T Series Funds

Meeting your needs with a predictable cash flow stream.

While every investor is unique, their investment objectives typically fall into three broad categories – capital growth, capital preservation and income generation. Finding the right solution becomes more challenging, however, when investors have a combination of investment objectives.

BMO Mutual Funds T Series provide monthly distributions to help investors better manage their cash flow needs. T Series Funds provide regular monthly cash flow with additional important benefits:

- More productive use of capital
- Greater investment flexibility

What are T Series Funds?

T Series funds provide investors with regular, predictable cash flow, regardless of the income generated by the underlying investments.

While similar to conventional Automatic Withdrawal (AWD) or Systematic Withdrawal Plans (SWP), T Series funds have some significant differences. AWD and SWP plans generate cash flow each month by selling units of the original investment. T Series funds generate cash flow each month by simply distributing, not selling, a predetermined portion of the investor's investment.

How do they work?

Every T Series Fund establishes a distribution rate at the start of each year, which is indicated in the name of the Fund – i.e. a T6 series would distribute 6% of the funds assets during the year.

The monthly amount is determined by applying the annual distribution rate to the T Series Fund's unit price at the end of the previous calendar year, arriving at an annual amount per unit for the coming year. This annual amount is then divided into 12 equal distributions, which are paid each month (see Table 1).

Any capital gains or additional distributions generated by the Fund are distributed at the end of the year. After year-end, tax receipts are issued detailing the amount of interest, dividend and capital gains income, as well as any return of capital (ROC) paid out by each T Series Fund.

The cash flow calculation. (Table 1)

6% annual distribution rate for $100,000 investment
$100,000 investment / $10.00 Unit price on December 31 of the previous year
= 10,000 Units
6% annual distribution rate x $10.00 unit price on December 31 of the previous year
= $0.60 annual distribution per unit
$0.60 annual distribution per unit / 12 months
= monthly distribution of $0.05 per unit
monthly cash flow of $0.05 per unit x 10,000 units
= $500 monthly cash flow

For illustrative purposes only.

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What are the benefits of T Series?

Tax Characteristics of T Series

The Canada Revenue Agency (CRA) recognizes four tax characterizations: interest, dividend, capital gains and ROC. Each is treated differently by the CRA, which results in some types of income being much more attractive on an after-tax basis.

The purpose of a T Series fund is to generate regular monthly cash flow regardless of the types of underlying investments within the Fund. Some T Series funds try to maximize the amount of ROC generated by investing in asset classes that don't traditionally produce income, such as non-dividend paying equities.

Generally ROC does not incur a tax liability, it is used to reduce the investors adjusted cost base (ACB) on the investment. If the investment's ACB eventually reaches zero, the proceeds of any further distributions or subsequent redemption of the investment will be taxed as a capital gain. This offers two benefits. First, this allows an investor to defer taxation, effectively controlling when he or she wishes to incur the tax liability. Second, once a gain is realized, it is taxed at the preferential capital gains tax rate, which is lower than the rates on either interest or dividend income in most provinces.

ROC explained

ROC is simply the difference between the amount distributed by each T Series fund and the taxable amount (the total of all interest, dividend income and capital gains) earned by that fund. For example, if a fund distributed twenty cents and its taxable income totalled five cents, the difference of fifteen cents would be treated as ROC. ROC is not immediately taxable because it is not considered income, but rather a return of the investor's own capital.

The ACB equation

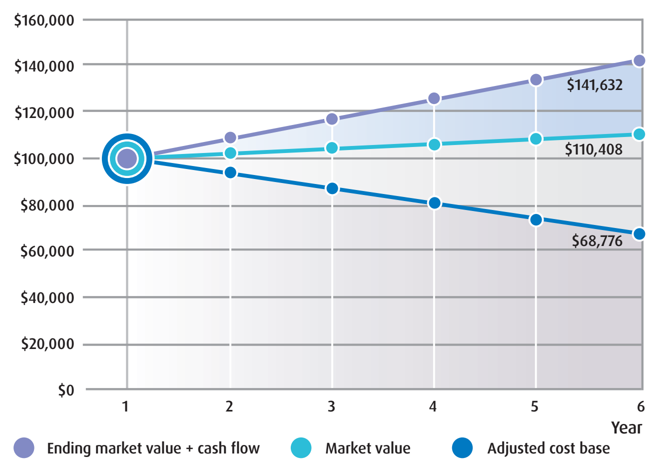
(Amount paid for mutual fund units or shares + Amount of reinvested units or shares) − Return of capital distributions = **Adjusted cost base**

More productive use of capital

As mentioned above, T Series funds and portfolios are more tax-effective because taxes aren't paid on the ROC cash flow in the year received, but when the investment is sold. This allows for more productive use of capital in three ways: lower distribution rates needed to meet your cash flow needs, more principal at work and the deferred tax bill.

In Chart 1, we have an example of a T Series fund distributing 6% in annual cash flow, based on a $100,000 investment that is generating an 8% total annual return.

8% Growth – 6% Annual cash flow. (Chart 1)



For illustrative purposes only.

In this example, the T Series fund generates a return in excess of the 6% annual distribution rate of 2%. The fund is able to not only sustain the annual distribution, but allows more of the principal to remain invested, resulting in capital growth on the investment.

By maintaining exposure to 8% market growth over 5 years, the investor in Chart 1 was able to generate $6,000 a year of cash flow and was also able to generate over $10,000 of capital growth over the period. It is important to realize that ROC does not mean avoiding paying taxes altogether, it is a deferral of taxes until the investment is sold.

Greater investment flexibility

T Series funds offer investors additional flexibility by providing an alternative to traditional income solutions. Investors have the flexibility to choose the between T4 and T6 Series to customize the level of cash flow they receive. As T Series funds have become more popular, it is now possible to invest in a wide variety of asset classes, an essential part of a diversified portfolio, while still generating much needed cash flow. With many investment options, BMO T Series Funds provide investors with complete investment flexibility.

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T Series considerations

Composition of T Series cash flow

When selecting any T Series Fund, it is important to consider that the amount of ROC cash flow generated depends in large part on the characteristics of the Fund. Some T Series Funds will generate a higher level of ROC than others. Funds that invest in bonds which generate interest income will reduce the amount of ROC distributed.

Asset class differences

Funds which have the potential to generate the highest amounts of ROC cash flow also have the potential for higher levels of volatility. Investors should be aware of this when selecting appropriate T Series Funds for inclusion in their portfolio. In general, T Series Funds have the same risk and reward attributes as the underlying funds and asset classes that they are investing in.

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