Brompton Global Healthcare Income & Growth ETF (TSX:HIG; HIG.U)

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 a registered positive return (+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%).

The 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 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 declines 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 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 January forecast. Due to 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, we believe the protracted inflation has created challenge for the U.S. economic outlook. With Fed’s commitment to keep raising interest rates, whether it can engineer a soft landing becomes increasingly questionable. Consumer confidence dropped to 16-month low, dragged by food and energy costs due to inflation overshoot, while household savings have started to decline from pandemic highs. Fiscal stimulus from pandemic has faded and becomes a drag. Even though equity valuations have largely declined due to the market selloff, we remain cautious on growth sectors but do see opportunities in some deep value names. In addition, the midterm election will serve as an additional risk factor to market volatility. In short, we believe U.S. equity would continue to suffer from asymmetrical downside risks amid headwinds from negative earnings revision, while maintaining our preference for defensive characteristics.

Healthcare Sector Review & Outlook

We continue to believe that healthcare offers an attractive risk/reward opportunity with political risk and drug pricing overhang abating. Demand for healthcare services continues to increase, with a growing and aging population enjoying longer lifespans. In addition, continued innovation in the sector drives the introduction of new treatments for more complex diseases and expanding market opportunities for healthcare companies. We believe the healthcare sector provides both stable dividend and defensive characteristics. Many large cap healthcare stocks generate durable cash flow, due to their diverse product offerings, and can maintain pricing power and pass-through costs in inflationary environments. Since the 1960s, healthcare has outperformed the broader market by approximately 3 percentage points annualized when inflation was elevated (according to Goldman Sachs November 18, 2021). While recessionary pressures can be a headwind, we note that the healthcare sector performs consistently well both heading into a recession and following a recession. In the last 5 recessions since 1981, Healthcare had a median return of 14% relative to the S&P 500 12 months after recessions starts, which makes it the second-best performing sector.

The factor rotation towards value away from growth during H1 2022 had a bifurcated impact on sector performance with pharma, managed care and distributors outperforming the broader market and hospitals, life sciences, biotech, animal health and dental underperforming. Given the macro dominated headwinds valuations in healthcare is attractive trading at 15.6x forward P/E vs the 10-year average of 20.7x. Similar to H1 2022 performance, EPS revisions in healthcare have been bifurcated with underperforming subsectors seeing EPS revised downwards.

There are some biotech companies trading below cash levels which could spur additional M&A in the space given attractive valuations and pipeline catalysts. We believe there will be a renewed focus on evaluating the potential for unrealized value across biotech companies that offer revolutionary platform technologies and processes. Examples include 1) gene editing - making permanent, precise edits to the genome to repair underlying genetic mutations or to create engineered immune cells for enhanced therapeutic benefit and 2) use of machine learning algorithms and artificial intelligence to better understand native biology and thus aid in the design and development of novel therapies.

Healthcare innovation remains a focal point especially given the success in novel platforms such as mRNA platform in the rapid development of a Covid-19 vaccine. Several companies are now advancing clinical programs in mRNA-based flu vaccines, notably 1) Moderna 2) Pfizer/BioNTech

3) Sanofi/Translate Bio and 4) GSK/Curevac. mRNA-based flu vaccines are expected to achieve higher efficacy than traditional egg-based viral replication (50% to 60% versus 20% to 60%) with shorter development times. This incremental improvement in efficacy could have a significant benefit to society as the WHO estimates that annual influenza epidemics are responsible for an estimated 3-5 million cases of severe respiratory illness, and about 250-500k deaths. In the US seasonal influenza is estimated to have an economic burden of $11 billion according to Goldman Sachs.

Overall, we believe healthcare is an attractively valued defensive sector that exhibits resiliency in the face of inflationary and recessionary headwinds. We note that the pharma and biotech subsectors have one of the most stable and least volatile dividend yield profiles compared to other dividend paying industries. We believe stocks in our portfolio are well positioned in their respective end markets, driving growth and durable cash flow. Our active management approach allows us to capture factor rotations given the dynamic macro backdrop.

Portfolio Review

Brompton Global Healthcare Income & Growth ETF (the "Fund") was down 16.5% in H1 2022 versus the MSCI World Health Care Index, which was down 10.1%.

The Fund's underweight position in the Biotechnology subsector contributed to performance which was ahead of the benchmark. Top performers include Abbvie (up 15.3%).

A market weight in the Life Sciences subsector contributed to performance that was ahead of the benchmark. Our holdings were on average down 22% versus the benchmark down 27%.

The Fund's overweight exposure to the Healthcare Equipment subsector detracted from performance which lagged the benchmark. Our holdings were down 33% versus benchmark holdings down 28%.

The Fund began the year underweight the Pharmaceuticals subsector, which negatively impacted performance relative to the benchmark since Pharmaceuticals performed well relative to other subgroups. We added to this group late in the first quarter and again early in the second quarter, which brought the subsector to an overweight position. Top performers in the group include Eli Lilly (up 18.3%), Merck (up 21%) and Astrazeneca (up 15.4%).

The Fund's market weight exposure to the Managed Healthcare and Facilities sectors detracted from performance that lagged the benchmark. Top performers include Humana (up 14.9%), McKesson (up 4.9%) and United Health (up 3%).

Laura Lau, CIO

Michael D. Clare, SVP & SPM

Annual Compound Returns[1]	YTD	1-YR	3-YR	5-YR	Since Inception[2]	Since Inception[3]
Brompton Global Healthcare Income & Growth ETF (CAD Hedged)	(16.5%)	(4.7%)	5.4%	6.2%	6.3%	-
Brompton Global Healthcare Income & Growth ETF (USD)	(16.8%)	(5.2%)	-	-	-	6.4%

(1) Returns are for the periods ended June 30, 2022 and are unaudited. The table shows the ETF's compound return or 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 September 24, 2015.

(3) Inception Date August 8, 2019.

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