Views from the Desk

Updates in the Equity and Fixed Income Market

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Canadian CPI

Canadian CPI year over year came in at 4.4% in April, exceeding the expectation of 4.1%. Core CPI was a bit more in line with expectations at 4.2%. What was driving these numbers was fairly broad based. A reminder to the market that we are still fighting inflation and that this process is not going to happen in a straight line. The market is now pricing in one interest rate hike by September. Keep in mind when allocating fixed income, and not just in Canada, that the expectations for quick cuts coming out of central banks, may start to erode over time. So what does that mean for portfolio positioning, we've talked about in the past using a barbell approach, and that continues to make sense. So you want exposure to the short end to get that yield, but also adding longer duration assets for risk control and mitigation against the equity side of your portfolio. Staying invested in long Federals with **BMO Long Federal Bond Index ETF (Ticker: ZFL)** or **BMO Long-Term US Treasury Bond Index ETF (Ticker:ZTL)** gives you that long duration exposure. While maintaining a shorter duration with **BMO Ultra Short-Term Bond ETF (Ticker: ZST)** can help you achieve a barbell fixed income strategy.

Low Volatility

The low volatility factor has lagged YTD. But stepping back, recall in 2022 that **BMO Canadian Low Volatility Equity ETF (Ticker: ZLB)** outperformed the broad market by 5.5% approximately, and **BMO Low Volatility US Equity ETF (Ticker: ZLU)** outperformed the broad market significantly by approximately 20%. So yes, we have seen a lag to start off 2023, mainly because of the strong performance of technology stocks. The concept behind low volatility, is a equity strategy that tries to invest in stocks, with everything else being equal, that are less risky or lower beta. For example, in Canada it would invest in Loblaws, or Dollarama instead of Shopify. The number one goal of these strategies is achieve less draw downs, which puts investors in a better position to have good returns going forward. Given that we will continue to see bouts of volatility in the equity market, we are still constructive on low volatility equities. A barbell approach with equities, exposure to both defensive and growth equities, can potentially add value for investors while still managing risk. You can use **BMO NASDAQ 100 Equity Hedged to CAD Index ETF (Ticker: ZQQ)** or **BMO ARK Innovation Fund ETF Series (Ticker: ARKK)** to gain exposure to the growth factor.

US Debt Ceiling

This is a tricky one, because of course it is hard to model any political decisions that are being made in terms of just posturing. Janet Yellen has indicated that the US government could run out of money by June 1 if the debt ceiling is not raised, and will not be able to issue new T-Bills. So this puts a date in terms of when negotiations have to be completed by. We've had negative feedback from both parties on how the negotiations have been going, but both sides have also said that a default is out of the question. Markets are concerned with, not just the US market, but global markets. US T Bills act as a global risk-free asset that every investment is priced off of. And so, if the US did default, the global economy is no longer risk free. That could obviously create a lot of chaos in global markets. The main thing is that the likelihood of a default is low, and that this shouldn't really affect long term financial planning. But in the short term, since T-bills could become no longer risk free, this may be part of the reason why we've seen the uptick in gold. So there's not a non zero probability being priced into the market. I would say maintain your asset allocation and your overall portfolio, and stay disciplined for the long run.

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US Earning Reports

From an earnings perspective, while things are slowing down, it is not as drastic as many had predicted. The market was pricing in about a 7%-8% earnings decline, but it turned out to only be 3%. Part of the reason why we saw a strong rally in these companies, post earnings. What's also interesting is that revenue is still growing, mainly because of inflation. If we look at the tech giants corporate outlooks, like Microsoft or Meta, they delivered better than expected earnings and are projecting higher revenue and EPS growth. There can also be unexpected events for the remainder of 2023, with the debt ceiling negotiations or more credit tightening that could cause a deeper market downturn. So having a diversified exposure is important in this environment. Having exposure to US blue chip companies, with a dividend focus provided through **BMO US Dividend ETF (Ticker: ZDY)** can help with not just diversification, but also lower volatility. So if some of these negative headwinds are realized in the market, you are defensively positioned within equities.

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