HAJ Quarterly Commentary

March 2018

Market Review

When trying to decipher what the market is saying or inferring, the key is to weed out the signal from the noise. In 2017, measures of volatility plummeted, with the CBOE's equity market volatility index (VIX) hitting record lows. As a result, the performance of risk assets moved strictly in one direction: up. In fact, 2017 was the first calendar year on record where the benchmark U.S. equity index did not post one negative monthly return.

The downward turn in stock markets during the first quarter (Q1 - the first three months ending March 31, 2018), which started in February, sparked confusion about what the market was truly signalling – raising concerns that the end of the nine-year bull market and economic expansion was coming to an end. However, this year's return of volatility is just turning up the noise in what had become an uncharacteristically quiet market; the underlying macroeconomic and market fundamentals continue to be positive and constructive for stocks. Prior to that 10% peak-to-trough drop starting on January 26, 2018, the S&P 500 composite price index had not seen a drawdown of more than 3% in 308 trading days – the longest such stretch in the post-WWII era. It had been 400 trading days since the last time markets declined at least 5% and fully 494 trading days since there was a drop of 10% or more.

As the world's largest economy, the U.S. is expected to be one of the few major markets that should post an accelerated pace of expansion in the current year. Tax cuts and full expensing of capital expenditures are expected to stoke an uptick in business investment, while increased government infrastructure spending will likewise be a positive. The American consumer should also continue to provide solid support for the economy as a whole, with extremely tight labour markets ultimately giving way to wage increases – both of which bode well for spending on goods, services and housing.

Within the Emerging Markets, China continues to be the most important player. The world's second-largest economy continues to grow at a robust rate – it alone accounts for one-third of total global growth despite its weight in terms of total output being less than half that – but is undergoing a managed moderation. Indeed, as President Xi Jinping begins his second term as president, the country is putting more emphasis on quality of growth rather than quantity and in doing so, attempting to address its problematic debt situation in an effort to quell concerns over a growing bubble.

India, in contrast, is expected to see growth accelerate and hold the mantle of world's fastest growing economy both this year and next as economic reforms pushed by Prime Minister Narendra Modi gain increasing traction and begin to pay dividends in terms of supporting business investment and providing governments with improved capacities to invest in infrastructure.

Likewise, the growth trajectory in Latin America is expected to continue to move higher, predominantly thanks to Brazil's continued recovery from recession and the sustained improvement of domestic economic conditions there as well as in Mexico. These two countries, however, face material risks from upcoming elections — Mexico in July and Brazil in October — with populist candidates currently polling strongly, while Mexico also faces the added risk associated with the uncertain trade relations between it and the U.S., the main destination for its exports.

Portfolio Review

The MSCI Emerging Markets Index (the "Index") was up 4.54% in Canadian dollars. The Horizons Active Emerging Markets Dividend ETF ("HAJ", the "Portfolio") underperformed the Index by 101 bps.

The Portfolio outperformed in 6 of the 11 sectors led by Consumer Discretionary, Consumer Staples, Materials and Utilities. Financials, Telecommunication Services and Industrials were the largest contributors to relative performance.

The Consumer Discretionary sector was the largest contributor to relative performance due strictly to allocation. The sector was the largest detractor in the index on an absolute basis and the portfolio had no exposure to the sector.

HAJ Quarterly Commentary

Consumer Staples was the second-largest contributor to relative performance during the quarter primarily as a result of positive stock selection. The Portfolio's holdings in Ambev, Vina Concha Y Toro SA and Industrias Bachoco SAB drove the majority of the outperformance in the Consumer Staples sector as all three companies posted double-digit gains.

The Materials sector also contributed to relative performance due to stock selection. Fibria Celulose SA, Braskem SA and Vale SA all contributed to relative performance.

The Financials sector was the largest detractor from relative performance due to stock selection as well as an underweight position in the sector. Indian banks, ICICI Bank and HDFC Bank were the largest detractors from relative performance.

The Telecommunications Services sector was the second-largest detractor from relative performance driven primarily by an overweight position to the sector. Telekomunikasi Indonesia, KT Corp and SK Telecom were the largest detractors from relative performance.

The Industrials sector also detracted from relative performance primarily due to stock selection. The Portfolios holdings in Mexican airports all detracted from relative performance.

Portfolio Activity:
In Q1, the portfolio did not initiate any new purchases.

In Q1, the portfolio sold Coca-Cola Femsa and PLDT Inc.

Positioning:
Based on the economic backdrop and outlook on economies and valuations, our core view on uses of cash investment recommendations are to own stocks that deploy cash in a shareholder-friendly way that reflects the current late stage of the economic cycle of rising interest rates, de-regulation, increased capex and marginal expansion. We look to position in stocks with low price-to-book values, high cash/assets, strategic M&A/assets ratio, sustainable net buyback yields and growing dividend yields. As well, we continue to emphasize higher yielding names that have the lowest probability of a dividend cut.

The Portfolio has an overweight position in yield-friendly, defensive sectors, including Consumer Staples , Telecommunication Services, Materials and Industrials. Underweight sectors are Information Technology and Financials.

The current market environment requires continued immunization to rising interest rates on a relative basis to our peer group. We continue to increase diversification, finding yield outside of the traditionally defensive sectors favoured by our peer group.

Outlook:
Economies are generally able to run above their potential growth rates for periods of time – particularly in the aftermath of a recession where there is ample resource slack. However, this is will not be the case forever, as eventually the production inputs required to maintain those above-trend rates of growth are just not available. For this reason, the expectation is that growth among the many of the major global economies will see a moderation in the current year relative to last. Moderation, however, is not to be confused with a decline. Economies are still growing; it is just that that growth rate may have peaked and may no longer be accelerating for many of the world's largest countries. Importantly, though, the deceleration is coming from a high level and as a direct result, the current year forecast is still for above-potential growth across the globe.

HAJ Quarterly Commentary

In our opinion, we must buy based upon model fundamentals that cover all three facets of investing, namely, relative opportunities, intrinsic conviction and objective non-human analysis through machine-learning methods. A sharp rise in volatility might have caught a higher floor and that will lead to some interim jitters, namely in trend-following and risk-parity type methods.

We believe fundamentals should ultimately prevail as companies continue to deliver double-digit earnings growth on the backs of a U.S. tax catalyst and global-synchronized growth. One should not forget the concept of shareholder yield as the benefits from above-discussed events will also be reflected in larger buy backs and further de-leveraging of debt. Further, don't assume bond proxies will provide down side protection. Low-volatility strategies might not reflect the true realities of where risks lie. Yield for yield's sake is not the right approach and we feel that stocks exhibiting consistent earnings strength, or those that signal shareholder-friendly activities (like dividend increases or buybacks with respect to cash flow usage) should allow for the best opportunities to buy on this long-overdue dip.