Views from the Desk

Updates in the Equity and Fixed Income Market

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Liberal-NDP deal takes aim at housing costs and bank profits

When the "recovery dividend" was announced last year, the banks dropped 3%. We believe that most of the potential price drop in the banking sector is already priced into the market. We don't think that Trudeau's goal to "curb excessive profits" will have much of an impact on banks since there is a lot more going on in the markets such as geopolitical issues and inflation. If banks do sell off, we'd look to buy on weakness. Furthermore, when volatility is elevated it could be a good idea to move into something like ZWB - BMO Covered Call Canadian Banks ETF especially if you're looking to grow income in your portfolio.

"The agreement between Trudeau's governing Liberals and the New Democratic Party says the government will act on the "financialization of the housing market by the end of 2023." No details were given, but in last year's election the Liberal platform pledged to review the tax treatment of large corporate owners of residential properties such as real estate investment trusts to "curb excessive profits." Source - Liberal-NDP deal takes aim at housing costs, bank profits | Wealth Professional March 22nd 2022

Bond Yields Jumping

Rising bond yields have been major headlines in 2022. 10-year yields are the highest they've been since 2018 and 2-year yields are now above 2%. The BoC and the Fed discussed possible rate increases of 50bps at a time and are now being priced into the market for the next meeting in May. Over the next several months there is about 3 rate increases being priced in for Canada and the U.S and in total about 6 before the end of the year. Jerome Powell has talked about moving beyond the neutral rate if inflation remains consistent.

ZBI - BMO Canadian Bank Income Index ETF is a great place to be since it invests in the capital structure of Canadian Banks (high quality corporate bonds, LRCNs and rate reset preferred shares). ZBI is only down about 1.5% so far in March compared to regular corporate bonds being down approx. 4% for the month. Thus far, ZBI is proving to be less volatile than other corporate bonds in this current environment.

Inflation Above Expectation

The expectation is that inflation is going to be somewhat "sticky" through the rest of 2022. In the U.S we've seen prints as high as 7.9% year over year and Canada at 5.7%. These inflation levels are some of the highest levels we've seen in some time. The geopolitical issues have not helped out in this regard putting on inflation pressures globally (oil, gas, wheat). With the supplies from Russia extracted from the global economy, we are going to see global inflation continue through the rest of this year (commodity prices will keep going up). ZTIP - BMO Short-Term US TIPS Index ETF / ZTIP.F - BMO Short-Term US TIPS Index ETF (Hedged Units) are one of the ways to combat inflation. At the 2-year level the "breakevens" are trading at about 4.8% which means that on average the market is expecting inflation to be around 4.8% on an annual level.

The 5-year “breakevens”, are only at 2.4% annualized, this could be good news as the market thinks that the central banks are in front of inflation, and that they are doing something to make sure inflation doesn’t get out of control. We’ve told investors to use ZTIP as a “bolt on” to your core fixed income holdings (around 5%).

Emerging Markets

The composition of ZEM - BMO MSCI Emerging Markets Index ETF is China 30% Taiwan 13%, South Korea 13%, India 12%, and Brazil 5%. ZEM is a very diversified basket with a large weight in China. ACWI has approximately 12% of EM in it. Even with uncertainties in emerging markets, as an investor, you may want to keep some EM in your portfolio. Furthermore…

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U.S. Health Care

Health care has traded a sideways this year however, we feel the health care sector to be a very important sector with strong long-term performance. We believe the sector to be in demand for the foreseeable future as the average age population continues to grow and pharmaceuticals become more in demand. The Canadian market doesn’t have a strong health care sector which is why we recommend using ZHU - BMO Equal Weight US Health Care Index ETF / ZUH - BMO Equal Weight US Health Care Hedged to CAD Index ETF in your portfolio. ZHU and ZUH has an equal weight methodology which can be beneficial to investors. With an equal weight methodology, you will get exposure to smaller innovative companies that are on the rise and potentially add more upside to your portfolio.

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