Views from the Desk

Updates in the Equity and Fixed Income Market

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Chris Heakes and Vishal Bhatia, BMO ETFs

Canadian CPI

Inflation and underlying price pressures fell substantially in line with expectations, which boosted the Bank of Canada's case for keeping interest rates unchanged. Consumer price index rose 5.2% in February versus a year ago. And that's less than the consensus prediction for 5.4% and down from 5.9% in January. That represents the biggest slowdown in headline inflation since April 2020. The Bank of Canada governing officials kept borrowing costs unchanged for the first time in nine meetings. The CPI numbers that came out showed that inflation is in fact, gradually cooling, and reinforced the BoC's decision to pause on its tightening campaign. The Bank thus far has indicated that it expects headline inflation to fall to around 3% by mid year. The overnight swap markets are suggesting rate cuts by 25 basis points at some point this year. This is positive for equities since we're moving to a towards rate normalization.

Bank Volatility

Overall, Credit Suisse being bought out has alleviated market fears and has been a positive development in containing some of the volatility. Credit Suisse is one of the globally systematically important banks. At it's height, it reached a $100 Billion market cap. Interesting developments where we saw significant bond losses, although the equity holders did get some compensation. The Swiss government had to guarantee, a lot of potential losses for UBS. UBS traded down initially about 15%, so the initial reaction was not good, but realizing that there was a lot of strength in client relationships within Credit Suisse, UBS is now up about 10%. In terms of US banks, we're still seeing some fears with the bankruptcy of Silicon Valley Bank and Signature. First Republic looks like it is still on the edge. But they are getting pledges of support and interest from other banks. So, optimistically it looks like this regional bank issue in the US is starting to stem the bleeding. For Central Banks, we're seeing inflation coming down particularly in Canada and that's providing a little more flexibility. If the banking system stabilizes now, rates could remain where they or perhaps drift back up a little higher. With the Fed reporting shortly, we're going to get more information on where they see things.

Infrastructure

A strategy that has been resonating in this environment has been listed infrastructure. In **BMO Global Infrastructure Index ETF (Ticker: ZGI)** the Fund invests in companies operating in the essential services that underpin society, things like water treatment plants, communications, infrastructure, toll roads, and electric power utilities. These benefit from inelastic demand and can act as an inflation hedge. Listed infrastructure assets, such as toll roads, airports, and utilities have contracts that explicitly link their revenue to inflation. Also in volatile times, the diversification benefits have helped infrastructure perform historically very well. In relation to broad markets, it is diversified across multiple geographic regions and industries. Underlying are very long-lived assets, which generate long and stable cash flow stream streams. That's why, a lot of investors have been looking at infrastructure for strong downside protection as well as for attractive up market participation, good for all seasons.

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Canadian Banks

Banks are globally linked; however Canadian banks still have that reputation for stability. Going back to 2008, they have proven they are well capitalized and well regulated. With a diverse business mix across sectors, solid dispositor base, and an average of 13.7% of tier one capital we continue to have confidence in them to navigate volatility. They've held up well, while we've seen US banks down 20 to 30%. **BMO Equal Weight Canadian Banks ETF (Ticker: ZEB)**, is yielding an attractive 5%. And **BMO Covered Called Canadian Bank ETF (Ticker: ZWB)**, yielding 8.1%. Historically, when the banks yield 5% on average, it is often a good time to buy for longer term investors. The Banks are trading at 9x forward earnings, about a 20% discount to historical, that gives them a buffer to weather a storm. **BMO Canadian Dividend ETF (Ticker:ZDV)** and **BMO Canadian High Dividend Covered Call ETF (Ticker:ZWC)** are examples of some bank heavier portfolios with more diversification across sectors. In this uncertain environment it can be a good time, for long term investors to continue add and hold the Canadian banks based on the track record delivering performance over long time periods.

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