HPR Quarterly Commentary

March 2019

General Market Review

Bond markets were strong in the opening quarter of the year (Q1 – the first three months ending March 31, 2019). Weakening global economic growth caused markets to remove the risk of further rate hikes by monetary authorities and pushed longer-term yields lower. Five-year Canada yields ended the quarter at 1.52%, down 37 basis points from the start of the year, and below the Bank of Canada's over-night target rate of 1.75%. Sector spreads also performed well in the quarter, reversing some of the risk-off spread widening that occurred at the end of 2018. As term yields fell, investors saw greater value in higher yielding corporate and provincial bonds. This was supported by more dovish messaging coming from central banks on the future path of policy rates which encouraged greater risk-taking and improved market liquidity.

The performance of the Canadian preferred share market timidly reversed in Q1, as the lower interest rate environment and ongoing selling pressure of the asset class capped the rebound despite the risk-on environment. The S&P/TSX Preferred Share Index returned 1.11% while the Solactive Laddered Canadian Preferred Share Index (100% fixed reset) returned 0.41% in Q1.

Floating rate and rate reset preferred shares underperformed in this weak environment while the fixed rate perpetual preferred shares outperformed. The preferred shares issues with a low or mid-reset level underperformed while the issues with a 400 bps reset level (or higher) outperformed. Telecommunication, Diversified financials and Energy sectors underperformed in Q1, while the Banking and Utility sectors outperformed.

Portfolio Review

The overweight position in the Horizons Active Preferred Share ETF's (HPR) was the main driver of the negative performance this quarter as those issues underperformed, given the decreasing rates. Our overweight position were somewhat offset by our strong selection in among floaters. Similarly, our underweight in perpetuals costs us value as they outperformed significantly. Security selection and overweighting in perpetual Utilities was highly beneficial to the fund.

Over the last quarter, we continued to be net buyer of rate reset preferred shares with a focus on quality of the issuers and on income yield. We did not participate in new issues during the quarter.

Outlook

Bond market sentiment has swung dramatically over the past several months in response to a slowing global expansion lead by weaker Chinese consumer demand and a post-tax reform let down in the U.S. This has been exacerbated in Canada by home grown headwinds facing Canadian households and business spending. We have lowered our expectations for growth and pushed out our expectations for further rate hikes in North America. In our view, the timely recognition by policy makers of the weaker backdrop combined with still moderate inflation pressure has reduced the risk of a policy mistake coming from rate hikes and could contribute to extend the current business cycle which is positive for riskier assets.

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The Canadian preferred share market performance should be close to the coupon rate over the next 12 months, assuming we are right with our base expectation of no recession and no rate cut by the FED and the BOC. Volatility should remain above average in the coming quarters and should be exacerbated with the low liquidity of the market. Demand for preferred shares should come back over the next quarters as the yield pickup remained attractive versus other fixed income products. Expected Banks supply and flows into preferred shares ETFs should add some volatility over the few next months. Rate reset issues should outperform the fixed rate perpetual over the next quarters. Within the rate reset issues, we think the reset with a mid-reset level will outperform the issues with a high reset level.

HORIZONS EXCHANGE TRADED FUNDS

ACTIVE BENCHMARK BETAPRO

MIRAE ASSET