Views from the Desk

Updates in the Equity and Fixed Income Market

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Bond Yields Jumping

There is a lot of noise in fixed income right now. There are several forces at play such as the Russian invasion of Ukraine (which let to flattening of the yield curve) and Central banks raising rates and due to inflation pressure. Canada had CPI numbers come in higher than market expectations at 5.7%. The 10-year yield in Canada is around 2.2% and investors should note that there is still a risk off behaviour going on in the market. Credit spreads are as wide as they were in April of 2020. We think that an overweight towards ZCS - BMO Short Corporate Bond Index ETF makes a lot of sense. Advisors are looking at three things when it comes to FI (low volatility, a healthy yield to maturity and quality bonds). With ZCS we have a duration of 2.75, a YTM of 2.6% and an average credit quality of A (all investment grade).

Canadian Dividends

There are a couple tailwinds going on with Canadian Dividends. Energy, Materials and Financials are doing well and are the three major sectors in Canada. Cash generative stocks that tend to pay dividends and grow dividends over time are being rewarded. With growth companies, when interest rates rise the present value of their future growth becomes less and less. In a rising rate environment, investors tend to move towards companies that have cash flow which is coming in today and are already "making earnings". Dividend oriented Canadian equity portfolios are up around 6% to 7% YTD. ZDV - BMO Canadian Dividend ETF is really benefiting from this theme. One of the major holdings in ZDV is Nutrien LTD with a 4.22% weighting. Nutrien LTD is a major producer of Potash and Canada is the largest producer of Potash followed by Russia and Belarus. Potash producers in Canada are benefiting from the war in Ukraine. Furthermore, Banks tend to do well in a rising rate environment which are also major positions in ZDV.

S&P 500 Hit the Death Cross

A death cross is a technical indicator where the short-term moving average crosses its long-term moving average. It can be an effective indicator to show that the market is losing its momentum however, it does not mean the market cycle is coming to an end. Between the 2008 and 2020 market cycle there were about 5 death crosses in the S&P 500. A death cross proceeds a major market sell-off but a major market sell off doesn't necessarily always follow a death cross. It can be a sign that investors do need to take caution. The Russian invasion, Central Banks increasing interest rates, inflation and U.S. Mid terms coming up later this year have a potential to weigh on the market. Having said that, if we get any kind of resolution in Russia/Ukraine we think that the markets could potentially rally at that point. Another plus is that the majority of the world is starting to open up. COVID is starting to become more endemic, and economies are learning to live with COVID. We think it is a good idea to take your foot off the gas when it comes to equities and taking a look at Low Vol ETFs such as ZLB - BMO Low Volatility Canadian Equity ETF and ZLU - BMO Low Volatility US Equity ETF. We put together our low volatility ETFs based on Beta and sector constraints to smooth out volatility.

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Covered Calls

Covered calls make a lot of sense for certain investors in this type of environment. A lot of investors are looking at different ways to take away risk in their equity portfolios. Covered calls provide lower volatility due to the call premiums and dividends which can act as a cushion for your portfolio.

There are risks associated when there is higher volatility such as capping your upside when markets rally. We manage our covered calls by making sure we don't cover each name in the portfolio, writing on 50% of the portfolio and we spread out the call option premiums so there is always something coming due (we can continually reset strike prices higher if the market is trending upwards). Covered call ETFs clients may want to look at are ZWB - BMO Covered Call Canadian Banks ETF, ZWK - BMO Covered Call US Banks ETF, and ZWT - BMO Covered Call Technology ETF.

Gold

Gold has been volatile lately and has been doing well this year. There are three reasons why investors buy gold as a hedge (a hedge against global macro economic risk, a hedge against inflation and a weaker U.S. dollar). Currently investors are concerned about global macro economic risk and inflation. We believe gold prices should remain elevated at this point. We believe gold will benefit from the economy reopening (which could cause "demand pull inflation") and a prolonged Russia/Ukraine. Gold has separated itself from crypto currency as it remains the investment of choice for mitigating risk in your portfolio. A 5% to 10% position in your portfolio can add diversification that can go a long way ZGD - BMO Equal Weight Global Gold Index ETF.

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Source: Bloomberg, All returns and data points February, 2022.
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