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Views from the Desk

Updates in the Equity and Fixed Income Market

Matt Montemurro and Chris Heakes, Portfolio Mangers, BMO ETFs

Fixed Income 2022 Expectations for Short-Term Bonds

September had some significant movements in rates. The 10-year increased by 32 bps in September and is now in line with US 10-year rates. There has been little to no movement in short-term rates, and what we are seeing in the market at the moment is what we call a “bear steepener”. The market is predicting that the BOC will be forced to act sooner than what they’ve anticipated (raise rates the second half of 2022) due to inflation concerns.

When we see a “bear steepener” it is suggestive of higher inflation expectations and bearishness in the overall stock market. When looking at fixed income portfolio allocations we would want to consider reducing duration. We still view ZAG - BMO Aggregate Bond Index ETF as a prudent core to your fixed income exposure. We think it makes sense to compliment your core exposure with short term fixed income ETFs. ZCS - BMO Short Corporate Bond Index ETF and ZQB - BMO High Quality Corporate Bond Index ETF are great ways to overweight credit (add extra layer of protection against rising rates) and will overweight the short end of your portfolio.

Additionally, an allocation to ZPR - BMO Laddered Preferred Share Index ETF will add low correlation to your fixed income portfolio and performs well in a rising rate environment. Inflation concerns are hard to ignore in this market so, we look to ZTIP - BMO Short-Term US TIPS Index ETF to hedge inflation.

Market Volatility

Historically, October is known as a month of heightened volatility. ZPAY - BMO Premium Yield ETF is a “get payed while you wait” type of strategy. With concerns around inflation, tapering and China right now ZPAY is the kind of strategy we’d use to monetize those concerns. ZPAY had grown in popularity when COVID first hit back in early 2020 due to its ability to withstand extreme volatility. BMO Premium Yield ETF uses option strategies (put-write and covered calls) combined with some long stock exposure to provide an enhanced income product that has less volatility, more diversification, higher yield and partial market exposure. The strategy will sell equities when the markets go up and buy equities when the markets go down. The portfolio will buy a concentrated basket of 40-60 large cap U.S. equities. These stocks will be selected based on quality fundamentals such as strong balance sheets, low debt to equity, high return on equity and liquidity screens. In normal market conditions, the fund will target a range of 20–50% to be invested in equity securities. For more on ZPAY please visit BMO Premium Yield ETF Methodology.

Small and Mid Caps

YTD ZSML - BMO S&P US Small Cap Index ETF are up 20% and the ZMID - BMO S&P US Mid Cap Index ETF is up 15%. Using small and mid caps are a great to compliment a core US strategy and is a fantastic way to capture growth in the US. Small-caps typically have a greater amount of their revenues generated from home markets. The S&P 600 has a strong domestic bias compared to the S&P 500 where revenues are more global. Additionally, mid-cap companies have successfully navigated the challenges specific to small companies, such as raising initial capital and managing early growth, and often have established infrastructure, access to capital, and developed distribution systems. By using ZSML and ZMID you can achieve a total US market approach when you decide it is necessary. For more on the S&P 400 and S&P 600 please see S&P 500, 400 and 600 indices: An entire universe at your fingertips.

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Base Metals

Price consolidation from the high on ZMT - BMO Equal Weight Global Base Metals Hedged to CAD Index ETF is of benefit right now. In May there was some “peak reopening trade” optimism and ZMT reached a high of approximately $65 and is now trading around the low $50s today. Base metal prices are on the rise (aluminum copper zinc up approx. 30%) and there is strong price momentum. Inflation continues to play a big roll.

China is a big user of commodities and we are watching the credit crunch play out with Evergrande and Fantasia. We think the Chinese government will be intervening to stabilize and protect their economy and we think the pros outweigh the cons when it comes to base metals. We would look to use ZMT as a satellite play that could be of benefit to your portfolio to capture that market growth.

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