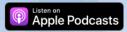
# Views from the Desk

Updates in the Equity and Fixed Income Market







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### **Equity Factor Positioning**

Nice start to the year with the S&P 500 up 6% YTD. It has been bumpier since the release of the job numbers last week, adding 500K plus more jobs. This creates the concern around inflation becoming entrenched with rising wages, hovering around 4-5%. So this has poured some cold water on the rally. Looking at earnings fundamentals from the bulk of Q4 reporting, you are looking at a decline of 4%. S&P is trading at a P/E of 19. The market is pricing in a rate cut in Q4 due to an anticipated economic slowdown. So, we think weighting towards more defensive factors makes sense. Dividend ETFs, Canada and EAFE specifically and high dividend covered calls, have kept up with performance. ZDV – BMO Canadian Dividend ETF is up about +7% YTD. The underlying companies are larger and more mature, paying sustainable dividends, that income stream can help mitigate volatility. Historically, dividends perform well in inflationary environments. Low Volatility is another defensive Factor investors can use if we have a slowdown. ZLB – BMO Low Volatility Canadian Equity ETF for example can be supplemented with energy exposure. You also may want to add some growth, just to hedge any upside risk. If inflation does cool down faster, ZQQ – BMO Nasdaq 100 Equity Hedged to CAD Index ETF, can perform well.

### **Fixed Income Opportunities**

The BMO ETF Outlook Report does an excellent job oft discussing overall fixed income position. Specifically looking at credit, intuitively, if we are expecting a slow down of growth, credit selling off is a legitimate concern. However we continue to be overweight credit. There are a number of reasons to be bullish. We've seen credit spreads widen substantially over the past year, in both Canada and the US. Most pronounced on the short end, and that indicates the market has already priced in a potential slow down in growth and has not swung back. Making further widening unlikely. This creates an excellent opportunity to buy cheap credit across the curve in Canada and across the border. Within US credit, it offers a deeper sector and issuer base, counter cyclical sector diversification relative to Canadian corporates. In Canada I would look at ZCS – BMO Short Corporate Bond ETF and ZQB – BMO High Quality Corporate Bond ETF – exposure to A rated bonds and above. In the US, ZSU – BMO Short Term US IG Corporate Bond Hedged to CAD ETF, to compliment your Canadian exposure. Where credit spreads sit, we remain bullish as we look forward in 2023.

### Energy

We may not see those same significant returns as 2022, but we are still constructive on Energy going into 2023. One near to medium term catalyst is the China re-opening. Their oil consumption is 20% below trend and China is a leading consumer of oil next to US, accounting for 15% of global oil consumption. Supply chains are still disrupted by the Russia Ukraine conflict. Capital underinvestment over the years is a tailwind. Approvals for new projects due to regulations have reduced capacity in the short term. That is bullish for short term price action. Lastly, there are discussions of refilling the US strategic reserves, 200 million barrells of oil. So a market weight in Energy makes sense. ZWEN – BMO Covered Call Energy ETF, is a excellent option targeting a yield in the 8% range, this will be declared in the next week. Underlying holdings have had dividend increases over a 3 year basis in the 15-20% range on average. The portfolio consists of larger cap, North American names with a 4% avg yield on the dividend alone. Avg portfolio P/E is 7.5. ROE – 28. Debt/Equity is half of the TSX. Lot of positives under the hood.



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### **ZBI - BMO Bank Income Index ETF**

ZBI – BMO Bank Income Index ETF was one of our more innovative launches in the recent past. The 1 year mark will hit later this month. ZBI can act as a compliment to your traditional fixed income portfolio. ZBI continues to be the only way for retail investors to access the highly coveted LRCN market, Limited Recourse Capital Notes. Accessing hybrid like fixed income exposure, to enhance yield without adding significant duration or credit risk. This helps solve investor income needs, without reducing credit quality. It consists of all non-equity segments of banks capital structure including – deposit notes, bonds, institutional preferred shares and LCRNs. 60/40 split between bonds and bank hybrids. Maintaining the stability of the Canadian banks, with AA avg credit rating, while adding 1% of yield relative to short corporate bonds. From a performance perspective, it was challenged in 2022, but is performing extremely well YTD. LRCN is a unique segment, and the ETF democratizes another institutional asset class. LCRN may replace bank issued preferred shares, so you can maintain preferred share exposure, if there is a structural change.

#### **Canadian Banks**

Canadian banks spanning 7 decades have delivered double digit compounded returns. That is a 12% compounded return through this period. Past returns are not indicative of future returns, but a fantastic track record. Referencing our ZEB – BMO Equal Weight Canadian Bank ETF, our benchmark ETF to measure performance, is up 11% this year. Forward P/E ratio is 9.5 and the dividend yield on the banks is 4.5%, P/B is 1.5. These metrics have improved vs 10 year averages. On a one-year basis, dividend growth on the banks within ZEB is 15%. Banks have less of an exposure to the housing market than commercial loans, which can be a bigger negative catalyst. Net however, is the commercial loan books appear to be relatively strong, we will get a better read on that. ZWB – BMO Covered Call Canadian Banks ETF is another way of getting that exposure if you are more income focused.







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

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