HAC Quarterly Commentary

Horizons Seasonal Rotation ETF

Q2 2022

Market Review

The S&P 500 started the second quarter of 2022 on a negative note as investors were concerned about the damaging effects of inflation. The continuing Russia-Ukraine war has caused supply chain problems and inflationary pressures to increase. The stock market declined in April, May, and June in correlation with the Federal Reserve (Fed) raising its federal fund's rate two times in the second quarter, maintaining a hawkish bias in its attempts to control inflation. In the second quarter, the economy continued to show signs of slowing. The combination of potentially rising inflation and a slowing economy put the S&P 500 into bear market territory.

On a relative basis, the Canadian stock market outperformed the S&P 500 for most of the second quarter. This was largely a result of the energy sector and other commodity sectors performing well in the first part of the second quarter. In addition, at this time, rising interest rates put downward pressure on the growth sectors of the stock market, including the technology sector. In the second half of June, as some of the commodity sectors of the stock market and the energy sector weakened, the S&P 500 gained strength compared to the Canadian stock market.

Quarter in Review

At the beginning of April, the ETF was substantially invested in equities. Towards the end of April, the ETF started to decrease its equity allocation as the unfavourable six-month seasonal period for stocks, from early May to late October, was approaching. The ETF benefitted from reduced stock market exposure in early May.

In the first five months of the year, US government bonds performed poorly as investors focused on the effects of rising inflation. US government bonds tend to perform well on a seasonal basis from early May until early October. In early May, HAC established a position in the US government bond market as the sector started its strong seasonal period.

In late May, the ETF allocated funds to the S&P 500 to take advantage of the strong seasonal trend in the market over month end. After benefitting from a strong market over month end, the ETF decreased its exposure to the stock market. In late June, the ETF increased its equity exposure to the S&P 500 to take advantage of the strong seasonal trend in the market over the June month-end, heading into the second quarter earnings season which starts in mid-July.

Outook and Positioning

Historically, the stock market tends to perform poorly for most of the third quarter. Over the long term, the two weakest contiguous months of the year have been August and September. In the third quarter, the stock market is facing many challenges, including rising inflation and a slowing economy. In addition, the stock market tends to perform poorly for most of the third quarter in U.S. mid-term election years.

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The sectors of the stock market that historically have performed well in the third quarter, relative to the broader stock market, are defensive sectors of the stock market, including consumer staples, health care, and utilities. This is particularly the case after the earnings season gets underway in mid-July. The cyclical sectors of the stock market generally tend to perform poorly in the third quarter of the year on a seasonal basis. Gold bullion and gold miners start their strong seasonal period in July. Given rising interest rates and a U.S. dollar, gold, on a relative basis, has been stable. If interest rates were to retreat and/or the U.S. dollar started to weaken, this could help gold bullion perform well in its historically strong seasonal period.

The risk to the stock market in the third quarter of the year is largely dependent on how the Fed navigates inflation and the market's reaction to economic growth numbers that are expected to be released. The Fed has recently been raising its federal fund's rate and has embarked on a quantitative tightening program, selling bonds into the market. If the economy continues to slow at the same time as the Federal Reserve's tight monetary policies are implemented, it's possible that the economy could slip into a recession. The third quarter is expected to be challenging for the stock market, but any weakness experienced during the third quarter could provide a good background for a strong rebound in stock performance in the fourth quarter.