Brompton European Dividend Growth ETF (TSX: EDGF)

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - DECEMBER 31, 2019

European Markets Review

Global markets finished the year with strong performance. Almost all stock markets and asset classes enjoyed double digit returns for 2019. The MSCI World Index gained 28.4% with the Information Technology sector as the best performing sector, gaining 48.1% during the year. In Europe, the STOXX 600 returned 27.7% for the year, led by France and Switzerland, where the CAC 40 and SMI were up 30.5% and 30.2%, respectively. Germany's DAX Index gained 25.5% amid concerns over slowing economic growth, while Spanish and U.K. equities also finished the year with double digit gains as the IBEX 35 increased 16.5% and the FTSE 100 returned 17.2% for the year. In terms of European sectors, cyclical sectors generally outperformed defensive sectors for the period as trade-war and Brexit concerns subsided towards the end of the year, while Financial Services, which was up 43.6%, and Construction and Materials, which was up 40.9%, were the top performing sectors. Communication Services, a defensive sector, underperformed while still earning positive returns during the period.

According to the latest forecast by the International Monetary Fund, the global economy is expected to grow 3.4% in 2020, a modest pickup from 2019's projected growth rate of 3.0%. Growth expectations were driven by a few topical issues. At the top of the list is progress on the U.S.- China trade war. During the month of December, expectation of a phase one trade deal between the U.S. and China partially alleviated long standing trade tensions between the two nations. As part of the trade deal, tariffs that were set to take effect on December 15th on about US$160 billion of consumer goods were averted; in exchange, China was expected to increase its purchases of American farm goods. The trade deal demonstrated compelling evidence of progress made by both sides and renewed market participants' confidence in global growth. Second, employment numbers and jobless claims are being closely monitored by investors for any signs of weakness. Employment and consumption continue to be robust and jobless claims remain at decade lows as service sectors across the globe kept labour markets buoyant and wage growth healthy. Lastly, Brexit-related fears subsided towards the end of 2019 after the U.K. held its third general election in four years in December, which resulted in Boris Johnson's Conservative party securing a parliamentary majority. We expect progress to be made on Brexit negotiations before the January 31 deadline and we anticipate 2020 to be a year of transition for the U.K.

Market performance and sentiment were also driven by central bank policies in 2019. In Europe, Christine Lagarde assumed office on November 1, succeeding former European Central Bank (the "ECB") President Mario Draghi. During 2019, the ECB cut deposit rate by 10 basis points to minus 0.5%. The ECB has also resumed its quantitative easing program in November purchasing bonds at a rate of €20 billion a month for as long as necessary to hit its inflation goal of just below 2%. Inflation averaged 1.2% in 2019. During the most recent policy meeting in December, Lagarde said the Eurozone's economic slowdown is showing signs of bottoming out. She believes risks impacting the Euro area growth outlook, including geopolitical factors, rising protectionism and emerging market vulnerabilities, have become less pronounced.

Looking forward to 2020, we expect growth in European economies to be somewhat similar to 2019. On the policy front, the ECB will likely keep rates steady for 2020. Instead of implementing further rate cuts, they will likely call on governments to deliver fiscal stimulus to help boost the economy, which could result in higher bond yields. In terms of volatility, geopolitical tensions in the Middle East could be a source of volatility that we'll be paying close attention to.

Portfolio Review

During 2019, Brompton European Dividend Growth ETF (the "Fund") gained 34.8%, significantly outperforming the STOXX Europe 600 Index, which was up 27.7%.

The Fund benefitted from overweight positions in Health Care and Information Technology during the year. Koninklijke Philips (up 42.3%), AstraZeneca (up 35.7%) and Medtronic (up 27.3%) were top contributors to its outperformance among the Health Care constituents. We continue to overweight Health Care given high growth prospects exhibited by pharmaceutical and medical device companies within the sector. Particularly, we believe AstraZeneca is poised to post double digit EPS growth driven by its strong cancer drug performance. Other large pharmaceuticals including GlaxoSmithKline, Novo Nordisk and Sanofi are also expected to deliver mid to high single digit growth in 2020. Within Information Technology, we have a favourable outlook on semiconductors heading into 2020. We hold market leaders within this high-barrier-to-entry sector including ASML and STMicroelectronics, who should benefit from the inflection point reached in the semiconductor cycle.

Our underweight position in Financials also contributed to the Fund's outperformance. Record low long-term yields in Europe and Brexit uncertainty pressured European banks and lifecos for much of 2019. Within the sector, we pivoted towards owning stock exchanges, whose performance typically correlates to volatility levels in the market. London Stock Exchange (up 93.0%) had one of the largest contributions to the Fund's outperformance. The stock soared upon announcement of its takeover bid for Refinitiv, which is expected to shift London Stock Exchange's business mix away from being tethered to trading volume and towards information services.

During the last quarter, we have made several adjustments to the portfolio as global equities experienced a rotation towards value and cyclical stocks. Ten-year treasury yields in major European countries bottomed out in the latter half of the year. Consequently, we trimmed the Fund's positions in Consumer Staples, and added cyclical names in Consumer Discretionary, Financials and Industrials. First, Consumer Staples names including Nestle, Danone and Diageo were trimmed as these global players experienced losses in market share to more nimble competitors in the sector. We no longer find risk-reward to be attractive in these names. Secondly, luxury brands in the Consumer Discretionary sector demonstrated resilience despite ongoing geopolitical tensions in Hong Kong. We continue to overweight the sector and see global players like LVMH, Adidas and Kering being able to drive sustained growth. Thirdly, we have taken Financials to overweight with the addition of BNP Paribas, Credit Agricole and Allianz. After trading down to depressed levels, Q4 presented an attractive entry point as margin pressures began to ease. Lastly, infrastructure developers like Bouygues should be able to capitalize on growth in French construction spending driven by the Olympics. We also added International Consolidated Airlines Group given its capacity constraint driven pricing power, and Schneider Electric for a play on the energy-management and industrial digitalization theme. Post these adjustments, we believe the portfolio is well positioned to benefit from the cyclical tailwinds heading into 2020.

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Annual Compound Returns[1]	1-YR	Since Inception[2]
Brompton European Dividend Growth ETF	34.8%	9.4%
STOXX Europe 600 Index	27.7%	6.6%

1) Returns are for the periods ended December 31, 2019. The table shows the Fund's compound return for each period indicated compared with the STOXX Europe 600 Index ("Stoxx Index"). 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, Beligium, 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 STOXX Index is 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.

2) Inception Date July 21, 2017.

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