HAL Quarterly Commentary

Horizons Active Cdn Dividend ETF

Q4 2023

Market Overview

During the fourth quarter of 2023 (Q4), inflation continued to slow globally due to higher interest rates and lower energy costs, and the S&P/TSX Composite Index increased by 8% while the S&P/TSX Dividend Aristocrats Index increased by just over 10%. Interest-sensitive sectors including Information Technology, Financials, and Real Estate outperformed during the quarter. Central banks held interest rates steady and investors began to anticipate interest rate cuts in 2024. Underperforming sectors included Health Care, Energy and Materials.

Central banks held interest rates flat as inflation continued to slow, but remained stubbornly above their target due to ongoing consumer resilience. Central bank language has taken a dovish turn. The U.S. Federal Reserve (Fed) said during its December meeting that they expect to cut rates by 75 basis points (bps) in 2024 as economic growth has slowed. The Bank of Canada (BoC) said during its December meeting that it is seeing growth moderations, but would like to see a drop in core inflation and is prepared to raise rates further if necessary.

Oil prices declined during the quarter despite OPEC members having deepened their supply cuts due to concerns about global demand. As economic growth has slowed, investor hopes for a "soft landing" have slightly risen as central banks look to begin cutting interest rates in 2024.

Quarter in Review

On a sector level, Energy was the largest detractor from relative performance as oil retraced some of its last quarter gains. An overweight in the sector led to a negative allocation effect coupled with positions in negative returns coming from positions in Tourmaline Oil, Freehold Royalties, ARC Resources Prairie Sky Royalty and Ovintiv which led to a negative stock selection effect. Positions in Altius Minerals and CCL Industries led to a negative stock selection effect in the Materials sector. In the Financials sector, positions in TD Bank, Intact Financial and Power Corporation led to a negative stock selection effect coupled with an underweight in the sector that led to a negative allocation effect. Brookfield Infrastructure and Fortis led to a negative stock selection effect in the Utilities sector. WSP Global, Aecon and Exchange Income lagged in the Industrials sector and led to a negative stock selection effect. In the Communication Services sector, BCE lagged and led to a negative stock selection effect. Granite REIT and FirstService lagged and led to a negative stock selection effect in the REIT sector.

An underweight in the Consumer Staples sector led to a positive allocation effect. In the Consumer Discretionary sector, Restaurant Brands led to a positive stock selection effect coupled with the mandates underweight in that sector that led to a positive allocation effect.

Tax loss capture selling during the period included the sale of Bank of Nova Scotia, Brookfield Asset Management and Canadian Tire. The proceeds were used to buy Alimentation Couche-Tard in the Consumer Staples sector. Restaurant Brands which owns Tim Hortons, Burger King, Popeyes, Louisiana Kitchen and Firehouse Subs was purchased in the Consumer Discretionary sector. It shows positive forecasted earnings per share (EPS) and dividend growth. In the Energy sector, CES Energy Solutions was purchased which also shows positive EPS and dividend growth forecasted, and is valued at an attractive level.

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Outlook and Positioning

The Sub-Advisor believes that all successful asset management is focused on three core pillars of investment: Growth, Payout and Sustainability. For outlook and positioning, each of these core beliefs will be addressed.

Growth - After a cycle of predicted earnings per share (EPS) recovery supported by a strong rally in Q4 2023, the Sub-Advisor continues to see EPS growth moderate. According to the Sub-Advisor's model, EPS growth rates look more attractive in Canada than in Europe, especially in the Financial and Energy sectors. Forward one-year EPS growth rates are also settling down slightly higher than the U.S. depending on the sector. The Sub-Advisor's model shows Energy forward one-year EPS growth rates looking more attractive in Canada than they do in the U.S. and Europe. REITS and Information Technology show the highest forecasted EPS growth in Canada. Dividend growth is looking robust for most sectors in Canada.

The Sub-Advisor continues to position and focus on companies with positive earnings growth and strong dividend growth, in an environment that has seen declining or flat earnings.

Notwithstanding the speculative nature of the Fed's interest rate cycles, we are more positioned for secular dividend growth versus timing the Fed's decision. Over the past 12 months, 100% of the companies in our portfolio have increased their dividends. Overall, Canadian earnings look resilient.

Payout — Despite a relief rally in high-yielding asset classes on an expected Fed rate cut, the Sub-Advisor focuses on quality dividend income and growth as it believes a yield for yield's sake approach or buying deep value stocks as yield proxies results in a minimal broad upside capture amidst hidden downside risks. This is especially apparent in a current higher-rate environment where credit quality is much more important. The Fed opted to leave policy unchanged in its final meeting of 2023 which was widely anticipated given the recent indications of moderating inflationary pressures removing the impetus to hike. What was unexpected was the dovish turn in the accompanying communications that appeared to signal the official end of the tightening. The BoC left rates unchanged in the last meeting of the year and also had more dovish rhetoric than the previous meeting. With the strong rally in Q4, the CBOE Volatility Index sold off. Based on the above reasons, the Sub-Advisor has stayed with its quality yield.

The Sub-Advisor believes that the market continues to be in a phase when profitability, stability and safety need to be embraced and continues to focus on earnings and cash flow growth supporting dividend growth versus extraneous events.

Sustainability (Cashflows) — Regionally, the probability of dividend cuts continues to be lower in the U.S. than it is in Europe. The probability of dividend cuts for Canada lies between the U.S. and Europe. The forecasted probability of dividend cuts is still low for Energy in Canada and the Sub-Advisor continues to stay overweight.

The mandate is overweight in the Energy and Industrial sectors and underweight in Consumer Staples, Financials, REITS, Materials and Health Care sectors.

The Sub-Advisor believes the Energy sector still represents an evolved industry that is focused on shareholder yield and a sustained payout of dividends. Along with the Industrial and Energy sectors, the Sub-Advisor considers the Banks and Insurance sectors' duration and credit cycles within the dividend asset class to dominate in 2024.

The Sub-Advisor believes its investment methodology offers a total return approach and 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 by portfolio managers.

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