Views from the Desk

Updates in the Equity and Fixed Income Market

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Mid Cap Equities

Mid and small cap equities benefit in a recovery phase. They are tilted to sectors like consumers and industrials which benefit from the ramping up of economic activity. The small caps are domestic focused. These businesses are contained in the U.S. while large caps have more global exposures. Mid caps are in the middle. Mid caps can be suppliers to large cap companies, so can be exposed to the global economy. For example, Apple announced a major expansion, a new campus in North Carolina. All the infrastructure and engineering to develop this campus will be pointed at mid cap industrial companies who have contracts with Apple. As investors look to play the reopening trade, mid caps are focused more on the growthier area of the market which is exposed to increasing economic activity. And mid caps generally have greater financial health than the small caps, so mid caps are better positioned than small caps to weather any short-term volatility. Mid caps can provide the best of both worlds: stability like a large cap, with growth potential like a small cap. The **BMO S&P US Mid Cap Index ETF (ticker: ZMID)** provides exposure to 400 mid cap US equities.

Yield Curve Update

There was significant steeping in the yield curve especially in Q1 (76 bps widening in Canada between the 2 and 10 year and a similar 79 bps widening in the U.S.). But in April rates have leveled off. The 10 year in the U.S. and Canada are both around 1.6% right now. The demand for Canadian bonds is near record levels. Europe and Japan are offering negative yields, so Canada, which is a high-quality issuer, is seeing a lot of foreign demand. The equity market is trading at full value: The S&P 500 Index's P/E ratio is 32x earnings. So, some investors are taking some risk off the table and reallocating to fixed income. Yields have been flat this month because of these factors. Further down the road, we will probably see long term rates move up again reflecting the reopening economy. How to position in this environment? We like the Canadian BBB space and shorter duration. The **BMO BBB Corporate Bond Index ETF (ticker: ZBBB)** avoids the long end of the curve because its bonds are between 1-10 years. The BBB space tends to be less sensitive to rising rates compared to other credit levels. ZBBB has 32% exposure to energy, which is well positioned for the reopening trade.

Innovation

In terms on innovations, we have seen a lot of interest in two of the themes so far: Genomics and Fintech. With vaccine roll outs, investors are understanding the opportunities that lie ahead in the genomics space and recognize the growth that can come in this space over the long term. In Fintech, investors have been looking to the **BMO MSCI Fintech Innovation Index ETF (ticker: ZFIN)** for indirect exposure to the theme of crypto currency and block chain. Investors have heard a lot about these themes, but it has been hard to figure out how much crypto exposure is suitable for them. What might make more sense is to invest in the companies which are involved in this area, such as Paypal, Square, and Mastercard. These are well established companies that investors know and understand which are pushing innovation forward in the crypto and block chain space. The growth-oriented sleeve of a portfolio would be a good place for these solutions.

Health Care

The Health Care sector is up more than the S&P 500 Index month to date. However, the vaccine development has already been priced in; overall vaccine makers have underperformed the broader health care sector recently. The equity market looks rich right now and investors are looking for out of favour sectors and health care was out of favour earlier in the year. The biggest story in this space has been Biden’s $2 trillion infrastructure package, of which $400 billion will be dedicated to health care. Over the next 8 years we will see this allocated to the companies in this sector. Outperforming sub sectors so far have been equipment makers and Health Care facilities which will be the main benefactors of the Biden infrastructure spend.

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