Views from the Desk

Updates in the Equity and Fixed Income Market

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Bank of Japan

Surprise announcement from the Bank of Japan last week that they would keep their target of 0% for 10 year bonds, but raise their upper limit from 50 bps all the way up to 1%. Effectively doubling of the range of yields that they are willing to accept. The market reaction to that was for yields to move up quickly over 60 bps. The BoJ said they were going to buy bonds at current market prices, an equivalent of about $2 billion worth at around the 60 bps level, not allowing the yields to move up to that 1% ceiling. There are a couple of different implications for investors. Japanese debt will ultimately trend higher in terms of yields, demand may decrease for US treasuries since Japan is a large buyer, and the Yen may strengthen if more investment dollars stay at home. For equity-oriented investors looking for Japan exposure, BMO offers **BMO Japan Index ETF (Ticker: ZJPN)** unhedged, with exposure to the Yen. We also offer a currency hedged version back to the Canadian dollars, **BMO Japan Index ETF - Hedged Units (Ticker: ZJPN.F)**. Investors that are bullish on Japanese equities, may want to just keep the currency noise out of the equation and tilt towards the currency hedge.

China's Economy

Investor aversion to China has intensified this year following a weaker than expected post Covid economic reopening. US tensions over trade, tech and geopolitics has been another factor affecting growth. Manufacturing PMI fell 1.3 points to 49.2 in July, the lowest reading this year. The Chinese government is taking steps to address the economic challenges facing the country and maintaining an easing bias. They plan to increase credit to the private sector, boost support for smaller firms in key supply chains, and increase spending on infrastructure and social welfare. The central bank may be willing to cut interest rates or provide other forms of monetary stimulus if needed. We feel that China should offer a relatively attractive tactical opportunity for long term equity investors, given that it's underpinned by a likely improvement in growth forthcoming. For investors to get exposure toe China, we offer a number of ETFs including the **BMO MSCI China ESG Leaders Index ETF (Tickers: ZCH)**, **BMO MSCI Emerging Markets Index ETF (Ticker: ZEM),** the **BMO MSCI All Country World High Quality index (Ticker: ZGQ)** and lastly, the **BMO Low Volatility Emerging Markets Equity ETF (Ticker: ZLE)**

US Downgrade

Fitch downgraded US government debt from AAA, being the highest rating, moving down one notch to AA+. Part of the announcement with the credit rating change was that the country's finances are likely to deteriorate over the next three years, given there's been tax cuts as well as new spending initiatives, bringing debt to GDP levels to all time highs. We saw a similar scenario play out back in 2011, when S&P Ratings downgraded US debt around similar concerns with US debt ceiling negotiations at that time. Fast forward to today, we are seeing a bit of a risk off tone with sell off in equities and risk oriented assets. Overall we don't see investors changing their view that US debt is a safe haven, rather the possibility that longer term rates drift higher than what we've seen in the past. There are a few ways investors can play that, we offer a few different US Treasury ETFs depending on which part of the curve you want to isolate. **BMO Short-Term US Treasury Bond Index ETF (Ticker: ZTS), BMO Mid-Term US Treasury Bond Index ETF (Ticker: ZTM)**, **BMO Long-Term US Treasury Bond Index ETF (Ticker: ZTL).** Investors can choose where they want to sit on the curve. If you're looking to take on some US corporate exposure and keep it ultra short, we also have **BMO Ultra Short-Term US Bond ETF - USD Units (Ticker: ZSU.U)** in US Dollars.

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Agriculture

The recent heat waves and record temperatures that we've witnessed around the world have wreaked havoc on agricultural output. The extreme weather increases drought risk and threatens global food supply chains. Food production is likely under pressure in the coming years and that may contribute to higher food prices and inflation. Another factor affecting agricultural commodities is political risk. In the last few months Russia weaponized food in the next stage of war. Sending agricultural commodity prices surging. Wheat futures have risen by about 16% in the last month. Investors can potentially hedge against these risks by investing companies that are involved in the production or distribution side of agricultural products, that could benefit from higher food prices. In January we launched the **BMO Global Agriculture ETF (Ticker: ZEAT)**. It invests in global agriculture equities that are involved in or benefit from agricultural production, chemicals, farm machinery, distribution and packaging, and it incorporates a Quality screen. Historically agricultural equities have had a tight linkage to commodity markets, so they've provided diversification benefits due to their low correlations to broad equity and fixed income markets. Alongside diversification it also offers the potential for hedging against food price inflation.

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