TSX CALL

SEMI-ANNUAL COMMENTARY

Evolve U.S. Banks Enhanced Yield Fund

CALL invests in large cap U.S. banks with the added value of a covered call strategy applied on up to 33% of the portfolio.

As at June 30, 2020

TICKER: CALL (Hedged); CALL.B (Unhedged); CALL.U (USD)

MACROECONOMIC HIGHLIGHTS:

Shares of the biggest U.S. banks by market cap, including JPMorgan Chase, Bank of America and Citigroup, which are significant holdings in the ETF, declined by more than 30% in the first half of 2020, significantly underperforming the S&P 500 which fell by 4%.

Bank stocks were not left unscathed by the market decline during the first quarter and thereafter tended to move in sync with the rest of the market in response to news relating to the coronavirus pandemic – rising on positive news and falling on negative news. However, unlike many other sectors, banks did not recover as quickly when the markets rebounded because they are uniquely vulnerable to changes in interest and unemployment rates.

With unemployment rates reaching record highs during the first half of the year and interest rates record lows, banks experienced a two-fold challenge – lower profitability on loans, accompanied by declining demand for loans. In addition, existing bank loans have become risker with higher potential for default in the current high unemployment environment. As a result, big banks have added cash to their balance sheets in the form of loss reserves and provisions, indicating they are preparing for high levels of loan defaults, which would eventually be written down.[i]

To make matters worse, the Federal Reserve ordered banks at the end of June to suspend stock buybacks in the third quarter, and capped bank dividend payments at their present level, with further limitations based on recent financial results. Banks will also have to resubmit capital plans to take more specific account of the stresses that the COVID-19 pandemic has put on them and the broader economy.[ii]

On a positive note, the investment banking operations of banks such as Goldman Sachs which is a significant holding in the ETF, have done well during the first half of the year. While commercial banking operations, for instance loans and deposits, have performed poorly, investment banking activity tends to increase in times of market volatility.[iii]

In company specific news, Wells Fargo & Co, another holding, announced that it will donate over $400 million toward helping small businesses recover from the coronavirus pandemic, giving away all proceeds from its participation in the Payroll Protection Program. Other major lenders, including Citigroup Inc, have made similar pledges not to profit from the government stimulus program meant to help small businesses hard hit by mandatory COVID-19 related shutdowns.

Evolve ETFs
Brookfield Place, 161 Bay Street, Suite 2700, Toronto ON M5J 2S1
416.214.4884 | 1.844.370.4884 | www.evolveetfs.com

But those banks have said they will use some of the fees generated to cover costs associated with quickly rolling out the infrastructure needed to run the program.[iv]

In the first quarter, Ameriprise Financial, one of the ETFs largest positions, announced that that its fourth-quarter net earnings declined in part because of hedges placed on variable annuities. However, adjusted operating earnings per share rose 11% after accounting for a one-time charge related to the annuities. The company also announced that will be offering additional banking products, including mortgages in 2020.[v]

Throughout the period, the manager periodically used a covered call strategy to add value to the portfolio. Although the manager has the option of writing covered calls on up to 33% of the portfolio, volatile market conditions did not permit the continuous application of the strategy.

PERFORMANCE ATTRIBUTION:

At the end of the June, the ETF held a diversified portfolio of banks and finance companies. SVB Financial GR was the largest holding by weight, followed by First Republic Bank. The best performing stock was Ameriprise Financial, followed by Fifth Third Bank.

SOURCES:

[i] https://www.fool.com/investing/2020/07/09/why-big-bank-stocks-plunged-30-in-the-first-half-o.aspx
[ii] https://finance.yahoo.com/news/zacks-analyst-blog-highlights-anglogold-135901651.html
[iii] https://www.fool.com/investing/2020/07/09/why-big-bank-stocks-plunged-30-in-the-first-half-o.aspx
[iv] https://financialpost.com/pmn/business-pmn/wells-fargo-pledges-400-million-in-support-of-small-business-after-ppp-payout
[v] https://www.startribune.com/minneapolis-based-ameriprise-completes-year-of-progress-in-advice-and-wealth-management-business/567436632/

Evolve ETFs
Brookfield Place, 161 Bay Street, Suite 2700, Toronto ON M5J 2S1
416.214.4884 | 1.844.370.4884 | www.evolveetfs.com