Views from the Desk

Updates in the Equity and Fixed Income Market

Chris Heakes and Alfred Lee, BMO ETF Portfolio Managers

Investing in Fintech

We are very excited about thematic investing, which is investing in a growing trend or theme that affects all industries across the globe. Thematic investments are growth-oriented strategies. At BMO ETFs we are focused on controlling volatility and controlling the risk profile of our growth mandates for investors. We brought the thematic investment strategy of Fintech to the marketplace in the **BMO MSCI Fintech Innovation Index ETF (ticker: ZFIN)**, and this ETF is consistent with the controlled risk profile and controlled volatility of the rest of our ETFs. ZFIN is very diverse with over 150 names, is market cap aware, and avoids concentrated risk with a single security cap at 5%. ZFIN is a good tool to get exposure to the emerging theme of Fintech in a robust and disciplined index approach. The portfolio holds companies with leading digital platforms such as PayPal, Amazon and Alibaba. The sub theme of blockchain technologies is 20% of the portfolio, and this will evolve as blockchain becomes more widespread and will be reflected in the ETF as we update and rebalance. If you are an investor who is looking for exposure to long term emerging themes which have the potential to outperform over time, fintech is really one of them.

Valuations

Is the recent market pull-back a buy opportunity or should investors focus on defensive equity? We saw a pullback like this back in the fall with the NASDAQ 100 Index, and it was a healthy consolidation after a summer-long market rally. If markets just go up this is not always good, markets need to "catch their breath" and correct every so often. However, valuation has increased in the NASDAQ 100 Index and fundamentals are stretched. We still have conviction in quality ETFs, such as the **BMO MSCI ACWI Quality Index ETF (ticker: ZGQ)** and we like tech and new economy companies as a long-term theme and ZGQ is overweight to the Information Technology sector. The tech companies in ZGQ have a quality bias so they are fundamentally strong and can weather market corrections better than their peers. The **BMO MSCI Innovation ETF (ticker: ZINN)**, would be a more aggressive way to add new economy companies to a portfolio. From a long-term investment point of view we believe tech is a theme going forward, even if it experiences some pull-backs along the way. ZGQ and ZINN are both great solutions to get exposure to these new economy companies. The decision between ZGQ and ZINN would depend on the investor's outlook on the market and how much risk they are willing to take.

Canadian Banks

The banks are releasing Q1 earnings this week and so far, all earnings reported have been large beats. Overall provisions for losses are lower than expected, credit risk has decreased, and commercial and retail banking is strong. The market volatility has been beneficial for capital markets' trading revenues and wealth management has also been strong with the market recovery. So, there is a lot working well for the Canadian banks right now. There is increasing speculation that dividends will be increased; they went on a pause in 2020. Dividend growth is back on track and this will be well received by the markets, so we continue to see upside potential for Canadian banks. The **BMO Equal Weight Banks Index ETF (ticker: ZEB)** is a great one stop shop to add exposure to all 6 Canadian Banks to a portfolio and the **BMO Covered Call Banks ETF (ticker: ZWB)** has the option overlay for the income focused play is also an option to get banks exposure. But we see solid momentum in the sector as businesses are recovering, and the reopening trade is proceeding.

Rates

The Canadian 10-year is trading above 1.3% this morning (Bloomberg), which is close to pre-Covid levels. The U.S. 10 year is also close to pre-Covid levels at 1.4% (Bloomberg). Why are yields rising? Inflation and reflation trade which are on the back of expectations of a global economic rebound. The Bank of America revised its U.S. GDP expectations up 50bps to 6.5% based on vaccine distributions. Retail reports also indicated that there was a lot more spending in the second half of 2020 and there was a surge of sales in January. Central bank activity is also putting upward pressure on rates because ultra low rates encourage people not to be in cash so instead investors have been rotating into equities. If you are looking to have less curve sensitive ETFs in your fixed income portfolio, investors can reallocate some of their core bond exposures, but we still believe a core exposure like the **BMO Aggregate Bond Index ETF (ticker: ZAG)**, is a good core holding. ZAG is diversified among term and credit so there is always something its holding that is working. Active managers are becoming more bearish on credit, and high yield looks overvalued. In the credit space we are seeing more opportunities in BBBs. The **BMO BBB Corporate Bond Index ETF (ticker: ZBBB)** provides precise exposure to Canadian BBB bonds where we see the most spread compression opportunities right now. ZBBB also provides diversification and liquidity benefits. Moving out on the risk spectrum we also like Emerging Market bonds such as the BMO Emerging Market Bond Index ETF (ticker: ZEF) to add more yield to a portfolio and where the spread compression opportunities look more favorable than in the high yield space.