Brompton Global Healthcare Income & Growth ETF (TSX:HIG; HIG.U)

BROMPTON FUNDS

Portfolio Manager Commentary - March 31, 2023

Global Markets Review

Global equity markets registered positive returns during the first quarter of 2023, despite the global banking crisis in March that fueled a sell-off in the Financials sector. Decelerating inflation, potentially peak interest rates, and China's reopening, sent major stock indices higher. The MSCI World Index gained 7.9%. Information Technology rallied 21.2% and was the top performer, while Energy was the bottom-performing sector (-3.1%). In North America, the S&P 500 rose by 7.5%, buoyed by Information Technology and Communication Services. The S&P/TSX Composite added 4.6%, also boosted by Information Technology (+26.5%). In Europe, the STOXX 600 returned 8.6% for the quarter. Major European indices also finished the quarter in positive territory. Italy FTSE MIB and France CAC 40 gained 15.1% and 13.4%, respectively. Spain, Germany, Switzerland, and the U.K. were up 12.8%, 12.2%, 5.1% and 3.6%, respectively.

Global economic data was mixed during the quarter. Inflation has materially come off the peak since June 2022 (9.1%) to 6.0% for the February 2023 reading, supporting the market expectations that the monetary tightening cycle may end soon. Labour markets remain resilient, with unemployment rates still well below 4% and hourly wage growth decelerating. However, other major economic indicators in the U.S. warn that economic growth remains weak. Manufacturing PMI largely retreated in Q4 2022 and entered March 2023 at 46.3, an indication of contraction if readings are below 50. Global bond markets also finished up in the first quarter of 2023, even though rate volatility remained elevated. The U.S. 10-year Treasury yield broke above 4% on stickier-than-expected core inflation measures in early March 2023, but quickly dropped following the market fear of a banking crisis due to the collapse of Silicon Valley Bank. The U.S. dollar was largely weak against most G10 currencies on the Federal Reserve's more dovish tilt. Following a robust gain in Q4 2022, most equity markets continued the upward trend in Q1 2023, with investors factoring in the end of central bank tightening, deceleration of inflation, and China's reopening. Information Technology, Communication Services, and Consumer Discretionary, the three bottom-performing sectors in 2022, have recovered and gained strong momentum in Q1 2023. From a factor perspective, the decline in bond yield supported growth stocks' outperformance against value during the quarter.

Central banks in developed economies started to deliver more dovish stances of their monetary policy as inflationary pressure abated. The Federal Reserve raised interest rates by 25 basis points at both 2023 February and March Federal Open Market Committee ("FOMC") meetings, sending the target rate to the 4.75%-5.00% range. As the Fed has slowed its pace of hikes, investors expect that cooler inflation data and the turmoil surrounding regional banks should end the tightening cycle soon. The Fed funds futures market is pricing in the terminal rate at 5%, followed by around 60 basis points of cut in the second half of the year. Given that inflation readings remain well above the Fed's 2% target and additional hikes add to the banking system stress, we believe the expectations of a dovish Fed pivot will continue helping market sentiment, but a discussion on the trajectory of rate cuts is premature.

The Bank of Canada (BoC) maintained its overnight policy rate at 4.5% in March 2023. This is the first meeting that hasn't resulted in a rate increase since January 2022. Since that time, the BoC hiked at eight consecutive meetings for a cumulative tightening of 425 basis points. However, the central bank does not rule out the option to increase the policy rate further if needed to return inflation to the 2% target. With the easing of inflation, there is a higher chance that this conditional pause should be sustained, translating to a temporary relief on household debt.

The European Central Bank (ECB) continued raising the benchmark interest rate by 50 basis points at both February and March 2023 meetings to 3.5%. The Governing Council will likely keep hiking interest rates to tame inflation, as core measures reached a new record high during the quarter. The concern over financial stability (i.e. collapse of Credit Suisse) would put ECB's rate hike in a complicated position, where delaying the tightening may have a negative impact on inflation expectations, resulting in more hikes necessary at a later stage. On the positive side, energy prices should continue to moderate due to falling wholesale energy prices and government support measures. Meanwhile, the Bank of England (BoE) also stepped down its pace of tightening by a 50-basis- point increase in February 2023 and a 25-basis-point increase in March 2023 to 4.25%. The communication suggests that the Monetary Policy Committee would not maintain a bias towards tighter policy, while the upcoming decision will be fully data dependent.

The first quarter of 2023 started with a recovery rally in some of the worse performing sectors in 2022, such as Information Technology. Most central banks have slowed their paces of monetary tightening. However, the global banking industry has once again been thrown into turmoil in March with the failures of Silicon Valley Bank, Silvergate Capital, and Signature Bank in the U.S., as well as the takeover of Credit Suisse by UBS Group at the behest of regulators in Switzerland. While there were specific issues impacting each of these entities, these recent failures have highlighted the risks associated with the rapid move higher in interest rates over the past year as central banks around the world have moved swiftly to tighten policy in response to high inflation.

We continue to believe that a volatile market should persist for the rest of 2023. Inflationary pressure remains high, especially the core measures. The labour market is still tight. Share buyback black out window, Q1 earnings and subsequent economic data releases could act as a catalyst for volatility expansion. Even though many investors conclude that the systemic risk is minimal in the financial sector, any near-term development in U.S. regional banks' failure and the acquisition of Credit Suisse could still add turbulence to the market. As the timing of ending monetary tightening remains unclear among global central banks, value and growth could change leadership frequently in the rest of the year. Regardless, this inflationary environment should keep favouring companies that demonstrate resilient balance sheets, generate inflation-resistant cash, and maintain strong margin levels. Furthermore, in high volatility market regimes, strategies that lower portfolio correlations, such as investing in low volatility styles and preferred shares, should enhance risk-adjusted returns. Additionally, Brompton's ability to lean on its covered call writing program to harvest volatility risk premia augments risk-adjusted returns, lowers portfolio volatility, and aids in funding distributions.

Healthcare Sector Review & Outlook

In our view healthcare continues to be an attractively valued defensive sector that exhibits resiliency in the face of inflationary and recessionary headwinds. We believe this environment shifts funds towards cash flow generating firms and those that return capital in the form of dividends and share buybacks. We note that the pharma and biotech subsectors have one of the most stable and least volatile dividend yield profiles compared to other dividend paying industries. Many large cap healthcare stocks generate durable cash flow, due to their diverse product offerings and can maintain pricing power and pass-through costs in inflationary environments.

Large pharma companies continue to manage operating leverage given inflationary forces. While wage inflation continues to be a headwind this is more than offset by drug pricing and efficiency programs. We believe that companies that are heavily dependent on consumer discretionary spending such as personal health, aesthetics etc are likely to face sustained inflationary headwinds in the near-term. For biotech companies margins are likely to compress in our view as Research & Development ramps up and pandemic-delayed spending normalizes. Patent cliffs are expected to become a headwind for pharma companies with $390 billion sales exposed to generics (up to 170 products set to lose exclusivity) during the 2023–2030-time frame according to Bloomberg (March 24 2023). Easy-to-replicate small molecules make up about a third of the at-risk sales, while biologics represent the largest copycat opportunities.

The drug pipeline for 2023 remains robust as we expect more regulatory and commercial delivery versus late-stage readouts which dominated 2022. Key delivery includes drug treatment for diabetes, heart disease, pulmonary arterial hypertension, hemophilia and respiratory syncytial virus vaccine. Significant datasets for Alzheimer, obesity, adjuvant breast cancer and lung cancer are expected to be released in 2023 according to company reports. On the medical technology front, product catalysts (trial enrollment, clinical data and FDA approval) include renal denervation, pulse field ablation and robotic surgery.

The tailwinds that boosted managed care are likely to abate in 2023 in our view. The cost of medical care continues to increase given surgical-care utilization recovery, investment in mental health, digital and ESG initiatives. According to Bloomberg (12/1/2022), the medical-cost trend is poised to rise in 2023 and 2024 significantly above the average 6.5% annual increase over the past three years. Insurers typically increase premium rates and deductibles to offset rising healthcare costs. However, in a recession employers would likely be unwilling to accept significant increases. In addition, a recession could trigger disenrollment in commercial health insurance given the uptick in unemployment. Medicare remains the only health-insurance program providing directional enrollment stability due to the continued aging population.

We continue to believe that healthcare offers an attractive risk/reward opportunity. Demand for healthcare services continues to increase, with a growing and aging population enjoying longer lifespans. In addition, continued innovation in the sector drives the introduction of new treatments for more complex diseases and expanding market opportunities for healthcare companies. We believe stocks in our portfolio are well positioned in their respective end markets, driving growth and durable cash flow. Our active management approach allows us to capture factor rotations given the dynamic macro backdrop.

Portfolio Review

Brompton Global Healthcare Income & Growth ETF (the "Fund") was down 4.8% in Q1 versus the MSCI World Health Care Index which was down 1.4%. The Fund was market weight the pharmaceuticals subsector with performance slightly lagging the benchmark. Top holdings include Novo Nordisk (up 18.5%), Astrazeneca (up 4%) and Zoetis (up 3%). A market weight exposure to Managed Care did not overly detract from performance relative to the benchmark. Our holdings were in-line with the benchmark, with our top performer Centene ahead (down 9%). The Fund was underweight Healthcare Distributors with performance lagging the benchmark. Our top holding was McKesson (down 5%). An underweight exposure to Biotechnology detracted from performance which lagged the benchmark. Our top holding was Abbvie (down 0.4%). In Life Sciences, the Fund was market weight with performance lagging the benchmark. Our top performer was Thermo Fisher (up 0.1%) and Lonza (down 0.9%). An overweight exposure in Healthcare Services negatively affected performance relative to the benchmark, with our holdings in CVS and Cigna lagging the benchmark. The Fund was overweight Healthcare Equipment, which contributed to performance which was ahead of the benchmark. Top holdings include Stryker (up 17%), Boston Scientific (up 4.4%) and Dexcom (up 1.5%).

Annual Compound Returns[1]	1-YR	1-YR	3-YR	5-YR	Since Inception[2]	Since Inception[3]
Brompton Global Healthcare Income & Growth ETF (CAD Hedged)	(4.8%)	(10.8%)	7.9%	6.7%	5.4%	-
Brompton Global Healthcare Income & Growth ETF (USD)	(4.6%)	(10.7%)	8.4%	-	-	4.5%
MSCI World Health Care Index	(1.4%)	(3.2%)	13.2%	10.7%	9.0%	11.4%
MSCI World Index	7.9%	(6.5%)	17.0%	8.6%	10.2%	10.2%

(1) Returns are for the periods ended March 31, 2023 and are unaudited. The table shows the ETF's compound return compared for each period indicated compared with the MSCI World Health Care Index ("Health Care Index") and the MSCI World Index ("MSCI Index") (together the "Indices"). The Health Care Index represents the healthcare industry group of the MSCI World Index. The MSCI Index captures large and mid-cap representation across 23 Developed Markets countries and covers approximately 85% of the free float-adjusted market capitalization in each country. The ETF invests in at least 15 large-capitalization healthcare companies. It is not expected that the ETF's performance will mirror that of the Indices, since the Health Care Index contains a substantially larger number of companies and the MSCI Index is more diversified across multiple industries. Further, the Indices are calculated without the deduction of management fees, fund expenses and trading expenses, whereas the performance of the ETF is calculated after deducting such fees and expenses. Past performance does not necessarily indicate how the ETF will perform in the future. The information shown is based on Net Asset Value per unit and assumes that distributions made by the ETF on its units in the period shown were reinvested at Net Asset Value per unit in additional units of the ETF.

(2) Inception Date September 24, 2015.

(3) Inception Date August 8, 2019.

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