BMO Value ETFs
Enhanced Access to the Value Factor

• **BMO MSCI Canada Value Index ETF** (ZVC) • **BMO MSCI USA Value Index ETF** (ZVU)

Defining the Value Factor

Value factor investing- the pursuit of low cost securities relative to their fundamental value- is an investing style employed by active managers. While the premise may be similar, not all value strategies are the same. Factor based value investing takes traditional value style investing a step further by selecting a more concentrated segment of the investable universe and adjusting securities weights by the value score. BMO Value ETFs provide a rules-based and transparent methodology while being cost effective and maintaining a more consistent risk-return profile.

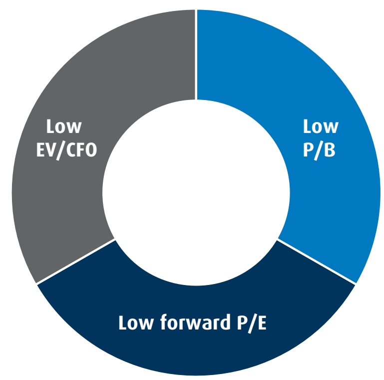
How Do We Identify Value?

Traditional value investors can employ flawed strategies that contain sector bias, have a high concentration of highly leveraged companies, or depend on metrics that can be subject to distortion. These characteristics can increase risk within a value strategy and lead investors into value traps: stocks that may seem inexpensive, but will not actually appreciate. BMO Value ETFs use a value index which more accurately identifies value companies while reducing risk associated with traditional value approaches. This is achieved by focusing on three core metrics:

- **Low Forward Price-to-Earnings (P/E)**
  Indicates a company is less expensive than its peers who have similar earnings projections; signals a market mispricing.
- **Low Price-to-Book (P/B)**
  Identifies companies which are less expensive than their peers.
- **Low Enterprise Value-to-Cash Flow from Operations (EV/CFO)** Enterprise Value reflects all sources of capital, debt and equity. Therefore, evaluating Enterprise Value will screen out companies which are highly financially leveraged. Lower EV companies with high levels of operating cash flow indicate a value company.

On their own, each metric is not an indicator of a value company. For example, P/B is a backward looking variable, can contain sector bias and only reflects the market value of the firm's equity. P/E can be volatile and earnings can be manipulated. When combined, these three value descriptors provide a more accurate assessment.

Three Value Metrics



Value Factor Investing

Factor investing is cyclical and there are certain macroeconomic factors which contribute to value factor success. The value factor performs best with restored investor confidence in the economy: as the economy recovers and grows, value stocks become more popular. BMO Value ETFs aim to accurately identify stocks that capitalize on value cycles.

Strategy Implementation

The selection universe begins with a neutral parent index (ZVC – MSCI Canada Index, ZVU – MSCI USA Index), then adjusts towards the value factor by using equal weights of the three core metrics to compute a composite z-score[1]. The z-score is scored by sector, producing a final value score which is multiplied by the market cap. The maximum

[1] Z-score is an indicator of how closely a value relates to the mean (average) of a set of values. Z-score is quantified by the number of standard deviations from the mean. A positive z-score means the data point is above the mean. A negative z-score means the data is below the mean. Standard deviation is a measure of risk in terms of the volatility of returns.

security weight in each index is capped at 10%. The index targets 50% of the parent market cap coverage. The weight of each sector is the same as the sector weights within the parent index. The indexes are rebalanced and reviewed semi-annually. This methodology aims to not only identify value companies, but to ensure high trading liquidity and to moderate security turnover while staying cost effective. BMO Value ETFs are designed to be core equity options.

Targeting Value

The MSCI Enhanced Value Capped Indices that ZVC and ZVU follow are constructed differently than the traditional MSCI Value indices in both geographic areas. One of the main distinguishing factors is the difference between style investing and factor investing. The traditional MSCI Value indexes follow value style characteristics (using P/B, forward P/E, and dividend yield), targeting 50% of the parent index (which are the same parent indexes as the Enhanced Value Capped Indexes) and can only moderately capture value, offering a tilt towards value bias. In contrast, the MSCI Enhanced Value Capped Indexes target the value factor, and are designed to capture high levels of exposure to value. The Enhanced Value Capped Indexes differ in that they use EV/CFO instead of dividend yield to identify value companies. This is a more precise metric because it assists in avoiding value trap situations. These indexes target 30% of their parent index (with the exception of Canada which targets 50%) and are based on derived value scores so companies exhibiting higher value scores will have a heavier weighting in the index. As a result, this creates a more focused exposure to value and provides the MSCI Enhanced Value Capped Indexes the potential to outperform the traditional value indexes over the long run.

For more detailed methodology information regarding the value factor variables, security composite scoring, security selection, weighting and index maintenance, visit the MSCI indices website: http://www.msci.com/factor-indexes

BMO Exchange Traded Funds

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BMO ETFs are managed by BMO Asset Management Inc., which is an investment fund manager and a portfolio manager, and a separate legal entity from Bank of Montreal.

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