HEE Quarterly Commentary

Q3, 2021

Market Review

Canadian energy stocks continued their positive trend, with the S&P/TSX Capped Energy Index posting a total return of 3.97% during the third quarter. The index is now close to being up 60% on the year, on track to posting the best performance since 2005. While crude oil prices were only slightly higher, natural gas prices surged with the front-month NYMEX crude oil future increasing just over 60% in Q3. Energy shortages in Europe and Asia have been driving natural gas prices higher globally. This is the second consecutive quarter where natural gas prices vastly outperform crude oil prices, favouring the more gas-weighted companies in the sector.

Quarter in Review

Tourmaline Oil Corp (TOU) continues to be a top performer in our basket of Canadian energy companies, as the company benefits more than others from higher natural gas prices. After returning close to 50% in Q2, TOU continued on its winning path returning close to 25% during Q3, the best performing stock in the portfolio.

Despite recent gains, volatility continues to be elevated in the energy sector as there remains substantial uncertainty on both supply and demand. Supply could be impacted by OPEC+ increasing production, while demand from developing countries could continue to be impacted by the pandemic. Volatility may be further exacerbated by greater electricity demand and heating demand as the winter season approaches. With both the supply and demand side influx, there remains the possibility of large moves in the underlying crude oil prices.

This elevated volatility increases the call premiums we receive on the option covered call overlay strategy. This benefit, however, has been somewhat offset by a large underlying move in the underlying securities.

Outlook and Positioning

During each month, options are generally written on up to 100% of the equities in the portfolio of the ETF. The premiums are received from selling call options approximately one standard deviation out-of-the-money. The ETF's monthly distributions are not fixed, but vary as the premiums generated from covered call writing are earned and passed through, and will change with changes in implied volatility and time to option expiration. Distributions also vary based on the dividends received from the securities in the ETF's portfolio during the period.

The equity positions in the ETF are rebalanced to equal weightings semi-annually with the objective of maintaining an equity basket of large-cap Canadian energy securities.