Global X Active Canadian Dividend ETF (HAL)

Market Overview

The S&P/TSX Composite Index finished flat in the second quarter of 2024, buoyed by strong performance in the Materials (+7.4%) and Consumer Staples (+4.2%) sectors. The Health Care (-18.6%), Real Estate (-5.7%), Information Technology (-5.6%), Industrials (-3.4%), and Financials (-1.1%) sectors all lagged the broader market.

Market sentiment was mixed this quarter, with growth subdued by ongoing employment challenges and a strained housing market. The unemployment rate rose to 6.2%, its highest since January 2022, though still low historically. With the growing threat of recession, the Bank of Canada (BoC) cut interest rates by 25 basis points (bps) in their June meeting to stimulate growth. Though fluctuating at the end of the quarter, annual inflation has cooled significantly since the rate hiking cycle in March 2022 and is now near its target rate. As interest rates moderate, sectors such as REITs, Utilities, Telecommunications, and Financials, among the hardest hit by higher rates, are now set for a strong recovery.

Oil prices reached annual highs in April, driven by escalating geopolitical tensions in the Middle East and concerns over potential disruptions to global supply. However, these pressures eased by the end of the quarter and West Texas Intermediate oil settled at US$81 ($111) per barrel, down from US$87 ($119) per barrel in April.

Quarter in Review

On a sector level, Energy continued to be the largest contributor to relative performance, driven by strong positions in CES Energy Solutions and Keyera. In Financials, Royal Bank of Canada, goeasy, and EQB contributed positively to stock selection, as the portfolio favoured a barbell approach of high-quality large-cap banks and secondary lenders in the sustained high-interest rate environment. An underweight position in the Communication sector created a positive allocation effect, and the exit from Telus last quarter continued to help with stock selection. Additionally, an underweight position in the Real Estate sector generated a positive allocation effect.

Conversely, Consumer Staples detracted the most from performance, as underweight positions and strong benchmark performance resulted in a negative allocation effect. In the Materials sector, negative stock selection effects arose from not owning Pan American Silver and a few other mining companies in the benchmark that posted strong performances.

BCE and Telus were sold at the beginning of the quarter as the outlook on Canada's telecom industry continued to cloud due to fierce competition, heavy capex, and debt burden amid high interest rates. Portfolio attribution confirmed the positive impact of this decision.

The Sub-Advisor's model suggested weakness in banks, particularly after the money laundering scandal of TD, which led to the sale of TD and BMO, with a rotation into Manulife Financial in the insurance industry.

The portfolio picked up Dollarama, a clear secular leader with an enduring business model. Strong AI-forecasted EPS growth, high-forecast dividend growth, and high quality justify its position in the mandate. Given its high valuation, the position was initiated at a small weight.

On the strength in Materials, as indicated by the model, Dundee Precious Metals and Barrick Gold were also purchased.

Outlook and Positioning

The Sub-Advisor believes that successful asset management should be focused on three core pillars, which are Growth, Payout and Sustainability of cash flows (GPS). For outlook and positioning, the Sub-Advisor will address each of these core pillars.

Growth — In positioning the portfolio to secular drivers of dividend growth, we believe consistent earnings growth is critical for predictable and sustained dividend growth. According to the Sub-Advisor's proprietary model, EPS growth forecast in the U.S. is strong for the Energy, Communications, Information Technology, Materials, Health Care and Industrial sectors. It has moderated in the Consumer Discretionary and Consumer Staples Sectors but still has positive growth and continues to lag in the Utilities Sector. In the U.S. these EPS growth signals are complemented by strong dividend growth forecasts in most sectors. The Communications sector leads with strong representation from Meta and Google. Information Technology and Consumer Staples sectors have the next strongest dividend growth. Globally, the Sub-Advisor saw earnings growth continue to improve, while dividend growth converged among sectors, to a level slightly lower than the U.S.

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In Canada, Energy, Industrials and Financials continue to have the strongest dividend growth, while Communications, Real Estate and Utilities, the rate-sensitive sectors, lagged. The probability of a dividend cut has stayed flat year-to-date and around 5% - 15% depending on the sector. Earnings growth improved in commodity sectors (Materials and Energy). Earnings growth forecast also improved among interest rate-sensitive sectors but has not translated to stronger dividend growth. Information Technology continues to have strong secular earnings growth throughout the year.

The Sub-Advisor sees the strongest revenue and cash flow growth from secular companies that are thematically driven, especially in the areas of Technology, Industrial Automation and Pharmaceutical Technology. AI demand is certainly a tailwind, as well as continued chip re-shoring, and the implementation of AI into software-as-a-service companies in multiple industries.

The Sub-Advisor continues to position and focus on companies with positive earnings growth coupled with strong dividend growth.

Notwithstanding the speculative nature of the Fed interest rate cycles, the mandate is positioned for secular dividend growth versus timing the Fed's decision. Over the past 12 months, 91% of the companies in the portfolio have increased their dividends.

Payout — The Sub-Advisor focuses on dividend growth as it believes a "yield for yield's sake" approach results in a minimal broad upside capture amidst hidden downside risks. This is especially apparent in a higher-rate environment where credit quality is much more important. The Fed has opted to leave policy unchanged so far in 2024 with a forecasted 25 bp cut during the second half of the year. Higher-for-longer rates have continued to put a strain on cashflows and dividend sustainability.

The Sub-Advisor believes that we are in a phase when profitability, stability and safety need to be embraced and continue focusing on earnings and cash flow growth supporting dividend growth versus extraneous events.

Sustainability (of cashflows) — According to the Sub-Advisor's model, regionally, the probability of dividend cuts continues to be forecasted lower in the U.S. than it is in Europe and continues to see dividend cuts decrease in the U.S. within all sectors. In Canada, the probability of dividend cuts has not decreased in the same way as in the U.S. but they are still at lower levels. Information Technology, Health Care and Consumer Staples all had a decrease in the probability of dividend cuts.

HAL is overweight the Energy, and Industrials sectors and underweight the Consumer Staples, Financials, Real Estate and Consumer Discretionary sectors.

The Sub-Advisor believes it is time to consider the duration and credit cycles within the dividend asset class. It believes its GPS strategy offers a total return approach through owning companies that can continue to reward shareholders through dividends, buybacks and debt reduction, ultimately combined with careful discretionary consideration of stock and sector allocations by the portfolio managers.

Commissions, management fees and expenses all may be associated with an investment in the Global X Active Canadian Dividend ETF ("HAL" or the "ETF"), (formerly Horizons Active Cdn Dividend ETF) managed by Global X Investments Canada Inc. The ETF is not guaranteed, its value changes frequently and past performance may not be repeated. The prospectus contains important detailed information about the Global X Funds. **Please read the relevant prospectus before investing.**

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