Views from the Desk

Updates in the Equity and Fixed Income Market

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Fixed Income Positioning

The big story in the market right now has been the ugly steepening of the yield curve. Both the US and Canadian 10 Year yields jumped about 100 basis points since July. Investors are now banking on the higher for longer theme to stick around, with another potential rate hike at the end of the year. With current US Treasury yields sitting at 4.7%-4.8%, this may not be unreasonable. If inflation continues to be sticky, it could make sense for the Fed to aim for a higher inflation target. This doesn't mean investors should avoid duration completely. Adding duration might make sense at some point down the road. While it is tough to pick the bottom in the long end, it's worth keeping in mind that diversification is king during periods of high uncertainty. The same goes for quality, its very important to have high quality while diversifying your fixed income portfolio. **BMO US Aggregate Bond Index ETF (Ticker: ZUAG)** is an excellent choice providing exposure to more than 10,000 bonds with an average credit rating of A and above. ZUAG as core bond holding complemented with our segmented fixed income ETFs, an investor can adjust their exposure efficiently and seamlessly while markets may remain volatile in the near term.

U.S Equities

Broad indices are up year to date with the S&P 500 and the Nasdaq up about 12% and 35%, respectively. But if you look closer the breadth of the market is actually very shallow. There is the need to be prudent, even though the economy seems resilient, there is still uncertainty and vulnerability in the market. Inflation has been cooling, the labor market is resilient, manufacturing is re-surging, and consumer spending remains strong. But with higher rates for longer, we could see potential headwinds building up as individuals and business start to renew their debt. So in terms of portfolio positioning we recommend staying defensive with an allocation to low volatility or quality factors. Investing in companies that can weather tightening conditions with strong balance sheets. **BMO Low Volatility Canadian Equity (Ticker: ZLB)** or **BMO Low Volatility US equity ETF (Ticker: ZLU)** can help you stay invested and not time the market. To also help investors manage downside risk, we recently launched **BMO US Equity Buffer Hedged to CAD ETF (Ticker: ZOCT)**, which seeks to provide investors some peace of mind by eliminating the first 15% of losses, and participate in potential upside up to cap of 10.5%. So if the market is down 15%, it is only after a breach of the buffer that you can start to incur losses. This buffer structure will be an important tool given rates may be higher for longer and slower growth is a likely scenario in the foreseeable future.

U.S Dollar Cash Management

We recently launched **BMO USD Cash Management ETF (Ticker: ZUCM)** to complement our **BMO Money Market Fund ETF Series (Ticker: ZMMK)** which invests in Canadian money market instruments such as Canadian T bills, bankers acceptance and commercial paper. With ZUCM, on the other hand, its 100% invested in US Treasury Bills. The goal of the ETF is to help preserve capital, ensuring high levels of liquidity while generating regular monthly income. Currently, the average yield is 5.5% with an average duration of less than 6 months. In comparison to a GIC where investors may lock in a lower return if interest rates rise, another benefit is its floating rate mechanism. Yields are typically in lockstep with central bank policy rates. The same goes for **BMO Ultra Short-Term Bond ETF (Ticker: ZST)** and **BMO Ultra Short-Term US Bond ETF (Ticker: ZUS.V)**. These ETFs invest in high quality investment grade corporate bonds with maturities less than one year.

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Sector Strategy

Interest rate sensitive sectors such as Utilities, Real Estate and Financials valuations have come down significantly. They have been trading at multi-year lows since rates are forecasted to stay higher for longer. For investors looking to stay invested in these sectors for the long term, we've launched a new Structured Outcome ETF with a built in Accelerator. **BMO Canadian Bank Accelerator ETF (Ticker: ZEBA)** provides exposure to the Canadian banking sector with the potential to double your returns up to cap. We use our option expertise to manufacture that enhanced performance. Given the sluggish growth outlook, this allows investors to enhance their returns while they wait for a potential full recovery. ZEBA has an expiry of three months, so until December there is cap set at 6.6%. You can learn more about incorporating these Structured Outcome ETFs in your portfolios by visiting our **BMO ETF Dashboard**.

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

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