HGY Quarterly Commentary

Horizons Gold Yield ETF

Q3 2022

Market Overview

Gold ebbed and flowed in the third quarter of 2022 as volatility continued unabated in most asset classes. July began with a swift selloff before a rebound was staged in the third week of the month. August brought another more severe rout as both bond and currency volatility raged across domestic and international markets. These days, it's all about the United States Federal Reserve (Fed) and its associated red-hot dollar. Inflation, traditionally a positively correlated measure to gold, should be helping to support the yellow metal, but it isn't. Unfortunately for gold, the incredible strength that the U.S. dollar has enjoyed due to the very rapid rise in the Federal Funds Rate, has proven far too difficult to overcome. Further, geopolitical uncertainty from the war in Ukraine, interest rate differentials, and trade relations with China have also served to drive global investor liquidity toward the U.S. dollar - "TINAC," or There is No Alternative Country, continues to push flows to the global safe haven currency. Disappointingly, fixed income turmoil in the United Kingdom has also had little effect in reviving interest in gold.

Inflation, principally, has been the culprit behind it all, driving rates higher and placing pressure on precious metals. While the Consumer Price Index (CPI) has soared in recent months pricing pressures have shifted and remained high overall. Goods inflation has begun to subside as pandemic at-home purchases have slowed significantly in the past year. Purchases of housewares, electronics, laptops, and home renovation goods hit the proverbial wall as years of spending were pulled forward into lockdown conditions. Service inflation has, however, taken the place of goods inflation as customers have emerged from pandemic conditions to begin spending on services and experiences once again. Restaurants, hotels, and airlines have exhibited pricing power as revenge spending has taken hold. More importantly, inputs in CPI calculations on the service side of the ledger have remained strong and sticky. Rents and rent equivalent measures have soared this year. Unemployment remains at historic lows, and labour participation is lackluster. This has helped to put upward pressure on wages, which has combined with existing supply chain issues to keep inflation exceptionally aggressive on a year-over-year basis. These are measures that the Fed is keeping a keen eye on, resulting in a particularly hawkish outlook from the central bank. We see some of these pricing pressures as exceedingly sticky and fear that a stubborn Fed could push world economies into a recession to tame inflation. For gold, this higher-for-longer prognosis has meant a particularly consistent headwind from the U.S. dollar.

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Outlook & Positioning

Looking forward, gold may benefit from a rebound as shorter-term rates look to be nearer the top than the bottom. The elusive Fed pivot may indeed be at hand should some of the lagging economic effects of said rate hikes begin to filter through the economy sooner rather than later. Already, drops in many commodities, shipping rates, and housing health measures have been seen in the data. The Fed will continue to be data-dependent in the months to come. Much like a landlord who collects rents on their units, covered calls continue to help in generating distributions as unitholders await the next move higher in gold.

Gold premiums, broadly speaking, have been stable in the quarter. HGY continues to evaluate appropriate coverage and "moneyness" measures for future covered call writes. As investors await the next move higher for gold, "clipping the rent" of option premiums may be of some value in generating distributions going forward. Option premiums may also help to generate better overall yields and contribute to lower volatility relative to the underlying basket without call premiums. The covered call strategy can also potentially reduce the volatility relative to a comparative basket of equities over time.

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