Views from the Desk

Updates in the Equity and Fixed Income Market

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Currency: CAD/USD

The Canadian dollar (CAD) is up 5.4% YTD vs USD. CAD has been rallying since the equity market bottom (March 2020). CAD's characteristics are opposite to those of USD. CAD is a risk on currency and does well when the economy recovers and grows whereas USD is a safe haven currency and does well in risk off environments. Most recently CAD rally has been driven by Bank of Canada (BoC) monetary policy and a commodity rally. Asset purchase programs have ended in Canada, and QE is tapering. Comparatively, the Fed hasn't even started talking about tapering yet. Secondly the demand for commodities (lumber, base metals, oil) has increased. Currency hedge ETFs allow investors to make a currency call. As a reminder, a foreign asset has two return streams: the underlying security return and the currency return. With a currency hedge you eliminate the currency return and just receive the asset return. Over the long term, USD provides diversification for Canadian investors. Short term, currency exposure can be used more tactically.

Bond Yields

The recent surge in yields after Q1 made bonds attractively priced. Some investors, given equity market valuations, have been taking some risk off the table and rebalancing into fixed income. Canadian bonds are rated investment grade and provide a positive yield, so from a foreign view these are attractive. Inflation numbers are creeping up as well. If The Fed starts to taper, this can cause upward pressure on rates. Because there are so many macro factors at play, a diversified mix of fixed income within a portfolio can really benefit investors. A diversified core position, such as the **BMO Aggregate Bond Index ETF (ticker: ZAG)** can work well in this environment because it is diversified among corporate and government bonds. Adding an inflation hedge as a satellite position, such as the **BMO Short Term US TIPS Index ETF (ZTIP)** can provide some inflation protection.

Banks

This has been a very good backdrop for banks. BMO just kicked off the banks' Q2 earnings cycle and posted a large earnings beat. We will be watching the other 5 big banks as their earnings roll in. For banks overall, credit risk is abating, PCLs are coming in and wealth is strong (assets under mgmt. have gone up as the markets continue to recover from covid lows). The yield curve is steeping (the 10 year has doubled this year) which is also a good back drop for banks. The **BMO Equal Weight Banks Index ETF (ticker: ZEB)** is up over 20% YTD. The banks' dividend yield is 3.8%, slightly under its long-term average. The banks have been prevented from increasing dividends, but it is likely these restrictions could lift soon which would be a catalyst for the asset class.

BMO Covered Call Tech ETF (Ticker: ZWT)

With covered calls, you want to ensure there is some upside growth exposure and that the option overlay doesn't sell away all the upside potential. With ZWT, we only write call options on half of the portfolio so there is always a portion exposed to the upside. ZWT has around a 5% distribution yield which is a meaningful amount of yield while still providing some upside capture. Tech names are slightly underwater this year but ZWT is up more than the NASDAQ 100 Index in the same time. The covered call approach can add value, especially in these sideways markets. ZWT is large cap and diversified. ZWT doesn't just hold IT companies but also holds broader tech names such as Google and Facebook which are in the Communication Services sector, and the inclusion of these stocks has been beneficial.

Source: Bloomberg, All returns and data points May, 2021.