BMO Monthly Income Fund

Quarterly Commentary

Market Commentary

During the fourth quarter of 2024 ("the quarter") – speaking to the Canadian equity component of the Fund, the Bank of Canada (BoC) reduced the overnight rate by 0.5% twice as inflation eased to 1.9%, below the Bank's 2% target, while bringing the weak economic growth to the spotlight. Despite the rate cuts, long-term rates rose, with Canada's 10-year yield rising from 2.957% to 3.225%. The oil and gold prices were rangebound, ending the quarter at +5.21% and -0.38%, respectively. The S&P/TSX Composite Index rallied and ended up 3.76%. Information Technology sector (+22.19%) performed the best this quarter, while the Financials, Energy, Consumer Staples and Consumer Discretionary sectors ended with positive returns. Notably, interest rate sensitive sectors like Communication Services (-19.21%) and Real Estate (-10.49 %) were the laggards. The S&P/TSX Composite Low Volatility Index had more muted returns of 0.76% as it has a higher weight in defensive and interest rate sensitive sectors like Communication Services and Real Estate while avoiding the higher growth Information Technology names like Shopify.

Within the Canadian equity component, the Fund underperformed the S&P/TSX Composite Index over the quarter.

Regarding the U.S. equity component, having produced three strong quarters in 2024, the final quarter of the year saw Global Equities (MSCI World Index USD) remain broadly unchanged. Generally favourable corporate earnings combined with Donald Trump's victory in the U.S. presidential election supported equity markets and helped them overcome moderating expectations for monetary policy easing alongside economic and geopolitical concerns outside of the U.S.

In the U.S., equities started on the backfoot as some better-than-expected labour market data and a smaller-than-expected decline in inflation in September dashed hopes the U.S. Federal Reserve Board (Fed) would implement a 50-basis-point (bp) rate cut in November, as it had done in September. However, U.S. stocks rallied sharply in November, as Trump's victory, combined with the Republican Party gaining control of both the Senate and House of Representatives, paved the way for a prospective policy mix that includes tax cuts and extra fiscal spending. Small caps and other stocks closely exposed to the domestic economy led the way. The Fed would subsequently implement 25bp rate cuts in November and again in December, but Treasury yields rose over the quarter, as markets viewed Trump's plans to implement tariffs on several trading partners as inflationary. As a result, expectations for rate cuts in 2025 were dialled back amid the favourable economic backdrop, which moderated demand for risk assets in the final weeks of 2024.

European equities faced headwinds from ongoing economic concerns in the eurozone. The quarter began with news that the region's composite purchasing managers' index had slipped into contractionary territory in September, before falling further in November after a moderate recovery in October. Political instability also impacted markets. The coalition government in Germany broke apart following disagreements over national debt levels, while the French Prime Minister Michel Barnier was ousted following a no-confidence vote in early December. Separately, the threat of fresh U.S. import tariffs eroded sentiment toward European exporters. However, the European Central Bank (ECB) provided support by cutting rates by 25bps in October and December, as expected. Although annual inflation in the eurozone ticked higher late in the year, policymakers struck a largely dovish tone.

Elsewhere, the Bank of Japan (BoJ) left interest rates unchanged and signalled it may continue to cautiously unwind its ultra-loose monetary policy stance in 2025. This combined with some encouraging economic data to fuel a strong quarter for Japanese equities. Meanwhile, the stronger dollar was detrimental for emerging-market (EM) stocks as it tempered demand for higher-yielding assets. Concerns about the U.S. trade policies and Chinese growth also hindered EMs, but performance improved late in the quarter following Chinese authorities' pledges of additional stimulus measures in 2025 as part of a "vigorous" effort to boost consumption.

Global equity markets, as measured by the MSCI World Index (USD), fell 0.2% over the quarter. In terms of styles, only Growth (as measured by the MSCI style indices) managed a positive return. Quality outperformed Value which in turn outperformed High Yield, whilst minimum volatility underperformed on both an absolute and risk-adjusted basis.

Of course, the quarter brought the year to a close. A year that has seen strong equity returns of over 18% for the market cap-weighted MSCI World Index, but over 25% for *Growth* and 30% for *Momentum* (as defined by the MSCI Momentum style index). Value, High Yield and Minimum Volatility have all struggled over 2024.

The final quarter of 2024 saw the strategy underperform by 56bps, bringing the year-to-date underperformance to 56bps.

Speaking to the Canadian fixed income component of the Fund, the BoC continued its easing cycle by delivering 50bp cuts at its October and December meetings, as the balance of risk shifted from inflationary pressure to the cooling economy and jobs market. Bond yields shifted up, and the government yield curve steepened as longer yields increased more than shorter yields. The Canadian bond market, as measured by the FTSE Canada Universe Bond Index, was down 0.04%. Corporate bonds outperformed government bonds by 1.43%.

Within the Canadian fixed income component, the Fund outperformed the respective benchmark over the quarter.

Attribution Comments

Within the Canadian equity component, the Fund's allocation and security selection detracted relative to the S&P/TSX Composite.

Defensive positioning detracted versus the S&P/TSX Composite Index as over-weights in interest rate sensitive sectors like Communication Services, Real Estate and Utilities and an underweight position in Energy detracted, while the underweight in Materials contributed. Security selection in Information Technology (underweight Shopify +41.20%), Financials (underweight Brookfield Corp +15.18%), and Real Estate (underweight FirstService Corp +5.52%) detracted. In comparison, overweight Agnico Eagle Mines (+3.71%) contributed as its higher quality operations converted the rising gold price to free cash flow, helping it outperform the Materials sector (-4.74%). Similarly, Quebecor (-9.88%), the portfolio managers preferred name in the Communications Services sector, outperformed the industry (-19.21%).

Compared to the S&P/TSX Composite Low Volatility Index, sector allocation added value due to an underweight position in Communication Services, offset by security selection. Security selection added value in Information Technology (SHOP +41.20%), while it detracted in Real Estate (Canadian Apartment REIT -21.83%) and Financials (Toronto-Dominion Bank -9.40%).

Within the U.S. equity component, the Fund targets the Columbia Threadneedle Investments equity risk premium (ERP) alpha factor, which consists of two principal components – fundamental and behavioural. The aggregate excess return attributable to the ERP factor was negative, with a negative contribution from fundamental being only partially offset by a positive contribution from behavioural. Within the fundamental component, the largest detractor was Value with Quality providing a strongly positive contribution.

Portfolio construction ensures that exposures to other 'common' factors are controlled, but that these factors can still contribute to performance over time. In aggregate, over the quarter, these common factors proved positive to performance, with residual exposure to commodities beta being the strongest contributor.

Sector exposures are controlled within the portfolio construction process, but industry group exposures are not. That said, in aggregate, the contribution from industry groups was positive, with positive contributions from Consumer Staples, Pharmaceuticals and Technology Hardware being partially offset by negative contributions from Telecommunication Services, Transportation and Food Beverage & Tobacco.

Individual names of interest from a security selection/idiosyncratic contribution perspective included Salesforce, Kinder Morgan Inc and Broadcom as positive contributors – whilst the largest detractors were TE Connectivity, Lennar Corp and Microchip Technology.

Regarding the Canadian fixed income component, the Fund maintained an overweight to the corporate sector. Corporate spreads above government treasury yields narrowed during the quarter, in what was a positive environment for risk assets. As a guide, the mid-term corporate bond spread began the quarter at +126bps and finished it at +106bps: a tightening of 20bps. The Fund's overweight to the corporate sector therefore contributed significantly to relative performance.

The overweight position to the corporate sector of the Fund helped maintain a portfolio yield in excess of that of the benchmark and resulted in a positive time return that contributed to relative performance during the quarter. The portfolio manager positioned the duration/interest rate sensitivity of the Fund, on balance, above that of the benchmark during the quarter. This detracted from performance versus the benchmark as longer-term rates rose.

Outlook for Market/Fund

Speaking to the Canadian equity component of the Fund, while inflation in Canada is being brought under control, GDP growth has been weak and political uncertainty persists at the Federal level. The Canadian economy may face more challenges and volatility given the uncertainty around the tariff policy to be followed by the Trump administration. The portfolio managers anticipate some potential further rate reduction from the BoC to provide some relief to consumers and housing markets in coming quarters, while growth and policy uncertainty could add volatility to the market.

Given the uncertainty in Canada's future policy and economic growth, the portfolio managers focus on lower volatility stocks, high-quality earnings, attractive valuation, and growing investor interest could add value in this market environment.

Regarding the U.S. equity component, the portfolio managers anticipate that the Fund is well positioned to potentially produce a positive excess return over the medium term irrespective of the prevailing market conditions.

Speaking to the Canadian fixed income component of the Fund – the BoC is confident that inflation is controlled, but has signaled that they are likely to proceed at a more gradual pace of easing. The timing and extent of any further rate cuts are likely to be driven by the job market and economic growth. The portfolio managers expect continued, elevated rate volatility as global central banks remain reliant on incoming data to inform their decisions and will soon have to navigate the potentially choppy waters of Trump-era policies. The portfolio manager expects to keep, on balance, the duration/interest rate sensitivity of the Fund in line with that of the benchmark while being tactically opportunistic amid evolving market conditions.

Credit spreads in the Canadian corporate sector are expensive relative to historical levels. Fundamentals, meanwhile, remain generally supportive of corporate credit. As a result, the portfolio manager will continue to overweight the corporate sector of the Fund while emphasizing areas of the credit curve that offer the best yield enhancement and protection against any potential spread widening.

Buys/Sells

Regarding the Canadian equity component, the Fund increased its allocation to Energy and Materials and Industrials while decreasing Consumer Staples, Information Technology and Real Estate.

The Fund added to its position in Gibson Energy, an Energy midstream company that operates infrastructure assets such as terminals, pipelines, and tank storage. It has multiple levers for growing profitability. It recently extended contracts with a customer at its terminal, which increased revenue, and has projects which could drive growth. Management plans to return cash to shareholders via share repurchases. The portfolio managers like its profitability, earnings quality, value and market sentiment.

The Fund added to its position in Chartwell Retirement Residences, a senior housing provider. Chartwell benefits from a multi-year demographic tailwind as the population aged 80 and above increases at 4%, while supply growth of new retirement residences remains low. This has driven rising occupancy and margins. Chartwell also could grow through acquisitions or new developments. We like its profitability, earnings quality, momentum, and market sentiment.

The Fund continues to hold a long-term position in Capital Power Corp, a power producer based in Alberta that has focused on reliable natural gas-fired generation capacity. These assets are essential for the reliability of electrical grids, especially considering the increasing intermittent power from renewable sources. The company has benefitted from re-contracting many U.S. assets at better rates. The location of Alberta, with cheap gas available and a favourable regulatory climate, is ideal for new data centers, and Capital Power could benefit from this via long-term contracts with data centers, a lift to power prices and long-term investment opportunities in developing new power plants. The stock rose by 30.92% during the quarter as the market became more aware of these long-term secular themes.

With regards to the U.S. equity component, the Fund rebalances each month. Stocks are bought and sold to maximize the exposure to the Columbia Threadneedle equity risk premium factor, whilst minimizing and controlling for other exposures including sectors and industry groups.

Speaking to the Canadian fixed income component of the Fund, the portfolio manager increased net corporate credit exposure during the quarter by selling Credit Default Swap Index (Investment Grade and High Yield) protection.

Hedging

Regarding the Canadian & U.S. equity component of the Fund, the Fund's currency exposure is unhedged.

Regarding the Canadian fixed income component, the Fund did not maintain any material exposure to foreign currency during the quarter.

Series	Fund Code	MER (%)
Series F	BMO95148	0.69
Series F6	BMO36148	0.69

* DSC closed to new purchase. As of November 2020, LL no longer available for sale. †Front End = Sales Charge