

HAZ Quarterly Commentary

Horizons Active Global Dividend ETF (HAZ)

Q4 2023

Market Overview

At the beginning of the fourth quarter of 2023 (Q4), global equity markets encountered a slowdown, continuing the downward trend that started in September. This decline was primarily driven by elevated interest rates, leading to reduced demand in global financial markets. Geopolitical tensions and ensuing higher global oil prices, coupled with a less optimistic earnings outlook, further contributed to the downturn and hindered the gradual recovery of economic growth.

This market backdrop improved notably mid-quarter, sending global equities to recovery from third quarter lows, as they ultimately capped off on higher gains by the end of Q4. Market confidence was buoyed by optimism surrounding a potential soft-landing scenario amid moderating inflation and expectations of declining interest rates. The U.S. Federal Reserve (Fed) left its key policy rate unchanged at the final meeting of the year. Similarly, the European Central Bank (ECB) held interest rates steady as inflation trended lower at the end of the quarter.

Risk indicators demonstrated a broad-based decline, with the CBOE Volatility Index (VIX) experiencing a substantial decline and hovering around a low of 12, a level not seen since before the 2020 COVID-19 pandemic. Credit spreads also contracted, triggering a rally towards higher-yielding asset classes. Notably, growth stocks outperformed their value counterparts, and their valuation multiples moved higher. These gains also bolstered the continued optimism in Artificial Intelligence (AI) and big tech names.

In China, persistent softness in domestic demand continued to exacerbate challenges in the real estate market and deepened concerns about the impact on the global economy. Despite these headwinds, the global equity market demonstrated resilience, supported by favourable economic indicators and a positive outlook for the coming quarters.

In Canadian dollar terms, both the MSCI World Index and S&P 500 Index ended the quarter up approximately 9%. The best-performing sectors were Information Technology and Real Estate, while Energy was the largest detractor.

Quarter in Review

On a sector level, Information Technology was the largest contributor to relative performance. Positions in Broadcom, ASML and Microsoft led to a positive stock selection effect. Schneider Electric, Wolters Kluwer, Waste Management, Republic Services and W.W. Grainger all had strong performances and led to a positive stock selection effect in the Industrials sector. In the Consumer Staples sector, a positive stock selection effect came from Costco.

In the Materials sector, HAZ's position in Air Products and Chemicals led to a negative stock selection effect. Positions in AstraZeneca, Sanofi and Johnson & Johnson led to a negative stock selection effect in the Healthcare sector. An overweight in the Energy sector led to a negative allocation effect but positioning led to a positive stock selection effect. With the dovish comments from the Fed, bank stocks had a large rally and the portfolio's positions in Mastercard and AXA lagged and led to a negative stock selection effect. Equinix lagged the rally in the Real Estate sector and led to a negative stock selection effect.

The mandate sold Woodside Energy, as the forecast probability of a dividend cut increased significantly, and purchased Canadian Natural Resources, which showed strong forecast dividend growth combined with a low probability of a dividend cut.

Crown Castle REIT was sold and replaced by Equinix REIT on a retracement of both. Equinix owns high-in-demand data centers and shows strong forecasted earnings and dividend growth. Verizon was sold and replaced with W.W. Grainger, which focuses on industrial machinery and equipment and shows strong dividend and earnings growth potential coupled with high-quality fundamentals.

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Outlook and Positioning

The Sub-Advisor has a core belief 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 have moderated in the U.S. at mid-to-high single-digit levels across most sectors. In this scenario, the quality and visibility of cash flow is even more important. In Europe, there is greater dispersion between sectors, with EPS moderating at much lower levels than in the United States. Early Q4 saw an initial recovery in projected Energy earnings but that quickly reversed in December with continued uncertainty related to geopolitics in Gaza and Ukraine. Dividend growth continues to stay healthy and ranges between high single to double-digits. The Information Technology sector is exhibiting the strongest forecasted dividend growth in the U.S. The Sub-Advisor continues to see greater dispersion between sectors in forecasted dividend growth in Europe with the Financials sector exhibiting the highest projected dividend growth.

The Sub-Advisor sees the strongest revenue and cash flow growth from secular companies that are thematically driven, especially in the area of technology and industrial automation. AI demand is certainly a tailwind, as well as continued chip re-shoring, and the implementation of AI into Software-as-a-Service companies in multiple industries.

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

Notwithstanding the speculative nature of the Fed's interest rate cycles, the Sub-Advisor is more positioned for secular dividend growth versus timing the Fed's decision. Over the past 12 months, 100% of the companies in the portfolio have increased their dividends.

Payout — Despite a relief rally in high-yielding asset classes on an expected Fed rate cut, the Sub-Advisor focuses on dividend growth as a yield for yield's sake approach results in a minimal broad upside capture amidst hidden downside risks. This is especially apparent in a 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 cycle - the result was a broad rally across asset classes following the decision. With the strong rally in Q4, the VIX sold off. The Sub-Advisor has not pivoted to a higher yield based on these reasons.

The Sub-Advisor believes that markets continue to be in a phase when profitability, stability and safety need to be embraced and it 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 forecasted probability of dividend cuts is still low for Energy in the U.S. and the Sub-Advisor continues to stay overweight. The forecasted probability of dividend cuts is much higher throughout most sectors in Europe with REITS and Materials exhibiting the highest probabilities of dividend cuts. The Sub-Advisor is staying underweight in these sectors for now.

The mandate is overweight in the Energy, Consumer Staples and Health Care sectors and underweight in the Consumer Discretionary, Communication Services and Financials sectors. Regionally, HAZ has approximately 35% weight in Europe, 65% in North America and 0% in the Asia-Pacific region .

The Sub-Advisor believes it is time to consider the duration and credit cycles within the dividend asset class. It 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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HORIZONS ETFs
by Mirae Asset

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