Views from the Desk

Updates in the Equity and Fixed Income Market

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Economic Slow-down

Comparing the economic slowdowns of the past 20 years to the potential slowdown in the next year or so, we may see a difference in how things unfold. Past recessions were driven by the demand side of the equation, the current slowdown in view is driven more by the supply side. The lack of supply has been a key factor leading to inflation. Central banks are engineering a slowdown by significantly tightening monetary policy. The concern here is that they are unable to stimulate the economy until inflation is under control. Interest rate expectations from the FED is now pricing in potential rate cuts in 2023. If you're an advisor, the safer way of allocation is hiking the short end of the curve. The yield curve is quite flat at this time and the difference between the 5yr and 20yr is just about 20 bps. So as an advisor, you may still want to allocate to ETFs like **ZCS - BMO Short Corporate Bond Index ETF** and **ZSB - BMO Short-Term Bond Index** to get exposure to the front end of the curve. But if one is looking to bet on the long-term, on long Treasuries and Federals now may be the time. This may be done via a barbel approach, essentially gain exposure to the short end of the curve, with majority of allocation in **ZCS - BMO Short Corporate Bond Index ETF** and with a small allocation into **ZFL - BMO Long Federal Bond Index ETF**.

Mortgage-Backed Securities (MBS)

With the **BoC** aggressively raising rates over the last few months, there are concerns around the impacts on the Canadian Housing market and more specifically the impact on defaults. For investors looking at Mortgage-backed securities (MBS), a point to note; the MBS market in Canada is very different from the U.S. In Canada the MBS market is fully guaranteed by the CMHC. The quality of the assets going into the Mortgage back securities in Canada are all high-quality loans (fully insured), there is no sub prime debt. This is good for investors looking for a sort duration product, that has AAA credit rating. Compared to federal bonds you are getting a 15-30bps pick-up. **ZMBS - BMO Canadian MBS Index ETF** allows advisors to easily access the MBS market, in addition you get the benefits of an ETF (liquidity and diversification).

Dividend Factor ETFs

We have seen a lot interest in the Dividend factor given the recent performance. Comparing **ZDY - BMO US Dividend ETF** to the broad market (S&P 500), YTD – we are seeing a 10% outperformance. This also translates over to **ZDV - BMO Canadian Dividend ETF** & **ZDI - BMO International Dividend ETF** with 6-8% outperformance relative to their broad market indexes. Globally investors have flocked to Dividend oriented strategies because they are looking for companies that are generating a high-level of cashflow today and in the near future. Looking specifically at the U.S. side, we see where some of the outperformance has come from. Being overweight in sectors that are naturally a little bit more defensive (consumer staples, healthcare, utilities), these sectors tend to be a bit more stable in market selloffs. As well as being under weight in the technology sector that has historically not paid many dividends.

ZWH - BMO US High Dividend Covered Call ETF - is a more concentrated version of our dividend-based ETF methodology with an options overlay on top. For more on this ETF and our Dividend Factor, please listen to our podcast a**t bmoetfs.ca**

Canadian Banks

We are seeing a lot of interest in banks right now (YTD flows into **ZEB - BMO Equal Weight Banks Index ETF** are approx. $735 million). Some reasons why one would want to own Canadian banks at the moment: Valuations (P/E ratios) are currently trading at 9x earnings – whereas broader TSX is approx. 15.5x earning – roughly getting a 40% discount to the market. Dividend is also another attractive opportunity at this point – with a div yield of approx. 4.7% at the moment, especially compared to historical amounts.

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BMO Premium Yield ETF

This is a strategy intended to be a less volatile exposure compared to a pure equity ETF, generally underinvested in equities (not a fully invested portfolio). As we enter the bear market, you can see the defensive posture of this ETF really helping the portfolio. YTD - **ZPAY - BMO Premium Yield ETF** is down approx. 9%, with the broad markets down in the 15-30% range. One thing to note, as the markets do selloff, the put options that we have sold move into the money, which we allow to get exercised, and we then enter the long stock position. As a result, the equity weight of 37% at the start of the year has moved up to just over 70% (accelerated in May and June). We allow for the puts to get assigned because we want to enter those long stock positions at the depressed levels. Another thing to note is that we are writing puts on stocks we would like to own. High quality companies that we are comfortable holding in a long position (i.e., Apple and Microsoft).

For more details on the above, please listen to our podcast at **bmoetfs.ca**

BMO ETF podcasts are also available on