Views from the Desk

Updates in the Equity and Fixed Income Market

Alfred Lee and Chris Heakes
BMO ETF Portfolio Managers

Update on Oil: Future Contracts Go Negative

The negative oil contracts this week was caused by a structural issue with the expiring May contract. Once these contracts expire owners would have to take actual delivery of the oil. But with so much supply and no demand, there is no storage capacity to take delivery of oil. Therefore, these contracts turned negative. The June contract, which is at $13 right now has lost half its value this week as the supply shock is being priced in. Contracts which expire further out, such as those going into the fall are still trading around the high $20 range. However, oil equities did not react much to this. For example, the **BMO Equal Weight Oil & Gas Index ETF (ZEO)** was only down 1% yesterday which showed this market volatility didn't impact the producers as much. Trudeau's rhetoric has suggested we will eventually move towards a slow and staged recovery therefore the oil demand will come back, but this will take several months.

Canadian Energy Producers: What is the Impact to Equities and Bonds?

There is a definite risk in investing in oil futures given futures contracts have gone negative. Most commodity ETFs are commodity pools and these have inherent risks that retail investors should be aware of. Currently we are witnessing contango in the oil market; forward prices are higher than spot prices. Therefore, those who need to roll over the contracts will be at a loss (sell low and buy high). The risk to pure equity exposure to Energy also has high right now. But we anticipate senior companies will fare much better than juniors as oil moves below $10. As a measure of prudence in the Energy space, the seniors will most likely be able to restructure and navigate economic hardships. Some junior oil companies may not make it out of this crisis. ZEO has good exposure to senior oil companies. It contains nine holdings which are equally weighted. These are all large cap names and include the pipeline sub-sector. This would be a prudent way to approach the Energy market at this time, and we are starting to see flows into Energy as a value play right now in the US. **Energy in the Fixed Income Space-** The difference in fixed income vs equities for Energy is that for fixed income, the exposures are to larger cap companies and more diversified companies. These are more pipelines which are less sensitive to oil prices (but still affected). On the provincial bond side, Alberta is very affected.

Bank of Canada Bond-Buying Program

The Bank of Canada announced last week that it will extend its bond-buying program to provincial bonds and corporate bonds. This will improve liquidity in the provincial bond and credit space. The focus will be on less-liquid issues (older, off the run or higher coupon bonds) to remove stale inventory from dealer balance sheets. Therefore, dealers will have more capacity to offer liquidity to the market. This creates a great buying opportunity for investors. If you're looking long-term, we believe credit will do well, but there will be bumps along the road such as some downgrades. If you're looking short-term, to manage risk in the portfolio, then federal bonds are the way to go.

Health Care:

We see Health Care as a compelling sector play right now as we believe the sector stands to profit from the current health care crisis, either by finding treatment for COVID-19, or because there will be a greater focus on Health Care going forward. There are two ways investors can get exposure to Health Care. The pure-play exposure is through a Health Care ETF such as the **BMO Equal Weight US Health Care Index ETF (ZHU)**. Or, investors can get indirect exposure to Health Care with the **BMO MSCI USA High Quality ETF (ZUQ)** which has 20% exposure to the sector, and these are the Health Care companies with the strongest balance sheets.

Infrastructure

Infrastructure could be one of the safest ways to play growth and stimulus going forward and it makes a great satellite portfolio holding. Infrastructure promises will be a big part of the US election as launching infrastructure products is a popular way to stimulate the economy. Infrastructure has a low correlation to the broad market, so it is a great portfolio diversifier. It is also an inflation hedge, and a defensive exposure. **The BMO Global Infrastructure Index ETF's (ZGI)** largest sub sector weight is in utilities which is a good place to be to generate income going forward. There is also pipeline exposure in this ETF which is interesting on a go-forward basis. ZGI also has a REIT component. These are not your typical residential and retail REITs, instead these are focused on wireless infrastructure; companies such as American Tower and Crown Castle. This sub-sector will stand to benefit from the 5G transformation trend.

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.

The viewpoints expressed by the Portfolio Manager represents their assessment of the markets at the time of publication. Those views are subject to change without notice at any time without any kind of notice. The information provided herein does not constitute a solicitation of an offer to buy, or an offer to sell securities nor should the information be relied upon as investment advice. Past performance is no guarantee of future results. The statistics in this update are based on information believed to be reliable but not guaranteed. This communication is intended for informational purposes only.

This article is for information purposes. The information contained herein is not, and should not be construed as, investment, tax or legal advice to any party. Investments should be evaluated relative to the individual's investment objectives and professional advice should be obtained with respect to any circumstance.

The BMO ETFs or securities referred to herein are not sponsored, endorsed or promoted by MSCI Inc. ("MSCI"), and MSCI bears no liability with respect to any such BMO ETFs or securities or any index on which such BMO ETFs or securities are based. The prospectus of the BMO ETFs contains a more detailed description of the limited relationship MSCI has with BMO Asset Management Inc. and any related BMO ETFs.

Commissions, management fees and expenses (if any) all may be associated with investments in exchange traded funds. Please read the ETF Facts or prospectus before investing. 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 and ETF series 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 ETFs are managed by BMO Asset Management Inc., which is an investment fund manager and a portfolio manager, and a separate legal entity from Bank of Montreal.