# BMO's ETF expansion emphasizes higher income, reduced risk

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**Covered-call funds among four new offerings**

Higher income and below-market volatility are key characteristics of BMO's four new equity exchange-traded funds that opened for trading today on the Toronto Stock Exchange.

BMO Asset Management Inc. said it has added the new ETFs in response to strong market demand for income-generating investment products at a time of market instability. Two of the funds are conservatively positioned in Canadian stocks, while the other two employ covered-call strategies to generate option-premium income.

"The general theme for these funds is more income and less risk," says Kevin Gopaul, vice-president and chief investment officer of BMO Asset Management. He noted that dividend payouts and covered-call premiums both mitigate volatility.

In its product expansion, BMO also addressed the issue of its previously 40-ETF family being underrepresented in broad Canadian-stock mandates. Since its initial launch in June 2009, the now $3-billion family has had only one such mandate: BMO Dow Jones Canadian Titans 60 Index.

Now, as of today, there are three industry-diversified BMO ETFs dedicated to Canadian stocks, both of which are designed to be higher-yielding and less volatile than the S&P/TSX Composite Index, the main benchmark for the Canadian stock market.

The more explicitly income-oriented of the two new diversified Canadian ETFs is BMO Canadian Dividend (ZDV/TSX). With 50 holdings, it provides exposure to a portfolio of Canadian dividend-paying stocks. In selecting stocks, BMO employs a proprietary rules-based methodology that factors in yields, dividend growth and payout ratios.

Though stocks selected for the dividend portfolio are subject to a liquidity screen, BMO Canadian Dividend is not a typical large-cap portfolio dominated by the Big Five banks. Along with pipelines and utilities, the ETF's initial top 10 holdings include the investment manager AGF Management Ltd. and the movie-theatre operator Cineplex Inc.

BMO's other new diversified Canadian ETF is BMO Low Volatility Canadian Equity (ZLB/TSX), which seeks to provide exposure to a weighted portfolio of lower-volatility Canadian stocks. "That is an institutional strategy that we developed internally," Gopaul says.

BMO's rules-based methodology is applied to the 100 largest and most liquid Canadian stocks. From these stocks, BMO selects a portfolio of the 40 stocks with the lowest betas, based on one-year data. (Beta is a statistical measure of a stock's sensitivity to movements in the broader market.) The portfolio will be reconstituted semi-annually, in June and December.

The top initial holdings of BMO Low Volatility Canadian Equity include the telecommunications firm Bell Aliant Inc. and the convenience-store operator Alimentation Couche-Tard Inc.

Generally, this ETF will be very much underweight in resources stocks, having started out with 10.5% in energy holdings and just 1.6% in materials. By comparison, energy is the second highest weighted sector in the S&P/TSX Composite, at 26.7% as of Oct. 21, while materials weighed in at 21.8%.

The ETF's major overweightings initially included 18.3% in consumer staples (versus only 2.8% for the market benchmark) and 15.3% in telecommunications (versus the index's 4.9%.)

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The other two new ETFs -- BMO Covered Call Dow Jones Industrial Average Hedged to CAD (ZWA/TSX) and BMO Covered Call Utilities ETF (ZWU/TSX) -- will generate tax-advantaged premiums in the form of capital gains.

The disadvantage of this approach is that it will severely limit capital gains in strongly bullish markets. In today's market conditions, however, that would appear to be among the least of many investors' worries.

The Dow Jones Industrial Average -- the granddaddy of U.S. market benchmarks -- consists of 30 blue-chip stocks. BMO Covered Call Utilities ETF, meanwhile, currently holds 17 stocks drawn from the utilities, pipelines and telecommunications industries. The portfolio holdings are reconstituted in December and rebalanced in June.

Today's launches bring the total number of covered-call ETFs offered by BMO to three. BMO's original offering in this genre is BMO Covered Call Canadian Banks, which has been an instant hit, having grown to nearly $600 million since it began trading on Feb. 3.

BMO's covered-call mandates, which like all of its ETFs are managed internally by BMO Asset Management, will be managed according to a rules-based proprietary trading system.

**About the Author**
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