PRIVATE CLIENT SOLUTIONS

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Insights & Strategies

Favouring a Defensive Game for the Second Half

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As we officially kick off the second half of 2023, we are still waiting for the long anticipated recession to appear. While we watch interest rates, economic data and inflation measures to see indicators of recession impacting the general economy, the stock market looks ahead to economic growth beyond the (possible) recession. Sometimes, however, the stock market gets a little too exuberant, and although generally focused on the longer term, the market can still be surprised in the short term.

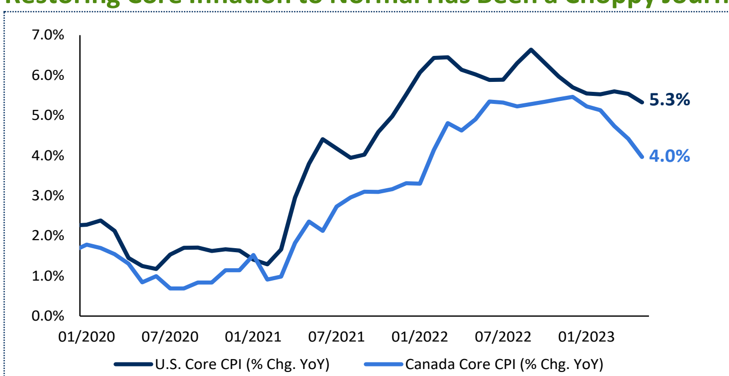
This brings us to our message this month: Regardless of whether Canada (and/or the U.S.) officially dips into recession, we are cautious about short-term negative surprises and volatility in the markets. Now, trying to time the market is a challenging game at best, and staying invested over the longer term is generally a much better strategy, especially through a well-crafted plan suited to an investor's personal objectives and risk tolerances. Staying invested also helps to avoid missing the most rewarding gains through the business cycle, which generally occur early on in the cycle, as market timers that have stepped out of the market debate whether or not to step back in.

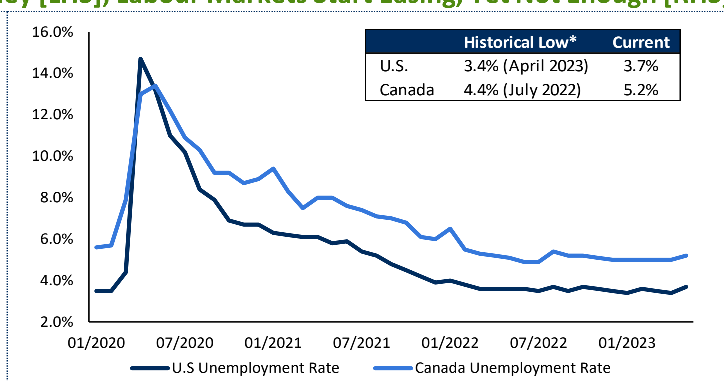
We are also optimistic about longer-term growth opportunities that might be spurred on by factors like the U.S. Inflation Reduction Act, Artificial Intelligence (AI), or an industrial resurgence in North America, as governments look to build manufacturing capacity to protect against future supply chain issues like the ones we experienced through the pandemic. With all that being said, the question is: Are there 'safe' sectors to favour during periods of market volatility and general pullbacks in the market? Looking back over 20+ years we can identify sectors that are likely to fare better than others, while allowing investors to remain invested.

Recession: To Be, or Not to Be

Just before we look at our second-half investment strategy, it's worth reviewing where the economy is currently sitting. In Canada, we saw still positive Gross Domestic Product (GDP) growth, increasing slightly from 2.1 per cent in 4Q22 to 2.2 per cent in 1Q23. April GDP was flat, but May has been estimated as being up another 0.4 per cent from April. It looks like Canada might skirt recession territory as the consensus is for growth to weaken, but remain slightly above zero per cent from 2H23 into 1Q24, before picking up again through 2H24. While in the U.S. the consensus is for a mild recession, but with an ever-shifting start date, now generally considered to be most likely in 4Q23.

Restoring Core Inflation to Normal Has Been a Choppy Journey [LHS]; Labour Markets Start Easing, Yet Not Enough [RHS]



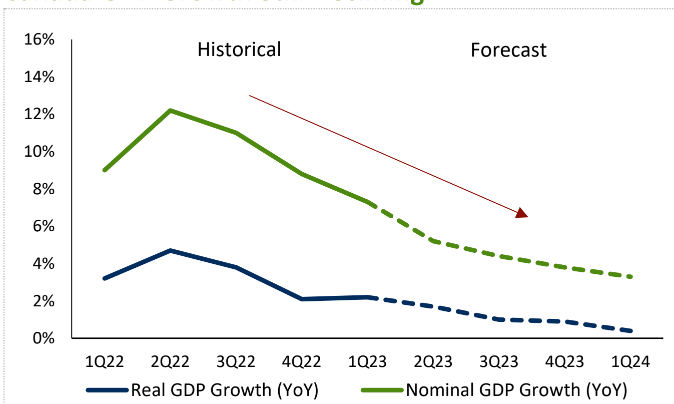


Source: FactSet; Raymond James Ltd.; Date as of May 31, 2023. *Unemployment rate historical low time frame: 12/31/1969 – 05/31/2023.

How Do We Define a Recession?

A recession is largely described as when the national economy, measured by real GDP (nominal GDP adjusted for inflation), declines for a significant period of time (usually at least six months). To fully satisfy economists, however, we generally also look for that to be accompanied by rising unemployment rates, decreasing consumer spending, and lower manufacturing output (fewer goods being produced). While recessions are a completely normal element of the economic cycle, they can be triggered by events such as the U.S. housing crash, which prompted the 'Great Recession' in 2008-09, and impacted confidence and financial sectors globally. Of course, most recently, there was no escape from the effects of the global pandemic. Since 1970, Canada has gone through six recessions (Dec 74-Mar 75, Jan 80-Jun 80, Jun 81-Oct 82, Mar 90-Apr 92, Oct 08-May 09, and Mar 20-Aug 20).

Canada GDP Growth Still Declining



Source: Capital Economics; Raymond James Ltd.; Data as of June 30, 2023.

The Bank of Canada (BoC) has been projecting approximately one per cent growth in 2023 for some time, avoiding a recession in Canada, and giving it leeway to keep interest rates higher for longer to tackle the stickier-than-expected inflation problem. Annualized real GDP growth (YoY) increased slightly from 2.1 per cent in 4Q22 to 2.2 per cent in 1Q23. Deputy Governor Paul Beaudry noted that the BoC was particularly surprised by growth in household spending on both goods and services. The BoC had expected to already see declines in spending on travel, entertainment, and at restaurants, and more particularly in goods that are normally more sensitive to higher interest rates, such as furniture and appliances. There has also been some strength returning to the housing market. With tight housing supply, the concern is that higher prices further fuel inflation, hence the still real risk of further rate hikes, putting further pressure on consumers, which could still push the economy into a recession.

While we normally also look for a rising unemployment rate as an indicator of recession, the tight labour market leading to wage inflation is more of a concern as the BoC's inflation battle rages on. Although there have been slight increases in the unemployment rate in both the U.S. and Canada, joblessness is still at an extremely low level, which allows the Fed/BoC to tolerate a greater increase in unemployment compared to previous rate hiking cycles.

Favouring Defensive Sectors

Getting back to investment strategy in this environment, rather than looking back to recessions in the 1970's and 80's, we thought it would be more useful to examine periods since 2000 wherein we saw declines of over 15 per cent in the TSX Composite benchmark. There were seven such periods, including three instances where the market fell more than 25 per cent, those being the Great Recession of 2008-09, the Tech Bubble Bursting of 2000-02, and the Pandemic Pullback in 2020. While certain sectors can be driven by specific factors in each time period, overall, we generally see **consumer staples**, **communication services**, and **utilities** being the most consistently 'safest' places to be invested, or at least the sectors that fare better than average.

S&P/TSX Comp Historical Drawdowns > -15%

Source: Bloomberg; Raymond James Ltd.; Data as of May 31, 2023. Drawdown periods are specified in the following table.

Defensive Sectors Generally Outperformed During Significant Market Downturns

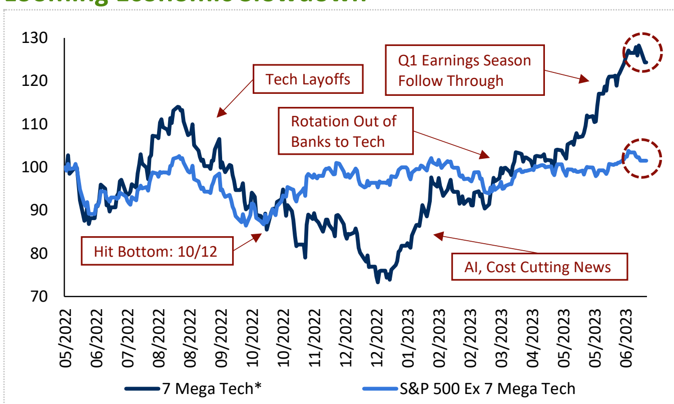
	9/2000 - 10/2002	6/2008 - 3/2009	4/2011 - 10/2011	9/2014 - 1/2016	7/2018 - 12/2018	2/2020 - 3/2020	3/2022 - 10/2022
Duration (Months)	25.2	8.7	6.0	16.5	5.4	1.1	6.5
Canada S&P/TSX Composite	-50.0	-49.8	-21.7	-24.4	-16.8	-37.4	-17.6
Consumer Staples	51.9	-11.4	-2.9	28.8	-3.0	-23.4	-2.7
Utilities	37.2	-34.0	-1.0	-9.8	-10.7	-37.9	-15.8
Communication Services	-49.9	-32.9	3.6	3.6	-4.0	-28.4	-18.9
Real Estate	12.5	-56.6	-8.8	-1.9	-9.3	-47.4	-26.6
Financials	-4.9	-53.0	-17.3	-15.9	-13.6	-39.9	-20.6
Materials	-0.3	-43.2	-23.3	-40.3	-14.3	-23.8	-22.0
Consumer Discretionary	-39.7	-37.0	-17.0	-4.3	-24.0	-44.6	-7.6
Industrials	-45.9	-47.2	-19.7	-22.1	-15.7	-30.7	-10.6
Energy	19.8	-54.8	-30.2	-50.7	-29.2	-52.1	-5.9
Health Care	-51.1	-27.3	-25.4	-3.8	-18.0	-42.6	-55.8
Information Technology	-96.3	-65.4	-42.9	19.0	-20.1	-27.0	-39.3

Source: Bloomberg; Raymond James Ltd.; Sectors are ranked by historical drawdowns (descending).

Are We in a New Bull Market?

A lot of headlines have pointed to a new bull market in the U.S., evidenced by the S&P 500 index gaining 20 per cent from its lows in October 2022. We could debate if we should base that assessment on an index that has been driven primarily by seven tech stocks, or if we should consider a broader base of stocks before making that call. The S&P 500 equally weighted index is up a slightly more modest 15 per cent over the same period. We have indeed seen improvement since October, with some broadening in the U.S. market, but it may be a little too optimistic to expect consistently strong markets just yet. For now we are still waiting to gauge the short-term effects as interest rate increases work their way through the economy and the potential impact to various companies' earnings, revisions, and outlooks over the next couple of quarters.

Reality Check: U.S. Market's Optimism Clashes with Looming Economic Slowdown



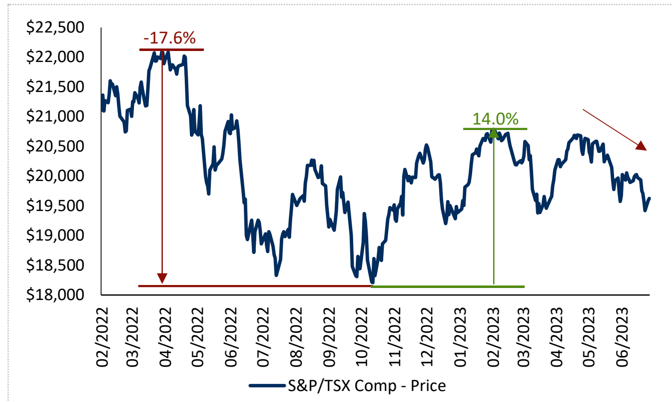
Source: FactSet; Raymond James Ltd.; Raymond James Research; Data as of June 27, 2023 (indexed, 5/31/2023 = 100). *Seven mega tech stocks: Apple Inc., Microsoft Corporation, Alphabet Inc., Amazon.com, Inc., NVIDIA Corporation, Tesla, Inc., Meta Platforms Inc.

Watch for More Volatility in 2H23

In Canada, we saw the TSX Composite dip (17.6 per cent off its March 2022 high) to its most recent low in mid-October 2022 as recession concerns mounted. The TSX Composite peaked at around 14 per cent above the October lows in February 2023, but has now given up half that gain, as economic slowdown concerns return.

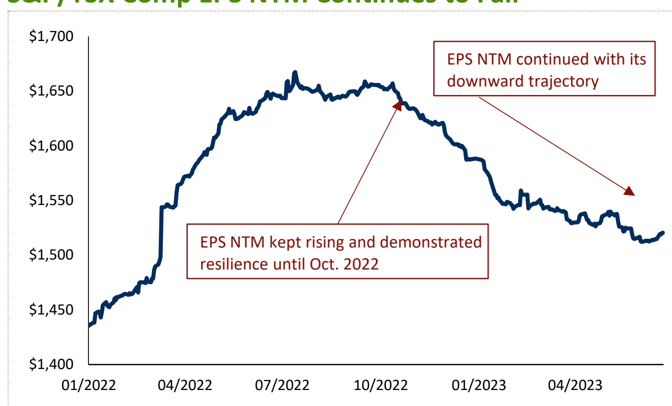
Following a difficult pandemic period, many companies came into 2022 setting low expectations. After a relatively good rebound, we saw a lot of positive revisions, including in March 2022, as oil prices spiked and energy sector EPS forecasts climbed, followed by gold spiking to US$2,000, driving up materials forecasts. Although markets sold off through the middle of 2022 as recession fears mounted and interest rates started to rise, by October we saw the start of negative earnings versions that have broadly continued. Now, as we are about to get into Q2 earnings season, analysts are a bit more conservative as the continuing interest rate hikes impact economic activity (on a 12- to 24-month lag), and we wait, once again, for the impending recession to more significantly hit things like discretionary consumer spending. As earnings expectations come down, the market can react to negative surprises and/or decide to look further ahead to a new economic cycle post-recession, hence the potential for increased volatility.

Recession Concerns Have Impacted Canadian Markets



Source: FactSet; Raymond James Ltd.; Data as of June 27, 2023.

S&P/TSX Comp EPS NTM Continues to Fall



Source: FactSet; Raymond James Ltd.; Data as of June 22, 2023.

Final Thoughts

As the market/economy moves closer to the end of this cycle and into an eventual/potential recession, we believe the defensive sectors (consumer staples, communication services, and utilities) are where equity investors should be focused, within the broader context of well-balanced and risk-appropriate portfolios. As history shows, the defensive sectors – and in particular companies that have durable business models, a sustainable competitive advantage, and high profitability – have performed the best during these types of challenging periods.

Neil Linsdell, CFA, Head of Investment Strategy
Eve Zhou, Multi-Asset Analyst

Mild Recession Likely to Dominate the U.S. Narrative in 2H23

The first half of 2023 in equity markets was marked by two "black swan" events; the regional bank liquidity crisis and Artificial Intelligence (AI) investment craze. This has disproportionately hurt financials, while aiding technology, specifically a few equities with substantial near-term positive AI-driven earnings revisions. However, the economy continues to slow, and inflation continues to disinflate, with last year's narrative for a "soft landing", with a resurgence in China's growth, not panning out as planned, as the export- and capital-spending-driven Chinese economy is having trouble transitioning to a consumer-led economy, especially with a severe property bubble deflating in the background. The new hope is that AI-related investment, combined with spending related to the Inflation Reduction Act, could create enough growth, even with higher rates, to create a "soft landing".

YTD the S&P 500 is up ~15 per cent, with ~80 per cent of that return due to seven large tech stocks, with the rest of the S&P 500, Midcap 400, and Small Cap 600 rallying ~5 per cent. It's unclear how real AI will be longer term, but it couldn't have come at a better time for an economy struggling to find a growth catalyst with China struggling. With wage inflation and a tight labour market assumed to last for a while, the potential productivity benefits of AI provide a narrative to offset the market's two perceived limitations near term (decelerating growth and high inflation).

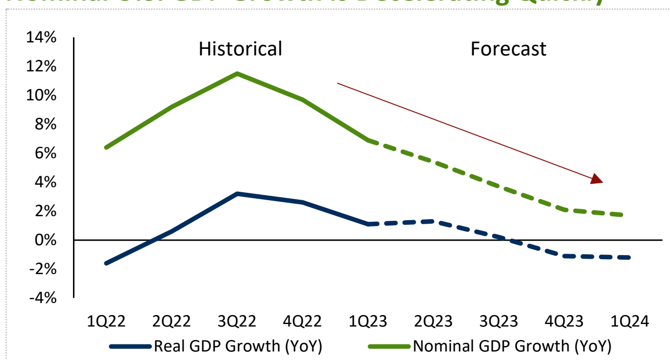
U.S. equity market expectations have drifted from a hard landing, to a mild recession, to a soft landing, and now maybe a soft landing with a magic investment elixir called AI, which holds the promise to not only reaccelerate global economic growth near term, but also lower inflation long term.

It is starting to feel like the market may be a bit too focused on rosy scenarios. Regardless of near-term AI investments, economies around the world are slowing as interest rates are ratcheted higher and Covid-related spending slows. Most economists expect this slowing to become severe within a couple of quarters, leading to negative real growth and likely some labour market weakness in late 2023/early 2024.

Also, after approximately six months of no new Treasury issues, the U.S. Treasury will need to issue well over $1 trillion over the course of 2023. This may impact treasury yields or overall liquidity in asset markets, either of which could pressure U.S. equities.

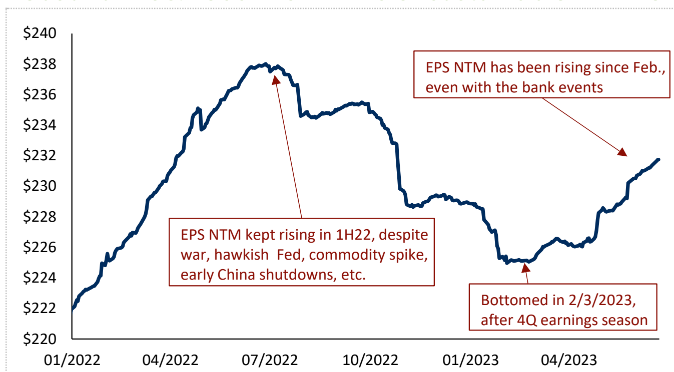
Consensus NTM EPS has been modestly increasing since February for the S&P 500. S&P 500 equity prices have been ~94 per cent correlated since 2000 with consensus NTM EPS. So, it's not surprising that the equity market has rallied. However, we take the recent optimism on re-accelerating EPS growth with a grain of salt. First and foremost, consensus NTM EPS continued to rise last year until mid-June, even though it was obvious that higher rates and a commodity spike were going to hurt earnings in 2022/2023. Secondly, if S&P 500 EPS follow the same seasonality as 2022, 2023 EPS would be $209 rather than the current $220. Right now, consensus EPS for the S&P 500 calls for increases from $217 in 2022, to $220 in 2023 and $240 in 2024. To us, this makes very little sense in a rising rate and slowing nominal GDP environment. We expect EPS to come down this year and next as 2023 rolls on, putting equities under modest pressure after the rally in 1H23.

Nominal U.S. GDP Growth Is Decelerating Quickly



Source: Raymond James & Associates; Raymond James Ltd.; Data as of June 9, 2023.

Rebound in S&P 500 EPS NTM Is Unsustainable in 2H23



Source: FactSet; Raymond James Research; Raymond James Ltd.; Data as of June 22, 2023.

So, the equity market is likely pricing in a rosier scenario for EPS and rates than we are likely to experience over the next year or so. In such an environment, more defensive sectors such as **healthcare**, **consumer staples**, **utilities**, and **real estate** tend to outperform more cyclical sectors. Although this was not the case in 1H23, we expect this to be the case in 2H23, as a mild recession becomes baked into expectations. Further issues in the banking system could make the outlook for equities worse, while more AI-related spending is likely to aid U.S. equities, specifically given the dominance of AI-related infrastructure by U.S.-based companies in the global economy.

Tavis McCourt, CFA
Institutional Equity Strategist (RJA)

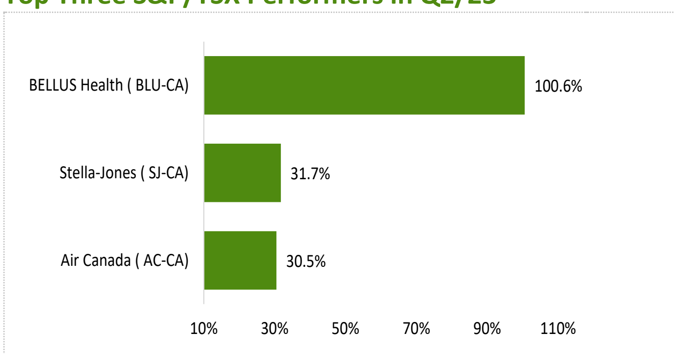
Q2/23 Review and Defensive Highlights

This month, we look at the top and bottom performers within the S&P/TSX Composite Index for the quarter, highlighting stock- and industry-specific drivers behind the leaders and laggards. Additionally, we will also highlight several stock ideas in defensive sectors that can be useful to investors in the current market.

Best Performers

BELLUS Health (BLU-CA) was the top performer during the quarter, beating its next closest peers by a large margin. BLU rallied after news of GSK plc (GSK-US) buying the company for USD $14.75 per share, or approximately USD $2 bln. Following the announcement, the stock price increased ~99 per cent on April 18, 2023. **Stella-Jones (SJ-CA)** reported earnings in May that beat sales and EPS estimates by 0.4 per cent and 34.5 per cent, respectively, resulting in a price increase of 7.8 per cent after the announcement. **Air Canada (AC-CA)** rallied after its earnings results as management revised its forward guidance on EBITDA, noting improved traffic and stronger demand environment, including a lower-than-expected fuel price for FY23.

Top Three S&P/TSX Performers in Q2/23

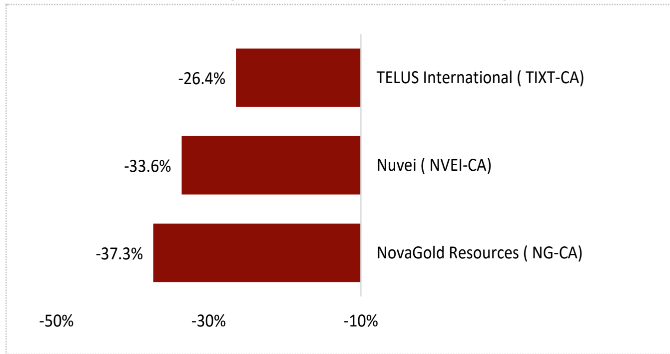


Source: FactSet; Data as of June 29, 2023.

Worst Performers

NovaGold Resources (NG-CA) declined throughout the quarter, generally following gold prices lower. Additionally, management also released earnings results that missed on EPS estimates and had a negative price impact of ~13 per cent after the announcement. **Nuvei (NVEI-CA)** declined following its earnings announcement, despite results that were mostly in-line, as management's forward guidance for Q2 and FY23 came in lower than street expectations. **TELUS International (TIXT-CA)** also declined in May after the mixed earnings results were announced, with revenue that came in below estimates and an earnings beat that was driven by slightly higher margins and a lower tax rate. Management also reaffirmed forward guidance for single-digit growth for FY23, which did not improve investor sentiment for the remainder of the quarter.

Bottom Three S&P/TSX Performers in Q2/23



Source: FactSet; Data as of June 29, 2023.

Highlighting Defensive Companies for 2H23

Given the macroeconomic landscape in both Canada and the U.S., as discussed by our investment strategists, we are highlighting a selection of defensive stocks that are well-positioned to weather economic uncertainties. In the S&P/TSX, consider the following companies across consumer staples, communications, and utilities:

- **Alimentation Couche-Tard (ATD-CA)** is a convenience store operator focused on selling groceries and fuel. *(RJL rating - strong buy)*
- **Quebecor (QBR.B-CA)** is a telecommunications company that provides internet and cable services in Canada. *(RJL rating - outperform)*
- **Emera (EMA-CA)** is an integrated utility company involved in the generation, transmission, and distribution of electricity and natural gas in the U.S. and Canada. *(RJL rating - outperform)*

Shifting focus to the S&P 100, here are some defensive companies across healthcare, consumer staples, and utilities:

- **Merck & Co (MRK-US)** is a global pharmaceutical company that is at the forefront of developing essential medications and treatments for the healthcare industry.
- **Costco Wholesale (COST-US)** is a wholesale retailer that offers a wide range of essential goods at competitive prices. *(RJA rating - outperform)*
- **NextEra Energy (NEE-US)** is a leading renewable energy developer and operator, focused on the generation, transmission, and distribution of electricity in the U.S.

Peter Tewolde
Senior Equity Specialist

Currencies Brace for Storm Clouds

As many global central banks continue to tilt toward a more hawkish monetary policy stance, despite growing demand concerns amid weak Chinese economic data and recessionary fears, the impact of such an economic environment on currencies can be somewhat complex and multifaceted.

The U.S. dollar has seen a modest rebound on signs that a global slowdown is underway, coupled with a growing sense that, like the Fed, many other key central banks may also be nearing the end of their respective tightening cycles. As a result, while we do expect the greenback to weaken as we move into the second half of the year, we cannot rule out short-term bouts of dollar strength as the outlook for the global economy continues to cast its shadow. Higher rates are generally a source of strength for currencies; however, the risk of rising rates possibly triggering an economic downturn has swayed investors to seek out safe-haven assets like the U.S. dollar.

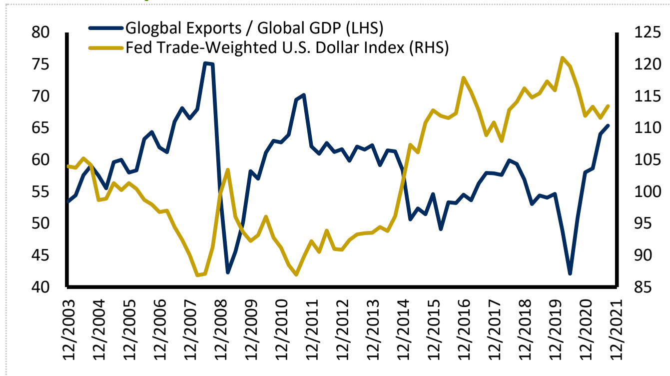
The Challenges Facing Central Banks

Recently, we received hawkish surprises from many central banks, namely the Swiss National Bank, the Bank of England (BoE), and the Norges Bank. The latter two decided to go with 50bps hikes, while the former followed through with a 25bps hike. What we witnessed thereafter was a bid in short-term interest rate expectations, while longer-term rate expectations slipped lower, capping some of the strength to their respective currencies. For example, another upside surprise to U.K. inflation prompted a surprise 50bps rate hike from the BoE, which did little to support the currency. Sterling gains have unwound to a certain degree as the risk of the BoE's terminal rate now breaching +6 per cent have augmented recessionary fears. Similarly, weak economic data out of Europe offset some of the hawkish remarks from European central bank members, limiting some of the strength in the euro as well. This just goes to highlight some of the challenges facing central banks. Aggressively front-loading rate hikes today, in order to curb persistent inflationary pressures, may dampen economic growth expectations to such a degree that policy rates will likely need to come down more precipitously. This may help to explain why some currencies have been unable to garner meaningful strength in the wake of additional rate hikes.

A Gloomy Outlook for Global Trade Growth

The latest report from the United Nations Conference on Trade and Development (UNCTAD) shows that, while global trade growth remains weak, growth in services has shown some resilience. Looking ahead, UNCTAD has expressed a pessimistic view and anticipates a slowdown in global trade growth on the back of various factors such as persistent inflation, rising interest rates, recessionary fears, and increasing geopolitical tensions. What is interesting to note, however, is that global trade activity is generally strong when the broader U.S. dollar is weak, and vice versa. This relationship has held quite well over the years.

Relationship Between the U.S. Dollar and Global Trade



Source: IMF.org and FactSet; Raymond James, Ltd.; Data as of Q4/2021

What Is in Store?

Looking ahead, calibration to monetary policy expectations will remain a key element for the global economy and currencies, especially in this environment of deteriorating confidence in the global economic outlook. Therefore, while the U.S. dollar tends to attract defensive support in times of market jitters, it is also facing challenges of its own. On the rates front, we have other key central banks matching or exceeding the Fed's more hawkish guidance, while Fed Chair Powell appears more inclined to move at a "careful pace" as he believes the Fed is nearing its destination.

As far as USD/CAD is concerned, there are signs of a brewing North American and global slowdown. After the summer months, both the Fed and the Bank of Canada are expected to hit the pause button on any subsequent rate hikes. A more clear end to Fed rate hikes should add fuel to the ongoing unwinding of U.S. dollar strength against some of its major peers, helping to push USD/CAD down into the ~1.30-1.32 range by the end of Q3, with possibly more strength in store for the loonie next year. In the interim, we continue to favour fading any tactical rallies, given the heightened two-way risk for incoming economic data, especially out of the United States.

Ajay Virk, CFA, CMT
Head Trader, Currencies

Choosing Between Baskets and Individual Bonds

Investors looking to add fixed income to their portfolio have many factors to consider. One could look at aspects like the time to maturity/duration of the bond, the credit quality, or the issuer type. You could also explore options in other currencies like U.S. dollar-denominated debt. Another decision that investors need to consider is the vehicle they will utilize, such as individual bonds, or unitized products, which include mutual funds and exchange traded funds (ETFs). Both individual securities and unitized products come with their own list of benefits and drawbacks, which should be considered before investing.

Diversification

Bond ETFs and mutual funds are often seen as efficient, low-cost alternatives to individual securities, where a small fee is paid to receive a basket of issues. Utilizing these products do provide ample diversification quickly. When purchasing individual names, more capital would be required as bonds often have minimums to investment. Depending on the fee structure of your account, there may be cost differences here as well.

Transparency

When you hold bonds in your account directly, you see each bond as a separate line item, giving you full transparency to your holdings and their individual contribution to returns. For unitized products, determining the actual holdings may require referring to the company's website or reports. Mutual fund holdings need to be disclosed quarterly, but ETFs publish their holdings monthly or even more frequently, depending on the manufacturer. Price transparency leans in the favour of unitized products, as they are listed on exchanges (ETFs) or have a daily NAV (mutual funds).

Maturity

Individual bonds have a final maturity date, where the investor is guaranteed to receive the bond's principal, or par value (assuming the issuer does not default). This means that, even if the bond experiences volatility during its life or falls due to rising rates, one can expect to see their principal returned when the security matures. The majority of bond ETFs and mutual funds do not share this feature, as they have a constant maturity, meaning, to convert the holding to cash, you would need to sell. However, some unitized products have a final maturity, when unitholders will receive NAV and the product will end.

Expertise

Purchasing active strategies run by professional bond managers may result in better performance. However, many financial advisors or portfolio managers have a wealth of experience in fixed income or rely on internal experts to construct portfolios that suit your needs. If you are looking to diversify into foreign currency bonds or high yield products, seeking the support of money managers who specialize in these areas is recommended.

Customization

ETFs and mutual funds give you quick access to a basket of securities, but this reduces your ability to customize the solution. Many niche unitized products exist, that focus on credit exposure, country, or duration, but true customization can most easily be found by purchasing individual bonds. For investors who have a specific use of funds in mind with a predetermined end date, such as a house down payment or university tuition, using bonds to more closely match maturity and level of desired safety may be preferred.

Yield Quotation

Although fixed income instruments may follow a few different yield formulas, such as semi-annual and annual equivalents, yield to maturity calculations include both the bond's coupon payments as well as the movement between the purchase price and the final maturity value, or par. ETFs and mutual funds usually provide a distribution yield, which is more similar to the dividend yield on a stock. This is a very important distinction when comparing product types as it can greatly affect the final return of the product and cannot be compared directly – although both are yields, they are not calculated using the same values.

Liquidity

In periods of extreme uncertainty, almost all securities experience increased volatility. This is true for ETFs, mutual funds, and individual bonds. When situations are at their worst, it is possible that market-makers may not provide reasonable markets to trade in. ETFs can experience this value fluctuation, but markets tend to be maintained in these products. Individuals who look to fixed income purely for safety should consider purchasing higher quality issues such as Government of Canada or Provincial securities as they maintain superior liquidity in trying situations.

As you can see, individual bonds and unitized products display different surface characteristics which change how they can behave, their pricing and when you can plan on receiving your capital back. Before adding fixed income exposure to your portfolio, it is important to determine the reason for investing and the potential cash needs over the life of the holding, which may indicate that one avenue of exposure is more appropriate than another.

Charlotte Jakubowicz, CMT, CIM
Vice President, Fixed Income and Currencies

Low Volatility ETF Powerplay

On Monday June 26th, 2023, Patrice Bergeron from the Boston Bruins won his sixth Frank J. Selke trophy – an award that is presented annually to the NHL forward who demonstrates the most skill in the defensive component of the game. This is a unique award, given that forwards are typically valued for their offensive goal-scoring qualities. In the same way, while traditional equity ETFs are typically viewed as products that provide more upside potential when compared to bond ETFs, low volatility equity ETFs (low-vol ETFs) can be seen as attractive defensive equity solutions to help reduce volatility in uncertain market environments.

Defensive Skills – Back-Checking ETFs

Most low volatility ETFs will employ stock selection based on either standard deviation or beta. The charts below illustrate beta and standard deviation figures from BMO, iShares and Invesco – the three ETF providers with the longest low volatility ETF track records. A lower beta and lower standard deviation than the broader index illustrates the defensive qualities found in these ETFs.

Low Vol ETF Risk Metrics vs. Broader Index ETF

Canadian Equity ETFs	5Yr Beta	10Yr Beta	5Yr Std Dev	10Yr Std Dev
BMO S&P/TSX Capped Composite ETF (ZCN)	1.00	1.00	15.87	12.41
BMO Low Volatility Canadian Equity ETF (ZLB)	0.71	0.67	12.81	10.18
iShares MSCI Min Vol Canada ETF (XMV)	0.80	0.78	13.45	10.54
Invesco S&P/TSX Composite Low Vol ETF (TLV)	0.72	0.69	13.07	10.23
US Equity ETFs	**5Yr Beta**	**10Yr Beta**	**5Yr Std Dev**	**10Yr Std Dev**
Vanguard S&P 500 ETF (VFV)	1.00	1.01	14.44	12.45
BMO Low Volatility US Equity ETF (ZLU)	0.54	0.65	11.24	11.34
iShares MSCI Min Vol USA ETF (XMU)	0.67	0.74	11.73	10.86
Invesco S&P 500 Low Volatility ETF (ULV.C)	0.61	*N/A*	11.94	*N/A*
International Equity ETFs	**5Yr Beta**	**10Yr Beta**	**5Yr Std Dev**	**10Yr Std Dev**
iShares Core MSCI EAFE IMI ETF (XEF)	1.01	1.01	13.32	12.09
BMO Low Volatility International Eq ETF (ZLI)	0.77	*N/A*	11.37	*N/A*
iShares MSCI Min Vol EAFE ETF (XMI)	0.64	0.69	9.75	10.00

Source: Raymond James Ltd.; Capintel; Data as of May 31, 2023. Beta figures are as of May 31, 2023 and sourced directly from ETF providers.

Offensive Skills in the Attacking Zone

While low volatility ETFs are primarily viewed as solutions to reduce volatility within a portfolio, it is interesting to note that many of these ETFs have displayed better risk-adjusted returns than the broader index as illustrated by their higher Sharpe ratios. In addition, the **BMO Low Volatility Canadian Equity ETF (ZLB.TO)** and the **iShares MSCI Min Vol Canada ETF (XMV.TO)** have even outperformed their broader indexes on an absolute basis over various trailing periods.

Low Vol ETF Performance Metrics vs. Broader Index ETF

Canadian Equity ETFs:	1Yr	3Yr	5Yr	10Yr	5Yr Sharpe	10Yr Sharpe
BMO S&P/TSX Capped Composite ETF (ZCN)	7.16%	10.90%	6.61%	8.20%	0.48	0.55
BMO Low Volatility Canadian Equity ETF (ZLB)	8.24%	12.47%	8.22%	10.91%	0.70	1.01
iShares MSCI Min Vol Canada ETF (XMV)	7.41%	12.14%	7.57%	8.75%	0.60	0.70
Invesco S&P/TSX Composite Low Vol ETF (TLV)	-0.10%	6.66%	3.40%	6.79%	0.29	0.56
US Equity ETFs:	**1Yr**	**3Yr**	**5Yr**	**10Yr**	**5Yr Sharpe**	**10Yr Sharpe**
Vanguard S&P 500 ETF (VFV)	17.93%	11.96%	10.94%	14.90%	0.73	1.11
BMO Low Volatility US Equity ETF (ZLU)	3.57%	9.28%	9.20%	13.40%	0.93	1.17
iShares MSCI Min Vol USA ETF (XMU)	7.58%	6.59%	7.58%	12.67%	0.70	1.11
Invesco S&P 500 Low Volatility ETF (ULV.C)	5.41%	8.60%	7.16%	*N/A*	0.64	*N/A*
International Equity ETFs:	**1Yr**	**3Yr**	**5Yr**	**10Yr**	**5Yr Sharpe**	**10Yr Sharpe**
iShares Core MSCI EAFE IMI ETF (XEF)	18.07%	6.03%	3.13%	7.69%	0.22	0.56
BMO Low Volatility International Eq ETF (ZLI)	11.25%	1.59%	0.89%	*N/A*	0.09	*N/A*
iShares MSCI Min Vol EAFE ETF (XMI)	12.07%	1.01%	0.59%	6.57%	0.01	0.55

Source: Raymond James Ltd.; Capintel; Data as of May 31, 2023.

Comparing Low Volatility ETF Game Plans

It should be noted that not all low volatility ETFs are created equal and each strategy utilizes a unique methodology that results in a wide dispersion amongst peer performance. BMO's low volatility strategy measures an investment's sensitivity to fluctuations in the broad market by focusing on beta as a risk measure. Invesco will leverage the S&P Low Volatility Indexes and will focus on companies that exhibit the lowest standard deviation as a risk measure. Lastly, the minimum volatility strategies at iShares will leverage the MSCI Minimum Volatility Indexes, which consider not only standard deviation but also correlations between stocks. The difference in methodologies will result in various sector allocations that should be considered when looking to add a low volatility equity ETF as a complementary position to an overall portfolio.

Additional Thoughts

Looking back over the previous decade, it is not surprising to see these strategies achieve the lower volatility that they set out to accomplish (as shown in previous risk metrics) but what is more interesting to note is how these ETFs have kept up and, in some cases, even outperformed their comparable indexes on an absolute basis.

While it is always exciting to watch talented NHL forwards such as Connor McDavid or Auston Matthews make aggressive goal-scoring plays, talented defensive-forwards such as Patrice Bergeron, who can win key face-offs or who can effortlessly defend a penalty, are also valuable players to have on the team, and can arguably make just as much of an impact to the end score. Similarly, low volatility ETFs can be valuable risk management solutions to consider during uncertain market environments that aim to provide a defensive tilt within an equity allocation.

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