Views from the Desk

Updates in the Equity and Fixed Income Market

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US Government Shutdown

While the US is working hard to find a compromise, it does look like the US government will likely shutdown on October 1. The two main sticking points are border security and funding for the war in Ukraine. It is possible they come to a short term solution and kick the can down the road, but is does seem unlikely. Government shutdowns have been reasonably short, averaging 8 days, and have less of an economic impact than the debt ceiling standoff. But government workers would be impacted, not being able to make ends meet, which might have some impact on spending and growth. We could see short term treasuries rally with a risk off sentiment. If you wanted to play this, you could look to **Short-Term US Treasury Bond Index ETF (Ticker: ZTS)** or **BMO Mid-Term US Treasury Bond Index ETF (Ticker: ZTM)**. This could also offset some of the rising yield pressure we've seen in the market. Another potential impact of a shutdown could be a delay in crucial economic reporting like CPI. With the market hanging on to every print, this could bring more volatility. That would be the other thing to consider.

India

We have seen foreign inflows into Indian equities, which have reached all time highs YTD. There is renewed interest and growing optimism for the Indian market, driven by a few factors. India's GDP expanded 7.8% on an annual basis in the June quarter. India has committed to enhancing it's infrastructure to support it's rapidly growing economy that attracts multinational corporations. Countries strategic moves to diversify away from China has benefited the investment flows going into India. China's slower than anticipated economic recovery added more momentum to the growth story of India. India's Purchasing managers index (PMI) was at 58.6 as of August, much higher than some developed economies, suggesting a more resilient economy with strong manufacturing and service sectors. India's resilience is underpinned by a robust domestic market and growing middle class. Finally India's banking sector is strong being well capitalized with strong adequacy ratios. So for investors looking for long term growth prospects and can accept the shorter-term risks in emerging market countries, you can look to **BMO MSCI India ESG Leaders Index ETF (Ticker: ZID)**.

Mortgage-Backed Securities

For investors looking for a risk off tool, MBS allows you to maximize yield while maintaining quality in your portfolio. Investors traditionally have looked at **BMO Short Federal Bond Index ETF (Ticker: ZFS)** to take risk off, and a lot of those investors are considering **BMO Canadian MBS Index ETF (Ticker: ZMBS)** as an alternative. ZMBS enables investors to earn about an additional 50 bps of yield for the basically the same credit profile and quality. ZMBS provides exposure to the Canadian NHA 975 mortgage pools, which are 100% CMHC insured 5 year fixed rate residential mortgages. There is an explicit guarantee by the Federal government which gives it a AAA rating. The current yield is about 5.1%. There is also a taxable benefit for investors, since it has a coupon of 0.98% and a YTM of 5.08%. The coupon is taxed as income which is more punitive. And the difference between the coupon and YTM, 4.1%, will be taxed as capital gains as you see bond prices move from discount to par, pulling to par at maturity. This could leave taxable investors with an additional 1% of after tax return, versus an equivalent security with a coupon that matches the YTM. So again, for investors looking to de-risk with AAA exposure and collect a tax efficient yield relative to other securities, ZMBS can be that alternative.

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Healthcare Sector

The S&P 500 Healthcare sector lagged the broader market by about 16% YTD. We've seen a shift in investor sentiment favoring tech and consumer discretionary sectors. The adoption of AI technology fueled a growth rally, which prompted the shift from more defensive sectors such as healthcare. The sector also had to grapple with weaker financial results since the pandemic. We do see pockets of strength within the healthcare sector such as health insurance and medical device companies. We are optimistic for the overall sector due to the potential growth in pharmaceutical and biotech companies. Companies that are investing in oncology, diabetes and obesity research have good growth potential. There is a lot of demand for these kinds of drugs that these companies are working on. For investors looking to get exposure to this space, there are a couple ETF options: **BMO Equal Weight US Health Care Hedged to CAD Index ETF (Ticker: ZUH)**, **BMO Equal Weight US Health Care Index ETF (Ticker: ZHU)**, **BMO Covered Call Health Care ETF (Ticker: ZWHC)** for clients who are more income focused. If we do enter a recession, the sector should provide defense, government spending into Medicare continues regardless of the economic cycle.

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