Views from the Desk

Updates in the Equity and Fixed Income Market

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Canada and the U.S.

Both the U.S. and Canada are volatile at the moment. Rates are moving upward quickly in both countries and there is a lot of uncertainty around the BOC and the FED. Once we see a clear path on what the central banks are going to do, we can expect volatility to stay elevated.

Higher interest rates are good for financial companies and in turn great for Canadian banks. Oil prices continuing to go up great for the Energy sector. Both Financials and Energy have been keeping Canada afloat. ZCN - BMO S&P/TSX Capped Composite Index ETF going forward is a great broad way to get exposure to financials and energy.

For the full podcase please see bmoetfs.ca

Hawkish Tone from Central Bankers

Inflation has started to become a concern to central bankers in the U.S. The yield curve has steepened and in Canada we have seen a bear steepener pattern (longer-term rates outpace shorter term rates due to inflation concerns). We have seen a meaningful pop in yields and the 5, 10 and 30-year yields went up over 40bps in the first few weeks of 2022. With the movement in rates, we have seen fixed income struggle thus far in 2022. We now see a 73% probability of a rate hike from the BOC next week and an aggressive interest rate path for the remainder of 2022 which includes a potential of 6 rate hikes. If that comes to fruition, we expect a flattening of the yield curve and lower economic growth. We think 6 hikes for 2022 to be aggressive and we wouldn't be surprised if there are less hikes than expected due to the Omicron variant and lockdowns. From a position perspective we look to credit. Corporate bonds and spreads are at manageable levels and we don't see spreads tightening too much over the next little while. ZBBB - BMO BBB Corporate Bond Index ETF, ZCB - BMO Corporate Bond Index ETF.

Inflation Risk

U.S. Consumer Price Index (CPI) printed Year over Year (YoY) at 7% last week- the fastest increase since 1982. Omicron continues to put upward pressure on prices due to supply chain disruptions but, we expect these to begin to subside over time. The market expects the Fed to act in March to push back against wage pressures and rising shelter inflation. Inflation fears have pushed up the Fed's agenda and timeline significantly. CAN CPI printed at 4.8% YoY in line with expectations. While still a concern, Canada continues to see less inflation pressure than the U.S. U.S. break evens are starting to tick higher and Canadian inflation is starting to level out. With continued lockdowns across the country and supply chain disruptions, globally, we should expect to see elevated levels of inflation in Canada for much of 2022. That being said, the BOC will look at act swiftly to combat inflation. We will know at their meeting on Jan 26 whether the first rate hike will be in Jan or March. If we expect inflation to continue longer than expected, we will want to look towards ZTIP.F - BMO Short-Term US TIPS Index ETF (Hedged Units).

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Oil and Gas Sector

There has been great returns from ZEO - BMO Equal Weight Oil & Gas Index ETF in 2021 and going into 2022. After the oil futures price went negative, a lot of investors saw that as an opportunity get into the sector and investors have been using sector ETFs as opportunities to get in and out of Oil and Gas. What has been driving oil prices in our view is economic activity. Looking at the futures curve we expect oil to stay above 70.00/barrel through 2022 and into 2023 especially if we see supply chains, increased production, and movement of goods pick up again. We see oil prices going back to 60.00/barrel only after a few years.

Factor Exposures

We have seen the value and small cap sectors perform well in this re-opening environment. It is important to start thinking about how to position your portfolio going forward. We do expect economic growth and recovery to continue to happen but, at a slower pace from what we have seen in 2021.

Dividend and quality factors are great factors to get a growth element to your portfolio and take risk off of the table (in equities). Quality companies have low financial debt stable earnings and high return on equity. The Dividend factor will have mature companies that have strong cash flow. Furthermore, if you happen to be concerned about a stagflation environment, then we'd want to look at the Low Volatility factor.

BMO Quality Methodology

- ZUQ - BMO MSCI USA High Quality Index ETF
- ZGQ - BMO MSCI All Country World High Quality Index ETF

BMO Dividend Methodology

- ZDV - BMO Canadian Dividend ETF
- ZDY - BMO US Dividend ETF

BMO Low Volatility Methodology

- ZLB - BMO Low Volatility Canadian Equity ETF
- ZLU - BMO Low Volatility US Equity ETF
- ZLI - BMO Low Volatility International Equity ETF

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