BMO Asset Management Global Absolute Return Bond Fund

Seeking to deliver a cash plus 4% return through the business cycle

BMO Asset Management Global Absolute Return Bond Fund is constructed with the ability to go short duration and credit, allowing for greater flexibility and the possibility for downside protection. The Fund's ability to exploit anomalies in the bond market provides greater confidence in generating positive returns throughout the market cycle.

Fund Details

Series F	JHI202
Management Fee:	0.35%
Sales Status:	Open
Min. Investment:	$5,000
Sub. Investment:	$100
Currency:	CAD

Category

Global Fixed Income

Benchmark

FTSE TMX Canada 91 Day T-Bill Index + 4%

About the managers

Keith Patton
Head of Multi-Strategy, Fixed Income

Ian Robinson
Head of Credit

BMO Asset Management Global Absolute Return Bond Fund

Simplicity

- Cash + 4% (gross) return target
- Attractive level of potential return in a low yield world
- Liquid investment strategy.

Flexibility

- Multiple underlying strategies allows for greater diversification and enables positioning to target opportunities where managers have the greatest conviction
- While the strategy is not locked into a particular maturity, credit rating band, sector or geography, this 'unconstrained' approach has strict risk limits to distinct return drivers, providing comfort to investors
- The absolute return bias of the strategy has the flexibility to create positive returns in both positive and negative market environments.

Greater certainty

- Enhanced portfolio diversification and the avoidance of unnecessary volatility are central to this strategy
- The use of multiple underlying strategies working together has the potential to provide a smoother overall return profile over time relative to traditional investment strategies
- The focus on less volatile fixed income instruments to generate a stable yield reduces the variance of outcomes resulting from the business and credit cycle.

"Our approach to absolute return fixed income is unconstrained and has a clear focus: the delivery of stable returns having a different profile to that of global bond markets. We target diverse return sources, managed by specialist teams and brought together in a sophisticated risk management framework, to deliver a positive risk/return outcome" – ***Keith Patton***

BMO Global Asset Management

Delivering simplicity and flexibility, with the aim of greater certainty

Diverse sources of return are assembled within a disciplined risk management framework. Each element contributes to the overall return and enhances risk diversification

Employing an unconstrained approach to build an absolute return portfolio

Core credit

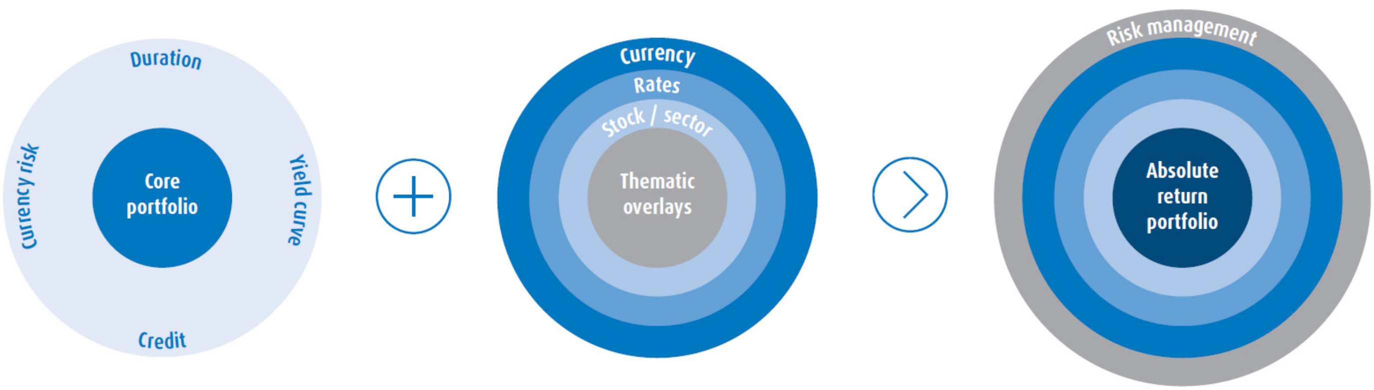
Exploiting persistent anomalies in investment grade and high yield securities.

Thematic overlays

Contributing to returns and providing diversification through the active management of credit, interest rate and currency risk through the cycle.

Thematic overlays

Drawing on the insights of specialist teams, disciplined risk management is used to calibrate risk up or down as necessary.



Core portfolio

The core portfolio is focused on generating an attractive yield within an understood range of outcomes. To ensure confidence in the outcome, the characteristics of the core portfolio are to focus on fixed income instruments with lower duration to reduce the risk of losses due to changes in the credit cycle; well diversified to minimise the possibility of capital loss from credit weakness and default and low turnover to reduce the risk of trading costs.

The core portfolio is not benchmark constrained and is therefore able to focus on security selection to exploit opportunities often found in the credit sectors.

Overlays

The overlay strategies are included in order to increase diversification and generate additional return. These strategies complement the core portfolio. They mostly target shorter-term relative value opportunities and allow for a broader opportunity set than the core portfolio.

Each strategy is managed independently by a specialist team and correlations between them are reduced.

The currency and rates portfolios are and use derivatives to express investment views.

The stock/sector overlay has a strong credit element, focusing on ideas and positions that fall outside the core portfolio. Given its very modest risk budget, the stock/sector overlay is able to target securities often ignored by indices and index-based strategies.

Risk Management

The Asset Allocation committee takes responsibility for setting the risk levels of the overall portfolio and monitoring the use of the allocated risk budgets. This team of senior professionals is responsible for ensuring the strategy is appropriately positioned across the key return drivers, interest rates, credit and currency.

The team takes a medium term cyclical approach with a key focus on minimizing the potential for losses. Derivatives are used to ensure these key decisions can remain independent from the core portfolio and the thematic overlays from the currency and interest rate teams. In addition, individual positions from the thematic overlays may be resized outside of these independent strategies where such strategies offer significant benefit at a total portfolio level.

Core portfolio

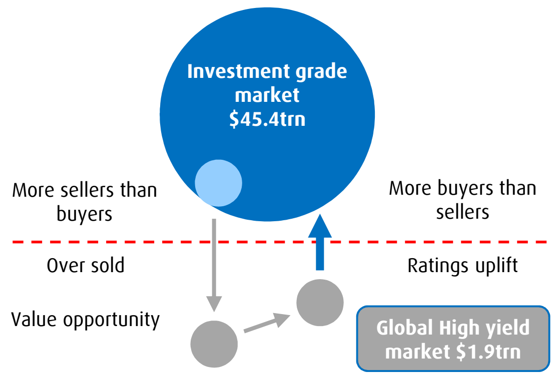
The core portfolio acts as a 'buy and hold' sleeve that seeks to deliver a greater certainty of positive returns. It offers a lower duration to traditional core fixed income and pure investment grade allocations, with a low correlation to government rates, for a marginal increase in credit risk.

The core portfolio seeks to capture the premia available from credit markets without exposing the strategy to significant cyclical risk, which may severely affect the ability to generate an absolute return.

To achieve a greater certainty of outcome, the manager's focus on short duration (lower volatility) securities of issuers having relatively resilient business models. These securities are typically those that the manager would be happy to hold to maturity. Overall portfolio returns benefit from this buy-and-hold approach because transaction costs are low, posing less of a drag on returns.

As the strategy is not benchmark constrained the team can focus on the area of the credit markets where traditional guideline and index constraints creates anomalies. The fine line that divides investment grade from high yield credit creates such anomalies. The reason for this anomaly is largely due to investment guidelines, as many institutional investors are prohibited from owning high yield bonds and become forced sellers when issuers are downgraded to high yield. Forced selling creates value opportunities (called "fallen angels"). In contrast, most high yield managers seeking to outperform a high yield index concentrate their exposure in lower quality (higher yielding) assets, paying less attention to opportunities in the BB segment of the market, which has historically delivered superior risk-adjusted returns in the high yield space.

Taking advantage of the rating transition



For illustrative purposes only
Source: Bloomberg, as at December 2015

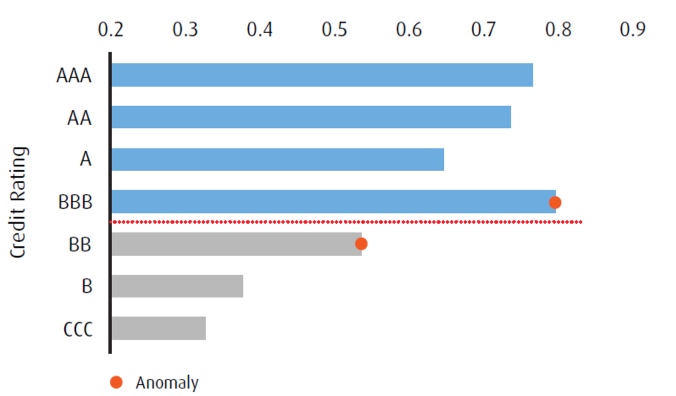
Some specific names may benefit from a rating transition from BB to BBB (called "rising stars") as they enter a much wider universe of buyers.

The strategy comprises of the lowest grade bonds in the investment grade sector (BBB) and the highest grade bonds in high yield sector (BB) – also known as "crossover bonds". This market segment has a long history of providing high yield-like returns with investment grade-like volatility.

Exploiting the anomalies for absolute return

The horizontal bar chart below illustrates the persistent premia that occurs around the BBB/BB crossover segment. The chart compares Sharpe ratios for different credit rating bands in the 3-5 year sector between December 1996 – December 2015.

Sharpe ratios for credit rating bands in the 3-5 year sector



Source: Bank of America Merrill Lynch (BAML). Chart data covers the following period: December 1996 to December 2015. The data is from the BAML US corporate indices 3-5 year maturity bands by rating. To calculate the Sharpe Ratio, the BAML USD 1 Month Deposit Bid Rate has been used.

A Sharpe ratio is the average return earned in excess of the risk free rate per unit of volatility (i.e. a measure of risk-adjusted return).

Overlays

These overlays are managed separately by highly experienced teams with a strong track record in adding value to mandates over both the long-term and short-term in a risk controlled manner. The team has embraced innovations in fixed income instruments and is able to scale their process to meet very specific risk/return objectives.

Interest rate overlay

The Fund's derivative-based global interest rate overlay is underpinned by fundamental and relative value analysis. The team's fundamental research involves assessing the fair value of a wide range of assets, modelling potential yield paths by combining the outputs of fair value models with scenario analysis, and quantifying the impact of changes in the many variables that can affect interest rates.

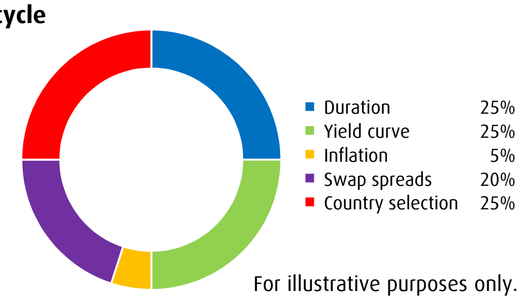
The team's relative value research involves idea generation via regression analysis and proprietary economic research, and identifying potential entry/exit points via analysis of historic trading patterns. Relative value analysis is used primarily for cross-market and yield curve trades. Typically, the team will seek to express its relative value ideas in a manner that minimizes the impact of potential spread movements.

The overlay has exposure to the entire opportunity set in interest rate swaps (nominal and inflation) and liquid exchange-traded derivative contracts. Both centrally cleared derivatives and over the-counter (OTC) interest rate swaps can be used. The variety of instruments available to the management team allows them to express an investment view in the most efficient manner. Specific sources of added value in this overlay include cross-market views, yield curve trades, inflation breakeven trades, swap spread trades and directional duration positioning.

Benefits of using an interest rate strategy:

- Ability to transform the risk profile of a portfolio
- Ability to express long and short term views, duration neutral curve trades, inflation breakeven trades and yield curve steepeners
- Ability to scale positions more appropriately and more efficiently

Expected sources of added value over the cycle



For illustrative purposes only.

Note: The contribution from different alpha sources will vary over the economic cycle. Swap spreads refer mainly to trades involving bond futures and interest rate swaps of the same maturity.

Currency overlay

This tactical overlay is designed to generate performance by targeting opportunities in FX markets. Currency views are expressed via currency derivatives. All positions are either liquid or have limited downside – possible when buying options.

Using an overlay strategy allows us to calibrate the level of return so that it reflects the strategy's risk target.

The management team employs a currency process that is underpinned by a combination of different research approaches. The relative importance attached to each research "*strand*" varies over the economic cycle. These strands are pulled together to create a relative valuation ranking of different FX pairs. The final stage in the process involves trade structuring, portfolio construction and risk management.

Currency overlay construction

Define the currency universe
Currencies range from Major (USD, EUR, JPY, GBP), Commodity Block (CAD, AUD, NZD), Scandinavian, Asia, EMEA and Latin America.

Research
Employ fundamental macroeconomic analysis (fiscal & monetary factors), positioning & flow data analysis (central bank asset purchases, cross border M&A flows, foreign direct investment trends & investor positioning data) and technical analysis (price action).

Valuation
Overvalued and undervalued currencies are measured relative to the manager's expectations. Deviations of spot prices from fair value is used to rank different FX pairs in terms of their relative attractiveness.

Portfolio construction
End result of a portfolio of highly liquid positions typically combines 5-10 FX crosses, expressing 3-5 major themes.

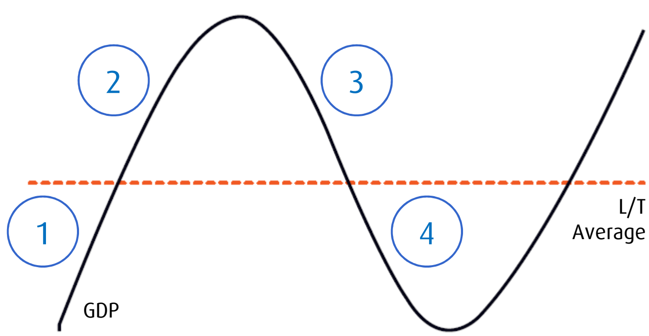
Risk management through the cycle

Risk management through the cycle encompasses three key components:
1) Effective diversification of risk
2) Tactical management of risk
3) Explicit risk strategies

The Fund embraces both market directional and non-market directional themes. Fundamental to the management of the portfolio is a focus on asset allocation and risk management through the cycle: resizing positions as necessary and avoiding unnecessary volatility. This process involves a strong emphasis on events or periods where capital is at risk.

A strong focus on periods and events where capital is at risk

Where in the growth cycle?



Phase	Economic Cycle	Bonds	Equities	Credits	Credits vs. Govt	%Time
1	GDP < avg & rising	- -	+ +	+ +	+ +	36%
2	GDP > avg & rising	=	+ +	+	+	10%
3	GDP > avg & declining	+	+	+	=	39%
4	GDP < avg & declining	+ +	- -	- -	- -	15% !

For illustrative purposes only

Source: BMO Global Asset Management, Bloomberg, as at December 2015

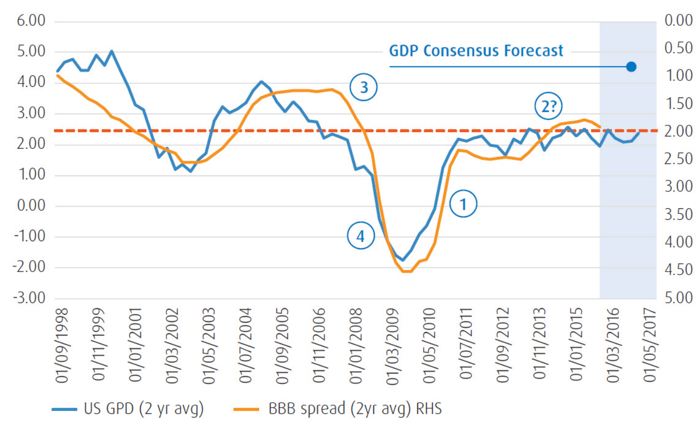
Responsibility for the resizing of investment ideas in the portfolio lies with the Strategic Allocation team. The Strategic Allocation team makes key decisions such as how much interest rate risk and credit risk is appropriate for the portfolio at a particular point in time. They are supported by an Asset Allocation Committee, which meets regularly to set overall risk parameters.

As is evident from the table below left, a long exposure to credit makes sense under most economic conditions. However, we pay particular attention to periods when capital is at risk. An example of this would be in phase 4, when GDP growth is below trend and declining. As appropriate, the management team will pare back long credit exposures and consider tactical hedging or deploying outright short credit positions.

The importance of managing credit risk through the economic cycle

The chart below indicates the importance of managing credit risk through the economic cycle:

BBB spreads relative to US economic growth



For illustrative purposes only

Source: BMO Global Asset Management, as at September 30 2015, Bloomberg since December 1996, assumes 2.5% trend growth

Delivering an attractive and stable return

At BMO Global Asset Management, we are able to offer clients a full range of fixed income solutions by leveraging an extensive mix of expertise and a wealth of experience. Our capability is derived from multiple specialist teams, each structured to facilitate collaboration, idea generation and the challenging of ideas.

BMO Asset Management Global Absolute Return Bond Fund

Approx. 50% of return

Approx. 50% of return

Cash + 4% Return

Core Portfolio
Low turnover with strategic focus on harvesting the premia in shorter duration credit

+

Shorter Term Independent Overlay Strategies
Currency
Rates
Stock/sector

Risk Management
through the cycle
Position resizing
Position resizing
Asset allocation

Overall Portfolio
Stable returns with downside protection

- Seeking to deliver 150-250 basis points (bps)
- Designed to deliver a relatively predictable return
- Targets short duration A/BBB/BB rated securities
- Approximately 150 holdings issued by relatively stable businesses

- Currency overlay strategy seeks to add 50 bps to overall returns
- Interest rates overlay seeks to deliver 50 bps to overall returns
- Sector/stock overlay seeks to deliver 30-40 bps to overall returns

- Seeks to deliver 100 bps
- A strong focus on downside protection
- Avoidance of unnecessary volatility
- Interest rate risk and credit risk managed independent of each other
- Flexibility to take negative duration and implement hedges
- Quarterly macro scenario probability analysis

Annualized Volatility:
3-5% (standard deviation)

Emerging Markets:
Max. 25% of portfolio

High Yield:
Max. 25% of portfolio

High Yield (<= B):
Max. 15% of portfolio

The combination of different strategies, each with very modest risk budgets and return targets increases the likelihood that the overall yield target will be achieved.

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