Views from the Desk

Updates in the Equity and Fixed Income Market

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ETF Flows this Year

ETF Flows in Canada have been $32 billion YTD which is a record for a calendar year, and we still have three months to go. ETF trading this year has been resilient, especially on the equity side, despite the type of year its been. Circuit breakers were hit in March which halted trading for a short while. but equity and ETF trading has been resilient. ETFs trade a lot more during periods of volatility. For example, the **BMO S&P 500 Index ETF (ticker: ZSP)** provides liquid exposure to the S&P 500 Index. Institutions can make block trades on this ETF and intra day trades which provide certainty of price. Institutions can also do a NAV trade in partnership with our market makers. ZSP develops its own liquidity pool because there is such a high number of participants active in this space.

Flows into Government Bonds

Investors are looking to de-risk going into year end. Investors are still facing a lot of unknowns, so they have been taking risk off the table until there is more clarity on what policies we will see south of the border and which direction we will go. In the short term being defensive against potential volatility makes sense, which has investors looking to government bonds for security. There is also some profit-taking happening in the corporate bond space as investors rebalance asset allocations or capture profits on corporate bonds which had a strong summer. If you allocated to corporate bonds in March and April, you would have enjoyed some very nice returns as you entered September. So, flows into the **BMO Government Bond Index ETF (ticker: ZGB)** were driven by rebalancing, reallocating to governments over corporates and being more defensive.

The Canada Trade, Revived?

We have seen heightened flows into Canadian equities this month. Investors seem to be looking for returns outside of the US right now (corona virus woes and election uncertainty have cooled demand). Additionally, investors may already have healthy weights in US equities and want to look elsewhere to diversify. A catalyst for Canadian equities has been the “no austerity” pledge from Prime Minister Trudeau compounded with the Bank of Canada ensuring rates will be lower for longer. Energy prices have also stabilized. So, this backdrop is supportive for Canadian equities.

ZEM and Emerging Markets

Investors are looking to diversify away from the US. Outside of the US, emerging markets have been the best place to be over the past year in terms of returns. EM is the centre of growth: They offer 4-5% GDP vs developed markets ~1%; strong population growth; future tech adaption; infrastructure being built out; the rise of the middle class...these are all major secular trends which support the EM growth story. The rise of China has recently been a major part of the EM story. EM now diversifies a Canadian investor. Today EM is less of a resource play than it was 10 years ago. The composition of the index has changed; it has moved away from resources and materials and is now more overweight in information technology and the consumer sectors. So from a Canadian investor point of view, the diversifying benefits have increased. For equity investors, EM is something you want to have in your portfolio. You can access EM equities using the BMO MSCI Emerging Markets Index ETF (ticker: ZEM) which has a ten-year track record and is the largest EM ETF in Canada, so it is a great way to access this exposure.

Global or Canadian for Fixed Income?

Investors need to think about what they are trying to accomplish with their fixed income allocation and does global fixed income fit this objective. We are in a very low interest rate environment, so fixed income allocation is more of a risk control tool to protect when equity markets sell-off rather than an income tool because there is such little yield out there. Canadian duration component that the **BMO Aggregate Bond Index ETF (ticker: ZAG)** gives you, in an equity market sell off, should protect a bit. Global fixed income does not offer as much protection in an equity market selloff. ZAG's returns are 8% this year, so strong returns from the Canadian market so far.