TOP investment themes of 2015

The year began with investors expecting stronger global growth, continued strength in the U.S. dollar and higher interest rates. The first half of 2014 took investors by surprise as the pick-up in growth was delayed on the back of disappointing first quarter gross domestic product (GDP) results in the U.S. and sluggish growth in most major developed economies. Eurozone and Japanese GDP flirted with recessionary levels, while China struggled to sustain its extraordinary 6-7% pace of growth. In the bond market, to the surprise of nearly everyone, 10-year U.S. Treasury yields grinded lower. Investors learned that the normalization of interest rates would be more gradual than what was previously expected.

It wasn't until the latter half of the year that economic indicators started building, leading to another year of U.S. equity market outperformance. Economic indicators were often reported above expectations, and the U.S. dollar continued to gain strength. As 2014 ends and we begin 2015, it's clear that momentum is building in the U.S.

Looking forward, we anticipate that political and economic uncertainty will continue to grab headlines around the world. The first theme of our outlook for 2015 is "divergence". As central bank policies begin to move in different directions to address their respective economies, some regions will fare better than others, and a handful will be left coasting in between.

> **Divergence:**
> As central bank policies begin to move in different directions to address their respective economies, some regions will fare better than others.

We believe the U.S. is a clear favorite to drive global growth. The two most battered sectors in the U.S. (banking and housing) have healed significantly. Specifically, the household sector has erased nearly 75% of the run-up in debt-to-income ratios which occurred during the credit bubble. Employment has been strong as more Americans are working now than ever before, with further gains expected through 2015. Based on these factors we expect the U.S. economy to accelerate at a 2.5% growth rate this year.

Sharply lower oil prices will also contribute to the "divergence" of economies. While some economies will suffer more than others, lower oil prices in the U.S. act as a de facto tax cut for U.S. consumers. This means Americans will be left with more money in their pockets after visiting the pump. It also serves as a reduction in costs for oil intensive enterprises. If oil prices remain in the current sub-$55 per barrel range, we anticipate that up to 0.4–0.8% could be realized in incremental U.S. economic growth this year.

Our next theme for 2015 is "lowflation". This refers to the tendency for inflation across most major markets to be persistently lower for a longer period of time.

Looking beyond the U.S., cyclical momentum has either stalled or weakened globally. The Eurozone is at an inflection point where an elevated risk of deflation exists. As a result, it is likely that the European Central Bank (ECB) will try to stimulate the economy via bond purchases. In Japan, job creation and wage growth remain low. The Abe government's decision to delay its second increase in sales tax is, however, quite encouraging and improves the odds of an upside boost to economic growth. The story in China continues to be weaker incoming economic data, which adds to the probability of more monetary easing and targeted injections of liquidity to come. Finally, the global impact of lower oil prices and weaker currencies (excluding the U.S. dollar) provide evidence that any risks to inflation in 2015 are to the downside and any rise is likely to be gradual through 2015.

Lowflation:

Refers to the tendency for inflation across most major markets to be persistently lower for a longer period of time.

The divergence of the U.S. from other major economies along with persistently lower inflation and anticipated monetary easing globally helps lead us to our central recommendation for asset allocation. We believe portfolios should be overweight equities and underweight bonds/interest rate sensitive assets. Within equities, our top three regions are the U.S., Europe and Developed Markets.

$ U.S. Equities

Driven by strong employment gains, housing starts, auto sales and nominal income growth, the U.S. will continue to lead the world this year.

U.S. holdings should be obtained with full currency exposure as U.S. dollar is expected to appreciate relative to the Canadian dollar.

For more discussion on the opportunity of U.S. equities in 2015, refer to page 3.

€ European Equities

Even though recent economic data shows risks of deflation in the Eurozone, the ECB has committed to growth and is expected to use U.S.-like monetary stimulus to stabilize assets. Lower commodity prices will also benefit European businesses as consumers will have more disposable income. For more discussion on the opportunity of European equities in 2015, refer to page 4.

¥ Asian Equities

Lower commodity prices divide performance for the main emerging market countries. Commodity producers, like Russia and Brazil, should be avoided as their economies underperform when commodity prices are low. The opposite is true for commodity consumers, such as China, who will benefit from lower prices. The combination of cheaper manufacturing inputs and monetary stimulus should help sustain growth in 2015 for the Chinese economy, albeit at a slightly slower pace. For more discussion on the opportunity of Asian equities in 2015, refer to page 5.

As the year progresses we are again likely to see some events unfold that could change both the political and economic landscape for investors. Using the ideas mentioned above may be a good place to start your planning as they were chosen based on our two central ideas that we expect to endure throughout 2015:

1) the "divergence" of the U.S. from global economies, driven in part by varying central banking policies

2) "lowflation" persisting in global economies, prompting risks of deflation and government intervention

On the following pages, we highlight some thoughts from our portfolio managers and their view on the areas where we see opportunities in 2015.

Paul Taylor, CFA, MBA
Senior Vice-President
and Chief Investment Officer, Asset Allocation
BMO Global Asset Management

2015 Opportunity: **U.S. Equities**

We expect the S&P 500 Index to reach a price target of $2,250 by 2015 year end. This would represent a roughly 9% annual return, in line with historical average annual returns.

Brian Belski
Portfolio Manager
BMO Capital Markets

Overview

What area within U.S. equities do you think provides the greatest potential in 2015?

- We favour financials, specifically the American banking sector, for the year ahead.

What are some of the main factors indicating that this area will perform well?

- Most investors are treating financials like it is still 2008-2009, and are ignoring the massive structural change that has occurred. Book values for the banks are strong, their cash positions are building and operating performance is steady.

What are the most important events or metrics that you are monitoring for the sector right now?

- We keep a close eye on earnings, as well as wages. Government regulation is also monitored since we believe regulation may loosen, benefiting the sector as a whole.

How are you positioning the portfolio for 2015?

- Sectors which we favour are financials and technology. We believe America will be a premiere innovator this year, especially within both software and hardware development.
- We are avoiding energy and materials, as the perfect storm of lower demand and higher supply for oil has helped prices tumble, with slower demand growth expected ahead. The portfolio is also underweight utilities, since we believe this sector is extremely overvalued.

Holding Example

What is one of the top holdings in the portfolio right now?

Bank of America Corp (BAC); one of the largest banks in the U.S.

What metrics are leading you to this conclusion?

BAC boasts an attractive business model with strong earnings and customer base. The company is well positioned to outperform in 2015, especially if we see government deregulation.

What is one metric that you are monitoring for BAC right now?

We continue to monitor and evaluate BAC's cash positions, with close attention to dividend and buyback decisions.

How do I invest in U.S. equities?

Mutual Fund: BMO U.S. Equity Plus Fund

Fund Codes	Sales Charge	Low Load	Deferred Sales Charge
A (No Load)	GGF70744		
Advisor	GGF99744	GGF98744	GGF97744
F (Fee Based)	GGF95744		

BMO S&P 500 Index ETF

ZSP	ZSP.U	ZUE
Unhedged	Unhedged | USD traded	Hedged to CAD

BMO Dow Jones Industrial Average Index ETF

ZDJ
Hedged to CAD

2015 Opportunity: **European Equities**

We believe that there are a number of high quality financial institutions in Europe that have sufficient capital and liquidity that are currently trading at very attractive valuations.

David Moss, CFA
Portfolio Manager
F&C Management Limited

Overview

What area within European equities do you think provide the greatest potential in 2015?

- We favour financials, specifically European banks, for the year ahead.

What are some of the main factors indicating that European banks will perform well?

- Capital levels within the banks are at pre-crisis levels, and liquidity is no longer an issue since the European Central Bank (ECB) has made it clear liquidity will be available to banks if necessary. Also, visibility on regulation has improved with the ECB aiming for Euro-wide consistency.

What are the most important events or metrics that you are monitoring for financials right now?

- We monitor revenue, earnings, and provision trends for the banks, but most importantly loan growth. We expect the demand for credit and willingness to lend to improve, a positive trend for European banks.

How are you positioning the portfolio for 2015?

- Using a bottom-up strategy and having a deep understanding of the businesses we invest in is our primary focus for positioning.
- While we invest over a minimum period of three years, we are currently overweight financials and underweight energy.

Holding Example

What is your favourite holding in the portfolio right now?

Intesa Sanpaolo SpA (ISP); the largest Italian bank with the best geographic coverage.

What metrics are leading you to this conclusion?

It has a long history of conservative risk underwriting and is one of the best capitalized banks in Italy. High capital and liquidity ratios allow ISP to focus on selling investment products to its client base while providing upside potential from its existing operations.

What is the main risk of this holding?

Further macro-economic deterioration in Italy is a risk, though we believe it will impact competitors more so than it would ISP.

What are the most important metrics that you are monitoring for this holding right now?

We keep a close eye on ISP's interest margin, as well as new loan issues. Also, commission income from investment products is quite important to us.

How do I invest in European equities?

Mutual Fund: BMO European Fund

Fund Codes	Sales Charge	Low Load	Deferred Sales Charge
A (No Load)	GGF70719		
Advisor	GGF99719	GGF98719	GGF97719
Advisor US$	GGF79719	GGF78719	GGF77719
F (Fee Based)	GGF95719		

BMO MSCI Europe High Quality Index ETF

ZEQ

Hedged to CAD

2015 Opportunity: **Asian Equities**

We remain focused on buying high quality companies with sustainable growth at price points that we believe are below their intrinsic value.

Robert J. Horrocks, PhD
Portfolio Manager
Matthews International Capital Management

Overview

What areas in the Asia Pacific region have developed in 2014 and what changes do you see for 2015?

- In 2014, the region saw exciting changes as reform-oriented regimes were put in place in both India and Indonesia. Looking to 2015, we hope for additional momentum in further liberalization through tax, labor and anti-corruption reforms.

What are some of the main drivers indicating that Asia Pacific will perform well?

- Asia's track record of productivity gains over the last 15 years has been very healthy. We believe improving urbanization, modernization and technological change will continue to drive GDP per capita higher.

What are the most important events or metrics that you are monitoring for Asia Pacific right now?

- Monetary policy tightening in the U.S. could lead to capital outflows and short-term weakness in Asia. We also continue to monitor the commitment to reform, specifically with the Chinese government.

What's your portfolio outlook in 2015?

- Volatility created by short-term policy decisions could provide us with greater opportunities to purchase companies below their intrinsic value. Overall, we will continue to focus on strong, domestic demand-oriented companies.

How do I invest in Asian equities?

Mutual Fund: BMO Asian Growth and Income Fund

Fund Codes	Sales Charge	Low Load	Deferred Sales Charge
Trust – A (No Load)	GGF70154		
Trust – Advisor	GGF620	GGF942	GGF120
Trust – Advisor US$	GGF625	GGF947	GGF119
Trust – F (Fee Based)	GGF734		
Trust – F US$ (Fee Based)	GGF737		
Class – Advisor	GGF87604	GGF86604	GGF85604
Class – H (High Net Worth)	GGF84604		
Class – F (Fee Based)	GGF88604		

Holding Example

What is your favourite holding in the portfolio right now?

AIA Group Ltd. (AIA), a leading pan-Asian life insurance company

What metrics are leading you to this conclusion?

AIA holds a strong market position and benefits from an established distribution channel. The company's management incentive structure is line with creating shareholder wealth, and it trades at an attractive valuation.

What is the main risk of this holding?

While equity markets always present some degree of risk for life insurance companies in the short-term, structural changes in tax, regulatory and capital regimes pose the biggest risks for AIA in the long-term.

What are the most important metrics that you are monitoring for AIA right now?

We pay close attention to new business growth across various markets, as well as AIA's expansion into mainland China.

BMO China Equity Index ETF

ZCH

Unhedged to CAD