July 7th, 2021

Views from the Desk

Updates in the Equity and Fixed Income Market

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Oil

Lack of production cuts from OPEC has led to higher prices of oil. Analysts are now predicting the price of oil to go to $100.00 a barrel again. Additionally, we are seeing very high demand for oil which is also keeping the price high. ZEO - BMO Equal Weight Oil & Gas Index ETF provides exposure to Canadian listed oil and gas producers on an equal weight basis. We believe equal weight is a great way to play the theme of economic reopening and continued demand for oil. We think regular demand for oil and demand globally for travel, should continue into 2022.

With ZEO you are getting access to the entire energy sector of oil and gas producers that should benefit from higher oil prices as demand is expected to continue into the future. The risk to oil could be OPEC coming to an agreement on production increases that may destabilize prices a little however, we believe oil prices should stay elevated for the near future and into 2022.

Fixed Income

Rates rose very quickly in 2021 which we believe was not sustainable. Given that the recovery has been anything but a straight line, we think that it makes sense that we've seen some repricing in the 10 year and a flattening of the yield curve. In June we started to see the yield curve flatten by about 23bps reflecting the risks that plague the markets overall. We've had some mixed economic data that growth and recovery has been slowing down. Inflation data continues to be highlighted in the news and those fears have been realised in real time. The real worry is that some of the elements in realized inflation that we are seeing are being more than just transitory. We have had a resurgence of COVID variants globally furthering fears that we are not done with this pandemic just yet. Future lockdowns could slowdown recovery and our growth path.

Rate hikes could be coming sooner that expected. Hiking expectations tend to flatten yield curve, so we see short term rates start to rise and long-term rates start to fall. We are still in an environment with historically low rates. We believe rates have upward pressure going forward. Duration in this type of environment will be a drag on performance. ZAG - BMO Aggregate Bond Index ETF is a prudent core holding to your FI portfolio. ZAG is a perfect way to stay invested since ZAG covers every aspect of the fixed income universe and allows you to benefit from any retracement and repricing. ZAG is a protection tool from a "non straight-line recovery".

As a compliment to ZAG we would look to lower our overall interest rate exposure with shorter duration assets and sticking with corporate bonds such as ZQB - BMO High Quality Corporate Bond Index ETF, ZBBB - BMO BBB Corporate Bond Index ETF, and ZCS - BMO Short Corporate Bond Index ETF. These 3 ETFs are an excellent compliment to a core holding such as ZAG to reduce your overall duration (with that long-term trend of rising rates) while navigating that short-term volatility that we are bound to see for the remainder of the year.

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REITs

ZRE - BMO Equal Weight REITs Index ETF has been performing very well outpacing the TSX composite. The fundamentals of the ZRE trade continue to be sustainable and continue to have legs throughout the rest of the recovery and reopening. The Pandemic has changed the way we work as a whole and as we look at reopening, much of the uncertainty around office retail and residential REITs should start to reduce.

For short term drivers, we look at office and residential. If you look at longer term, we think REITs are starting to evolve and ZRE is positioned very well in smaller cap REITs such as health care and industrials. The equal weight methodology which has a focus on smaller names should be drivers in future performance. We continue to see value in this trade as many of the holdings continue to trade below their pre-COVID levels.

If you would like to look at a more in depth analysis on REITs, Alfred Lee put out a fantastic trade idea called " "Playing the Long Game in REITs" that's available on bmoetfs.ca.

Quality

ZUQ - BMO MSCI USA High Quality Index ETF has started to take off during the second quarter of the year where the first quarter remained flat. We've seen a transition with inflation expectations and with interest rate expectations. These larger established companies within the quality methodology aren't going away any time soon. The companies at the top of the market cap spectrum lead the charge (Alphabet, Facebook, Apple, Microsoft). No matter were interest rates go, these companies shouldn't be affected too much. If rates rise and lending becomes pricier it wouldn't affect these companies as much because these companies have strong balance sheets. For long term investors quality is a great way to get access to growth in a responsible way. The quality methodology focuses on low financial leverage, stable earnings growth and high return on capital.

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