HAL Quarterly Commentary

Horizons Active Cdn Dividend ETF

Q3 2023

Market Overview

During the quarter (Q3), Central Banks continued to raise rates as core inflation remained stubbornly high due to ongoing consumer resilience. The Bank of Canada (BoC) raised rates by 25 basis points (bps) during their July meeting, as inflation had picked back up again. The U.S. Federal Reserve (Fed) also hiked rates by 25 bps during their July meeting held in August, but continues to signal that more rate hikes may be necessary.

Oil prices rose significantly during the quarter as OPEC countries have deepened their supply cuts due to concerns about global demand. As unemployment has risen, investor hopes for a "soft landing" have dimmed and uncertainty lingers as Central Banks ponder their interest rate decisions for the fourth quarter (Q4).

Despite this prevailing market volatility, recent economic indicators demonstrated consumer-driven resilience, suggesting continued growth, notwithstanding the burden of higher interest rates. Wage pressures gradually eased, signalling a more balanced supply and demand and instilling confidence that labour markets may continue to cool off. Amid the challenging supply-chain landscape, the U.S. ISM Manufacturing Purchasing Managers' Index (PMI) showed signs of improvement, reflecting a move toward recovery driven by an increase in factory employment and a rise in new orders. However, it should be noted that U.S. ISM Services PMI contracted, led by a decline in non-manufacturing new orders, contributing to the aforementioned market volatility.

In Q3, the S&P/TSX Dividend Aristocrats Index (the benchmark) declined -4.2%. The S&P/TSX Composite Index declined (-2.2%). Health Care, Energy, and Consumer Staples outperformed the overall index during the quarter. Energy rose 9.9% during the quarter as oil supply tightened. Underperforming sectors included Communication Services, Information Technology, Consumer Discretionary, Utilities, Real Estate, Industrials, Materials, and Financials. These sectors suffered amidst investor worries about higher for longer interest rates.

Quarter in Review

On a sector level, Energy was the largest contributor to relative performance as overweight in that sector led to a positive allocation effect coupled with strong performance from Canadian Natural Resources and Ovintiv. Positions in WSP Global, TFI International and Stantec led to a positive stock selection effect in the Industrials sector. As REITS continue to struggle, and underweight in this sector led to a positive allocation effect. An underweight in the Consumer Discretionary sector led to a positive allocation effect.

Relative underperformance came from the Utilities sector where an overweight led to a negative allocation effect and positions in Brookfield Infrastructure led to a negative stock selection effect. In the Financial sector, an underweight led to a negative allocation effect coupled with underperformance in RBC. Negative performance in Telus and BCE led to a negative selection effect in the Communication Services sector.

In the Energy sector, ARC Resources and Prairiesky Royalty were purchased. ARC Resources had a yield of 3.2% with a low probability of dividend cut and strong dividend growth characteristics. Prairiesky Royalty has a yield of 4.0% and also has strong dividend growth coupled with a low probability of a dividend cut. The Energy sector is an attractive area for quality yield. First Service Corp, a multiline insurance broker was also purchased.

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Outlook and Positioning

Focusing on companies with positive earnings growth coupled with strong dividend growth in an environment that has seen declining earnings is imperative. Dividend growth predictions came down since the end of 2022, but are on the rise near the end of 2023 and 2024. In Canada, our models are predicting the strongest dividend growth coming from the Energy sector and this mandate has an overweight to this sector. In the U.S. our models are predicting the strongest dividend growth coming from the Consumer Discretionary sector with the lower dividend growth coming from Utilities and Communications. With AI predictions of EPS flat-lining and starting to increase near the end of 2023 and the beginning of 2024, dividend growth is following the same trajectory.

We continue to favour 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. We are overweight Energy as we continue to see strong dividends coming from the Energy sector. Other sector overweights are Industrial, Consumer Staples and Utilities. The mandate is underweight Financials, REITS, and Consumer Discretionary.

After years of muted performance versus other equity styles, we believe it is time to consider the duration and credit cycles within the dividend asset class. We believe dividends offer the best of many worlds through owning companies that can continue to reward shareholders through dividends, buybacks and debt reduction, combined with careful consideration of stock and sector allocations.

Commissions, management fees and expenses all may be associated with an investment in Horizons Active Cdn Dividend ETF ("HAL" or the "ETF") managed by Horizons ETFs Management (Canada) Inc. The ETF is not guaranteed, its value changes frequently and past performance may not be repeated. The prospectus contains important detailed information about the ETF. **Please read the relevant prospectus before investing.**

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