Tech Leaders INCOME ETF

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - JUNE 30, 2018

Portfolio Review

The Tech Leaders Income ETF was up 16.0% during the first half of 2018, outperforming the S&P 500 Information Technology Index, which was up 10.9%, and the S&P 500 Index which was up 2.6%. The Fund benefitted from strong performance in Netflix, Amazon and Adobe, which were up 103.9%, 45.4% and 39.1%, respectively. Netflix continues to develop its own content, which has driven price increases alongside increased user subscriptions, which now stand at over 120 million globally. We believe a large opportunity lies in India, the world's fastest growing smartphone market, where wireless usage surged 6.5x in 2017 driven by heavy mobile video consumption. Amazon remains dominant in e-commerce and cloud services and continues to explore opportunities in markets such as food and drug retailing. We believe Amazon's Twitch platform is an underappreciated asset and is well positioned to benefit from significant growth in the US$100 billion+ global video game industry, a market that continues to grow at a double digit rate. Recently Amazon announced the acquisition of Pillpack, a U.S. online pharmacy, officially marking Amazon's entry into the U.S. prescription drug market, which we view favourably. Adobe reported solid Q2 results and continues to exhibit strong momentum in digital media, driven by the TubeMogul acquisition, as well as creative cloud segments, due to the company's dominant market position with Acrobat and Photoshop/Illustrator. We believe the acquisition of Magento will allow Adobe to compete more effectively in the digital commerce space as it can now bring its leadership position in content creation, marketing, advertising and analytics to business-to-business (B2B) and business-to-customer (B2C) markets globally.

The Fund's strong performance in these names more than offset weaker relative performance in Applied Materials and Oracle, which were both down single digits. Applied Materials reported solid Q2 earnings but lowered its Q3 guidance due to weaker than expected display revenues as a result of projected softness in smartphone shipments. However, sales of semiconductor equipment remain solid given robust end markets. Oracle reported solid Q4 results but street concerns over a change in reporting methodology will result in less visible cloud growth moving forward, which we believe will hinder share appreciation over the near term.

The Fund is underweight the Hardware & IT Equipment sector due to our more cautious view of the current smartphone upgrade cycle, which is only partially offset by our expectation for an improving PC market outlook and potentially higher telecommunication capital spending ahead of the 5G build. The Fund is overweight the Software & IT Services sector given the group's subscription-based model that helps drive recurring revenues resulting in high earnings and cash flow visibility. The Fund is market weight the Semiconductor & Semi Equipment sector given strong demand in data centres and artificial intelligence, as well as in automotive and industrial end markets. Although we expect growth to potentially slow as the near-term cycle matures, we believe in the long-term secular opportunities as semiconductor stocks become increasingly levered to a data driven global economy.

We continue to own marquee companies like Apple, Amazon, Facebook, Google and Netflix, which we believe will continue to perform well over the long-term. Apple remains a dominant provider of premium end smartphones and continues to create a stronger ecosystem as it grows its services and other products such as Apple Music, Apple Pay, Home Pod, Apple Watch and iCloud, while investing more heavily into original content. We believe Amazon will continue to consolidate its power in e-commerce and cloud, while growing its total addressable market as it penetrates new verticals such as retail drug distribution, groceries and gaming. In our view, Facebook and Google will remain dominant in the online advertising space – Facebook, given its 4 billion+ monthly active users across all its platforms (Facebook, Instagram, WhatsApp and Facebook Messenger), and Google, given its ubiquity in search. Despite the Cambridge Analytica controversy that surfaced in March and the expectation of Europe's new General Data Protection Regulation (GDPR) pressuring margins due to higher compliance costs, both stocks managed to close the first half of 2018 well off the March lows suggesting that the market believes these developments will unlikely impact earnings in the future. We favour Adobe given its near monopoly position in the media/publishing industry with Adobe Photoshop and Acrobat and recent foray into digital commerce through the acquisition of Magento as well as its high recurring revenue base; Intel for its ubiquity in PC and server chips and leverage to secular growth verticals such as cloud, autonomous vehicles and Internet of Things; Netflix for its dominance in over-the-top video streaming services globally, future growth

potential in original content giving rise to further user growth and price increases and further penetration into long term growth markets like India, the fastest growing smartphone market in the world; and Texas Instruments for its exposure to industrial and automotive growth markets combined with strong free cash flow generation.

Market Review

U.S. equities, as represented by the S&P 500 Index, finished the first half of 2018 up 2.6%. The S&P 500 Index experienced significant volatility with the VIX Index averaging 16.3%, hitting a low of 9.2% in January before climbing to a high of 37.3% in February. This was primarily driven by rising anti-trade rhetoric between the U.S. and China combined with news concerning Facebook and the alleged breach of data, which negatively impacted sentiment in a sector that has exhibited strong leadership in the market. The best performing sectors in the S&P 500 Index were Consumer Discretionary, Information Technology and Energy while the worst performing sectors were Consumer Staples, Telecom, and Industrials.

The most notable policy development during the first half of 2018 was the Federal Reserve's decision to raise its benchmark interest rate by 25bps at both the March and June meetings by an FOMC committee now led by Jerome Powell as Chairman. The benchmark target range now stands at 1.75% to 2.00%, while the Federal Reserve remains on track to reduce the size of its balance sheet by US$600 billion annually. The Fed continues to observe data points that suggest the labour market is strengthening and that economic activity has been rising at a solid rate, but they will adjust monetary policy depending on the evolution of the data. Meanwhile, the market continues to price in a measured path for future interest rate increases reflecting the high level of central bank accommodation that is still available to the economy. The Fed anticipates hiking rates 2 more times in 2018 and 3 times in 2019.

On the fiscal side, the U.S. passed the first overhaul of the tax code in more than 30 years late in 2017, which reduced the corporate tax rate from 35% to 21% while offering U.S. companies a one-time tax break on repatriated funds by paying a 15.5% rate. We believe tech stocks such as Apple, Cisco, Microsoft and Oracle stand to benefit given the nearly US$500 billion in combined cash held overseas which, when repatriated, should result in dividend increases, accelerated share repurchases and/or further M&A and investments.

Trade war rhetoric between the U.S. and China escalated during the first half of 2018 with the first major move being made when President Trump introduced tariffs on solar panels and washing machines. The decision was not well received by China which currently produces approximately 65 percent of the world's solar modules. In March, the Trump administration raised import taxes on steel and aluminum by 25 percent and 10 percent, respectively, to which China responded by issuing tariffs on $2.4 billion in U.S. exports. In April, President Trump unveiled a list of 1,300 Chinese goods that could be hit with 25 percent tariffs and proceeded to implement a seven-year ban on exports to Chinese telecom company ZTE, which was subsequently reversed in June. In early July, the trade war between the U.S. and China officially got underway when the Trump administration confirmed that the U.S. would begin collecting tariffs on $34 billion in Chinese goods and warned that subsequent rounds could see tariffs on more than $500 billion of goods. In response, China's Ministry of Commerce issued a statement saying that the U.S. had launched the biggest trade war in economic history. In our view, we believe these global trade disputes will ultimately be settled amicably, though we acknowledge the possibility that rhetoric and actions may intensify further over the near term.

Technology Sector Review & Outlook

According to the latest data from World Semiconductor Trade Statistics (WSTS), global semiconductor sales rose 22% in 2017 and are expected to grow 12% in 2018 and 4% in 2019 driven by data center growth, graphics chips memory demand and continued strength in automotive and industrial end markets. A theme that has been supportive of semiconductor strength, given the importance of computing power, storage and memory requirements, has been the rise of artificial intelligence and its potential application across all industries. The portfolio currently holds Applied Materials, a leading semiconductor equipment provider to device manufacturers worldwide, Intel, a dominant player in the server and PC market transitioning to higher growth end markets such as cloud and autonomous vehicles, and Texas Instruments, the most diversified semiconductor company that also generates significant free cash flow. We would emphasize that all the companies in our portfolio are either directly or indirectly levered to artificial intelligence and should benefit, to varying degrees, as the technology proliferates across industries and becomes more ubiquitous.

According to Macquarie, global smartphone shipment growth is expected to grow 4% year-over-year in 2018 and 3% year-over-year in 2019 driven by a replacement cycle led by manufacturers such as Huawei (P10 devices), Samsung (Galaxy G8), Google (Pixel 2) and Apple (iPhone 8 and X devices). Though the current cycle is likely to be less robust compared to prior upgrade cycles, we still expect the introduction of new smartphones to benefit several holdings in the Fund's portfolio – dominant smartphone manufacturers Apple and Google, semiconductor companies serving the global smartphone supply chain Applied Materials, Texas Instruments and Intel, and connectivity provider Amphenol.

According to RBC's proprietary cloud capex tracker (which tracks the collective annual spending of the largest Cloud and hyperscale providers in the market), Q1/18 cloud capex increased 65% year-over-year to US$20.8 billion while Q2/18 cloud capex growth is expected to grow 57% year-over-year. For the full year 2018, RBC expects cloud capex to grow 37% to US$89 billion. The portfolio currently holds Amazon, Cisco, Google, Intel, Microsoft, Oracle and Texas Instruments, which are all exposed to cloud growth. RBC has yet to release its latest data but since the last publication in January, RBC's proprietary telecom capex tracker (which includes the largest providers such as China Mobile, AT&T, Verizon, Deutsche Telekom and Nippon Telegraph) calculated that total global telecommunication capital spending fell 0.7% year-over-year to US$45.3 billion in Q3/17. In the U.S., telecom capex increased 9.4% year-over-year in Q3/17. RBC suggests that early indications look positive for 2018 capex trends. Global telecommunication capital spending is a proxy for broad networking equipment demand, which has had a negative impact on a portion of Cisco's and Oracle's networking revenues; however, we believe this has been gradually reversing over the last few quarters. We would note that a growing proportion of sales by Cisco and Oracle are being generated by cloud revenues that remain a significant longer term opportunity. According to Conviva, an online video analytics company, global viewing of over-the-top (OTT) video services content more than doubled to 12.6 billion hours in 2017 reflecting the on-going shift away from linear TV. EMarketer, a global market research company, projects that by 2020, Netflix will still have a considerable lead over other OTT competitors such as Amazon and Hulu. We believe Netflix should continue to benefit from the secular shift to online streaming with improved pricing power as of result of further investments into original content. We would note that the introduction of Disney's over-the-top service expected to launch sometime in 2019 will certainly increase competition in the industry and we will be monitoring developments closely.

We remain positive on the longer term outlook for technology stocks, particularly those tied to secular themes based on disruptive trends (FinTech and Mobile Payments, Cloud, Digital Advertising, Social Media/Messaging, E-commerce, Media and the Internet of Things), demographics (millennials driving future adoption), Artificial Intelligence and the continued digitization of businesses.

Annual Compound Returns[3]	YTD	1-Year	3-Year	5-Year	Since Inception
Tech Leaders Income ETF	16.0%	32.0%	16.6%	15.2%	11.4%
S&P/TSX Composite Index	1.9%	10.4%	6.9%	9.2%	5.6%
S&P 500 Information Technology Index	10.9%	31.3%	22.6%	21.9%	17.9%

[1] Returns are for the periods ended June 30, 2018. The table shows the Fund's compound return for each period indicated compared with the S&P/TSX Composite Index ("Composite Index") and the S&P Information Technology Index ("Technology Index"). The Composite Index tracks the performance, on a market weight basis, of a broad index of large-capitalization issuers listed on the TSX. The Technology Index, a sub-index of the S&P 500 Index, tracks the performance of major North American technology companies on a market-weight basis. The Fund's portfolio is comprised of technology companies and is rebalanced at least annually in accordance with the Fund's investment guidelines. Since the indices contain a substantially larger number of companies, it is not expected that the Funds performance will mirror that of the indices. The benchmark 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.

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BROMPTON FUNDS

VALUE
INTEGRITY
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THE FOUNDATION FOR EXCELLENCE

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, P.O. Box 793
Toronto, Ontario M5J 2T3