HEMB Quarterly Commentary

March 2019

Market/Economic Update

Emerging Market ("EM") fixed income securities had a strong start this year, reversing most of the price decline that took place late last year due to (1) the Fed's reversed stance to dovishness, (2) positive news on the U.S./China trade talks and (3) the Chinese government's stimulus policies designed to stabilize the economic activity. In fact, the EM credit index had the best Q1 performance since the Global Financial Crisis. Mayhem hit the bond markets in late March as the U.S. Treasury yield curve officially inverted – a traditional sign of an upcoming recession – as the 10-year Treasury bond yields 6 bps less than the 3-month note. U.S. treasuries gained about 2.1% this quarter; 10-year yields ended the quarter at 2.405%, down 28 bps.

In the first quarter of 2019 (Q1, the first three months ending March 31, 2019), the EM credit index returned +7.34% with greater performance contribution from the high yield sector with +8.47%. The high yield sector outperformed the investment grade sector, which generated a return +5.78%. The Africa region, which performed poorly late last year, staged a strong comeback in the first quarter with a performance of +10.2% as the financial conditions improved and commodity prices (e.g. oil price) recovered from the December lows. From a country level, the best-performing country was Ecuador, which returned +16.36%, as the Moreno administration was able to secure a IMF financing deal of $4.2 billion by agreeing to the IMF's comprehensive reform package. On the other hand, Turkey underperformed the index with a return of +0.47% as political risk tensions rose ahead of March's local election.

Argentinian and Mexican sovereign bonds were major winners this quarter, with 10-year yields in those countries decreasing about 75 and 63 bps, respectively. New Zealand and Portuguese sovereign bonds also rallied, while Japanese bonds saw only minor gains. Continued political turmoil hurt Turkish bonds, with yields there defying the global trend.

Portfolio performance and positioning

The credit portion of the ETF outperformed during the January-March 2019 period. Yield curve and security selection contributed positively to the outperformance. Country selection was the main detractor. The ETF's overweight positions in South African corporate issuers, both of which having a majority of cash generating assets in developed markets, contributed strongly to the ETF's performance. Also, the ETF's exposure to agrochemical industrial issuer, Syngenta, which is owned by Chinese SOE ChemChina and agrichemical producer "Israel Chemical", contributed significantly to the ETF's security selection contribution. The largest detractor was our under-weight allocation to Sub-Saharan African credits, which performed strongly during the period.

Latin America, in general, was very helpful for performance throughout the first quarter of 2019. Mexican bonds proved beneficial for us as those issues rallied and were among the best performers in the world. We also had 36 bps of performance added thanks to holdings in the government of Ecuador, while Brazilian and Chilean bonds were also helpful. Strong performance was mitigated somewhat due to weak performance in Turkish bonds, whose yields gained significantly as mentioned above.

We continue to favour Argentinian sovereign bonds as we have faith in the reforms happening in that country. Given factors such as the securing of funding for 2019 by reaching an agreement with the IMF, its targeting of a balanced budget in 2019, and now having a competitive exchange rate to stimulate export, we expect spreads in Argentina to tighten and outperform in the first half of 2019 and then stabilize before the general election in October. We also have a strong weight in Mexico, Indonesia, Turkey and South Africa. The ETF has small exposure to Russia, which is our biggest underweight position in the portfolio as we expect more noise around potential sanctions on the country.

HEMB Quarterly Commentary

December 2018

Outlook

We are constructive on EM bonds. The recent volatility provided some good opportunities, and we expect the asset class to outperform over the first half as valuation and economic outlook is supportive for the asset class.

Although a macro outlook for emerging markets has improved on the back of the Fed's dovish pivot and the Chinese government's stimulus measures to help stabilize the downward spiral in economic activity, we remain cautious that global growth and trade dispute concerns will continue to negatively impact market risk sentiment. Furthermore, we expect the bout of spikes in market volatility we saw in 2018 to continue to reappear throughout 2019 as we are in the late economic cycle. That being said, the current macro environment of slower growth with central banks' dovishness is favorable for carry assets such as the emerging markets credit sector. Bottom-up EM corporate fundamentals are still stable as a majority of key issuers focus on a conservative capital strategy. We expect the credit spreads to move range-bound in the near-term until the market has a better sense of whether the recent dovish stance by the Fed will be enough to elongate the business cycle and ,therefore, support the carry environment or not. We plan to tactically increase the ETF's beta exposure when market pressure or volatility rises. However, we intend to gradually reduce its beta exposure when a strong technical continuously compresses valuation levels.

HORIZONS EXCHANGE TRADED FUNDS

ACTIVE ✶ BENCHMARK ✶ BETAPRO

MIRAE ASSET