Views from the Desk

Updates in the Equity and Fixed Income Market

Chris McHaney and Alfred Lee, BMO ETF Portfolio Managers

Index Changes: BMO Government Bond Index ETF (ZGB), BMO Corporate Bond Index ETF (ZCB), BMO Short Bond Index ETF (ZSB)

BMO launched three segmented Canadian fixed income ETFs in 2018. During that time, iShares had an exclusive contract with the segmented FTSE indexes, so BMO used the very similar Bloomberg Barclays indexes to gain these exposures. However, today the FTSE indexes are no longer exclusive, and so we are moving ZGB, ZCB, and ZSB to these indexes. In terms of the other Canadian fixed income ETFs on BMO's shelf, most are on FTSE indexes, so moving to the FTSE index on ZGB, ZCB and ZSB aligns all our Canadian fixed income products. From an institutional perspective, most Canadian institutions benchmark to the FTSE indexes and these institutions are very index sensitive, so moving to the FTSE indexes accommodates the institutional space as well. Our suite of BMO U.S. fixed income ETFs still use the Bloomberg Barclays indexes. BMO offers significant cost savings in the segmented Canadian fixed income space, relative to the iShares tickers which track the same FTSE indexes. ZCB and ZGB are both 15bps management fee, vs XCB at 40 bps and XGB at 35 bps.

Vaccine News Gets Digested by the Market

COVID-19 numbers are still on the rise, both in Canada and globally. But the market is shaking this off and is focusing instead on the positive vaccine story. Markets are forward looking, so they are interpreting the vaccine dissemination as a positive indicator for re-opening the economy looking forward. There are still some near-term hurdles however, such as the transportation of the vaccines and the logistics involved in distributing it. Therefore, we believe investors should still be cautiously optimistic going forward and should stick with the defensive growth theme using BMO Quality ETFs such as the **BMO MSCI USA High Quality Index ETF (ZUQ)** and the **BMO MSCI Europe High Quality Index ETF (ZEQ)** as core portfolio positions. For investors who are growth-oriented, have a longer time horizon and who perhaps are seeking out that "recovery trade", sectors such as small caps have historically done well in the early recovery phase after market corrections and recessions. The **BMO S&P U.S. Small Cap Index ETF (ZSML)** offers exposure to the S&P 600 US SmallCap Index, which has a quality bias over other small cap indices. This is a good way to leverage the economic reopening in a diversified index approach, to mitigate company specific risk.

Stimulus Update

The Whitehouse has still not released a stimulus package and it is still unclear when a package will be approved. However, some headlines this week suggest momentum is building to push this to the finish line. As vaccines begin to be rolled out and the economy begins to reopen, and the stock market continues to climb, some people question the need for a stimulus package at all. But not all indicators have been positive. Spending dollars were down on black Friday this year vs last year, and the employment numbers in the U.S. are also lower. So, we believe a stimulus package is still necessary to help bridge the gap from now until next summer when more of the population becomes inoculated, especially for small business, to help keep them afloat, and solvent. The Democrats are also pushing to pass more aids to states, to keep government workers such as police and teachers all working and getting paid. Overall, if there is no stimulus package in the short term, we may be facing a double-dip recession which would not be good for markets.

Dividends & Income

This has been a very challenging time to find income solutions for portfolios. Fixed income remains an important part of portfolio construction for security and to mitigate equity market risk, but it is no longer producing the same yields as it used to, as interest rates are set to be historically low for a long time. Investors are gravitating to dividend equities to make up for this yield shortfall, but these securities are still riskier than fixed income and do not offer the same stability. At BMO, our approach to dividend ETFs is to identify companies who are not just *dividend payers* but who are *dividend growers*. An example of a dividend payer would be a utility stock which offers a good and stable yield, but not a lot of growth. What investors may prefer is the *dividend grower*: a company who pays a consistent dividend today and plans on growing that dividend in the future, through the growth of good company fundamentals and strong operating cash flows. This also lowers the level of risk relative to other companies who are dividend payers, and this strategy helps to strike a nice balance between both dividend income and portfolio growth.

Chris's top income pick for the month: The BMO Global High Dividend Covered Call ETF (ZWG)
ZWG yields 6.5% (annualized, as of November 30). It earns income through dividends, using the *dividend growers* approach and through the use of a covered call overlay. This is a global basket of the best dividend growers in the world and companies which can still grow their stock price as well.

Chris's top growth pick for the month: The BMO MSCI ACWI Quality Index ETF (ZGQ)
ZGQ has returned 14.1% (annualized) over the last 5 years. It is a basket of the highest-quality companies globally. These companies have strong balance sheets, good management teams, and have lower debt-to-equity than their industry peers. These characteristics offer a defensive growth profile, which we like looking out as there are still some uncertainties for markets in the near term.

Source: All returns December, 2020.
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.