HRAA Quarterly Commentary

Horizons ReSolve Adaptive Asset Allocation ETF

Q4 2022

Market Overview

Global markets continue to march to the drumbeat of central banks' policies, their effects on liquidity, and the anticipation of future rate fluctuations moves. Although the Federal Open Market Committee (FOMC) increased policy rates by 75 basis points (bps) at the fourth consecutive meeting and indicated greater concern with doing too little than too much to tame inflation, a lower-than-expected Consumer Price Index (CPI) print in November led U.S. equities to recover some lost ground. The U.S. dollar sustained a steep decline against major currencies after displaying incredible strength for much of the year. Powell and other officials were quick to highlight that any expectations of a pause in monetary tightening (much less a pivot) were premature. They reiterated that taming inflation would likely require "some softening of labour market conditions," which have remained surprisingly resilient.

Across the Atlantic, the Bank of England (BOE) also raised rates as inflation exceeded expectations and hit a 41-year high of 11.1% in October. The BOE was also forced to intervene in the Gilts market to stave off a financial crisis in the wake of a political and fiscal debacle by one of the shortest-lived governments in British history. In addition to tightening policy rates, the European Central Bank warned of "significantly" more to come, leading long-duration sovereigns farther into their downward spiral, though equity indices rallied (even more than their U.S. counterparts).

The Bank of Japan's decision to widen the interest rate band under its yield curve control (YCC) policy also weighed on government bond markets worldwide, increasing the opportunity cost for one of the world's largest exporters of capital, leading to a selloff in Japanese stocks and a sharp appreciation of the Yen. In the wake of growing popular pressure and mounting evidence of economic malaise, Chinese authorities began to relax the country's zero-COVID policy, leading local equities to regain some of the huge losses in October caused by a renewed crackdown on private enterprise under new guiding principles of "Common Prosperity." The Chinese reopening may serve as a powerful boost to the global economy, though it could also prove disruptive by pushing commodity prices higher and reigniting global inflationary pressures.

After an attack on a bridge linking Crimea to mainland Russia, Russia temporarily pulled out of the Black Sea Grain Initiative --an agreement brokered by Turkey and the U.N. to lift a naval blockade and allow exports to flow from southern Ukraine. This highlighted the fragile balance upon which global food supplies currently rest. Data released by the U.S. Department of Agriculture showed global wheat stocks are at their lowest levels in several years. Soymeal inventories in China are down by almost half year-over-year, while global sugar supplies remain tight due to harvest delays in key producing countries.

Quarter in Review

HRAA experienced negative returns in the final quarter of 2022. Led by positions in currencies and grains, it concluded its second full calendar year with modest losses. Though negative performance is never a cause for celebration, the strategy has withstood an extremely challenging environment relatively unscathed, while most traditional portfolios have endured some of the largest losses in living memory.

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The Adaptive Asset Allocation strategy offers exposure to a global risk parity "beta" core stacked with an active macro trading "alpha" strategy. The risk parity strategic core realized positive returns in the fourth quarter, while the alpha strategy suffered, especially in the final two months of the year.

Table 1. HRAA Performance Attribution – Q4 and 2022

Sector	Q4 (%)	2022 (%)
Bonds	0.7	-2.9
Currencies	-2.1	-1.0
Energies	1.5	4.6
Grains	-1.0	1.3
Indices	0.4	-2.3
Volatility	-0.1	-0.2
Meats	0.0	0.0
Metals	-0.1	3.3
Softs	-0.5	-4.7
Total	**-1.2**	**-1.8**

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Analysis by ReSolve Asset Management SEZC (Cayman). Q4 and 2022 return figures as of December 31st, 2022. Note: Results may differ due to rounding. Performance is expressed in CAD. Strategy attribution is a best effort approximation due to rounding and trade timing, net of all applicable borrowing costs, fees and fund accruals for the period.

Energies were the best performers, led by longs in gasoline, heating oil, crude oil, and active trading in natural gas (with an especially profitable short exposure in December). Importantly, as energy markets sold off, the strategy managed to protect a large portion of earlier gains.

Bonds provided important returns, primarily driven by short German Bobl, followed by longs in U.K. Gilts and Canadian 10-year bonds.

Equity indices contributed positively, with most gains stemming from longs in the Italian MIB, EStoxx50, Spanish IBEX, and Canadian TSX 60, partially offset by shorts in the S&P 500, Russell 2000, and Dutch AEX.

Currencies were profitable for most of the year but endured the largest losses in the quarter, led by shorts in the Japanese Yen, Australian Dollar, and Swiss Franc.

Grains detracted, primarily due to longs in milling wheat and Kansas City wheat, and short soybeans.

Softs contributed negatively through short cotton and active trading in coffee. Long positions in sugar, however, offered important offsetting gains.

Metals had a marginal contribution, as losses from short gold were mostly counterbalanced by long silver.

Table 2. Q4 and 2022 Asset-class Highlights

	Heating Oil (%)	Gasoline (%)	Sugar (%)	Copper (%)	Soybeans (%)	Gold (%)	S&P500 (%)	TSX60 (%)	Canadian Dollar (%)	US 30Y Treasury (%)	German 30Y Buxl (%)	US Dollar Index (%)	Milling Wheat (%)	Coffee (%)	US Natural Gas (%)
Q4 Returns	18.7	14.34	13.6	11.5	10.6	8.4	6.3	4.6	2.0	-1.2	-7.2	-7.5	-13.6	-23.8	-41.4
2022 Returns	107.1	40.0	9.5	-13.9	26.7	-2.0	-19.6	-8.2	-5.7	-21.5	-36.6	8.2	22.4	-24.5	16.2
Annualized Volatility	53.7	44.8	20.4	27.2	24.6	15.1	23.6	15.8	8.3	13.9	22.7	-7.5	37.2	35.1	81.8
Maximum Peak to Trough Loss	107.1	40.0	9.5	-13.9	26.7	-2.0	-19.6	-8.2	-5.7	-21.5	-36.6	8.2	22.4	-24.5	16.2

Source: Data from Tiingo. Using continuous futures contracts.

Outlook and Positioning

Risk appetite will likely remain under pressure while central banks are committed to draining liquidity. An unfamiliar territory has been created for investors who have grown accustomed to monetary largesse, and conditioned to "buying the dip." In the coming months the new "reverse currency war" is yet another risk dynamic facing the global economy and is likely to play a central role. The, so far, mild winter in the northern hemisphere and its impact on energy prices is yet another key variable to be monitored.

On the geopolitical front, a successful counteroffensive by Ukrainian forces recaptured large swathes of territory while raising fears that the conflict could escalate further (and even lead to the use of nuclear weapons). Deglobalization was one of the major themes of 2022, with several events compounding towards this dynamic: the weaponization of the U.S. dollar and other precedents set by sanctions; the U.S.' decision to ban exports of advanced semiconductors (and the technology to produce them) to China; the "reshoring" of critical supply-chains away from would-be adversaries; and the deterioration of U.S.-Saudi relationships stand out.

A new global order continues to take form, where U.S. hegemony is giving way to a more fractured, multi-polar world. This will likely have profound implications for growth, inflation, liquidity, and by extension, asset prices worldwide. Traditional stock-bond portfolios, which have thrived beyond most investors' wildest dreams in the previous regime, are expected to face significant challenges in the coming years.

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HORIZONS ETFs
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