

Taking the Edge Off a Late Equity Cycle



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Snapshot

The recent equity correction has put a spotlight on the need to mitigate portfolio risks, while maintaining some participation in late-cycle returns. BMO offers six ETFs to this end, ZLB (Canada) and ZLU (U.S.). They help:

- Preserve investors' upside potential by leveraging the **"low volatility anomaly"** and
- Manage clients' expectations by taking action to reduce risk while staying invested in the markets.

To demonstrate these historical benefits offered by ZLB, consider its the legacy of achievement for ZLB – 1st percentile in its fund class since inception and a top-decile performer year-to-date.

Details

[BMO Low Volatility U.S. Equity ETF \(Ticker: ZLU\)](#)

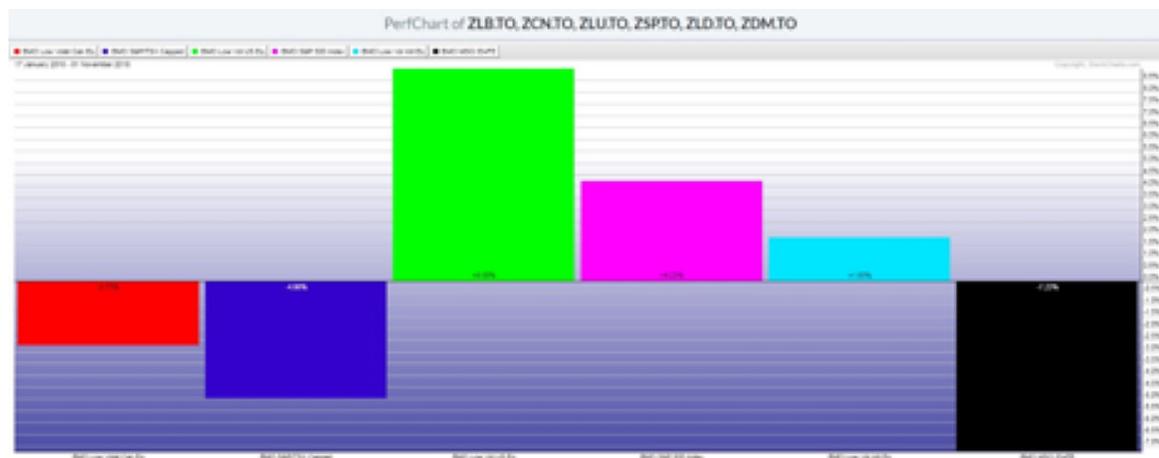
[BMO Low Volatility Canadian Equity ETF \(Ticker: ZLB\)](#)

Benefits

Continued equity exposure, while minimizing drawdowns by adding low-beta-weighted ETFs,¹ putting you in a better position to outperform once markets recover. ZLB and ZLU consistently have had lower downside capture relative to broad indexes.

Trade Idea – Use Low Vol to Reduce Risk and Add Value

With the prolonged bull market signalling its end, you can play defence without timing the market. Morningstar data shows the average VIX² level rising quickly, from 11.1 in 2017, to 19.4 in October.

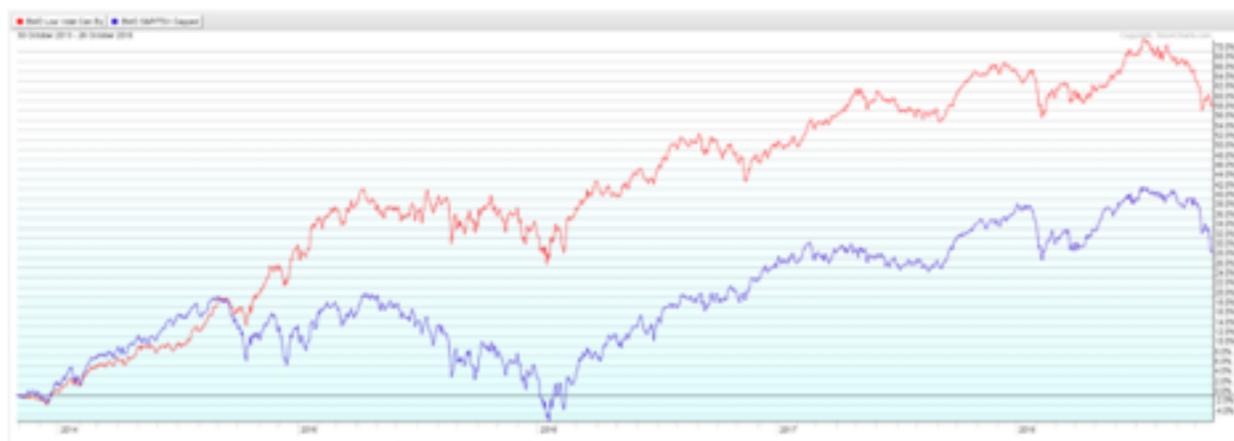


To combat this growing risk, a low-volatility strategy is ideal. Research demonstrates that stocks with comparatively low variability often outperform over full market cycles, by preserving a greater portion of their capital during times of decline. Adding exposure to these assets is important, given how difficult it is to predict the timing and source of external shocks.

For U.S. equities, our approach is to remain deliberately open to exchange rate fluctuations. Underlying economic forces, including trade negotiations and monetary policy, generally tilt in favour of the U.S. dollar. The US dollar also tends to shelter value in market corrections, adding an additional diversification benefit for investors.

It's also important to choose a low volatility fund that's uncorrelated with the broader market. Some low-volatility ETFs have active caps on sector allocation, keeping them tied to the index and limiting the risk mitigation value they provide. ZLB and ZLU are pure-play funds, with largely unrestricted exposure to low-risk equities in their respective markets.

Outlook



Over the last five years, ZLB doubled the performance of ZCN, our proxy for the S&P/TSX Composite – demonstrating the power of the “low volatility anomaly” to guard against drawdowns, and keep you in a position of strength for when equity prices recover. Investors anxious over the pullback in equities, but willing to stay in the market, will find ZLB and ZLU offer a perfect middle-of-the-road approach.

ZLB – Top 10 Drawdown Relative Performance

| | ZLB return | TSX Comp return | Diff |
|------------|------------|-----------------|-------|
| 24/08/2015 | -2.70% | -3.11% | 0.41% |
| 21/06/2012 | -1.37% | -2.98% | 1.61% |
| 01/09/2015 | -1.53% | -2.72% | 1.19% |
| 28/09/2015 | -1.77% | -2.71% | 0.94% |
| 15/04/2013 | -0.84% | -2.70% | 1.86% |
| 09/11/2011 | -0.90% | -2.66% | 1.76% |
| 05/01/2015 | -1.17% | -2.45% | 1.27% |
| 20/06/2013 | -2.14% | -2.44% | 0.30% |
| 10/12/2014 | -1.50% | -2.40% | 0.90% |
| 07/12/2015 | -1.33% | -2.37% | 1.03% |

Source: Bloomberg, as of October 31, 2018.

ZLU – Top 10 Drawdown Relative Performance

| | ZLU return | SPX (CAD) return | Diff |
|------------|------------|------------------|-------|
| 24/08/2015 | -2.70% | -3.68% | 0.99% |
| 01/09/2015 | -1.93% | -3.67% | 1.75% |
| 05/02/2018 | -2.28% | -3.49% | 1.21% |
| 08/02/2018 | -2.14% | -3.29% | 1.15% |
| 10/10/2018 | -0.54% | -3.20% | 2.66% |
| 03/02/2014 | -2.31% | -3.12% | 0.82% |
| 09/10/2014 | -0.81% | -2.76% | 1.94% |
| 21/08/2015 | -1.57% | -2.75% | 1.18% |
| 22/03/2018 | -0.93% | -2.70% | 1.76% |
| 23/03/2018 | -1.63% | -2.58% | 0.95% |

Source: Bloomberg, as of October 31, 2018.

Annualized Performance (as of October 31, 2018)

| NAV | 1 Year | 3 Year | 5 Year | 10 Year | Since Inception |
|-----|--------|--------|--------|---------|-----------------|
| ZLB | -3.53% | 5.65% | 10.03% | - | 12.40% |
| ZLU | 11.75% | 9.32% | 16.49% | - | 17.38% |

Source: BMO Global Asset Management.

¹ Beta is a measure of volatility.

² CBOE Volatility Index.

Disclosure:

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