Views from the Desk

Updates in the Equity and Fixed Income Market

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Technology & Innovation

Rising rates and inflation have been on investors' minds as stimulus continues and central banks have signalled the willingness to let inflation run hot. This has been good for equities overall. The U.S. 10-year has almost doubled this year to 1.6% which has had a large impact on growth-oriented companies especially in the tech sector. These companies are priced a lot in part based on their expected cash flows which are still way out in the future, and when you discount this back at these higher interest rates it will impact those cash flows. Therefore, these companies have cooled off over the last few months. The Information Technology sector is coming off back-to-back 40+% yearly returns which is very strong. We are seeing more of a cyclical value rally this year with sectors such as Financials, Industrials, and Materials doing very well, sectors which underperformed last year. Our long-term outlook for tech is still bullish; it is hard not to be with the amount of tech flooding our daily lives. The "innovation" side of tech, which looks at growing trends rather than a specific sector can be a higher beta application of the tech trade on the risk spectrum (for example, the **BMO MSCI Innovation ETF, ticker: ZINN**), followed by the NASDAQ 100 Index (**BMO NASDAQ 100 Index ETF, ticker: ZNQ**) and then the S&P 500 Index (**BMO S&P 500 Index ETF, ticker ZSP**).

Inflation in Fixed Income Portfolios

Janet Yellen startled markets with her comments on inflation and markets over heating earlier this week, but she quickly clarified the remarks and reiterated she is not predicting inflation but said if inflation was a biproduct of spending and low rates, the Fed has the tools to effectively manage this risk. Inflation breakevens are anticipating 5-year inflation of 2.7% (forward-looking) while CPI reported from March was 2.6% (backward-looking). Both indicate inflation fears are real and should be considered. Given the interest rate moves (steepening yield curve) fixed income investors must also consider managing duration risk in addition to inflation risk. The **BMO Short Term US TIPS Index ETF (ticker: ZTIP)** provides exposure to U.S. TIPS (inflation protected government bonds) which have a short duration of 1-5 years. With ZTIP, investors can protect against inflation but also shorten their overall portfolio duration. ZTIP can compliment a core fixed income strategy and protect from rising rates and inflation fears.

Base Metals

Cyclical exposures like base metals and energy tend to outperform in rising rate environments. We have seen this so far this year as prices on these resources has really gone up. Within the base metals space, the price of copper has skyrocketed as the demand has increased with the economic reopening. Up until now there has been under investment in this space but the sector is seeing a lot of tail winds right now. The **BMO Global Base Metals Index ETF (ticker: ZMT)** is a diversified way to get exposure to this trade for a higher risk tolerance investor who wants to get exposure to the cyclical rally.

Outlook for Canadian Equities

The U.S. market has been the market of choice for quite a while, but Canada is coming back into focus. The Canadian equity market offers exposure to the economic reopening trade. Canada is overweight to cyclical sectors on the resource side as well as Industrials and Financials. The relative valuation of Canada is very attractive on a P/E basis vs the U.S. There has also been good momentum in earnings in Canada which is supported by monetary and fiscal stimulus and the commodity backdrop has been beneficial. CAD is also doing well so it has been good to be hedged against EU currencies and the USD.