

Views from the Desk

Updates in the Equity and Fixed Income Market

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Inflation

U.S CPI just printed at 6.2% which is the highest point we have seen since Oct 21st, 1990. The Fed is just beginning their tapering phase at about 15 billion per week and is to be completed by June 2022. The US will start considering rate hikes in the second half of 2022.

Fixed income markets have gone into a little bit of a frenzy over the last little while. Canada is saying inflation is transitory but not necessarily short lived. The Bank of Canada (BOC) changed their forecast for inflation to an avg of 3.4% with an expectation of 2% by the end of 2022 as supply issues subside. Short term rates were volatile over the last month in Canada with 5-year rates rising about 40bps to 151bps and the 10-year increased 21bps to 172bps at the end of October this year.

BOC is pricing in 5 rate hikes for 2022 with the first being on March of 2022. To protect against inflation concerns we look at [ZTIP.F - BMO Short-Term US TIPS Index ETF \(Hedged Units\)](#) and recommend allocating 5% to 10%. We also look to [ZPR - BMO Laddered Preferred Share Index ETF](#) to protect against rising rates. ZPR is well positioned to benefit from a rising rate environment because of the reset structure of preferred shares. Canadian bank preferred shares continue to be redeemed in exchange for the new LRCN issuances.

For more on inflation please visit [BMO ETF Inflation Report Nov 2021](#).

Credit Spreads

Credit spreads provide more yield to help offset negative drag that is caused by duration in a rising rate environment and offsets interest rate sensitivity. While credit has been a top performer (we have seen credit spreads tighten and hold firm) going forward a lot of companies are in a strong position having secured financing at lower rates which can insulate your portfolio from some of these negative impacts of rising rates and inflation concerns. We think having an overweight in corporate credit on the short end to be prudent. A great compliment to your ZTIP and ZPR would be [ZCS - BMO Short Corporate Bond Index ETF](#). From a granular point of view, we look to [ZBBB - BMO BBB Corporate Bond Index ETF](#).

Covered Calls for Income Oriented Investors

The financial sector has been very strong this year. We normally expect our covered call ETFs to substantially lag our “non-covered call” versions in a strong equity environment but our covered call ETFs have been performing quite strong. We use the volatility in the underlying holdings and move the moneyness out as far as possible to try and avoid getting called. We also only write on half of the portfolio to participate on the upside. For [ZWK - BMO Covered Call US Banks ETF](#), the average option we’ve been writing this year has been 8% out of the money which means we have been collecting an income stream from selling those options and getting 8% growth potential before we sell any upside each month. We have found this to be a great way to deploy a covered call strategy to adjust the moneyness dynamically based on the implied volatility over that time. The income stream in ZWK has been approximately 4% over its regular dividend distribution.

For more on covered calls please visit our [Monthly Derivatives Report](#).

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Energy

Most people believe the transition from traditional energy to clean energy is currently happening and will happen over time. Although we are slowly transitioning away from oil and gas, on the short term we are still dependent on it. It is expected that energy consumption is going to go up approximately 50% from today's levels. A positive goal would be to have these clean energy sources ramp up quickly and meet the needs of the increased energy demand. According to the International Energy Agency, they estimate that renewable energy will not surpass traditional energy until about 2050. Oil companies are able to benefit from these higher oil prices and are reinvesting into their own businesses. We believe that a lot of oil and gas companies will be thinking about how to make themselves more energy efficient and invest in alternative energy as time goes on to reduce carbon intensity. This energy transition is going to play out over decades.

For Energy solutions look to [ZCLN - BMO Clean Energy Index ETF](#) and [ZEO - BMO Equal Weight Oil & Gas Index ETF](#).

Industrials

Industrials are one of those sectors that are tied to North American economic growth. As economic activity increases the companies within the sector will continue to benefit. Transportation (airlines rails), construction engineering, trading companies and distribution are some of the subsectors within our ZIN ETF. For investors are looking at continued economic expansion, a great way to get a diversified basket of companies within industrials is through [ZIN - BMO Equal Weight Industrials Index ETF](#).

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Source: Bloomberg, All returns and data points July, 2021.

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