Views from the Desk

Income Ideas: Getting Paid To Wait

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Market Update

The S&P 500 reached an all-time high on Aug 18th, surpassing pre-covid levels. While investors often look to the index as an indication of the overall market/economy's health, really what's happening is bifurcation of the market. Certain companies (Microsoft, Amazon, Apple, Facebook) are doing very well benefitting from the secular trend of digitization while other companies are still well below where they were pre-covid. 1/3 of companies in S&P 500 are in a bear market. With these 4 or 5 stocks driving the increase back to all-time highs it may not be an indication that the economy is coming back with a vengeance. If you strip out those 4 companies the S&P 500 Index is still down on the year. High unemployment, outside this secular story indicates you have to be careful where you invest and that there are still risks of a prolonged slow down. Interesting to note the NASDAQ is up ~25%, while the Dow down ~3% - a huge spread further supporting the idea of this secular digitization trend.

Getting paid while you wait with income generating ideas is a good way to ride out the slow down **5 ETFs yielding over 5%**

Dividends

Natural place to look to for income. The Dividend Factor has under-performed this year and represents a recovery trade, with the potential to out-perform as we navigate the economy's recovery.

BMO Canadian Dividend ETF - ZDV (5.4% yield) – Canada – Canadian market has three things driving the growth; Shopify, IT and gold. These three are driving approx. 8% of the relative difference between CDN Dividends and the TSX Composite. Exposure to financials and consumer stocks in ZDV is good opportunity to play the recovery and get paid to wait.

BMO International Dividend ETF - ZDI/ZDH (5.5% yield) – International – Financials and consumers sectors have underperformed YTD, as we navigate reopening this is a potential recovery play with attractive valuations. Recommend a hedged position (ZDH) to eliminate currency volatility from geo-political risks. Recent portfolio rebalance in June saw some companies removed due to dividend cuts.

Sectors

BMO Equal Weight REITs Index ETF - ZRE: (5.4% yield) – Diversified REIT exposure to office, residential, and mixed use REITs is a play on economic recovery as people will need their real estate space with economy reopening and be better able to pay rent. The risk premium for investing in real estate vs. fixed income is higher than it has been in 12 years (as measured by yield spread on REITs relative to 10 Year Bonds).

BMO Equal Weight Banks Index ETF - ZEB: (5% yield) – Investing in Canadian banks makes sense for income-oriented investors and is tax effective in non-reg accounts. Safest dividend in Canada, even with recent drawdown did not cut dividends. Banks were in a position to even raise dividends but were asked not to. The only other time in history the average dividend on banks has been over 5% was in 2008, and only lasted two quarters.

The market is expecting a slow recovery which is depressing the price somewhat as investors would expect them to be affected by loan losses, however portfolio managers believe the banks look very well capitalized.

BMO Equal Weight Oil & Gas Index ETF - ZEO: (6.1% yield) – most upside potential out of the three, as economic recovery takes hold demand for oil will recover. Economic growth and industrial production will drive the price of oil. Good distribution to get paid while you wait.

Enhanced Dividend Strategies: Covered Calls

Covered call solutions' premiums are driven by volatility. The VIX has trended down from its march high. We are seeing somewhat normalized VIX levels while still on the high end of normal. The expectation that volatility will increase around the November election and stay relatively elevated through March next year. This bodes well for covered calls who are selling volatility.

BMO Global High Dividend Covered Call ETF - ZWG (6.8% yield): half of portfolio is covered allowing clients to participate in upside, with only 50% limited. Options written far out of the money, 1-2 months out, giving equities a buffer to go up over the month without impacting that upside. Yield is made up of dividend yield of 3.9%, and 5% from options premiums.

BMO Europe High Dividend Covered Call Hedged to CAD ETF - ZWE (7.9% yield): Europe has a lot of opportunity as a recovery play and has not benefitted from having IT stocks like the US. Well rounded portfolio to add diversification with growth exposure. Pairs well with ZEQ (European Quality).

BMO Covered Call US Banks ETF - ZWK (10.3% yield): The US Banks dividend yield is around 4%, and currently portfolio managers are getting approximately 8.9% from options, writing over 12% out of the money. US Banks are currently sold off relative to broad market due to credit risk and volatility is fairly high, making it attractive as a recovery play delivering high income.

Covered Call Methodology