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Views from the Desk

Updates in the Equity and Fixed Income Market

Chris McHaney and Chris Heakes, Portfolio Managers, BMO ETFs

Low Volatility Holding Up

We started to see a catch up in performance from the low volatility factor in the fourth quarter of 2021. The invasion of Russia into Ukraine had caught the market by surprise, and we are seeing the Low Volatility ETFs shine as investors move to more defensive stocks. Growth stocks haven't been performing well since the fear of a rising rate environment started. ZLU - BMO Low Volatility US Equity ETF has a significant underweight in Information Technology and has an overweight to Consumer Staples and Utility stocks.

ZLB - BMO Low Volatility Canadian Equity ETF is up 1.3% YTD and Canada has been one of the best performing markets this year. Technology stocks such as Shopify have dragged down a lot of Canadian Equity portfolios which ZLB does not hold. ZLB is underweight Energy and Materials however, the telecoms and staples are doing well which has added to performance. Lastly, EAFE stocks started rallying recently and ZLI - BMO Low Volatility International Equity ETF is outperforming the broad EAFE index. Overall, BMOs low volatility ETFs have been a great tool for client portfolios.

Quality Factor

U.S. and EAFE have been struggling. The global exposure in ZGQ - BMO MSCI All Country World High Quality Index ETF is lagging the portfolio. More specifically, the Technology sector (which is an overweight in Quality) has seen a lot of struggles. Having said that we are comfortable with the overall long-term performance of Quality. The quality factor has companies with low financial leverage, stable earnings growth and high return on equity and this methodology is proven to do well over time due to the resilience of the companies in the portfolio. We believe in diversifying your factors and complimenting the quality factor with the dividend and low vol factor ETFs.

Aggregate Bond

We are certainly seeing a different regime as we are seeing central banks starting to raise rates. The Russian invasion has slowed down the potential 50bps increase to a standard 25bp rate increase for the BoC (and expected from the Fed next week). Going forward, forward market pricing is showing approximately 6 more rate increases for both US and Canada. The market hasn't really slowed down the expectations of interest rates moving up. Fixed income markets in general have sold off. If the Russia and Ukraine situation is prolonged, we can see expectations of GDP growth slow down. Inflation running high has been hard for consumers and there is a challenge where raising rates too fast could cause stagflation. The first few rate hikes we see in the first half of 2022 will most likely be followed up by a pause and we may see rate some potential hikes being pushed into next year. The primary goal in a diversified portfolio such as ZAG - BMO Aggregate Bond Index ETF is to balance the risk in a FI portfolio and offset equity market risk.

Alternative Investments for Portfolio Construction

We have ZGI - BMO Global Infrastructure Index ETF 10-year performance numbers now and the average performance number is 12%. There is a diversification benefit to having alternatives such as infrastructure in your portfolio. Infrastructure generally has a low correlation to equities. Brookfield is one of the top names in the infrastructure space and GRNI - BMO Brookfield Global Renewables Infrastructure Fund ETF Series and TOWR - BMO Brookfield Global Real Estate Tech Fund ETF Series are 2 new ETFs that BMO launched (and Brookfield is the manager of both of these active portfolios). The renewable stocks have been getting some “wind” behind them as traditional energy becomes more and more expensive. As a megatrend, renewable energy may speed up more quickly than expected due to the war in Ukraine and the increasing costs of traditional energy.

Currency

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