

THIS WEEK WITH SADIQ



May 9 to May 13, 2022

50bps Rate Hikes, Consumer Sentiment, Europe

Weekly Commentary

Rate Hikes

Last week, the U.S. Federal Reserve raised its benchmark interest rate by 50 basis points, its biggest increase since 2000. This move was widely anticipated, and the expectation is that they will raise rates by another 50 basis points at their next meeting in June. Perhaps the most noteworthy development of the day came afterwards in a press conference, when Fed Chairman Jerome Powell was asked point-blank if the Fed would consider a 75-basis-point hike. To his credit, Powell didn't beat around the bush – he said that they would not consider it for the next meeting. Markets appreciate clarity, and that comment prompted a brief rally. If there was one small surprise to be found, it came when Powell sounded more alarm bells around inflation, mentioning not only the Russia-Ukraine conflict but also the COVID situation in China, which is causing supply chain bottlenecks. These developments are continuing to create inflationary pressure, and Powell's comments can be interpreted to mean that while a 75-basis-point increase is off the table for now, the Fed isn't going to be slowing down its rate hike schedule any time soon. This is probably why the rally was short lived and the markets reacted violently the next day.

Bottom line: Inflation is likely to remain high for somewhat longer than expected.

Consumer Sentiment

What's the state of the consumer in the United States and Canada? During the pandemic, household savings moved up considerably as people tightened their belts and took a cautious approach. Because governments stepped in with stimulus packages, balance sheets looked great, there was strong employment, the housing market did well, asset levels went up, and the cost of debt went down. Now, we're seeing savings rates coming back down to 2019 levels as spending has occurred. Normally, we'd be worried about rising interest rates showing up on consumers' balance sheets, but, given the strong starting point, we doubt that will be a concern this year. Rising mortgage rates mean that affordability could become an even greater concern, but again, that's not likely to play out until next year. The impact of supply chains is taking a toll on consumer sentiment, as people are paying more at the gas pump and the grocery store. This is affecting spending patterns, eating into disposable income, and causing GDP forecasts to be revised down.

Bottom line: Recent hiccups won't erase the largely positive consumer sentiment we've seen this year.

Europe

Europe is one area that we're concerned about. Before the pandemic, its economy was good, but not as good as North America's—and now, aside from COVID-related challenges, it is also dealing with the knock-on effects of the Russia-Ukraine situation. Energy reliance is a big part of that story, as European governments scramble to reduce their dependence on Russian oil and gas. That is the right thing to do for the long run, but higher energy prices and supply uncertainties will mean negative consequences for both businesses and consumers in the short term. We don't believe that the negative outlook is fully priced in, and on top of that, the Russia-Ukraine situation does not appear to be any closer to resolving. Travel and tourism have rebounded somewhat, but probably not to the levels they should have because of the war. And Europe's close trading ties with China mean that the economic slowdown there is having an affect as well. The one positive takeaway is that while the European Central Bank is raising interest rates to combat inflation, they're not expected to be as aggressive as their counterparts across the Atlantic.

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: With so many challenges, it's going to take more than one or two solutions for the European economic situation to improve

Positioning

Is a reopening trade still on the table? The short answer is no, with the exception of Airlines. That process of travel and tourism returning to normal is starting to occur, especially as the school year ends, businesses return to the office and travel restrictions are lifted. Overall, however, we're not playing the reopening anymore because much of it has already been priced in, and valuations have also changed the situation. Strength in Energy still fits the story, but it also makes sense in the context of other developments – rising interest rates, high inflation and the war in Ukraine. Now, our focus is on Quality – companies with consistent earnings and multiples that aren't excessively high that can pass costs through to consumers and manage supply chains.

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

Market Update

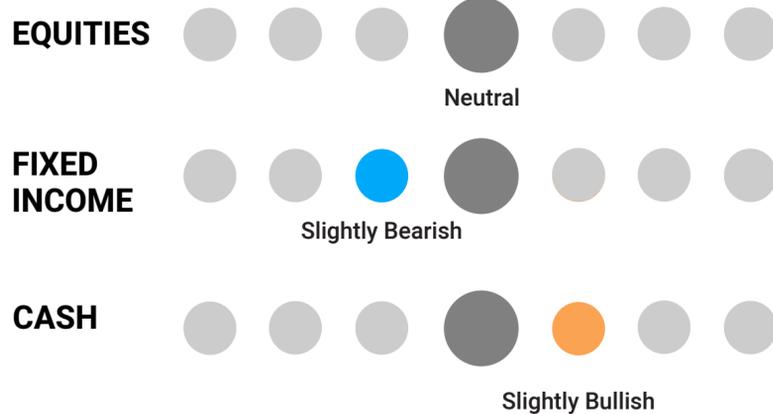
- Equity markets fell again this week in volatile trading, as the Federal Reserve raised rates 50 bps, and a made it perfectly clear that more like-sized moves are coming.
- The S&P 500 was down 0.2%, but with some wild swings around the Fed meeting. Canadian stocks gave back 0.6%, while the Nasdaq shed 1.5%, including a 5% spill on Thursday.
- The reality of tighter policy and a mopping up of liquidity seems to have now sunk in for equity investors.

Asset class views, as of May 2022

Monthly Perspectives

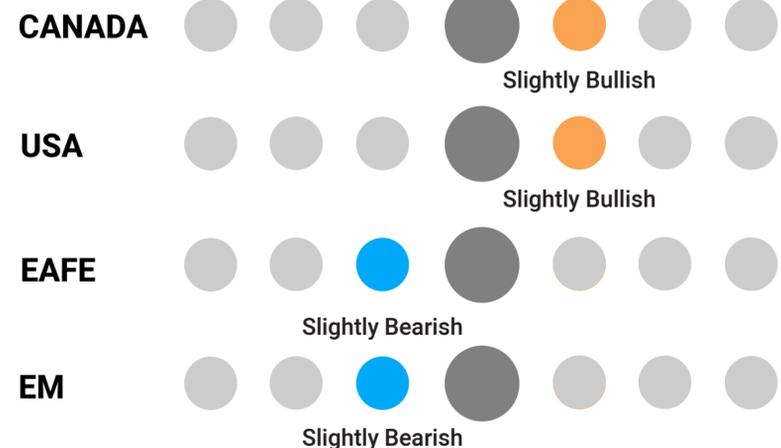
Asset mix

- Global growth expectations are cooling further, which should weigh on the outlook for earnings.
- Inflationary pressures should remain elevated, thereby forcing a quick pace of monetary-policy normalization and weigh on bonds.
- Until we reach peak U.S. Federal Reserve (the "Fed") expectations, bonds remain unattractive while equities could be range bound.



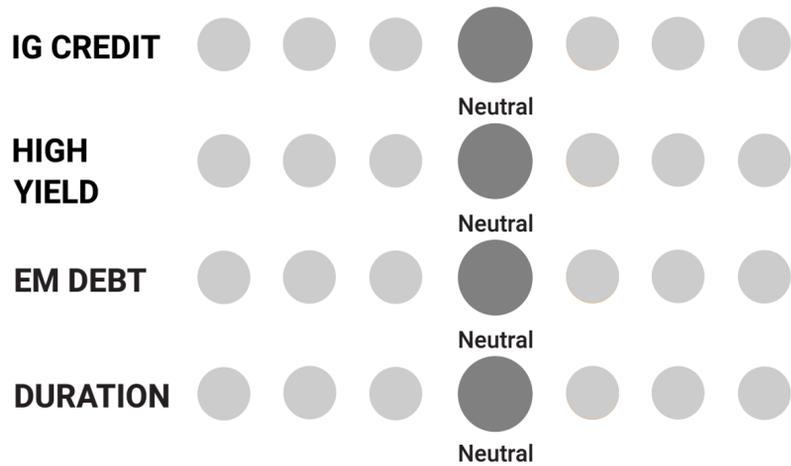
Equity

- We expect the Canadian economy to remain strong, which should continue to benefit equities.
- We expect disappointing growth from EAFE economies, currencies and equities.
- China's economic outlook is facing lingering headwinds from the virus, a slowing global economy, and a hawkish Fed.



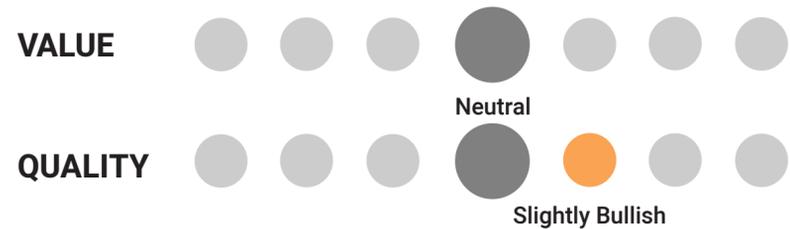
Fixed Income

- We expect the Fed and Bank of Canada to quickly raise policy interest rates into the summer.
- Government bonds and bond duration remain unattractive as inflationary pressures could linger into 2023.
- The pace of balance-sheet reduction could also weigh on long-term bonds in 2022.



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:

The viewpoints expressed by the Portfolio Manager represents their assessment of the markets at the time of publication. Those views are subject to change without notice at any time without any kind of notice. The information provided herein does not constitute a solicitation of an offer to buy, or an offer to sell securities nor should the information be relied upon as investment advice. Past performance is no guarantee of future results. This communication is intended for informational purposes only.

BMO Global Asset Management is a brand name that comprises BMO Asset Management Inc. and BMO Investments Inc.

Any statement that necessarily depends on future events may be a forward-looking statement. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although such statements are based on assumptions that are believed to be reasonable, there can be no assurance that actual results will not differ materially from expectations. Investors are cautioned not to rely unduly on any forward-looking statements. In connection with any forward-looking statements, investors should carefully consider the areas of risk described in the most recent simplified prospectus.

This article is for information purposes. The information contained herein is not, and should not be construed as, investment, tax or legal advice to any party. Investments should be evaluated relative to the individual's investment objectives and professional advice should be obtained with respect to any circumstance.

Commissions, management fees and expenses (if applicable) all may be associated with investments in mutual funds. Trailing commissions may be associated with investments in certain series of securities of mutual funds. Please read the fund facts, ETF facts or prospectus of the relevant mutual fund before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. Distributions are not guaranteed and are subject to change and/or elimination.

For a summary of the risks of an investment in the BMO Mutual Funds, please see the specific risks set out in the prospectus. ETF Series of the BMO Mutual Funds trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

BMO Mutual Funds are managed by BMO Investments Inc., which is an investment fund manager and a separate legal entity from Bank of Montreal.

®/™ Registered trade-marks/trade-mark of Bank of Montreal, used under licence.

®/™ Registered trade-marks/trade-mark of Bank of Montreal, used under licence.

BMO Global Asset Management is the brand name for various affiliated entities of BMO Financial Group that provide investment management, and trust and custody services. BMO Global Asset Management comprises BMO Asset Management Inc. and BMO Investments Inc. Certain of the products and services offered under the brand name, BMO Global Asset Management are designed specifically for various categories of investors in a number of different countries and regions and may not be available to all investors. Products and services are only offered to such investors in those countries and regions in accordance with applicable laws and regulations. BMO Financial Group is a service mark of Bank of Montreal (BMO).

BMO ETFs are managed and administered by BMO Asset Management Inc., an investment fund manager and portfolio manager and separate legal entity from Bank of Montreal. Commissions, management fees and expenses all may be associated with investments in exchange traded funds. Please read the prospectus before investing.

Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

BMO Mutual Funds are managed by BMO Investments Inc., which is an investment fund manager and a separate legal entity from Bank of Montreal.

Commissions, trailing commissions (if applicable), management fees and expenses all may be associated with mutual fund investments. Please read the ETF facts, fund facts or prospectus of the relevant mutual fund before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

For a summary of the risks of an investment in the BMO Mutual Funds, please see the specific risks set out in the prospectus. ETF Series of the BMO Mutual Funds trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

BMO Life Assurance Company is the issuer of the BMO Segregated Funds individual variable insurance contract referred to in the Information Folder and the guarantor of any guarantee provisions therein. The BMO GIF Information Folder and Policy Provisions provide full details and govern in all cases. BMO GIF products are offered through BMO Life Assurance, a separate legal entity than BMO Global Asset Management and wholly owned by BMO Financial Group. Segregated funds are only available for sale by individuals with appropriate insurance licences and are not considered a mutual fund. Segregated fund fees are higher than mutual funds as they include insurance fees to provide for the guarantees on deposits at maturity or on death.