Views from the Desk

Updates in the Equity and Fixed Income Market

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Announcement of the Canadian Federal Election

As the campaign moves on and each party releases their platform, we will be able to see what that means for all Canadian Equities once there is analysis done on them. The Conservatives have already announced their platform and plan to balance the budget within 10 years which seems like a long timeline for a traditional Conservative government. The Conservatives themselves are pledging a lot of government spending than what they typically pledge as a result of how different the overall economic landscape is this time around due to COVID. COVID is going to continue to play a very big roll in this election and the Canadian economy over the next couple of years. The end result is going to be a lot of government spending no matter which party comes into power.

Conservatives typically are the most "conservative" when it comes to government spending out of the three major political parties (Liberals, NDP and Conservatives), and we think that the Liberals and NDP have spending plans that are even higher. We do anticipate over the next couple of years that there will be a lot of fiscal spending for Canadian consumers and Canadian businesses which bodes well for the economy in general. High fiscal spending could lead to concerns over government debt and deficits over the long run however, the near-term impacts should be beneficial to the economy overall.

When it comes to certain sectors being affected, it is too early to say however, the Conservatives are talking about broadening competition in the banking sector and allowing fintech companies to be able to compete with the traditional banks. The impact on the banking industry profitability and the financial sector would be still unknown. There will be more opportunities to see where those sector opportunities in the weeks to come. ZCN - BMO S&P/TSX Capped Composite Index ETF

Energy

We have had a strong run in energy prices and ZEO - BMO Equal Weight Oil & Gas Index ETF is up significantly year to date. We like ZEO because it has a 50% weighting in pipelines and when energy is volatile, pipelines tend to me more stable. Pipelines deliver a yield of approximately 3.5% and historically have been more of the return generator within this space in comparison to the explorers which provide high betas. Pipelines and transportation and storage continue to give us good returns over time for energy ETFs.

In terms of the election we view traditional energy such as oil and gas to be favored by the Conservative party and green energy to be favored by the Liberal/NDP parties. Generally speaking when it comes to the energy sector, we like a pairing of ZCLN - BMO Clean Energy Index ETF and ZEO - BMO Equal Weight Oil & Gas Index ETF.

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Discount Bonds for Taxable Accounts

In a taxable account investors have to pay tax on coupons from fixed income they are holding. As yields go down the majority of bonds being issued in the past will typically have a coupon that is higher than the current Yield to Maturity (YTM). For taxable accounts this is not ideal. The discount bond strategy will invest primarily in bonds that have a coupon which is closer to the YTM. Instead of buying bonds at a premium that are going down in value, you are buying bonds that are at a discount and will go up in value when you are closer to maturity (or at least your bonds are not at a significant premium and are close to trading at par). Therefore, Investors will pay tax on the coupon that is very close to their total return they are expecting from the YTM. The taxable liabilities for investors are much more aligned from a taxable point of view.

ZDB - BMO Discount Bond Index ETF is an ETF that tracks the discount bond index which closely mimics the aggregate bond index. What you are getting is risk return metrics that are very similar to the overall bond universe with a slight advantage for taxable investors. The discount bond universe is very liquid, and we believe its best for investors to pay attention to the returns they are getting after tax.

Infrastructure

Last week the Senate passed a 1.2 trillion-dollar infrastructure bill that includes an allocation of $550 billion for new spending which covers funding for roads, bridges, water infrastructure, freight rail, transit systems, the electric grid and broadband. Infrastructure investors particularly ZGI - BMO Global Infrastructure Index ETF holders are benefiting from this passed bill and will continue to do so. The geographic allocation in ZGI is 70% in the U.S 23% in Canada and 6% in the United Kingdom. ZGI is up 18% this year and is a good portfolio completion tool with low correlation to U.S and Canadian equities.

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Source: Bloomberg, All returns and data points July, 2021.
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