BMO ETF Portfolio Strategy Report

First Quarter 2020 BMO EXCHANGE TRADED FUNDS

Look Ahead With "20-20" Vision

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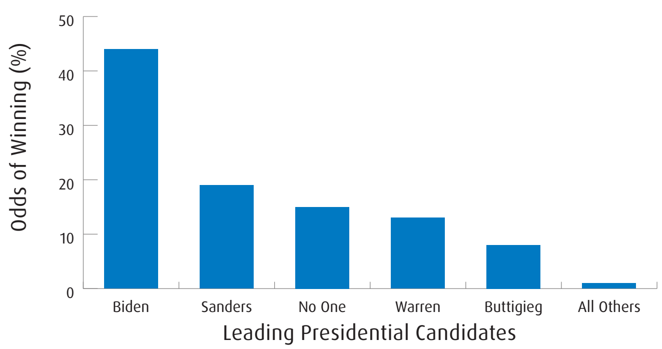
In this report:

All prices, returns and portfolio weights are as of market close on January 20, 2020, unless otherwise indicated.

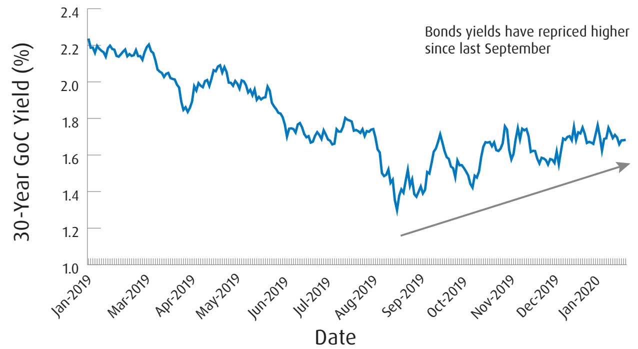
- **In recent quarters, we stated that the market outlook was highly dependent on the outcome of several events that tended to be more geo-political in nature.** Then, during the last several months, many steps were taken toward positive resolutions in the U.S.-China trade war and "Brexit".
- **While these developments should be positive for the market, new conflicts between U.S. and Iran have surfaced, which could cause new disruptions in the market.** With the underlying economic fundamentals remaining strong, we are still positive on risk assets over the next six months.
- **Provided tensions between U.S. and Iran do not escalate, the potential stumbling block this year is the U.S. presidential elections.** As the year progresses, the market's appetite for risk may be dependent on who becomes the front-runner to represent the Democratic Party (Chart A), as the current candidates have varying economic platforms.
- **On the trade front, the U.S. and China have recently signed the first stage to a trade agreement, representing a truce to the long-running trade conflict.** We believe further positive developments are likely, as President Trump will look to remove tariffs (particularly in agricultural exports) in order to gain back some of the votes in the swing states.
- **Politics aside, we believe the underlying health of the economy remains sound.** The removal of geo-political risk items should provide central banks some breathing room, and allow them to at least become less dovish and slow down the pace of monetary easing. Again, provided tensions between the U.S. and Iran do not escalate, bond yields could potentially continue to reprice higher, particularly on the longer end of the yield curve (Chart B).
- **While tighter (less dovish) monetary conditions may result and provide a headwind, we believe interest rates will remain low on an absolute level.** Furthermore, with lackluster corporate earnings growth last year, a more favourable trade environment and reduced tariffs should provide a boost to corporate earnings.
- **Although there are uncertainties that remain, we are optimistic that some of the issues will be resolved.** We anticipate this process will require time, and markets will experience volatility at points, as some days will look more positive than others. However, we don't anticipate risk-assets will experience the same magnitude of returns as we saw in 2019. It should be noted that many assets experienced a significant rebound last year, after the market had a significant drawdown in the fourth quarter of 2018.

Chart A: 2020 U.S. Democratic Primary Race: Who Will Win?



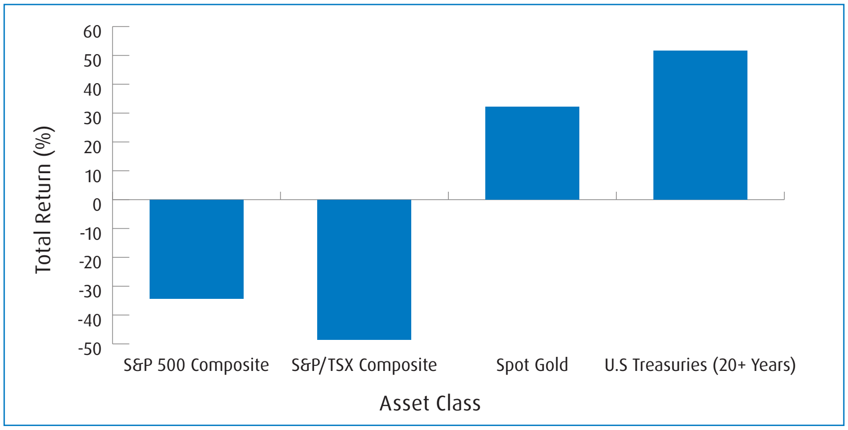
Source: FiveThirtyEight.

Chart B: Long Bond Yields Have Risen



Source: Bloomberg, January 1, 2019 – January 20, 2020.

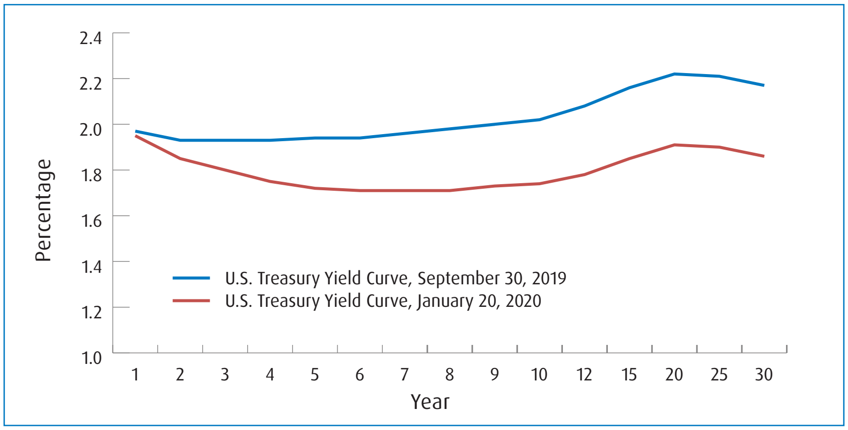
Things to Keep an Eye On



Source: Bloomberg (Total Returns from May 20, 2008 to March 9, 2009).

As a hedge to macroeconomic uncertainty, gold often gets talked about as a catch-all to mitigate various types of risk in a portfolio. The commodity tends to perform well when investors are concerned about risk-assets, inflation or global currencies – particularly the US dollar. However, its multi-purpose function as a hedge to all things also leads its negative correlation to risk assets, such as equities, to be lower than that of U.S. Treasuries. U.S. Treasuries tend to exhibit a stronger negative correlation given they are more of a direct hedge to risky assets.

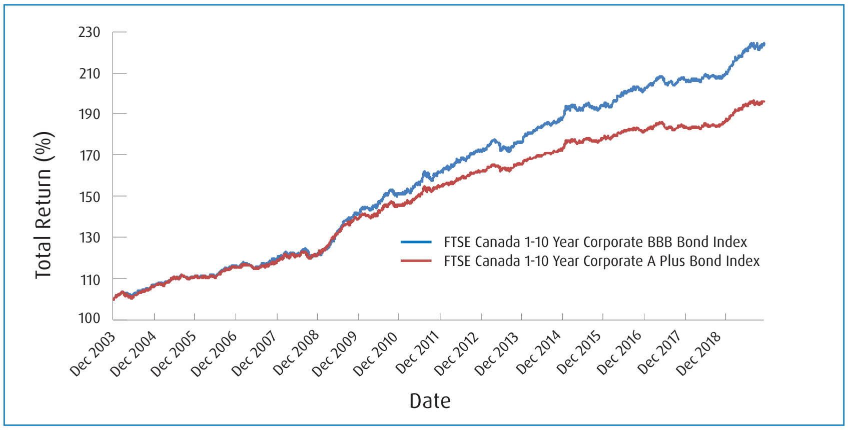
Recommendation: As mentioned in our previous reports, we believe a small allocation to U.S. Treasuries can go a long way in reducing the volatility of a portfolio, while also improving its efficiency. A benefit to Canadian investors of locally listed ETFs is that they are denominated in Canadian dollars, which allow investors to save the foreign exchange costs of converting to US dollars. We believe our ***BMO Long-Term US Treasury Bond Index ETF (ZTL)*** is a great strategic position to improve the long-term returns of a balanced portfolio. Tactically, however, we prefer the ***BMO Mid-Term US Treasury Bond Index ETF (ZTM)*** at the moment.



Source: Bloomberg, BMO Global Asset Management.

If political unrest remains muted, we believe the market will anticipate that current monetary policy has become too dovish. With so many political risk items on the horizon, a positive resolution to all events is far from a certainty. However, in our view, there will be a gradual improvement in the U.S.-China trade war and further progression on Brexit, which are positive signs that may lead to a repricing of bond yields, especially on the long end of the curve.

Recommendation: Rising U.S.-Iran tensions and upcoming U.S. presidential elections are two items that can disrupt our thesis. However, given our overall portfolio strategy is rather defensive, we can afford to take some risk. All else being equal, both Canadian and U.S. banks tend to benefit from a steepening yield curve. The ***BMO Equal Weight Banks Index ETF (ZEB)*** and the ***BMO Equal Weight US Banks Hedged to CAD Index ETF (ZUB)*** provide exposure to Canadian and U.S. banks, respectively.



Source: Bloomberg.

In the last several quarters, our approach to fixed income positioning has been to de-risk our exposure to areas like U.S. high yield bonds. Our reasoning is this asset class tends to be one of the first asset classes that experience a downfall when a recession eventually hits. While the probability of a recession is slowly being priced out in various markets, high yield bonds may actually be well positioned for fast money investors. However, we prefer to stay on the sidelines for this asset class.

Recommendation: Given we prefer to remain in investment grade bonds, investors can increase their beta to credit risk by focusing on corporate bonds rated "BBB". This allows investors to avoid the more speculative high yield sector, but pick up yield relative to the broader Canadian corporate bond universe.

Changes to Portfolio Strategy

Sell/Trim	Ticker	(%)	Buy/Add	Ticker	(%)
BMO Covered Call Canadian Banks ETF	ZWB	5.00%	BMO Equal Weight Banks Index ETF	ZEB	5.00%
BMO Ultra Short-Term Bond ETF	ZST	2.00%	BMO Covered Call US Banks ETF	ZWK	2.00%

Asset Allocation:

- At the risk of sounding repetitive, we are again making no significant changes to our asset mix. We believe our diversified exposure to assets beyond traditional stocks and bonds has been a key attribute in delivering better risk-adjusted returns (compared to a 60/40 balanced portfolio) since the inception of this strategy report in mid-2012. The combination of non-correlated returns has allowed us to have varying areas within our strategy provide a lift as market dynamics change.

Fixed Income:

- As mentioned in our outlook on the first page, should geo-political threats remain muted, we anticipate a potential steepening of the yield curve. As a result, we would limit our exposure to the long end of the yield curve. We believe a small exposure to long duration bonds, still makes sense as a strategic risk-mitigation position within a portfolio. However, from a tactical standpoint, long duration bonds may be the most negatively impacted should bond yields actually reprice higher, particularly as long bonds rallied significantly last year.
- Our exposure to long bonds is limited, with most coming through the ***BMO Discount Bond Index ETF (ZDB)*** and the ***BMO Corporate Bond Index ETF (ZCB)***. This means the bond segment of our portfolio may underperform should economic growth taper or political events unhinge the global economy. However, on a portfolio level, we remain more defensively positioned through our conservative asset mix and defensive equity positioning.

Equities:

- Despite our positive outlook, we remain cautious given the number of political hurdles that can potentially disrupt the market. We anticipate the market to face bouts of volatility and, consequently, we expect our core equity positioning around the low volatility and quality factors to remain the best exposures for this market. This is particularly true, with the recent comments by the Bank of Canada (BoC) implying the economy is no longer operating at capacity.
- We remain confident that our portfolio is well positioned in both recessionary and moderate growth environments. However, should there be a positive resolution in many of the political risk items and markets rally significantly, our strategy would likely underperform. As a way to better position ourselves in a steepening yield curve scenario, we are switching our long-standing 5.0% position in the ***BMO Covered Call Canadian Banks ETF (ZWB)*** to the ***BMO Equal Weight Banks Index ETF (ZEB)*** and also increasing our position in the ***BMO Covered Call US Banks ETF (ZWK)*** by 2.0%.
- Banks tend to outperform as the spread widens between long- and short-term yields, as they tend to borrow short and lend long. However, we are electing to remain in a covered call strategy in U.S. banks, given the U.S. Federal Reserve has been more dovish than its Canadian counterpart, and the U.S. Presidential elections may cause the U.S. banking sector to experience more volatility.

Non-Traditional/Hybrids:

- By carving out a section dedicated to non-traditional/hybrid assets, we have been able to improve the efficiency of our overall portfolio strategy. While many investors have shunned Canadian preferred shares, we believe rate reset preferred shares are one of the few asset classes that provide protection to rising rates. While we aren't necessarily anticipating central banks to become hawkish, it is possible that the market anticipates policy makers to be less dovish. Since the beginning of September of last year, the five-year government of Canada bond yield has risen 39 bps to 1.58%. The ***BMO Laddered Preferred Share Index ETF (ZPR)*** has gained 6.07% on a total return basis since September 30, 2019.
- U.S. preferred shares continue to provide diversification to its Canadian equivalent. The asset class provides a similar net yield of 5.1%, while also being structurally different, composed of fixed coupon issues that are not negatively impacted by falling rates. In addition, the exposure to U.S. issuers is also complimentary, given many Canadian portfolios tend own the same companies through different parts of the capital structure. The ***BMO US Preferred Share Hedged to CAD Index ETF (ZHP)*** continues to provide stable income to our portfolio strategy.

Investment Objective and Strategy: The strategy involves tactically allocating to multiple asset-classes and geographies areas to achieve long-term capital appreciation and total return by investing primarily in ETFs.

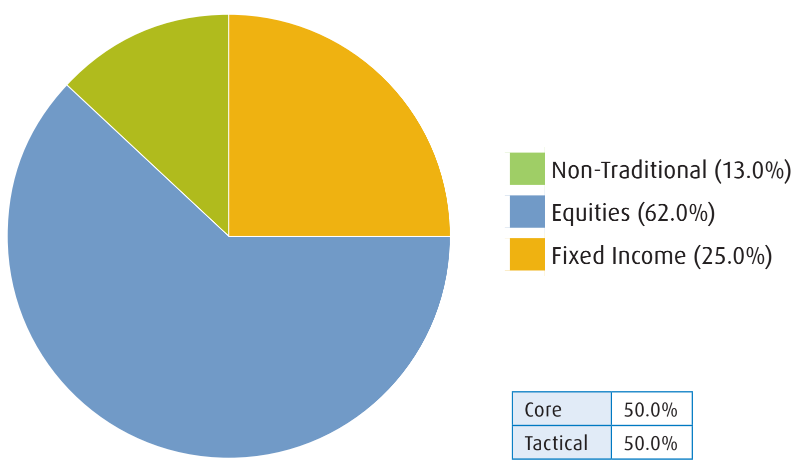
Stats and Portfolio Holdings

Ticker	ETF Name		Position	Price	Management Fee*	Weight (%)	90-Day Vol	Volatility Contribution	Yield (%)**	Yield/ Vol
	Fixed Income									
ZDB	BMO DISCOUNT BOND INDEX ETF	Fixed Income	Core	$16.48	0.09%	7.0%	5.2	5.0%	2.2%	0.42
ZIC	BMO MID-TERM U.S. IG CORPORATE BOND INDEX ETF	Fixed Income	Tactical	$19.71	0.25%	11.0%	6.8	10.3%	3.5%	0.52
ZCB	BMO CORPORATE BOND INDEX ETF	Fixed Income	Tactical	$51.65	0.15%	4.0%	4.9	2.7%	3.1%	0.63
ZTM	BMO MID-TERM US TREASURY BOND INDEX ETF	Fixed Income	Tactical	$51.91	0.20%	3.0%	4.9	2.0%	2.0%	0.40
	Total Fixed Income					25.0%		20.1%		
	Equities									
ZLB	BMO LOW VOLATILITY CANADIAN EQUITY ETF	Equity	Core	$35.73	0.35%	17.0%	5.9	13.8%	2.4%	0.41
ZCN	BMO S&P/TSX CAPPED COMPOSITE INDEX ETF	Equity	Core	$23.76	0.05%	3.0%	6.0	2.5%	2.9%	0.49
ZLU	BMO LOW VOLATILITY U.S. EQUITY ETF	Equity	Core	$40.10	0.30%	10.0%	7.6	10.5%	1.5%	0.20
ZLD	BMO LOW VOLATILITY INTERNATIONAL EQUITY HEDGED TO CAD ETF	Equity	Core	$26.69	0.40%	7.0%	8.2	7.9%	2.2%	0.26
ZEQ	BMO MSCI EUROPE HIGH QUALITY HEDGED TO CAD INDEX ETF	Equity	Tactical	$24.65	0.40%	5.0%	10.9	7.5%	1.8%	0.16
ZUH	BMO EQUAL WEIGHT U.S. HEALTH CARE HEDGED TO CAD INDEX ETF	Equity	Tactical	$61.79	0.35%	3.0%	11.6	4.8%	0.3%	0.03
ZEB	BMO EQUAL WEIGHT BANKS INDEX ETF	Equity	Tactical	$29.96	0.55%	5.0%	6.4	4.4%	3.7%	0.57
ZUQ	BMO MSCI USA HIGH QUALITY INDEX ETF	Equity	Core	$43.98	0.30%	6.0%	10.1	8.3%	0.8%	0.08
ZWK	BMO COVERED CALL U.S. BANKS ETF	Equity	Tactical	$31.79	0.65%	6.0%	14.4	11.9%	5.9%	0.41
	Total Equity					62.0%		71.7%		
	Non-Traditional/Hybrids									
ZPR	BMO LADDERED PREFERRED SHARE INDEX ETF	Hybrid	Tactical	$10.02	0.45%	7.0%	5.2	5.0%	5.2%	0.99
ZHP	BMO US PREFERRED SHARE HEDGED TO CAD INDEX ETF	Hybrid	Tactical	$24.52	0.45%	6.0%	3.8	3.1%	5.1%	1.36
	Total Alternatives					13.0%		8.2%		
	Total Cash					0.0%	0.0	0.0%	0.0%	
	Portfolio				**0.34%**	**100.0%**	**7.3**	**100.0%**	**2.9%**	**0.40**

Please note yields of equities will change from month to month based on market conditions.

Ticker	Name	Weight
ZLB	BMO LOW VOLATILITY CANADIAN EQUITY ETF	17.0%
ZIC	BMO MID-TERM US IG CORPORATE BOND INDEX ETF	11.0%
ZLU	BMO LOW VOLATILITY US EQUITY ETF	10.0%
ZDB	BMO DISCOUNT BOND INDEX ETF	7.0%
ZLD	BMO LOW VOLATILITY INTERNATIONAL EQUITY HEDGED TO CAD ETF	7.0%
ZPR	BMO LADDERED PREFERRED SHARE INDEX ETF	7.0%
ZUQ	BMO MSCI USA HIGH QUALITY INDEX ETF	6.0%
ZWK	BMO COVERED CALL US BANKS ETF	6.0%
ZHP	BMO US PREFERRED SHARE HEDGED TO CAD INDEX ETF	6.0%
ZEQ	BMO MSCI EUROPE HIGH QUALITY HEDGED TO CAD INDEX ETF	5.0%
ZEB	BMO EQUAL WEIGHT BANKS INDEX ETF	5.0%
ZCB	BMO CORPORATE BOND INDEX ETF	4.0%
ZTM	BMO MID-TERM US TREASURY BOND INDEX ETF	3.0%
ZCN	BMO S&P/TSX CAPPED COMPOSITE INDEX ETF	3.0%
ZUH	BMO EQUAL WEIGHT US HEALTH CARE HEDGED TO CAD INDEX ETF	3.0%

Bloomberg, BMO Asset Management Inc. (As of December 31, 2019)



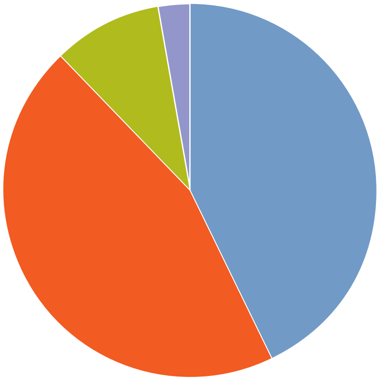
Core	50.0%
Tactical	50.0%

*Management Fee as of March 29, 2019.

**Yield calculations for bonds is based on yield to maturity, which includes coupon payments and any capital gain or loss that the investor will realize by holding the bonds to maturity and for equities it is based on the most recent annualized income received divided by the market value of the investments.

Portfolio Characteristics

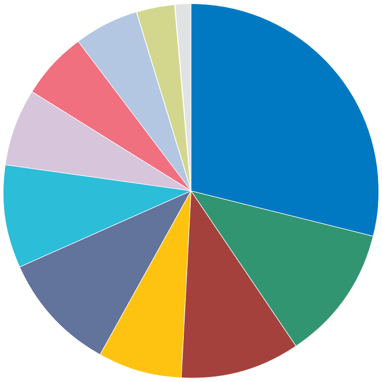
Regional Breakdown (Overall Portfolio)



Canada	43.0%
United States	45.0%
Europe	9.5%
Asia	2.5%

*Regional Breakdown includes equities, fixed income and non-traditional/hybrid sleeves.

Equity Sector Breakdown



Financials	29.08%
Health Care	11.54%
Consumer Staples	10.24%
Utilities	10.02%
Consumer Discretionary	7.47%
Industrials	9.05%
Real Estate	6.03%
Communication Services	5.50%
Information Technology	6.56%
Materials	3.15%
Energy	1.36%

Fixed Income Breakdown

Federal	21.7%
Provincial	10.3%
Investment Grade Corporate	68.0%
Non-Investment Grade Corporate	0.0%

Weighted Average Term	8.34
Weighted Average Duration	6.71
Weighted Average Coupon	3.1%
Weighted Average Current Yield	2.9%
Weighted Average Yield to Maturity	2.4%

Weighted Average Current Yield: The market value weighted average coupon divided by the weighted average market price of bonds.

Weighted Average Yield to Maturity: The market value weighted average yield to maturity includes the coupon payments and any capital gain or loss that the investor will realize by holding the bonds to maturity.

Weighted Average Duration: The market value weighted average duration of underlying bonds divided by the weighted average market price of the underlying bonds. Duration is a measure of the sensitivity of the price of a fixed income investment to a change in interest rates.

Source: Bloomberg, BMO Asset Management Inc. (As of December 31, 2019)

The Good, the Bad, and the Ugly

Conclusion: The investment horizon over the next 12 months remains largely dependent on a number of geo-political risk items. While we have seen several positive developments in the U.S.-China trade war and "Brexit", new risks have arisen between the U.S. and Iran. The U.S. presidential election later this year also adds to potential uncertainty. However, should geo-political risks remain muted, underlying economic strength in North America could take the pressure off central banks and allow them to be less dovish. Therefore, there is potential for a steepening yield curve as bond yields reprice higher. Our portfolio strategy continues to be defensively positioned as risks remain, though we have repositioned slightly to account for the possibility of a steepening curve.

	Global-Macro/Geo-Political	Fundamental	Technical
Good	• The employment situation in the U.S. continues to be the main bright spot in the global economy. The unemployment rate in the U.S. is now at 3.53%, its lowest reading since 1970. • U.S. and Canadian gross domestic product (y/y) have recently ticked down but still remain healthier relative to global counterparts. • The U.S. and China signing phase 1 of a trade agreement should provide some certainty to the market. • Global Purchasing Managers' Index (PMI) has now moved above the critical 50-market to suggest expansion.	• High yield credit spreads have tightened. Their current level of 290bps above U.S. Treasuries is typically where we see them bounce back to wider levels. • While tighter spreads indicate fewer opportunities in the asset class, they also suggest confidence in the credit market. • Potentially lower tariffs may lead to higher corporate earnings and earnings per share (EPS) growth.	• Net creation activity on U.S. high yield ETFs in the U.S. has ticked up, indicating fast money accounts are positioning for a rebound. • The stocks to bonds ratio has accelerated in January, which indicates a rotation into risk. • Low volatility to high beta U.S. stocks ratio is shrinking, which further emphasizes a shift towards risk taking. • The Moving Average Convergence Divergence (MACD) on MSCI World Index indicates a buy.
Bad	• Conference Board U.S. Leading Index (Ten Economic Indicators) (y/y), which is a series of leading economic indicators, has continued to tick down since September of 2018.	• The run-up in equity prices last year has again led valuations in stocks to be slightly overpriced relative to long-term averages. However, lower tariffs may help to expand EPS.	• After last year's "reflation trade," it is unlikely that we will see similar returns from the equity markets this year. However, we do remain constructive on equities over bonds for 2020.
Ugly	• Manufacturing PMI in the U.S. has ticked lower to 47.2, which indicates a slowdown in manufacturing. • Household debt in Canada remains one of the main concerns, however, it may limit the degree to which the BoC can reduce rates.		• Margin debt has increased to all-time highs. Interest rates rising too quickly can cause markets to deleverage. Interest rates moving lower, however, could encourage further leverage in the system.

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Any statement that necessarily depends on future events may be a forward-looking statement. Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Although such statements are based on assumptions that are believed to be reasonable, there can be no assurance that actual results will not differ materially from expectations. Investors are cautioned not to rely unduly on any forward-looking statements. In connection with any forward-looking statements, investors should carefully consider the areas of risk described in the most recent simplified prospectus.

The viewpoints expressed represents herein is our assessment of the markets at the time of publication. Those views are subject to change without notice as markets change over time.

Commissions, management fees and expenses all may be associated with investments in exchange traded funds. The indicated rates of return are the historical annual compound total returns including changes in prices and reinvestment of all distributions and do not take into account commission charges or income taxes payable by any unitholder that would have reduced returns. Please read the ETF Facts or Prospectus before investing. Exchange traded funds are not guaranteed, their value change frequently and past performance may not be repeated.

For a summary of the risks of an investment in the BMO ETFs, please see the specific risks set out in the prospectus. BMO ETFs trade like stocks, fluctuate in market value and may trade at a discount to their net asset value, which may increase the risk of loss. Distributions are not guaranteed and are subject to change and/or elimination.

The payment of distributions is not guaranteed and may fluctuate. The payment of distributions should not be confused with a fund's performance, rate of return, or yield. If distributions paid by the fund are greater than the performance of the fund, your original investment will shrink. Distributions paid as a result of capital gains realized by a fund, and income and dividends earned by a fund are taxable in your hands in the year they are paid. Your adjusted cost base will be reduced by the amount of any returns of capital. If your adjusted cost base goes below zero, you will have to pay capital gains tax on the amount below zero. Please refer to the fund's distribution policy in the prospectus.

The exchange traded funds referred to herein are not sponsored, endorsed or promoted by MSCI, and MSCI bears no liability with respect to any such exchange traded funds or any index on which such exchange traded funds are based. The prospectus contains more detailed description of the limited relationship MSCI has with BMO Asset Management Inc. and any related exchanged traded fund.

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