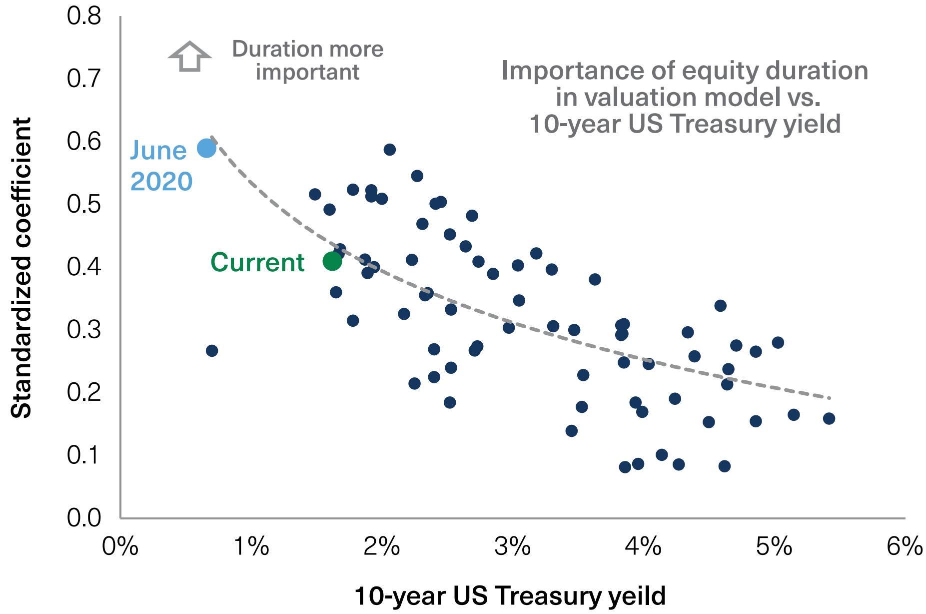
Is Value the New Momentum?

Funds in focus: Brompton Tech Leaders Income ETF (TSX: TLF; TLF.U), Brompton North American Financials Dividend ETF (TSX: BFIN; BFIN.U), Brompton Global Dividend Growth ETF (TSX: BDIV), Brompton Split Banc Corp. (TSX: SBC), Life & Banc Split Corp. (TSX: LBS)

Over the past decade, investors have benefited from the outperformance of growth versus value. During this time, betting against growth was a losing proposition. However, since announcement of the COVID-19 vaccine in November 2020, value has outperformed growth. This outperformance has been amplified in 2021 with YTD performance of a net long/short value strategy yielding a +35% return versus -10% for a net long/short growth strategy according to Bloomberg (as of June 23, 2021)[1]. So, the question on investors' minds is whether value can continue this strong outperformance.

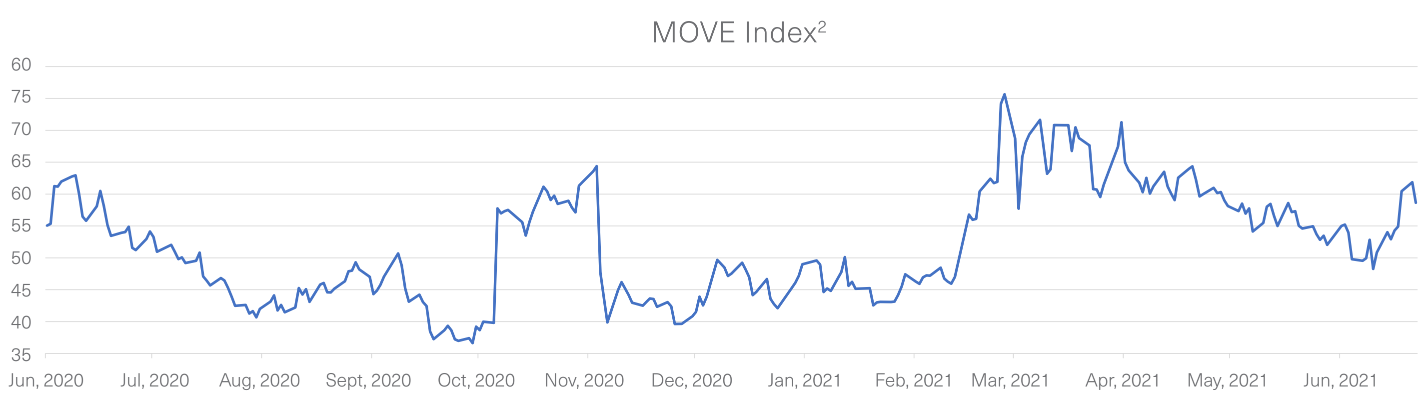
Source: Goldman Sachs (June 9, 2021)

Value typically outperforms growth during the early stages of economic recoveries, when growth is very strong, given the inflationary expectations i.e. rising interest rates. The chart below illustrates the inverse relationship between equity duration and the 10-year US Treasury yield since 2002. As interest rates rise, investors pay a smaller premium for stocks with strong long-term growth prospects. Value also outperforms when economic growth is extremely weak. In a mediocre growth environment, with falling interest rates (characteristic of the environment over most of the past decade) growth significantly outperforms value. However, as shown in the figure above, value's outperformance is usually short lived. At the risk of sounding cliché, this time could be different. In addition to the reopening of the economies around the world, governments have also pledged massive fiscal stimulus. If one expects fiscal policy to dominate monetary policy in the near-term, an argument can support the case for value over growth as the valuation gap between them will narrow. In other words, investors will pay up for companies that generate solid cash flows and return of capital through share buybacks and dividends. Furthermore, the G7's move towards a minimum global tax rate of at least 15% bodes well for value's outperformance as value sectors tend to have higher tax rates and fewer intangible assets compared to growth sectors.



Source: Goldman Sachs (June 9, 2021)

While we believe there is a solid argument that supports value over growth, nothing moves in a straight line. In fact, since November 2020, the value growth factor unwinds have been significant. This is attributed to the volatility of theinterest rate environment (as measured by the MOVE Index[2] below) which contributes to these extreme moves. In other words, the higher the rate of change in interest rate volatility the more explosive the value-growth factor unwind. We believe value growth rotations in the market will continue to be volatile, with value having the slight upper hand in the near-term. On a more forward-looking basis, the duration of value's outperformance over growth depends on whether inflationary expectations are transitory and if the market expects long-term economic growth will remainstructurally low.



Source: Bloomberg (June 11, 2021)

Brompton's Approach:

At Brompton we employ a barbell approach in actively managing our portfolios, which essentially means we overweigh factors that are expected to provide attractive risk-reward (i.e. the overweight factors are the heavy bells and the underweight factors make up the bar). We believe this method of active management provides more consistency in performance especially during factor rotations versus a passive investment style. For Brompton Tech Leaders Income ETF (TLF) which is typically skewed towards growth, we have adjusted our exposure to capture value stocks that are typically considered lower growth (i.e. higher dividend paying, solid cash flow generation and growth-at-a-reasonable-price). Brompton North American Financials ETF (BFIN) provides exposure to Financials which are trading at a substantial discount to the market and Brompton's Financial split share funds have been and continue to be one of the beneficiaries of the value rotation. The volatility of market rotations also provides us with an opportunity to employ our tactical covered call writing program to enhance our risk adjusted returns.

Brompton Tech Leaders Income ETF (TSX: TLF; TLF.U) provides high monthly distributions and the opportunity for capital appreciation through an investment in an actively managed portfolio of large cap global Technology companies selected by Brompton, complemented by a proprietary covered call options program.

Brompton North American Financials Dividend ETF (TSX: BFIN; BFIN.U) offers investors a way to invest in a portfolio of large cap North American financial services companies selected by Brompton, complemented by a proprietary covered call program.

Brompton Global Dividend Growth ETF (TSX: BDIV) provides monthly distributions and the opportunity for capital gains through an investment in an actively managed portfolio of large cap global dividend growth companies selected by Brompton, complemented by a proprietary covered call program.

Brompton Split Banc Corp. (TSX: SBC) offers investors a way to invest in an equal weight portfolio of the "Big Six" Canadian Banks.

Life & Banc Split Corp. (TSX: LBS) offers investors a way to invest in an equal weight portfolio of Canada's four largest publicly-listed life insurance companies and "Big Six" banks.

[1] Net long/short strategy – Percentile ranked stocks based on a factor (or group of factors) and going long the top ranked stocks and shorting the bottom ranked stocks.

[2] MOVE Index is a yield curve weighted index of the normalized implied volatility on 1-month Treasury options which are weighted on the 2, 5, 10, and 30 year contracts.

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