

# Ease the Tension with Quality



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## Summary of Recommendations

### [BMO MSCI USA High Quality Index ETF \(Ticker: ZUQ\)](#)

A preference toward higher-quality stocks has been one of our overriding investment themes for many years. Our work suggests that these stocks perform very well over longer periods and are particularly well suited for the market environment we expect to unfold in the coming quarters. Indeed, our work shows that higher-quality stocks can help investors combat periods of increased volatility, while also allowing for participation in the upside during periods of market strength.

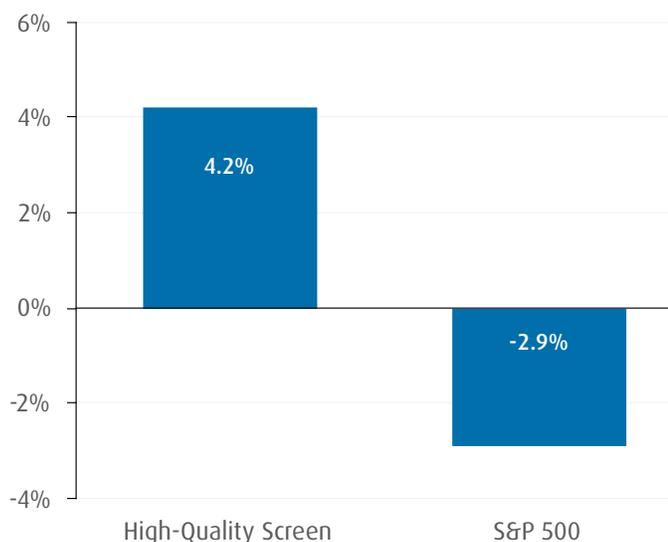
In fact, our work shows:

#### 1. Quality Can Help Guard Against Volatility, but Also Benefits During Periods of Market Strength

Although we continue to be bullish on the outlook for U.S. stocks, we do believe that investors will be forced to contend with higher levels of volatility in the coming quarters. As such, we decided to highlight quality strategies, which tend to perform well during these types of periods, according to our work.

#### High Quality Can Combat Elevated Levels of Volatility... Average Annual Price Return Comparison During Periods of Elevated Market Volatility

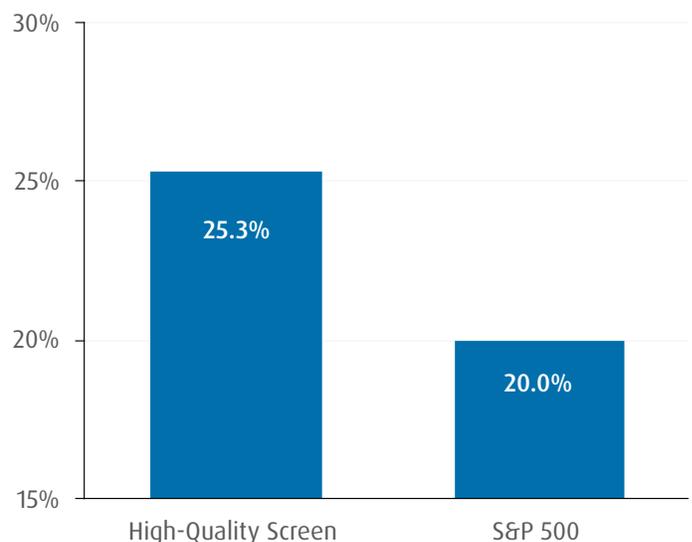
based on rolling monthly data beginning Jan. 1990 where S&P 500 1M Volatility was at an above-average level



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES, Bloomberg.

#### ...But Also Benefits During Periods of Market Strength Average Annual Price Return Comparison During Peri- ods of Market Strength

based on rolling monthly 1Y periods data beginning Jan. 1990 where the S&P 500 gained at least 10%



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

## 2. Quality Performs Well in Range-Bound Markets

### Performance of High-Quality Screen for Range-Bound S&P 500 Periods Beginning 1990 S&P 500 Range-Bound Period as Identified by the High-Quality Screen

Start	End	Duration (Days)	Period Return
4/4/1991	12/11/1991	251	7.60%
1/2/1992	11/17/1992	320	4.20%
12/18/1992	7/6/1993	200	1.30%
7/16/1997	1/9/1998	177	11.60%
3/18/1999	10/8/1999	204	-7.60%
11/18/1999	10/5/2000	322	12.80%
10/11/2001	5/16/2002	217	26.50%
12/23/2003	10/25/2004	307	3.10%
11/12/2004	10/27/2005	349	-3.60%
11/25/2005	7/3/2006	220	7.30%
4/25/2007	12/26/2007	245	0.10%
1/18/2011	7/29/2011	192	4.60%
3/15/2012	12/28/2012	288	3.30%
2/18/2015	8/17/2015	180	-0.20%
11/3/2015	11/4/2016	367	2.00%
		Average	4.90%

Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

## 3. High Quality Represents a Diverse Strategy

Despite common perceptions, high quality is not necessarily associated with defensive strategies. In fact, our current quality screen actually represents a pretty cyclically diverse strategy, as shown in the sector composition pie chart below. While Health Care certainly makes up a sizeable portion of high quality currently, the traditional defensive areas of the market have fairly low exposure, with Telecom, Real Estate, and Utilities entirely absent from the screen.

### Fundamental Backdrop Favours Quality

Given the type of market environment we expect to unfold, we believe our quality strategy will outperform the broader market over the next 12-18 months. This is especially true given the solid fundamental backdrop of these stocks.

### Quality Exhibits Attractive Fundamentals

Metric	High-Quality	S&P 500
ROE	21.2	14.9
Cash as % of Market Cap	9.4	5
EPS Growth Volatility	8.6	15.1
NTM EPS Growth	14.4	14.3

Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

## 4. Trade Idea: BMO MSCI USA High Quality Index ETF (ZUQ)

- Since ZUQ's inception, it has had strong tracking with our U.S. High-Quality Screen, which we used in the analysis (see NOTE below)
- Focus on blue-chip companies with high Return on Equity (ROE), low leverage (Debt/Equity) and stable earnings growth
- Rebalanced semi-annually to ensure continued adherence to the quality exposure

- An attractive way to obtain exposure to equity growth in the U.S. market, while maintaining a measure of defensiveness relative to the broad market by focusing on companies with higher profitability and stronger balance sheets

For more information, please see our most recent publication, [“Ease the Tension with Quality.”](#)

NOTE: The above analysis is not based on ZUQ, but on our BMO Capital Markets Investment Strategy Groups High-Quality Screen: B+ or higher S&P stock rank; BBB- or higher S&P LT debt rating; 5-year EPS growth volatility lower than S&P 500 median value; ROE higher than S&P 500 median value; and cash as a percentage of market cap higher than S&P 500 median value.

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MSCI USA Quality Index (“Index”) is based on the MSCI USA Index, its parent index, which includes large and mid cap stocks in U.S. The Index aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. All securities eligible for inclusion in the Index are weighted by the product of their market cap weight in the parent index and their quality score. Issuer weights are capped at 5%. The Index is rebalanced semi-annually, as of the close of the last business day of November and May.

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