HAC Quarterly Commentary

June 2018

The S&P 500 Index started the second quarter (Q2 – the first three months ending June 30, 2018) on a positive footing as investors pushed up the stock market in the first half of April, anticipating a strong earnings season. As the earnings season got underway, the S&P 500 declined in the second half of April as investors once again focused on the trade tensions between the U.S. and many other countries around the globe.

In addition to the increasing trade rhetoric at the beginning of Q2, investors were largely concerned with rising interest rates as inflation appeared to be increasing – combined with the underpinnings of a strong economy. As a result, U.S. government bonds performed poorly. Towards the end of Q2, investors tempered their expectations for economic growth and yields on the U.S. 10-Year Treasury Notes declined, boosting bond prices. Despite increasing trade war rhetoric that largely affected investors' appetite for risk in the equity markets, the S&P 500 managed to produce a gain of 5.4% by the end of Q2 in Canadian dollar terms.

The Canadian stock market and S&P/TSX 60 Index managed to outperform the S&P 500 in Q2, largely based upon the energy sector performing well as the result of rising oil prices. Investors largely ignored the possible negative ramifications of a breakdown in North American Free Trade Agreement (NAFTA) talks between Canada and the U.S. As the quarter progressed, investors became more convinced that the NAFTA discussions were going to be delayed until after the U.S. mid-term elections in autumn. As a result, the NAFTA discussions had less of an impact on the stock market compared to the first quarter of 2018.

At the beginning Q2, the Horizons Seasonal Rotation ETF (HAC) was fully invested in equities. HAC benefited from its allocation being largely weighted in the Canadian stock market and in the Energy sector. In early May, HAC substantially reduced its equity weighting as the stock market transitioned into the six-month unfavourable period for stocks from May 6th until October 27th. The fund exited its energy position in early May. In addition, HAC benefited from entering into bond positions in both the Canadian and U.S. markets in early May. In the latter part of June, HAC exited its bond positions in order to fund an equity allocation in the stock market, in order to take advantage of the seasonal trend of the stock market performing well in the last few days of June into mid-July. At this time of year, investors tend to push-up the stock market in anticipation of a strong earnings season. At the end of June, HAC was substantially invested in equities, with an expectation to decrease equity exposure in the second half of July as the earnings season got well under way.

Historically, the stock market tends to perform poorly for most of the third quarter of the year. August and September have historically been the two worst contiguous months of the year over the long-term for the S&P 500. This year, the risk of the stock market performing poorly in the third-quarter is increased as trade war tensions continue. If all parties continue to implement tariffs and become more entrenched in their positions, the global economy has a high probability of being negatively affected. In addition, the autumn U.S. mid-term elections are probably going to provide an increased level of uncertainty for investors, which could translate into a volatile stock market. Large corrections in the stock market, particularly in the latter part of the third quarter, could present buying opportunities in the stock market.

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