

CORPORATE PARTICIPANTS

Tom Flynn *Bank of Montreal - EVP & CFO*

CONFERENCE CALL PARTICIPANTS

Stefan Nedialkov *Citi Research Analyst*

Caution Regarding Forward-Looking Statements

Bank of Montreal's public communications often include written or oral forward-looking statements. Statements of this type are included in this document, and may be included in other filings with Canadian securities regulators or the U.S. Securities and Exchange Commission, or in other communications. All such statements are made pursuant to the "safe harbor" provisions of, and are intended to be forward-looking statements under, the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation. Forward-looking statements may involve, but are not limited to, comments with respect to our objectives and priorities for 2013 and beyond, our strategies or future actions, our targets, expectations for our financial condition or share price, and the results of or outlook for our operations or for the Canadian and U.S. economies.

By their nature, forward-looking statements require us to make assumptions and are subject to inherent risks and uncertainties. There is significant risk that predictions, forecasts, conclusions or projections will not prove to be accurate, that our assumptions may not be correct and that actual results may differ materially from such predictions, forecasts, conclusions or projections. We caution readers of this document not to place undue reliance on our forward-looking statements as a number of factors could cause actual future results, conditions, actions or events to differ materially from the targets, expectations, estimates or intentions expressed in the forward-looking statements.

The future outcomes that relate to forward-looking statements may be influenced by many factors, including but not limited to: general economic and market conditions in the countries in which we operate; weak, volatile or illiquid capital and/or credit markets; interest rate and currency value fluctuations; changes in monetary, fiscal or economic policy; the degree of competition in the geographic and business areas in which we operate; changes in laws or in supervisory expectations or requirements, including capital, interest rate and liquidity requirements and guidance; judicial or regulatory proceedings; the accuracy and completeness of the information we obtain with respect to our customers and counterparties; our ability to execute our strategic plans and to complete and integrate acquisitions; critical accounting estimates and the effect of changes to accounting standards, rules and interpretations on these estimates; operational and infrastructure risks; changes to our credit ratings; general political conditions; global capital markets activities; the possible effects on our business of war or terrorist activities; disease or illness that affects local, national or international economies; natural disasters and disruptions to public infrastructure, such as transportation, communications, power or water supply; technological changes; and our ability to anticipate and effectively manage risks associated with all of the foregoing factors.

We caution that the foregoing list is not exhaustive of all possible factors. Other factors could adversely affect our results. For more information, please see the discussion below, which outlines in detail certain key factors that may affect Bank of Montreal's future results. When relying on forward-looking statements to make decisions with respect to Bank of Montreal, investors and others should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Bank of Montreal does not undertake to update any forward-looking statements, whether written or oral, that may be made from time to time by the organization or on its behalf, except as required by law. The forward-looking information contained in this document is presented for the purpose of assisting our shareholders in understanding our financial position as at and for the periods ended on the dates presented, as well as our strategic priorities and objectives, and may not be appropriate for other purposes.

Our first quarter 2013 regulatory capital, risk-weighted assets and regulatory capital ratios have been calculated pursuant to the Capital Adequacy Requirement (CAR) Guideline released by the Office of the Superintendent of Financial Institutions (OSFI) in December 2012 to implement the Basel III Accord in Canada. When calculating the pro-forma impact of Basel III on our regulatory capital, risk-weighted assets (including Counterparty Credit Risk and Market Risk) and regulatory capital ratios in prior periods, we assumed that our interpretation of OSFI's draft implementation guideline of rules and amendments announced by the Basel Committee on Banking Supervision (BCBS), and our models used to assess those requirements, were consistent with the final requirements that would be promulgated by OSFI. We also assumed that the proposed changes affecting capital deductions, risk-weighted assets, the regulatory capital treatment for non-common share capital instruments (i.e. grandfathered capital instruments) and the minimum regulatory capital ratios would be adopted by OSFI as proposed by BCBS, unless OSFI had expressly advised otherwise. We also assumed that existing capital instruments that are non-Basel III compliant but are Basel II compliant can be fully included in the relevant pro-forma calculations. We have not recalculated our pro-forma Basel III regulatory capital, risk-weighted assets or capital ratios based on the CAR Guideline and references to Basel III pro-forma items referred to these items as previously estimated. In setting out the expectation that we will be able to refinance certain capital instruments in the future, as and when necessary to meet regulatory capital requirements, we have assumed that factors beyond our control, including the state of the economic and capital markets environment, will not impair our ability to do so.

Assumptions about the performance of the Canadian and U.S. economies, as well as overall market conditions and their combined effect on our business, are material factors we consider when determining our strategic priorities, objectives and expectations for our business. In determining our expectations for economic growth, both broadly and in the financial services sector, we primarily consider historical economic data provided by the Canadian and U.S. governments and their agencies. See the Economic Outlook and Review section in BMO's First Quarter 2013 Report to Shareholders.

Non-GAAP Measures

Bank of Montreal uses both GAAP and non-GAAP measures to assess performance. Readers are cautioned that earnings and other measures adjusted to a basis other than GAAP do not have standardized meanings under GAAP and are unlikely to be comparable to similar measures used by other companies. Reconciliations of GAAP to non-GAAP measures as well as the rationale for their use can be found in Bank of Montreal's First Quarter 2013 Report to Shareholders and Bank of Montreal's 2012 Management's Discussion and Analysis, all of which are available on our website at www.bmo.com/investorrelations.

Examples of non-GAAP amounts or measures include: efficiency and leverage ratios; revenue and other measures presented on a taxable equivalent basis (teb); amounts presented net of applicable taxes; adjusted net income, revenues, provision for credit losses, specific provision for credit losses, expenses, earnings per share, effective tax rate, ROE, efficiency ratio and other adjusted measures which exclude the impact of certain items such as credit-related items on the acquired M&I performing loans, run-off structured credit activities, M&I integration costs, amortization of acquisition-related intangibles, decrease (increase) in collective allowance for credit losses and restructuring costs.

Bank of Montreal provides supplemental information on combined business segments to facilitate comparisons to peers.

PRESENTATION

Tom Flynn - *Bank of Montreal - EVP & CFO*

Thank you for that introduction. It's good to be here in Boston. I'll make a brief presentation, 10 minutes at most, and then I'm happy to take questions. Before I begin, please note the caution regarding forward-looking statements on slide two. You'll find additional details in our public filings.

BMO Financial Group is a diversified North American universal bank. We provide a broad range of retail banking, investment banking, and wealth management products and services to more than 12 million customers. BMO is the second largest Canadian bank as measured by the number of retail branches in Canada and the US. We're the eighth largest bank in North America by assets and the ninth largest by market cap. In fiscal 2012, approximately two-thirds of our revenues were generated in Canada and the other third in the US.

Our footprint is centered in the US Midwest states, Illinois, Indiana, Wisconsin, Minnesota, Missouri and Kansas, and the two largest Canadian provinces, Ontario and Quebec. This contiguous market has a combined population of more than 74 million and generates GDP of over \$3 trillion. BMO is well diversified with a retail focused business mix. We have strong retail businesses in Canada and the US Midwest with over \$200 billion of customer deposits and approximately 1,600 branches, 930 in Canada and 630 in the US.

Retail banking is the largest contributor to total bank income and within this segment, commercial banking is a proven strength across our North American platform. We rank second in commercial lending share in Canada at 20%. In the US, we have strong deposit share positions, number two in greater Chicago and number two in Milwaukee. Our commercial business is also strong, positioning us well in an environment of business expansion. We're solidifying our position as a leading Midwest commercial bank through a combination of local access, sector and product expertise, and excellent treasury management services. Segments of focus include corporate finance, diversified industries, financial institutions, food and consumer, auto dealership, equipment finance, healthcare, agricultural, and commercial real estate. We have top three commercial lending share positions in Wisconsin, Chicago, and Minneapolis.

Our Private Client Group manages and administers total assets of \$479 billion. This business provides a broad range of wealth management and insurance offerings, including full-service and direct brokerage, mutual funds, institutional asset management, private banking, and ultra-high net worth family offices. During the first quarter, we completed the acquisition of a Hong Kong and Singapore-based private bank and are now operating as BMO Private Bank Asia, providing our investment expertise and service to high net worth clients. This transaction is another element of our overall Asian wealth strategy, creating an integrated platform that bridges our North American and Asian markets.

China represents a growth opportunity for BMO outside of North America and we're one of only three North American banks with local incorporation through our subsidiary bank, Bank of Montreal China Co. Limited. Importantly, we've established very good working partnerships in China over time, including a 28% interest in Shanghai-based FullGoal Fund Management Co, one of China's leading fund management companies; Hong Kong-based Lloyd George Management, a boutique asset manager we acquired in 2011; and a 19.9% interest in COFCO Trust Co, a subsidiary of COFCO group, one of China's largest state-owned enterprises.

BMO Capital Markets is our fourth business segment. We provide a full range of products and services to corporate, institutional, and government clients. We operate in Canada as a bulge bracket firm with a mid-cap focus in the US. We have a full offering of investment and corporate banking services, including equity and debt underwriting, M&A, and trading products with leading equity research.

In sum, we have a diversified business mix with personal, commercial, and wealth businesses representing more than 75% of adjusted group operating revenue.

I'd now like to touch on BMO's risk philosophy, practices, and performance. Our objective is to have a leadership position in integrated risk management consistent with our strong credit history. In this regard, we developed a statement of our vision, strategy, and priorities for the Risk group similar to the way we do it for our operating business groups. Our approach is to provide appropriate and independent oversight, while working with all of our businesses to generate sustainable shareholder returns within our risk appetite. BMO's strategic priorities include ensuring that our strength in risk management underpins everything we do for our customers, and our performance relative to peers remains strong over time.

Moving now to a few comments on strategy and areas of focus. Our brand strategy places the customer front and center and we'll drive revenue growth by achieving industry-leading customer loyalty and delivering on our brand promise: Making Money Make Sense.

We also have an ongoing initiative to improve productivity. We are targeting efficiencies in both parts of the equation, revenue and expense, and we're making good progress.

In fiscal 2012, expenses increased a modest 2% after adjusting for acquisitions and the stronger US dollar. This was a result of good cost management and continued investment in our businesses, including investing in technology and development initiatives that support lowering the cost of generating each dollar of revenue. And in the first quarter, adjusted operating leverage improved for the bank and for all business groups quarter-over-quarter, excluding costs related to employees eligible to retire booked in Q1 of each year.

As I've talked about, we are focused on leveraging our expanded North American platform to drive business. At the same time, we have made selective investments internationally to advance our business and expand our reach.

Our focus is paying off, with 2012 a year of progress for BMO. We delivered record financial performance with over \$15 billion in revenue¹ and earnings² of \$4 billion. We successfully completed the conversion of our US banking system and advanced our strategic agenda. Each of our businesses is well positioned to build on this momentum and success in 2013.

BMO also had a strong start to the fiscal year. First quarter adjusted net income³ was \$1.041 billion. This marked the third consecutive quarter with adjusted earnings³ over \$1 billion and both reported and adjusted income have been in the billion dollar range for five consecutive quarters. Adjusted results adjust for acquisition-related items like integration costs and loan accounting on the acquired loan portfolio, as well as certain other non-core items. In Q1, adjusting items were similar in character to prior quarters and netted to just \$7 million. Q1 EPS⁴ was up 7% year-over-year to \$1.52 and return on equity⁵ was approximately 15%.

Effective Q1 2013, regulatory capital ratio requirements for Canadian banks are calculated on a Basel III basis. Our capital position is strong with a Common Equity Tier 1 ratio of 9.4% at the end of January on an all-in Basel III basis, and 12.4% on a Basel III transitional basis. Last week, we announced a dividend increase of 3% to \$0.74 per share or \$2.96 annually. BMO's dividend yield is approximately 4.6%. The return of capital to shareholders was supported by our capital strength and the success of our business strategies.

Looking briefly at operating group results for Q1, P&C Canada adjusted net income⁶ was \$461 million, up 4%. There was strong loan growth for the third consecutive quarter with both commercial and personal lending up more than 9%.

¹ On a reported basis, F2012 revenues were \$16.1 billion

² On a reported basis, F2012 earnings were \$4.189 billion

³ On a reported basis, F2013 Q1 earnings were \$1.048 billion

⁴ On a reported basis, F2013 Q1 EPS was down 6% year-over-year to \$1.53

⁵ On a reported basis, F2013 Q1 ROE was 14.9%

⁶ On a reported basis, F2013 Q1 P&C Canada net income was \$458 million, up 4%

Personal & Commercial US had a very good quarter with adjusted net income⁷ of USD \$197 million, up 13% year-over-year, and we're seeing continued good growth trends in core C&I loans. Volumes were up 18% from a year ago and our pipeline remains strong.

BMO Capital Markets had a strong quarter with net income of \$310 million. Results reflect good execution in an improved environment and the benefit of a diversified business mix. Strong revenue in Q1 was driven by M&A activity, debt underwriting and trading revenues.

Private Client Group produced adjusted net income⁸ of \$169 million, similar to Q4. Traditional wealth was up 36% year-over-year, excluding a gain on a strategic investment recorded last year, and insurance results bounced back nicely.

To wrap up, we had a strong first quarter with good operating group performance and momentum across our businesses. Against the backdrop of slower consumer growth, we're well positioned with other avenues of growth.

Our strong commercial banking business, north and south of the border, positions us well in a business-led recovery. We have upside from an expanded and upgraded US platform. This is true of our US banking business, but also in Capital Markets and our Wealth group.

We expect to drive performance and shareholder value through our focus and efforts around efficiency across the bank, while delivering exceptional customer experience to help drive revenues.

And lastly, as mentioned earlier, our capital position is strong. And with that, I'd be happy to take your questions.

⁷ On a reported basis, F2013 Q1 P&C US net income was USD \$183 million, up 16.5% year-over-year

⁸ On a reported basis F2013 Q1 net income was \$163 million, similar to F2012 Q4

QUESTION AND ANSWER

Stefan Nedialkov - Citi Research Analyst

Okay. I'll start. In terms of your US business, you guys reported some pretty strong commercial lending results in the first quarter. You noted that your commercial real estate pipeline in the US is pretty strong. As a Canadian owner of a US regional bank, how do you see 2013 in terms of, number one, growth versus peers? And number two, how much NIM you're willing to give up in order to produce that growth?

Tom Flynn - Bank of Montreal - EVP & CFO

The focus there is on the US business, a few comments on the US business. We thought we had a very good quarter in the first quarter with good growth, both year-over-year and quarter-over-quarter. The quarter was really driven by strong growth in our C&I portfolio, which was up 18% year-over-year and up 7% quarter-over-quarter. So exceptionally strong performance, I would say, quarter-over-quarter. And as I said in my remarks and as we said on our Q1 call, the pipeline remains strong on the commercial side.

The performance there reflects, in part, the strong capability in commercial lending that Harris Bank had and M&I, the bank that we acquired about a year and a half ago had. Combined, we've got a very good capability in our footprint in the commercial space, and we've been investing in the brand as well. And so we've got a good capability that is paying off for us in the marketplace.

Total loan growth for us in the portfolio was positive quarter-over-quarter in Q1. That's the first quarter of total positive loan growth that we've had in the business since we closed the acquisition of M&I. And since closing, we've been working down parts of the portfolio that were higher risk and we wanted to sort of right size. And so we're pleased this quarter to see the crossover point, driven by the C&I growth. And our hope would be that we would continue to show loan growth over the balance of the year.

We do have NIM pressure and we're not alone in that. US regionals generally experienced some NIM pressure, mainly driven by the impact of low rates, although pricing is competitive on the loan side as well. In Q1, our NIM was down 9 basis points quarter-over-quarter and that was more than we thought it would be down heading into the quarter. A few things contributed to that, including the strong loan growth. And over the balance of the year, we do think that the NIM will trend down through time, but at a lower rate than we saw in the first quarter and more like in the order of around 5 basis points a quarter is the number to think about. And there'll be movement around that number.

So that's sort of the picture on the NIM and the loan growth side. We had good non-interest revenue performance in the quarter that was generated from good fees on the commercial lending side that went with the loan growth volume. And we have also been in the practice of selling the majority of our originated mortgages. We're selling over two-thirds of our originated US mortgages. And so we're generating fee income off of that activity. And so against the backdrop of a net interest number that's going to be hard to grow, given the NIM compression, we're focused on generating non-interest revenue where we can. And revenue growth in total, we'll have some challenges around it in the US, but we're focused on moving the business where we can.

Stefan Nedialkov - Citi Research Analyst

Sure. Now let's talk a little bit about your US business in the context of the overall group. Obviously, the US is on a recovery path. Most your competitors are preparing for the expansion, for more lending growth, et cetera. For you, right now, the US contributes around 20% of group net profit. What would you like that percentage to be five years from now? Are you happy with 20%? Would you want to have more exposure to the US given the relative growth differential between Canada and the US going forward?

Tom Flynn - Bank of Montreal - EVP & CFO

So the US retail banking business and wealth business are generating a little over 20% of group income and capital markets is on top of that. And in the first quarter, our US Capital Market business generated about USD \$88 million (sic) of income, which was a very good quarter for it. So in total, this quarter we were a little above 25% of the income across the three business groups.

And the way I would think about your question is that through time, given our outlook for the two economies, we do expect the US business to show stronger growth than the Canadian business, given the investments that we've made in the platform over the last few years, and also slightly higher economic growth in the US than in Canada. In Canada, this year we're calling for sort of 1.5% to 1.8% growth, in the US, 2% plus a bit. And our footprint is growing basically in line with the national average in the US. So we expect we'll have a positive growth delta organically coming from the US. It's clearly a larger market for us to grow into.

From an acquisition perspective, what we've been saying is that having completed a large acquisition about a year and a half ago and completed the integration of it, we're now focused on making sure we get the payoff from those investments. And so we're not expecting to do another acquisition of any size in the US anytime soon, and that reflects the confidence we've got in growing the business organically and, again, taking advantage of the investments that we've made.

Stefan Nedialkov - Citi Research Analyst

In terms of synergies from your M&I acquisition, you have upped the guidance up to around \$400 million with around 90% of that being phased in by the end of this year. Is there a scope for additional synergies from -- maybe for 2014 onwards?

Tom Flynn - Bank of Montreal - EVP & CFO

That's a great question. We have moved our synergy target up quite meaningfully, as you know. So when we announced the transaction, we said that we thought synergies would be approximately \$250 million and that was based on the initial work that we did pre-transaction. We've increased that number really quite significantly to go from the \$250 million to \$400 million. And we're now at the point where about 75% of the synergies have been realized, expect to move up into the 90s by the end of the year. And there will be a trickle after this year as we move from in the 90s to 100, but they won't be significant.

And I think beyond the \$400 million number that we've talked about, the synergies will be more like just benefits from the transaction. And our hope would be that with the stronger platform and the process -- the approach we took to integration, which was really to take the best from both organizations, people, products and processes, that we'll have a much more competitive bank and that we will take share and we'll realize higher growth than we otherwise would. And so we see upside from that, benefits from that, but I wouldn't call them synergies.

Stefan Nedialkov - Citi Research Analyst

I see. So moving more towards Canada, in a slowing domestic consumer market, in my eyes, you're actually one of the more uniquely positioned Canadian banks because you have the largest market share in business lending, according to the data that we have access to. The number two player is not very much far away from you, but you are still the top dog right now in terms of share. Yet, you have chosen to expand your mortgage book by offering very low, almost rock bottom, mortgage products such as a five-year fixed or even an 8 to 10-year fixed. What is driving you to expand in an area that is slowing, rather than building on your strengths in terms of business lending, something that is looking up in my view?

Tom Flynn - Bank of Montreal - EVP & CFO

So I guess the way I would answer that question is we were looking to get growth on both sides and we do think that the market opportunity will be larger on the commercial side, given the leverage that exists with the Canadian consumer and having a business-led recovery. But we run our personal business separate from our commercial business. And so putting energy into one side of that business doesn't really detract from our ability to look to grow the other side. And we do think that our business mix is very well suited to the current environment from a growth perspective, because we are overweight commercial lending in both Canada and the US, and we think commercial lending will be higher from a growth perspective than personal.

We've also got upside from our US businesses, having invested them over the last few years, and we think there's natural operating leverage there, plus the US economy we think will grow more rapidly than the Canadian economy and we'll be a beneficiary of that to a greater extent than some of the Canadian banks that aren't as big in the US, and our capital position is strong. So we feel good about our mix as it lines up against the current environment.

On the mortgage product, we have promoted a mortgage product that we think is a good product for our customers. And the product offers customers a fixed rate for, generally, 5 years and a 25-year amortization period for the principal repayment. And we think it makes sense for our customers to lock in a mortgage rate at the current time because rates are low, and also to pay off their mortgage more quickly. And the product that we've promoted, we think, lines up well with market demand, but also with good financial planning from an individual customer perspective. And so living our brand of, Making Money Make Sense, we think it's a good product.

The product has been very successful. We had a campaign around it about a year ago. This week, we've just relaunched the campaign for the, sort of the spring house sale season. And we've had very good success at cross-selling customers and also bringing in new business. So in the campaign that we had about a year ago, 40% of the business that we did came from customers who were new to our bank, and that was a great customer acquisition strategy. The spreads on the product are in line with the average spread on our overall mortgage product and that's in part because we're doing the business at the advertised rate versus having a higher rate that you might discount off of to do business. And so the spreads are reasonable, and we've had very good success at cross-selling new customers other products. And on average, we've cross-sold 1.9 products to the new customers who have come to the bank with that product.

So from our perspective, we've got spreads in line with the portfolio, we're attracting new customers, we're cross selling them other products and we're gaining share. And our share in mortgages is relatively low, it's around 11%, about half of our share in commercial lending. And although growth is likely to slow in the mortgage market, we think it should from a market health perspective, our share is relatively low in that segment. So having growth makes sense in our overall mix.

Stefan Nedialkov - Citi Research Analyst

In terms of your other residential exposures, you do have a fair amount of home equity lines of credit. I believe you are the second most exposed bank as a percentage of the total loan book at around 15% of your domestic loan book is held. It's not materially larger than most of the other banks, which are around 9% to 10%, and it's below one of your competitors who is around 20%. Yet that is the one product that could potentially keel over if the consumers slow down. And it's a product that introduces almost nonlinear risks, if you will. You just need a little bit of negativity in the economy, either from the construction sector, in employment, GDP slowing down overall, in order for the infection to start spreading. Do you think this risk is overblown? Are people worried too much about it? And what are you doing to sort of mitigate the risk around your HELOC exposure overall?

Tom Flynn - Bank of Montreal - EVP & CFO

So we have been active in that market as have the other banks as you've said. And the short answer to your question is that we're mindful of the risk, managing the risk, but not unduly concerned about the risk. And we had a US bank through

the US downturn and that bank had a home equity portfolio, and a mortgage portfolio, and an indirect auto portfolio. And we've seen what can happen to home equity portfolios through a significant housing correction. And clearly, there is risk. And the risk can be very sensitive to employment and the housing market.

But there's one, I think, very material structural difference between the way the business is done in Canada and the way it's done in the US, and that difference relates to the loan-to-value that we'll lend at. And we don't have home equity exposure above an 80% loan-to-value ratio. And in the US, it was common to have meaningful exposure above an 80% loan-to-value ratio. And so that's a huge cushion that exists in the Canadian marketplace relative to the US marketplace, and I think materially lowers the risk profile of the product in Canada compared to the risk profile that existed in the US.

Stefan Nedialkov - Citi Research Analyst

Does the LTV of less than 80%, is that applicable to both first and second lien, so the entire HELOC book? Or just on the first lien?

Tom Flynn - Bank of Montreal - EVP & CFO

The entire book. And then on the question of first and second lien, I think losses were highest in the US obviously with high loan-to-value HELOC products, and also when a bank was in a second position behind another bank who was first. And in Canada, virtually all of our product is either first in itself or part of a package, a business that we're doing with our customers. So there's very little that would be in a second position, structurally, behind another institution. And so that's another mitigant to the market. So overall, I'd say we're mindful of the risk. We think we've underwritten the business in a prudent way and we're not unduly concerned.

Stefan Nedialkov - Citi Research Analyst

Sure. And I asked this question of Janice right before you as well, very, very curious to hear your thinking. What will cause Toronto real estate prices to follow those of more Western cities such as Vancouver?

Tom Flynn - Bank of Montreal - EVP & CFO

I used to be in the risk group, as you mentioned, and so I've been asking that question for probably at least 3 years. And I would say, there is a reasonable degree of comfort around the Toronto housing market. One of the important drivers of that comfort relates to the net inflow of population into the market, and Canada is a country that has net migration in, and Toronto receives a very disproportionate amount of that migration to the city. And the economy is doing well, generally, and attracts people from the surrounding region. So there's a net inflow of population that provides a natural base of support to the housing market.

Second point would be that the new supply that's coming on stream is generally not being built on spec. And in the US, at the peak, there was a meaningful component of the new construction market that was built on the expectation that the product would sell as opposed to having it sold before the shovels went into the ground. And in Canada, it's more a practice, particularly in the condo market, to have presales above the prescribed level before the construction begins, which also helps with just maintaining supply and demand in the marketplace.

And last point, I guess, would be that affordability remains reasonable. And that's obviously helped in a very significant way by the current rate environment. But our expectation is that rates will remain low for some time. And with that, we don't see a big shock to the capacity to pay that individuals have for mortgages. So all that to say is prices are up. Almost by definition, there therefore, must be some incremental downside. But we think the market is pretty much in balance at the present time. And for that to change, I think you'd need some combination of a significant downturn in the economy, a

spike up in unemployment and potentially an increase in rates. And it's clearly possible that we'll have another recession. We will have another recession at some point. It doesn't feel imminent, but based on all the stress testing that we've done, under fairly extreme assumption scenarios, the losses would be very manageable coming from the mortgage business.

Stefan Nedialkov - Citi Research Analyst

Okay. Well, thank you. Can we open the floor for questions?

Unidentified Audience Member

I would just be curious to hear how you are thinking about your Capital Markets business, capital allocation within that. Are there certain businesses where you're going to keep pushing for market share and hope that returns follow? Sort of what's your thinking on that?

Tom Flynn - Bank of Montreal - EVP & CFO

Sure. So for those listening, the question was how do we feel about our Capital Markets business and the capital allocation within the business.

I would say we feel very good about the business. We've had two quarters in a row with income above \$300 million. That's well above the run rate that we had over the preceding four quarters. And it feels to us like the capital market environment is improved, and that's partly a function of confidence slowly crawling its way back and having an uptick in corporate M&A as a result of management teams feeling more confident. And it's also helped by a stronger equity market.

So heading into the new year, we feel good about the business, in general, and the outlook for the year and we've had two good quarters given that kind of a backdrop. In terms of share, in the Canadian market, we view ourselves as kind of a Canadian bulge bracket player. We've got very good capabilities across the product suite and fight it out for market share every day with our competitors, and feel good about our capacity to compete.

In the US, over the last three or four years, we've invested in upgrading talent and strengthening the alignment between the different parts of our business. And we are hoping to see this year a good payoff from that investment, given that the teams have been together for a while now. They've gelled and we've got a better environment.

And as I mentioned earlier, in the first quarter, we had strong profitability from our US Capital Markets business, USD \$88 million (sic) of net income. There was a tax reserve release included in that. So the operating earnings would have been lower, but it was still a very good quarter. And the upside that we see from the capital markets we hope will come from continued good performance in the US, where the focus is very much on the mid-cap sector, and we're not trying to compete with bulge bracket firms.

And taking advantage of some opportunities that result from having a relatively strong balance sheet and trade finance has been an area of focus for us over the last two years. We've seen good gains in share in that business and very good returns, and we're hopeful that will continue. From an overall mix perspective and a capital allocation perspective, we're happy with the portion of the total business that Capital Markets represents at the current time. And so not looking to make any big changes from an allocation perspective and the return on capital has been good. Our return last year was about 19% and in Q1 was 21%.

Unidentified Audience Member

Could you provide more color as to your stress test scenarios that you used?

Tom Flynn - Bank of Montreal - EVP & CFO

I'll provide more color, and we do a variety of stress tests as you would expect, and do some stress tests individually as an institution where we look at different scenarios, and then our regulator has the industry run through different scenarios. And we run scenarios where the market is down for housing by 40% and by greater amounts in the large markets in the country. Unemployment is double-digit and interest rates are up. So what I would describe as pretty extreme downturn scenarios, and in those scenarios as you would expect, the losses that are modeled go up. They go up meaningfully, but they don't take away from the profitability in the Canadian retail business.

So I come back to the point about the structure of the market and I think people in the room know this. But when you don't have exposure above an 80% loan-to-value position in either home equity or the mortgage product, you really have a different risk profile were you to head into a downturn. And that shows up in the stress testing results that we run.

Unidentified Audience Member

You just talked about economies of scale in your US business. I mean, I know you were asked about whether you had more ambition there. But do you get economies of scale from the US business being part of the group? Or do you need some other national franchises in the US to really make US regional banking work because that's what you are in the US? All the regional banks that are really good in the US seem to have some other national franchises, something special in them, not just deposits and C&I?

Tom Flynn - Bank of Montreal - EVP & CFO

So I'll answer that question in a few ways. Firstly, on whether we get economies of scale across the broader group, the answer is that we do and it's part of our focus on productivity. We're working to increase the extent to which that is true. And the phrase that we use internally is that we want to leverage our platforms north-south. And that's a reference to getting activities on common platforms in the Canadian business, north, and the US business, south. Our technology and operations group, I would say, is very focused on this, has been focused on it for over a year. And there's a constant challenge to try to leverage platforms in that kind of a way. It isn't always easy, because you do have differences in products between different jurisdictions and clearly, it can be hard to put different products on the same platform. But we're making good progress. And as an example, we run our call center business and support centers on a north-south basis with one management team. Our computer backup systems are on a common platform with the redundancy built-in into a location in Toronto. Our senior management teams across the business groups and the functions are common management teams across the different parts of the business.

And there are also customer benefits that flow from being active in both Canada and the US. So for example, our Capital Market business is absolutely more relevant to our Canadian clients, both investing and corporate. Because we've got a window onto the US, we can raise debt and equity in the US, we've got perspectives on M&A in the US, and we've got research coverage on a large number of US stocks and that's helpful for our Canadian investors. And vice versa to a degree, but more so for the Canadians.

And so we're focused on it as a theme and see benefits and are going to continue to work it. On the point related to national businesses, we don't have at the current time what I would call a national asset gathering business, and we don't have plans to create that right now. We feel good about the ability to grow the business. We see leverage in that and likes in that and are focused on that right now, and aren't in the process of ramping up a national asset origination type of a business.

Stefan Nedialkov - Citi Research Analyst

Any more questions? I have one more question for you. Your interest rate sensitivity as reported by yourselves has gone up over the past few quarters. I think you now would benefit by \$50 million to \$60 million in earnings from a 100 basis point increase, while just a few quarters ago the impact would have been negative. So this is quite a significant change in how you have positioned your balance sheet. Now, this is obviously most likely due to your view on interest rates going up over the short to medium term. What if that doesn't happen? What is the risk to your potential P&L and balance sheet if rates do not rise?

Tom Flynn - Bank of Montreal - EVP & CFO

So we have changed the positioning directionally in the way that you've described. The change is based on a view that given where rates are they're more likely to go up than to go down. And I'd say, we have more upside sensitivity to increases than downside exposure to decreases. So the exposure isn't symmetrical. And I think the real answer to your question, though, is that if rates stay low, then there will be for a while longer a continuation of the pressure that we and other banks have seen on margin. And that comes from basically reinvesting assets that are maturing at old higher rates into a lower rate environment.

And we're not fully through the cycle of reinvesting in a low rate environment given the duration that we've got on our equity and our deposit investments. And that will continue a little bit further if rates were to stay low. That said, we're, we think, well through the halfway point of sort of repricing into a lower market.

Stefan Nedialkov - Citi Research Analyst

Okay, great. Well, Tom, thank you so much for your time and for your insight.

Tom Flynn - Bank of Montreal - EVP & CFO

Okay.