Brompton Insights

Riding the Red Tide: U.S. Election and Financials

November 14, 2024

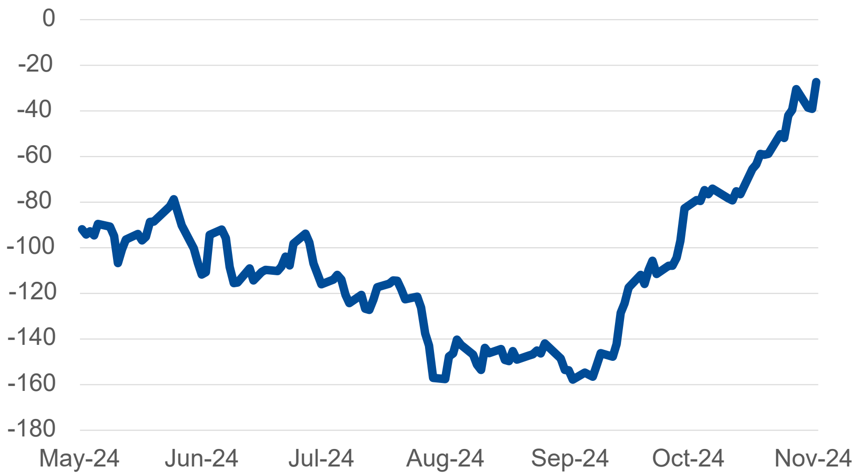
Fund in focus: Brompton North American Financials Dividend ETF (BFIN)

With the U.S. election now in the rearview mirror, investors have begun to assess the likely policies that we will see from a Republican-controlled government over the next two years. While some policy uncertainty remains, it is clear that the financial sector has emerged as one of the biggest winners. There are several reasons why we think financials remain well-positioned as we look out to 2025.

1. Steepening Yield Curve

All else being equal, a steeper yield curve is positive for financials given the benefit of higher reinvestment yields on fixed rate assets as long-term rates push higher, while banks also benefit from lower short-term rates on their deposits. Heading into the election and in the days since the results became known, long-term rates have moved higher as the market priced in a Trump win along the inflationary policies we will likely see once he takes office. At the same time, short-term rates continue to move lower as the Federal Reserve is widely expected to continue cutting rates through the first half of 2025. As a result, the difference between the 5-year yield and the 3-month yield, which we believe is the most relevant part of the yield curve for banks, has steepened by 131 basis points ("bps") from its recent low in September through November 6th, the day after the election. We believe this trend will remain positive for financials into 2025.

U.S Yield Curve: 5-year rate minus 3-month rate (bps)



Source: Bloomberg (November 6, 2024)

2. Reduced Regulatory Burden

We expect to see a general loosening of the regulatory environment under a Republican government. As it relates to financials, there are three key areas were this is positive.

Capital requirements: We believe that it is highly likely that the Basel 3 Endgame proposal will be finalized in a form that is much less onerous for banks. As such, banks will have excess capital that can be returned to shareholders through higher dividends and share buybacks.

Consumer fees: Under the current administration there are proposals in place to reduce certain fees, such as credit card late fees and overdraft fees, that banks and consumer finance companies can charge to consumers. We believe that these changes are unlikely to take place under the new government. This would be particularly beneficial for consumer finance companies. For example, Synchrony Financial was up 18.8% on the day after the election.

Antitrust enforcement: There will likely be fewer regulatory challenges of large M&A deals under the new administration. This is positive for regional banks, as we may see a consolidation wave, as well as investment banks, who stand to benefit from a potential M&A boom.

3. Potential for Lower Taxes

With Republican control of congress and Trump as president, we may see further corporate tax reform. This would be positive for financials given how heavily skewed their earnings are to the domestic market in the U.S.

4. Capital Markets Boom

We believe that we are in the early innings of an acceleration of capital markets activity, with many indicators flashing green. Management teams have pointed towards a build in pipelines and private equity players are beginning to return to the IPO market just as investment banking volumes relative to nominal GDP are beginning to take off from multi-decade lows. The election results are only likely to accelerate these trends further with a reduced regulatory burden, which is positive for the M&A cycle as well as institutional trading businesses. There are several sub-sectors within diversified financials that are well-positioned to capitalize on this environment including the large cap banks, investment banks, and alternative asset managers.

As there are several sub-sectors within financials that are poised to benefit from these trends over the next several quarters, we believe that investors would be well-served to invest in a portfolio that includes diversified financials in addition to the banks. By combining investments from different financial sub-sectors with varying risk profiles and return characteristics, investors can potentially achieve a more favourable risk-adjusted return profile for their portfolios. This can improve overall portfolio stability while adding growth potential and resilience against industry-specific downturns.

A Diversified Financials Solution

Brompton North American Financials Dividend ETF (BFIN) provides monthly distributions and the opportunity for capital gains through an investment in an actively managed, diversified portfolio of large cap North American financial services companies. BFIN's portfolio comprises of North American Financial Services companies with a market capitalization of at least $5 billion at the time of investment. The strategy includes an active covered call writing program to earn option premiums and lower the overall volatility of portfolio returns.

BROMPTON FUNDS

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