

# 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.

Any statement that necessarily depends on future events may be a forward-looking statement. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although such statements are based on assumptions that are believed to be reasonable, there can be no assurance that actual results will not differ materially from expectations. Investors are cautioned not to rely unduly on any forward-looking statements. In connection with any forward-looking statements, investors should carefully consider the areas of risk described in the most recent simplified prospectus.

The viewpoints expressed by the Portfolio Manager represents their assessment of the markets at the time of publication. Those views are subject to change without notice at any time without any kind of notice. The information provided herein does not constitute a solicitation of an offer to buy, or an offer to sell securities nor should the information be relied upon as investment advice. Past performance is no guarantee of future results. The statistics in this update are based on information believed to be reliable but not guaranteed. This communication is intended for informational purposes only.

This article is for information purposes. The information contained herein is not, and should not be construed as, investment, tax or legal advice to any party. Investments should be evaluated relative to the individual's investment objectives and professional advice should be obtained with respect to any circumstance.

The BMO ETFs or securities referred to herein are not sponsored, endorsed or promoted by MSCI Inc. ("MSCI"), and MSCI bears no liability with respect to any such BMO ETFs or securities or any index on which such BMO ETFs or securities are based. The prospectus of the BMO ETFs contains a more detailed description of the limited relationship MSCI has with BMO Asset Management Inc. and any related BMO ETFs.

Commissions, management fees and expenses (if any) all may be associated with investments in exchange traded funds. Please read the ETF Facts or prospectus before investing. Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

For a summary of the risks of an investment in the BMO ETFs, please see the specific risks set out in the prospectus. BMO ETFs and ETF series trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

BMO ETFs are managed by BMO Asset Management Inc., which is an investment fund manager and a portfolio manager, and a separate legal entity from Bank of Montreal.

®/™Registered trade-marks/trade-mark of Bank of Montreal, used under licence.