first quarter. Other global bond performances such as U.K. Gilt and German Bund also mirrored the U.S. treasury. Growth continued outperforming value for both large cap and small cap, on the back of the AI hype and peaking interest rates. Communication Services and Information Technology were still the main contributors to the broader equity market performance, while the Energy sector caught up with the oil price rally in March and became one of the best performers in the quarter.

During the first quarter, global central banks in developed economies remained dovish towards their monetary policy while remaining patient in making policy shifts amid sticky inflation. The Federal Reserve (the "Fed") left interest rates unchanged in the 5.25%-5.5% range in January and March Federal Open Market Committee ("FOMC") meetings. In the March FOMC meeting, the Fed Chair Jerome Powell reaffirmed the central bank's intention to cut interest rates before the end of this year. Meanwhile, the FOMC raises its 2024 GDP growth forecast meaningfully by 0.7 percentage points to 2.1%, mainly driven by robust labour supply recovery. Encouraged by the Fed's dovish messaging and broadly falling inflation, the Fed funds futures market is pricing in two quarter-point rate cuts this year, with the first reduction in July. However, compared to six 25-basis-point cuts forecast at the beginning of the year, the market consensus was overly optimistic at that time. We might see the next cuts pushed out even further if the current macro mix of inflation and labour markets holds.

The Bank of Canada (BoC) kept the overnight policy rate at 5% in the March meeting. The BoC communicated that it is "too early to consider lowering the policy rate", ruling out the possibility of a rate cut in the upcoming April and June meetings. The central bank was still concerned about the inflation outlook and signaled that they want to see "further and sustained easing in core inflation". At the same time, the Canadian economy has shown clear signs of weakness against a backdrop of declining labour productivity. The number of active businesses showed its first annual decline since 2017, excluding COVID periods. Eight out of ten provinces reported active business contraction year over year. Given the current policy rate levels, the situation is unlikely to alleviate in the coming months.

The European Central Bank ("ECB") left the benchmark interest rate unchanged at 4.5% in the March meeting. The Governing Council noted that "most measures of underlying inflation have eased further". President Christine Lagarde also highlighted that inflation is making good progress towards target and that the Governing Council is gaining confidence that inflation will return to 2%. However, the pace of cuts remains uncertain. Recent inflation readings in the Euro Area suggest that Energy and food costs have dropped, although inflationary pressure in the region remains high, reflecting strong wage growth and rising unit labour costs. In the U.K., the Bank of England (BoE) also held the policy rate unchanged at 5.25% and turned more dovish than previous meetings, noting that inflation is moving in the right direction and that labour has continued to loosen. Recent economic data release confirmed that wage growth and services inflation have come down notably.

Upbeat market sentiment persisted in the first quarter of 2024, amid mild inflation and strong corporate earnings. According to Bloomberg, more than 75% of S&P 500 companies reported earnings that beat consensus. Moreover, the U.S. broader index performance continued to be driven by Magnificent Seven (Meta, Nvidia, Amazon, Apple, Alphabet, Microsoft, Tesla). AI beneficiaries can still gain as their earnings profile looks robust. Moreover, cyclical sectors such as Industrials, Energy, and Financials have also shown more widespread and resilient growth. As the dominant weight of "big tech" skews the U.S. equity market valuations, investment opportunities have unveiled outside of the U.S. for global investors, such as Europe and Japan. The latter's Nikkei 225 registered a 20.8% return in Q1, significantly outperforming most global indices in local currency terms. A recovery in wage and inflation after decades of sluggish economic growth enabled Bank of Japan to abolish negative interest rate policy (NIRP) along with yield curve control (YCC) in March. Shunto, the spring wage negotiation between unions and employers, secured strong wage growth, which should stimulate consumer spending and allow room for monetary normalization.

As we argued in the previous quarter's macro commentary, markets were overly optimistic in pricing too many rate cuts in 2024. Most global central banks were digesting economic data during Q1, while leaving policy rates unchanged. Indeed, headline inflation across most developed economies has been falling towards central banks' 2% target, but labour markets remain tight, keeping services inflation elevated in the near term. Thus, the timing of the first rate cut will remain the key challenge to monetary policymakers. While we remain positive on the Technology sector and favor AI themes, we believe the next phase of equity market performance should include broader sector leadership. Furthermore, given global equity valuations (ex-U.S.) are at historical low relative to the U.S., we have carefully selected companies in Europe and Japan that demonstrate appealing risk-reward profiles. Furthermore, Brompton also expects increased volatility from these low levels and believes that investors will be well-served by strategies that have historically demonstrated lower volatility than the market, such as dividend growth and covered call strategies.

Portfolio Review

During Q1 2024, Brompton European Dividend Growth ETF (the "Fund") was up 10.1%. This compares to the STOXX Europe 600 Index, which was up 7.8% over the same period.

The Fund benefited from our selections in Industrials and Financials. Our top contributors were Unicredit, Safran and SAP. Our industrial picks benefitted from some large secular themes such as electrification and data center build outs. Secondly, the longer lead time for new airplanes also helped us as older planes need to run longer, benefiting aerospace engine & equipment makers with increased after-market, higher margin revenue. Our picks in financials benefitted from increased confidence in a soft landing in the European economy and higher comfort that a major credit event is unlikely to occur. Add to that the lower valuations of financial stocks over the last year.

Our underweight in Materials and Energy and overweight in Real Estate partially detracted from our performance. Energy and Commodities had a strong quarter, as the markets priced in higher expected inflation. With the economy being stronger than initially anticipated, the demand for commodities was strong. In addition, with expectations for higher data center build outs, copper had a strong quarter. On the back of this stronger economy and higher inflation, interest rate sensitive stocks such as those in Real Estate performed poorly with the expectation for fewer rate cuts this year.

During the quarter, we added to positions in Financials and Communication Services. European financials remain attractively valued supported by the end of negative interest rate era.

Laura Lau, CIO

Michael D. Clare, SVP & SPM

Annual Compound Returns[1]	YTD	1-YR	3-YR	5-YR	Since Inception[2]
Brompton European Dividend Growth ETF	10.1%	15.8%	5.5%	8.1%	6.8%
STOXX Europe 600 Index	7.8%	15.8%	9.6%	9.7%	7.8%
S&P/TSX Composite Index	6.6%	14.0%	9.2%	10.0%	9.1%

(1) Returns are for the periods ended March 31, 2024 and are unaudited. The table shows the Fund's compound return for each period indicated compared with the STOXX Europe 600 Index ("Stoxx Index") and the S&P/TSX Composite Index ("Composite Index"), (together the "Indices"). The STOXX Index is a subset of the STOXX Global 1800 Index. With a fixed number of components, the STOXX Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Demark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. Since the Fund is actively managed, the sector weightings may differ from those of the STOXX Index. 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 Indices are calculated without the deduction of management fees, 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 July 21, 2017.

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