Views from the Desk

Updates in the Equity and Fixed Income Market

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Inflation

The August US CPI print came in at 3.7%, slightly hotter than expectations. The continued expectation is that the Fed will follow the Bank of Canada's lead in holding their position, moving into the fall. Setting overnight rates in Canada in the US at 5% and 5.5% respectively. We've seen inflation breakevens come down meaningfully YTD. Every time we think we've made meaningful progress, inflation proves to be sticky and there is still work to be done, cementing the higher for longer narrative. **BMO Short-Term US TIPS Index ETF (Ticker:ZTIP)** and **BMO US TIPS Index ETF (Ticker: TIPS)** both have outperformed their nominal bond counterparts of the same term YTD. We continue to see realized inflation higher than what the market expects. We're likely nearing the end for the need for TIPS because we are starting to see a meaningful decrease in price concerns. However with 1 year US breakevens at 1.71%, and inflation proving to be sticky, it would be surprising to see inflation dip below that. So there is still value in TIPS within a portfolio. Short term positioning may be more prudent right now. But If I was looking for US government exposure with more duration, **BMO Mid-Term US Treasury Bond Index ETF (Ticker: ZTM)** or **BMO US Aggregate Bond Index ETF (Ticker: ZUAG)** both provide more full term exposure. With nominal bonds you don't have to pay for that inflation protection, which may not be necessary further out in the curve.

Seasonality

If we look back at a 20 year window, September on average has been the worst performing month. I would caution investors that nothing is absolute, and nothing works 100% of the time. Specifically in 2023, January in June, historically two of the weakest months in the equity market, the S&P 500 was up over 6% in each of those months. So the message to investors is to stay invested over time and stay true to your asset allocation mix. For S&P 500 exposure, **BMO S&P 500 Hedged to CAD Index ETF (Ticker: ZUE)** can be used to remove the currency effects. Holding ZUE you would be up around the mid to high teens in terms of YTD performance. As we move in towards year end, you may want to allocate a portion to more defensive sectors or factors such as low volatility with **BMO Low Volatility US Equity ETF (Ticker: ZLU)**, giving you a more defensive tilt. As mentioned there is an element of stickiness to inflation, so it can make sense to take a bit of the performance that we've benefited from this year and lock that in, and move it into a slightly more defensive tilt.

High Yield

In spite of higher rates, High Yield has actually continued to perform very well. It has outperformed both Investment Grade and Emerging Market Debt YTD. **BMO US High Yield Bond Index ETF (Ticker: ZJK)** benefitted from spread tightening that we've seen throughout the year. High yield issuers that locked in historically low rates in 2020 do have some refinancing risk on the horizon. If we do see default rates increase even just few percentage points, it can cause spreads to widen. So High Yield is concerning in the near term. Even in a soft landing scenario, I see risk in the bottom distressed issuers. But in the longer term high yield does continue to be a strong diversifier in a portfolio. It provides attractive yields and correlation benefits to complement other fixed income holdings. If I were to add high yield, I would look to **BMO Floating Rate High Yield ETF (Ticker: ZFH)** to get exposure with little to no duration exposure.

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If I'm looking tactically when to put this exposure on, my preference is still higher quality credit. I would stay on the short end with **BMO Ultra Short-Term US Bond ETF (US Dollar Accumulating Units) (Ticker: ZUS.V)** or **BMO Short-Term US IG Corporate Bond Hedged to CAD Index ETF** (**Ticker: ZSU).** Both provide close to 6% yields with less than three years of duration risk. So if you are not as yield hungry and looking to improve quality in the portfolio, ZUS.V and ZSU are great options.

Utilities

Utilities is generally a defensive sector and has been the worst performing sector YTD, largely due to higher rates. If you believe we are nearing the end of this rate cycle and expect some stability in longer term rates, utilities can act as a portfolio diversifier. We have seen some renewable names down significantly which has not helped the utility sector in general. Both **BMO Equal Weight Utilities Index ETF (Ticker: ZUT)** and **BMO Covered Call Utilities ETF (Ticker: ZWU)**, have a small element of renewable exposure in each. Mentioned previously, investors who have been fully invested all year can potentially take some risk off by adding defensive sectors, such as utilities. ZUT is a more pure Canadian play. ZWU has more broader exposure, with 1/3 invested in US equities. Better fit for more income focused investors with it’s covered call overlay, distributing about 7-8%. ZUT offers a decent dividend yield as well, without the covered call enhancement to provide pure Canadian exposure.

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