Views from the Desk

Updates in the Equity and Fixed Income Market

Chris McHaney and Chris Heakes
BMO ETF Portfolio Managers

Update on the Recovery: Is it For Real?

New virus cases are down, and government stimulus has been heavy, both which have been positive for market sentiment. However, a cautious outlook on the economy is still warranted as the pace of the recovery is looking more challenging. Leaders are aware of the dangers of reopening economies too soon. The labour market in Canada and the US has 15% unemployment, which is staggering. Some of these jobs could return quickly as we reopen (restaurants and hotels) but other jobs won't come back anytime soon. The drop in economic activity is a challenge for markets going forward. This macro backdrop suggests a risk-reduced focus to equities: Low volatility, Quality, and defensive strategies like Covered Calls. The **BMO Low Volatility Canadian Equity ETF (ticker: ZLB)** offers a risk-reduced focus to Canadian equities. We like the Quality factor for US and European equities, which offers a portfolio that is overweight growth sectors and comprised of stable businesses with high profitability. Adding covered call strategies are a good idea to generate income, and with the volatility in the market this could prove to be a good trade. Covered calls are an effective way to get paid while you wait for recovery.

Regional Exposures in this Environment

Overall, we still believe the US offers the companies in the strongest position to survive the economic downturn such as developed and profitable Tech companies (ie: FAANG stocks, Visa, MasterCard, Microsoft). In Canada we believe the Low Volatility approach is prudent especially with the uncertainty around the Energy sector. Overall, the US continues to be strong, especially among the highest quality names.

Fixed Income Update: Fed and BoC Bond Buying Programs

The Fed started its corporate bond buying program this week: $75 billion has been set aside to purchase corporate bonds and corporate bond ETFs on the secondary market. The March announcement had a powerful impact on IG spreads which went from 140bps to 90bps (still high relative to the last few years). Now that the Fed will start investing, we will see if it helps tighten spreads even more. In Canada, the BoC announced similar activity: a $10 billion plan to purchase corporate bonds directly (but not ETFs). They will also be buying IG bonds (BBB or higher) which have less than 5 years to maturity. Exclusion- deposit taking institutions (bank bonds not supported by this program). The $10 billion represents 10% of this IG, short duration, non-bank universe. In Canada, the **BMO Short Corporate Bond Index ETF (ticker: ZCS)** contains mostly bonds within this universe, (except for some bank bonds) and could stand to benefit from the bond-purchasing program. The **BMO BBB Corporate Bond Index ETF (ticker: ZBBB)** would also be a good way to benefit from the program, which is a little more out on the risk spectrum. ZBBB has very low financials exposure, is IG, and most of the portfolio is bonds of 5 years or less. Historically, the BBB segment has the best risk-return trade off, although this strategy could carry some short-term volatility if some names get downgraded.

Covered Calls

Yields have jumped up on covered calls because the underlying stock prices have dropped, but also because of the increased premiums which we can earn from greater market volatility. The VIX dropped from 80 (mid-March) to almost 35. This seems low now, but it is still double the volatility since last year, so volatility is still quite elevated. In April we were able to write our calls 10-15% OTM to generate the 3-5% incremental yield from our option portfolio. In May these options will be around 7-13% OTM to generate the 3-5% additional yield. We are still setting strikes at very attractive levels. A benefit to our strategy is that we write on single names whereas the VIX actually represents the entire S&P 500. We write calls name by name, taking advantage of the precise volatility on each individual stock. The yield on our covered call strategies is 7-9%, so we continue to believe a covered call ETF is a great place to get paid while you wait for a market recovery.

ESG

During the market sell-off, ESG ETFs have proven their worth. All BMO ESG equity ETFs, which use the MSCI ESG Leaders Indexes, track a full market exposure. For example, the **BMO MSCI Canada ESG Leaders Index ETF (ticker: ESGA)** has a heavy weight to Energy. Across geographies, each BMO ESG ETF performed better than the broad market within each region during the sell-off. Part of this can be explained by quality companies getting rewarded in this environment. These companies have strong management teams which equates to good governance which scores these companies high on the "G" element of ESG metrics.

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.