Views from the Desk

Updates in the Equity and Fixed Income Market

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Valuations in Equity Markets

We have seen some volatility over the past month, with market sentiment being generally positive but fragile. This sentiment can change quickly. What is interesting to note is the disconnection between the S&P 500 Index (a measure of the US market) and the VIX (a measure of market volatility). There is historically an inverse relationship between these two. The S&P 500 is at pre-covid highs, but the VIX is double its pre-covid ranges. This is interesting and an important data point to keep in your back pocket. There is lots of uncertainty in the markets right now. The pandemic backdrop, election volatility, geopolitical strains and valuation highs all lead back to the notion that defensive growth positioning remains a prudent exposure to have with the combination of quality and low volatility factor exposures. We are certainty not out of the woods, and people should not get too aggressive in portfolio positioning right now.

Defensive Strategies: ZPAY

The **BMO Premium Yield ETF (ticker: ZPAY)** is a defensive way to approach equity markets. It is defensive because in a normal market environment, only 35-40% of the overall portfolio is exposed directly to equities. The remainder holds T-bills and writes puts and calls to earn option premiums. Click here to read more about how the strategy is executed. With increased volatility, we reached around 60% exposure to equities through April and May as puts were called. This provided us with an attractive entry point to buy equities at lower valuations and participate in the spring rally. The portfolio today is back to around 35% long equity exposure. In a strong upwards market ZPAY won't match the return but it will protect on the downside and earn premiums to enhance its yield. It can also occupy the alternative space in a portfolio, because of its lower correlation to equity markets.

The Peak Oil Report

It is a challenging backdrop for the Energy sector and the peak oil report illustrates this. The peak oil report released by BP on Monday suggests a word of caution for the Energy sector. The report theorized that we have hit peak oil consumption; the number of barrels that the world consumes per day peaked in 2019. This is attributed to changing societal behaviors, adaption of greener energies and changing government policies combined with the global pandemic which has certainly eroded the demand for energy and oil. If you are questioning why BP would write this report if they are a traditional oil company, it may be that they are transitioning to a greener energy company. This report highlights the increased risk in the Energy sector. How would you play the energy market right now given these concerns? The **BMO Equal Weight Oil & Gas Index ETF (ticker: ZEO)** holds senior Energy companies which we believe is the most prudent play for this sector as we have seen bankruptcies over the past few months in the smaller energy companies. Also, the inclusion of pipelines in ZEO's portfolio is something you want to look for in an Energy ETF, because pipelines offer a different return stream than other sub sectors such as the explorers. The pipeline companies (Enbridge, Trans Canada) increase yield and provide positive fundamental characteristics.

Has ESG Kept Up with the Equity Market Recovery?

We think most advisors should have a thought-out strategy that they can give to their clients as this topic becomes more and more important to investors. Around $1 billion has been invested in ESG ETFs in Canada out of the $31 billion in new ETF assets so far this year. Most of the ESG specific ETFs are new, and so don't have a track record to support performance. A lot of the strategies including our own don't have a huge track record yet, but in the selloff, we noticed some downside protection here. For example, The **BMO MSCI Canada ESG Leaders Index ETF (ticker: ESGA)** had less draw down than the broad Canadian market during the selloff and kept pace during the recovery. As strategies start to build more of a track record, we will continue to see investor interest here as they realize there is not a return penalty to invest in ESG, in fact this might be the other way around. These could be better performing companies in the long run.