

THIS WEEK WITH SADIQ



April 11 to April 15, 2022

Equity Recovery, Russia-Ukraine, Canadian Dollar

Weekly Commentary

Equity Recovery

The recent story in equity markets has been one of recovery, but is that recovery likely to hold? Currently, markets are still grappling with three things. First, they're coming to terms with the likelihood that interest rates will go up faster than they'd previously anticipated. Second, they're considering valuations—earnings will be important, but what price should investors be willing to pay for that growth given the rising rate environment? And lastly, there's the issue of inflation, which greatly affects consumers' purchasing power. Prior to the Russian invasion of Ukraine, supply chains were easing, which hinted that inflation may start to ease soon as well. Now, supply chains are impacted again and inflation is soaring even more, and it's unclear how much longer it will remain high. Will companies be able to pass along that additional cost to the consumer, or will it depress profit margins? While only time will reveal the answers, the upside story for markets, at least for now, is that earnings will likely remain strong but not necessarily for all companies. Rates are moving up, but they're still relatively low, and the alternative to equities – fixed income – isn't attractive because yield is currently better on the dividend side.

Bottom line: There is a case to be made for investing in equities, but it comes with higher volatility, particularly in the short term. Buying on the dips could make sense..

Russia-Ukraine

Despite some seemingly positive signs over the past couple of weeks, it does not appear that Russia's offensive will stop any time soon, as they've now intensified their assault on eastern Ukraine. Previously announced sanctions against Russia will continue and there have been rumblings of additional measures. At this point, the most significant sanctions have already been introduced, so any new ones would only have marginal effects on the Russian economy. Their potential impact on the European and global economies, however, is less clear. The biggest takeaway from these developments is that the war and related sanctions should now be considered the status quo—they're here to stay for at least some period of time. Even if the conflict were to be resolved, sanctions would not end immediately, nor would international relations with Russia instantly revert to normal. For investors, this means the longer the situation persists, the more GDP is likely to come down and compress valuations.

Bottom line: The longer the Russia-Ukraine conflict continues, the more it will impact the economy and equity markets.

Canadian Dollar

A big question we're hearing is: given the current price of oil, why isn't the Canadian dollar stronger relative to the U.S. dollar? Earlier in the year, the environment was one of risk aversion. Those conditions typically favour the greenback, which is considered a "safe haven" currency. But going forward, and especially considering the Russia-Ukraine situation, the outlook for the Canadian dollar is brighter. The ongoing war has impacted not only oil and gas, but also wheat, gold and lumber —areas in which Canada is resource-rich. Markets and investors are aware of this trend, and we're seeing money flowing into Canada to purchase those commodities, which in turn necessitates the purchase of Canadian dollars. There's also the overall strength of Canada's economy—our employment numbers look good, and key sectors like Financials, Metals and Energy are ripe for investment. Together, these factors should help push the Canadian dollar higher.

Expert

Sadiq S. Adatia

Chief Investment Officer BMO
Asset Management

Mr. Adatia joins BMO AM from Sun Life Global Investments, where he most recently held the role of Chief Investment Officer. Prior to that, he held investment roles at Russell Investments Canada and Mercer Canada. He holds an Honours Bachelor of Mathematics degree in Actuarial Science & Statistics from the University of Waterloo. He is also a CFA Charterholder and is a Fellow, both of the Society of Actuaries (Investment Specialty Track) and the Canadian Institute of Actuaries.



Bottom line: The Canadian dollar is undervalued and likely to move up vs. the U.S. dollar, but we shouldn't expect a dramatic surge.

Positioning

Given the aforementioned strength of the Canadian economy, we're currently overweight to Canadian equities. With one of the big global players – Russia – in trouble, there should be increased demand for Canadian commodities, and we're already seeing that with talk of the U.S. wanting to import more Canadian oil. Given these dynamics, we've been reducing our U.S. equity exposure and moving it to Canada. Another exposure under review is Financials. We've seen a flattening and, in some cases, an inversion of the yield curve—but will that persist? The answer is unclear, so if the curve begins to slope upwards again, we will choose to remain bullish. We may eventually take some profits if there's a run-up in prices, but for now, we're holding in place and will continue to closely monitor the situation.

As Chief Investment Officer, Sadiq S. Adatia's views directly influence the [BMO ETF Portfolios](#).

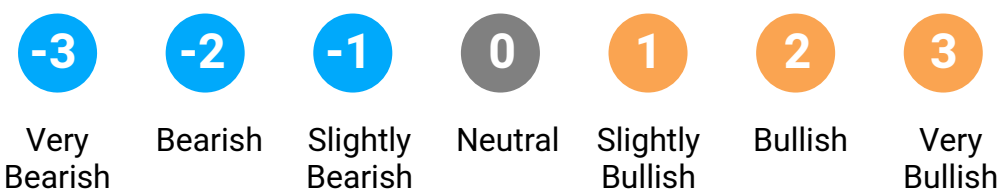
Market Update

- Equity markets struggled this week, with another round of hawkish talk and higher bond yields weighing.
- The S&P 500 fell 1.3%, with technology and consumer discretionary deepest in the red. Defensive sectors, along with energy, were firm again.
- Meantime, the TSX dipped 0.4%, as rallies in consumer staples, energy and telecom offset declines in banks, tech and industrials.

Asset class views, as of March 2022

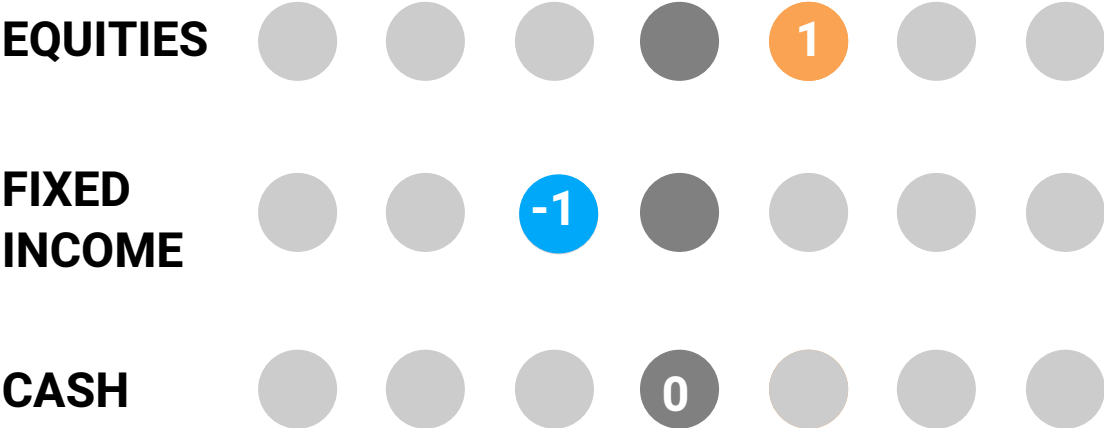
Monthly Perspectives

At BMO Global Asset Management, we recognize that asset allocation is the primary driver of long-term portfolio performance. That's why our Multi-Asset Solutions Team (MAST) has developed a simplified "Five Lenses" view to help explain what is driving their asset allocation decisions.



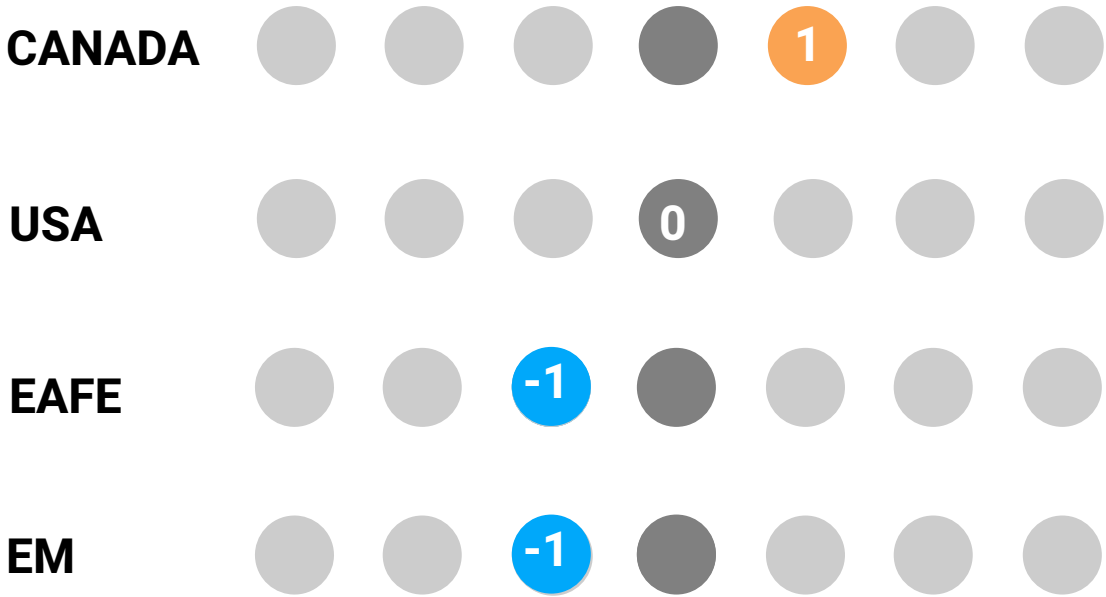
Asset Mix

- COVID-19 and Omicron are lingering but no longer posing a material threat to the economic outlook.
- We expect global growth to cool but to remain above trend in 2022 while inflation remains elevated.
- Excessively pessimistic investor sentiment is signalling a good entry point for long-term investors.



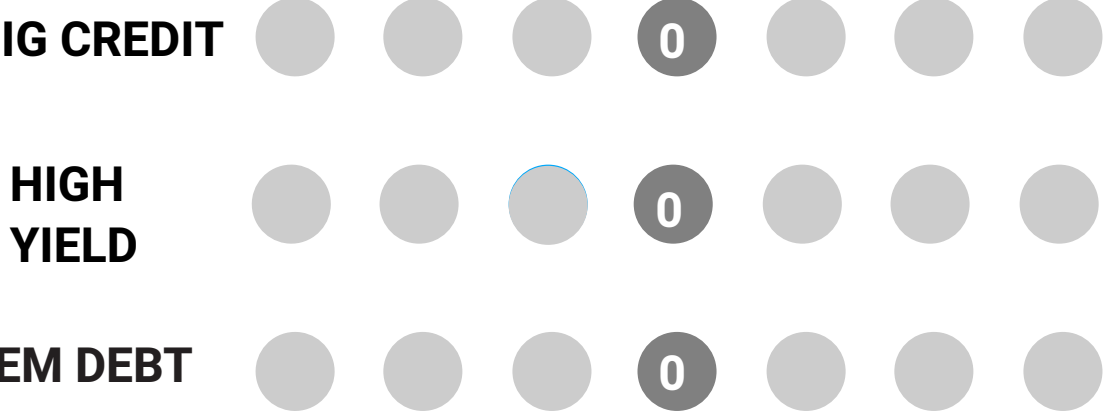
Equity

- Canadian equities are positioned to benefit from rising commodity prices.
- The Russia/Ukraine crisis will continue to produce market volatility, but the direct impact on North America is smaller than International markets.
- We downgraded Europe and EM to underweight as the Russia/ Ukraine conflict will be an overhang for these regions.



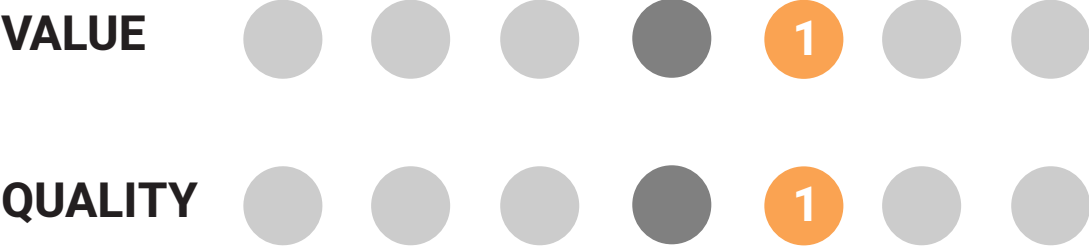
Fixed Income

- March is widely expected to see the Fed and BoC start normalizing interest rates, probably at a fast pace throughout 2022.
- Government bonds and bond duration remain unattractive as central banks are about to hike while the growth and inflation outlook remain strong.



Style/factor

- Anxiety over Fed hikes and geopolitical tensions favours higher quality stocks, whose revenues and earnings are more predictable and less sensitive to swings in economic expectations.
- As we move past the worst of the global COVID pandemic, we added a bias towards the value factor.



Implementation

- Bank of Canada may hike interest rates sooner than other central banks which would support the currency, versus heavy commodity-importing currencies such as the Euro and Japanese Yen.

Thank you for reading!

Disclosures:

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