Views from the Desk

Update on BMO ETFs and Trade Ideas: The Equity Rally & Defensive Investing

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Defensive Growth- is it still working in this new bull market?

April and May were the strongest months for equities since 2009. But defensive positioning is still doing well. The BMO MSCI USA Quality Index ETF (ticker: ZUQ) has added about 1% over the broad market and the BMO US Low Volatility ETF (ticker: ZLU) is just modestly behind the S&P 500 in May. A 50% mix of Quality and Low Vol has outperformed the S&P 500 by about 2% YTD. We have also seen a small upside in Value. This was especially evident within US and Canadian Financials. The BMO Canada Low Volatility ETF (ticker: ZLB) has less Energy, less gold and no Shopify which differentiates it from the board Canadian market.

Update on Credit Spreads

Credit spreads have come in since March, but they are still elevated vs where they were when we entered 2020. In the US, equities are back to where they were to start the year and given the amount of global market risk this is surprising. But credit spreads are telling a different story. High quality (AA) spreads entered 2020 around 50bps, spiked to 124bps, and are now down to 75bps. There has been significant contraction, but spreads are still elevated. This could present opportunity when we argue for caution in these markets; invest in high quality assets and pick up some yield. Within the BBB space, spreads have not come down has much as the AAs. Entering 2020 the spread was 150bps, then spiked to 300bps, and now it's back down to 235bps. Historically BBBs represent the best risk reward pay off. Risk is to the economic slowdown, if the rebound is not as strong as forecasts, some of these names could be downgraded to HY and face selling pressure. Investors who can ride out near-term volatility can capture a decent pick up in spreads here. More cautious investors should stick with the quality bonds (A and above), such as **the BMO High Quality Corporate Bond Index ETF (ticker: ZQB).**

Adding Growth through Small and Mid-Cap US equities

The S&P 1500 represents 90% of the US market cap universe and can be divided: S&P 500 (large cap), S&P 400 (mid cap), S&P 600 (small cap). For investors with a long-term time horizon, small and mid-caps historically outperform large caps as smaller companies typically have more room for growth than established companies. There are also different sector exposures. The S&P 500 has a higher weight to the IT sector. The Mid and Small have more sector diversity: more industrials, real estate and utilities. The S&P 500 is also multinational because its revenues are more global. For investors with a higher conviction to the US economy small-caps offer a purer exposure to the US consumer and US economy. Mid-caps add more liquidity than small-caps, while still offering more exposure to the US economy. BMO offers both in an ETF: **the BMO S&P US Small Cap Index ETF (ticker: ZSML)** and **the BMO S&P US Mid Cap Index ETF (ticker: ZMID).**

Health Care Sector

This is a secular, long term trade. In Canada, Health Care is a small portion of our economy and not diversified (almost all are marijuana companies). The US is the global leader in the sector. The health care crisis has been a tail wind as these companies are racing to get therapies and vaccines created. Short term the sector has already rallied. But it still offers longer-term growth while being defensive. For exposure to US Health Care BMO offers **the BMO Equal Weight US Health Care Index ETF (ticker: ZHU).**

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