

Views from the Desk

Update on BMO ETF Income Strategies

Chris McHaney and Chris Heakes
BMO ETF Portfolio Managers

What's been working in equities?

The market is improving, but we still advocate a prudent approach to equities. The BMO NASDAQ 100 Index ETF (unhedged ticker: ZNQ, hedged ticker: ZQQ) has been the strongest broad beta ETF YTD up 14% this year. Sectors such as Health Care and Info Tech and popular thematic exposures such as e-commerce, AI and cloud computing (tech sector) are all overweighed in the NASDAQ index, setting it up well to survive and thrive in the current market environment.

Income Strategies: Update

Option Writing with ZPAY: The BMO Premium Yield ETF (ticker: ZPAY) is an options-based strategy which performed as anticipated during the increased volatility. This is a more conservative way to play the equity market vs full beta exposure and it generates cash flow through the options market as its primary source of return. During the sell-off, because it had less the equity exposure (around 30% in March) it was down much less than the S&P, which creates downside protection. During the sell-off the equity weight built up to about 70%. The higher equity weight really paid off through the April and May recovery. It provided a 75% upside and about 50% downside, during this period. Currently, ZPAY is down to a 50% equity weight. Plus, the cash flow is tax efficient. It has a monthly distribution with some allocation to equities which will dynamically adjust as equity markets move up and down.

Yield Pick-Up with ZMBS: The BMO Canadian MBS Index ETF (ticker: ZMBS) offers a portfolio of mortgage backed securities for investors. This is a new asset class exposure in the ETF arena. There is a yield pick-up associated with MBS securities. These are all Canadian mortgages and are AAA rated and fully guaranteed by the Canadian government. The ETF has a short term duration (2 yrs). Compared to short federals, which offer around 39bps spread, the yield spread on an MBS is about 70 bps. They have similar duration and similar credit risk so in the short term fixed income space this is a substantial pick up.

Preferred Shares with ZPR: BMO's Laddered Preferred Share Index ETF (ticker: ZPR) offers rate reset preferred shares. This creates a somewhat floating element in terms of its portfolio yield. 20% of the portfolio resets each year. In times of stress prefs see spread widening, but you "get paid while you wait" for spreads to normalize. Currently it as a 6.5% annualized dividend payment, all tax efficient. Rate cuts creating volatility in the space right now, but this is a good place for income oriented investors who have a little longer time horizon as rates stabilize.

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