USCC.U and USCC Quarterly Commentary

Q4 2023

Horizons US Large Cap Equity Covered Call ETF (USCC.U and USCC)

Market Review

For 2023, U.S. equities, as measured by the Solactive US Large Cap Index, experienced a return of 27.3%. With no shortage of downward pressure, the bull run that markets ultimately experienced was a welcome sight. The significantly positive performing sectors were information technology and communication services, while the primary detractors from performance were in the utilities and energy sectors. The historically technology-heavy NASAQ 100 in particular saw significant gains on the back of Artificial Intelligence (AI)-driven rallies during the year, shrugging off repeated sell-offs throughout 2023.

The U.S. Federal Reserve ("Fed") raised rates by 25 basis points in four out of their eight meetings as they battled inflation that had previously been described as transitory. Hikes that had been put into place in the previous year finally began to expose cracks in the U.S. banking system as Silicon Valley Bank failed, followed shortly by two more regional banks in March of 2023, putting downward pressure on yields. In contrast, the U.S. May Consumer Price Index report showed that repeated rate hikes had already helped in halving inflation and later job reports suggested that the labour market has begun cooling, driving debates on whether the Fed is succeeding in orchestrating a soft landing. Additionally, the U.S. hit its debt ceiling in January of 2023 leading to a months-long standoff in Congress, which was ultimately resolved in May and may have contributed to Fitch's credit rating downgrade of U.S. government debt from AAA to AA+ in July. The latter event kicked off yet another sell-off during the year as equities had largely recovered from the regional banking crisis in March.

This was a volatile year for oil which was driven by geopolitical turmoil and uncertainties about the oil output levels by producers around the world. The price of oil as measured by West Texas Intermediate returned -6.7% for the year finishing at US$72 per barrel; it reached a low of US$67 and peaked at US$93 per barrel. Gold prices rose by 12% breaking the US$2,100 level this year and ending the year at $US2,065 per ounce. This was largely driven by increased gold buying from central banks which collectively bought approximately 800 tonnes of gold over the first three quarters of the year.

Despite the various sources of downward pressure, general market optimism about the likelihood of a soft landing acted as ballast alongside a tech-driven bull run on the back of the excitement for AI. This was particularly evident in the later portions of the year wherein the Fed first paused hikes, then eventually signalled the potential of cuts. Simultaneously, the "Magnificent Seven" (Microsoft, Amazon, NVIDIA, Meta Platforms, Apple, Alphabet, Tesla) leading technology stocks carried large-cap equities to undo any losses experienced throughout the year. Given the events of the year, yields experienced their fair share of turbulence as well, quickly rising in early 2023 before a sharp decline during the regional banking crisis. This was followed by a volatile rise to an eventual peak in late October close to (but not quite) 5%, declining down to 4% into early 2024. Despite the turbulence, investors generally approached it with a level of cautious optimism as they navigated 2023's unique series of challenges.

Quarter in Review

During Q4 of 2023, the top three performing stocks were SNAP, NET Lease Office Properties, and Block Inc. with total returns of 85.30%, 71.99%, and 70.43% respectively. The bottom three performers were Paycom Software, Lattice Semiconductor, and Hormel Foods with total returns of -22.08%, -21.71%, and -16.95% respectively. The top three performing sectors were Real Estate, Information Technology, and Financials with total returns of 15.66%, 14.38%, and 11.92% respectively. The bottom three performing sectors were Energy, Consumer Staples, and Health Care with total returns of -9.15%, -2.90%, and -3.73% respectively.

Outlook and Positioning

With the Fed suggesting an end to interest rate hikes at its December 2023 meeting, market attention will shift towards 2024 interest rate cuts, corporate earnings, and the presidential election.

Having maintained its federal funds target range between 5.25% and 5.5%, the Fed has not raised interest rates since July 2023. The market rally that ensued should extend into 2024 for the first half of 2024 as calls for rate cuts increase.

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Echoing their 2023 performance, the "Magnificent Seven" should continue to outperform the rest of the S&P 500 Index ("S&P 500") and contribute heavily to index returns as earnings growth accelerates into the new year. Contributing nearly two-thirds of the S&P 500 performance for 2023, the main uncertainty facing these seven mega-cap stocks revolves around their earnings growth rate and the extent and magnitude of a possible soft landing during 2024.

Potentially tempering the 2024 growth forecast is the uncertainty facing investors with the November U.S. presidential election. According to the Stock Traders Almanac, the S&P 500 has gained 13% in an election year when a sitting president was running for re-election. While President Biden's approval ratings remained low at the beginning of 2024, the potential for new policies tends to impact sentiment leading into the November voting season and may push for a bullish end to 2024.

Into 2024, the covered call strategy is favourably positioned to potentially provide value from a yield, hedging and upside capture perspective in the current environment. Each month, call options are dynamically written on the S&P 500. Option yields for the S&P 500 trended lower in 2023 versus the prior year. Each month, USCC.U generally writes out-of-the-money options, which yielded roughly 9.4% for the fund in 2023. The monthly premiums generated for the year showed consistency and may remain stable into 2024.