

BMO Global Asset Management

Monthly ETF Update

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Emerging markets set to build on recovery in 2017

The macroeconomic forecast for emerging markets (EM) is supportive of steady positive growth combined with lower inflation by historical standards. In 2017 EM GDP is expected to grow at 4.5% versus developed markets where GDP growth projections are at 1.9%. Interest rates are expected to move higher in the US and EM countries are broadly equipped to leverage this increase. Opportunity and growth rates vary from country to country, but EM countries have overall improved their balance sheets and deleveraged in the aftermath of the 2008 financial crisis. (Source: IMF World Outlook 2017).

Investors have historically gained exposure to EM through broad benchmarks such as the MSCI Emerging Markets Index and they can now achieve superior risk adjusted returns over pure beta benchmarks by employing a factor based approach to investing. Factors such as 'quality' and 'high dividend' are effective in identifying companies that are less likely to be negatively impacted by political and/or currency risk and deliver attractive yield levels with the potential for capital appreciation over time.

Factor Approach

'Quality' and 'high yield' factors help to reduce risk in a region exposed to political and currency risk.

- 'Quality' has exhibited a beta of 0.92 and a Sharpe ratio of 0.54 vs 0.42 for the broader index¹.
- 'High yield' factor has exhibited a beta of 0.95 and a Sharpe ratio of 0.57 vs 0.42 for the broader index¹.
- Relative to the MSCI EM benchmark, 'quality' consistently trades at a premium as shown in chart 2. It is the only factor that has not dropped below the parent index on a relative valuation metric during the period 2001-2016, thus providing a potential cushion for investors through turbulent markets.
- Over the last 5 years, the 'quality' factor is the strongest performing factor after 'momentum' for this region.
- Conversely, the 'high yield' factor is trading at a discount to long term average valuations (chart 2 below) but has demonstrated far superior risk adjusted returns relative to the EM index over the long term (chart 1 below). Investors are attracted to the recent outperformance of this factor (by 1.3% over 1 year) which may be the signal that this discount is narrowing.

Source: Figures above and charts below are from MSCI Jan 31 2017 Factor Report

¹Annualized for the 30-Nov-2001 – 31-Jan-2017 period

Chart 1

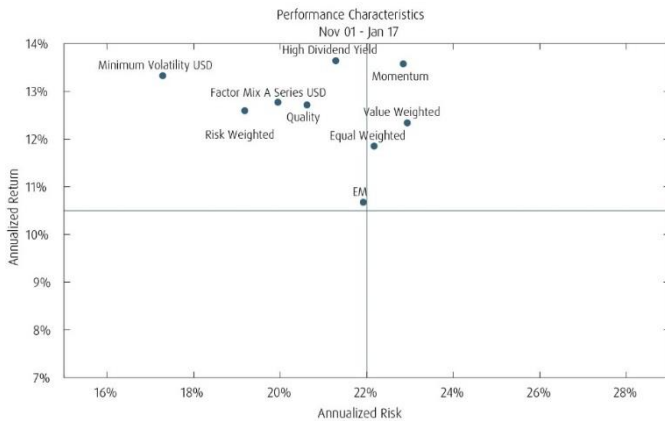
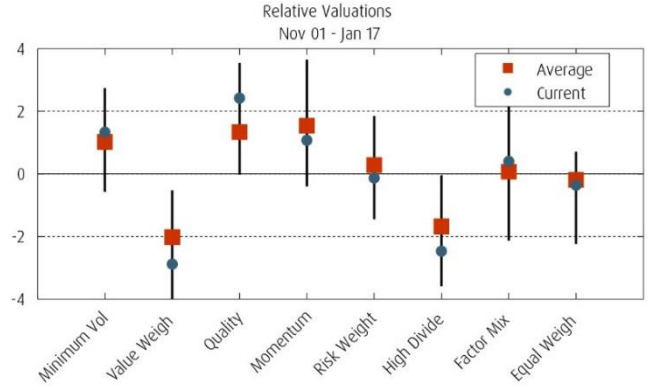


Chart 2



Based on price to earnings, price to book value, price to cash earnings and price to sales at month end dates. Values below 0 indicate the factor is cheaper than the parent. A current value below average indicates that the factor is cheap relative to its own history. The line endpoints indicate historical minima and maxima.

BMO Income Leaders

The MSCI Select Quality Yield Index takes a multi-factor approach, first screening stocks for quality (companies that exhibit high return on equity, stable earnings growth and low financial leverage) and then for stocks with the highest dividend yields. It is this combination of factors in emerging markets that helps reduce the exposure to companies that may be affected by political and currency risks. The strategy seeks to select leading companies with long-term sustainable business models and clear competitive advantages.

The result is a forward looking strategy investing in quality, high income paying companies in EM such as Taiwan Semiconductor, Delta Electronics and Foxconn Technology Group. Market Cap weighting provides enhanced liquidity and exposure to growth areas of the market, in contrast to yield weighting which can over-weight less growth oriented companies and carry greater sector biases. The strategy pro-actively avoids companies vulnerable to a dividend cut; rather than reacting to dividend cuts like many traditional strategies.

As a result of the methodology, the BMO MSCI Income Leaders Emerging Markets UCITs ETF looks quite different from the MSCI Emerging Markets Index, geographically. For example, currently the Select Quality index is underweight India and Mexico as a result of the methodology’s emphasis on quality and yield. This is a benefit in the current economic environment, India’s growth forecast for 2016-2017 was cut by approximately half a percentage point as a result primarily of cash shortages and payment disruptions resulting from the recent currency note withdrawal and exchange initiative thereby leading to a negative consumption shock. In addition, growth projections were also cut for Mexico as it faces increased uncertainty and headwinds from Trump’s proposed trade policy reforms and a depreciating Peso. (Source: IMF World Outlook 2017)

Finally, the impact of combining the quality & yield factors is illustrated in the chart below; over 16 years, the MSCI Emerging Markets Select Quality Yield Index has outperformed the benchmark by nearly 3% on an annualised basis and has achieved a Sharpe ratio of 0.58².

² Based on Monthly Net returns data, since Dec 29, 2000, using 1 month ICE LIBOR rate.

CUMULATIVE INDEX PERFORMANCE - NET RETURNS (USD) (DEC 2001 – DEC 2016)



Source: MSCI Information as at December 30, 2017

Overview of Methodology:

MSCI Emerging Markets Select Quality Index

Universe: Constituents must be members of the MSCI Emerging Markets Index.

Constituent Selection: Top 50% of securities with the highest quality scores, followed by top 50% by dividend yield

Minimum Market Cap: Constituents must be large and mid-cap securities, currently defined at float-adjusted market cap of at least USD 512.6 million as of January 2017.

Diversification: Individual stocks are capped at 5%

Weighting: Market Cap

Quality Scores based on three variables:

High Return on Expenditure – Indicates a business with a sustainable competitive advantage, efficient operations and profitability.

Stable Earnings Growth – Demonstrates durability and stability of a company’s business model.

Low Financial Leverage – Determines if returns are based on underlying operations and protects on the downside.

BMO MSCI Emerging Markets Income Leaders UCITS ETF

Fund Ticker	Net Assets (MM) Jan 13, 2017	Base Currency	Trading Currency	Estimated Index Yield	OCF**	Inception Date	Index	ISIN
ZIEM	US\$10.41	USD	GBP	4.20%*	0.38%	Dec 06, 2016	MSCI Emerging Markets Select Quality Yield Index	IE00BZ053T90

*Source: MSCI. Information as at 30 December 2016. Estimated Index Yield does not include withholding tax. **Ongoing Charges Figure

Regulatory Disclosure

F&C Management Limited is the investment manager of BMO UCITS ETF ICAV which is authorised by the Central Bank of Ireland as a UCITS.

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