Views from the Desk

Updates in the Equity and Fixed Income Market

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Volatility and Portfolio Placement

Since volatility has been increasing significantly it has been creating opportunities for equity investors. Equities are attractive as they provide a hedge against inflation. Value and Dividend equities are strong performers in a rising rate environment historically. Dividends (so far in 2022) have outperformed the broad market. BMO's Covered Call ETFs (dividend ETFs with a covered call overlay) can help with volatility by generating a tax efficient premium which adds an additional 3% to 4% yield on top of the dividend yield the ETFs already provide.

Our Quality factor ETFs do have more growth companies in them however, these companies will have low financial leverage, stable earnings growth and high return on equity which tends to do well compared to your standard growth companies. Additionally, Low Volatility Factor ETFs can be very effective to smooth out volatility.

Canadian Bank stocks have hit some volatility recently and the stocks have come down in price however, there is a lot of cash still on the balance sheets and our outlook on Canadian Banks remains positive. Additionally, we expect more dividend increases in the future (which Canadians love) and a rising rate environment tends to bode well for Canadian banks. We recommend looking at ZEB - BMO Equal Weight Banks Index ETF and ZWB - BMO Covered Call Canadian Banks ETF to add to your portfolio.

For more on this topic please listen to the ETF podcast at BMO ETFS Trade Ideas & Podcasts

Fixed Income

The Bank of Canada (BoC) and the Fed are set to announce potential rate hikes. There was a 74% chance based on market expectations for a rate hike today from the BoC (markets priced in). If there is no rate hike from the BoC we can almost guarantee we will see one in March. On the Fed side they are going to raise rates in March. There is chatter about a potential 50bps rate hike from the Fed in the future as well. The market expectation is that we will see 6 rate hikes from the BoC and 3 to 4 rate hikes from the Fed in 2022.

We think that the BoC are more "handcuffed" in terms of how quickly they can move rates. If rates move to quickly it may impact Canadian families that are over-extended in household debt (Canadian household debt is still at historical levels). Canada and its monetary policy are not necessarily independent as they consider what the Fed does. The BoC doesn't want to have the Loonie run too high since Canada is an export driven economy. The central banks are expected to tighten due to inflation. A big part of why we are seeing inflation is because it is "monetarily" driven, and also due to the disruption in manufacturing and logistics. It is believed that if we start to treat the pandemic more like an "endemic" we will see the economy start to open up. Its important that the central banks don't raise rates to quickly to "chock out" the economy which could potentially send us into a stagflation environment. We think that some of these potential rate hikes get pushed into 2023 to avoid stagflation. The short end of the curve is a great place to park cash (to protect from rising interest rates) ZST - BMO Ultra Short-Term Bond ETF, ZUS.U - BMO Ultra Short-Term US Bond ETF (USD Units) and ZPR - BMO Laddered Preferred Share Index ETF. Overall, we do think being in equities is the best way to fight inflation ZEB - BMO Equal Weight Banks Index ETF.

Update: Both the BoC and Fed held rates firm in their announcements on Jan 26th 2022.

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Rate Decrease in China

Emerging markets (EM) had a tough year in 2021 and ended the year flat. China had a tough year due to credit issues such as Evergrande. The Chinese government have been supportive, and they are talking about rate decreases to support the economy. Fiscal and Monetary support will be important for China. It is tough to be overweight in EM but we think its still important to have some exposure ZEM - BMO MSCI Emerging Markets Index ETF. Russia and Ukraine could trigger a lot of volatility with EM and there could potentially be some good entry points however, we are watching cautiously.

Tensions in Russian and Ukraine

We think there are opportunities in the Energy space. WTI is up 33% YTD and has significantly outperformed the broader TSX which is down 3%. The conflict in Russian and Ukraine is creating volatility in the markets and could cause energy prices to go higher (disruptions with supply in Russia). The U.S. and NATO are supporting Ukraine if Russia does invade. Russia would likely retaliate by cutting off supply to Europe. Europe does rely on Russian oil and could cause economic impact. JP Morgan is calling for $150 per barrel which we think is aggressive however, we do believe oil prices will remain high over the next several years. OPEC nations are having a hard time increasing supply and are falling short of their production promises. There have been low capital expenditures placed against traditional fossil fuel (which is causing energy prices to go upward) and traditional fossil fuel will fill the energy demand until clean energy can catch up. ZEO is a great way to play the energy to get pure exposure. ZEO - BMO Equal Weight Oil & Gas Index ETF

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