Brompton Insights

Canadian Banks – Steady Sails in Shifting Winds

January 16, 2025

Funds in focus: Brompton Split Banc Corp. (SBC), Life & Banc Split Corp. (LBS), Brompton North American Financials Dividend ETF (BFIN)

The Canadian banks demonstrated remarkable strength in 2024, with the Big 6 gaining 25.3%, outpacing the S&P/TSX Composite Index by 3.7 percentage points.[1] This strong performance came despite multiple headwinds facing the industry last year, including slowing economic growth, muted consumer spending, and rising unemployment. We think Canadian banks will still be able to perform well this year driven by an improvement in the economic environment, steepening yield curve, stabilization of credit quality, and a friendlier regulatory environment. The economic implications of US tariff threats and an election year in Canada are sources of uncertainties that we will closely monitor.

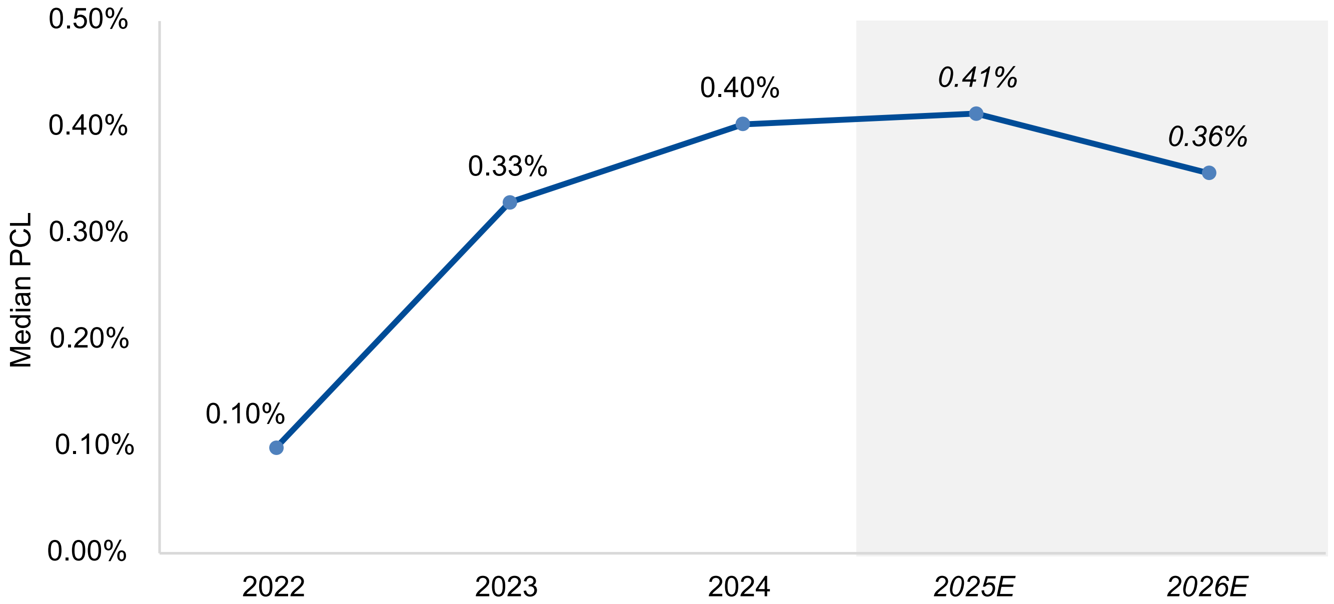
Improving Growth and Steeper Yield Curve Benefit Banks

We believe that the economic environment will become more favorable for Canadian banks in 2025. Canada's GDP growth is forecasted to improve this year with economists projecting 2% GDP growth in Canada compared to a 1% gain in 2024.[2] In terms of monetary policy, the Bank of Canada is projected to continue lowering interest rates throughout the year. Currently, the market is pricing in 2 to 3 additional rate cuts in 2025 with the overnight rate settling between 2.50% and 2.75% by year end.[3] At the same time, long rates are expected to stay roughly unchanged this year, leading to a steeper yield curve. Banks can borrow at lower short-term rates, easing funding cost pressure, and lend at higher long-term rates, potentially increasing net interest margin.

Lower Credit Losses and Higher Loan Growth Expected for Canadian Banks

As interest rates decline and economic conditions improve throughout 2025, we believe that the credit environment should stabilize, potentially leading to a peak in provision for credit losses (PCLs) during the year, as shown in the chart below. As the market starts to gain confidence that credit losses are peaking, this should have a positive impact on bank stock performance.

Credit Loss Provisions Expected to Decline for Big 6 Canadian Banks



Source: Bloomberg, as of December 31, 2024. Big 6 Canadian banks = Bank of Montreal, The Bank of Nova Scotia, Canadian Imperial Bank of Commerce, National Bank of Canada, Royal Bank of Canada, and The Toronto-Dominion Bank.

We believe that lending volume will pick up in 2025, particularly in residential mortgages. The housing market recovery, coupled with lower interest rates, is likely to drive increased demand for mortgages. TD is forecasting a 16% rise in home sales in 2025 on a year over year basis.[4] Recent changes to mortgage rules that came into effect on December 12, 2024, such as expanding eligibility for 30-year mortgage amortizations for all first-time homebuyers and for all buyers of new builds and raising the price cap for insured mortgages from $1 million to $1.5 million, should further stimulate mortgage lending.[5]

Positive Regulatory Environment

On the regulatory front, the capital rules for Canadian banks seem to have reached their peak, and there's growing expectation that the Office of the Superintendent of Financial Institutions (OSFI) may need to adjust its stance in response to developments in the United States. As the US considers softening the final stages of the B3E (Basel III Endgame) rules, we expect OSFI to follow suit directionally in order to maintain competitiveness in the market. This potential easing of capital requirements could provide Canadian banks with more flexibility in their operations and lending capacity.

Brompton's Approach

Split Corp. Class A shares provide investors an opportunity to generate enhanced returns on a portfolio of stocks compared to a direct investment in those stocks. Brompton Split Banc Corp. (SBC) and Life & Banc Split Corp. (LBS) invest in Canada's six largest banks, offering enhanced capital appreciation potential and monthly cash distributions.

Compound Annual Returns[6]	Yield[7]	1-Yr	3-Yr	5-Yr	10-Yr
Brompton Split Banc Corp. (TSX: SBC)	12.0%	44.0%	6.5%	15.1%	12.6%
Brompton Life & Banc Split Corp. (TSX: LBS)	13.3%	52.9%	15.8%	19.0%	15.2%

Brompton North American Financials Dividend ETF (BFIN) provides monthly distributions and the opportunity for capital appreciation 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.

Compound Annual Returns[6]	Yield[7]	1-Yr	3-Yr	5-Yr	Since Inception	Inception Date
Brompton North American Financials Dividend ETF, CAD-hedged (TSX: BFIN)	5.9%	33.9%	5.3%	8.9%	9.1%	10/17/2018
Brompton North American Financials Dividend ETF, USD (TSX: BFIN.U)	5.9%	32.9%	5.3%	9.6%	11.1%	08/08/2019

[1] Source: Bloomberg, as of December 31, 2024.

[2] Source: Bank of Canada. October 23, 2024. Monetary Policy Report—October 2024—Canadian economy.

[3] Source: Bloomberg, as of January 3, 2025.

[4] Source: TD Economics, December 2024. https://economics.td.com/ca-forecast-tables#home-sales.

[5] Source: Department of Finance Canada. September 16, 2024.

[6] Returns are for the periods ended December 31, 2024, and are unaudited. The tables show the compound return on the Class A shares Brompton Split Banc Corp. and Life & Banc Split Corp. and the CAD and USD units of Brompton North American Financials Dividend ETF, for each period indicated. Past performance does not necessarily indicate how the funds will perform in the future. The performance information shown is based on the net asset value per Class A Share or NAV per unit, as applicable, and assumes that distributions made by the funds on their Class A Shares or units during the periods shown were reinvested at net asset value per Class A Share or net asset value per unit in additional Class A Shares or units of the respective fund. Past performance does not necessarily indicate how the funds will perform in the future.

[7] An estimate of the annual yield an investor would receive if the most recent monthly distribution remained unchanged for the next 12 months, stated as a percentage of the closing market price of the Class A Shares or units on December 31, 2024. Source: LSEG Eikon.

BROMPTON FUNDS

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