HAL Quarterly Commentary

Q2, 2020

Market Overview

In Q1 2020, the Canadian market experienced a sharp downturn from the COVID-19 pandemic; however, the portfolio had positive alpha and provided downside protection. The markets have had a V-shaped recovery in Q2 2020 as global central banks added unprecedented liquidity to stabilize the markets. With this significant bounce in the market, the mandate lagged the market.

The largest underperformance came from the industrials sector, where Canadian National Railway, Waste Connections, Exchange Income and WSP Global had negative selection effects, while Boyd Group had a positive selection effect. The financials sector underperformed primarily due to the positions in RBC, TD, BMO and Intact Financial, which lagged the market during the rebound. TMX Group was an addition to the portfolio, and contributed to the positive stock selection effect. In the materials sector, Agnico Eagle Mines and Kirkland Lake Gold were sold during the quarter, both of which were detractors to relative performance. The underperformance of the utilities sector largely came from the negative allocation effect due to the overweight in this sector.

The best-performing sector was information technology, due to an overweight in this sector and the positive stock selection effect from the position in OpenText. The real estate sector outperformed due to the positive stock selection effect contributed by Summit Industrial and Granite. In the energy sector, Gibson Energy and Pembina Pipeline were contributors to the relative performance. Within consumer staples sector, the positive stock selection effect came from Alimentation Couche-Tard.

Quarter in Review

The U.S. stock market had a V-shaped strong rebound in the second quarter of 2020, leading the worldwide rally of equities. This is, in part, due to the optimistic expectations for a speedy recovery of the global economy and the strong commitment of support from central banks and other policymakers for confidence and liquidity of financial markets. Both the Bank of Canada and the U.S. Federal Reserve's Federal Open Market Committee ("FOMC") are continuing to do what they can to keep monetary conditions ultra-loose to help the broader economy overcome the significant shock from the COVID-19 pandemic. However, global economic activity is still significantly lower than it was a few months ago. There are growing indications that conditions are improving; however, with governments around the world still working on proper ways and phases to reopen business and social activities, the answer to the question of how long it will take economic output to fully recover remains unsolved. The risk of a second wave of COVID-19 and increasing geo-political tensions would also add fuel to market uncertainties. As a result, there is high probability that higher than normal market volatility may continue throughout the rest of the year.

At the beginning of 2020, we called for increased volatility and, based on our models, we had reduced risk and exited holdings that have higher cash flow variability and cyclical sensitivity. The machine learning Dividend Cut Probability aggregated at the sector level created further separation between the Cyclical and Defensive sectors. With the outbreak of the COVID-19 crisis, the markets plummeted in Q1 2020 and the CBOE Volatility Index ("the VIX") traded near its all-time highs. The Horizons Active Canadian Dividend mandate owns high-quality global companies with strong fundamentals, visible cash flows and sustainable growing dividends, and historically tends to outperform when market volatility rises.

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Yield for yield's sake can be dangerous in the market as many companies will not have the cash flow to pay dividends and will be forced to cut. We focus on high-quality companies with strong fundamentals, visible cash flows and sustainable growing dividends. We continue to stay disciplined and believe exposing our portfolios to those holdings with greater earnings and cash flow visibility — plus a sustained growth in dividends and a low probability of dividend cuts — is critical for income-oriented mandates.

We exited the materials sector (sold Agnico Eagle Mines and Kirkland Lake Gold) and reduced some of our overweights in the more defensive sectors (sold Empire and Metro in the Consumer Staples sector). We have sold them to enter stocks with stronger longer-term dividend and earnings growth trajectories.

We increased our weight in the real estate sector, purchasing Granite REIT. In the financials sector, TMX Group was added, and in the industrials sector, Waste Connections was purchased. These stocks generate strong, secular runways of cash flow that maintain visibility, which support the future dividend growth aspects of these companies.

Market Overview:

In Q2 2020, equities outperformed other asset classes. The S&P 500 had an unprecedented V-shaped rebound throughout the quarter with a 20.5% (USD) return, significantly outpacing Bloomberg Barclay's U.S. Aggregate Total Return Index, which was up 2.9% (USD). However, during the first half of 2020, stocks still underperformed bonds due to the market shock in Q1 2020. The S&P 500 was down -3.1%, while Bloomberg Barclay's U.S. Aggregate Total Return Index had a 6.1% return, both in USD terms. For the S&P 500 index, consumer discretionary, information technology and energy were the best performing sectors for this quarter, while information technology, consumer discretionary and communication services were the top three sectors YTD. As for Canadian markets, S&P/TSX Composite Index jumped 17% (CAD) in Q2 2020 but was still in negative territory YTD (down -7.5%), while FTSE Canada Universe Bond Index was up 5.9% and 7.5% (CAD) in Q2 2020 and YTD, respectively. Overall, in USD terms, U.S. stock markets outperformed international equities as the MSCI World Index, MSCI EAFE Index and MSCI Emerging Markets Index all trailed the S&P 500 Index in Q2 2020 and YTD.

Geographically, for the MSCI All Country World Index (USD), all regions across the globe had double-digit returns in Q2 2020 as markets bounced back, with Latin America, Africa and the Middle East and North America being the best- performing regions. As for YTD performance, North America outperformed all other regions; however, no region posted positive returns due to the worldwide market shock in Q1 2020 triggered by the outbreak of the COVID-19 pandemic.

HORIZONS ETFs
by Mirae Asset