Brompton European Dividend Growth ETF (TSX: EDGF)

BROMPTON FUNDS

Portfolio Manager Commentary - March 31, 2022

Global Markets Review

First quarter of 2022 was a difficult start after a stellar 2021, with a majority of global equity markets experiencing turbulent performance. The Russia-Ukraine war, monetary uncertainty, and inflation concerns fueled a rise in market anxiety. For the three-month period ended March 31, 2022, the MSCI World Index fell by 5.0%. The index fell to the quarter-low in early March, followed by a sharp rebound through month-end. Energy was the best-performing sector, up 31.0%, while Consumer Discretionary was the bottom-performing sector, down 10.6%. In North America, the S&P 500 dropped 4.6%, while the S&P/TSX Composite gained 3.8%, well ahead of most global equity markets. The energy sector was the top performer in both the S&P 500 and S&P/TSX Composite. In Europe, the STOXX 600 was down 5.9%. The U.K. was the only developed European market that a registered positive return, with FTSE 100 up 2.9%. Spain and Switzerland fell by -2.6% and -4.3% respectively. France, Italy, and Germany also finished the period in negative territory with the CAC 40 down 6.7%, FTSE MIB down 8.1%, and DAX down 9.3%.

As the global economy was looking to emerge from the COVID-19 pandemic, the war between Russia and Ukraine became the top exogenous shock that escalated the existing concerns over inflation pressure and supply chain disruptions. Major economic indicators were mixed during the first quarter. U.S. Manufacturing PMI entered March at 57.1, the lowest reading since September 2020. On the positive side, we continued to see sequential decline in unemployment rates. However, inflation kept rising, as the March CPI data hit 8.5%, particularly through food and gasoline. Global yields rose sharply, with the U.S. Treasury market suffering from one of its worst selloffs on record. The 2-year and 10-year Treasury spread narrowed during Q1 and turned negative by the end of March for the first time since August 2019. The U.K. Gilt yield curves also flattened during the quarter, but not as pronounced as the U.S. Value stocks dominated in Q1 as rising rates weighed on growth names. Commodity-oriented stocks, such as crude oil, natural gas, and agricultural producers, led the rally amid the fear of tightening supply. This was also due to the Russia-Ukraine war and sanctions from the U.S. and its allies.

During the first quarter, central banks in developed economies delivered more hawkish stances of their monetary policy to combat inflationary risks. At the March Federal Open Market Committee ("FOMC") meeting, the Federal Reserve raised interest rates by 25 basis points, lifting its 0%-0.25% policy rate since March 2020. The policy rate change also marks the first rate hike since December 2018. As the Fed signaled further hikes at all six remaining meetings this year, the market is pricing in a 2.5%-2.75% target rate by year-end. The Committee also indicated in the recent Fed Minutes that they will begin to reduce the size of their balance sheet at a faster pace than was experienced in 2017-2019, reflecting more aggressive tightening and upward pressure on yields.

In Canada, the Bank of Canada (BoC) also commenced the tightening cycle to raise the overnight policy rate by 25 basis points to 0.5% at the March meeting. Even though Governor Macklem did not provide a detailed timeline on changing the reinvestment plan, he suggested that they will end purchases of government bonds, rather than slowly taper the reinvestment phase once the process of balance sheet reduction starts. The Bank is also open to 50-basis-point moves at individual meetings to tackle the rising inflation.

The European Central Bank (ECB) kept the benchmark interest rate unchanged at -0.50%. ECB President Christine Lagarde did not rule out the possibility of raising the policy rates this year. The Governing Council was clear on the necessity to reduce the asset purchases program (APP) over the coming months, while leaving it to the June meeting to decide on when to end the program. The decision is set to taper the APP from EUR40 billion in April to EUR30 billion in May, and EUR20 billion in June. Meanwhile, the pandemic emergency purchase program (PEPP) ended in March as stated in previous ECB meetings. In the U.K., the Bank of England (BoE) voted to lift the policy rate by two consecutive 25 basis points in its February and March meetings to 0.75%. The BoE also expected inflation to peak around 7.25% in April and dissipate over time. However, as the projections were published in February before the Russia Invasion of Ukraine, the upward pressure on inflationary risks could persist longer than projected.

The geopolitical tensions have been on the center stage in the first quarter, where Russia surprised the world with a full-scale military action on the Ukrainian border in late February, marking the first major military conflict in Europe in decades. Many developed countries have imposed economic sanctions on Russia, including banning Russian oil exports and its financial institutions from SWIFT. As a result, the conflict sent commodity prices such as crude oil, natural gas, and wheat sharply higher, which exacerbated the already-high inflation and supply chain bottlenecks, especially in Europe. In response, the U.S. announced to releasing 180 million barrels of crude oil over a six-month period from its Strategic Petroleum Reserve (SPR). The global oil supply had been tight even before the war. This has largely benefited commodity producers, resulting in Energy being the best-performing sector among most global equity indices. As market sentiment rose in response to the war, concerns over a global economic slowdown have been intensifying.

Looking forward to the rest of 2022, the global economy and broad equity markets will continue to be driven by high inflation readings, normalized monetary policies, and the unknown war duration. In addition, the impact of COVID-19 cannot be ignored yet, as many countries have seen rising cases after loosening pandemic measures. China in particular has extended strict lockdowns on major cities to contain the outbreak. In this vein, it would be inevitable to see market turbulence persist in the near-term, which raises the importance of active portfolio strategies. The barbell approach (owning both cyclicals and defensive) remains our preferred strategy, while favoring dividend-paying quality companies, which generally demonstrate solid balance sheets, stable earnings growth, and reasonable valuations. In our stock selection process, we also carefully examine the candidate's Russian exposure and pricing power to deal with the uncertainties arising from geopolitical conflict and rising inflation.

Portfolio Review

During the first quarter, Brompton European Dividend Growth ETF (the "Fund") was down 9.8%. This compares to the STOXX Europe 600 Index, which was down 5.9% over the same period.

The Fund benefitted from overweight positions in Energy during the quarter. Equinor was the top performance contributor in the sector. We have a favorable view on Energy heading into the next quarter. Energy acts as an effective hedge against geopolitical uncertainty. At the same time, energy companies have strong free cash flow generation and earnings growth potential through buybacks. Strong stock picks within the Consumer Discretionary sector also contributed positively to the Fund's performance. LVMH, Mercedes-Benz and EssilorLuxottica all generated superior performance versus the Consumer Discretionary complex. High consumer savings should continue to support consumer spending in this sector, especially in the services segment. We favor luxury players who faces relatively inelastic consumer demand in the face of rising inflation.

The Fund's overweight positions in Health Care offset some of the gains in the aforementioned sectors. We have a positive outlook for this sector heading into the second quarter, as the Russian-Ukraine war supports capital flow into defensive sectors such as Health Care and Utilities. The underweight position in the Materials sector was also a deterrence to the Fund's performance. Industrial gas stocks posted solid performance last year but weakened over the course of Q1 as investors shifted away from high quality names and into cyclical names within Materials.

Our cautious outlook for Q2 given the current geopolitical tension led us to trim allocations in certain cyclical sectors, including Information Technology, Industrials and Consumer Discretionary, while maintaining exposure to others like Energy. The Fund currently employs a barbell approach which balances exposure to both pro-cyclical sectors like Energy and Financials, as well as defensive sectors like Health Care, Utilities and Real Estate. We believe a barbell approach is appropriate in the current environment where market sentiment rotates quickly and frequently.

Laura Lau, SVP & CIO

Michael D. Clare, VP & PM

Annual Compound Returns[1]	YTD	1-YR	3-YR	Since Inception[2]
Brompton European Dividend Growth ETF	(9.8%)	6.4%	10.2%	7.5%
STOXX Europe 600 Index	(5.9%)	9.2%	9.6%	6.9%

[1)] Returns are for the periods ended March 31, 2022 and are unaudited. The table shows the Fund's compound return for each period indicated compared with the STOXX Europe 600 Index ("STOXX Index"). The STOXX Index is a subset of the STOXX Global 1800 Index. With a fixed number of components, the STOXX Index represents large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Demark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. Since the Fund is actively managed, the sector weightings may differ from those of the STOXX Index. The STOXX Index is calculated without the deduction of management fees, expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses.

[2)] Inception Date July 21, 2017.

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