SHIFTING LANDSCAPE

HOW ETF STRATEGISTS ARE PREPARING FOR THE EVENTUAL RISING-RATE ENVIRONMENT

With so much anxiety and uncertainty coursing through the global economy as markets move through their sixth year of recovery, ETF Report asked 10 ETF strategists how they plan to shift fixed-income allocations in anticipation of the Federal Reserve raising short-term interest rates next year.

TYLER MORDY

President and co-Chief Investment Strategist of Toronto-based Hahn Investment Stewards

Our firm has maintained a "lower for longer" stance on yields since the dark days of 2008. However, a key inflection point may be approaching. Crucially, U.S. monetary policy is now moving countercyclically to other major world central banks.

While we continue to expect policy-prescribed interest rates to stay near zero in 2015 (even in the U.S.), tactical asset allocators should be alert to the following fixed-income risk factors:

- First, the U.S. bond market is still likely to be a beneficiary of its "senior currency" status. Apparently, no one can explain why longer-dated Treasury bonds are flying off the shelf right now. Look no further than geopolitical conflagrations, a renewed eurozone slowdown and increasingly frantic monetary efforts in Japan. This will ensure a persistent bid for the U.S. dollar, and therefore U.S. fixed income.

- Second, a variety of income-oriented investments are vulnerable to shifting investor psychology. To be sure, central bankers have become victims of their own success. While they have systematically shrunk rates to generational lows, they have also boosted the valuations of yield-oriented asset classes to stratospheric levels. REITs, junk-bond debt and even dividend-paying equities have all soared on government wings. Yet if monetary policy changes direction, these flows could abruptly reverse.

- Finally, the Fed's retreat from an unprecedented policy-easing experiment—even in baby steps—is bound to come with market instability. More often than not, policymaker attempts to cushion volatility of the economic cycle ends up increasing volatility of financial markets down the road.

This means that global macro tactical opportunities will remain in abundant supply for some time.