

Views from the Desk

Updates in the Equity and Fixed Income Market

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Optimism in Equity Markets

Markets are responding to vaccine news and are reaching all-time highs. The market growth up until this point has been very narrowly focused, concentrated in the IT sector and new economy companies (Zoom, Amazon, Netflix etc). These companies have led the markets higher recently. The vaccine news has given a boost to the broader market. It indicates an end to the stay-at-home orders. The unknown which we are facing however is how long will it take to get back to "normal". There is still a high level of unemployment. The virus is still surging, and we are entering the winter months and flu season. Unemployment is still high, and this number will be significant looking forward. With this backdrop, it still makes sense to have defensive growth and quality exposures in your portfolio, because things will be choppy in the next few months. Investing in companies which are cash-rich, and which have low financial leverage are well positioned going forward.

Tesla Inclusion in S&P 500

Investors have been watching this for some time; the speculation started in August that Tesla would be added to the S&P 500 in the fall. The S&P 500 Index is not a basic number driven methodology. There is an index committee which ultimately decides which companies are added and when they are added. There is a profitability requirement, which looks at the most recent quarter plus the most recent four quarters, to see if the GAAP accounting standards profitability is enough. Up until recently, Tesla did not make the profitability requirement. But today it does. The announcement of the inclusion boosted Tesla's stock price 10% because there will now be about \$50-\$60 billion dollars flowing into the stock when the index rebalances in December. All index-based funds which track the S&P 500 Index will have to buy it. For example, the **BMO S&P 500 Index ETF (ticker: ZSP)**, on the December rebalance date, will be buying Tesla. Active managers that are benchmarking to the S&P 500 will now have to consider if they want to buy this stock now, so there will be some money from active funds into the stock as well. This is a rare event that a company this large (\$400 billion market cap) is added to this Index. (10 years ago, Berkshire Hathaway, which was half the market cap of Tesla, was added.) Tesla is expected to be around a 1% weight in the Index. We think this is a one-time event creating the price bump. Tesla will need to execute on manufacturing electric vehicles and keep profitability up to drive the price going forward. The expectation that over the next 10-20 years, there will be a huge shift to electric vehicles bodes well for Tesla and demand for their products.

Fixed Income's Reaction to Vaccine News

There has been a rotation into higher yield and higher beta areas of the fixed income market as there has been more risk on sentiment since the vaccine news was announced. We still think it is prudent to have some allocation to government bonds such as the BMO Long or Mid Federal Bond ETFs (**tickers: ZFL, ZFM**). Having these defensive positions allows a portfolio to be more efficient over time and provides protection against black swan events. A tactical trade today to react to the vaccine news and the potential for a full, wide-spread economic reopening, would be into high yield, however it could be a choppy road for the next 6 months. Energy and Consumer Cyclical, which make up 35% of The **BMO High Yield US Corporate Index ETF (ticker: ZJK)**, have been hit hard during the pandemic. However, since the Pfizer news broke, CDX spreads have tightened around 85 bps. Another tactical trade could be Emerging Markets Bonds, using the **BMO Emerging Markets Bond Index ETF (ticker: ZEF)**. Emerging Market countries haven't had to use quantitative easing, so their sheets are more stable than developed nations right now. EM economies are less energy focused today than before. ZEF uses a smart beta weighting strategy, using each country's GDP weight, so the ETF is overweight countries which have stronger growth profiles.

The Environment is a New Priority for the New President-Elect

As we got closer to the election, polling was pointing to a Biden win. So, flows started moving towards companies which would benefit from stricter environmental standards which had relaxed during the Trump regime. There is a strong indication that President Biden will re enter the Paris agreement. Environmental considerations will become the new normal as sectors and companies become more willing to adapt to these standards. ESG ETFs, both fixed income and equity, will benefit from this trend. ESG is positioned well to take advantage of this. Fixed income reacted like equity markets. ESG will be a big story over the next 10 years.

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