Views from the Desk

Updates in the Equity and Fixed Income Market

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2023 Federal Budget

Macroeconomic considerations from the new federal budget include the $43 billion of new spending over the next six years. We are expecting slower economic growth right now, so this bit of stimulus could help reduce that slowdown. However, on the other hand, this could impact inflation and have implications for interest rates and investors more broadly. More targeted initiatives that investors might be interested in is the support for the transition to a clean energy economy. The Government is looking to provide about $20 billion of incentives to help businesses accelerate the transition to clean energy. So, this leads naturally to looking at **BMO Clean Energy Index ETF (Ticker:ZCLN)** for investors who want to take advantage of this multi-decade, mega trend. We see this commitment from Governments, both north and south of the border. Certainly, there could be some payoff over the shorter term, but we've seen volatility in the sector as well. So, it is for investors who can weather the volatility and hold over the long term.

Fixed Income

Additional Tier one bonds or AT1 bonds for short, were introduced in the wake of 2008 specific to banks, and were junior to traditional bonds. The difference between AT1 bonds and traditional senior issue debt is the convert ability feature. Their purpose was to give banks a better chance of remaining solvent should issues arise. A trigger event allows the issuing bank to remove the debt from its balance sheet by converting that debt into common equity. So, from a coupon perspective, because you're lower down the capital structure, you're going to get a higher yield than senior debt to compensate you for taking on that additional risk. This became a concern in the case of Credit Suisse over the last couple of weeks. I think was missed in a lot of headlines about AT1 bonds though, is that the issuer of the instrument is very important. If you have a strong issuing bank behind that AT1 bond, then that instrument is going to be very sound. We do hold some AT1 bonds in our **Canadian Bank Income Index (Ticker:ZBI)**. And it was trading roughly flat, during the time Credit Suisse had issues. Main point here is that Canadian banks were still very well capitalized. ZBI essentially owns traditional bonds, but also has some AT1 holdings, both in the preferred shares and bond space. The yield to maturity, with bonds lower down the capital structure, is 5.8%. So this is a good one own in your bond portfolio, with a short 2.5 duration.

US Banks

We've seen both bullish and bearish option trades exploding in volume in the US regional bank sector. It appears there is no real consensus from the market on the path forward. The indices that BMO tracks which hold US banks have recently rebalanced. And obviously Signature Bank and Silicon Valley Bank were removed from the index, three other of the smaller regional banks were removed as well. Both **BMO Equal Weight US Banks Hedged to CAD Index ETF (Ticker:ZUB)** and **BMO Equal Weight US Banks Index ETF (Ticker:ZBK)**, now have more exposure to larger regionals as well as diversified national banks. Another flavor in this area is the **BMO Covered Call US banks ETF (Ticker:ZWK)** for an extra layer of income, that gives you some upside exposure with limited downside. The strength of the Canadian banks overall within the global financial system has been notable.

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And in fact, our **BMO Equal Weight Canadian Bank Index ETF (Ticker:ZEB)** has seen over $800 million of net inflows since March 8th, since the crisis started. Our **BMO Canadian Covered Call Bank ETF (Ticker:ZWB)** is another great option for income oriented investors.

US Monetary Policy

Rate hikes are becoming less of what dictates the market. Every incremental move from this point is going to have less of an effect. What went largely unnoticed, was the Bank Term Funding Program, that was announced a couple of weeks ago. It essentially allows banks to swap their held to maturity portfolios in exchange for their par value. The Bank Term Funding Program essentially erased more than half of the effect of quantitative tightening. Since the Fed has expanded their balance sheet, I think now maybe good time to add some duration risk to your portfolio. Looking at ETFs, **BMO Long-Term US Treasury Bond Index ETF (Ticker:ZTL)** and **BMO Long Federal Bond ETF (Ticker: ZFL)** can provide that exposure. **BMO Covered Call Technology ETF (Ticker: ZWT)**, is a good one to get some duration exposure into your stock portfolio, but we're also writing call options against these positions in order to generate yield and monetize volatility. For Factor exposure, Quality is a good way to maintain a defensive growth oriented position. **BMO MSCI High Quality USA ETF (Ticker: ZUQ)** is a good way to play it.

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

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