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

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - DECEMBER 31, 2020

U.S. Markets Review

2020 was a tumultuous year and surely a year for the history books. The 2020 stock market crash marked the fastest correction in market history; yet numerous stock markets defied expectations and closed at all-time highs. All in all, global markets finished the year with stellar performance, especially when taking into account the major correction that took place in March. The MSCI World Index gained 16.5% with the Information Technology sector as the best performing sector, gaining 44.3% during the year; Consumer Discretionary was the second-best performing sector, outperforming the MSCI World Index by 20.5%. In North America, the S&P 500 was up 18.4%, while the S&P/TSX Composite was up 5.6%, both of which were led by strong performance from the Information Technology sector. In Europe, the STOXX 600 was down 1.4% for the year. Germany and Switzerland had the best performance, where the DAX and SMI were up 3.5% and 4.3%, respectively. France's CAC 40 Index declined 5.0%. Spain and U.K. also finished the year in negative territory as the IBEX 35 and FTSE 100 declined 12.7% and 11.4%, respectively.

During the fourth quarter, global economies continued the path to recovery while certain parts of the world combated a resurgence of COVID-19. In general, Asian countries have been able to control the spread of COVID-19 much better than North America and Europe. In November, Significant progress was made with the development and the rollout of COVID-19 vaccines. Pfizer and Moderna's vaccines both showed efficacy rates above 90%. AstraZeneca's vaccine also showed efficacy rate above the 50% threshold set by the World Health Organization. Several countries have granted emergency approval for these vaccines and are undergoing the inoculation process. At the same time, we saw sequential improvement in manufacturing production and sequential declines in the unemployment rate after peaking out in April. In the U.S., Democratic presidential nominee Joe Biden was elected the 45th president of the United States and was inaugurated on January 20, 2021. The two Georgia Senate runoff elections in January 2021 resulted in Democratic control of the Senate by the slimmest of margins. Democrats gained control of both the Congress and the White House for the first time since 2011. A Democratic win in combination with vaccine news pushed stock markets to new highs in November. The more cyclical parts of the economy benefited the most, including Energy, Financials, Materials and Industrials. Performance of Information Technology stocks remained robust, as the work from home theme continue to be a secular tailwind for the sector. In December, equity markets rallied further despite the implementation of lock down measures in certain countries. Risk appetites continue to favor pro-cyclical stocks as additional coronavirus relief get passes by the U.S. congress.

Effective central bank policies played an essential role in the recovery of global equities. In Europe, the European Central Bank expects to keep its benchmark interest rate unchanged at -0.50% until inflation outlook improves. The Governing Council also increased the envelope of the pandemic emergency purchase program (PEPP) in the face of a resurgence COVID-19 cases, by EUR500 billion to EUR1,850 billion, and extended the horizon for the PEPP to at least the end of March 2022. Purchases under the asset purchase program (APP) will continue at a monthly pace of EUR20 billion. During the fourth quarter, France announced another US$23.7 billion in aid to small business and furloughed workers; funding for loans to business was extended to June 2021. Italy passed a fourth stimulus package worth US$6.4 bullion for rent support, subsidies and wage support. U.K. Prime Minister Boris Johnson's Brexit deal gained approval in the House of Lords and became law just hours before the Brexit transition period ended on December 31, 2020.

At the end of 2020, the number of confirmed infections worldwide exceeded 84 million, with cumulative deaths approaching 2 million- more than double the number of infections at the end of the third quarter. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in October 2020, global gross domestic product is projected to contract 4.4% this year, a less severe contraction than the previous forecast in June as activity began to improve sooner than expected after lockdowns were scaled back in May and June. The IMF projected the global growth rate for 2021 to be 5.2%. The path to recovery will follow a choppy trajectory as it is predicated upon a confluence of factors including public health response, progress with vaccines rollouts and the size and effectiveness of the policy response. The intricacy of interactions between multiple factors at play makes forecasting a difficult exercise.

Looking forward 2021, we expect strong recoveries in European equities as the Euro continues to appreciate against the US dollar. Elimination of Brexit uncertainties should support equity prices. European equities should outperform U.S. equities when investor sentiment rotate to risk-on. On the policy front, the ECB will likely keep rates steady for 2021. The Next Generation EU stimulus program should provide secular growth opportunities in infrastructure, renewable energy, and automation.

Technology Sector Review & Outlook

The COVID-19 pandemic accelerated the digital transformation trend that had already been in motion. Consumer and corporate behavior resulting from the work/learn/game-from-home dynamic supported robust demand for cloud computing, connectivity, e-commerce, collaboration and security. While the pandemic resulted in a 5.4% decline for global IT spending in 2020, according to Gartner, the impact was mainly around devices (less hardware refreshes), IT consulting and to a lesser extent delayed software implementation for large scale projects.

Global IT spending is expected to rebound in 2021, up 4% to $3.7 trillion according to Gartner. Enterprise software is expected to have the strongest rebound in 2021 up 7.2% given the acceleration of digitalization efforts by enterprises and resumption of large-scale software implementations. Data center spending is projected to grow 5.2% in 2021 as providers accelerate data center build outs given the increasing demand for cloud computing and resumption of enterprise data center expansion.

The global semiconductor market remained largely resistant to global macroeconomic headwinds from the pandemic. The global semiconductor wafer equipment market grew 11% to $59 billion in 2020, with 5% growth expected in 2021 according to SEMI. The foundry and logic segments, which account for about half of total wafer fab equipment sales, is expected to grow in the mid-teens reaching $30 billion in spending driven by investments in leading-edge technologies. Semiconductors continue to lead cyclical recoveries and we believe we are on the cusp of the next leg of innovation. Semiconductor demand continues to be driven by datacenters, as a result of uptake in cloud computing, the 5G cycle, Internet of Things and intelligent automation.

The propensity of increasing regulations around big tech continues to be a concern. US President-elect Joe Biden has spoken assertively about tech regulation and he suggested revoking Section 230 of the Communications Decency Act, which holds that online platforms are not liable for what users post on them. In the UK, the Competition and Markets Authority wants to be able to impose fines of up to 10% of global revenue on tech companies that abuse their market position. In the EU, the Digital Service Act regulation suggests that tech companies may be banned from preferential treatment of their own services on their sites/ platforms, to the detriment of rivals, and that companies should not be allowed to pre-install their own applications on hardware devices, or force other companies to exclusively pre-install their software.

US Congress recently concluded a 16-month investigation into Amazon, Apple, Google and Facebook has found that the tech giants hold “monopoly power” in key business segments and have abused their dominance in the marketplace. The House Judiciary Committee’s antitrust panel argues that tech giants have maintained their monopoly position by using the vast amounts of data they’ve gathered on consumers and other businesses in order to muscle out rivals, gain an advantage in new product markets and reduce innovation by others; and that conduct is anti-competitive. The US FTC and 46 states have brought antitrust cases against Facebook, accusing the company of using its social media dominance to thwart competition and calling for penalties that include a forced break-up. Critics argue that legal precedent on antitrust cases are viewed through the lenses of price, choice and corporate collusion. The use of data in the digital economy is a novel argument in the antitrust paradigm. Based on precedent, any antitrust in investigation would take a long time to complete with likely outcomes ranging from severe penalties, to unwinding prior acquisitions and/or breaking up the company, the latter being the most cumbersome and complex.

In the latter part of 2020, we witness an extreme factor rotation from growth to value. With line of sight to economic reopening given the Covid-19 vaccine and fiscal stimulus kickstarting the economy, reflationary expectations will continue to drive factor rotation away from growth into cyclical and value styles in our view. Our portfolio is well position to benefit from these factor rotations given our actively managed weighting in cyclical tech such as semiconductors, hardware and software that have exposure to industrial, automotive and infrastructure segments.

Overall, the technology sector remains an attractive structural growth story. 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 both in the near and long term. 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 up 38.4% in 2020 versus the S&P 500 Equal Weighted Information Technology Index, which was up 30.8%.

The Fund benefitted from an overweight position in the software subsector which contributed to an outperformance relative to the benchmark. Top performing holdings include ServiceNow (+95%), Synopsys (+71%) and Adobe (+52%).

An underweight position in IT services also contributed to the Fund’s outperformance relative to the benchmark. Top performing holdings include PayPal (+36%), Accenture (+26%) and Mastercard (+20%).

A relative market weight in the hardware subsector also contributed positively to the Fund's performance given holdings in Apple (+82%) and Logitech (+33%).

The Fund is overweight technology-related sub sectors such as interactive media and internet media given its holding in Amazon (+76%) and Alphabet (+31%).

Laura Lau, SVP & CIO

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Annual Compound Returns[4]	1-Year	3-Year	5-Year	Since Inception[2]	Since Inception[3]
Brompton Tech Leaders Income ETF (CAD Hedged)	38.4%	25.5%	23.5%	14.5%	-
Brompton Tech Leaders Income ETF (USD)	41.2%	-	-	-	39.3%
S&P 500 Equal Weight Information Technology Index	30.7%	23.0%	24.3%	18.4%	33.3%

(1) Returns are for the periods ended December 31, 2020. Inception date May 20, 2011. The table shows the ETF's compound returns 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 Index, 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 ETF'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 ETF is calculated after deducting such fees and expenses.

(2) Inception Date May 20, 2011.

(3) Inception Date August 12, 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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