Brompton North American Financials Dividend ETF (TSX:BFIN; BFIN.U)

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - JUNE 30, 2020

Financial Sector Review & Outlook

There seems to be a bifurcated view regarding the outlook for the financial sector. Some investors are working under the assumption that the US economy will continue to recover in 3Q20 and gradually gain momentum into 2021. A sustained recovery is expected to be led by a combination of fiscal and monetary stimulus and businesses coming back on-line following the passing of COVID-19. Under this view and combined with successful forbearance strategies implemented by the banks and regulators, there is an argument to be made that bank stocks are in the "bottoming" phase. On the other hand, investors who believe the US economy will continue to be in a recession by the end of the year, have adopted a negative view on bank stocks as credit issues would escalate, leading to greater credit losses.

We continue to believe the current pandemic will be an earnings issue for the banks, rather than a balance sheet issue similar to the financial crisis in 2008–2009. We note that banks have higher capital levels to allow them to sustain an extraordinary amount of loan losses while still maintaining capital ratios above minimum requirements. In addition, banks are more profitable compared to a decade ago and as a result banks are better able to withstand credit losses.

Towards the end of Q2, the Federal Reserve released the results of the Dodd-Frank Act Stress Test (DFAST) and Comprehensive Capital Analysis and Review (CCAR). In 2020, the Federal Reserve changed the stress test process and excluded the approval/disapproval of a company's capital action plans. Additionally, the Federal Reserve introduced the SCB (Stress Capital Buffer) into this year's DFAST. The DFAST results demonstrated that under a supervisory severely adverse economic scenario, the US banking industry's capital levels could withstand significant losses and remain above well capitalized levels. In addition to the DFAST process, the Fed also conducted three different sensitivity analyses related to the Covid-19 event. Informed by these results, the Fed for the 3Q20 is suspending share repurchases for large banks (nearly all the large banks had already suspended share repurchases) and capping dividend payments at their current levels.

We see digital transformation within the financial sector as a means to partially offset pandemic-driven headwinds. Firstly, it allows firms to reduce expenses, which bodes well for operational leverage. Secondly, it provides revenue opportunities through online channels and data offerings. Demand for data is being driven by tougher regulatory requirements, more automated trading and enhanced technologies, such as artificial intelligence, that can be used to create and utilize new analytics products. We note that technology spending disproportionately favours large banks with some allocating up to 10% of revenues to tech investments. For example, JPMorgan's tech budget is equivalent to that of the top 10 largest regional banks combined. Over time, the gap in tech spending could lead to even higher deposit costs and weaker funding bases for regional banks.

Portfolio Review

Brompton North American Financials Dividend ETF (the"Fund") was down 17.6% in the first half of 2020 versus the S&P/TSX Capped Financials Index, which was down 16.2% and the S&P 500 Financials Index down 23.6%.

The Fund is slightly overweight Diversified and Regional banks and though overall performance was negatively impacted our positions outperformed benchmark holdings. Our holdings in JPMorgan, Bank of America, Citigroup, National Bank of Canada, Royal Bank and TD were down an average of 24% versus benchmark holdings which was down 36%. Our holdings in First Republic and PNC Financial were down 21% versus benchmark holdings down 32%. We continue to have a positive view on the banks as high capital levels to allow them to sustain an extraordinary amount of loan losses.

An overweight position in investment banking and brokerage, through our holdings in Morgan Stanley and Goldman Sachs, did not overly detract from the Fund's performance. We continue to have a favorable view on capital markets business given elevated market volatility, increased client trading across all products as well as and debt and secondary offerings returning to the market.

The Fund's overweight position in Financial Exchanges contributed to outperformance relative to benchmark holdings. Top performers include S&P Global (+21%), which is well positioned given its resilient subscription-based revenue streams along with tailwinds in the index business.

An overweight position in Life and Health Insurance negatively impacted performance with holdings in SunLife and Manulife down 25% on average in Q2. We exited our position in Aflac during Q2.

The Fund's overweight position in Data Processing and Outsourced Services had a neutral impact to performance. Despite this we have a favorable view on data processing holdings given their relatively defensive business models (Broadridge, Fidelity National and Automatic Data Processing) and oligopolistic position in payments networks (Mastercard).

Laura Lau, SVP & CIO

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Annual Compound Returns[1]	1-YR	Since Inception[2]
Brompton North American Financials Dividend ETF (CAD Hedged)	(10.6%)	(4.7%)
S&P/TSX Capped Financials Index	(11.0%)	(3.5%)
S&P 500 Financials Index	(13.9%)	(6.3%)

(1) Returns are for the periods ended June 30, 2020. The table shows the Fund's compound returns for each period indicated compared with the S&P/TSX Capped Financials Index ("Financials Index") and the S&P 500 Financials Index ("S&P Index") (together the "Indices"). The Financials Index is comprised of constituents of the S&P/TSX Composite Index that are classified as members of the financial sector with individual constituents capped at 25% weight. The S&P Index is comprised of constituents of the S&P 500 Index that are classified as members of the financial sector with individual constituents capped at 25% weight. The Fund invests in at least 15 North American Financial Services companies with market capitalization of at least $5 billion. It is therefore not expected the Fund's performance will mirror that of the Indices which have more diversified portfolios. Further, the Indices are 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.

(2) Inception Date October 17, 2018

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Commissions, trailing commissions, management fees and expenses all may be associated with exchange-traded fund investments. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. Please read the prospectus before investing. Exchange-traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

Certain statements contained in this document constitute forward-looking information within the meaning of Canadian securities laws. Forward-looking information may relate to matters disclosed in this document and to other matters identified in public filings relating to the Fund, to the future outlook of the Fund and anticipated events or results and may include statements regarding the future financial performance of the Fund. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Actual results may vary from such forward-looking information. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

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