Brompton Tech Leaders Income ETF (TSX: TLF; TLF.U)

BROMPTON FUNDS

Portfolio Manager Commentary - December 31, 2022

Global Markets Review

The 2022 market presented investors with a challenging environment. The Russia-Ukraine war, aggressive monetary tightening, and rampant inflation fueled a rise in recessionary concerns, sending most major global indices to their worst yearly performance in decades. All in all, the MSCI World Index slumped by 17.7%. Energy significantly outperformed and was the only sector that registered positive returns during the year (+47.7%), while Communication Services was the bottom-performing sector (-36.7%). In North America, the S&P 500 dropped by 18.1% with Energy also the best-performing sector. The S&P/TSX Composite edged down 5.8%, boosted by Energy (+30.9%) and Consumer Staples (+10.1%). In Europe, the STOXX 600 lost 9.9% for the year. Major European indices also finished the year in negative territory except for the U.K. FTSE 100 (+4.6%). Spain IBEX 35 and France CAC 40 were down by 2.0% and 6.7%, respectively. Italy, Germany, and Switzerland fell by 9.4%, 12.3%, and 14.3%, respectively.

Global economic growth was challenged by elevated inflation throughout 2022. The impact from exogenous shocks, such as the Russia-Ukraine war and China's Covid restrictions, faded during the back half the year. While inflation trended down from the June high (9.1%) to 6.5% by December, other major economic indicators in the U.S. confirmed an economic slowdown. Manufacturing PMI largely retreated in Q4 and entered December at 48.4, an indication of contraction if readings are below 50. Global bond markets remained volatile during the second half of 2022. The U.S. Treasury market kept rising in response to the inflation overshoot and monetary tightening, while the 2-year and 10-year Treasury spread went deeper below zero territory. The US dollar appreciated during the first three quarters thanks to a hawkish Federal Reserve, but weakened against major currencies during Q4 amid expected moderation in further rate hikes. Meanwhile, the Bank of Japan ended the year with a hawkish surprise of widening the target range for 10-year government bond yields, which spiked to the highest levels since 2015. Most equity markets made robust gains in Q4, with investors balancing a slower pace of central bank tightening, deceleration of inflation, and reopening in China. Energy, Industrials, and Materials were strengthened during the quarter. From a factor perspective, value generated the best risk-adjusted returns for 2022, which came at the expense of growth.

Central banks in developed economies continued to deliver hawkish stances of their monetary policy to combat inflationary risks, although the pace started decelerating. The Federal Reserve dialed back to a 50-basis-point hike in December after a 75 basis-point tightening in November, sending the target rate to the 4.25%-4.50% range. As investors expect a less aggressive Fed and attempt to evaluate where the tightening cycle would end, the Fed funds futures market is pricing in 60 basis points of tightening in the first half of 2023 and at least 40 basis points of cut in the second half of the year. However, as the discussion on Fed pivot is being debated, the tone could quickly change to an even higher target rate if inflation does not moderate further and the labor market remains tight.

During the second half of 2022, the market narratives continued to focus on inflationary risks and the path of tightening. While inflation appears to have decelerated during Q4, it remains elevated and well above central bank targets. We believe it will take some time for inflation to cool due to the stickiness of things like service inflation and lagging components like shelter. The pace of interest rate increases has begun to decelerate and is expected to be more modest in 2023. Having said that, we must acknowledge the path to inflation reduction is not a linear one as there are elements of structural inflation that will likely persist in the future. These include, reversal of many globalization trends, underinvestment in infrastructure and commodities, and the cost of climate change and decarbonization. Moreover, low unemployment rates, elevated job-workers gap and higher wage growth will continue to tighten the labor market, making broader inflation more stubborn. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in April 2022, the global economy is projected to grow 2.7% for both 2022 and 2023, revised down by 0.9 percentage points lower from the April forecast. Global inflation is forecast to decline to 6.5% in 2023 and further to 4.1% by 2024.

Looking forward to 2023 in our view, while the pace of Fed tightening will not likely exceed that of 2022, the uncertainty in the mix of growth, inflation, and recession risk will be an overhang to risk assets in the first half of 2023. We believe the market is slowly beginning to price in recession scenarios, as the S&P 500 is trading at 16.5x forward earnings compared to 19x in November. While U.S. equity valuations witnessed a sharp decline in 2022, they are still trading at a premium to the rest of the world. We believe investors should continue to favor the U.S. market, which offer more stable earnings picture and stronger economic outlook than many other major developed markets. More opportunities should unfold in the back half of 2023 as additional economic data emerge to provide more clarity to the uncertainty, and when forward valuations begin to reflect probabilities of a post-recession environment.

Technology Sector Review & Outlook

The technology sector was negatively impacted by the pace of rising yields and increasing interest rate volatility, which led to a valuation re-rating. In addition, recession risk has begun to pressure top-line growth and as a result many technology companies have begun to optimize expenses and lower capex. While valuations have been re-rated downwards, recessionary risk could drive it lower in our view. We believe a rising interest rate and inflationary environment shifts risk premia towards cash flow generating firms and those that return capital in the form of dividends and share buybacks. Our portfolio is well positioned to benefit from these factor rotations given our barbell approach in actively managing over weights on growth and value styles and our preference for investing in cash flow generating tech companies versus unprofitable ones. In addition, our call writing strategy allows us to harvest volatility risk premia from our portfolio.

Global IT spending is expected to grow 2.4% to $4.5 trillion in 2023, down from 5.1% from the prior forecast according to Gartner. Growth is projected to be driven by software spending, up 9.3% and IT services up 5.5%. The device segment is expected to decline by 5% given lengthening hardware refresh cycles. High inflation, currency fluctuations, supply chain disruptions and recessionary pressures have lowered business and consumer demand for devices across the world and is set to impact the PC market the hardest. While enterprise IT spending remains stable, companies have begun to curb spending on digital growth initiatives given the economic slowdown.

The Global semiconductor market is projected to decline 5% to $604 billion in 2023 according to IC Insights. Growing uncertainty over chip demand, along with potential inventory buildups at original equipment manufacturers, supply chain shortages and lead times provides an unfavourable environment for semiconductor manufacturers. After a solid 3-year period of double-digit percentage increases in capital spending, IC Insights projects a 19% decline in 2023 give weakness in memory market demand and US sanctions on China. The US is moving to curb semiconductor technology transfer to China – companies will require licenses to export high-performance chips as well as tools/software/manufacturing process that aid in the design and manufacture of high-performance chips. Despite the headwinds of the new export restrictions, US chipmakers could still take relief from the $52 billion in federal investment to boost domestic semiconductor production under the CHIPS Act and the tax-credit plan for facilities envisaged by the FABS Act.

We believe the technology sector remains a structural growth story with valuations becoming more attractive. While recessionary pressures are a headwind to the sector in the near-term, over the long-term the digital transformation opportunity, which is underpinned by enabling technologies such as cloud, hyper connectivity (e.g. 5G), digital media, e-commerce, payments and intelligent automation, provides many avenues for growth. Disruptive emerging technologies, such as artificial intelligence and quantum computing, are expected to reshape business models and drive economic value add in the global economy. Stocks in our portfolio are uniquely positioned to benefit from this growth given their respective market position in the products and services they offer as well as degree of innovation that enhances competitive moats.

Portfolio Review

Brompton Tech Leaders Income ETF (the "Fund") was down 29% in 2022 versus the S&P 500 Equal Weighted Information Technology Index down 24%.

The Fund's overweight exposure to software and services lagged the performance of benchmark holdings. Top performing holdings include Gartner (up 5.8%), IBM (up 5.6%) and Oracle (up 2.6%).

An underweight exposure to semiconductors detracted from the Fund's performance relative to benchmark holdings. This was mainly attributed to our holdings in ASML which was down 30%.

The Fund was underweight hardware and equipment with performance ahead of the benchmark. Top performing holdings include Amphenol (down 1.2%), Cisco (down 1.3%) and CDW (down 2.8%).

The Fund was overweight technology-related sub sectors including internet media, which underperformed relative to the benchmark with holdings in Alphabet (down 39%).

Laura Lau, SVP & CIO

Michael D. Clare, VP & PM

Annual Compound Returns[4]	1-YR	3-YR	5-YR	10-YR	Since Inception[2]	Since Inception[3]
Brompton Tech Leaders Income ETF (CAD Hedged)	(29.1%)	8.6%	12.8%	13.3%	11.1%	-
Brompton Tech Leaders Income ETF (USD)	(27.9%)	10.1%	-	-	-	12.6%
S&P 500 Equal Weight Information Technology Index	(24.2%)	8.5%	12.7%	17.6%	14.7%	12.1%

(1) Returns are for the periods ended December 31, 2022 and are unaudited. The table shows the ETF's compound return for each period indicated. compared with the S&P 500 Equal Weight Information Technology Index ("Technology Index"). The Technology Index, a sub-index of the S&P 500, tracks the performance of major North American information technology companies on an approximately equal-weight basis. Since the Technology Index contains a substantially larger number of companies, it is not expected that the Fund's performance will mirror that of the Technology Index. The Technology Index is calculated without the deduction of management fees, fund 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 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 May 20, 2011.

(3) Inception Date August 8, 2019.

The Fund has changed its technology benchmark from the S&P Information Technology Index to the S&P Equal Weight Technology Index. The S&P Equal Weight Technology Index tracks the performance of information technology companies included in the S&P 500 Index on an approximately equal weight basis. The S&P Information Technology Index, a sub-index of the S&P 500 Index, tracks the performance of information technology companies on a market cap weighted basis. Since the Fund also invests on an approximately equal weight basis the Manager believes that the S&P Equal Weight Technology Index provides a more comparable benchmark to assess relative performance of the Fund.

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