

Views from the Desk

Updates in the Equity and Fixed Income Market

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Core ETF Flows

53 Billion dollars flowed into ETFs in Canada for 2021. The Canadian industry has brought a lot of innovation to the market however, the bulk of flows have gone into core broad based ETFs. Core ETFs like [ZSP - BMO S&P 500 Index ETF](#) have a very diverse user base from individual investors to pension fund managers. Core ETFs are essentially gateway ETFs and a lot of advisors who never used ETFs have started to use them within the last 12 to 24 months for the first time. Most of these new ETFs users (advisors) were wanting to put new money to work. Some of the most efficient ways of putting capital to use is through ETFs since they are very inexpensive, transparent and liquid. ETFs are very scalable for both small and large accounts and investors/advisors are starting to recognise this more and more. ETFs are also an easy way to get exposure to international markets such as [ZEA - BMO MSCI EAFE Index ETF](#) during regular trading hours.

Equity and Fixed Income

There has been a lot of volatility in both the equity and fixed income markets. Risk isn't necessarily a bad thing as long as it can be overcome. Omicron seemed to be put into the rear-view mirror in December and the market volatility is more centered around inflation and rising rates. The market is now pricing in an 80% chance of a Fed hike in March and a 65% chance that the BOC does the same. Jerome Powell is using a very hawkish tone saying that they will not hesitate to raise rates to combat inflation. Inflation numbers in the US came back this morning at 7%.

Bond prices are being impacted right now and the forecast over the next 2 years indicates there will be many rate hikes. We believe the true value of fixed income will be capital preservation and portfolio diversification. Our chief investment strategist Brian Belski believes that higher inflation isn't necessarily bad for stocks. That if you look at increases in CPI historically, they are associated with double digit returns in the US. Belski and his team at BMO Capital Markets have also mentioned that historically, that even when there are CPI declines, the S&P500 has averaged a 13% return. We believe equities to be your true inflation hedge. We expect dividend and quality factors, to outperform in 2022.

Inflation Hedge

US CPI numbers came in around 7% which has been the highest it has been since 1982. The central banks have acknowledged that the inflation we are experiencing isn't as "transitory in nature" as previously mentioned. We believe overall, what has been driving inflation has been "supply chain driven" and we have seen major disruptions. When it comes to inflation, investors have to ask themselves how they see the developments of COVID this year. We could very well start to see this pandemic come to an end after Omicron however, we still think peak inflation is yet to come.

[ZEB - BMO Equal Weight Banks Index ETF](#) is a good way to hedge inflation and there are still more headwinds to come for Canadian Banks such as a steeper yield curve, wider term spreads, and more dividend increases for the banks. Furthermore, the valuations of Canadian banks continue to remain attractive. The average P/E for Canadian Banks are around 11.5 times earnings vs the broader market of 19.2 times earnings. We don't anticipate stagflation unless central banks significantly overshoot tightening monetary policy. The prospects for economic growth still remain positive so that means there will be more demand for loans, mortgages, asset management services, mergers and acquisitions and capital markets activities (such as IPOs).

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ETFs that surprised us in 2021 and ETFs that will do well in 2022

Surprised in 2021

- [ZGI - BMO Global Infrastructure Index ETF](#)
- [ZLB - BMO Low Volatility Canadian Equity ETF](#)
- [ZEB - BMO Equal Weight Banks Index ETF](#)
- [ZRE - BMO Equal Weight REITs Index ETF](#)

Do well in 2022

- [ZUQ - BMO MSCI USA High Quality Index ETF](#)
- [ZDV - BMO Canadian Dividend ETF](#)
- [ZWC - BMO Canadian High Dividend Covered Call ETF](#)

For more details, please listen to the podcast at bmoetfs.ca.

Halt financing to oil and gas

We think this is a more longer-term project (potentially 5-10 years). Many of the traditional oil and gas companies will be embracing a cleaner energy transition and we expect these companies to be supported in this transition. We think that over the long term those companies that do not transition to cleaner energy may have difficulties in the future.

For Energy ETFs please see [ZEO - BMO Equal Weight Oil & Gas Index ETF](#) and [ZCLN - BMO Clean Energy Index ETF](#).

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

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