Brompton North American Low Volatility Dividend ETF

BROMPTON FUNDS

PORTFOLIO MANAGER COMMENTARY - SEPTEMBER 30, 2021

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.

Portfolio Review

Brompton North American Low Volatility Dividend ETF (the "Fund") focuses on lowering total portfolio volatility through investing in a diversified blend of North American equities with a minimum market cap of $5 billion. In Q3, BLOV was up 3.1% versus the benchmark (MSCI Minimum Volatility USA) which was up 0.3%.

The Fund was significantly overweight the Consumer Staples sector, which outperformed relative to the benchmark. Top performing holdings include Costco (+13.8%), Loblaw (+11.9%) and P&G (+4.3%). The Fund also benefited from an overweight position in Utilities, which contributed to performance and beat the benchmark. Top performing holdings include NextEra Energy (+7.6%) and Brookfield Infrastructure (+2.1%). The Financials sector was underweight, but was the top contributor to the fund performance, with the only holding SVB Financials up 16.3% given rising yield curves. An underweight position in Information Technology contributed to the outperformance relative to the benchmark. Top performing holdings include Accenture (+8.8%) and NXP Semiconductors (+2.8%). A market weight position in Communication Services also contributed to Fund's performance versus the benchmark. Top performing holdings include BCE (+2.9%).

The Fund was overweight Consumer Discretionary, which underperformed relative to the benchmark, with its holding in Dollar General down 10.9%. An overweight position in Materials through holdings in Franco Nevada (-10.4%) detracted from the Fund performance. The Fund was underweight Healthcare, which underperformed the benchmark during the period.

For the first time in over a decade, the low volatility factor has generated poor returns. In our view, this short-term data point does not signify a trend neither an inflection point given the historic performance of low volatility. In H1 2021, the low volatility factor continued to underperform along with all other factors except value. This is attributed to heightened interest rate volatility given reflation of the yield curve due to fiscal stimulus. Although the low volatility factor has underperformed, we note that the low volatility factor has generated a positive premium in every decade since 1929, with a higher level of statistical significance than the other factors[1]. We expect the low volatility factor to mean revert to its historical premia over time as excessive risk taking by investors makes low volatility equities underpriced, which bodes well for long-term risk-adjusted returns.

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Annual Compound Returns[2]	YTD	1-YR	Since Inception[3]
Brompton North American Low Volatility Dividend ETF	8.4%	10.7%	14.2%
MSCI USA Minimum Volatility Gross TR USD Index	9.6%	17.2%	17.6%

(1) Blitz, David and van Vliet, Pim and Baltussen, Guido, The Volatility Effect Revisited (August 26, 2019).

(2) 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 MSCI USA Minimum Volatility Gross TR USD Index ("Minimum Volatility Index"). The Minimum Volatility Index is designed to reflect the performance characteristics of a minimum variance strategy applied to the large and mid cap U.S. equity universe. The Minimum Volatility Index is calculated using Barra Optimizer to optimize its MSCI parent index for the lowest absolute volatility with a certain set of constraints. The Fund invests in equities from North American issuers with a minimum market cap of $5 billion and employs quantitative analysis with an active fundamentals overlay to construct a portfolio with lower overall volatility than the market. It is therefore not expected the Fund's performance will mirror that of the Index. Further, the Index is 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.

(3) Inception date April 30, 2020.

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