Financial Split Share Funds: Portfolio Manager Commentary – Q2 2020

Sector and Applicable Funds	Sector Commentary
Banks Life & Banc Split Corp. Brompton Split Banc Corp.	The Bank of Canada and the U.S. Federal Reserve have both cut rates aggressively in response to the COVID-19 induced economic slowdown. As a result, net interest margins have begun to decline and will put pressure on pre-provision profit growth over the next four quarters. Nevertheless, the Canadian banks remain profitable. The average pre-provision/pre-tax income for the Big Six Canadian banks, which is an indicator of how a bank is performing before the impact of the credit cycle, increased +3.6% for the quarter ending April 30, 2020 relative to the same quarter in the prior year. However, the average provision for credit losses ("PCL") increased by +429% from the prior year as banks increased their expectation for loan losses as a result of the economic slowdown. In spite of this massive increase in PCLs, the banks remain profitable with an average return on equity (ROE) of 12.7%, down only 291 bps from last year. The banks remain very well capitalized. The average Tier 1 Common Equity Ratio sits at 11.2% as of the quarter ending April 30, 2020, which is down only 27 bps from the same quarter last year. Even with the credit provisions, the big six banks are all comfortably above the minimum Tier 1 capital ratio of 9% mandated by the regulator. This strong capital position and continuing profitability put the banks in an excellent position to continue to pay their dividends; however, we will likely see a pause in dividend growth during this period of heightened uncertainly in the macro environment. The average dividend yield for the Big Six Canadian banks sits at 5.7% as of May 29, 2020. In terms of valuations, the Canadian banks have recently traded near lows not seen since the 2008 financial crisis. As of May 29, 2020, the banks trade a 1.2x on a P/B basis, which is well below the 5-year average of 1.6x, and the banks trade at a discount of 46% to the TSX on a P/E basis, which is also well below the 5-year average discount of 30%.
Lifecos Life & Banc Split Corp. Brompton Lifeco Split Corp.	The Canadian lifecos remain well capitalized after capital levels increased over the past several years. With the new regulatory framework OSFI implemented for the lifecos, capital levels should, in general, be less sensitive to changes in long-term interest rates. Additionally, the lifecos have been able to rely on expense initiatives, productivity gains and capital management to maintain returns in a low interest rate environment. This puts the sector in a strong position to continue to perform well despite the current macro backdrop. However, we do expect to see some headwinds over the next few quarters as a result of the COVID-19 induced economic slowdown and the decline in interest rates globally. Lifecos have recently underperformed over concerns that their investment portfolios are exposed to real estate and credit. Real estate mortgage and rental payments have been better than expected. Credit markets have stabilized with effective programs from the central banks and government worldwide. Return on equity (ROE) for the sector is expected to remain in double digits for 2020, averaging 10.7% for the Canadian lifecos, down only 153 bps from 2019. This strong capital position and continuing profitability put the lifecos in an excellent position to continue to pay their dividends; however, we will likely see a pause in dividend growth during this period of heightened uncertainly in the macro environment. The average dividend yield for the Canadian lifecos sits at 5.9% as of May 29, 2020. With the lifecos trading near all-time valuation lows, the manager believes that the sector provides a compelling opportunity when considering strong capital levels, continuing profitability, and stable and attractive dividend yields. The sector trades at a P/E of 7.7x as of May 29, 2020, which is a 61% discount to the TSX, well below the 5-year average of a 37% discount.[1]

Fund & TSX Ticker	Fund Description
Life & Banc Split Corp. LBS LBS.PR.A	A split share fund invested in an equal-weight portfolio of Canada's four largest listed life insurance companies and the Big Six Canadian banks. Class A shares provide leveraged portfolio returns. Preferred shares pay quarterly dividends and are rated Pfd-3 by DBRS.
Brompton Lifeco Split Corp. LCS LCS.PR.A	A split share fund invested in an equal-weight portfolio of Canada's four largest listed life insurance companies. Class A shares provide leveraged portfolio returns. Preferred shares pay quarterly dividends and are rated Pfd-3 (low) by DBRS.
Brompton Split Banc Corp. SBC SBC.PR.A	A split share fund primarily invested in an approximately equal-weight portfolio of the six largest Canadian banks. The portfolio may also include an allocation of up to 10% in global financial services companies. Class A shares provide leveraged portfolio returns. Preferred shares pay quarterly dividends and are rated Pfd-3 (high) by DBRS.

(1) Source: Bloomberg, as at May 29, 2020.

You will usually pay brokerage fees to your dealer if you purchase or sell shares of a Fund on the Toronto Stock Exchange or other alternative Canadian trading platform (an "exchange"). If the shares are purchased or sold on an exchange, investors may pay more than the current net asset value when buying shares of the investment fund and may receive less than the current net asset value when selling them.

There are ongoing fees and expenses associated with owning shares of an investment fund. An investment fund must prepare disclosure documents that contain key information about a fund. You can find more detailed information about a Fund in public filings available at www.sedar.com. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.

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