Views from the Desk

Updates in the Equity and Fixed Income Market

Chris Heakes & Matt Montemurro, BMO ETF Portfolio Managers

Low Volatility Update

Low volatility provides equity upside while sheltering you through negative markets. The last six months have not been strong for low volatility as the markets were strong. However, since the start of September as volatility picked back up, both the **BMO Canadian Equity Low Volatility ETF (ticker: ZLB)** and the **BMO US Equity Low Volatility ETF (ticker: ZLU)** have outperformed the broad markets. So, we still have conviction in owning some low volatility in portfolios because there is a lot of uncertainty right now which might not be all priced into the market such as the second wave of the virus, where the U.S. in particular is struggling to contain it, and U.S. election volatility. We believe in equities long term and low volatility gives exposure to equities with a measure of defensiveness. For U.S. equities, quality remains our number one pick, with the addition of low vol as "equity insurance".

Is There Still Room in The Gold Trade?

Gold Is traditionally a great asset to hedge negative downside in equities and inflation. The Fed is saying they will keep rates near 0% until 2023. We are seeing a record level of stimulus on both the monetary and fiscal side, and it is going to exceed anything we saw in 2008. There has also been a heavy focus on getting back to 2% inflation and The Fed might have to overshoot on the inflation target to get there. The economic backdrop is prime for gold. In terms of gold equities, they offer a leverage to the gold price. You can see this in returns, where the **BMO Equal Weight Global Gold Index ETF (ticker: ZGD)** is up 40% YTD while the price of gold is up 25%. We recently witnessed Warren Buffet purchase a decent sized stake in Barrick Gold, strengthening the argument here. You don't need a ton of exposure; this is a satellite position. ZGD is 35 names equal weighted, so no one stock is over weight. Gold is consolidating right now around $1900. The consensus is that with this backdrop the price will continue to rise over the next 1-2 years.

Long Federal Bonds

The **BMO Long Federal Bond Index ETF (ticker: ZFL)** is very popular right now among both retail and institutional clients who are looking to this ETF as a portfolio stabilizer among fall volatility. This exposure can help insulate portfolios from volatility. ZFL is a flight to quality trade over a yield generating trade. The government exposure will protect against credit spread volatility and the long duration will provide stability if we see an increase in equity volatility. The Canadian yield curve steepened in August, but we think there will be a flatter curve over the next six months as we navigate the second wave of the virus.

Credit Exposure with BBBs

We have seen growing interest in the **BMO BBB Corporate Bond Index ETF (ticker: ZBBB)** as a search for yield trade. Investors can benefit from the ability to segment the universe with this ETF; they can pinpoint this exposure to add yield while remaining investment grade. ZBBB is a perfect solution for investors looking to add yield but who do not want the risk of high yield bonds. ZBBB is duration moderate (around 4 years) and yields 1.9%. BBB credit spreads have not compressed as much as other segments, they are still 50bps wider than pre-covid levels. There is some down grade risk here, but issuers of BBBs in the Canadian market are more stable than the higher beta names in the US. In 2020, only 2 issuers downgraded (Ford and Air Canada) and the exposure is diversified by issuer and by sector.

The NASDAQ Cools Off

The return this year for the Nasdaq 100 Index has been remarkable, and some investors are seeking to profit by using a leveraged product on this index. This is a very aggressive play and investor activity like this can be negative for the index. Leveraged products are a daily reset, so as the market rises, they buy more of the index and as the market falls, they sell more. This exacerbates the index's price movements and has caused the index to move sharply and is contributing to the sell off that we have seen this month. We have identified that valuations in the Nasdaq are getting stretched. We believe that those investors who want exposure to the Microsoft, Facebook, Apple and other names like this are best to do so in a well-rounded portfolio. So, stick with the US quality trade in the **BMO MSCI US Quality Index ETF (ticker: ZUQ)** where the companies are fundamentally strong. The return experience here has been very positive for ZUQ on the short and long term with less volatility than the NASDAQ, the latter which has become very wobbly as leverage products impact its returns.

ZWG- Global Dividends & ESG

The **BMO Global Covered Call ETF (ticker: ZWG)** is an extension of BMO's high dividend covered call strategies where we already offer several regional exposures. ZWG is a truly global portfolio where the country weights resemble the MSCI World Index and it seeks out the strongest dividend payers in the world. The ETF also uses an ESG overlay within the strategy which identifies companies that are better than their peers on an overall ESG basis. This strategy has outperformed the MSCI World Dividend Index by quite a bit this year, so performance has been good in terms of dividend strategies which overall this year have faced a lot of head winds. ZWG is a great one ticker solution for global equity exposure for the income-oriented investor.