

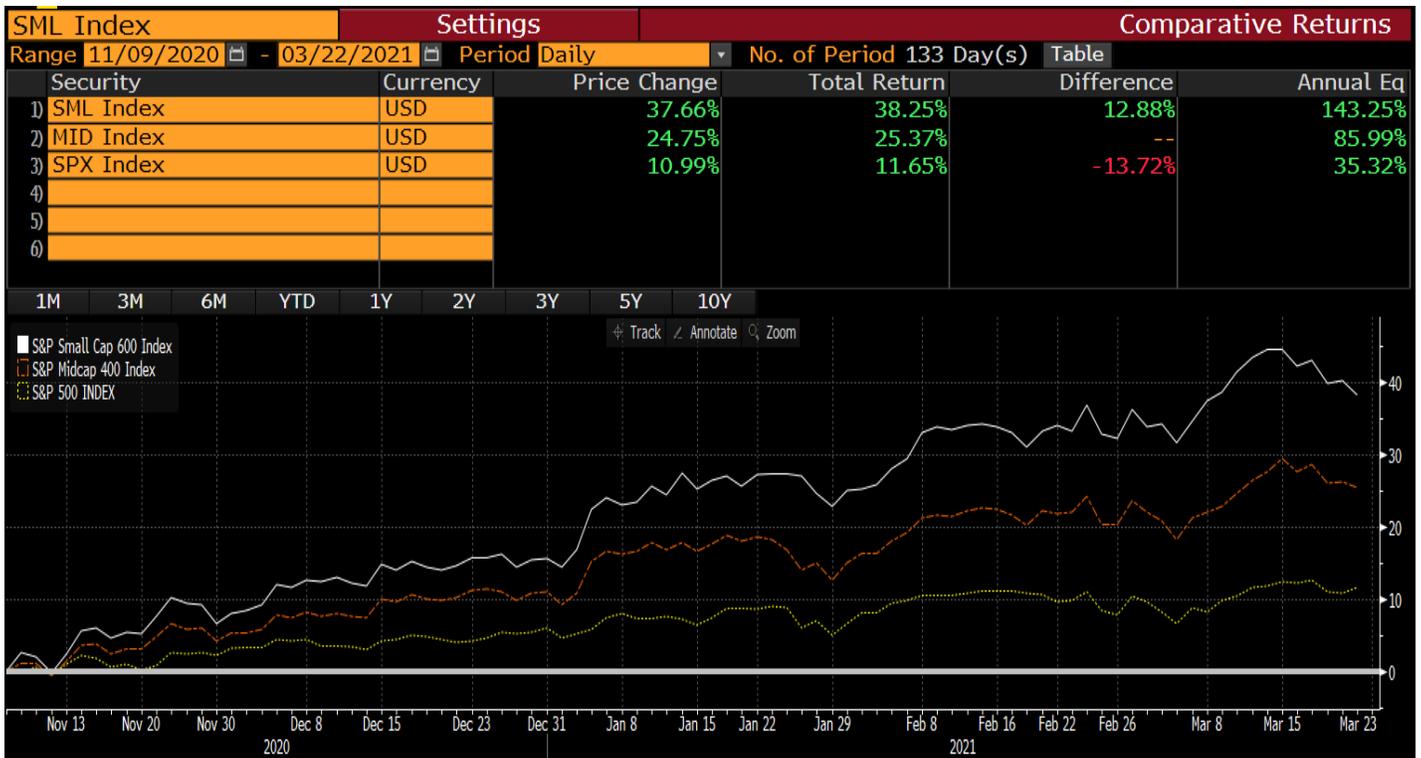
# BMO Trade Opportunity

In a Recovering Economy, Mid & Small Caps Are All That

It is a tactical time to be looking at small and mid cap equities. These cap levels are rotating into favour as the current market cycle benefits these companies. Investors can diversify their large cap holdings by adding tactical exposures to mid and small caps. **The BMO S&P US Small Cap Index ETF (ZSML) and the BMO S&P US Mid Cap Index ETF (ZMID)** are baskets of small and mid cap equities, both using an index approach with recognized S&P indexes.

### Mid and small cap equities are profiting off the “Reopening Trade”:

Mid and small cap equities have historically been the place to go in the early stages of a recovering economy. Their higher risk profile allows them to benefit in risk-on environments when markets rally off lows and their sector makeups are overweight cyclical stocks which also tend to outperform coming out of market lows. We have seen this play out since the vaccine news was announced on November 9<sup>th</sup> and the market rotation began as cyclical sectors (Financials, Materials, Energy) began outperforming the large cap, high-growth tech and healthcare stocks. The S&P 600 Small Cap Index and the S&P 400 Mid Cap Index have both outperformed the S&P 500 Index since November 9<sup>th</sup> by 26.6% and 13.7% respectively<sup>1</sup>:



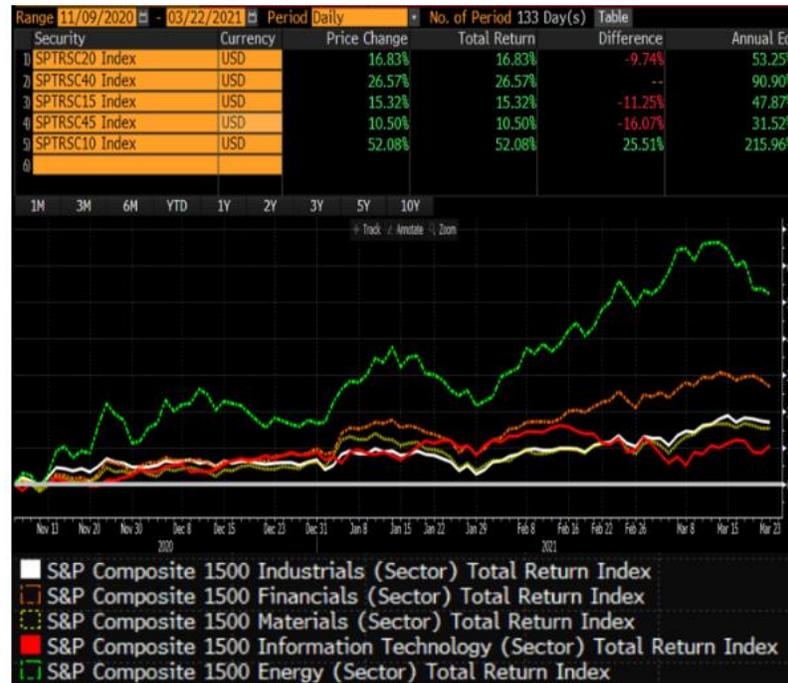
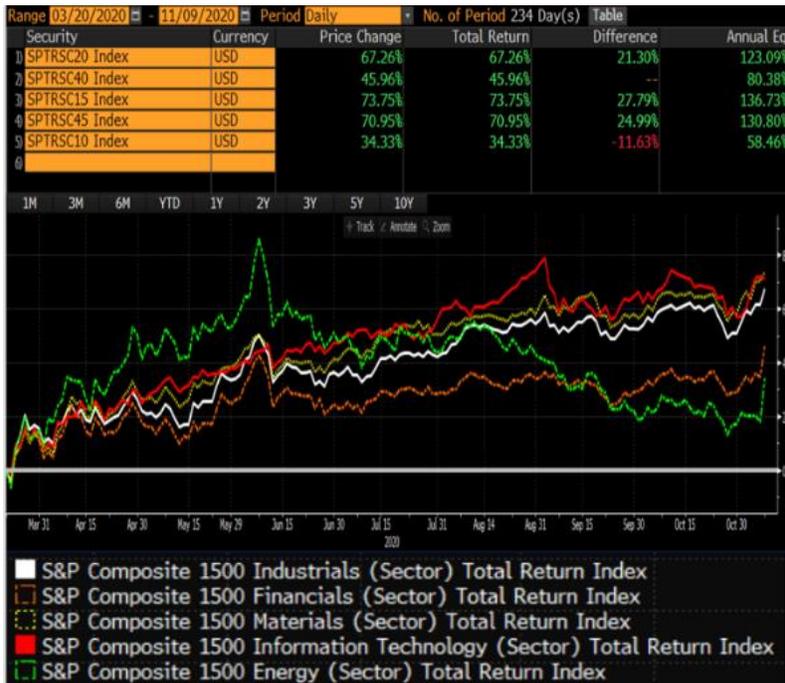
<sup>1</sup>Source: Bloomberg, March 23, 2021

**Cyclical sectors are in the spotlight, and mid and small caps are overweight these sectors:**

We witnessed a sharp “V Shape” recovery from new economy companies which were large beneficiaries of stay-at-home mandates. When the news of the vaccine hit the market, we saw this trend reverse. Energy, Materials, Industrials and Financials all had a strong rebound on the hopes of a reopening economy. Small and mid cap equities are overweight to these cyclical sectors, and this has helped drive recent performance for these cap levels over the last several months.

**Sector returns prior to vaccine news:**

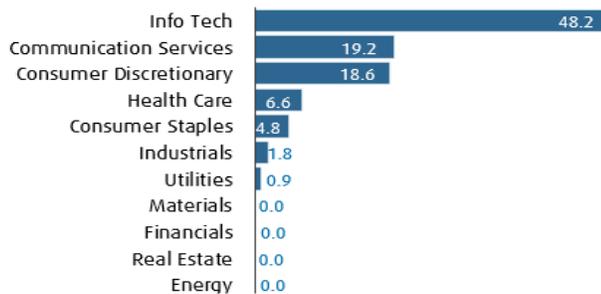
**Sector returns after vaccine news:**



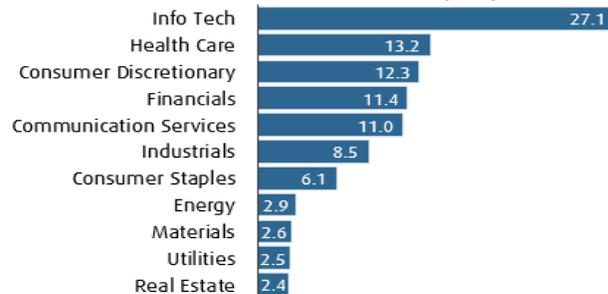
Source: Bloomberg, March 24, 2021.

**Sector Breakdown of Large Cap U.S. Indices vs. Small & Mid Cap U.S. Indices:**

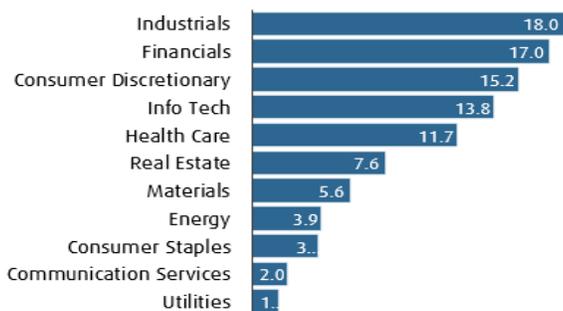
**BMO NASDAQ 100 Index ETF (ZNQ)**



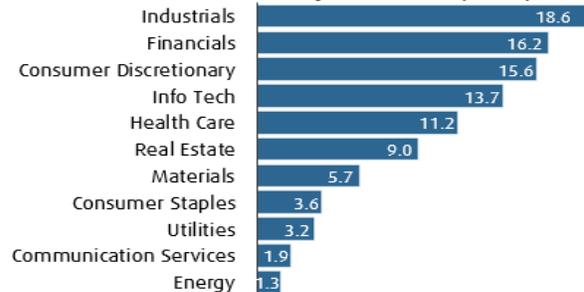
**BMO S&P 500 Index ETF (ZSP)**



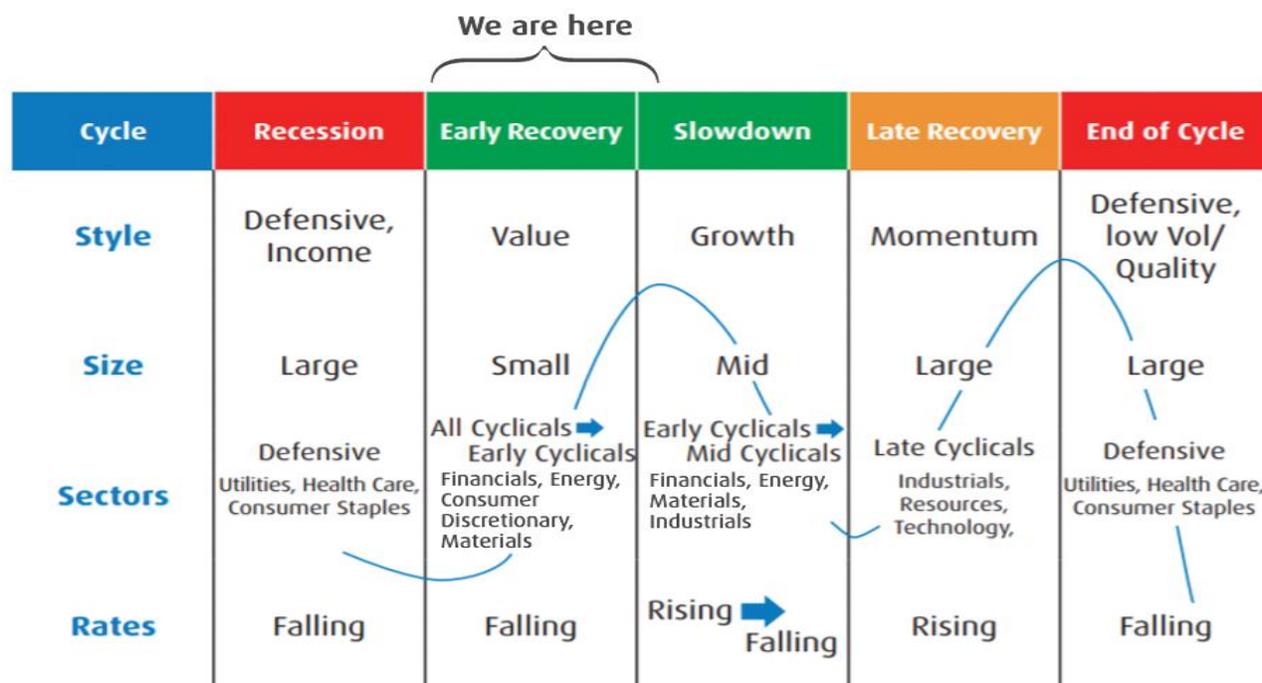
**BMO S&P US Small Cap Index ETF (ZSML)**



**BMO S&P US Mid Cap Index ETF (ZMID)**



## What Does the Economic Cycle Tell Us About How to Position Portfolios?



### Why we think small and mid caps can compliment large cap exposures:

We believe now is a tactical time for investors to consider reallocating some of their U.S. equity exposure to small and mid caps.

- Diversification:** The S&P 500 has become more concentrated than ever before, with its top 10 holdings accounting for 26% of the index<sup>1</sup>. The S&P 500 is also underweight cyclicals and overweight growth sectors (a combined 40% in Information Tech and Health Care) which are more sensitive to a steepening yield curve.<sup>2</sup> Adding small and mid cap exposures can diversify among securities and among sectors.
- Exposure to the “reopening trade”:** Small and mid caps are a pure play on a recovering U.S. economy versus large caps which are more global. Stimulus cheques will have a greater and more direct impact on these companies, as will a successful vaccine roll out. For investors with large core exposures to large caps such as the S&P 500 or the NASDAQ, adding small and mid cap companies can benefit the growth profile of your equities by diversifying among return streams and growth themes.
- Economic Cycle:** During the Recovering Phase and Expansion phase of the economic cycle, small and midcaps historically outperform, as do the sectors in which these cap levels are overweight.

### Why We Like S&P Indexes to Gain Exposure to the Mid and Small Cap Space:

- Index construction matters in mid and small caps.** S&P 600 Small Cap Index and S&P 400 Mid Cap Index have stricter inclusion criteria than other small cap indexes such as the Russell 2000.
- The S&P 400's and 600's profitability criterion creates a **quality bias**. One of the most important characteristics is the **earnings criteria** which includes companies with positive earnings, whereas the Russell 2000 does not have any profitability screen.
- A **disciplined and diversified** index approach is proven to be successful. Looking at 10-year returns, the S&P 600 Small Cap Index outperformed small cap active funds 76% of the time, and the S&P 400 Mid Cap Index outperformed mid cap active funds 73% of the time.<sup>3</sup>

<sup>1</sup>Bloomberg, March 31, 2021. <sup>2</sup>Bloomberg March 31, 2021. <sup>3</sup>S&P SPIVA Report, December 31, 2020.

**Implementation:**

To add small cap U.S. equities to your portfolio, consider buying the [BMO S&P U.S. Small Cap Index ETF \(ticker: ZSML\)](#). Also offered in USD (ticker: ZSML.U) and Hedged to CAD (ticker: ZSML.F).

To add mid cap U.S. equities to your portfolio, consider buying the [BMO S&P U.S. Mid Cap Index ETF \(ticker: ZMID\)](#). Also offered in USD (ticker: ZMID.U) and Hedged to CAD (ticker: ZMID.F).

**BMO S&P US Small Cap Index ETF**  
**ZSML.F** **ZSML** **ZSML.U**  
 hedged to CAD unhedged USD units  
 Distribution Yield: 1.1% | Q  
 Mgmt. Fee: 0.20%  
**Risk Rating:**  
 Medium to High

**BMO S&P US Mid Cap Index ETF**  
**ZMID.F** **ZMID** **ZMID.U**  
 hedged to CAD unhedged USD units  
 Distribution Yield: 1.2% | Q  
 Mgmt. Fee: 0.15%  
**Risk Rating:** Medium to High

**Performance (as of March 31, 2021):**

ETF	Ticker	1 month	3 month	6 month	YTD	1 year	Since Inception (Feb 5, 2020)
<b>BMO S&amp;P US Small Cap Index ETF</b>	<b>ZSML</b>	<b>1.9%</b>	<b>16.4%</b>	<b>45.9%</b>	<b>16.4%</b>	<b>73.4%</b>	<b>20.4%</b>
<b>BMO S&amp;P US Mid Cap Index ETF</b>	<b>ZMID</b>	<b>3.3%</b>	<b>11.9%</b>	<b>32.9%</b>	<b>11.9%</b>	<b>63.1%</b>	<b>17.5%</b>

Source: BMO ETFs, March 31, 2021.

**Learn More:**

[Read](#) our report on investing in S&P Indexes with BMO ETFs

[Listen](#) to our podcast “Exploring Upside in mid and small caps with S&P 400 and 600 indexes”

## Forward Looking Statement:

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.

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