

HRAA Quarterly Commentary

Horizons ReSolve Adaptive Asset Allocation ETF

Q3 2023

Portfolio Review

The portfolio was led by longs in energies, the U.S. dollar, and short U.S. equities, in the third quarter. Long sugar and short German government bonds also contributed positively, while grains and metals detracted.

The Adaptive Asset Allocation strategy offers exposure to a global risk parity “beta” core stacked with an active macro trading “alpha” strategy. Both components experienced positive returns, with the alpha strategy outperforming earlier in the quarter, while the risk parity core delivered strong results in June.

Table 1. HRAA Performance Attribution – Q3 2023

Sector	Q2
Bonds	0.3%
Currencies	1.0%
Energies	4.5%
Grains	-0.3%
Indices	1.0%
Volatility	0.1%
Meats	0.0%
Metals	-0.3%
Softs	0.6%
Total	6.8%

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Analysis by ReSolve Asset Management SEZC (Cayman). Q3 return figures as of September 29th, 2023. 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 by far the main drivers of performance, led by longs in crude oil and diesel.

Currencies contributed with important gains from shorts in the Japanese Yen, Swiss Franc and Aussie Dollar, while the Canadian Dollar detracted.

Equity indices also provided meaningful returns, mostly from shorts in the S&P500, Russell2000, German DAX and French CAC40. Active trades in the Hang Seng added further gains.

Softs benefit primarily from long sugar, while long cocoa also contributes.

Bonds offered modest gains because large profits from shorts across the German sovereign curve (especially at the long end) were somewhat countered by losses from longs in U.S. 5- and 10-year Treasuries, and Canadian 10-year.

Volatility contributed to incremental profits as long as VSTOXX capitalized on the selloff in European equity markets in August.

Grains were negatively affected by active trades in milling wheat and long bean oil, though short soybean and corn led to important gains.

Metals sustained modest losses, driven primarily by long silver and gold, and short copper.

Market Overview

Displaying remarkable resilience, U.S. Gross Domestic Product (GDP) accelerated in the second quarter to 2.4%¹, well ahead of expectations. Robust business and consumer spending were the main drivers of growth. Consumer sentiment approached a two-year² high as measured by the University of Michigan. However, despite an increase in nonfarm payrolls, the US unemployment rate rose significantly in August, climbing well ahead of expectation to 3.8%³. Consumer Price Index (CPI) also rose ahead of consensus estimates⁴, fueled by higher gasoline and housing prices, raising the prospect that the dynamics observed in the last twelve months may amount to transitory disinflation⁵.

Speaking at the important Jackson Hole Symposium, U.S. Federal Reserve (Fed) Chair Powell reiterated that the battle against inflation continues⁶, indicating that developments in monetary policy remain largely data-dependent. Weeks later, the Fed kept policy rates unchanged at a 22-year high while signaling there is likely more tightening ahead this year, and that monetary policy would remain restrictive for a considerably longer period⁷. Longer-dated Treasuries and sovereign bonds across the Atlantic responded in kind, leading to a widespread selloff in global risk assets. A narrowly averted government shutdown⁸, an expected doubling of the federal budget deficit⁹ and a national debt milestone of 33 trillion dollars¹⁰ further contributed to the souring mood, bringing the precarious U.S. fiscal position into focus.

The European Central Bank raised interest rates to an all-time¹¹ high while signaling an end to the current hiking cycle, as Eurozone inflation fell to its lowest in almost two years¹². In a split decision, the Bank of England held rates steady¹³ following better-than-expected inflation figures. Chinese indicators continue pointing to a faltering recovery as growth remains sluggish, rising youth unemployment (which hit a record high, prompting the government to stop publishing the numbers¹⁴) and deflationary pressures, as both CPI and PPI July figures contracted¹⁵ on an annualized basis. Policymakers have rolled out successive rounds of stimulus to try and reanimate the economy¹⁶. Despite loosening its yield curve control (YCC) policy in July, moving one step closer to normalization¹⁷, the Bank of Japan was forced to intervene and protect the 1 percent yield cap on 10-year government bonds in the wake of the biggest selloff in 25 years¹⁸.

Adverse weather conditions, in some cases related to the El Niño phenomenon, and expected lower production yields continue to drive the prices of cocoa¹⁹, cotton²⁰ and sugar²¹ higher. Despite the interruption of the Black Sea Grain Initiative, a bumper late harvest in Russia and Ukraine, and increased export shipments from the former, pushed wheat prices further down. Saudi Arabia, Russia and other OPEC members announced an extension of production cuts²², leading to steep inventory declines for crude oil²³ and refined products²⁴. Precious metals continued to suffer from real yields (which have reached an almost 15-year high²⁵), while concerns over Chinese and global growth weighed on copper prices²⁶.

As investors adjusted expectations to interest rates remaining higher for longer, major global equity indices and sovereign bonds declined in lockstep, led by U.S. markets. The yield on the 10-year Treasury hit 4.49%, a 16-year high²⁷, and the U.S. dollar rallied strongly against most major peers.

¹<https://www.cnbc.com/2023/07/27/gdp-q2-2023-.html>

²<https://finance.yahoo.com/news/americans-havent-felt-this-good-about-the-economy-in-almost-two-years-151453360.html?tsrc=372>

³<https://www.reuters.com/markets/us/us-job-growth-picks-up-august-wages-gains-slow-2023-09-01/>

⁴<https://www.reuters.com/markets/us/us-consumer-prices-accelerate-august-gasoline-2023-09-13/>

⁵<https://thefelderreport.com/2023/09/15/what-if-disinflation-turns-out-to-be-transitory/>

⁶<https://www.federalreserve.gov/newsevents/speech/powell20230825a.htm>

⁷<https://www.reuters.com/markets/rates-bonds/fed-projections-show-if-soft-landing-is-new-baseline-or-baseless-2023-09-20/>

⁸<https://www.bloomberg.com/news/articles/2023-10-01/senate-clears-bill-to-avert-government-shutdown-sends-to-biden>

⁹<https://www.bloomberg.com/news/articles/2023-10-01/senate-clears-bill-to-avert-government-shutdown-sends-to-biden>

¹⁰<https://www.cnbc.com/2023/09/19/united-states-national-debt-tops-33-trillion-for-first-time.html>

¹¹<https://www.reuters.com/markets/europe/ecb-considers-lifting-rates-record-high-even-economy-slows-2023-09-13/>

¹²<https://www.ft.com/content/37b13644-5ed9-4caa-83a4-4f3094125d8e>

¹³<https://www.cnbc.com/2023/09/21/bank-of-england-ends-run-of-14-straight-interest-rate-hikes.html>

¹⁴<https://www.washingtonpost.com/world/2023/08/15/china-economy-youth-unemployment-rate/>

¹⁵<https://www.reuters.com/markets/asia/chinas-consumer-prices-fall-july-deflation-risks-build-2023-08-09/>

¹⁶<https://seekingalpha.com/article/4634598-china-steps-up-stimulus-economy-falters>

¹⁷<https://www.reuters.com/markets/rates-bonds/boj-seen-keeping-ultra-low-rates-may-debate-tweak-yield-cap-2023-07-27/>

¹⁸<https://www.bloomberg.com/news/articles/2023-09-29/redux-of-1998-selloff-hits-japan-bonds-as-boj-support-wanes>

¹⁹<https://www.nasdaq.com/articles/icco-expects-global-cocoa-deficit-of-116000-t-for-2022-23-season>

²⁰<https://www.bloomberg.com/news/articles/2023-08-11/cotton-jumps-on-larger-than-expected-crop-cut-grains-slide>

²¹<https://www.reuters.com/article/global-softs-idAFL1N3AB2CY>

²²<https://caspiannews.com/news-detail/russia-saudi-arabia-extend-oil-output-cuts-to-stabilize-market-2023-8-4-1/>

²³<https://twitter.com/ericnuttall/status/1699039252925849765?s=46&t=sFwxlljubhpOgHA2GDpoTQ>

²⁴<https://www.bloomberg.com/news/articles/2023-09-17/wall-street-is-coming-to-grips-with-how-wrong-it-s-been-in-2023>

²⁵<https://www.capitalspectator.com/has-treasury-market-misjudged-timing-for-peak-rates-again/>

²⁶<https://www.reuters.com/article/global-metals-idAFL1N39V0F4>

²⁷<https://www.reuters.com/markets/rates-bonds/10-year-yields-hit-16-year-peak-fed-seen-higher-longer-2023-09-21>

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Q3 2023

Table 2. Q3 2023 Asset-class Highlights

	Diesel (%)	WTI Crude (%)	Sugar (%)	Cotton (%)	US Dollar Index (%)	Japanese Topix (%)	S&P 500 (%)	Soybeans (%)	Gold (%)	European Equities (%)	US 30y Treasury (%)	German 30y Buxl (%)	Wheat
Q3 Returns	44.6%	30.7%	15.1%	8.5%	3.5%	2.6%	-4.7%	-5.1%	-5.2%	-5.6%	-10.5%	-12.5%	-20.3%
Annualized Volatility	30.6%	22.3%	22.8%	21.7%	6.1%	12.6%	10.6%	19.4%	9.0%	14.6%	11.7%	17.0%	42.8%
Maximum Peak to Trough Loss	-5.5%	-5.8%	-6.9%	-5.1%	-3.5%	-4.3%	-7.5%	-10.5%	-7.8%	-8.2%	-11.2%	-14.5%	-31.8%

Source: Data from Tiingo. Using continuous futures contracts. Returns are expressed in USD. European Equities represent the EStoxx50 Index.

Outlook and Positioning

While the Fed is no longer the dominant buyer of Treasuries under Quantitative Tightening (QT), U.S. banks have pulled back from the market in the wake of the banking crisis earlier this year, and appetite from foreign sovereign buyers also appears to be waning at the margin. Combined with surging debt and ballooning deficits, market forces are pushing U.S. Treasuries to clear at a lower price, resulting in higher yields. As Ray Dalio recently put it: “We’re going to have a debt crisis in this country. How fast it transpires, I think, is going to be a function of that supply-demand issue, so I’m watching that very closely.”²⁸

The geopolitical picture also grows murkier. Despite a recent diplomatic push and intentions to reopen communication lines between the two countries, the U.S. announced successive rounds of export and investment bans aimed at curbing China’s ability to produce state-of-the-art computer chips. Beijing has countered with its own measures, restricting exports of key minerals, as the “semiconductor war” marks yet another chapter in great power competition.

²⁸ <https://www.cnbc.com/2023/09/28/ray-dalio-says-the-us-is-going-to-have-a-debt-crisis.html?qsearchterm=dalio>



HORIZONS ETFs
by Mirae Asset

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