Global X Active Global Dividend ETF (HAZ)

Market Overview

Global equity markets maintained upward momentum through the second quarter despite headwinds posed by ongoing geopolitical tensions and electoral uncertainties in key economies such as the U.K., France, India, and the upcoming U.S. presidential election. Investors remained cautious amidst these uncertainties, mindful of potential economic growth impacts later in the year. However, underlying economic indicators painted a resilient picture, driven by robust consumer spending and a notable improvement in the global composite Purchasing Managers' Index, which surged to 52.8 in June, surpassing the pre-pandemic decade average of 51.2.

Overall performance this quarter was driven by the persistent strength of U.S. Big Tech, and significant valuation increases across the sector, fueled by ongoing enthusiasm surrounding advances in Artificial Intelligence (AI). This momentum lifted Technology stocks and also played a crucial role in bolstering broader market gains, highlighting the evolving landscape of technological innovation driving economic growth. Major players such as NVIDIA and Microsoft stood out with impressive earnings beats, contributing significantly to the market's gains this quarter.

Globally, inflationary pressures that surged to unprecedented levels by June 2022 dramatically eased, reflecting the significant progress of global central banks' stabilization efforts. The Bank of Canada (BoC) and the European Central Bank initiated their first-rate cuts during the quarter, while the U.S. Federal Reserve (Fed) kept rates at the 5.25% to 5.5% range, noting moderate progress towards its 2% inflation target. The Eurozone experienced a modest recovery following a long stagnation period. Despite the relatively higher interest rates in the U.S., the economy was still resilient with a strong labour market and stellar productivity gains in AI which helped offset broader market weaknesses, particularly for small-cap stocks which have taken a hit due to current interest rate levels. In China, policymakers took a more aggressive step to revive the Real Estate sector by introducing a program that allowed local governments to purchase excess inventory in various cities. While this measure was insufficient in returning the economy to pre-COVID levels, it marked a significant step towards the country’s recovery.

Quarter in Review

The index gained 3.7% this quarter. The Information Technology (12.7%) and Communication Services (9.4%) sectors collectively drove the index's total return while the Materials and Real Estate sectors were the worst performers, each declining by 2%.

On a sector level, Consumer Staples was the largest contributor to relative performance. Costco had double-digit returns with above-consensus earnings. The company shows strong forecasted AI earnings per share (EPS) growth in the mandate’s model coupled with high forecasted dividend growth and a low probability of a dividend cut. These factors, combined with Costco’s enduring business model strength as a leader in gaining long-term market share, underscores its positive fundamentals. HAZ’s position in Unilever also led to a positive stock selection effect. In the Health Care sector, positions in Novo-Nordisk, AstraZeneca and Amgen all led to a positive stock selection effect. Stock selection in the Industrial sector continues on its positive note with positions in Wolters Kluwer, Schneider Electric and Republic Services all outperforming that sector. Williams Companies and Shell had strong relative performance in the Energy sector which led to a positive stock selection effect. An underweight in the materials sector led to a positive allocation effect coupled with strong performance from the HAZ’s position in Air Products and Chemicals. In the Information Technology sector, the mandate’s positions in Broadcom and Apple led to a positive stock selection effect. The mandate had relative outperformance in this sector without owning NVIDIA.

The mandate lagged in the Communications Sector where an underweight in this sector had a negative allocations effect. In the Financials Sector, AXA and Mastercard lagged the benchmark and led to a slight negative stock selection effect.

In keeping with the strategic trajectory of lengthening duration via dividend growth, HAZ exited BCE and Telus. This was a strategic decision based on our proprietary investment model which focuses on high quality (a low probability of dividend cut and strong dividend growth) and strong cash flow (EPS growth predictions).

With the proceeds from BCE, HAZ purchased ICICI Bank on strong dividend and earnings growth forecasts, giving exposure to the growing economy in India.

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Alphabet was purchased from the proceeds of the Telus sale when it initiated a dividend this quarter and screens very well for EPS growth and forecasted dividend growth.

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, the Sub-Advisor believes consistent earnings growth is critical for predictable and sustained dividend growth. According to the Sub-Advisor's 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. In the U.S., the Communications sector leads with strong representation from Meta and Google. Information Technology and Consumer staples have the next strongest dividend growth and all sectors are trending stronger in dividend growth compared to Europe. In Asia, the model is showing strong earnings growth from Information Technology, Energy and Materials with Materials and Energy showing the largest change.

In Europe, the model is showing an overall rebound in earnings growth. The leading sectors for forecasted earnings growth are REITS, Information Technology (part of the AI supply chain), Materials (Metals and Mining and some packaging and chemicals), Communications, Healthcare and Energy. While earnings growth has turned more positive for Europe, dividend growth is more subdued than in the U.S. and the sectors are converging.

We see 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 SaaS 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 Fed interest rate cycles, the Fund is positioned for secular dividend growth versus timing the Fed's decision. Over the past 12 months, 98% 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-basis point cut this year. Higher-for-longer rates have continued to put a strain on cashflows and dividend sustainability.

The Sub-Advisor believes that we continue to be in a phase when profitability, stability and safety need to be embraced and the Sub-Advisor will continue to focus 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 the U.S. but they are still at lower levels. In Europe, there is more dispersion between the sectors with the overall probability of dividend cuts remaining higher than in the U.S. Information Technology, Health Care and Consumer Staples all had a decrease in the probability of dividend cuts.

HAZ is overweight the Energy, Consumer Staples, Health Care and Industrials sectors and underweight the Consumer Discretionary, Communication Services, Materials and Utilities sectors. Regionally, the mandate has approximately 34% weight in Europe, 65% in North America, and 1% in the Asia-Pacific region.

The Sub-Advisor believes it is time to consider the duration and credit cycles within the dividend asset class. The Sub-Advisor believes that its 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.

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