Views from the Desk

Updates in the Equity and Fixed Income Market

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Blue Chip Equities

Blue chip equities including the larger US tech names are reporting earnings, and they are coming in ahead of expectations. Microsoft reported a 7.1% increase in top line revenue and Google announced a $70 billion stock buyback program. Visa was the other big name with very upbeat earnings. There is a preference in the market for larger companies with stronger balance sheets. We are likely going to get another 25 bps from the Fed, and it is likely rates will remain high for the remainder of the year. Companies with more durable balance sheets and lower debt loads will be able to withstand higher carrying and refinancing costs. **BMO MSCI USA High Quality Index ETF (Ticker: ZUQ)** up 10% YTD, while the **BMO S&P 500 Index ETF (Ticker: ZSP)** is 7.2%. The way we define quality is high return on equity, low earnings variability, and low financial leverage. So the underlying companies in ZUQ that are carrying less debt are going to have a much easier time navigating this environment where interest rates potentially remain higher. Quality is an easy way for investors to get the best blue-chip companies in the US, which is going to be major theme for this year.

Fixed Income

The added concern of the debt ceiling deadline is currently dominating headlines. Further cracks in the system are being exposed. Default rates within senior loan issuers have increased. There have been four senior loan defaults in April. The variable nature of these loans is very problematic during a period of rising rates. High yield has fared quite a bit better than senior loans thus far YTD. The percentage of the high yield market that is considered distressed is increasing. Leads me to believe that there's some downside in the near term in high yield. For investors who are considering high yield or have long term strategic allocations, the next 12 months could be an opportunity to add to high yield positions and take advantage of locking in attractive yields at 9-11%. **BMO High Yield US Corporate Bond Index ETF (Ticker: ZJK)** is our high yield offering. I do see more value in investment grade versus high yield right now. **BMO Short Term US IG Corporate Bond Hedged to CAD ETF (Ticker: ZSU)** and **BMO Mid Term US IG Corporate Bond Index ETF (Ticker: ZIC)** both provide yields of 5% while getting US investment grade credit quality. I would consider these two ETFs as opportunities to add more quality to the fixed income side of your portfolio.

US Banks

First Republic Bank's deposits quarter over quarter declined 41%, net interest margin was reported at 1.77%, and going forward that's expected to shrink. These were the main concerns that spooked investors and the company withdrew guidance and did not take analyst questions. The share price was down 49% yesterday. The impact to **BMO Equal Weight US Banks Index ETF (Ticker: ZBK)** will be limited. Keep in mind that we no longer hold First Republic in the ETF. As of the last rebalance in March, we sold those shares because it no longer met the market cap requirement. Western Alliance and Comerica were removed as well for the very same reason. From our viewpoint, we believe that the Canadian banks are much better player at this point. **BMO Equal Weight Banks ETF (Ticker: ZEB)** is a good way to get exposure to the Canadian banks. If you have a longer time horizon, ZBK is worth a look. Keep in mind, the sector is likely to be very volatile. Another potential way to play it is through **BMO Covered Call US Banks ETF (Ticker: ZWK)** which allows investors to monetize the volatility, the yield on ZWK is 11.2%.

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US Aggregate Bond Index

The launch of **BMO US Aggregate Bond Index ETF (Ticker: ZUAG)** has been successful as investors flocked to quality and the full market exposure that it provides. In three short months it has amassed over 300 million in assets thus far. The combination of yield, full term exposure and quality at a competitive price point make it a core building block for a lot of portfolios. It is currently yielding 4.5%, with a duration of six years. From a credit perspective, you're getting 75% AAA rated bonds, with a yield premium versus the Canadian market. It is complementary to a core Canadian bond exposure, relative to **BMO Aggregate Bond Index ETF (Ticker: ZAG)**, ZUAG provides diversification benefits with a much deeper universe. ZUAG is an ETF that can help offset some of the volatility from the equity market side of your portfolio, while not having to give up your income needs at the same time.

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