HAC Quarterly Commentary

Horizons Seasonal Rotation ETF (HAC)

Q2 2023

Market Overview

At the start of the second quarter (Q2) in 2023, the U.S. economy was on stable footing with a positive GDP and low unemployment. Inflation peaked in the summer of 2022 and was continuing to decline in Q2. Overall, the economic conditions provided a moderate tailwind. There were concerns that several coincident and leading indicators were showing potential weakness in the economy. The mixed economic signals made it a challenging environment for investors. The U.S. Federal Reserve (Fed) continued to implement tight monetary policy as it continued to increase its Federal Funds rate until June when it paused its rate hiking schedule. In late June, the Fed took the position that it would probably hike its rate at least one more time in 2023.

The increase in the S&P 500 in Q2 was dominated by large-cap technology stocks which performed particularly well. In Q2, there was a lot of investor excitement about the potential of Artificial Intelligence (AI) that helped to boost the technology sector. The stock market generally had narrow breadth as most stocks in the S&P 500 lagged the performance of the technology stocks.

Quarter in Review

In Q2, the Canadian stock market underperformed the S&P 500. This was largely the result of the commodity sectors of the stock market performing poorly. In addition, the Canadian banks had a mediocre performance at best in Q2. Generally, the composition of the value-oriented Canadian stock market did favor its relative performance compared to the S&P 500.

At the beginning of April, the ETF was substantially invested in equities. Towards the end of April, HAC started to decrease its equity allocation as the unfavourable six-month seasonal period for stocks, from early May to late October, was approaching. In early May, the ETF substantially reduced its equity allocation as the unfavourable six-month period for stocks started. The ETF benefitted from reduced stock market exposure compared to the Canadian stock market which was negative over the May to June period. Compared to the S&P 500, the ETF lagged in the May to June period.

In May, HAC initiated a position in U.S. government bonds, which have a strong seasonal period from early May to early October. The position was negative as government bond yields continued to climb in May and June. In April, HAC initiated a position in the consumer staples sector as it tends to perform well in May on a seasonal basis. HAC exited the position in late May, as it lagged the market. In addition, HAC also initiated small pair trade positions, with short sell positions in the industrials and technology sectors. The trades were offset with long positions in the S&P 500. The positions were closed in late June. HAC also initiated a position in the healthcare sector in June, as the sector tends to perform well in June.

The sectors of the stock market that tend to perform well in the third quarter are defensive sectors of the stock market, including consumer staples, health care, and utilities. This is particularly the case after 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. The energy sector starts a strong seasonal period in late July. Although this seasonal period is relatively minor, the energy sector can perform well if it has lagged the stock market in recent months. This has been the case in Q2. Gold bullion and gold miners start their strong seasonal period in July. Gold and gold miners performed poorly in late Q2 as rising interest rates dampened their prospects.

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Outlook 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 central banks continuing to exercise tight monetary policy to fight inflation. Stock market investors have persistently pushed back on the Fed's tight monetary position, believing that the Fed will hit its terminal rate soon and start to reduce its Federal Funds' rate at a quicker pace than the Fed is communicating. The battle of expectations between the Fed and stock investors will probably be a source of volatility in the third quarter. The third quarter is expected to be challenging for the stock market, but any weakness is expected to present a good background for strong performance in the fourth quarter.