Updates in the Equity and Fixed Income Market

Chris Mchaney and Matt Montemurro, BMO ETF Portfolio Managers

The Impact of the European Stimulus Package

The EU announced an agreement which involves $750 billion euros of grants and loans to help countries recover from the pandemic. This is the largest ever joint borrowing the EU has ever done. The deal was not immediately positive for equity markets. It has been in the making for a while, so it could have been priced into markets already. The deal did however strengthen the Euro; the Euro is up 2% relative to the USD which is its highest level relative to the USD since 2018. The news creates a nice backdrop for Europe for the next few years as it recovers from the recent market bottom. The **BMO MSCI High Quality Europe Index ETF (ticker ZEQ)** is a nice way to play Europe right now.

RBC Issues AT1 Notes

Banks have been looking for a cheaper alternative to tier 1 capital for some time and the AT1 notes have just been approved by the regulators. These are like a pref-bond hybrid. These are interest bearing notes, with a rate which resets every 5 years, and will mature in 60 years. RBC issued $1.75 billion to institutional investors which is a large issuance for this structure. This caused the **BMO Preferred Share Index ETF (ticker: ZPR)** to rally 8%, a huge rally for an asset class that has been struggling lately. The upward pressure on the pref market is because if banks redeem at higher reset spreads, there will be price appreciation on those calls in the ETF and in the Pref market. Once redeemed, investors will reinvest in the market causing upward pressure.

Update on Energy

The oil market has normalized. The low prices we saw in March and April were an overreaction to the closed economy which caused a strong price action to the negative. The market is now stabilizing as the economy slowly reopens. In 2019 oil was trading at $60 and now it is trading at $40 so we are still not back to where we were pre-COVID. Before COVD related shutdowns oil was selling off to the $50 range as the supply glut came on board. To get exposure to this recovering sector, we like the large caps and senior producers who are more capitalized: names in the **BMO Equal Weight Oil & Gas ETF (ticker: ZEO)** such as Enbridge, Trans Canada, and Suncor. These companies are more able to ride out short term price fluctuations. The Energy sector is related to overall growth and overall economic recovery and playing this theme through ZEO could be good. The ETF also provides a healthy income stream as you wait for the sector to recover, it is yielding close to 6% right now.

Volatility

The VIX measures the implied volatility on the S&P 500, so it is a good gauge of volatility in the overall market. Right now the VIX is at 25, which is the lowest it's been since late February. But this is still double where we were pre-COVID which was around 12. We have seen premiums on call writing come in a bit, but they are elevated relative to where we were before the shutdown. In March all equities had high vol. So, during this time we generated high option premiums. Now the premiums are more specific to sectors. Names in Health Care, IT and the Consumer Discretionary sectors have stayed quite elevated. The average moneyness and premiums are still higher than where they have been before. And the high vol is expected to continue. VIX futures say it will trend higher into the fall with uncertainty around the US elections.

IG Credit

Credit has outperformed provincial and federal bonds from April-June as spreads have tightened. But we still see an opportunity because credit spreads are still 30% higher than historical norms. There is an opportunity to play further credit spread compression as we look out. The Bank of Canada Corporate bond buying program has a cap of $10 billion, but it has only purchased $1.3 billion so far. So, the spread tightening we've seen is caused by the ability to buy vs the actual buying.