Views from the Desk

Updates in the Equity and Fixed Income Market

Alfred Lee, Portfolio Manager, BMO ETFs

Innovation ETFs

COVID has been expediting the adoption rate of innovation companies. Genomic innovation has really started to come to the forefront. Messenger Ribonucleic Acid (mRNA) was discovered in the early 60s and has been discussed over the last 4 decades on how it can be applied to vaccines however, it never got the attention and funding. Since COVID a lot of vaccine makers have brought mRNA technology front and center such as Pfizer and Moderna. We are now starting to see laboratories continue to explore options for other diseases (not only COVID) and incorporating the mRNA technology to those vaccines as well. Moderna is a top holding in both ZGEN - BMO MSCI Genomic Innovation Index ETF and ZINN - BMO MSCI Innovation Index ETF.

Furthermore, here are some other examples of innovation companies that have been expedited because of COVID:

- Teledoc Health Inc which is a multinational telemedicine and virtual healthcare company based in the US. Teledoc's primary services include telehealth, medical opinions, AI and analytics, telehealth devices and licensable platform services. With Teledoc, instead of waiting an hour in a waiting room or traveling to the doctor, your doctor will call/video conference you at your set appointment time. This has become much more efficient for patients.
- DocuSign, Inc., is an American company headquartered in San Francisco, California, that allows organizations to manage electronic agreements. As part of the DocuSign Agreement Cloud, DocuSign offers eSignature, a way to sign electronically on different devices. More and more businesses are using DocuSign since it is more efficient and can speed up the process of doing business as we've been adapting to the work from home (WFH) environment.
- And finally, we can't forget about cashless payments. Retailers are preferring digital payments more than ever before. Google Pay, Apple Pay, Mastercard, PayPal have been a big providers in this space.

The world economic forum highlighted how innovation companies over the next decade are going to be on pace with the industrial revolution in terms of how it is going to change our everyday life. To get access to innovation companies see our Megatrend and Thematic ETFs.

REITS

Office and retail-oriented REITs have been the more obvious segments of the sector that the coronavirus pandemic has negatively impacted. As most office workers have shifted to work from home (WFH), the majority of office towers have laid empty, with tenants looking to reassess their leases. Retail properties have also experienced much lower foot traffic, as provinces have implemented ongoing lockdown measures.

However, as the vaccination rates in Canada are finally starting to pick up, this should provide a bump for REITs. In addition, as we move closer to an economic re-opening, this should remove much of the uncertainty with office, retail, and even residential REITs. Over the short term, these sub-industries of the REIT sector will likely be the drivers as they price in the normalization of the economy. Over the long term, however, the smaller-cap REITs within health care, industrial and diversified sub-sectors will likely be the drivers in the post-COVID world. As a whole, we believe REITs are well positioned as a late re-opening play and attractively valued, given that many constituents are still trading below pre-COVID levels.

When comparing the sectors in our ZRE - BMO Equal Weight REITs Index ETF to its market cap equivalent, there's a greater focus on smaller-cap REITs given the equal weighting methodology of the index. Over the long term, the equal weighting methodology provides exposure to the sector while minimizing concentration risk and therefore reducing company-specific risk. More specifically to the REITs sector, an equal weighting methodology reduces the concentration in top holdings such as RioCan Real Estate Investment Trusts (REI-U) and Allied Properties Real Estate Investment Trusts (AP-U), which are focused on retail and offices, respectively. For more information on the REITs trade idea please visit Playing the Long Game in REITs.

Industrials

We have seen a lot of advisors focus on ZIN - BMO Equal Weight Industrials Index ETF in the last few weeks. Earlier this week Canada announced that COVID cases remain low and will be opening the boarders to US residents that are fully vaccinated for at least 14 days on Sept 7th. This is a positive sign that economic activity is starting to normalize. We could expect business and personal travel to pick up and the transportation of goods back and forth across the boarders to pick up again dramatically. A lot of the names within the industrial sector are going to be leveraged to economic activity such as airline, railroad and infrastructure companies.

Currently, there are worries of the COVID delta variant spreading rapidly. The mRNA vaccines so far have been proven to minimize cases and severity of COVID delta variant symptoms. In Canada, the mRNA vaccines have been widely used. If COVID cases remain low in Canada and the US, it could be a catalyst for the industrial sector as we head into the fall and winter months. We believe a satellite position of 3% to 5% in ZIN to be a great way to access growth in a defensive portfolio.

10 Year Bond Yields

What drove bond yields lower in the second quarter from our view were three things. One, a lot of investors were taking risk away from their portfolios and started buying bonds. Two, the asset allocators started to rebalance their portfolios from equities back into bonds. Three, foreign investors were buying a lot of Canadian and US bonds to add more investment grade credit quality to their portfolios.

Moreover, within the last few months, we have started to see a rotation into defensive equity such as quality and low volatility companies. We haven't seen the same pressure on fixed income since the first quarter and bond yields started moving lower. We expect equity valuations to start to look attractive again late in Q3 and Q4 so, we may see a rotation back into equities which would put more upward pressure on yields. We believe ZAG - BMO Aggregate Bond Index ETF is still a good core position in your portfolio and complimenting with ZPR - BMO Laddered Preferred Share Index ETF and ZTIP.F - BMO Short-Term US TIPS Index ETF (Hedged Units) to play the inflation in a rising rate environment trade.

To listen to BMO ETF podcasts please visit bmoetfs.ca.

BMO ETF podcasts are also available on

Listen on Apple Podcasts Spotify Listen on Google Podcasts