Fixed income that works in today's environment

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BMO ETFs

Summary of Recommendations

BMO Ultra Short-Term Bond ETF (Ticker: ZST) | BMO Ultra Short-Term Bond ETF (Accumulating Units) (Ticker: ZST.L)

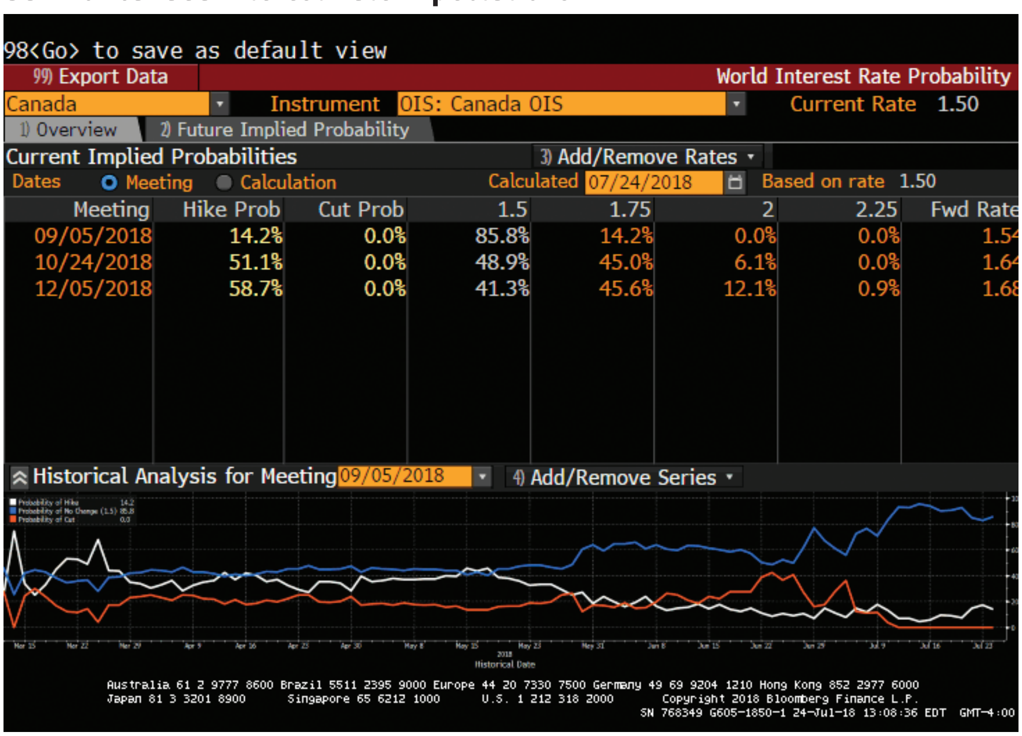
Uses

1. **Benefit from the changes in interest rates:** the short term nature of the ETF works well in a rising rate environment (According to Morningstar data, ZST is in the 9th percentile on a 3-year return basis).
2. **Putting cash to work for the short term:** Money market exposure with 100% investment grade Canadian corporate bonds that have a duration of 0.7 years and held to mature at par. All at the cost of 17 bps MER.

Market overview

- As widely anticipated, the Bank of Canada (BoC) raised its overnight rate by 0.25% on July 11, 2018. Similar to other notable central banks over the last year, the BoC has been focused on normalizing interest rates. In the past 12 months, the BoC has raised its overnight rate four times, to its current 1.5%. Going forward, Canadian central bank has remained intent on taking a more hawkish tone. Interest rate futures are currently implying there is a 80.3% chance that we will see at least another rate hike by the BoC by the end of the calendar year.

Bank of Canada Interest Rate Expectations



Meeting	Hike Prob	Cut Prob	1.5	1.75	2	2.25	Fwd Rate
09/05/2018	14.2%	0.0%	85.8%	14.2%	0.0%	0.0%	1.54
10/24/2018	51.1%	0.0%	48.9%	45.0%	6.1%	0.0%	1.64
12/05/2018	58.7%	0.0%	41.3%	45.6%	12.1%	0.9%	1.68

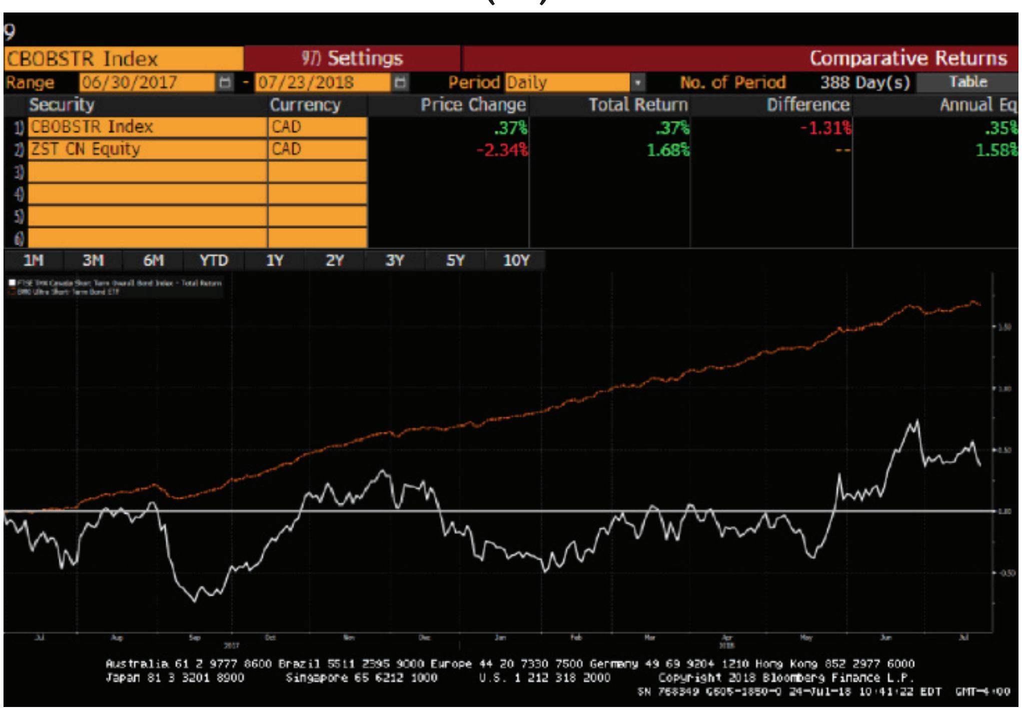
Source: Bloomberg, as of July 24, 2018.

ZST has performed well given the constant ultra-short term nature of maturing bonds.
Bonds that are one year and under in term are selected by the portfolio manager and held to maturity. This ETF is a diversified portfolio of investment grade corporate bonds. Currently ZST holds 48 bonds, but will constantly have a portion of the portfolio maturing at par and new bonds entering the portfolio. This provides a simple structure to mitigate interest rate risk and allows ZST to adjust to higher interest rates as bonds enter the portfolio with a higher current yield.

Trade Idea

- Reduce risk as bonds with less than one year to maturity provide stability, given that their prices are more anchored to par value and any deviations caused by an interest rate shock are eventually restored when they ultimately mature at par.
- Pick up additional yield, investors can focus primarily on investment-grade corporate bonds that are selected based on having an attractive yield. Furthermore, investors can better minimize default risk by avoiding sub-investment-grade bonds.
- BMO Ultra Short-Term Bond ETF (ZST/ZST.L) provides investors with a diversified portfolio of investment-grade corporate bonds with less than one year from maturity. Bonds in the portfolio are selected to allow for the ETF to have a higher distribution (Weighted Average Yield to Maturity 2.40%).
- Compared to short-term bonds, ZST has provided a much more stable return profile in the face of the recent tightening of monetary policy by the BoC (Chart below).
  - Offered in two versions
    1. **ZST –** for investors that want premium income
    2. **ZST.L –** for investors that want a more stable value NAV as the coupon in reinvested

The BMO Ultra-Short-Term Bond ETF (ZST) Has Been More Stable Than Short-Term Bonds



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