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

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - MARCH 31, 2020

Financial Sector Review & Outlook

Overall, we are cautious on the financial sector given the sudden slowdown in the economy as a result of the COVID-19 pandemic, net interest margin pressure from the near-zero interest rate environment and continued pressure on fee-based revenue. Despite this we have a positive tilt to our cautious stance as banks have strong capital levels that can withstand higher provisions and the sector is already trading at trough valuation levels.

The sudden economic shutdown driven by the pandemic has raised fears that borrowers will be unable to repay their loans and reduce consumer leverage would limit credit growth. In addition, dislocation in the energy, travel/leisure, restaurant sectors as well as small businesses are potential stress points that has the propensity to test reserves and erode capital. In an attempt to mitigate the fallout from the sudden economic shutdown governments and central banks have acted swiftly with fiscal and monetary stimulus on a scale never seen before. These actions include supporting business and individuals with loan programs and enhanced social security as well as several liquidity facilities to keep the flow of credit going.

Today banks have higher capital levels to allow them to sustain an extraordinary amount of loan losses while still maintaining capital ratios above minimum requirements. The median Common Equity Tier 1 (CET1) ratio for the eight U.S.-based global systemically important banks (G-SIB) has gone from 3.8% at the lows in 2009 to 11.6% today. Similarly, the median CET1 ratio for the six largest Canadian banks has gone from 6.8% at the financial crisis lows to 11.7% today. In addition, banks are more profitable compared to a decade ago and as a result banks are better able to withstand credit losses. The median pre-provision profit margin for the eight U.S. G-SIBs has gone from 15.6% at the lows in 2008 to 32.3% today, while the margin for the big six Canadian banks has gone from 26.8% to 39.4%.

We see digital transformation within the financial sector as a means to partially offset pandemic-driven headwinds. First of all, 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, JP Morgan'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 29.2% in Q1 versus the S&P/TSX Capped Financials Index, which was down 21.1% and the S&P 500 Financials Index down 31.9%.

The Fund is slightly overweight Diversified and Regional banks and though overall performance was negatively impacted our positions fared well relative to the benchmark. Our holdings in JP Morgan, Bank of America, Citigroup, National Bank of Canada, Royal Bank and TD were down an average of 33% versus benchmark holdings which was down 40%. Our holdings in First Republic and PNC Financial were down 34.7% versus benchmark holdings down 43.6%. We continue to have a positive view on the banks as higher capital levels to allow them to sustain an extraordinary amount of loan losses.

An overweight position in Life and Health Insurance negatively impacted performance with holdings in Aflac, SunLife and Manulife down 33.5% on average in Q1.

The Fund's overweight position in Data Processing and Investment Banking negatively impacted performance relative to the benchmark. Despite this we have a favorable view on data processing holdings given their relatively defensive business models (Broadridge, Automatic Data Processing) and oligopolistic position in payments networks (Mastercard).

Laura Lau, SVP & CIO

Michael D. Clare, VP & PM

Annual Compound Returns[1]	1-YR	Since Inception[2]
Brompton North American Financials Dividend ETF (CAD Hedged)	(17.7%)	(14.8%)
S&P/TSX Capped Financials Index	(13.2%)	(8.0%)
S&P 500 Financials Index	(17.2%)	(14.4%)

(1) Returns are for the periods ended March 31, 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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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