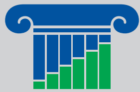

BROMPTON SPLIT BANC CORP.

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

Brompton Split Banc Corp. (the "Fund") invests in a portfolio consisting primarily of the six largest Canadian banks as well as up to 10% of the portfolio can be invested, from time to time, in global financial companies through an investment in the Brompton North American Financials ETF ("BFIN"). BFIN is an exchange-traded fund that invests in the equity securities of North American financial services companies with a market capitalization of at least $5 billion.

In the first quarter of 2022, the Fund was up 2.3% versus the S&P/TSX Financials Index, up 2.2%, and the S&P/TSX Banks Index, which was up 3.4%. We maintain our positive view on Canadian banks as economic recovery from COVID-19 continued during the quarter. With U.S. and Canada's central banks entering a rate tightening cycle, Canadian banks have been well positioned to benefit from rising policy rates. Profitability saw further improvement, boosted by spread revenue growth. Capital markets segment also saw strong trading revenue and contributed to revenue diversification, although the results are expected to normalize. Overall loan growth remained solid, propelled by robust commercial lending and mortgage applications. More encouragingly, credit card balances saw the first year-over-year growth this quarter since the first quarter of 2020, in line with pre-pandemic levels. At the same time, credit quality and reserve adequacy remained intact. We believe continued reserve releases should further benefit bank earnings over the upcoming quarters. Canadian banks are well capitalized, with CET-1 ratios ranging from 12.0 % at BNS to 15.2% at TD, well above the regulatory requirement. Regarding capital deployment, with robust balance sheets and high capital levels, many banks announced increased dividend and share buy backs. CIBC a announced 2-for-1 stock split. Some banks also made sizable acquisition announcements. For example, TD will acquire First Horizon, a U.S. regional bank, for US$13.4 billion; RBC will acquire U.K.'s Brewin Dolphin for $2.6 billion to expand their wealth management business.

Valuations for the large Canadian banks remain appealing, with P/B and forward P/E multiples trading around historical averages since 2010. We believe Canadian banks present a better risk/reward profile than their global peers given their low exposure to Russia-Ukraine geopolitical tensions, high-single to low-double digit return potential, and attractive divided yields.

The Fund was negatively affected by its holdings in BFIN during the quarter, which was down 7.0%. BFIN's performance was dragged by all sub-industry groups except for P&C Insurance as well as Diversified Banks.

Laura Lau, SVP & CIO

Michael D. Clare, VP & PM

| Annual Compound Returns[1] | YTD | 1-YR | 3-YR | 5-YR | 10-YR | Since Inception[2] |
|---|---|---|---|---|---|---|
| Brompton Split Banc Corp. - Class A | 2.8% | 35.7% | 24.3% | 14.9% | 16.8% | 12.9% |
| S&P/TSX Capped Financials Index | 2.2% | 22.5% | 15.9% | 11.3% | 12.3% | 9.3% |
| Brompton Split Banc Corp. - Preferred | 1.3% | 5.1% | 5.1% | 5.0% | 4.9% | 5.1% |
| S&P/TSX Preferred Share Index | (2.5%) | 6.9% | 8.1% | 4.5% | 2.8% | 2.9% |
| Brompton Split Banc Corp. - Unit | 2.3% | 23.9% | 16.3% | 10.9% | 11.6% | 9.5% |

*(1) Returns are for the periods ended March 31, 2022 and are unaudited. The table shows the Fund's compound return on a Class A share, Preferred share and unit for each period indicated compared with the S&P/TSX Capped Financials Index ("Financials Index") and the S&P/TSX Preferred Share Index ("Preferred Index") (together the "Indices"). The Financials Index is derived from the Composite Index based on the financials sector of the Global Industry Classification Standard. The Preferred Index tracks the performance, on a market weight basis, of a broad index of preferred shares trading on the TSX that meet the criteria relating to size, liquidity and issuer rating. The Fund passively invests on an approximately equal weight basis in a portfolio comprised of six Canadian banks which are in the Financials Index but may hold up to 10% of its assets in global financial services companies. Since the Indices have more diversified portfolios, it is not expected that the Fund's performance will mirror that of the Indices. The Indices are calculated without the impact of management fees, fund expenses and trading commissions, whereas the performance of the Fund is calculated after deducting such fees and expenses. Further, the performance of the Fund's Class A shares is impacted by the leverage provided by the Fund's Preferred shares.*

*(2) Inception Date November 16, 2005.*

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*You will usually pay brokerage fees to your dealer if you purchase or sell shares of the Fund on the Toronto Stock Exchange or other alternative Canadian trading system (an "exchange"). If the shares are purchased or sold on an exchange, investors may pay more than the current net asset value when buying shares of the investment fund and may receive less than the current net asset value when selling them.*

*There are ongoing fees and expenses associated with owning shares of an investment fund. An investment fund must prepare disclosure documents that contain key information about the Fund. You can find more detailed information about the Fund in the public filings available at www.sedar.com. The indicated rates of return are the historical annual compounded total returns including changes in share value and reinvestment of all distributions and do not take into account certain fees such as redemption costs or income taxes payable by any securityholder that would have reduced returns. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.*

*Certain statements contained in this document constitute forward-looking information within the meaning of Canadian securities laws. Forward-looking information may relate to matters disclosed in this document and to other matters identified in public filings relating to the Fund, to the future outlook of the Fund and anticipated events or results and may include statements regarding the future financial performance of the Fund. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Actual results may vary from such forward-looking information. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.*

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