Views from the Desk

Updates in the Equity and Fixed Income Market

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Canadian Banks - LRCNs

Our portfolio management team is constructive on Canadian Banks. Investors can take advantage of the entire Canadian Bank capital structure by using ZBI - BMO Canadian Bank Income Index ETF. Limited Recourse Capital Notes (LRCNs) are a great way for Banks to raise capital. LRCNs are hybrid like instruments that exhibit both bond and preferred share characteristics. This new structure is likely to replace traditional retail $25 preferred shares over time. When LRCNs were first approved the expectation was that the banks would redeem the preferred shares that are already in the market and re-issue new LRCNs. There is now an annual limit as to how much the banks can redeem/re-issue. Issuance has picked up in Aug and Sept with over 3 Billion across several banks. LRCNs are designed for institutional use only however, there could be a chance down the line for retail investors to access. BMO has launched ZBI which holds Bank LRCNs. LRCNs offer a larger premium and provides almost a 7% yield in the ETF. ZBI: Over 5% Yield to Maturity1 from Income Securities from Canadian Banks

Low Volatility ETFs

Low Vol factors have performed well this year. ZLB - BMO Low Volatility Canadian Equity ETF has outperformed the TSX by approximately 4% YTD and ZLU - BMO Low Volatility US Equity ETF has outperformed the S&P 500 by 12%. Low vol strategies have a goal of delivering less drawdown while participating in upside. We are constructive on the low vol factor when there is high volatility in the markets. Defensive sectors such as Utilities and REITs are within the portfolio and the portfolio is underweight cyclical sectors such as Energy and Technology. We like using ZLU with growth ETFs such as ZNQ - BMO NASDAQ 100 Equity Index ETF or ZSP - BMO S&P 500 Index ETF. On the Canadian side we like using ZLB with ZCN - BMO S&P/TSX Capped Composite Index ETF. By using a barbell approach, you get the best of both worlds and add defence to growth and vice vera.

Tax Loss Selling

We do expect the worst may be behind us in the Fixed Income market investors may want to start crystalizing those fixed income losses by either using a “like for like” exposure or repositioning their fixed income exposure altogether. ETFs are an excellent tool for the tax loss process. BMO has a wide variety of fixed income ETFs. Our discount bond ETFs provide a tax efficient exposure. ZDB BMO Discount Bond Fund Exchange Traded Fund | ZDB | BMO Bank of Montreal has similar exposure the aggregate bond universe, ZSDB - BMO Short-Term Discount Bond ETF has a similar exposure to the 1–5-year universe and ZCDB - BMO Corporate Discount Bond ETF has a corporate exposure. These ETFs also mimic the broad universe from a risk characteristics perspective such has duration, yield, sector, and subsector, only we select coupons that are attractive from a tax perspective. Investors will benefit from a lower tax burden going forward when switching into our discount bond ETFs.

Technology Outlook

It has been a challenging year for technology companies this year however, we are cautiously optimistic going forward. Once inflation starts to slow down, we’d look to be more overweight in Technology. Gaining exposure through ZWT - BMO Covered Call Technology ETF will provide a good balance of income and growth. ZWT holds mega cap companies such as Google, Apple, Amazon and we write Covered Calls on half the portfolio to generate option premium yield. The additional yield when reinvested into the portfolio can help minimize volatility.

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