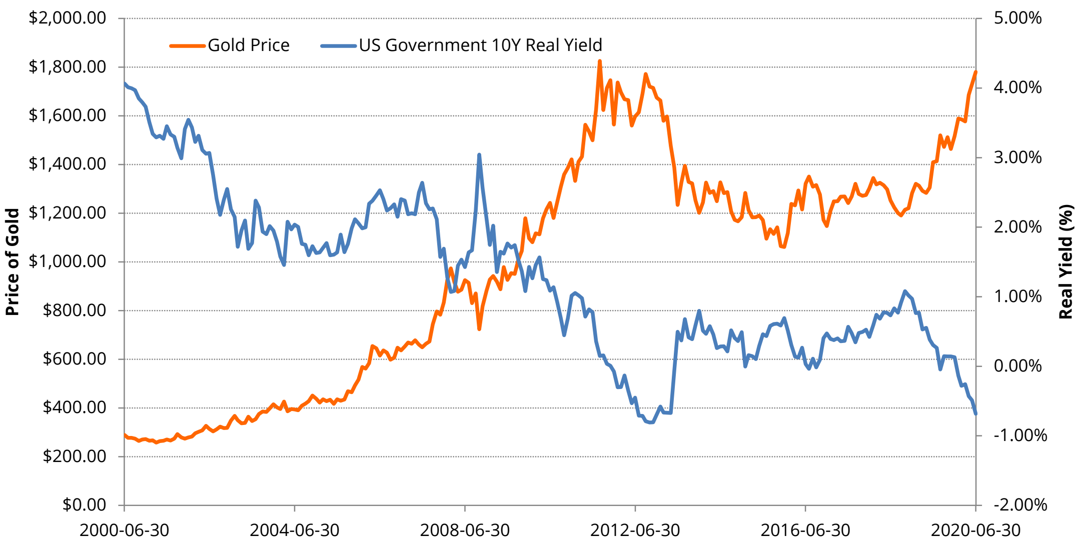
Putting Gold to Work

Gold is a polarizing asset class. Similar to champions of certain types of nutrition and health supplements, ardent followers of gold can have an unwavering belief that gold should be a constant and large portion of a person's portfolio. On the other hand, there are those who view gold as a fetishized commodity that offers little value for an investment portfolio.

As with most things, the truth probably lies somewhere in between. Historically, there seems to be some modest value to owning gold — particularly as a deflationary hedge or defensive asset class — but one of the single biggest challenges for most investors in owning gold is that it doesn't pay out an income stream, which puts it at odds with its perceived value as an asset class that thrives during low interest rates and market volatility.

Here's a chart showing the price of gold futures vs. U.S. 10-year real yields over the last 20 years. It's a near perfect inverse correlation. As real interest rates decline, the price of gold rises; conversely, as real interest rates rise, gold tends to stall, if not decline at some points.



Source: Bloomberg, from June 30, 2000 – June 30, 2020.

There is some debate about the merits of gold as an inflationary hedge; for example, is it any better at providing an inflationary hedge than other commodities priced in U.S. dollars, or even equities for that matter? An interesting study[1] from 2012 by the National Bureau of Economic Research, authored by Duke University professor Campbell Harvey and Claude Erb, largely debunked the idea of holding gold as an inflation hedge, while highlighting that it does hold up as store of value – that is, it retains its value during rising inflation, but other assets might actually generate strong positive returns during inflation.

[1] The Golden Dilemma, Financial Analysts Journal, as at August 28, 2015. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2078535.

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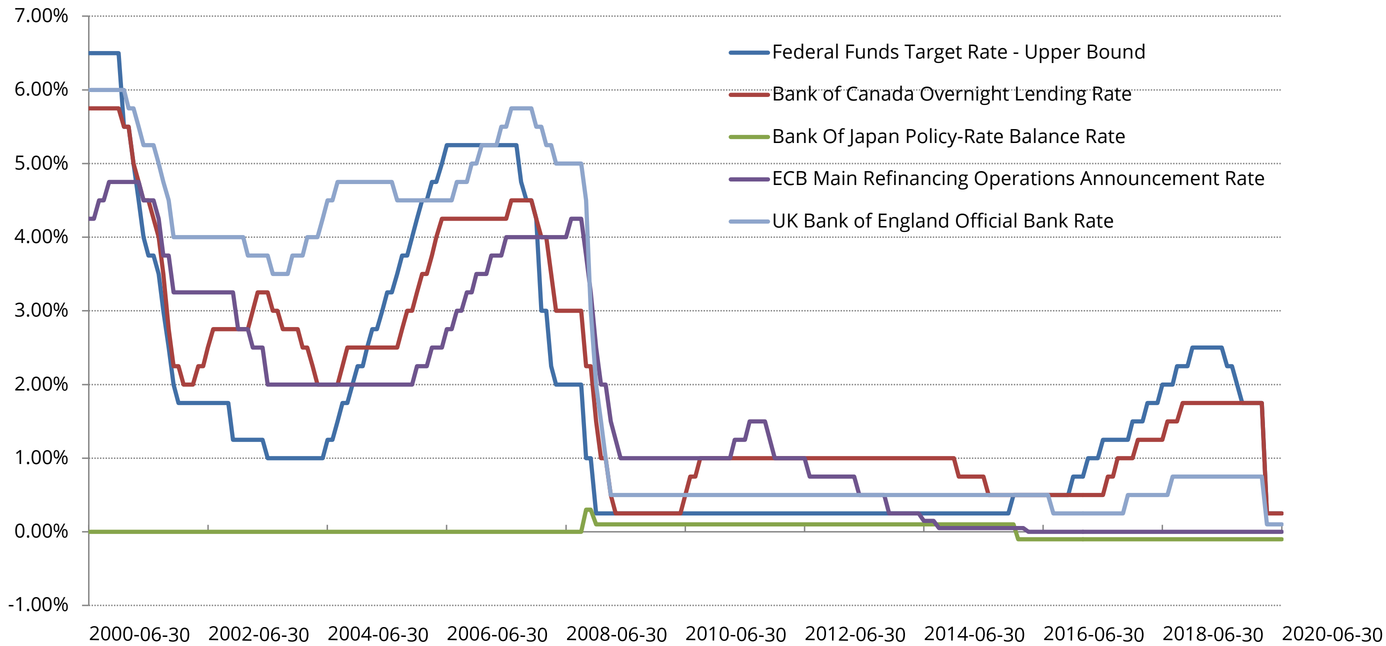
Let's think of this from a retail investment portfolio perspective and take market timing out of the equation. Since gold clearly has bull and bear markets where investors can make speculative profits, the value for most investors in gold is probably as a defensive asset class; that is, an asset class that holds its value or increases in value during periods of market impairment.

Let's think of the conditions that arise during a broad capital markets selloff. We have historically observed high volatility, declining values in many asset classes (correlations moving to 1) and declining interest rates. It's this last feature, declining rates, where gold provides value. As highlighted above, gold historically rallies on declining rates, but this provides a conundrum for an increasingly aging demographic of investors as to where to get their income in such an environment.

Increasingly, investors have a need for income. Central bank rates are close to zero, or negative in some circumstances



Source: Bloomberg, from June 30, 2000 – June 30, 2020.

Holding gold can provide some capital cushion for investors but it doesn't solve the income need. This is where several ETFs offered by Horizons ETFs, including the Horizons Gold Yield ETF (HGY) and the Horizons Enhanced Gold Producers ETF (HEP), can offer value for investors.

These two ETFs provide exposure to gold and gold equities, while providing a monthly income stream by writing covered calls. These strategies effectively allow investors to take a long position in gold or gold equities, while having a portion of their total net returns delivered back to them in a tax efficient manner.

The value in this for investors is that they can have meaningful exposure to gold, take advantage of its benefits during a period of declining interest rates, but also generate a tax-efficient income stream during the very period where they likely need more income.

HORIZONS GOLD YIELD ETF (HGY)

(www.horizonsetfs.com/HGY)

HGY seeks to provide unitholders with:

1. Exposure to the price of gold bullion hedged to the Canadian dollar, less the ETF's fees and expenses;
2. Tax-efficient monthly distributions, which can mitigate downside risk, and exposure to a covered call option strategy; and
3. The portfolio management team writes on approximately, but not more than, 33% of the securities of the gold portfolio. The level of covered call option writing to which Horizons HGY is exposed may vary based on market volatility and other factors. Generally, investors get two-thirds of the upside exposure to the price of gold, and a potentially attractive monthly income stream generated by at-the-money options written on approximately 33% of the portfolio's holdings.

HGY gives investors exposure to physical gold, but effectively returns 33% of the return trajectory as income, in a tax efficient manner. Historically a considerable amount of this return has been characterized as Return of Capital (ROC) rather than capital gains. In circumstances where the ETF is in a capital loss position for the calendar year, but has paid out distributions, there is a greater likelihood of the distributions being characterized as ROC

THE HORIZONS ENHANCED GOLD PRODUCERS ETF (HEP)

(www.horizonsetfs.com/HEP)

The investment objective of HEP is to provide unitholders with:

1. Exposure to the performance of an equal weighted portfolio of North American-listed gold mining and exploration companies; and
2. Monthly distributions of dividend and call option income.

HEP invests primarily in a portfolio of equity and equity-related securities of North American-listed companies that are primarily exposed to gold mining and exploration and that, as at the constituent reset date, are among the largest and most liquid issuers in their sector. It currently holds 15 stocks that are equally weighted, as at June 30, 2020.

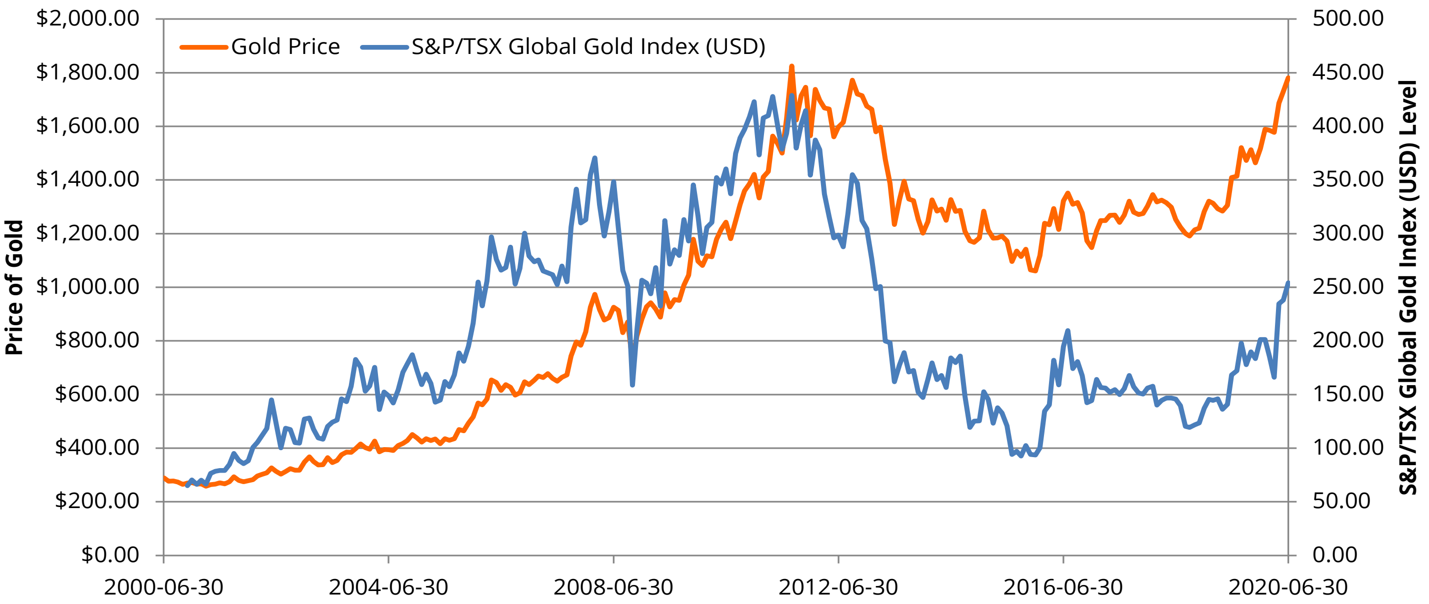
HEP will generally write covered call options on 100% of the portfolio securities. The level of covered call option writing may vary based on market volatility and other factors. The level of writing that the portfolio management team utilizes, often referred to as the delta coverage of the portfolio, will vary, so that while 100% of the portfolio is being written on, the amount of options coverage is typically less than 100%.

HEP INVESTS PRIMARILY IN A PORTFOLIO OF EQUITY AND EQUITY-RELATED SECURITIES OF NORTH AMERICAN-LISTED COMPANIES.

Again, the goal here is provide exposure to gold equities, where investors get the majority of the upside performance of the equity holdings while receiving monthly income. The big difference between HEP and HGY, aside from the fact that HGY invests in physical gold and HEP invests in equities, is that HEP writes covered calls out-of-the-money, with strike prices that are set dynamically based on the stock's volatility. The higher the volatility, the more out-of-the-money the option price is, which gives the stock more upside runway on its pricing, and generally provides a steady amount of option premium.

Compared to physical gold, equities have the added advantage of providing operational leverage. Many of the producers have engaged in aggressive cost-cutting and balance sheet improvements over the last decade and can see substantial revenue advantages when the price of gold rises. This can be observed with the strong correlation to rising gold prices during the last four years in the chart below.

GOLD EQUITIES VS. GOLD PRICES



Source: Bloomberg, as at June 30, 2020.

In both cases, the yields generated by these ETFs have fluctuated with market conditions and volatility, but have remained attractive for the near-decade that Horizons ETFs has been offering them.

CALENDAR YIELDS

	June 2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Horizons Gold Yield ETF (HGY)	4.41%	4.20%	4.67%	4.63%	5.39%	6.16%	6.32%	7.80%	9.01%	8.01%
Horizons Enhanced Income Gold Producers ETF (HEP)	5.05%	4.58%	5.27%	7.09%	9.21%	11.61%	11.31%	18.44%	14.54%	16.91%

Source: Bloomberg as at June 30, 2020.

The ETFs do not have fixed distributions but pay distributions monthly. Distributions are generally based on the net premiums resulting from the writing of covered calls, any dividend income received, less expenses payable by the ETF. The amount of monthly cash distributions fluctuates from month to month and there can be no assurance that an ETF will make any distributions in any particular month. Monthly distributions will be paid in cash, unless the investor has enrolled in the ETF's dividend reinvestment plan.

Even in today's low-rate environment, HEP and HGY are still yielding in excess of 4%, while also benefitting from the strong rise in gold prices (up 26.35% for the one year period ending June 30, 2020). It's an effective way to truly put gold to work for a portfolio that needs a consistent income stream!

	1 Month	3 Months	6 Months	YTD	1 Year	3 Years	5 Years	Since Inception	Inception Date
Horizons Gold Yield ETF (HGY)	2.43	12.37	14.53	14.53	21.64	8.76	5.07	-0.18	17/12/2010
Horizons Enhanced Income Gold Producers ETF (HEP)	3.01	45.98	20.86	20.86	42.29	20.45	17.20	-1.41	11/04/2011

Source: Bloomberg as at June 30, 2020. The indicated rates of return are the historical annual compounded total returns, including changes in unit value and reinvestment of all distributions, and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated.

MONTHLY DISTRIBUTIONS WILL BE PAID IN CASH, UNLESS THE INVESTOR HAS ENROLLED IN THE ETF'S DIVIDEND REINVESTMENT PLAN.

HORIZONS ETFs
by Mirae Asset