

## Fund Manager Commentary

As of December 31, 2023

### Fund Highlights

- Invests primarily in issues having a market capitalization above \$5 billion at time of purchase
- Distinctive approach is centered on linking valuations with barriers to entry
- Seeks to invest in businesses that are trading below what is believed to be its estimate of the companies' intrinsic value
- Focuses on businesses that are believed to have a sustainable competitive advantage or a high barrier to entry in place
- Concentrated, high conviction portfolio generally holds 25-45 companies

### Market Recap

The final quarter of 2023 unfolded with a series of significant global market dynamics. October was marked by a rapid de-inversion of the U.S. yield curve, with rising U.S. 10-year yields breaching key thresholds. The U.S. 10-year rate breached 4% to approach 5%. In the Middle East, the breakout of the Israel-Hamas conflict increased fears it could spread across the region with the potential risk of disruption to key commodities such as oil and natural gas prices. Despite a good earnings season, these macro dynamics were negative for risk assets such as equities.

In November, a material shift in sentiment occurred with peak rates narrative surfacing, i.e. central banks being at the end of their tightening cycles. Falling inflation and weak economic prints, including manufacturing and labor market data, contributed to this peak rates narrative, particularly in Europe, where Germany is in recession. Consequently, the general move towards lower bond yields witnessed in November has been supportive of developed market equities.

Finally, the month of December was marked by increased investor confidence that monetary policy is well positioned to get inflation back to 2%, and that there is no reason for rates to remain high should inflation continue to fall. This soft landing narrative was supported by cooler-than-expected October personal consumption expenditures data and Eurozone inflation falling to its lowest level since mid-2021, while labor markets remained solid. Reflecting these expectations, yield curves across developed market economies have re-inverted with longer-maturity rates falling back rapidly.

Rising evidence of moderating inflation should be good for equities, so long as it is not accompanied by very weak growth. Therefore, the general move towards lower bond yields witnessed in November and December has been supportive of developed market equities.

In the last quarter of 2023, the equity markets declined until the end of October, when it reversed until December, to end with a double-digit percent gain. Throughout this period, U.S. equities stood out as the top performers, closely followed by European equities while Japanese equities lagged. During the quarter, all sectors within the MSCI World Index performed positively, except Energy. Notably, Information Technology sector was the strongest, followed by Real Estate and Industrial. Conversely, the weakest sectors were Energy and traditional defensive sectors such as Consumer Staples and Health Care. Across different investment styles, Growth emerged as the strongest, followed by Quality while Value lagged behind.

### Portfolio Review

The Touchstone Climate Transition ETF (NAV) underperformed its benchmark, the MSCI World Index, for the 3-month period ended December 31, 2023.

During the period, the Fund's underperformance was driven by its stock selections, mostly within Consumer Discretionary, Materials and Industrials. However, the Fund benefited from its sector allocation, mostly due to its structural underweight in Energy, Health Care and Consumer Staples sectors, which tend to be defensive and can typically lag behind sudden upward market moves.

Our top contributors to relative performance in the quarter were:

- United Rentals Inc. (Industrials sector), a construction equipment rental company which continues to benefit from U.S. infrastructure spend intentions.
- Sika AG (Materials sector), a specialty chemicals company where we have seen margins starting to inflect higher and strong execution of the recently closed MBCC acquisition.
- Trex Company Inc. (Industrials sector), a wood-alternative

*(continued)*

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Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. **For performance information current to the most recent month-end, visit <https://www.westernsouthern.com/touchstone/etfs/climate-transition-etf>.**



decking products company where we have started to pass through the tough COVID comparisons and see the business return to executing on its structural product advantage.

The largest detractors to relative performance in the quarter were:

- Array Technologies Inc. (Industrials sector), a global provider of utility-scale solar tracker technology which has suffered in the broader clean technology sell off as investors question renewables returns profile in a higher interest rate world.
- Anglo American plc (Materials sector), a mining company exposed to key metals for the sustainability transition who provided downbeat guidance on production numbers and where the market remains skeptical on its investment into green agricultural products.
- BYD Co. Ltd. (Consumer Discretionary sector), a Chinese manufacturer of electric vehicles (EV) cars and batteries who has suffered from industry price wars yet continues to execute now as the world's largest EV manufacturer.

Over the quarter, we reduced exposure to names where we were incrementally concerned about execution such as key renewables players in the Utilities sector, Orsted and AES. We replaced with Utilities sector companies CMS Energy Corp. where we are more comfortable in managements' handling of higher rates as well as Enel where we see a strong capital return story. Elsewhere, we took profits in strongly performing names such as Sprouts Farmers Markets (Consumer Staples sector) investing into broader transition enablers such as ST Micro and ASMI (both Information Technology sector).

## Outlook and Conclusion

After turbo-charged rate hikes and an initial normalization of a steeply inverted US yield curve, investors will adjust to a new regime in 2024. It could be characterized by higher-for-longer interest rates until a material deterioration in economic activity unfolds, in our view. When that happens, consumers could likely feel the pinch of stubborn, albeit decreasing, inflation as wage growth and employment cool. Markets will focus on consumers' health, credit quality, their down-trading to cheaper products and prioritization in spending. Decelerating growth, margin compression and higher funding costs would compel corporates to seek savings and productivity gains through artificial intelligence (AI) and other efficiency-boosting measures.

The prior calendar year was also marked by risk aversion, with bifurcated markets driving significant valuation dispersion across sectors, market capitalizations, regions and styles – epitomized by the dominance of the 'magnificent seven'. This has resulted in considerable gloom being (perhaps unfairly) priced into specific market segments. For instance, small and mid-caps have reached abnormally cheap valuations versus larger companies, especially mega caps. Chinese companies have been discounted to a level not seen in decades, and rising rates have hammered bond-proxy equities in the Consumer Staples and Utilities sectors. If either recession hits or the economy keeps humming, we believe asymmetrical opportunities exist as many growth concerns are already priced in. Interestingly, the consensus among bottom-up analysts monitored by Bloomberg is for a 2024 earnings expansion of almost 10%.

Inflation, supply-chain and energy-supply disruptions are increasing the costs of resources. We anticipate the adoption of renewables and energy-efficiency solutions to continue amid the \$1.7 trillion investment in clean-energy technologies expected this year and cumulative global capital expenditure for electrification forecast to reach \$24.5 trillion by 2030, according to our research. Secular themes that we focus on – like renewable power, energy efficiency, water infrastructure, robotisation and smart farming – should be supported by continuing fiscal expansion and constructive industrial policies, with the rollout of subsidies in some key economies. Although some themes suffered from the 2023 rise in interest rates, their longer-term outlook is still one of structural growth despite cyclical headwinds. Progress is evident in other sustainability themes, too. In agriculture, AI and advanced cameras that can distinguish crops from weeds are enabling precise watering and reduced chemical spraying. In the U.S., more than \$100 million is being committed to recycling projects to improve physical waste management, planning and data collection.

Such change is not currently reflected in markets. However, in the medium term, we expect sustainable assets to be revalued upwards towards their intrinsic value.



**Fund Facts** (As of 12/31/23)

Symbol	Inception Date	CUSIP	Exchange	Annual Fund Operating Expense Ratio	
				Total	Net
HEAT	04/28/23	89157W509	Cboe BZX	1.17%	0.69%
<b>Total Fund Assets</b>	<b>\$11.3 Million</b>				

Expense ratio is annualized. Data as of the current prospectus. Touchstone Advisors has contractually agreed to waive a portion of its fees and/or reimburse certain Fund expenses in order to limit certain annual fund operating expenses (excluding Acquired Fund Fees and Expenses "AFFE," and other expenses, if any) to 0.69%. These expense limitations will remain in effect until at least 04/29/24.

**Total Returns** (As of 12/31/23)

	4Q23	Inception
ETF NAV	7.73%	0.87%
ETF Market Price	7.75%	1.12%
Benchmark	11.42%	12.92%

Benchmark - The MSCI World Index

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**<https://www.westernsouthern.com/touchstone/etfs/climate-transition-etf>. From time to time, the investment adviser may waive some fees and/or reimburse expenses, which if not waived or reimbursed, will lower performance. Returns assume reinvestment of all distributions. Returns are not annualized for periods less than one year.**

Investing involves risk, principal loss is possible. Unlike mutual funds, ETFs may trade at a premium or discount to their net asset value. Touchstone ETFs are new and have limited operating history to judge. Shares are bought and sold at market price not net asset value (NAV). Market price returns are based upon the consolidated market price and do not represent the returns you would receive if you traded shares at other times.

**Top 10 Holdings of Fund** (As of 12/31/23)

	(% of Portfolio)		(% of Portfolio)		
1	Compass Group plc	2.9	6	CMS Energy Corp.	2.7
2	NextEra Energy, Inc.	2.8	7	SSE plc	2.5
3	CSX Corp.	2.8	8	Taiwan Semiconductor-SP A	2.5
4	Autodesk, Inc.	2.7	9	Hexcel Corp.	2.5
5	RWE AG	2.7	10	National Grid plc	2.5

Source: BNY Mellon Asset Servicing

Please consider the investment objectives, risks, charges and expenses of the ETF carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at [TouchstoneInvestments.com/resources](https://TouchstoneInvestments.com/resources) or call Touchstone at 833.368.7383. Please read the prospectus and/or summary prospectus carefully before investing.

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Not FDIC Insured | No Bank Guarantee | May Lose Value

The MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across 23 developed market countries.

The indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible. Unmanaged index returns do not reflect any fees, expenses or sales charges.

Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used to create indices or financial products. This report is not approved or produced by MSCI.

**A Word About Risk**

There are risks associated with investing, including possible loss of principal. The Fund invests in equities which are subject to market volatility and loss. The Fund invests in foreign securities, including depositary receipts, such as American Depositary Receipts, Global Depositary Receipts, and European Depositary Receipts, which carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. The Fund's climate transition investment criteria may limit the available investments or may cause the Fund to forgo opportunities to buy certain securities, or forgo opportunities to gain exposure to certain industries, sectors, regions and countries, which may cause the Fund to underperform funds that invest in a broader array of investments. In addition, the Fund may be required to sell a security when it might otherwise be disadvantageous for it to do so.

Touchstone exchange-traded funds (ETFs) are actively managed and do not seek to replicate a specific index. ETFs are bought and sold through an exchange at the then current market price, not net asset value (NAV), and are not individually redeemed from the fund. Shares may trade at a premium or discount to their NAV when traded on an exchange. Brokerage commissions will reduce returns. There can be no guarantee that an active market for ETFs will develop or be maintained, or that the ETF's listing will continue or remain unchanged.

The Adviser engages a sub-adviser to make investment decisions for the Fund's portfolio; it may be unable to identify and retain a sub-adviser who achieves superior investment returns relative to other similar sub-advisers. Events in the U.S. and global financial markets, including actions taken to stimulate or stabilize economic growth may at times result in unusually high market volatility, which could negatively impact Fund performance and cause it to experience illiquidity, shareholder redemptions, or other potentially adverse effects. Financial institutions could suffer losses if interest rates rise or economic conditions deteriorate. The Fund's service providers are susceptible to cyber security risks that could result in losses to a Fund and its shareholders. Cyber security incidents could affect issuers in which a Fund invests, thereby causing the Fund's investments to lose value.

The Fund invests in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. The Fund invests in mortgage-backed securities and asset-backed securities which are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. The Fund may experience higher portfolio turnover which may lead to increased fund expenses, lower investment returns and higher short-term capital gains taxable to shareholders. Current and future portfolio holdings are subject to change.



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