Brompton Sustainable Real Assets Dividend ETF (TSX: BREA)

BROMPTON FUNDS

Portfolio Manager Commentary - June 30, 2022

Global Markets Review

The first half of 2022 was undoubtedly a difficult start for most global equity indices, with some of them entering a bear market during the period. The Russia-Ukraine war, global monetary tightening, and rampant inflation fueled a rise in recessionary concerns. For the six-month period ended June 30, 2022, the MSCI World Index fell by 20.3%. Energy was the only sector that registered positive returns (+24.7%), while Consumer Discretionary was the bottom-performing sector (-31.8%). In North America, the S&P 500 slumped 20.0%, while the S&P/TSX Composite lost 9.9%. Energy, again, was the best contributor to both markets. In Europe, the STOXX 600 was down 14.4% for the first half of this year. The U.K. FTSE 100 was the best-performing index (-1.0%). Spain and Switzerland were down by 5.3% and 14.3%, respectively. France, Germany, and Italy all finished the period in negative territory (CAC 40 -15.2%, DAX -19.5%, FTSE MIB -19.6%).

Global economic growth has been challenged by rising inflation. Exogenous shocks, such as the Russia/Ukraine war since the end of February and a two-month lockdown in Shanghai, have exacerbated the already-high inflationary pressure. Elevated energy prices are weighing on every aspect of industrial and consumer activities, while inventory levels are accumulating as both pandemic-induced supply shortages and avid demand start to ease. Major economic indicators in the U.S. confirmed an economic slowdown. May CPI surged to 8.6%, the highest reading since December 1981. Food and gasoline price increases have been the main drivers of inflation accelerating. Rising inflation is eroding real wage growth, while unemployment rates continued to see sequential decline so far this year. Manufacturing PMI entered May at 56.1, ticking up from the April low, but the gauge has largely trended down since its peak in March 2021. Global yields rose in response to the inflation overshoot and monetary tightening. The U.S. Treasury market suffered from one of its worst selloffs on record during the first half of 2022, while the 2-year and 10-year Treasury spread narrowed and dipped twice below zero during the period. Bond market selloffs also deepened in Europe on the expectation of a more aggressive pace of tightening from the European Central Bank. With the tight oil market and inflation on the rise, energy stocks showed robust performance, with many enjoying double-digit returns. The sector has become one of the few places to hide in this turbulent market. In addition, quality names which offer decent dividend yields in defensive sectors such as Consumer Staples and Utilities generally showed better resilience than cyclical and growth peers such as Consumer Discretionary and Technology sectors during the 6-month period.

During the second quarter, central banks in developed economies continued to deliver more hawkish stances of their monetary policy to combat inflationary risks. At the June Federal Open Market Committee ("FOMC") meeting, the Federal Reserve raised interest rates by 75 basis points to the 1.5%-1.75% range, representing the biggest increase in a single meeting since 1994. As the Fed signaled further hikes at all remaining meetings this year, the Fed Fund Futures market is pricing in another 165 basis points of tightening to 3.3% by year-end, including another possible 0.75% hike at the July meeting. The Committee also reiterated the balance sheet reduction at a pace of $47.5 billion a month starting from June 1 and will ramp up to $95 billion in September. GDP forecasts were also sharply revised down to 1.7% in 2022, down from 2.8% in the March estimates.

The Bank of Canada (BoC) also stressed the importance of taming inflation by delivering back-to-back 50-basis-point policy rate increases at the April and June meetings, respectively. This brought Canada's overnight policy rate from 0.5% at March meeting to 1.5%. The statement communicated explicitly that the central bank may act more aggressively if the commitment to achieve the 2% inflation target needs to be met. Higher interest rate will test Canadian households' ability to service their debts, as the housing market cooled in Q2, which is expected to slow further amid the rate hike cycle.

The European Central Bank (ECB) kept the benchmark interest rate unchanged at -0.50%, while expecting its first policy rate hike at the July meeting. Surprisingly, the ECB held an unscheduled monetary policy meeting in June and subsequently announced it will create a new instrument to tackle the risk of fragmentation. However, the detail of the new instrument will remain uncertain until the July meeting, and whether it can alleviate the ongoing economic and geopolitical risks resulted from the war in Ukraine will remain in question. Meanwhile, the Bank of England (BoE) voted to lift the policy rate by two consecutive 25 basis points hikes in May and June to 1.25%. The BoE also revised up its forecast for peak of inflation this year to "slightly above" 11%. Even though energy shocks are larger in the U.K. than in the U.S., indicating a sharper consumer spending drop, the fiscal policy remains more growth supportive in the U.K., while the U.S. fiscal impulse has become a drag.

The geopolitical tensions have been on the center stage during the first half of 2022, where Russia surprised the world with full-scale military action on the Ukrainian border in late February, marking the first major military conflict in Europe in decades. As a result, the war, along with the consequent sanctions imposed by Western countries, 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 a release of 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. According to the latest World Economic Outlook update issued by the International Monetary Fund (IMF) in April 2022, the global economy is projected to grow 3.6% for both 2022 and 2023, revised down by 0.8 and 0.2 percentage points lower respectively from the January forecast. Due to the war-induced commodity price surge, the IMF also expected inflation in advanced economies to rise by 5.7%.

Looking forward to the back half of 2022, the global economic slowdown should persist, and broad equity markets should continue to experience high volatility driven by further monetary tightening, high inflation readings, and the unresolved Russia/Ukraine conflict. Inflation will stay elevated before it cools down. This, along with monetary hawkishness, is weighing on corporate profitability. Companies' abilities to maintain stable margins and earnings growth become the key focus in the upcoming earnings season. However, we do not believe all negative earnings revisions have been priced in yet. Therefore, in response to the ongoing market turbulence and growing likelihood of a recession, we are positioning our portfolios tilted towards more defensive names. We continue to favor high quality companies that demonstrate strong balance sheets, sustainable earnings growth, and reasonable valuations. Regarding country exposure, some European and Asian equity markets have shown relatively cheap valuations, such as U.K. and Japan. In our stock selection process, we also carefully examine the candidate's pricing power, cost management capabilities, and leverage risks to analyze their performance under this inflationary and monetarily restrictive environment. We have also increased our call options overwrite levels to generate additional yields while providing a cushion against further market decline.

Portfolio Review:

Brompton Sustainable Real Assets Dividend ETF (the "Fund") was down 8.7% during the first half of 2022, in-line with the Blended Index (75% Dow Jones Brookfield Global Infrastructure Composite Index and 25% Dow Jones Global Select Real Estate Securities Index), which was down 7.6% over the same period.

The Fund benefitted from overweight exposures to Communication Services and strong stock picks in Energy. Canadian Natural Resources, Equinor and Williams were the top contributors to the Fund's outperformance, generating gains in the range of 25% to 32% during the holding period. Canadian telecommunication stocks in the portfolio including TELUS and Bell have outperformed their European and U.S. peers due to solid fundamentals and healthy competitive dynamics in Canada. We continue to be buyers of Canadian telcos on rapidly improving revenue profiles and attractive dividend yields in the space.

Overweight positions in Industrials and Materials detracted from the Fund's performance. During the period, defensive sectors generally outperformed cyclicals except for Energy. High quality industrials automation players and global transportation giants including Schneider Electric and AP Moller-Maersk have seen rotation out of their respective sub-sectors into defensives. We believe their balance sheets remain healthy and that the emphasis placed on infrastructure spending and energy efficiency by regulators should bode well for revenue growth in the medium and long term.

During the period, we have increased the Fund's allocation to Energy and Utilities and trimmed exposure to Industrials, Materials and Real Estate. Energy was the top performing sector in the S&P 500 and the S&P/TSX Composite during the six-month period. We believe oil prices will stay elevated for the duration of the Russian-Ukraine war. We have seen powerful rotations into the Utilities sector as investors sought shelter during times of uncertainty. We see attractive risk-reward within the sector as we believe the global shift to energy independence will attract more capital into the space.

Laura Lau, CIO

Michael D. Clare, SVP & SPM

Annual Compound Returns[1]	YTD	1-YR	Since Inception[2]
Brompton Sustainable Real Assets Dividend ETF	(8.7%)	3.0%	10.8%

[1] Returns are for the periods ended June 30, 2022 and are unaudited. The table shows the ETF's compound returns for each period indicated. Past performance does not necessarily indicate how the ETF 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 ETF.

[2] Inception date April 30, 2020.

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