Views from the Desk

Updates in the Equity and Fixed Income Market

Chris Heakes and Matt Montemurro, Portfolio Managers, BMO ETFs

Positioning in These Volatile Markets

Pfizer had announced that a third vaccine neutralizes the Omicron variant to which the market responded positive. We are still waiting on more Omicron data however, thus far we know that the Omicron variant is less deadly than the Delta variant and the markets are shaking off these Omicron fears. The S&P 500 is back to its pre-Omicron highs after only 8 days. Cautiously speaking we have to be mindful of volatility however, we still have strong conviction on being overweight equities vs fixed income. We remain unchanged in our view that quality companies are a great way to get equity exposure through ZUQ - BMO MSCI USA High Quality Index ETF or ZGQ - BMO MSCI All Country World High Quality Index ETF (quality factor holds companies with low financial leverage, high return on equity and stable earnings growth). Additionally, Dividends and Value factors are correlated factors that perform well in a rising rate environment and with the banks announcing their buy backs/dividend increases we feel this trade is well supported.

For bank exposure please look at ZEB - BMO Equal Weight Banks Index ETF, ZBK - BMO Equal Weight US Banks Index ETF, ZWB - BMO Covered Call Canadian Banks ETF, ZWK - BMO Covered Call US Banks ETF.

From a Fixed Income point of view, we believe keeping a core exposure to ZAG - BMO Aggregate Bond Index ETF. ZAG will give you diversification across the yield curve and provide duration protection when volatility picks up. ZBBB - BMO BBB Corporate Bond Index ETF is a great way to compliment an aggregate bond portfolio since ZBBB is all corporate bonds. In a period of rising rates, you take advantage of adding more yield and lower duration risk to your fixed income portfolio with ZBBB.

BOC and FED Expectations

In Canada the expectation has been to take a more aggressive path than the FED to raise rates. We had the BOC rate expectations shift from March to April when the Omicron news first came out, now the expectation of a rate hike is 68% in January. The market is pricing in approximately 5 rate hikes in 2022 but we think that will be unlikely. Along with ZBBB you can also look at complimenting your fixed income with ZPR - BMO Laddered Preferred Share Index ETF, ZCS - BMO Short Corporate Bond Index ETF, or ZQB - BMO High Quality Corporate Bond Index ETF.

We expect the FED to act slower than the BOC and potentially raise rates in June. The FED is expected to have 2 to 3 rate increases in 2022. Expectations of rate increases are a moving target however; it is important to consider these potential rate hikes into your portfolio. For US fixed income we look to ZFH - BMO Floating Rate High Yield ETF to get exposure to high yield credit while eliminating duration risk and we also look to ZSU - BMO Short-Term US IG Corporate Bond Hedged to CAD Index ETF to shorten your duration within the investment grade side of your portfolio.

Credit Exposures - Canada vs U.S.

Investors typically look to corporate bonds to help protect against the impact of duration. Currently, Canadian credit looks very attractive compared to the US. US Credit spreads have narrowed much more than Canada and the US continues to grind tighter. From an interest rate perspective, we are seeing a steeper yield curve in the US. Looking at a 5-year differential, Canada is about 23bps higher and on the 10 Canada is 11bps higher than the US.

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Factor and Sectors

From a factor perspective we think Quality and Dividends are what we want to lean into. Dividends in Canada are more of a reopening value trade. Our ZDV - BMO Canadian Dividend ETF and ZWC - BMO Canadian High Dividend Covered Call ETF gives you exposure to those cyclical sectors such as financials and energy. ZLB - BMO Low Volatility Canadian Equity ETF is more of a quality low risk exposure and balances nicely against the dividend value play.

From a sector point of view, we look at sectors that have a positive correlation to interest rates rising such as Financials ZEB - BMO Equal Weight Banks Index ETF , ZWB - BMO Covered Call Canadian Banks ETF, Industrials ZIN - BMO Equal Weight Industrials Index ETF and Energy ZEO - BMO Equal Weight Oil & Gas Index ETF. The valuation levels in Canada are still very low and overall we are bullish on Canada.

China

ZCH - BMO MSCI China ESG Leaders Index ETF was an ADR index that has recently changed. ZCH will now invest in local Chinese markets and has an ESG tilt to it. Screening for companies with better governance we believe can be very meaningful to investors.

For more on changes to ZCH please visit BMO Index Change Announcements

Bank Dividends

Last week the big 6 Canadian banks raised their dividends by 15% and announced plans to repurchase up to 160 million shares, equivalent to 2.7% of outstanding stock after the country's financial regulator lifted a nearly two-year moratorium.

To hear more on Bank Dividend increases please listen to our quarterly deep dive that will be released next week at BMO ETF Current Podcasts.

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