Brompton Flaherty & Crumrine Investment Grade Preferred ETF

TSX:BPRF

Brompton Flaherty & Crumrine *Enhanced* Investment Grade Preferred ETF

TSX:BEPR

Portfolio Manager Commentary - November 30, 2021

Preferred Market Conditions

The preferred securities and contingent capital (CoCo) markets continued their strong performance in the third quarter, resulting in impressive returns year-to-date. Despite a few pauses along the way, low interest rates, a strong economic rebound from COVID, and continued accommodative monetary policy have provided a stiff tailwind for equity and fixed-income markets so far in 2021. Savings accumulated during earlier periods of COVID restrictions and consumers' own limits on their activities increased investable funds, and options for earning a respectable yield have diminished. The result has been highly technical markets, where investors are more worried about earning virtually nothing holding cash than potential market downturns if interest rates or equity-market valuations were to normalize.

From a credit perspective, Q3 continued to provide good news, with most issuers maintaining strong capital positions and healthy earnings, especially as the economy rebounded from earlier COVID restrictions and consumers and businesses resumed many activities. Banks once again passed stress tests with flying colors; insurance companies continue to wrestle with low interest rates but seem to be navigating the situation quite well; and energy has rebounded strongly as the pandemic receded. The Fed continues to stand behind the recovery and has indicated a willingness to let the economy "run hot", if necessary, to achieve long-run inflation and employment targets. Accommodative monetary policy both here and abroad should continue to support markets, although volatility may increase as we get closer to achieving the Fed's goals and central banks begin to dial back accommodation.

Outlook

As discussed in previous updates, flows into fixed-income investments have been robust. These flows have continued at a steady pace, but cash from issuer redemptions of callable securities was notably strong in Q3. Nearly every preferred security is callable at some point in time – it is just a matter of how far into the future. Interest rates have remained very low for an extended time, and credit spreads have compressed. Many securities became callable in 2021 at a time when refinancing was especially attractive for issuers. Issuers took advantage of this, and much of the issuance in Q3 was directly refinancing older securities, often at the lowest coupons that issuers have ever achieved.

We have always valued call protection in the Fund, viewing it as an important part of generating more sustainable income over time by providing greater control over reinvestment timing. As a result, the Fund's redemption experience in 2021 has been well below the broader market. Nonetheless, the Fund experienced some redemptions and reinvestment at lower yields. This wave of refinancing – along with future redemptions if interest rates and spreads remain low – will negatively impact distributable income over time.

Today's preferred securities and CoCo markets can be difficult to evaluate from a historical perspective, as coupons have moved materially lower with interest rates and spreads. By that measure, many securities appear fully priced, if not excessively priced. However, we also measure valuation in terms of credit spreads, and although they are tighter than a year ago, preferred securities and CoCos still offer a healthy subordination premium relative to senior securities of the same issuer. Lower coupons and tighter spreads in most cases can be explained by improved credit profiles, especially for financial issuers.

Recent issuance remains concentrated in a fixed-reset structure, and the reset index has broadly changed from 3M LIBOR (or SOFR) to 5Y Treasuries. This change, in addition to healthy backend credit spreads, results in an attractive combination of strong credit quality, relatively high income, intermediate interest-rate duration and moderate extension risk. Although we would like to see higher front-end coupons (mostly a function of interest rates), we continue to like this structural combination and think these instruments compare favorably to most other fixed-income securities.

Annual Compound Returns[1]	YTD	1-YR	3-YR	5-YR	10-YR	S.I. BPRF[2]	S.I. BPRF.U[3]
BPRF - Brompton Flaherty & Crumrine Investment Grade Preferred ETF (CAD-H)	3.2%	4.8%	7.9%	-	-	6.9%	-
BPRF.U - Brompton Flaherty & Crumrine Investment Grade Preferred ETF (USD)	3.4%	5.2%	-	-	-	-	7.3%
BEPR - Brompton Flaherty & Crumrine *Enhanced* Investment Grade Preferred ETF (CAD-H)	6.4%	8.6%	9.9%	7.4%	9.8%	-	-
ICE BofAML 8% Constrained Core West Preferred & Jr Subordinated Securities Index	2.0%	3.7%	8.6%	-	-	7.6%	6.1%
S&P/TSX Preferred Share Index	17.8%	20.6%	8.4%	7.0%	3.2%	5.2%	12.5%

(1) Returns are for the periods ended November 30, 2021 and are unaudited. The table shows the Fund's compound returns for each period indicated compared with the ICE BofAML 8% Constrained Core West Preferred & Jr Subordinated Securities Index ("Preferred & Jr Subordinated Securities Index") and the S&P/TSX Preferred Share Index ("Preferred Index") (together the "Indices"). The Preferred & Jr Subordinated Index tracks the performance of US dollar denominated high grade and high yield preferred securities and deeply subordinated corporate debt issued in the US domestic market. Qualifying securities must be rated at least B3, based on an average of Moody's, Standard & Poor's and Fitch and have a country of risk of either the U.S. or a Western European country. The Preferred Index tracks the performance, on a market-weight basis, of preferred shares listed on the TSX that meet the criteria relating to size, liquidity and issuer rating. 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. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on Net Asset Value per unit and assumes that distributions made by the ETF on its units in the period shown were reinvested at Net Asset Value per unit in additional units of the Fund.

(2) BPRF inception date October 15, 2018.

(3) BPRF.U inception date August 8, 2019.

BROMPTON FUNDS

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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