

# Views from the Desk

## Updates in the Equity and Fixed Income Market

**Chris Heakes & Matt Montemurro, BMO ETF Portfolio Managers**

### Correction in Tech Stocks

The sell-off in tech stocks started on September 2<sup>nd</sup> and the tech-heavy NASDAQ 100 Index dropped 11% since this date. The average trailing P/E for the NASDAQ is around 20-25 (NASDAQ has a heightened P/E vs other indexes). Recently, its forward P/E hit almost 35, which indicated it was overbought. The P/E is recently 31, which is still its historical average, which could indicate a correction will continue. The sell-off was concentrated in the FAANGs, and in levered names such as Tesla, Nvidia and Zoom. The S&P 500 Index was down much less during this sell-off, given its more diversified sector exposures, but was still affected. We believe this is a healthy correction, and not a rotation out of tech names, and we believe the companies in the NASDAQ are still some of the very best in the world. The NASDAQ is up 22% this year, so these names are still strong and this does not change our long-term outlook on these stocks.

### Defensive Growth in Equities This Week

The US quality exposure has a 20% overweight to tech. The **BMO MSCI USA High Quality Index ETF (ticker: ZUQ)** was down 6.3% this week vs the S&P 500 Index which was down 5.6%. But the construction of the quality exposure finds businesses with distinct fundamental strengths which can weather a short-term correction. For example, ZUQ does not hold ZOOM or Tesla which are more leveraged. Other sectors in ZUQ are also outperforming the NASDAQ. Our Low Vol exposure **the BMO US Low Volatility ETF (ticker: ZLU)** outperformed the S&P 500 by 3% this week. So, the low vol and quality combo is working well, and we continue to believe defensive growth is a great place to be.

### Flows to Aggregate Fixed Income

We saw strong retail and institutional flows into aggregate bond products such as the **BMO Aggregate Bond Index ETF (ticker: ZAG)**. This was driven mostly by investors who have been sitting on cash for months who couldn't handle any more performance drag. Investors are realizing that they can no longer be sitting on the sidelines, so they are moving out of money market investments and into ZAG. Aggregate bonds are a simple and easy way for investors to stay invested while providing protection heading into the uncertainties that the market faces this fall. Aggregate bonds are a diversified exposure to the Canadian fixed income market, provide downside protection, and generate more yield than cash.

### Flows into Corporate Bonds

Last week, we saw a lot of inflows into the **BMO Corporate Bond Index ETF (ticker: ZCB)**. The flows into corporates are a "search for yield" trade. We are in a period of historically low rates. Credit spreads have returned to near historical levels: Financials are around pre-covid levels (very tight) while Real Estate and Energy spreads are still quite wide. In maturities that are under 7 years duration we have seen significant spread tightening as well, thanks to the BoC bond buying programs. In the Canadian credit market, we will probably see some new issuance this month which we haven't seen all summer. This could widen spreads and increase secondary market trading. We think investors could cash in on their summer profits in the credit space and move into a higher quality asset base, quality bonds which are rated A and above, such as the **BMO High Quality Corporate Bond Index ETF (ticker: ZQB)** if you want to stay invested in credit. For investors who want to get out of credit altogether, the **BMO Mid Provincial Bond Index ETF (ticker: ZMP)** or the **BMO Government Bond Index ETF (ticker: ZGB)** are good solutions as a "flight-to-safety" trade into government bonds. The pure provincial play will provide additional yield over federals and both will provide some added duration exposure while offering less torque than we see in corporates. The government exposure will provide protection if volatility picks back up.

## ZEM and Emerging Markets

It is important to stay balanced in your overall portfolio asset allocation, and investors still need equities to provide portfolio growth. This is where the **BMO MSCI Emerging Markets Index ETF (ticker: ZEM)** really fits in. The US has been the darling of the equity market for many years now and has been strong again this year. But we need to find other sources of return beyond the US. The other broad beta indexes such as those in Canada and EAFE have not been so impressive in terms of performance, both being down 1-2% on the one year. However, ZEM is up 10% over the past year, beating the other regions' broad beta indexes. The returns reflect the changing exposure of Emerging Markets. 20 years ago, these were countries who were in their early stages of development, and had concentrated sector exposures in resources, energy, and materials. The sector makeup of the index is very different now. Today, emerging markets have a very strong consumer base, and return drivers by sector have been Consumer Discretionary and Tech. China has lots of tech exposure. Regionally, China makes up 40% of the EM index and this will likely go higher as A shares become more incorporated. China is a global powerhouse and the strongest driver of returns for emerging markets YTD. Emerging markets are a good diversifying exposure to pair with US equities. The CPP went on the record and said they want a third of their portfolio in EM. A third is not appropriate for retail, but the pension interest is an indicator that investors should certainly be looking to this space to add long term growth to portfolios beyond US equities.

## Flows- Outflows from Financials

We are still constructive on Canadian banks. August was good for Canadian banks. The **BMO Equal Weight Banks Index ETF (ticker: ZEB)** was up 9% in August. In general, Canadian earnings were positive and we saw earnings surprises to the upside and lower provisions for bad loans. When you look at a 2-year recovery path, this is an attractive exposure. The Canadian banks average dividend yield is 5%. Buying at this valuation is an attractive level; the long-term average is 4%. If you are assuming a recovery, the numbers are on your side: you're collecting a strong dividend yield while you are waiting for the sector and the economy to recover.

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.



Exchange Traded Funds