HAL Quarterly Commentary

Horizons Active Cdn Dividend ETF

Q1 2023

Market Overview

In the first quarter (Q1) of 2023, there were significant shifts in volatility and sentiment in the global marketplace. January 2023 was the fifth-best start for global equities in the last 50 years[1], but was followed by declines in February, wiping out nearly half of those gains. In March, adding to volatility was a risk appetite reversed by turmoil due to events in the U.S. banking sector.

In Canada, the S&P/TSX Composite Index performance was driven by Information Technology, Materials, Consumer Staples, Utilities, Industrials, Communication Services, and Real Estate, which outperformed the overall Index during the quarter and were helped by falling interest rates. Underperforming sectors included Energy and Financials, which faced cyclical headwinds during Q1.

Inflation expectations remain the focus, with improvement expected as headline inflation decelerated in Q1. The lower inflation rate was driven by lower transportation costs as a slowing economy lowered energy costs, and costs for shelter also slowed. Food inflation continues to remain elevated.

Quarter in Review

On a sector level, the REIT sector was the largest contributor to relative performance where positions in Granite REIT and Allied Properties led to a positive stock selection effect. Positions in Brookfield Infrastructure led to a positive stock selection in the Utilities sector. In the Materials sector, positions in CCL Industries and Transcontinental led to a positive stock selection effect.

HAL's position in the Energy sector led to strong outperformance in Q4 2022 but reversed in Q1 2023. The negative stock selection came from positions in Ovintiv, Arc Resources, Freehold Royalties, and Tourmaline Oil. In the Industrial sector, positions in Aecon Group, CNR, Waste Connections and Exchange Income led to a negative stock selection effect. The portfolio's underweight in the Information Technology sector led to a negative allocation effect. A position in TD led to a negative selection effect in the Financials sector.

Several names in the Energy sector were sold during the quarter, including Arc Resources, Peyto Exploration and Development, Prariesky Royalty, and Whitecap Resources. This was done to reduce the portfolio's overweight in the sector amid continued drops in Earnings Per Share (EPS) predictions, according to our AI model. The portfolio continues to be overweight in Energy but with less exposure to small-cap names in the sector. The proceeds were reinvested into the Bank of Montreal after a correction in the sector following the Silicon Valley Bank-related volatility, and into Aecon Group in the Industrials sector, for its attractive cash flow growth.

Outlook and Positioning

The 2022 headwinds that punished equities, including inflation, rising rates, geopolitical turmoil, and recession fears, remained a force in Q1 2023. However, they continue to shift and vary in magnitude. Investors seem to have increasingly accepted a narrative of "higher-for-longer" interest rates. With likely continued volatility and uncertainty on the horizon, stocks of companies that are well-positioned to sustain profit margins and earnings growth amid a challenging economic backdrop should outperform the broad market.

HAL favours companies with solid free cash flow and earnings, and strong balance sheets, with the ability to continue to grow dividends and with a low probability of dividend cuts. Over the past 12 months, 87% of the companies in our portfolio had dividend increases and there have been no dividend cuts. HAL continues to be overweight in Energy, Utilities, and Industrials while being underweight in Financials, Consumer Staples, and Real Estate.

[1]Source: Guardian Capital based on MSCI World Index data from Bloomberg to March 7 2023

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The Canadian market predicted earnings growth and dividend growth still look relatively strong. The Sub-advisor takes a hands-on approach to every stock in HAL when it comes to the probability of dividend cuts and exercises due diligence on any names where the rising probability of dividend cuts is observed.

Given the current environment, it is expected that dividend yields and growth will moderate. HAL focuses on attractive dividend yields and growth with a low probability of dividend cuts, rather than chasing the highest yielding companies that may expose the strategy to unwanted credit risk and potential dividend cuts.

After years of muted performance versus other equity styles, it is potentially time to consider the duration and credit cycles within the dividend asset class. It is the sub-advisor's view that dividends could offer the best opportunity of many options by owning companies that can continue to reward shareholders through dividends, buybacks and debt reduction, combined with careful consideration of stock and sector allocations.