# Quarterly Fixed Income Strategy

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**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

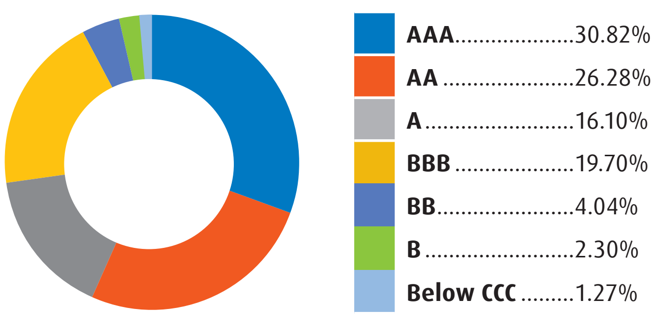
- The growing interest rate differential between the U.S. and Canada has led to a stronger Canadian dollar year-to-date, however, the BoC has been resourceful in using its monetary policy guidance to keep the loonie relatively range bound.
- This should be seen as a positive, as a lower dollar allows 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

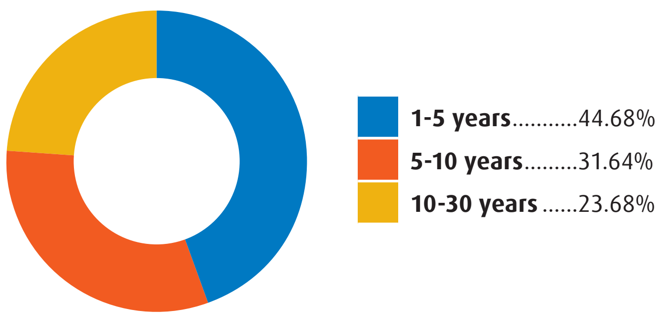
| Ticker | ETF Name | Weight (%) | Duration* | Yield-to-maturity* | Management Fee | Exposure | Positioning |
|---|---|---|---|---|---|---|---|
| ZAG | BMO AGGREGATE BOND INDEX ETF | 62.0% | 8.03 | 2.15% | 0.09% | Canadian | Core |
| ZCB | BMO CORPORATE BOND INDEX ETF | 17.0% | 6.32 | 2.58% | 0.15% | 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.

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BMO Exchange Traded Funds