Portfolio Manager Commentary - June 30, 2023

Canada Market Review

In Canada, the Bank of Canada ("BoC") delivered a hawkish surprise by lifting the overnight policy rate to 4.75% in June (a 25-basis-point increase). This marks the resumption of the tightening cycle that was held off since January. The decision was made based on stronger-than- expected economic growth, housing market rebound, CPI uptick and a tight labor market. BoC's communication suggests that more rate hikes would be needed to tame inflation, increasing the pressure on household debt.

Looking forward to the back half of 2023, commodity prices will remain one of the key factors for Canadian equities to catch up with other developed markets. During the first half of 2023, oil prices struggled, and risk of demand headwinds continued to overhang the market. However, Energy sector fundamentals still look resilient with attractive free cash flow generation and investor-friendly capital allocation. While inflation has decelerated, above-target CPI readings, rebounding housing activities, and a tight labor market could keep BoC's policy rates higher for a longer period. Households remain constrained by higher debt-servicing costs, while labour income and excess savings are still supportive, meaning that consumer spending will remain healthy. A stabilization in revision trends and guidance will be key to restoring confidence in earnings.

Portfolio Review

Brompton Split Banc Corp. (the "Fund") invests in a portfolio consisting primarily of the six largest Canadian banks as well as up to 10% of the portfolio can be invested, from time to time, in global financial companies through an investment in Brompton North American Financials Dividend ETF ("BFIN"). BFIN is an exchange-traded fund that invests in the equity securities of North American financial services companies with a market capitalization of at least $5 billion.

In the first half of 2023, the Fund rose 1.4% versus the S&P/TSX Financials Index (+3.7%), and the S&P/TSX Equal Weight Diversified Banks Index (+3.1%). The Canadian bank index underperformed the broad market amid an unfavourable macroeconomic backdrop and mixed earnings results. Spread revenue saw a y/y double-digit growth, helped by net interest margin (NIM) expansion. Sequentially, banks such as TD and RBC witnessed NIM contraction due to continued pressure from depositors chasing higher interest rates. As BoC policy rates remain elevated and competition among banks intensifies, we expect spread revenue to moderate in the back half of this year. This is also consistent with management guidance on their segment revenue growth outlook. Loan growth decelerated during the 6-month period, with commercial and mortgage lending normalizing further, whereas credit card balances remained robust. Expenses were still elevated, reflected by wage inflation and headcount increases, which are expected to be management's focus to bring down non-interest expense growth. Moreover, provision for credit losses also edged up, reflecting further buildup of performing loan allowances. Normalized revenue, higher credit costs, sticky expenses weighed on profitability. Amid policy rate hikes and increased risks from household indebtedness, OSFI announced a higher capital buffer requirement from 3% to 3.5% in June, implying a 50-basis-point raise of the regulatory minimum CET-1 ratio to 11.5%. The near-term impact could be negative to the Big 6 Banks, as higher capital requirements are expected to slow loan growth, suppress ROE, and slow down the pace of dividend increases and share buybacks. However, with the industry CET-1 levels still well above the new regulatory requirement, Canadian banks continue to remain well capitalized. On the M&A front, TD and First Horizon Corp agreed to terminate their merge agreement amid the regional bank crisis in the U.S. Under the terms, TD will pay US$200 million to First Horizon, on top of a US$25 million reimbursement fee.

Despite near-term headwinds, we believe valuations for the large Canadian banks are still attractive for long-term investors. With P/B and forward P/E multiples trading below historical averages since 2010, Canadian banks remain well capitalized, more profitable, and run more diversified business models than their U.S. and European peers. A better visibility around the trajectory of economic outlook and inflation should also help the broad Financials sector.

The Fund was negatively affected by its holdings in BFIN, which was down 2.5% during the 6-month period. BFIN's performance was mainly dragged by the following sub-industry groups: Regional Banks, Financial Exchange & Data, Diversified Banks, Human Resources & Employment Services, as well as Investment Banking & Brokerage.

Annual Compound Returns[1]	YTD	1-YR	3-YR	5-YR	10-YR	Since Inception[2]
Brompton Split Banc Corp. - Class A	(0.8%)	(2.7%)	23.7%	5.8%	12.8%	9.9%
S&P/TSX Capped Financials Index	3.7%	5.9%	15.9%	7.8%	10.2%	8.1%
S&P/TSX Equal Weight Diversified Banks TR Index	3.1%	1.1%	16.3%	6.9%	10.6%	9.4%
S&P/TSX Composite Index	5.8%	10.6%	12.5%	7.7%	8.4%	6.8%
Brompton Split Banc Corp. - Preferred	3.1%	5.9%	5.3%	5.2%	4.9%	5.1%
S&P/TSX Preferred Share Index	0.2%	(9.0%)	5.4%	(0.3%)	0.7%	1.7%
Brompton Split Banc Corp. - Unit	1.4%	1.9%	14.3%	5.6%	9.6%	7.9%

(1) Returns are for the periods ended June 30, 2023 and are unaudited. The table shows the Fund's compound return on a Class A share, Preferred share and unit for each period indicated compared with the S&P/TSX Capped Financials Index ("Financials Index"), the S&P/TSX Equal Weight Diversified Banks TR Index ("Banks Index"), the S&P/TSX Composite Index ("Composite Index") and the S&P/TSX Preferred Share Index ("Preferred Index") (together the "Indices"). The Financials Index is derived from the Composite Index based on the financials sector of the Global Industry Classification Standard. The Banks Index is the equal-weighted version of the S&P/TSX Diversified Banks Index, a benchmark including commercial banks whose businesses are derived primarily from commercial lending operations and also have significant activity in retail banking and small and medium corporate lending. 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 ("TSX"). The Preferred Index tracks the performance, on a market weight basis, of a broad index of preferred shares trading on the TSX that meet the criteria relating to size, liquidity and issuer rating. The Fund passively invests on an approximately equal weight basis in a portfolio comprised of six Canadian banks which are in the Financials Index but may hold up to 10% of its assets in global financial services companies. Since the Indices have more diversified portfolios, it is not expected that the Fund's performance will mirror that of the Indices. The Indices are calculated without the impact of management fees, fund expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses. Further, the performance of the Fund's Class A shares is impacted by the leverage provided by the Fund's Preferred shares. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on net asset value per Class A share and per unit, or the redemption price per Preferred share and assumes that distributions made by the Fund on the Class A shares, Preferred shares and units in the periods shown were reinvested (at net asset value per Class A share and per unit, or the redemption price per Preferred share) in additional Class A shares, units and Preferred shares of the Fund.

(2) Inception Date November 16, 2005.

BROMPTON FUNDS

VALUE
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THE FOUNDATION FOR EXCELLENCE

Investor Relations
PHONE 416.642.6000
TOLL FREE 1.866.642.6001
FAX 416.642.6001
EMAIL info@bromptongroup.com

Website
www.bromptongroup.com

Address
Bay Wellington Tower,
Brookfield Place
181 Bay Street
Suite 2930, Box 793
Toronto, Ontario M5J 2T3