# Views from the Desk

## Updates in the Equity and Fixed Income Market

**Chris Heakes and Alfred Lee, BMO ETF Portfolio Managers**

**Growing Acceptance of ESG**

The **BMO MSCI USA ESG Leaders Index ETF (ticker: ESGY)** received a $1.6 billion dollar trade this week and is now the largest ESG ETF in Canada. This trade came from an institutional client who moved out of an S&P 500 exposure and into an ESG exposure as its core U.S. large cap portfolio holding. Institutions have been ahead of the curve when looking to ESG investments. We have been talking a lot about ESG for a while now and we are seeing more and more flows move in this direction. ESGY is appealing as a core portfolio holding because it still provides the broad-based, market cap exposure in an ESG-friendly way. In terms of satellite exposures for ESG, we are seeing growing popularity in clean energy funds. Clean energy ETFs, such as the **BMO Clean Energy Index ETF (ticker: ZCLN)** are a more growth-oriented solution and is a great intersection of both ESG and thematic investing.

**Market Correction in New Economy Companies**

We are seeing a market correction, especially concentrated among tech-related new economy companies, much in part due to rising treasury yields. For example, companies like Tesla have really dropped off their highs. Because of this pull-back, long term growth-oriented investors could view this as a buying opportunity as valuations cool off a bit. An ETF like the **BMO Technology and Industrial Innovation ETF (ticker: ZAUT)** provides exposure to companies such as Tesla and could be suitable for investors looking for exposure to Tesla and other companies like it, but in a diversified way. ZAUT is invested in companies who benefit from advancements in vehicle automation, robotics, artificial intelligence and machine learning. We believe these are all key technologies and trends which will play a major role in society in the future, and believe that the companies involved in these technologies will benefit as they become more widely used and adopted. A five-year time horizon is a good way to consider ZAUT and other thematic ETFs like it, because they have a higher volatility profile but a longer time horizon smooths this as the theme plays out. So it makes sense to look at these as longer term vehicles and not short term, so investors have time to ride out short term volatility (as we are witnessing play out now) and take advantage of the long term growth potential. We are confident that these are key themes going forward so for investors who can buy and hold there is a good chance for great outcomes.

**Rising Bond Yields**

Rising yields are dominating headlines right now and are having a huge impact on the market. However, the rise in yields is mostly contained to the long end of the curve; the two-year rate has been flat, because the Fed has committed to keeping the over night rate steady for the next 24 months. Investors who are looking to minimize rate shock could consider the high yield space which is less sensitive to rates. High yield spreads have also widened recently (from 290 bps to 310 bps), so we see these levels as more attractive given the opportunity for spread compression. Other tail winds include rising energy prices (oil is up $18 YTD), and the high yield space has a generous weight to energy companies. For example, the **BMO High Yield US Corporate Bond Index ETF (ZHY, ZJK)** is 12% energy companies.

### Emerging Market Bonds

Credit spreads in emerging market (EM) bonds are wider compared to historical levels. So, in the long term there is more upside for EM bonds than in other areas of the fixed income market. The EM bond universe is very diversified. Several countries are oil exporters, and these countries which will benefit from rising oil prices. Other countries are tech and consumer focused, such as China. Debt to GDP is an important factor too. EM countries have been more fiscally responsible through covid which is positive for balance sheets. EM bonds are about three quarters investment grade, which may surprise some investors, so a different quality aspect to consider as well. We think EM bonds have some long term potential for income oriented investors.

### Value

The underperformance of value accelerated in 2020. But since the vaccine news, we have seen a factor shift in the market, which was part of the reopening trade. This cyclical rally has always been a very bullish sign for value investors. Since the vaccine news was released, the **BMO MSCI USA Value Index ETF (ticker: ZVU)** has been outperforming the S&P 500. Not only are we seeing pure value strategies like ZVU rally, but also more value-oriented factors and sectors such as dividends, small caps, and financials. The reopening trade is still underway as there is still a lot of good news to come, and a value ETF such as ZVU as a pure play value exposure is really delivering in this space.