Views from the Desk

Updates in the Equity and Fixed Income Market

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Yield Curve Steepening

The yield curve has been inverted for more than a year now. We saw steepening moves happening in July, followed by the bear steepening in early August. A steepening yield curve is no stranger to most investors, it happens every cycle. The catalysts this time include a surge in Treasury supply, commercial banks are not buying the same level of government bonds, and lastly energy prices increasing sharply, stoking inflation concerns. To protect portfolios from further bear steepening, while long term bond yields do look a bit more attractive now and there could be an entry point somewhere in the future, we believe investors should still avoid overweighting long duration bonds for the time being. We would recommend adding short term investment grade credit, by owning **BMO Short Corporate Bond Index ETF (Ticker: ZCS)** or **BMO Short-Term US IG Corporate Bond Hedged to CAD Index ETF (Ticker: ZSU)**. Taking a more defensive position by overweighting the short end of the curve by buying these two ETFs makes a lot of sense as the economy can begin to show some slowdown in the coming quarters. Both ETFs are 100% invested in investment grade bonds, investors can take advantage of the attractive yield offer by these two ETFs as well.

Banks

Banks have certainly taken it on the chin over the last week, both in Canada in the US. For Canadian banks, a main driver was the higher than expected inflation print. Another concern is the record high Canadian household debt right now. At some point these mortgages will have to be forced to reset. Over the last few quarters, banks have been increasing their loan loss provisions. They are not actual losses, just allowances that they put aside in preparation for potential losses. From a valuation perspective, they are looking very cheap at these levels. Forward P/E Ratio of the big six banks, on average right now 9.5x, compared to the TSX, at about 14x. **BMO Equal Weight Bank Index ETF (Ticker: ZEB)** dividend yield is 5%. **BMO Covered Call Canadian Banks (Ticker: ZWB)** is yielding 7.7%, for investors who are taking a longer term view. The recent headwinds in the US come from downgrade concerns. If the Fed continues to raise rates it will put further pressure on regional banks. Looking at the downgrade list, most are smaller names not included in **BMO Equal Weight US Bank Index ETF (Ticker: ZBK)**. If you are looking 2 to 4 years out, some of the US banks look attractive at this point and may get cheaper. One way to get exposure is through **BMO Covered Call US Banks ETF (Ticker: ZWK)** because we anticipate volatility in the space, and volatility can be monetized through a covered call ETF. It has a net yield of 11.7% right now, so it is an interesting way to play it.

Fixed Income Positioning

The conversation has shifted to how long will central banks hold their policy rates at these elevated levels. Diminishing hopes of a pivot have settled in and bond investors are slowly coming to terms that rates will likely stay elevated for longer. Refinancing will become much more expensive and we may begin to see some cracks in lower credit quality companies. In an elevated rate environment, we continue to favor diversification and investment grade bonds. The BMO **US Aggregate Bond Index ETF (Ticker: ZUAG)** is an excellent option offering both diversification and quality. It provides exposure to more than 10,000 bonds and 88% of the holdings are A rated and above. Another product to mention for investors who seek higher yields with a corporate focus would be the **BMO High Quality Corporate Bond Index ETF (Ticker: ZQB)**, 100% invested in an A rated and above Canadian corporate bonds with term to maturity of 10 years or less. A great product for investors looking to move up the credit curve and remain defensive.

BMO Exchange Traded Funds

August 23, 2023

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NASDAQ

The NASDAQ Composite is up 30% YTD in USD terms and the NASDAQ 100 is up 37% YTD. The market is starting to come to the realization that rates aren't necessarily going to come down right away and may be more resilient. Unless inflation ignites to the upside, we're probably a few quarter point moves from, reaching the Feds terminal value. We're hearing whispers of FOMC members are having disputes over whether they've tightened too much. Current valuation levels are more fairly priced at this at this point. 10 to 15 years out, a main source of economic growth will be from new technology and artificial intelligence. One way to play that is through our **BMO Covered Call Technology ETF (Ticker:ZWT)**. It focuses on the 30 largest US tech companies, cash rich, larger cap names. ZWT has a distribution yield of 4%.We write on about 40 to 50% of the portfolio, out of the money call options. A good way to keep growth and potentially monetize volatility that comes with this space. Getting some yield in a sector that does not typically pay a distribution.

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Source: Bloomberg, All returns and data points July 2023.

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