BMO Exchange Traded Funds

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Views from the Desk

Updates in the Equity and Fixed Income Market

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US CPI

US CPI came in softer than expectations at 7.1% and 6% core inflation. Indicates inflation is potentially coming under control. As a result, equity markets opened strongly with the Nasdaq up and ARKK up 8%, before reversing, and ending the day slightly positive. So, there is upside potential if inflation continues to abate. Markets are also weighing in this week's Federal Reserve meeting, not only their rate decision, but the 2023 dot plots. Markets are widely expecting a 50bps increase. For growth stocks to perform they need clarity on the terminal rate. We are cautiously optimistic on growth. ZQQ - BMO NASDAQ Hedged to CAD Index ETF contains developed companies with strong free cash flows. While ARKK – BMO ARK Innovation Fund ETF Series, contains less developed companies with positive cash flows farther out on growth curve. For investors with long term growth horizons, 5 years +, market pullbacks could good buying opportunities. The major risk is if inflation stays elevated when the Fed hits their terminal rate. So, it's wait and see mode for when growth takes off again.

Fixed Income 2023

Investors have weathered the storm in fixed income in 2022. ZAG – BMO Aggregate Bond Index ETF is down -9% YTD. We are nearly reaching peak rates. BoC has softened their stance and data dependent going forward. Given what see in the market for 2023, a flat to inverted yield curve, OAS at 4.3%, and a 4.25% terminal rate now, ZAG is a solid buy and hold to provide stability to portfolios. Expect higher rates for 2023 and chance of rate cuts at the end of 2023, early 2024. This is the most stability markets have been predicting in a long time. ZAG has a 4% YTM to help meet income needs and provides full term exposure for flexibility. For further fixed income positioning you can find our latest trade opportunities -BMO ETFs: Bank of Canada Update "We Love Barbells". It fits well with a core ZAG portfolio, a barbell strategy that includes the short end ZCS – BMO Short Corporate Bond Index ETF or ZBI – BMO Canadian Bank Income Index ETF and pairing it with long ZFL – BMO Long Federal Index ETF or ZTL – BMO Long-Term US Treasury Bond Index ETF (Hedged Units).

Global Infrastructure

Global infrastructure remained resilient in 2022. Returning +9% this year. With the type of companies in ZGI – BMO Global Infrastructure Index it's not surprising it held up well. It contains long life assets like cell phone towers, airports, and toll roads that that generally have consistent cash flow streams indexed to CPI. Shielding from inflation with the ability adjust prices and revenue. It also has an overall lower correlation to broader equity markets at 0.5 - 0.6. ZGI is a core portfolio building block, with diversification benefits, and potential to do well in adverse environments. If growth equites stage a comeback in 2023, you won't get that huge growth potential from global infrastructure but can expect that consistent return stream that will help in a potential recessionary environment.

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Covered Call Strategies

Volatility in equity markets remained elevated this year, with the potential to continue into 2023. Even in 2021 with easy monetary policy, volatility never got back to average. The VIX, S&P Volatility index, never dipped below the long run average of 15. Covered call strategies tend to benefit from higher levels of volatility, being able to extract more premiums from writing options. Volatility a major input in option pricing, so the higher volatility, the higher the income. There are also not huge tailwinds for equities with potential recession and earnings coming down, if that continues covered call strategies can make a lot of sense. Depending on your market views, if you are anticipating more growth in Canada, look at ZEB – Equal Weight Banks Index ETF. If you're more bearish on growth prospects of the banks as the economy weakens, you may want to look at ZWB – BMO Covered Call Canadian Banks ETF to capture both growth and income. And then if market dynamics shift, you could move back into ZEB when the Canadian economy strengthens.

Tax Loss Harvesting

It is not too late to consider tax loss selling. A couple weeks left in 2022, and with most asset classes are down, this presents an opportunity for future tax benefits. In fixed income, an area where we are seeing trades regularly, investors are crystalizing their losses. It's not every year that you see deep negative losses in fixed income. ETF usage is increasing for tax loss purposes, moving from individual positions into a broad-based ETFs or switch from ETF to ETF. Discount bonds for example, provide a tax benefit while still maintaining aggregate exposure. Look out on Dec 19 for BMO ETF Tax Press Release. Pay attention that you are not switching or buying into a large end year tax position, to avoid adverse tax positions at year end. For more information, see BMO ETFs Tax Loss Harvesting Guide 2022 and tune into Podcast – Tax Loss Selling for 2022 Year End.

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Source: Bloomberg, All returns and data points December 2022.
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