Worried About a Recession? Try BMO’s Covered-Call ETF!

Description

With central banks ready to take interest rate hikes to the next level, some folks are worried that a recession or “hard landing” could be in the cards. While the Fed and Bank of Canada (BoC) need to raise rates at a quicker pace to bring high levels of inflation back down to reality (hopefully, it can fall to a range closer to 2-3% by early 2023), the medicine of rate hikes will come with drastic side effects.

While the U.S. Fed seeks to minimize such side effects, the main of which could weigh on economic growth and corporate earnings, it’s tough to tell what the future holds, given the situation that unfolded back in the 1970s, when a recession was sparked to curb inflation.

Recession looming? A yield curve inversion could signal such

Today, the economy is strong, surging back from its coronavirus recession. But what will it be like a few quarters down the road? It’s hard to tell. In any case, the U.S. yield curve is at a high risk of inversion.

We all know what happens when the yield curve inverts; a recession could be waiting around the corner. I found it intriguing that the markets rallied, despite the near inversion experienced last Tuesday. Perhaps investors are buying into the Fed’s ability to walk the tightrope to engineer a soft landing for the economy? Or maybe the stock market has already had a chance to fuss about the less-than-ideal situation.

In any case, investors shouldn’t fear a recession. While the risks of falling into one have risen amid profound macro uncertainties (Ukraine-Russia crisis and the COVID crisis), investors need to focus on the 10-year investment plan rather than looking out to the next 10 months. Could 2022 be the lost year? We don’t know. Nobody knows. The first quarter could signify what is to come for the rest of the year. High volatility and unforgiving plunges to investors who seek to chase the hottest stocks in the market.

That’s why I’d look to take a more cautious stance. An 8-10% return annually moving forward sounds suitable to many investors in the face of such high volatility and uncertainty. For those seeking additional gains, a greater amount of discipline and stock selectivity will need to be had. Stock pickers ought to be pickier if they desire to continue doing better than the indices. And those who have cash ready for those big dips can punch their ticket to better-than-average results.

Staying invested but playing it safe with BMO Covered Call ETFs

In this piece, we'll look at a passive investment in **BMO High Dividend Canadian Covered Call ETF** (TSX:ZWC). The main appeal to the ETF is undoubtedly its sizeable distribution, which currently yields 6%. With a 0.72% MER, investors will pay for the lofty passive income provided by the fund.

The ZWC doesn't differ greatly from your vanilla TSX 60 ETF. It holds all of the favourites from banks to pipelines and even utilities. The TSX is already yield heavy, but the ZWC takes it to the next level, with a greater focus on the firms with larger and growthier dividends. The covered-call aspect trades off some of the upside in the names owned in the basket for premium income that tops off the dividends already paid by the ETF's holdings. The result? A hedged or cautiously optimistic bet on the Canadian economy. Amid recessionary fears, I'd say such a prudent, cautiously optimistic approach is only smart, even if a recession doesn't happen this year or next!

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