Views from the Desk

Updates in the Equity and Fixed Income Market

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Earnings Season

Majority of S&P 500 companies have reported third quarter earnings and despite recession fears, we have seen earnings growth. Estimated to be around 5% at the top level. If we look at certain sectors such as health care, energy and materials, they're actually lagging, so that number could be closer to 10%. It's understandable for health care's earnings to be down versus last year where the demand for drugs and vaccinations were strong. Looking at the tech sector and the Magnificent 7, they delivered very strong earnings again. From a market perspective we are cautiously optimistic. The role of the Fed and upcoming data is very important in shaping the direction of the market. So in this environment we would look to something like **BMO US Dividend ETF (Ticker: ZDY)** or **BMO US High Dividend Covered Call ETF (Ticker: ZWH)** which provides very diversified exposure from a company and a sector perspective as well. You are holding blue chip dividend paying companies within growth sectors, like Apple or Microsoft. Finally ZWH provides clients with an additional income source through call writing, a great tool for income oriented investors who want to boost their monthly cash flows.

Low Volatility

Low volatility has lagged the broad market this year, stepping back let's define low volatility. It is a new concept that tries to invest in less risky stocks. A grocery instead of a junior mining company for example, to accomplish less draw downs, putting the investor in a better position to have good returns going forward. Winning by not losing. These strategies tend to be more overweight interest rate sensitive sectors, because they tend to be more defensive versus the broad market. So as central banks hiked interest rates, the valuations of these sectors were pressured. As well this year the tech driven growth rally prompted a shift from more traditionally stable and defensive stocks. Looking forward we are still constructive on low volatility equities. Given the likelihood of more bouts of volatility potentially coming from geopolitical tensions in Europe and the Middle East. We might also be near the end of rate hiking cycles, which can be a tailwind for the strategy. Low volatility can be an great complement to growth exposure using a barbell approach. For example combining **BMO US Low Volatility ETF (Ticker: ZLU)** with **BMO NASDAQ 100 Equity Index ETF (Ticker: ZNQ)**, it has provided better risk adjusted returns versus the broad market. In Canada, combining **BMO Low Volatility Canadian Equity ETF (Ticker: ZLB)** with **BMO S&P/TSX Capped Composite Index ETF (Ticker: ZCN)** can potentially add value while managing risk.

Canadian CPI

The Canadian CPI came in at 3.1%, largely in line with expectations. Good news is that we are trending in the right direction. Looking deeper into the economic numbers in Canada, it suggests that the economy is cooling. GDP came in at 0. %. Interest rate futures are showing some pretty aggressive rate cuts for both the Fed and Bank of Canada, pricing in at least three quarter point moves by both central banks in 0 4. Which maybe getting ahead of itself. From a central bank perspective they would rather over-tighten than under-tighten to eliminate the risk of inflation coming back. We're probably going to see rates higher for longer. So looking further out I would want to focus on defensive growth factors including dividends and quality. Quality is high return on equity, stable earnings growth and low financial leverage.. So those low debt loads gives investors exposure to higher quality balance sheets.

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We have a number of Quality ETFs, such as **BMO MSCI All Country World High Quality Index ETF (Ticker: ZGQ)**, **BMO MSCI Europe High Quality Hedged to CAD Index ETF (Ticker: ZEQ)** and BMO **MSCI USA High Quality Index ETF (Ticker: ZUQ).** Personally, I like the US Quality, a diversified way to get exposure to strong tech names that have been performing well this year.

Oil Prices

Israel and Hamas have agreed to a four-day truce. First and foremost the ceasefire is good from a humanitarian standpoint. But from a markets perspective, it's positive on a geopolitical level. It is likely to cause additional downward pressure in oil prices. Brent crude prices since September's peak has been down and it was recently announced that the OPEC plus meeting was postponed until November 30. The likelihood is that we'll see some volatility in oil prices, but over the long term 5-10 years, we are bullish on oil. With the clean energy transition, until we get there, there will be a lot demand for fossil fuels. In the short term, lower oil prices creates deflationary pressure, putting less need for central banks to hike rates. We have a couple ways for investors to play energy. First, **BMO Equal Weight Oil & Gas Index ETF (Ticker: ZEO)** has a dividend yield of about 4.8%. Another way is through **BMO Covered Call Energy ETF (Ticker: ZWEN)** yielding about 8.7%. It combines Canadian and US energy companies. With the potential for volatility and disruption in the Middle East, this could put potential additional demand on North American energy, leaving these companies in a better spot.

US Dollar ETFs

US Dollar ETFs or .U ETFs are US dollar denominated, not hedged products. They trade in US Dollars. So you would use your USD to purchase a .U ETF and any income or dividends that you receive is paid out in USD. If you were to sell the ETF, all of the proceeds would be in USD as well. Generally, a lot of Canadians hold US cash they might need in the future, so one of the biggest benefits is allowing Canadians to invest without having to covert currencies. Conversion fees can be expensive. A lot of Canadian like to travel to the US during the winter, have children attending US schools or just traveling for leisure, so having the ability to match your US expenses with US cash flows makes it easier to manage. As well, even though the ETF holds US dollars, it actually considered a Canadian asset, because it trades in Canada. So you don't have to fill out a T1135 tax form which can be a hassle. For solutions that we offer, please visit our **BMO ETF Dashboard** under USD currency, for the full line up of BMO US dollar ETFs.

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