Views from the Desk

Updates in the Equity and Fixed Income Market

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ESG ETFs

ESG has become more topical in the last few years, and most recently the Biden administration has really pushed ESG to the forefront. The administration has already set several "green" goals which is a catalyst for ESG investing. Social values also highlighted under the new administration. Performance between ESG and in ESG mandates has been equal for the most part of late. However, we are seeing the largest performance differential in Canadian equities. The **BMO MSCI Canada ESG Leaders ETF (ticker: ESGA)** has outperformed the S&P/TSX Composite Index since January, where most of its performance is coming from the Energy sector, as ESGA focuses on energy names more affiliated with renewable energy, and renewables really rallied in the fall. ESGA screens out smaller Energy companies those which are more exposed to conventional oil and gas.

Covered Call ETFs- Our Picks this Week

The S&P 500 is at an all-time high. The VIX is at 21, which is double pre-covid levels. This demonstrates that there is still a lot of investor concern and fear regarding markets. This presents a good opportunity for an options seller. In covered call funds, we can monetize the volatility and remain pretty far out of the money relative to pre-covid levels, which gives investors more room to participate in growth. So, this backdrop is good for equities and good for covered calls. BMO's High Dividend covered call suite is positioned well in this environment. Depending on the region you want to play there are 4 options (**ZWC (Canada), ZWH (U.S.), ZWE (Europe), and ZWG (global)**). Dividends have underperformed this year, but in the recent recovery trade, you've seen dividends start to outperform. The outlook for dividends has turned positive over the next 12 months and with a covered call strategy you can monetize the volatility and increase your income with the covered call overlay.

Low Vol

The past 8 months have not been conducive to low vol strategies. The market has had an incredible rally, and the low vol nature of these strategies cannot keep up in these types of rallies. The **BMO Low Volatility Canadian Equity ETF (ticker: ZLB)** has been keeping up with the market over the last few months but is down about 2% YTD. Shopify has had the largest impact on ZLB this year (ZLB doesn't hold this stock). Shopify alone has added a 4% boost to the S&P/TSX Composite Index this year. The underweight of energy has contributed to ZLB' performance this year. In the U.S., the rally has been driven mostly by Tech stocks and The **BMO Low Volatility U.S. Equity ETF (ticker: ZLU)** doesn't own any of these companies, so this has been a headwind. Investors need to think about- what are their goals? If its to lower the risk profile while participating in growth, then the quality and low vol mix is still a good strategy. Low Vol has a very good history of defending equities in times of market stress.

Inflation

Inflationary assets are gaining popularity this year as inflation concerns flare up. The Fed changed its inflationary policy in the summer and is now less focused on short term inflation. When you look back at 1970s, ignoring short term inflation became a problem. Massive central bank balance sheets are expanding. Suppliers will go out of business and a survivorship bias means that remaining suppliers could push their prices up. The velocity of money (the rate at which money changes hands) has accelerated in Q3 which sets up for inflation. Gold is up 20% on the year even though it has recently pulled back. Gold stocks are a good way to play inflation, but they have been facing headwinds recently with less macro risk in the market and the vaccine news. The **BMO Equal Weight Global Gold ETF (ticker: ZGD)** offers exposure to a basket of gold equities. The **BMO Real Return Bond ETF (ticker: ZRR)** is a good way to hedge against inflation. This ETF has a longer duration, so is a good substitute for long federal, and is a good hedge for equity market risk as well.

Source: All returns December, 2020.