# Rotating for success with BMO ETFs

## Why ETFs Make Sense for Sectors

With sectors, investors look for precise exposure, high liquidity, and quick access. Exchange traded funds (ETFs) can be the perfect solution to respond to market swings and the changing global economic environment. The efficiencies of ETFs attract all types of investors, offering diversification to a sector or industry combined with high liquidity and effective trading. ETFs appeal as core portfolio building blocks and help to position portfolios around market events.

Investors can tactically shift between sectors and achieve instant diversification, as an ETF typically holds most of the securities within a particular exposure. This is a significant benefit to investors as searching for individual positions in certain regions and sectors may be costly and time consuming.

## Global Exposures

Investors exploring sectors often encounter concentrated domestic exposures dominated by a single name or group of companies. With global exposures investors can reduce domestic exposure, also known as home country bias.

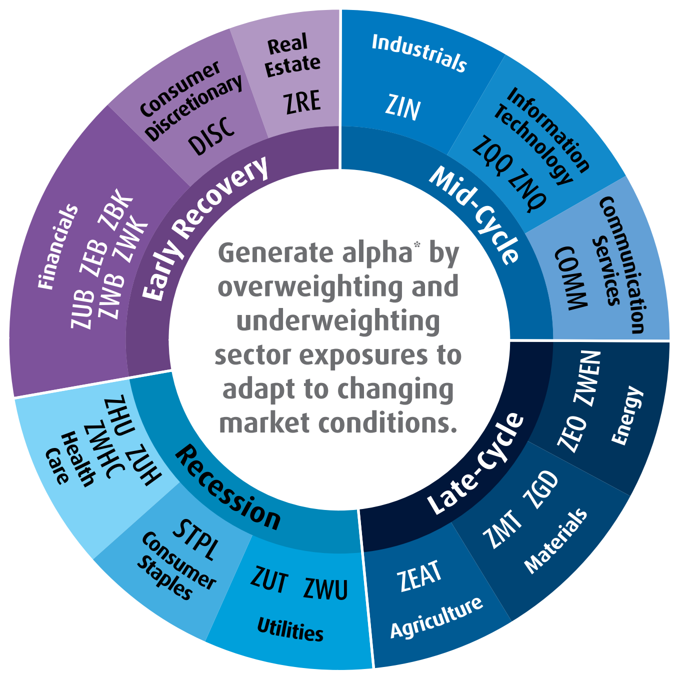
## Canadian Exposure

Investors who look to Canadian sectors will find a mature marketplace for sectors such as Financials, Energy and Resources. The Canadian market has a small amount of companies in Health Care and Technology, therefore exposure to these sectors should be obtained outside of Canada.

## Regional Exposures

Through regional exposures, investors can benefit from country specific return drivers from the companies they know and trust. Instead of picking single stocks, for example a U.S. bank, where Canadian investors might not have the expertise as they do domestically, an ETF gives investors exposure to an entire industry with the convenience of a single trade.

BMO ETFs strategically built our suite across key exposures ensuring investors can position their portfolio to benefit from both domestic and global growth. Different sectors have different return drivers; we have thoughtfully constructed our strategies to take advantage of each of these opportunities.




## Portfolio Construction

**Equal weight:** An effective strategy for reducing concentrated risk by equally weighting each stock. For highly concentrated markets and sectors, such as Canada, for example, equal weighting is a powerful index construction methodology both to mitigate individual security concentration and to properly diversify sector exposures.

*A measure of performance often considered the active return on an investment. It gauges the performance of an investment against a market index or benchmark which is considered to represent the market's movement as a whole. The excess return of an investment relative to the return of a benchmark index is the investment's alpha.

**Market Capitalization:** One of the most common strategies providing a more pure sector exposure which some portfolio managers argue is more effective in expressing a view on a specific sector.

**Alternative Market Capitalization:** BMO's global sector and industry ETFs follow UCITs* rules which apply the 5/10/40 rule to address concentration risk. This guideline states that a maximum of 10 percent of net assets may be invested in a security from a single issuer, and that investments of more than 5 percent with a single issuer may not make up more than 40 percent of the portfolio.

## How to Use Sector ETFs across Market Cycles

Sectors offer differentiated correlations† to the broad market. The use of a sector rotation strategy using ETFs allows investors to seek alpha and diversify risk through their tactical views more efficiently. Using economic cycles to guide the allocation process. Sector rotation strategies attempt to determine which sector of the global economy will perform best and when done effectively can result in higher returns than a basic buy and hold strategy.

### Economic Cycle

Economic cycles drive the market and market cycles drive sector rotation. Fluctuations within economic cycles consist of contractions (recessions) and expansions (growth). In the U.S., recessions have typically lasted on average 11 months, while expansions 58 months (around 5 years).

### Market Cycle

Defensive sectors (also known as counter-cyclical sectors), such as Consumer Staples, Utilities, and Health Care tend to perform well during recession and economic troughs. Pro-cycle sectors, such as Consumer Discretionary, Financials, Industrials, Information Technology and Telecommunication Services, tend to do well when the economy is expanding.

### Sector Performance over the Market Cycle

Implementing a sector rotation strategy can generate superior returns with lower volatility‡ over a straight market capitalization and equal weight strategy over long economic cycles if executed correctly.

Economic cycles tend to lag market cycles as markets are forward looking. There are four distinct phases in the economic cycle:

**Early Recovery –** Growth begins to rebound from a recession; investment and consumption pick up. Monetary policy remains loose.
**Sectors:** Financials, Consumer Discretionary, Real Estate

**Mid-Cycle –** Economic growth strengthens. Credit expansion and profit margins grow. Monetary policy begins to tighten.
**Sectors:** Industrials, Information Technology, Telecommunication Services

**Late-Cycle –** Economic growth peaks as monetary policy becomes tight and restrictive. Credit standards are tightened and corporate profits begin to decline.
**Sectors:** Energy, Materials
**Sub Sector:** Agriculture

**Recession –** Economic growth contracts and unemployment rises sharply while corporate profits turn negative. Monetary policy loosens to provide relief.
**Sectors:** Utilities Consumer Staples, Health Care

A large driver of performance over the cycle is the effect of monetary policy on the economy. Interest rates in general rise at the beginning of the economic cycle, and peak just before the economy hits a recession, and then through loosening monetary policy from the central bank, interest rates fall to help stimulate the economy.

The sector that performs best when interest rates are rising is the Financial sector, especially at the beginning of the rate cycle, where increases in central bank rates are stronger in magnitude. Banks are especially strong due to their core business of borrowing short and lending long (also known as the Net Interest Margin, or NIM).

* Undertakings for Collective Investments in Transferable Securities
† Correlation: A statistical measure of how two securities move in relation to one another. Positive correlation indicates similar movements, up or down, while negative correlation indicates opposite movements (when one rises, the other falls).
‡ Measures how much the price of a security, derivative, or index fluctuates. The most commonly used measure of volatility when it comes to investment funds is standard deviation.

On the other end, highly leveraged sectors such as Utilities and Real Estate, which borrow heavily, perform poorly when interest rates rise, and tend to outperform when interest rates fall.

Another effect of the economic cycle is movement of commodities. When the economy is in an expansionary phase, commodities tend to rise due to an increase in demand. Stronger commodity prices drive the performance of the Energy and Materials sectors, which outperform near the end of the cycle "Late-Cycle". Other sectors have negative correlations such as Consumer Discretionary and Telecommunication Services, which tend to outperform in the "Early Recovery" and "Mid-Cycle". The reason is likely due to the portion of disposable income that goes to gasoline expense, from higher energy prices, which reduces the amount of money available to discretionary spending.

BMO ETFs provide sector and industry solutions for investors to respond strategically and tactically to changing markets and help to provide better risk-adjusted returns. Sector ETFs provide diversification, risk management and allow investors to attract alpha by aligning their investment strategy with market views.

## Sector Returns – By Year (2012-2022)

| 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| F 28.81% | CD 43.08% | RE 30.19% | CD 10.11% | E 27.36% | IT 38.83% | HC 6.47% | TS 50.29% | IT 43.89% | E 54.64% | E 65.72% |
| CD 23.92% | HC 41.46% | U 28.98% | HC 6.89% | TS 23.48% | M 23.84% | U 4.11% | U 32.69% | E 33.30% | RE 46.19% | U 1.57% |
| RE 19.74% | I 40.68% | HC 25.34% | CS 6.60% | F 22.80% | CD 22.98% | RE 3.39% | RE 32.13% | SP 23.61% | F 35.04% | CS -0.62% |
| TS 18.31% | F 35.63% | IT 20.12% | IT 5.92% | I 18.86% | F 22.18% | CD 0.83% | I 31.48% | TS 20.73% | IT 34.53% | HC -1.95% |
| HC 17.89% | SP 29.60% | CS 15.98% | RE 4.68% | M 16.69% | HC 22.08% | IT -0.29% | HC 29.37% | U 18.39% | SP 28.68% | I -5.48% |
| I 15.35% | IT 28.43% | F 15.20% | TS 3.40% | U 16.28% | I 21.03% | SP -6.24% | CS 29.01% | RE 13.45% | M 27.28% | F -10.53% |
| M 14.97% | CS 26.14% | SP 11.39% | SP -0.73% | IT 13.85% | SP 19.42% | CS -8.38% | IT 27.94% | HC 11.06% | HC 26.13% | M -12.27% |
| IT 14.82% | M 25.60% | I 9.83% | F -1.53% | SP 9.54% | CS 13.49% | TS -12.53% | SP 27.61% | F 10.75% | CD 24.43% | SP -18.13% |
| SP 13.41% | E 25.07% | CD 9.68% | I -2.53% | CD 6.03% | U 12.11% | F -13.03% | F 26.35% | CD 0.48% | TS 21.57% | RE -26.13% |
| CS 10.76% | U 13.21% | M 6.91% | U -4.84% | CS 5.38% | RE 10.85% | I -13.29% | CD 24.58% | M -1.69% | I 21.12% | IT -28.19% |
| E 4.61% | TS 11.47% | TS 2.99% | M -8.38% | RE 3.39% | E -1.01% | M -14.70% | E 20.82% | CS -2.17% | CS 18.63% | CD -37.03% |
| U 1.29% | RE 1.60% | E -7.78% | E -21.12% | HC -2.69% | TS -1.25% | E -18.10% | M 11.81% | I -33.68% | U 17.67% | TS -39.89% |

| | | | |
|---|---|---|---|
| CD Consumer Discretionary | F Financials | IT Information Technology | SP S&P 500 |
| CS Consumer Staples | HC Health Care | M Materials | TS Telcommunication Services |
| E Energy | I Industrials | RE Real Estate | U Utilities |

Returns are total return figures and are based on historical performance of the sector indicies. Sector indices used were as follows: SPTRCOND Index (Consumer Discretionary), SPTRHLTH Index (Health Care), SPTRCONS Index (Consumer Staples), SPTRINFT Index (Information Technology), SPTRTELS Index (Telecommunication Services), SPTRFINL Index (Financials), SPTRINDU Index (Industrials), SPTRUTIL Index (Utilities), SPTRMATR Index (Materials), SPTRENRS Index (Energy), SPTRRLST index (Real Estate), SPX Index (S&P 500)

Source : Bloomberg, February 2023.

## Early Recovery

| ETF Name | Ticker | Geography | Portfolio Construction | Beta* | MER† |
|---|---|---|---|---|---|
| BMO Equal Weight US Banks Hedged to CAD Index ETF | ZUB | U.S. | Equal Weighted | 1.52 | 0.38% |
| BMO Equal Weight US Banks Index ETF | ZBK | U.S. | Equal Weighted | 1.24 | 0.38% |
| BMO Covered Call US Banks ETF | ZWK | U.S. | Equal Weighted with Options | 1.23 | 0.71% |
| BMO Equal Weight Banks Index ETF | ZEB | Canada | Equal Weighted | 1.00 | 0.28% |
| BMO Covered Call Canadian Banks ETF | ZWB | Canada | Equal Weighted with Options | 0.92 | 0.72% |
| BMO Global Consumer Discretionary Hedged to CAD Index ETF | DISC | Global | UCITS | 1.49 | 0.40% |
| BMO Equal Weight REITs | ZRE | Canada | Equal Weighted | 1.17 | 0.61% |

## Mid-Cycle

| ETF Name | Ticker | Geography | Portfolio Construction | Beta* | MER† |
|---|---|---|---|---|---|
| BMO Equal Weight Industrials Index ETF | ZIN | Canada | Equal Weighted | 1.53 | 0.61% |
| BMO Nasdaq 100 Equity Hedged to CAD Index ETF | ZQQ | U.S. | Market Capitalization Weighted | 1.42 | 0.39% |
| BMO Nasdaq 100 Equity Index ETF | ZNQ | U.S. | Market Capitalization Weighted | 1.17 | 0.38% |
| BMO Global Communications Index ETF | COMM | Global | UCITS | 0.96 | 0.40% |

## Late-Cycle

| ETF Name | Ticker | Geography | Portfolio Construction | Beta* | MER† |
|---|---|---|---|---|---|
| BMO Equal Weight Global Gold Index ETF | ZGD | Global | Equal Weighted | 1.15 | 0.61% |
| BMO Equal Weight Global Base Metals Hedged to CAD Index ETF | ZMT | Global | Equal Weighted | 1.10 | 0.61% |
| BMO Equal Weight Oil & Gas Index ETF | ZEO | Canada | Equal Weighted | 0.87 | 0.61% |
| BMO Global Agriculture ETF | ZEAT | Global | Market Capitalization Weighted | – | 0.73%‡ |
| BMO Covered Call Energy ETF | ZWEN | Global | Equal Weighted with options | – | 0.73%‡ |

## Recession

| ETF Name | Ticker | Geography | Portfolio Construction | Beta* | MER† |
|---|---|---|---|---|---|
| BMO Covered Call Utilities ETF | ZWU | Canada | Equal Weighted with options | 0.74 | 0.71% |
| BMO Equal Weight Utilities Index ETF | ZUT | Canada | Equal Weighted | 0.55 | 0.61% |
| BMO Global Consumer Staples Hedged to CAD Index ETF | STPL | Global | UCITS | 0.59 | 0.40% |
| BMO Equal Weight US Health Care Hedged to CAD Index ETF | ZUH | U.S. | Equal Weighted | 1.13 | 0.39% |
| BMO Equal Weight US Health Care Index ETF | ZHU | U.S. | Equal Weighted | 0.82 | 0.39% |
| BMO Covered Call Health Care ETF | ZWHC | U.S. | Equal Weighted with options | – | 0.73%† |

* 3-year historical beta. Source Morningstar February 28 2023. Beta: A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole.

† MERs as of December 31, 2022.

‡ Estimate only. Audited MER is unavailable since the ETF has not yet completed a financial year.

BMO | Exchange Traded Funds