

# Quarterly Fixed Income Strategy

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**In this report, we highlight our fixed income positioning strategies for the third quarter.**

## Duration

- The COVID-19 pandemic has caused a great deal of uncertainty not only socially, but also in terms of the economic impact and the resulting long-term transformation on all industries. With the unemployment rate at record levels in both the U.S. and Canada, central banks will likely hold its overnight rate at current levels unless we see runaway inflation. The Bank of Canada (BoC) recently implied that it's likely to keep its benchmark rate of 0.25% unchanged until at least 2023.
- Unless we see economic conditions significantly deteriorate, it's likely the BoC will keep its current overnight rate, as its effective lower bound. The Canadian central bank has also previously suggested that negative rates are not currently part of its intended toolkit. As a result, the yield curve has flattened over the quarter, which has benefitted longer-duration bonds.
- The U.S. yield curve has seen significantly less flattening, but the Federal Reserve (Fed) was far more aggressive in easing monetary policy, even prior to Coronavirus. Long-term rates in the U.S. have stabilized, however, and as such we would shift our exposure in the *BMO Mid-Term US Treasury Bond Index ETF (ZTM)* into the *BMO Long-Term US Treasury Bond Index ETF (ZTL)*.

## Credit

- The bond purchase programs initiated by central banks have provided a significant backstop to liquidity and much needed confidence at the same time. Credit spreads, while still wider than pre-COVID-19 levels, have tightened significantly since March. Canadian corporate credit spreads currently reside at 149bps above federal bonds. Similarly, we have seen spreads in U.S. investment-grade and high-yield tighten, as a result of significantly improved liquidity over the quarter and a more balanced market.
- High-yield CDX spreads of 446bps still look attractive from a long-term perspective. Over the near term, there will likely be significant default risk; lower-grade issuers tend to have weaker balance sheets, and are therefore less able to withstand the new COVID-19 environment. We still believe U.S. preferred shares, which have offered a similar return stream to high-yield bonds, are better positioned. Even though U.S. preferred shares are ranked lower in terms of an issuer's capital structure, the investment universe is typically much higher in quality.

## Currency

- As outlined in our BMO ETF Portfolio Strategy Report, the Canadian dollar has seen notable gains relative to its U.S. counterpart since mid-March. This is attributed to improved liquidity, which has led to lower demand for US dollars (USD). The outlook between the two currencies is a function of which economy will successfully find its solid footing first. The U.S. has a much more diverse economy, but has also shown to lean toward more accommodative interest rate policies. Fixed income investors should have their currency exposures hedged, but we recommend investing a small portion in USD for diversification purposes.

Buy	Ticker	%	Sell	Ticker	%
BMO LONG-TERM US TREASURY BOND INDEX ETF	ZTL	7%	BMO MID-TERM US TREASURY BOND INDEX ETF	ZTM	7%
<b>TOTAL</b>		<b>7%</b>			<b>7%</b>



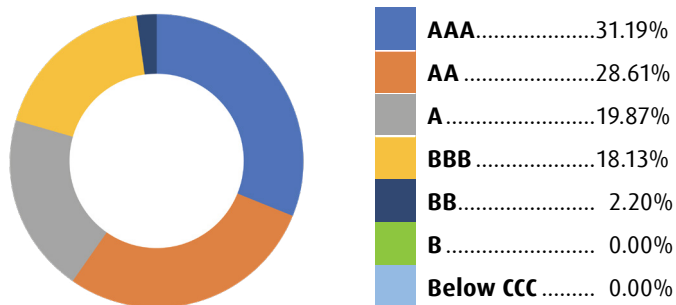
Exchange Traded Funds

## Model Portfolio

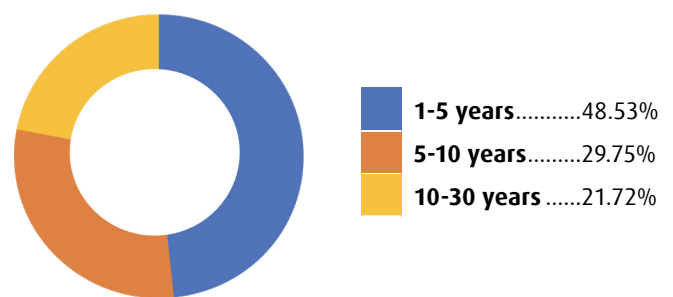
Ticker	ETF Name	Weight (%)	Duration*	Yield-to-Maturity*	Management Fee	Exposure	Positioning
ZAG	BMO AGGREGATE BOND INDEX ETF	62.0%	8.42	1.33%	0.08%	Canadian	Core
ZQB	BMO HIGH QUALITY CORPORATE BOND INDEX ETF	16.0%	3.61	1.23%	0.10%	Canadian	Core
ZIC	BMO MID-TERM US IG CORPORATE BOND INDEX ETF	5.0%	6.48	1.77%	0.25%	U.S.	Core
ZTM	BMO MID-TERM US TREASURY BOND INDEX ETF	7.0%	19.04	1.27%	0.20%	U.S.	Core
ZPR	BMO LADDERED PREFERRED SHARE INDEX ETF	4.0%	3.11	5.92%	0.45%	Canadian	Non-Traditional
ZHP	BMO US PREFERRED SHARE HEDGED TO CAD INDEX ETF	6.0%	5.00	5.96%	0.45%	U.S.	Non-Traditional
<b>Portfolio</b>		<b>100.0%</b>	<b>7.88</b>	<b>1.79%</b>	<b>0.14%</b>		

Exposures	Duration	Yield	Weight
CORE	8.28	1.33%	90.0%
NON-TRADITIONAL	4.24	7.11%	10.0%
<b>Total</b>	<b>7.88</b>	<b>1.91%</b>	<b>100.0%</b>
CANADIAN	7.22	1.62%	82.0%
U.S.	10.87	3.21%	18.0%
<b>Total</b>	<b>7.88</b>	<b>1.91%</b>	<b>100.0%</b>

### Credit Summary



### Term Summary



\*As of June 30, 2020. Please note yields will change from month to month based on market conditions.  
Source: BMO Global Asset Management, Bloomberg.

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Exchange Traded Funds