

# Views from the Desk

## Updates in the Equity and Fixed Income Market



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### BoC Rate Announcement – Fixed Income

The Bank of Canada raised rates by 0.25% today, bringing the overnight rate to 5%. The BoC will probably move to a policy similar to the Fed, which is more data dependent. US CPI also came in at 3%, trending in the right direction. Canada will get a fresh print next week and the BoC will be very focused on that. Every 25bps move will have to be measured, with household debt at record levels, discretionary income will get tighter. Higher rates will cut down on discretionary items, like restaurants and traveling. The fixed income market is the most attractive we've seen it in 10-15 years. Using **BMO Aggregate Bond Index ETF (Ticker: ZAG)** as a proxy for the overall bond universe, the YTM is 4.6%. **BMO Mid-Term US IG Corporate Bond Hedged to CAD Index ETF (Ticker: ZMU)** YTM is 5.5%. Interest rate futures are surprisingly still pricing in rate cuts. Unless we get a recession, we will probably see higher rates for longer. Currently a focus on higher quality and investment grade bonds is a good way to play the market. With more normalized rates, it is a good opportunity to scale back risk. ZAG can be used for low cost, core, broad market exposure. And ZMU for exposure to corporates with stronger balance sheets. And for money markets, **BMO Money Market Fund ETF Series (Ticker: ZMMK)** is yielding 4.9%, can act as a good GIC replacement, without being locked in.

### Rate Announcement - Equity Markets

From an equity investor point of view, most of the longer term rates beyond one year came down, and the cyclical areas of the market rallied today. Sectors that are more interest rate sensitive such as materials, industrials, financial, utilities and real estate. If excess demand persists, that means the consumer is still in good shape, and cyclical sectors tend to benefit from a strong consumer. Looking at cyclical areas with cheaper valuations to put money to work; **BMO Equal Weight Industrials Index ETF (Ticker: ZGN)**, **BMO Equal Weight Oil & Gas Index ETF (Ticker: ZEO)**, and **BMO Equal Weight Banks Index ETF (Ticker: ZEB)**. ZEO and ZEB are yielding 6% and 5%, respectively. If you are concerned of a potential slowdown, you may want to look at **BMO Equal Weight Utilities Index ETF (Ticker: ZUT)** or **BMO Equal Weight REITs Index ETF (Ticker: ZRE)** which are paying 4.7% and 5.7% respectively. Canadian dividends are tax effective, and can make portfolios more defensive in nature if you anticipating the economy to weaken.

### NASDAQ 100 Index

The NASDAQ 100 Index is preparing for a special rebalance that aims to address the over concentration of some of the larger constituents. The NASDAQ 100 has an extraordinary rebalancing rule, which can take place under two conditions. If the largest constituents exceed the weight of 24%, or if all stocks which have an individual weight of more than 4%, exceed 48% in aggregate. When you sum Microsoft, Apple, Google, Nvidia, Amazon and Tesla together, it is greater than 50%, triggering the rebalance. This will be effective on July 24. We offer three ETFs that track the NASDAQ. **BMO NASDAQ 100 Equity Hedged to CAD Index ETF (Ticker: ZQQ)**, **BMO NASDAQ 100 Equity Index ETF (Ticker: ZNQ)**, and **BMO Nasdaq 100 Equity Index ETF (USD Units) (Ticker: ZNQ.U)**. The gains from the big six names are essentially being redistributed and reinvested across the index. So from a diversification standpoint, this is a very good thing for investors.

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## ETF Flows & Trends

2023 has been a renaissance for fixed income ETFs. Almost 60% of all new flows in the industry have gone into fixed income ETFs and about a third have gone into equity ETFs. Within equity flows in terms of geography, investors have been taking money out of the US and redeploying into markets outside of North America. The largest equity inflow went into **BMO MSCI EAFE Index ETF (Ticker: ZEA)**. **BMO Japan Index ETF (Ticker: ZJPN)** was number 3. The largest outflow came out of **BMO S&P 500 Index ETF (Ticker: ZSP)**. On the fixed income side, flows are going mainly into money market or ultra short-term bond ETFs. Then government, particularly longer term. We are seeing this barbell approach used by investors. **BMO Long Federal Bond Index ETF (Ticker: ZFL)** lead all flows. **BMO Long-Term US Treasury Bond Index ETF (Ticker: ZTL)** is popular as well. And on short end, **BMO Money Market Fund ETF Series (Ticker: ZMMK)**. Taking advantage of those short term yields and balancing out with long duration exposure. Never before has there been a better time to be an ETF investor in terms of the granularity and precision that the ETF industry offers Canadian investors as we move through this new regime that we're seeing in the marketplace.



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

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