June 16th, 2021

Views from the Desk

Updates in the Equity Market

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G7 Meetings Focus on China

We saw in the G7 meetings focus on China, trying to be more collaborative as apposed to being more combative in recent years. We don't view anything from the G7 meetings that will have an immediate impact on the market. We are still waiting to see what plays out. The G7 did announce a counter to China's Belt and Road Initiative (a global infrastructure development strategy adopted by the Chinese government in 2013 to invest in nearly 70 countries and international organizations). However, we view this as more of a political influence than market influence. If the G7 is successful with some of these initiatives, it might reduce China's overall long-term growth and political influence over the long term globally but, we don't see any immediate impact to China's equities.

ZEM – BMO MSCI Emerging Markets has approx. 36% exposure to China. China has started the year strong as far as returns are concerned and recently returns this year out of emerging markets has started to move sideways. China is the second largest global economy and their domestic economy has been growing over time. Exports 10 years ago were about 25% GDP and now China is at about 17% to 18% today. It has come down slowly over time as the domestic economy becomes more important to the growth of China's overall economy. US is about 13% GDP exports. Canada, more reliant on exports is sitting at about 30%. If you view Emerging Markets to be successful, ZEM – BMO MSCI Emerging Markets could be a great option.

International Monetary Fund projected global economic growth at 6% in 2021 and 4.4% in 2022. Emerging Markets are expected to be even higher at 6.7% growth in 2021 and 5% growth in 2022. China's growth is expected to be 8.4% 2021 and 5.6% in 2022. Furthermore, when looking at EM we can't forget about India. India is expected to grow 12.5% in 2021 and 6.9% in 2022. As global markets ramp up, we expect EM to be a great place to invest.

Canada and ZWC – BMO Canadian High Dividend Covered Call

We've seen strong growth coming out of Canada. The sectors that ZWC – BMO Canadian High Dividend Covered Call is exposed to have been big contributors (financials & energy). ZWC is tilted toward dividend paying companies, and dividend paying companies are doing very well. ZWC has 40% exposure to the financial sector in Canada. We've seen a rotation into financials and value investing. Dividend companies generally have a value tilt to them. Furthermore, the steepening of the yield curve has been successful for financials.

Energy is also doing well. Oil is sitting at around 72 and 74. There are very strong fundamentals in the Energy sector right now. We see energy continue to do well over the foreseeable future. Moreover, there is zero exposure to IT in ZWC, which has been a tailwind for the portfolio. The distribution yield in ZWC is approx. 7% (through dividends and covered call option premium). ZWC produces a good, tax efficient income for investors that will continue for the foreseeable future.

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ZLB Canadian Low Vol

The factor rotation in November started to even out in the market overall. We have very low IT exposure to in ZLB – BMO Low Volatility Canada. IT is still providing returns but not as much as other sectors in Canada in 2021. ZLB has a 10% exposure to REITs. Analyst view REITs as being a strong sector going forward. What's interesting is in 2020, ZLB didn't really underperform the market if you strip out IT. Moreover, if IT was stripped out of the broad market ZLB would have outperformed.

In 2021, ZLB has continued to pick up on a relative basis. We have 10 years of live data and about 27 years of back testing on ZLB. There are very few years where ZLB has underperformed the broad market. We've seen the growth companies start to moderate and value/dividend companies outperforming, which ZLB has been able to benefit from.

US Small Cap Outpacing Mid and Large Cap

Investors in the small cap space have benefited. ZSML – BMO S&P US Small Cap Index ETF and ZMID – BMO S&P US Mid Cap Index ETF have done well. However, ZSML was a big story of the reopening trade. You may ask yourself, when do we move up the CAP spectrum? The best answer is, when we get concerned about the future growth of the market or, when we see growth slow down and flatten out. We don't think we are there yet.

The expectation for GDP growth in the US for 2021 is 6.4%. The US overall, is in line with the overall growth in developed markets. We expect in 2022 US growth to be 3.5% vs 3.6% in developed markets. The 3.5% expected growth for 2022 in the US is still an above the avg trend pre COVID. We believe there is a lot of growth in small and mid cap going into 2022. We might only need to start to look at rotating into large cap around mid to late 2022.

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