Brompton Insights

July 2021

Financials Open the Vaults - Back to Dividend Growth & Buybacks

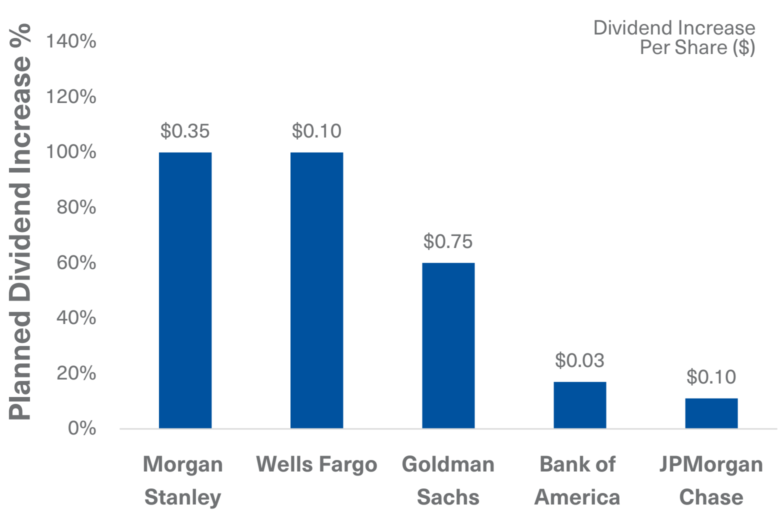
Fund in focus: Brompton North American Financials Dividend ETF (BFIN), Brompton Split Banc Corp (SBC), Life & Banc Split Corp. (LBS), Brompton Lifeco Split Corp. (LCS)

Dividend growth and share buybacks for Financials have been limited due to the capital restrictions imposed by regulators following the onset of the COVID-19 pandemic. With the economic outlook now improving and Financials demonstrating resilient capital levels, regulators in the U.S. and the U.K. have begun relaxing capital restraints. This allows banks to use their excess capital to increase dividends and re-start share buyback programs. Canadian regulators will follow, albeit with a more conservative timeline. We believe this will be a positive catalyst for banks and lifecos.

In March 2021, the Fed announced that the restrictions on buybacks and dividends would be lifted for most U.S. banks at the end of Q2 provided capital levels were above the Fed's stress test requirements. All 23 U.S. banks that took the recent stress test passed with an average tier-one capital ratio of 10.6% under the stress test scenario – more than twice the level required by the Dodd-Frank Act.

Accordingly, a number of major U.S. banks have announced significant dividend increases, some of which are illustrated in the chart below. In addition to the dividend increases, these banks announced share buyback plans totalling $55 billion so far. The news that banks were now eligible to raise dividends and increase share buybacks caused the S&P 500 Financials index to rise 3.1% vs 0.9% for the S&P 500 Composite index in the 2 days following the announcement, on a total return basis.[1] Prior to the change in regulations, the S&P 500 Financials Index had underperformed the S&P 500 Composite Index by 4.8% quarter-to-date.

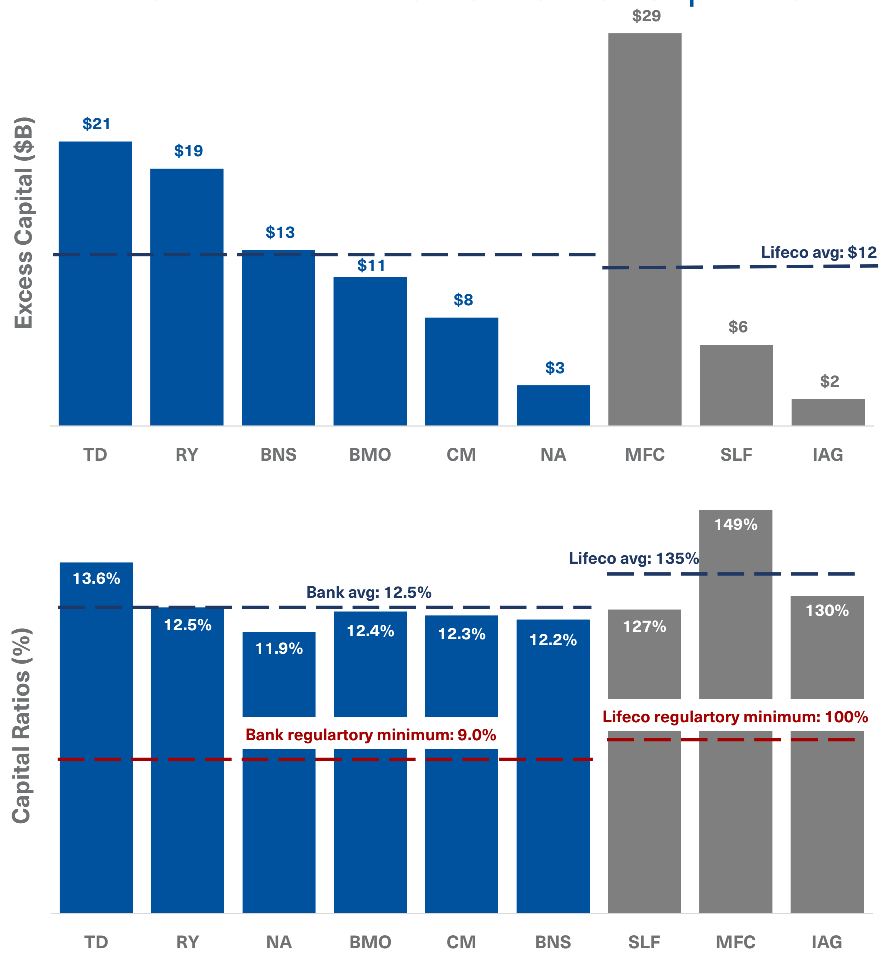
Upcoming Dividend Increase Per Share (USD)



Source: CNBC, "Morgan Stanley doubles its dividend as most banks raise payouts following Fed stress tests", June 28, 2021

In Canada, the Office of the Superintendent of Financial Institutions (OSFI) has been more cautious to relax regulations, and in fact moved to increase the regulatory minimum capital requirement from the current 9.0% level to 10.5% as of October 31, 2021. This increase is quite manageable because Canadian banks are flush with capital. With Canada's more positive economic outlook, benign credit environment and record-high capital levels in the banking sector, we believe that once the restrictions are lifted, the Canadian banks will start buying back shares and raising dividends which will be supportive for share prices. OSFI is widely expected to lift these restrictions in the second half of 2021. According to Bloomberg, the Big Six banks could increase their dividends by an average of 13% to bring payout ratios back in line with targets (40-50% for the big 6 banks) and still have room to buy back almost 2% of their shares.[2]

Canadian Financials Are Well Capitalized



Source: Canaccord Genuity, “Excess capital provides capital deployment flexibility”, April 5, 2021

Canadian lifecos have lagged their U.S. counterparts, which have not been restricted from share buybacks and dividend increases. U.S. lifecos have been increasingly buying back stock, increasing dividends, and as a result outperforming Canadian lifecos. Since the beginning of the COVID-19 stock market drawdown, U.S. lifecos have returned 10% vs a decline of 1% for Canadian lifecos, on a market-cap weighted basis (February 14, 2020 to May 18, 2021).[3] Once OSFI lifts restrictions, as anticipated by many analysts[4], we expect that Canadian lifecos will resume pre-pandemic share buybacks and dividend increases, enhancing Canadian lifeco share price performance.

We remain bullish on North American Financials heading into the second half of the year and believe Financials are fundamentally well positioned for the continued recovery. Not only are banks and lifecos very well capitalized, they are also cheap relative to the broad market. We believe earnings from the sector will continue to strengthen into 2022 with an expected return to dividend growth and buybacks providing another tailwind for share price gains.

Brompton’s Approach

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 Split Banc Corp. (TSX – SBC, SBC.PR.A) offers investors a way to invest in an approximately equal weight portfolio of the “Big Six” Canadian Banks.

Life & Banc Split Corp. (TSX – LBS, LBS.PR.A) offers investors a way to invest in an approximately equal weight portfolio of Canada’s four largest publicly-listed life insurance companies and “Big Six” banks.

Brompton Lifeco Split Corp. (TSX – LCS, LCS.PR.A) offers investors a way to invest in an approximately equal weight portfolio of Canada’s four largest publicly-listed life insurance companies.

(1) Refinitiv Datastream, June 23, 2021 to June 25, 2021

(2) Bloomberg, "Banks Poised for 13% Dividend Boost When Canada Regulator Allows", July 5, 2021

(3) BMO Capital Markets, "Q1/21 Recap - Lots of Excess Capital; Expect Accelerated Capital Returns Soon", May 18, 2021

(4) e.g. Scotiabank, "OSFI Raises DSB Buffer, But Still Waiting For A Green Light On Buybacks and Divvy Raises", June 17, 2021

BROMPTON FUNDS

VALUE

INTEGRITY

PERFORMANCE

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, Box 793
Toronto, Ontario M5J 2T3