Views from the Desk

Updates in the Equity and Fixed Income Market

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Investing in Quality Companies Has Paid Off

Quality has been very strong for the last few years, outperforming the broad market as well as all other factors. Quality companies have been benefitting from new economy models. What works with the Quality index approach, is that the portfolio adapts to equity leadership, rebalancing twice a year to always include companies with strong fundamentals such as high return on equity and low levels of debt. When is rebalances it will gravitate to these companies, which most recently have been the big tech and health care names. The **BMO MSCI All Country World High Quality Index ETF (ticker: ZGQ)** really is a superstar in the suite of BMO ETFs. This is a true global strategy with exposure to the quality factor. As a single-ticket equity solution it is very compelling. For pure exposure to the US, the **BMO MSCI USA High Quality Index ETF (ticker: ZUQ)** has been very strong: ZUQ has a 3% annualized excess return over the **BMO S&P 500 Index ETF (ticker: ZSP)** over the last 5 years, which is very meaningful. Even throughout the "September wobbles" ZUQ still outperformed the broad index by 1.3%.

Positioning a Global Portfolio

The U.S. is not out of the woods from a Covid perspective and is facing several headwinds. We are beginning to see investors diversify away from U.S. exposures and add more global holdings to their portfolios. Sticking with the Quality theme, **ZGQ** is a great way to get global exposure, and provides a one-ticket equity exposure to all regions, while using the same quality methodology as **ZUQ**. **ZGQ** is still overweight the US (about 67% total US exposure). It holds the best companies in the world. It has a similar makeup to the U.S. ticker **ZUQ**, as it is overweight to tech, consumer staples and health care. **ZGQ** is also underweight to financials. This resonates with Canadians who have higher financial exposure in domestic equities. **ZGQ** can simplify your portfolio while providing a core equity position. As we look forward to a lot of global uncertainty, you want to be invested in strong quality companies that can weather the storm.

Infrastructure

Infrastructure is still a great place to be. This is a sector which will be utilized by governments to stimulate the economy. Infrastructure has been out of favour this year and has not enjoyed the bounce back that other sectors have seen over the summer. However, when you look at the last 10 years the **BMO Global Infrastructure Index ETF (ticker: ZGI)** has an 11% annualized return. The Democrats and Republicans can both agree on infrastructure: it creates jobs and revitalizes the US. Both sides advocate for infrastructure spending. They cannot agree on how much to spend and where to spend it; so disagreeing on these details may have hurt the sector in the near term. Infrastructure companies work on contracts, so their revenues tend to be more stable than other companies in the S&P 500.

Preferred Shares

RBC issued LRCNs this summer and the other banks are beginning to follow. LRCN's qualify as Tier One capital. When banks issue LRCN Bonds, they take the capital raised and recall existing preferred shares. The outstanding prefs are redeemed at par value ($25). This has put upward pressure on all the bank-issued prefs which were trading around $16 and are now at $25. The coupons on LRCNs act like the prefs (government of Canada 5-year plus reset spread). Because most of the reset market in Canada is bank-issued and is now being widely recalled, the overall universe benefits as capital in the asset class will be reinvested in the existing market. So, all the other sectors are getting more flows as capital is reallocated. The **BMO Preferred Share Index ETF (ticker: ZPR)** is up 56% since the market bottomed in March, which has outpaced both equities and bonds, so this news has definitly been positive for the asset class.

US Health Care Update

The Health Care sector is completely underrepresented in Canada, which makes up about 1% of the index and is predominately marijuana companies. So Canadian investors should especially look to add Health Care exposure to their portfolios. This is a sector where there will be long-term demand. People are living longer and will always require Health Care services. The opportunity to innovate in the sector can lead to strong investor opportunities, most recently the hunt for a Covid vaccine. Politics will have a large impact on the sector in the short-term. The Democrats right now are the favorite. Democratic policy will increase regulation and corporate taxes; both will impact health care. The Pharma sub-sector will be affected by the level of drug pricing. The Bio Tech subsector is compelling but be careful trying to choose one or two companies. This sector is known for its wide dispersion of returns. We think exposure to the entire sector- the ETF approach- is a very good way to play this sector. You benefit from the overall theme and trends fo the sector and are exposed to all the companies. Trying to pick a biotech stock is almost impossible, there are a lot of variables in terms of getting a drug to market**. The BMO Equal Weight US Health Care Index ETF (ticker: ZHU)** has 60 stocks, equally weighted. Pharma is the biggest underweight (market cap is 28%, ZHU is 14%) and if there is one subsector perhaps at the most risk of a Democratic Sweep it would be pharma. The S&P 500 (**ZSP**) is about 14% health care and US Quality (**ZUQ**) has a 19% weight to health care so these are good ways to play the sector as well.