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Views from the Desk

Updates in the Equity and Fixed Income Market

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Russian Invasion Trade Freeze

The last time we had a trade freeze was during the Greek debt crisis in 2015 and the Greek stock market closed for 2 to 3 days. In the ETF space during this time, Greek ETFs kept trading due to the secondary market liquidity. ETFs have a great characteristic of being an added price discovery vehicle even when the underlying markets aren't trading. As such, we are seeing the Russian ETFs continue to trade even though the underlying holdings are frozen. It is important to keep in mind that for any ETF that would trade while the underlying holdings are frozen, we would expect wider spreads. Currently at BMO ETFs, we don't have any Russian specific ETFs however, we do have ZEF - BMO Emerging Markets Bond Hedged to CAD Index ETF and ZEM - BMO MSCI Emerging Markets Index ETF that do hold small allocations to Russia. Overall, Russia's stock market accounts for just under 3% of the MSCI Emerging Market Index (EM), and not even 1% of the MSCI Global Equity Index (ACWI). Moreover, even for a typical balanced fund that owns no more than 10% of Emerging Markets (EM) equities, that translates into a less than 0.3% of direct exposure to Russian equities, whereas Ukraine equities are virtually inexistent in global portfolios. For more on this please visit Russian Drums of War Spark Boxing-Day Stock Sales | BMO GAM

Bank of Canada Meeting

We do think that the "Russian Invasion" will have an impact on how aggressive the Central Banks can be. We have seen an 88% chance of a rate hike by the BoC today. At one point there was an expectation that the BoC was going to raise by 50bps, but it is more likely we will see a 25bps rate hike. When looking at the yield curve, the 10-year government of Canada yield is down approximately 26bps. We have seen the 10-year government rate drop around the world while investors look to government bonds for a safe haven. The central banks don't want to cause an inversion in the yield curve, so they have to be cautious with rate hikes. Earlier this year we saw the BoC rate hike expectations as high as 7 for 2022, now, we are only seeing 6 hikes however, we still think this is too aggressive. The market is starting to price in the Russian/Ukraine conflict, and closer to the end of the year, we may see the Central banks to become more aggressive with rate hikes. Looking at volatility during the last few weeks, we believe it is evermore important to keep a well diversified portfolio. We look to ZAG - BMO Aggregate Bond Index ETF with ZTIP.F - BMO Short-Term US TIPS Index ETF (Hedged Units) as a compliment.

UPDATE: The Bank of Canada today increased its target for the overnight rate to ½%.

Oil and Gas

There has been a lot of price action in the Energy sector. Overall, volatility in the Energy space has been a factor of supply and demand. If Russia's oil supply is taken off the grid, that will affect energy prices since Russia is a major contributor to supply. For long-term trends in the global market, we are seeing a push towards renewable energy as capital expenditures towards traditional fossil fuels are getting lower. We are seeing heating, gas and groceries going up significantly which affects the end consumer. A good way to hedge this is by looking at ETFs that are going to benefit from rising energy costs ZEO - BMO Equal Weight Oil & Gas Index ETF. Furthermore, we look to rebalance ZEO when it goes up approximately 10% to 15%, take those profits and place them into the core portion of your portfolio (such as large blue-chip stocks).

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Bank Earnings

Banks have seen some benefits of rising rates however, the biggest driver of banks across the board has been Capital Markets. Trading revenues and investment banking have been some of the main contributors for Capital Markets. Moreover, BMO is buying the Bank of the West and TD is buying First Horizon, so we are starting to see more expansion for Canadian banks as well. The Canadian Banks (since 2008) have been a great place to be and still have more room to go as we will most likely see dividend increases. Additionally, we see P/E and P/B ratios at attractive levels. Look to ZEB - BMO Equal Weight Banks Index ETF to take advantage of the Canadian Bank trend.

Asset Allocation ETFs

Having a disciplined approach to investing has been proven to provide great results for investors and asset allocation ETFs help with that. ZBAL - BMO Balanced ETF rebalances every quarter and is a 60% equity 40% fixed income ETF. ZBAL has been delivering a 1st and 2nd quartile ranking and we expect it to stay consistent on a go forward. For more on asset allocation ETFs please visit Investing with BMO's Asset Allocation ETFs.

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