Views from the Desk

Updates in the Equity and Fixed Income Market

Listen on Apple Podcasts Spotify Listen on Google Podcasts

Alfred Lee & Winnie Jiang, BMO ETFs

High Yield

We are seeing a fair degree of downgrades in the high yield market right now. In a low interest rate environment, investors had to stretch for yield and issuers could borrow at tighter credit spreads and access capital at lower rates. With rates normalizing high yield issuers have more difficulty in this environment, accessing capital and rolling over their debt. So investment grade is outcompeting high yield, since it is offering decent rates with better credit quality. **BMO Mid-Term US IG Corporate Bond Index ETF (Ticker: ZIC)** for example is yielding 5.4% right now. The big question is are spreads in the high yield market reflective enough of current risks. If interest rates level off, the secondary effect would be that credit spreads potentially tighten as refinancing for high yield issuers could potentially level off as well. So, on a go forward basis, investment grade corporate bonds from a risk adjusted perspective are more attractive. But for a strategic allocation, high yield definitely makes sense for a long-term investor, because a 450 basis point credit spread may not be sustainable over the long term. And an ETF can be the best way to play it to diversify issuer specific risk, and we offer **BMO High Yield US Corporate Bond Index ETF (Ticker: ZJK)** or **BMO High Yield US Corporate Bond Hedged to CAD Index ETF (Ticker: ZHY)**. We also have **BMO Floating Rate High Yield ETF (Ticker: ZFH)**, composed of T-Bills and high yield CDS, which provides exposure with liquidity.

Monetary Policy

The Bank of Canada left the overnight rate unchanged at 4.5%, which was broadly expected by the market. The Bank continues to pledge to hold the policy rate at its current level as long as the economy continues to cool. Policymakers are still a bit concerned about the tightness of the labour market and wage growth. It could take around 12 to 18 months for the impact of earlier rate hikes to be fully felt. The banks still expect inflation to fall to around 3% by the middle of the year, given the softness we've seen in consumer spending and slower GDP growth. While the BoC has a more dovish tilt to their comments, the Fed has shown more openness to a higher terminal rate. The market is pricing in a 70% chance of a 50 basis point hike in the upcoming FOMC meeting, with stubborn inflation and US jobs data, suggests a longer and bumpier path to normalization. It makes sense to expect the Fed to take a pause at some point in 2023, while they continue to monitor macro trends as US disinflationary forces work their way through the economy.

Canadian REITs

Slight outperformance from REIT sector year to date. **BMO Equal Weight REITs Index ETF (Ticker: ZRE**) was up 7.1%, while **BMO S&P/TSX Capped Composite Index ETF (Ticker:ZCN)** was about 5.5%. REITs have bounced back due to the market correctly anticipating a BoC rate pause this year. With the rate stability at the moment, the market can get comfortable with the cost of doing business. So that's good for property prices, both on the commercial and residential front. The main drivers of the REIT sector has been the residential and office sub sectors, as more people are returning to the office. The sub industry is up 12% on a total return basis this year. Average Price/FFO for ZRE was trading at about 16.4 prior to covid, which is now trading at 12.9, so even with the rally it is still trading at attractive valuation levels. Canadian REITs are something to keep on the radar at this point.

Views from the Desk

Fixed Income

There are mixed signals coming out of recent economic data. On one hand you have low unemployment rates and on the other an inverted yield curve, that typically precedes recessions. We continue to believe a soft landing if possible, and the Fed will do whatever it takes to combat inflation. With a potential economic slowdown, there a sense for investors to be more defensive in their portfolios. And with the shape of the yield curve, you don't have to take on the highest risk to get a decent yield. We currently recommend investors adding short term investment grade bond ETFs, by owning **BMO Short Corporate Bond Index ETF (Ticker: ZCS)**, whose term to maturity is one to five years. It's a great opportunity to take advantage of the higher yields on the short end of the curve. Additionally, **BMO High Quality Corporate Bond Index ETF (Ticker: ZQB)** is another great alternative for investors who want to be more conservative, move up the credit curve and still find a decent yield. Both tickers mentioned offer a yield of more than 5%. We believe it will lead to nice returns in the short and medium terms as we move forward in 2023.

BMO ETF Tax Resources

Under the **Strategy and Insights** section on our ETF Dashboard we have a great tax section. We highlight everything from our annual tax breakdowns to FAQ articles on phantom distributions. We have recently posted tax breakdowns for each respective ETF on the website. So if you are looking for any tax information, we encourage you to the **BMO ETF Dashboard**.

Listen on Apple Podcasts | Listen on Google Podcasts | Spotify

Updates in the Equity and Fixed Income Market

To listen to BMO ETF podcasts please visit bmoetfs.ca.

BMO Exchange Traded Funds

Views from the Desk

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