Views from the Desk

Updates in the Equity and Fixed Income Market

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Bank of Canada Rate Hike

The Bank of Canada surprisingly raised the overnight rate by 25 basis points to 4.75% this morning. They are concerned that inflation is becoming entrenched and stickier. They are willing to act quickly to any sort of adverse inflationary pressures. Stronger than expected GDP growth and a very tight labor market are the main reasons for the move. The market is firmly expecting another hike in July. That would bring the overnight rate to 5%. Thinking about portfolio positioning, I would still favor short credit exposure. **BMO Short Corporate Bond Index ETF (Ticker: ZCS)** or **BMO Ultra Short term Bond ETF (Ticker: ZST)** both provide very attractive yields, above 4.75%. They continue to be well positioned to help reduce some of that interest rate sensitivity.

Covered Calls and Volatility

Equity market volatility has come down a bit in June. Typically, volatility is inversely correlated with equity markets, so as we seen markets go up, volatility has been coming down. But we've been in what we have described as a new regime for volatility post COVID. Previous to COVID the average VIX index was around 15. We've only seen it drop below 15 in the last couple of days, post COVID. The VIX Index acts as a proxy for equity market volatility. When volatility is higher, you can generate more premiums from selling call options with a covered call overlay. So far in 2023, the call premiums from covered call strategies such as **BMO Covered Call Canadian Banks (Ticker: ZWB)** have come down a bit from 2022. Implied volatility hasn't been as high as we've seen in the last year. But it doesn't take much for that to turn around and pick up again. So for income oriented investors seeking protection against increased volatility, having exposure to covered call strategies allows them to monetize that volatility to provide a downside cushion, should it pick up again.

US Treasury Issuance

Investors are bracing for a wave of US Treasury T-Bill issuance, as the US Treasury needs to refill its depleted coffers. To replenish, the expected total amount of T-Bills, which we expect most of this to come in very short term, under one year, will be about 1.5 trillion of issuance from now until the end of the year. The market expects about 400 billion of issuance in June alone. And then 500 billion, so that's 900 billion already from June to September. One concern is that this could be a meaningful drain on liquidity. This could lead to much tighter financial conditions. It could be a very similar tightening impact of an additional rate hike of 25bps. So we expect that there's going to be more volatility ahead. One way to soften that impact is through US money market funds, much like the money market funds in Canada, have seen record inflows. Short term rates are very attractive, so investors have been sitting on the sideline and getting paid for it. I think it means the Fed will likely hold tight next week. We could see some potential liquidity challenges in several markets, especially in the corporate space. That's something to keep an eye out for the rest of the year

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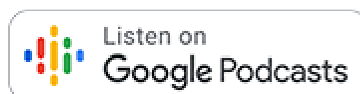
Sell in May & Go Away?

This is a popular saying that refers to the seasonality embedded in the equity markets. There is some element of truth to this, however it doesn't happen every single year, and so it is not a tried-and-true process. We would never recommend investors completely sell out of their equity positions in May, and then re-enter them in November. But for investors that are interested in playing seasonality, a risk on risk off tone, as a rotation type strategy. We do recommend investors look at sector ETFs, to potentially tilt their portfolios without changing their overall asset allocation mix. ETFs that we offer for to play the seasonality theme is **BMO Global Consumer Discretionary Hedged to CAD Index ETF (Ticker: DISC)** and **BMO Global Consumer Staples Hedged to CAD Index ETF (Ticker: STPL)**. You can take advantage of one sector that is more pro growth with consumer discretionary and pairing that with the consumer staples sector, a more defensive exposure. When we're talking about consumer staples, think about global companies like Procter and Gamble, Nestle, and Unilever. On the discretionary side, you can think of companies like Home Depot, Lowes, Amazon, Tesla, Louis Vuttion, Sony, and L'Oreal. You can tilt your portfolio to be more defensive or growth oriented using these ETFs based on your market expectations.



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

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