HRAA Quarterly Commentary

Horizons ReSolve Adaptive Asset Allocation ETF (HRAA) Q4 2023

Market Overview

U.S. economic data offered signs that a rare soft landing might be underway. Gross Domestic Product (GDP) accelerated in the third quarter, beating estimates and annualizing at 4.9%. It was the fastest pace of the last two years and displayed remarkable resilience in the face of high interest rates. The Consumer Price Index (CPI) rose by 3.1%, just below consensus, benefitting from sliding gasoline prices to offset food, shelter and medical care. The U.S. Federal Reserve's (Fed) preferred Personal Consumption Expenditures Price Index (PCE) annualized at 1.9% over the previous 6 months, while the core reading fell from the prior month, the first outright decline since April 2020. November payroll figures grew versus the previous month and beat expectations, while the unemployment rate crept back down to 3.7%.

The final Federal Open Market Committee (FOMC) meeting of the year kept interest rates unchanged at their 22-year high but showed that most members expect a reduction of as much as 75 basis points (bps) in 2024 as inflation converges to an annualized 2.4%, unemployment hits 4.1%, and growth continues at a similar pace, according to their forecast. Powell carried the sanguine message forward in his press conference, setting the tone for the strong rally in risk assets into the year-end.

Despite a warning from the European Central Bank's (ECB) president that rates would hold steady for "the next couple of quarters", the decline in Eurozone inflation to 2.4% – the slowest annual pace in more than 2 years and within sight of the ECB's own 2% target – further fueled global risk appetite. Like the ECB, the Bank of England kept policy rates unchanged through the final quarter of the year, as inflation also declined, albeit still annualizing at 4.6%.

Moody's downgraded its outlook on Chinese sovereign credit in the wake of decelerating growth and continued real estate woes in the Middle Kingdom. Japanese GDP shrank by 0.7% in the third quarter, more than forecasted by economists, which could impair the Bank of Japan's apparent plan to normalize its ultra-loose monetary policy.

Energy prices continued to slide as the U.S. increased crude oil production to a record 13.2 million barrels a day, surpassing Russian and Saudi output. Weaker demand, especially from China, replaced geopolitical concerns and also weighed on the energy complex. The apparent dovish pivot by the Fed weakened the U.S. dollar and benefitted gold, which rose to a record high (in U.S. dollar terms) in December, and other precious metals. Disruptions related to the El Niño weather phenomenon in major producing countries catalyzed a major rally in coffee and cocoa prices, while expectations of increased production in Brazil alleviated supply concerns and sent sugar prices tumbling.

Table 1. Q4 2023 Asset-class Highlights

	Arabica Coffee	German 30y Buxl	Nasdaq	Russell 2000	Wheat	Gold	US 30y Treasury	European Equities	US Dollar	Milling Wheat	Diesel	WTI Crude	Sugar
Q4 Returns	34.2%	15.8%	13.1%	12.7%	10.5%	10.3%	9.5%	7.1%	-4.2%	-7.9%	-17.5%	-20.3%	-22.7%
Annualized Volatility	38.2%	17.8%	15.6%	23.6%	28.9%	13.8%	15.5%	11.6%	7.5%	16.5%	32.7%	36.6%	35.1%
Maximum Peak to Trough Loss	-7.3%	-4.2%	-7.7%	-8.5%	-10.1%	-4.5%	-5.2%	-4.6%	-5.4%	-10.4%	-21.5%	-23.4%	-27.0%

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

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Quarter in Review

Losses in October (from long energies) and December (short bonds and long U.S. dollar) drove HRAA down by 5.2% in the fourth quarter, giving back most of the gains attained in the previous quarter, and ending the year up 0.8%.

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 losses, with the alpha strategy underperforming in October, while the risk parity core struggled in December.

Table 2. HRAA Performance Attribution – Q4 2023

Sector	Q4	2023
Bonds	-0.6%	-1.8%
Currencies	-2.6%	0.2%
Energies	-2.9%	-1.5%
Grains	-0.1%	-2.6%
Indices	1.5%	7.9%
Volatility	0.0%	-0.1%
Meats	0.0%	0.0%
Metals	-0.3%	-1.8%
Softs	-0.1%	0.5%
Total	**-5.2%**	**0.8%**

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

Analysis by ReSolve Asset Management SEZC (Cayman). Q4 return figures as of December 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.

Equity indices were the main source of positive returns, driven by longs in European (Italian MIB, Spanish IBEX and EStoxx50) and U.S. (S&P 500 and Nasdaq) markets.

Energies detracted most, led by longs in crude oil and active positioning in diesel, with important offsetting gains from shorts in natural gas and gasoline.

Currencies also struggled, primarily from shorts in the Swiss Franc, Japanese Yen and Canadian Dollar.

Bonds suffered almost entirely from a short in the German 30-year Buxl, while longs in Canadian 10-year and U.K. Gilts offered meaningful compensation.

Metals sustained modest losses, largely from a small short position in gold.

Grains were marginal contributors, with losses from long bean oil largely offset by gains from short corn and active trading in soy meal.

Softs saw gains from long coffee erased by long cotton and sugar, and short cocoa.

Outlook and Positioning

A narrowly averted government shutdown, an expected doubling of the federal budget deficit and a national debt milestone of 33 trillion dollars further contributed to the souring mood, bringing the precarious U.S. fiscal position into focus. It is estimated[1] that an unprecedented US$8 trillion of government debt will be maturing over the next 12 months, or approximately one-third of total outstanding Treasuries. That represents more than 3.5 times the total net issuance in 2023, notwithstanding the additional US$2 trillion that must be issued to cover the expected budget deficit for 2024. Given this trajectory, it is hard to imagine the Fed sustaining balance sheet run-off (so-called Quantitative Tightening) for much longer. If the U.S. is forced into outright debt monetization, it would have severe consequences for the global reserve currency and the Treasury market.

The war in Ukraine seems to have ground to a stalemate, with no end in sight. Conflict in the Middle East has affected global shipping and could escalate anytime. U.S.-Sino relations remain strained, despite recent diplomatic efforts for rapprochement, and might be further complicated by the upcoming elections in Taiwan. A growing number of countries, led by the BRICS, have been moving away from the U.S. dollar and conducting bilateral trade in their currencies. It has been many decades since the world saw this much geopolitical tension. As the paradigm shifts, investors should continue to focus on diversification, rebalancing portfolios and managing risk as opportunities arise.

[1] https://twitter.com/TaviCosta/status/1724287792920871059