



Quarterly Fixed Income Strategy

Alfred Lee, CFA, CMT, DMS
Director, BMO ETFs
Portfolio Manager & Investment Strategist
BMO Asset Management Inc.
alfred.lee@bmo.com

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

Duration

- For both the U.S. Federal Reserve (“Fed”) and the Bank of Canada (“BoC”), decisions in managing the overnight rates played out according to the market’s expectations. The Fed continued in its aggressive path to lower rates, whereas the BoC remained firm in keeping its overnight rate unchanged.
- Recent actions by these two central banks are in-line with our long-term expectation that the BoC will be prudent in resorting to rate cuts and policy guidance rather than non-traditional measures, such as quantitative easing (“QE”).
- As rates have moved down across the yield curve, we choose to be duration agnostic at this point, preferring to gain access to bonds across the term structure rather than specific parts of the curve.
- Full-term exposure to bonds makes sense, given the current binary state of the market, in which the direction of rates over the next 12-18 months will be driven by the outcome of specific events. For example, a resolution in the U.S.-China Trade war and Brexit would cause rates to rise, whereas rates would likely continue to trend lower should we not see a positive outcome.

Credit

- High yield credit spreads currently sit at 330bps above U.S. treasuries. While there are short-term opportunities in the asset class, given spreads have historically tightened to as much as 290bps, we continue to avoid this space as defaults tend to occur in non-investment grade bonds first in the later stages of a business cycle. Additionally, issuers in the high yield space tend to be businesses that operate in more cyclically-oriented sectors of the economy.
- Our preference in the bond space continues to be investment grade corporate bonds. We believe it to be the “sweet spot” at this stage of the economic cycle. The investment-grade nature tends to make them lower default risks, yet with more yield than government bonds.
- Even in the event of positive outcomes in the political events previously mentioned, we expect rates to remain low for the foreseeable future. This means investors will stretch for yield. Aging demographics also mean that investors will prefer assets that tend to be stable in nature and are also largely investment grade, given we are in the later stages of the business cycle. U.S. preferred shares check all these boxes, and we view this as a way for investors to gain additional yield in a portfolio. Also, U.S. preferred shares have fixed coupons, meaning there are no rate reset structures south of the border.

Currency

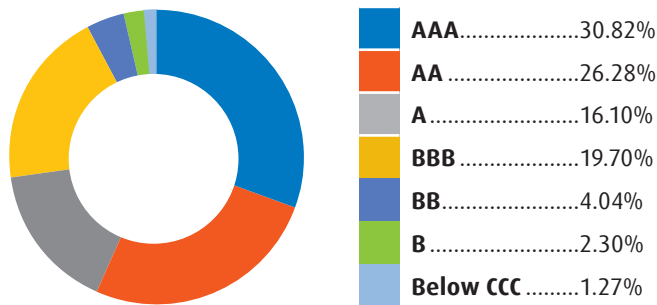
- The growing interest rate differential between the U.S. and Canada has led to a stronger Canadian dollar year-to-date, however, the BoC has been resourceful in using its monetary policy guidance to keep the loonie relatively range bound.
- This should be seen as a positive, as a lower dollar allows our exports to be competitive, while the BoC saves any rate cuts for a “rainy day” should a recession actually occur.
- Policy guidance can only go so far in managing rate expectations without ultimately affecting the credibility of a central bank. All else being equal, the Canadian dollar should gain momentum, should the BoC remain steady with its overnight rate. While we prefer currency hedged exposures in U.S. at this point, we do believe some exposure to U.S. dollar will provide an additional level of protection, should we get a sell-off in risk assets due to politicians not finding a resolution to the events previously stated.

Model Portfolio

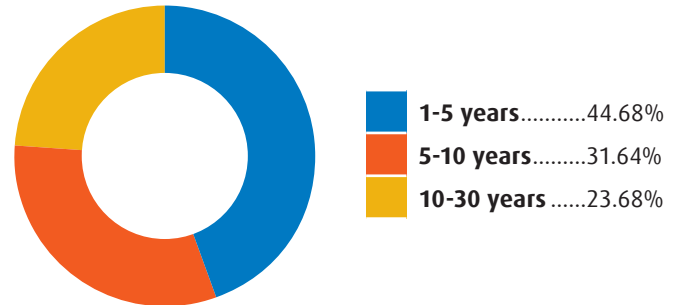
Ticker	ETF Name	Weight (%)	Duration*	Yield-to-maturity*	Management Fee	Exposure	Positioning
ZAG	BMO AGGREGATE BOND INDEX ETF	62.0%	8.03	2.15%	0.09%	Canadian	Core
ZCB	BMO CORPORATE BOND INDEX ETF	17.0%	6.32	2.58%	0.15%	Canadian	Core
ZTM	BMO MID-TERM U.S. TREASURY INDEX ETF	7.0%	6.34	1.92%	0.20%	U.S.	Core
ZPR	BMO LADDERED PREFERRED SHARE INDEX ETF	4.0%	3.11	4.62%	0.45%	Canadian	Non-Traditional
ZHP	BMO U.S. PREFERRED SHARE HEDGED TO CAD INDEX ETF	6.0%	4.06	5.06%	0.45%	U.S.	Non-Traditional
ZMSB	BMO GLOBAL MULTI-SECTOR BOND ETF	4.0%	4.50	4.39%	0.60%	Global	Core
Portfolio		100.0%	7.05	2.57%	0.16%		

Exposures	Duration	Yield	Weight
CORE	7.42	2.32%	90.0%
NON-TRADITIONAL	3.68	4.88%	10.0%
Total	7.05	2.57%	100.0%
CANADIAN	7.44	2.36%	83.0%
U.S.	5.29	3.37%	13.0%
GLOBAL	4.50	4.39%	4.0%
Total	7.05	2.57%	100.0%

Credit Summary



Term Summary



As of October 31, 2019. Please note yields will change from month to month based on market conditions. Source: BMO Global Asset Management, Bloomberg.

Visit bmo.com/etfs or contact Client Services at 1-800-361-1392.

Any statement that necessarily depends on future events may be a forward-looking statement. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although such statements are based on assumptions that are believed to be reasonable, there can be no assurance that actual results will not differ materially from expectations. Investors are cautioned not to rely unduly on any forward-looking statements. In connection with any forward-looking statements, investors should carefully consider the areas of risk described in the most recent simplified prospectus.

This communication is intended for informational purposes only and is not, and should not be construed as, investment and/or tax advice to any individual. Particular investments and/or trading strategies should be evaluated relative to each individual's circumstances. Individuals should seek the advice of professionals, as appropriate, regarding any particular investment. Investors cannot invest directly in an index.

BMO ETFs are managed and administered by BMO Asset Management Inc., an investment fund manager and portfolio manager, and separate legal entity from Bank of Montreal.

Commissions, management fees and expenses (if applicable) all may be associated with investments in exchange traded funds. Please read the ETF Facts or prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

For a summary of the risks of an investment in the BMO ETFs, please see the specific risks set out in the prospectus. BMO ETFs trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

© "BMO (M-bar roundel symbol)" is registered trademark of Bank of Montreal, used under licence.