# Views from the Desk

## Updates in the Equity and Fixed Income Market

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### US Midterms

Markets were anticipating a Republican red wave, instead it is being termed as a red ripple. Looks like the House of Representatives will flip from Democratic to a narrow edge for the Republicans. The Senate's most likely outcome is to stay with the Democrats. Not a bad outcome for equity markets. The most negative outcome would have been a Democratic sweep that would have increased corporate taxes and more noise about windfall taxes for the energy sector. It was perhaps disappointing for markets not to see more Republican strength, being more business friendly. They captured some ground, but not as much as expected. Some market participants are already looking to the next election cycle. 2024 will be a balanced race. A divided government is a good place to be for markets, which prefers a bit of gridlock. Overall, since 1950, markets have always been positive in the 12 months following the election, with an average 12% return in equities. Seasonal strength, keeping aggressive taxation policy out of the equation bodes well for equities. The S&P 500 has been down about 15% in CDN dollar terms ZSP – BMO S&P 500 ETF or ZUE S&P 500 ETF Hedged to CAD are great options to buy US equities at a discount.

### Fixed Income

Last week's Fed announcement delivered a hawkish message that rates have to go higher. Key takeaway, whether the terminal rate is 4.5% or 5%, the Fed is going to keep hiking until inflation materially slows down. From a fixed income perspective, this a great opportunity because yields are much higher providing more income to investors. We do expect volatility in the bond market to remain elevated. However, there is great opportunities on both the short and long end. Strong yields can be found on the long end of the curve, with US bond yielding about 4%-4.5%. Investors can get exposure by using ZGB – BMO Government Bond ETF or ZTL – BMO Long Term US Treasury Bond ETF. Where you can get that extra protection while getting paid a healthy yield. On the short end, using ETFs such as ZST – BMO Ultra Short-Term Bond ETF or ZCS – Short Term Corporate Bond ETF, currently yielding about 4.5% - 5.5%, can act as great cash alternatives. Using these shorter duration tools, provides liquidity to also move easily into other exposures, avoiding lock up periods of GICs.

### Canadian Banks

Updates on ZEB – BMO Equal Weight Banks ETF and ZWB – BMO Covered Call Canadian Banks ETF. We are about two weeks out from earning releases. There has been some concern with real estate exposure and loan books. As a reminder we've seen resiliency from the Canadian Banks, who are well capitalized with strong competitive positions. Recession concerns caused by rates potentially overshooting are mitigated by exceptionally strong labour markets, with a strong reading in Canada. Banks are trading at 9x forward earnings, P/Bs are 25% below historical averages. So fundamentals continue to look very strong. Higher volatility will benefit the covered call banks for income investors. As a reminder, long term performance for Canadian banks for the past 50 years, returned avg 13% annually. And each decade, double digit compounded returns. Market stress this year provides a great entry point for Canadian banks.

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**US Q3 Earnings**

In Q3, investors are keeping an eye out for signs of slowdown in revenue growth. Large Tech, including Meta and Google, reported a slowing ad revenue outlook. We've been used to seeing the tech sector leading on the earnings front, so it was disappointing to see weaker numbers. However, McDonalds and Caterpillar reported higher earnings on stronger sales and orders. So in 2022, other sectors are benefitting from inflation where they can pass higher prices onto consumers such as consumer staples. Coca Cola reported strong earnings and revenue forecasts and Visa was up +4.5% on good earnings. Diversified sector exposure can be achieved using ZDY – BMO US Dividend ETF or ZDV – BMO Canadian Dividend ETF for Canadian equities. And for specific sector exposure, investors can look to STPL – BMO Global Consumer Staples Hedged to CAD ETF.

**Energy**

The Energy sector is known for it's booms and busts, 12-18 months of boom, then flat for a few years. There are factors that will extend the boom period this time around. Oil prices have settled into the $80-$90 range. Factors in the US include strategic oil reserves being drawn down substantially, about 40%. Biden says he's a buyer at $70, which creates somewhat of a government fiscal Put. Supply chain is a big concern, with the Russia-Ukraine conflict, redrawing availability and supply agreements. China and Saudi Arabia oil supply are also factors. We are starting to see more capital flow into China, for a perhaps positioning for a recovery in 2023. They are big buyers of oil as well. Tailwinds continue to be present in this sector, with underinvestment in the oil space. ZEO – BMO Equal Weight Oil & Gas ETF is well diversified and currently yielding close to 4%,. While we recommend a Low Volatility and Growth combination for a core portfolio, don't forget energy as well. 5-10% of energy in your portfolio can take advantage of these trends.

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BMO Exchange Traded Funds

Source: Bloomberg, All returns and data points October 2022.
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