Views from the Desk

Updates in the Equity and Fixed Income Market

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The Fed and Fixed Income

The market seemed to like the recent commentary from the Fed as markets rallied. The Fed views the current economic conditions as pandemic related/transitory in nature and they don't seem to be in a hurry to raise rates. Our view is the delta variant is spreading fast in the U.S and this may be one of the main reasons they are putting off tapering. Our long-term view is the Fed will eventually have to taper, rates will rise, and there will be a steepening of the yield curve but, at a slow and manageable pace. Our prediction is the Fed will look at raising rates around mid 2022.

When we look at navigating the fixed income market, we look to maintain some long duration exposure to help mitigate some of that equity volatility. We look to compliment that long duration with ZTIP - BMO Short-Term US TIPS Index ETF to mitigate rising inflation. We want to be aware of currency as well, ZTL.F - BMO Long-Term US Treasury Bond Index ETF (Hedged Units) and ZTL.U - BMO Long-Term US Treasury Bond Index ETF (USD Units) can be valuable tools to allow you to remove volatility from currency and maintain long duration at the same time. Regarding credit, we favour investment grade over high yield as tapering is on the horizon and high yield spreads will be most vulnerable. For the U.S we like ZSU - BMO Short-Term US IG Corporate Bond Hedged to CAD Index ETF and ZMU - BMO Mid-Term US IG Corporate Bond Hedged to CAD Index ETF, and for Canada we like ZBBB - BMO BBB Corporate Bond Index ETF and ZQB - BMO High Quality Corporate Bond Index ETF. Additionally, you may want to look at ZPR - BMO Laddered Preferred Share Index ETF which is uncorrelated to traditional fixed income and gives you tax efficient income. ZPR will also help you navigate a rising interest rate environment with its rate reset structure.

Canadian Equity Positioning

Canada's current account has been in deficit since 2008 and recently Canada recorded a surplus for two quarters in a row. Some of the drivers have been forestry products, energy products, and building and packaging materials. Areas where we saw deficits were in the services sectors however, this has been mainly attributed to travel restrictions due to the pandemic (which we would normally see in surplus in Canada). It will be interesting to see how Canada can hold on to this surplus as the economy and boarders reopen.

Canada's economy tends to do well when the commodity sector does well as it leads to better employment and consumer spending (which in turn is good for Canadian equities). ZCN - BMO S&P/TSX Capped Composite Index ETF is a great way to get exposure to Canada. Alternatively, if you think there is some softness around energy you may want to look at ZLB - BMO Low Volatility Canadian Equity ETF.

Energy

Most of 2020 and 2021 we have seen oil prices increase all the way up to $75/barrel. Prices started to come off but recently increased due to hurricane season. We think global economic activity will get better over the near and mid term, and we think a sustained level of higher oil prices will benefit oil companies. ZEO - BMO Equal Weight Oil & Gas Index ETF is a good way to play oil/energy.

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Some say that the increase of hurricanes/stronger hurricanes over the years is a result of climate change and global warming. In 2020 there was exponential growth in clean energy. Clean energy and alternative energy should be a huge sector over the long term. The need for cleaner energy sources and the transfer to electric vehicles will require a lot of energy sources to be utilized so, we should see significant demand and investment in these areas. We think clean energy is a great investment over the long term. See ZCLN - BMO Clean Energy Index ETF for more information.

Quality Factor

We believe the quality factor to be one of the best ways to play the market in the near term and going forward. We see a potential shift in the Feds monetary policy in the next 6 to 12 months as some of the emergency related measures used to stimulate the economy during the pandemic will be taken away. Through that transition there is potential for volatility in the equity markets. If there is a sell off in the equity markets those quality companies with strong earnings should have lower volatility. Alternatively, if the equity markets rally, you are exposed to quality companies that should do well over time. The MSCI High Quality Factor looks at companies that have high return on equity, stable earnings growth and low financial leverage. To get access to the MSCI High Quality Factor please see ZUQ - BMO MSCI USA High Quality Index ETF, ZGQ - BMO MSCI All Country World High Quality Index ETF and ZEQ - BMO MSCI Europe High Quality Hedged to CAD Index ETF.

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