BKCL Quarterly Commentary

Q4 2023

Horizons Enhanced Equal Weight Canadian Banks Covered Call ETF (BKCL)

Market Review

Canadian equities, as measured by the S&P/TSX Capped Composite Index, experienced a return of 12.05% in 2023. The significant positive performing sectors were Information Technology and Real Estate, while the only negative contributing sectors were Communication Services and Materials.

The Bank of Canada (BoC) raised the interest rate by 25 basis points in three out of eight meetings in 2023, leaving the overnight rate at 5% by the end of the year. In their meeting in December, the BoC decided to hold the overnight rate as they highlighted a cooling labour market where job creation has been slower; the unemployment rate slightly increased to 5.5% as of September 2023. The BoC also commented on the improvement in inflation, stating that the slowdown in the Canadian economy was reducing inflationary pressures. However, the BoC was still concerned about the risks of the inflation outlook and was willing to raise the policy rate further if necessary.

The Canadian Consumer Price Index rose 3.1% year-over-year. This was a volatile year for oil, which was driven by geopolitical turmoil and uncertainties about the oil output levels by producers around the world. The price of oil, as measured by the West Texas Intermediate, experienced a return of -6.7% for the year finishing at US$72 per barrel; it reached a low of US$67 and peaked at US$93 per barrel.

Gold prices rose by 12% breaking the US$2,100 level this year and ending the year at $US2,065 per ounce. This was largely driven by increased gold buying from central banks which collectively bought approximately 800 tonnes of gold over the first three quarters of the year.

Canadian bank stocks trended lower for the majority of the first three quarters of the year largely due to higher interest rates, which led to lower trading activity, increased costs for the banks, and increased provisions for bad loans. However, towards the end of the year, equity markets rallied resulting in positive year-to-date returns for all six banks held in the ETF.

Quarter in Review

BKCL holds the Horizons Equal Weight Canadian Bank Covered Call ETF (BKCC) in its portfolio. In Q4, the top three performing stocks in BKCC were the Canadian Imperial Bank of Commerce, Bank of Montreal, and Royal Bank with total returns of 23.41%, 16.06%, and 14.29% respectively. The bottom three performers were Toronto Dominion Bank, Bank of Nova Scotia, and National Bank with total returns of 5.90%, 5.95%, and 13.13% respectively.

Outlook and Positioning

With fears of a recession, higher inflation, and the ongoing conflict in Europe, more volatility is expected. Central banks will likely face a fine line between containing rising price levels and sending the economy into a recessionary slowdown. With consumer and investor sentiment near decade lows, it will be a difficult task, but could also lead to sharp moves higher should the situation improve. Rising rates could also have an impact on the housing market in Canada, which would further add volatility for Canadian banks.

Option premiums were volatile in the first half of the year and closed higher. The second half of the year saw volatility slide slightly. Risk premiums will continue to be monitored to apply appropriate coverage levels throughout the cycle. Continuing uncertainty surrounding inflation, interest rates, COVID-19, supply chain disruptions, and other economic realities may continue to keep option premiums elevated.

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Into 2024, the covered call strategy is favourably positioned to potentially provide value from a yield, hedging and upside capture perspective in the current environment. The ETF invests in BKCC, therefore BKCL inherits an option writing strategy. BKCC dynamically writes options on its underlying stocks. Option yields for Canadian banks trended lower in 2023 versus the prior year. The monthly premiums generated for the year showed consistency in the second half of the year and may remain stable into 2024.