Views from the Desk

Updates in the Equity and Fixed Income Market

Chris McHaney and Alfred Lee, BMO ETF Portfolio Managers

Volatility & ZWG

The VIX futures a month ago were predicting a long period of volatility leading up to, and after, the election. This reflected the concern of a contested election. However, over the last few weeks, polls are strongly suggesting that Biden will win, and there is a strong probability of a "blue wave" (Democrats will control both the senate and the house). This has reduced expected volatility a bit. But there is still a lot of uncertainty about how the economy will rebound as we navigate a second wave of the virus and what economic activity will look like in the coming months. This elevated volatility environment is supportive of covered call strategies which sell options and gain a volatility premium. **The BMO Global High Dividend Covered Call ETF (ticker: ZWG)** has consistently achieved over a 5% annualized yield each month by selling call options in addition to its dividends. We have recently been in sideways trending equity markets throughout October, and this is an ideal scenario for covered call strategies where they are able to capture some growth while adding option premiums as well. Dividend strategies in general have lagged this year, but ZWG has been outperforming comparable dividend strategies YTD.

ZPAY

Elevated volatility works well for the **BMO Premium Yield ETF (ticker: ZPAY)** because it writes puts and calls and, in this environment, we are really getting a pickup in the premiums that we are generating. We are seeing the largest premiums this month since the March-April time period. So, we can generate a high level of cash flow in this strategy. Equity weight is at 30% right now as the summer equity rally brought this weight down as we sell call options on equity positions to generate more premiums and create a sell signal as they rally. The 30% equity worked well in September: The S&P 500 was down -7% from September 2-23 and ZPAY was 0.1%. So, the lower equity weight really protected on these down days. ZPAY's standard deviation is 40% less than the broad market, so it is a less risky way to play the equity market, with a tax efficient income flow.

Real Return Bonds

Inflation has become more topical as of late. There are many economic tail winds right now for inflation (monetary stimulus, fiscal stimulus etc.) so inflation concerns are becoming more mainstream. Real Return Bonds have an inflation component built in, their notional value is tied to CPI. If inflation goes up, the principal of the bonds is adjusted for inflation (coupons remain fixed but are indirectly adjusted for inflation). If inflation goes down, the notional is adjusted down. The **BMO Real Return Bond Index ETF (ticker: ZRR)** holds federal issues; these bonds are more liquid and guaranteed by the federal government. In Canada, real returns bonds tend to be issued with long terms so have longer durations. Therefore, ZRR not only offers inflation protection, but is also an equity market hedge because long bonds do well when equity markets sell off.

Tax Loss Harvesting

Tax loss harvesting is an effective tool that is under utilized by a lot of investors. When we invest in a security, sometimes it takes a while for the investment theme to play out. In the meantime, if you are down on a position that you are still bullish on you can sell the security, crystallize the loss and offset the gain elsewhere (you have up to 3 years to carry forward the loss to offset future gains). Then you can replace this exposure using an ETF to maintain the exposure (because you will not be able to purchase the security back for 30 days, or the loss is nullified). You can use an ETF which tracks a similar sector or theme.

Tax Loss Harvest- Sectors to Look At

The sectors which are down YTD and have yet to recover are Financials (Banks), Energy, Real Estate (REITs) and Preferred Shares. For investors who have specific stocks in these sectors and are sitting on losses, you can sell them and replace with a Banks ETF (**BMO Equal Weight Banks Index ETF, ZEB**), Energy ETF (**BMO Equal Weight Oil & Gas Index ETF, ZEO**) or REIT ETF (**BMO Equal Weight REITS Index ETF, ZRE**). Therefore, you are maintaining a very similar exposure to what you had, while crystallizing a loss. Alternatively, if you own a sector ETF such as XEG (ishares S&P/TSX Capped Energy Index ETF) and are in the red, you can sell it and switch to ZEO. This way you can leave your investment portfolio undisturbed from original exposure while harvesting some tax losses.