Global Markets Review

Following a stormy month in September, global equity markets narrowly extended positive gains during the quarter. For the three-month period ending September 30, 2021, the MSCI World Index edged up 0.1%, led by the Financials sector, which gained 2.2%; Energy was the second-best performing sector, rising 1.6% during the quarter and boosted by robust oil and gas prices. In North America, the S&P 500 was up 0.6%, also driven by Financials, while the S&P/TSX Composite was up 0.2%, with Consumer Staples and Industrials as the top performing sectors. In Europe, the STOXX 600 rose 1.0% during the quarter. Italy and the U.K. were the best-performing countries, where the FTSE MIB was up 3.0% and the FTSE 100 was up 1.9%. CAC 40 and IBEX 35 ticked up 0.4% and 0.3%, respectively. Switzerland and Germany finished the period in negative territory, down 2.4% and 1.7%, respectively.

Global economies continued the path to recovery through the third quarter, while sentiment on the growth deceleration has weighed on the market. U.S. manufacturing PMI came in at 61.1 for September, the strongest reading during the quarter, while the unemployment rate also saw sequential improvement. Nonetheless, inflationary pressures remained elevated, with August core CPI at 4%, despite dropping from the June high (4.5%). Global yields spiked after bottoming in August. The U.S. 10-year Treasury yield peaked above 1.5% after a mildly hawkish Federal Open Market Committee (FOMC) meeting. The U.K. 10-year Gilts also mirrored its U.S. peer, touching 1% for the first time since May 2019. These triggered market selloffs of high-growth names especially among Information Technology and Healthcare sectors in the back half of September, while value stocks in Financials and Energy sector were buoyed on the back of rising yields. Although growth still outperformed value during the quarter, the gap has narrowed since mid-September, which coincides with rising yields. At the same time, uncertainties around China's slowing economic momentum and contagion risks due to the property developer Evergrande's debt crisis also sent market volatility higher in September.

There were few major monetary policy changes among global central banks in developed economies during the quarter, with inflationary pressures becoming the key variable for the pace of policy shifts. The Federal Reserve left the policy rate unchanged at 0%-0.25% at the September FOMC meeting, while acknowledging that "a moderation in the pace of asset purchases may soon be warranted". The latest median dot plot projects the fed funds rate at 1% by the end of 2023 and 1.75% by the end of 2024. Moreover, the 2021 inflation outlook was substantially lifted again to 4.2%, 80 bps above the June estimate, reflecting stickier inflation than had previously been expected. Real GDP forecast for the year was also revised down to 5.9% from 7%, implying headwinds in the near-term economic growth outlook.

In Canada, the Bank of Canada (BoC) kept all policy variables unchanged in the September statement, including the overnight policy rate at 0.25% and government bond purchases at C$2 billion per week. On inflation, the central bank still saw the current spike as transitory, highlighting that wage increases have been moderate and medium-term inflation expectations are well anchored. BoC Governor Tiff Macklem also released a roadmap to exit monetary stimulus, outlining that once the new stimulus is removed the first step would be to move to the reinvestment phase of the QE program (most likely cutting bond purchases from C$2 billion per week to C$1 billion). He also reiterated that the reinvestment would be maintained well past the initial rate hikes.

The European Central Bank (ECB) kept the benchmark interest rate unchanged at -0.50%. President Christine Lagarde repeated in September that the upswing in inflation was temporary, and that base effect and rising energy prices would not result in lasting inflation. The Governing Council decided to moderately lower the pace of purchases under the pandemic emergency purchase program (PEPP) from that of the past two quarters, with an unchanged envelope of EUR1.85 trillion through the end of March 2022 at the least. Purchases under the asset purchase program (APP) will progress at a monthly pace of EUR20 billion. The ECB raised their projections on 2021 annual real GDP growth for the euro area to 5% from 4.6% in the June assessment and annual inflation rate to 2.2% from 1.9% in June. Despite the bullish tone on the economic rebound, it is still too early to call for an end of the PPEP, as the decision will still depend on upcoming economic data before the December meeting. The Bank of England (BoE) voted in September to keep the policy rate unchanged at 0.1% and maintain the asset purchase target of £875 billion, while revising down the Q3 GDP forecast to 2.1% from 2.9%. BoE also reiterated that it expected CPI inflation to rise slightly above 4% this year, double its target, largely on the back of upside risks posed by hefty energy and goods prices. On the political front, Olaf Scholz of the Social Democrats narrowly led Chancellor Angela Merkel's Conservatives in the German election. This narrow victory suggests that long negotiations lie ahead before a coalition government can emerge, which could raise extended period of market and policy uncertainties.

According to the statistics compiled by the World Health Organization, the number of confirmed infections worldwide exceeded 233 million by the end of September, while the weekly cases have continued to drop after peaking in August. On the other hand, global vaccination efforts are well underway, with 70% of the population fully vaccinated in Canada and 56% in the U.S. However, due to fears of vaccine effectiveness against the Delta variant and delay of the vaccine rollout for ages 5-11 in the U.S., the pace of reopening was slower than previously anticipated during the

third quarter. Fiscal support in Q3 was a mixed bag. The American Rescue Plan, along with other assistances such as Child Tax Credit, continued enhancing household savings, which were channeled into consumer spending amid reopening. Furthermore, the U.S. Senate passed a $1.2 trillion infrastructure package in August, with the House vote delayed to the end of October. However, as many fiscal stimuli are fading, the fiscal impulse on growth could turn negative next year according to Goldman Sachs.

Looking ahead to the rest of 2021, sector rotations into value and cyclical could persist if the yield curve finds its support and ticks up. However, volatility would potentially linger into the fourth quarter given rising inflation expectations and contracting monetary gauges, as well as global supply chain issues and China's growth deceleration. Market leaderships would be rotating among value/growth and cyclical/defensive alternatively within short timeframes. In this regard, the barbell approach to our portfolios is still the preferred strategy, supplemented by opportunities in the covered call writing amid high volatility risk in the near term. We expect to have clearer visibility after upcoming waves of corporate earnings for Q3 and key economic releases. At the same time, widening vaccine coverage, resilient fiscal support, and abundant household savings should keep fueling economic growth.

Financial Sector Review & Outlook

We are constructively optimistic on the financial sector as the economy reopens and COVID-19 vaccinations hit a crescendo coupled with fiscal stimulus and proposed infrastructure spending which are positive tailwinds. We expect to see strong economic growth given an increase in the reopening of more businesses and the rebuilding of inventories. While supply chain disruptions could become a headwind, we view this as temporary and should be resolved over time. 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 and the return of excess capital will be tailwinds for bank stocks.

The pandemic has accelerated digitization trends that have been reshaping the financial sector. In the near-term digital transformation expenses continue to be a fast-growing cost item however we believe banks would unlikely pare technology expenses. Over time, investment in digital technologies is expected to lower banks' cost structure and improve efficiency gains. Banks continue to control operating expenses in the current environment. As the effects of the pandemic wane, related expenses continue to decline however, this is offset by increase in travel, wages and incentive compensation resulting in year-over year increases in non-interest expenses.

Capital deployment and progress on integrating previous acquisitions continue to be a focus for many investors. Banks have announced significant increases to dividends 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 which are skewed towards share buybacks. Goldman Sachs estimates that over the next twelve months banks will be buyback 9% of their current market cap.

Banks stocks are currently trading above book value (1.7x) and a slight premium to historic P/E (13.1x vs 11.1x) according to Bloomberg. We do not see valuation as stretched but rather a reflection of the optimism in future economic expansion. Taking into account a parallel shift in the yield curve, faster loan growth rates, improvement in efficiency ratios and total return of excess capital, current valuations provide embedded optionality to the upside in our view.

Portfolio Review

Brompton North American Financials Dividend ETF (the "Fund") was up 2.8% in Q3 2021 versus the S&P/TSX Capped Financials Index, which up 1.1% and the S&P 500 Financials up 2.7%.

The Fund was market weight Diversified Banks, which contributed to performance however lagged the benchmark. Top performers include JP Morgan (up 5.9%), Bank of America (up 3.5%), National Bank of Canada (up 3.3%).

An overweight position in Investment Banks contributed to the Fund's performance which was above the benchmark. Top performers include Morgan Stanley (up 6.9%) and Raymond James (up 6.9%).

The Fund was overweight Financial Exchanges which contributed to performance with. Top performers include NASDAQ (up 10%) and S&P Global (up 3.7%).

The Fund's overweight position in Life Insurers contributed to performance which slightly lagged the benchmark with as strength in Metlife (up 4%) was partially offset by weakness in Manulife.

The Fund benefitted from a market weight exposure to Regional Banks, with performance ahead of the benchmark. Top holdings include SVB Financial (up 16.3%), Fifth Third Bancorp (up 11.8%) and First Republic (up 3.2%)

The Fund's overweight position in Data Processing and Outsourced Services negatively impacted performance given weakness across our holdings in Mastercard, Paychex and Visa.

Annual Compound Returns[1]	YTD	1-YR	Since Inception[2]	Since Inception[3]
Brompton North American Financials Dividend ETF (CAD Hedged)	24.6%	46.7%	12.1%	-
Brompton North American Financials Dividend ETF (USD)	25.3%	49.7%	-	18.7%
S&P/TSX Capped Financials Index	24.8%	45.6%	12.9%	15.8%
S&P 500 Financials Index	29.0%	59.0%	14.7%	19.7%

[1] Returns are for the periods ended September 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.

BROMPTON FUNDS

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