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Views from the Desk

Updates in the Equity and Fixed Income Market

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Buying opportunity

We are more than likely to see two 50bp rate increases in the U.S. (June and July). Jerome Powell hasn't kept a 75bp increase off the table. The Fed wants to keep all their tools at their disposal to manage inflation. Cost of borrowing will go up and growth with slow down which in turn will slow down the economy. The Fed may cause a recession trying to control inflation. Volatility in the short term will be elevated and buying opportunities will present themselves (for long term investors). S&P 500 P/Es have come down and large cap tech companies have come down to very attractive prices. P/Es haven't been at these low levels in some time, and it is a good time to look at ZSP - BMO S&P 500 Index ETF and buy on the dip. If you're worried about downside then compliment with something like ZLU - BMO Low Volatility US Equity ETF.

Inflation

ZTIP - BMO Short-Term US TIPS Index ETF and ZTIP.F - BMO Short-Term US TIPS Index ETF (Hedged Units) have been some of BMO's fastest growing ETFs that we've launched last year. It has been a tough environment for FI however, ZTIP has stood out compared to the rest of our FI solutions. Adding ZTIP to a traditional portfolio can be of benefit. ZTIP is driven by actual inflation being higher than expected inflation. "Inflation breakevens" compares U.S. TIPs with a matching "plain vanilla" U.S. Treasury. Breakevens will tell you the inflation level which you would be indifferent between owning TIPs or Treasuries. The 1 year breakeven is around 4.87% so if inflation is above 4.87% than you are better off owning U.S. TIPs. If inflation comes in under 4.87% than you are better off owning U.S. Treasuries such as ZTS - BMO Short-Term US Treasury Bond Index ETF. As breakevens move higher it makes inflation protection more expensive. YTD inflation breakevens shot up and has started recently to come down. We believe that 4.87% is a reasonable level to use ZTIP as a compliment to your FI portfolio.

Covered Calls

Volatility has stayed relatively elevated this year. For ZWH - BMO US High Dividend Covered Call ETF BMO is trying to add a 2% to 4% premium to the regular distribution in the portfolio. We only write on half of the portfolio and are currently writing 8% to 9% out of the money (which generally means we can see an increase in your portfolio of about 8% or 9% before any upside is lost}. The current economic environment is great for covered calls. Furthermore, the underlying holdings for most of our covered calls are dividend-oriented companies which tends to do well in a rising rate environment.

Oil

Oil is back above 110/b and we are starting to see oil trend upwards again. The Russian invasion has accelerated the price of oil and transportation cost of goods has increased as a result of higher oil prices. We anticipate oil prices to stay elevated throughout the Russia/Ukraine war. We believe that if more European countries stop using Russian oil, we may see the price of oil increase further. Countries have started to refill their reserves. High oil prices are good for marginal producers to drill and get oil out of the ground however, in turn these marginal producers are at risk of oil prices dropping again which is making them hesitant to turn on the taps. ZEO - BMO Equal Weight Oil & Gas Index ETF is up over 40% YTD.

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U.S. Health Care

Health care is usually viewed as a defensive sector, but it is down this year. We think there was a little bit of froth in the sector and valuations got out of hand. If we move into a low growth environment, we may see health care start to shine again and hold up compared to other sectors. Health care is needed every day and prescriptions need to be filled regardless of what GDP is doing. ZHU - BMO Equal Weight US Health Care Index ETF, ZUH - BMO Equal Weight US Health Care Hedged to CAD Index ETF, ZLU - BMO Low Volatility US Equity ETF.

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