

Views from the Desk

Updates in the Equity and Fixed Income Market

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Canadian Banks

The Canadian banks have a lot of tail winds right now, one being the continuation of heavy fiscal stimulus evidenced by the recent announcement of the Canadian budget. The big six Canadian banks are yielding close to 4% which is near historical levels. The recovering economy coupled with continued monetary and fiscal stimulus means there is less credit risk today than one year ago. Rising rates are also good for banks and we are seeing this in the middle of the yield curve. We might also see some dividend increases on the horizon. During the height of the pandemic, banks were told not to increase dividends, so now that the economic outlook has improved, there are a lot of investors looking for the restrictions to come off. If dividends get raised this would be welcome for investors, particularly those seeking income. So there has been a lot of momentum for Canadian banks and investor increase is growing in solutions such as the **BMO Equal Weight Banks Index ETF (ticker: ZEB)** to get exposure to Canadian banks for both growth and income.

High Yield Bonds

Year-to-date, high yield (HY) bonds have been one of the best performing segments in the fixed income market. Market sentiment as turned positive, and so HY spreads have come in, leading to strong outperformance relative to investment grade (IG) credit. Default rates are down and are lower overall than initially predicted. In this low rate environment, we are also seeing a record number of HY issuance. The number of bonds in the Bloomberg Barclays US High Yield Very Liquid Index is up 30%. However, there is not a lot more room to tighten, as we are near historic tightness relative to IG. We have not seen HY spreads at these levels in a very long time. This could be an issue. As rates rise, investors may look back to IG. Within Canadian credit we see the most opportunity for spread tightening in the BBB space. The **BMO BBB Corporate Bond Index ETF (ticker: ZBBB)** offers lower duration (4.5 years) and a yield pickup over the entire IG space, while remaining investment grade.

Mortgage-Backed Securities (MBS)

Mortgage Backed Securities are a good place in the fixed income market where investors can look at to de-risk their portfolio. The **BMO Canadian MBS Index ETF (ZMBS)** is an ETF with exposure to the Canadian MBS market that can be useful as a defensive fixed income position. ZMBS will offer protection on the downside more than a credit focused product. ZMBS provides exposure to 5-year fixed mortgages, and the key to highlight is that these mortgages are 100% guaranteed by the Canadian government. Which means ZMBS provides federal bond exposure with a yield pickup over this asset class of 30 bps. ZMBS's lower duration (2.5) also can reduce overall interest rate risk in the portfolio.

Dividend Strategies

The main theme of 2019 and 2020 was U.S. large cap tech stocks. These stocks generally don't pay dividends. With the reopening trade dividends have bounced back, from a performance point of view. Year-to-date BMO ETF dividend strategies are outperforming the broad index equivalents. The **BMO Canadian Dividend ETF (ticker: ZDV)** is underweight gold and info tech which has been positive so far this year. ZDV is also overweight Canadian banks and holds all six of the biggest banks which has also been positive this year. Overweights to other cyclical names such as Magna and Great West Financial have also been drivers of performance.

Covered Calls

Covered calls are doing well as the strategies are also tilted to dividend paying companies. The BMO covered call portfolios are biased to larger blue-chip companies as these companies provide option liquidity. On the options side, as the market rallies, overall volatility comes down. The VIX today is at 18 which is a healthy level overall in terms of option writing. Pre-covid the VIX was closer to 10. This means we can generate a good level of income adding 3-4% more to the yield through option premiums.

Source: Bloomberg, All returns and data points April, 2021.

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