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

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - JUNE 30, 2021

Global Markets Review

The global economic reopening remains on track as the vaccine rollout gathers pace. All in all, global markets finished the quarter with solid performance, especially for pro-cyclical sectors, as several of them enjoyed double digit returns. The MSCI World Index gained 13.3% with the Energy sector being the best performer, gaining 33.2% during the first half of 2021; Financials was the second-best performing sector returning 21.1%, outperforming the MSCI World Index by 7.8%. In North America, the S&P 500 was up 15.2%, also led by the Energy sector, while the S&P/TSX Composite was up 17.3%, with Energy and Financials as the top performing sectors. In Europe, the STOXX 600 was up 15.8% for the first half of this year. France and Italy continued to be the best-performing countries, where CAC 40 and FTSE MIB were up 19.5% and 14.7%, respectively. Germany's DAX gained 13.2%. Spain and the U.K. also finished 1H21 with solid returns as the IBEX 35 and FTSE 100 increased 10.5% and 10.9%, respectively.

During the first half of 2021, global economies continued the path to recovery. U.S. Manufacturing PMI entered June at 60.6 after peaking at a record high of 64.7 in April, while the unemployment rate continued to decline, reaching 5.9% in June. In the U.S., Biden's sharp focus on immunization efforts in combination with unprecedented fiscal stimulus pushed stock markets to new highs by the end of 1H21. Global yield curves were mainly subdued in Q2 and flattening in June, with the U.S. 5 year to 30 year Treasury spreads narrowing to August 2020 levels. The U.K. yield curve also mirrored its U.S. peers. This has driven the sector rotation back from value to growth in the past month. Cyclical parts of the economy led the equity market rally during the first half of this year, with Energy, Industrials and Financials gaining the most, even though Financials were negatively affected by flattening yield curves in June. Performance of Information Technology stocks was lackluster during Q1, due to investor sentiment shifting away from large capitalization growth names, but they have had a big run since mid-May as investors took some profits and rotated back to high-growth names, sending both the S&P 500 and NASDAQ to new highs in June. Pro-cyclical stocks are still favored, while the risk-on mentality would keep sending growth stocks higher.

During the second quarter, several central banks in developed economies started to gradually shift their monetary policy stance amid growing concern over inflationary risks. During the June Federal Open Market Committee (FOMC) meeting, despite no policy rate hike, the Federal Reserve's dot-plot projections indicated at least two rate hikes in 2023, signaling an earlier than expected tightening. In response to inflation concerns, the Fed also lifted its inflation expectations to 3.4%, 100 bps above its previous estimate. Potential tapering of the bond-purchase program could commence late 2021 or early 2022. On the fiscal front, President Biden signed a US$1.9 trillion pandemic relief bill in March, titled the American Rescue Plan, into law. The plan includes additional stimulus cheques, enhanced unemployment aids, rental assistance, and childcare support among other assistance. In late June, a bipartisan group of senators and the White House reached a preliminary agreement on a potential $1.2 trillion infrastructure package. While the details are still under discussion, the bill would be another wave of robust fiscal stimulus.

By the end of the second quarter, the number of confirmed infections worldwide exceeded 183 million, about 2.15 times greater than the number of infections at the end of 2020. On the other hand, global vaccination efforts are well underway, with 47% of the population fully vaccinated in the U.S. and 31% in Canada. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in April 2021, the global economy is projected to grow 6.0% in 2021, up from the previous forecast of 5.2%. The contraction of 2020 was also smaller than the previous projection due to outsized growth in the second half of 2020, driven by the easing of lockdown measures. However, there still remains a high degree of uncertainty surrounding the global economic outlook, such as whether the current vaccines are effective again new COVID-19 strain, capacity adjustments in the economy, and effectiveness of global policies.

Looking forward to the rest of 2021, with a growing percentage of the population fully vaccinated, the U.S. labor market recovery is accelerating so we expect to see further decline in the unemployment rate and pickup in labor force participation. Meanwhile, household savings have piled up in the past year to support strong spending, as more states open for business. On the monetary policy front, we believe Fed tapering is not likely until the last quarter this year or first quarter next year. On the fiscal policy front, the Biden administration is laser-focused on boosting economic growth through the American Rescue Plan, which should be supportive of further economic recovery.

Financial Sector Review & Outlook

We are optimistic on the financial sector given the line of sight in reopening of the economy as COVID-19 vaccinations hit a crescendo coupled with fiscal stimulus and proposed infrastructure spending which are positive tailwinds. As the vaccinated population increases, combined with an increase in the opening of more businesses and the rebuilding of inventories, we expect to see strong economic growth that will be beneficial to the financial sector.

In addition, the combination of loan loss reserve releases, the positive impact that a steepening in the yield curve will have on net interest margins, an expected pick-up in loan growth in the latter part of 2021, and expected return of excess capital to shareholders will be tailwinds for bank stocks. While bank valuations are slightly more expensive than historic levels (1.5x higher), the premia suggests upside earnings potential in our view.

The pandemic has accelerated digitization trends that have been reshaping the financial sector. We note that pandemic-driven costs incurred through activities such as retrofitting branches and moving employees to a work from home environment are expected to roll off in 2021. In the near-term, digital transformation expenses continue to be a fast-growing cost item however we believe banks are unlikely to pare technology expenses. Over time, investment in digital technologies is expected to lower banks' cost structure and improve efficiency gains.

On March 26, the Federal Reserve Board announced that the temporary and additional restrictions on bank holding company dividends and share repurchases will end for most firms after June 30, following the completion of the 2021 annual bank stress tests. On June 24, The Federal Reserve released the results of the Dodd-Frank Act Stress Test (DFAST). DFAST is a set of forward-looking exercises for determining whether participating institutions have sufficient capital to absorb losses and support operations during adverse economic scenarios. Key changes to this year's DFAST were: 1) this year's test did not require extended-cycle firms with assets between $100 billion and $250 billion to participate and 2) removal of the additional COVID-19 sensitivity analysis that was introduced last year in response to the pandemic. The DFAST results demonstrated that under the supervisory severely adverse economic scenario, the U.S. banking industry's capital levels could withstand significant losses and remain above well-capitalized levels. As a result, the additional restrictions on capital distributions put in place during the COVID-19 event ended.

The top 7 banks recently announced significant increases to dividends (35% dividend per share increases or dividend yields up to 2.6% from 2.1%), and the pace and scale of inorganic growth has also accelerated for the first time since the 2008 financial crises. With additional capital restrictions removed in 3Q21, banks will have significantly enhanced flexibility to return capital to shareholders. Goldman Sachs estimates that banks will repurchase 5% of their market cap in 2021, and 6% in 2022, with 2H21 repurchases roughly 1.5x the % of market cap vs. 1H21, given the lifting of Fed restrictions.

Portfolio Review

Brompton North American Financials Dividend ETF (the "Fund") was up 21.3% during the first half of 2021 versus the S&P/TSX Capped Financials Index, which was up 23.4%, with the S&P 500 Financials Sector Index (the "Benchmark") up 25.6%.

The Fund benefitted from an overweight position in Diversified Banks, which contributed to performance though slightly lagging the Benchmark. Top performers include Bank of America (+37.3%), National Bank of Canada (+35.3%) and TD (+26.7%).

An overweight position in Investment Banks contributed to performance which slightly lagged the Benchmark. Top performers include Goldman Sachs (+44.5%), Morgan Stanley (+35%) and Raymond James (+21.2%).

A market weight position in Financial Exchanges contributed to outperformance of the Benchmark. Top performers include S&P Global (+25.4%), NASDAQ (+23.3%) and CME (+17.8%).

The Fund's overweight position in Life Insurers contributed to performance which lagged the Benchmark. Top holdings include Metlife (+16.2%), Manulife (+13.3%) and Sunlife (7.1%).

The Fund benefitted from a market weight exposure to Regional Banks, with performance in-line with the Benchmark. Top holdings include First Republic (+27.7%), Fifth Third Bancorp (+20.8%) and SVB Financial (+13.7%).

The Fund's overweight position in Data Processing and Outsourced Services contributed to performance. Top holdings include Broadridge (+3.7%), Mastercard (+2.5%) and Fidelity National Information Services (+2.4%).

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Annual Compound Returns[1]	YTD	1-YR	Since Inception[2]	Since Inception[3]
Brompton North American Financials Dividend ETF (CAD Hedged)	21.3%	48.0%	12.2%	-
Brompton North American Financials Dividend ETF (USD)	22.4%	52.8%	-	19.9%
S&P/TSX Capped Financials Index	23.4%	49.6%	13.7	17.3%
S&P 500 Financials Index	25.6%	61.6%	15.0%	20.9%

(1) Returns are for the periods ended June 30, 2021 and are unaudited. 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 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

(3) Inception Date August 8, 2019.

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