

# Annual Management Report of Fund Performance

## BMO Private Diversified Yield Portfolio

For the period ended December 31, 2018

This annual management report of fund performance contains financial highlights, but does not contain the complete annual financial statements of the Portfolio. If the annual financial statements of the Portfolio do not accompany the mailing of this report, you may obtain a copy of the annual financial statements at your request, and at no cost, by calling 1-855-852-1026, by e-mailing us at [contactcentre@bmo.com](mailto:contactcentre@bmo.com), by writing to us at BMO Private Investment Counsel Inc., 1 First Canadian Place, 100 King St. W., 41st Floor, Toronto, Ontario, M5X 1A1 or by visiting our website at [www.bmoprivatebanking.com](http://www.bmoprivatebanking.com) or SEDAR at [www.sedar.com](http://www.sedar.com). You may also contact us using one of these methods to request a copy of the Portfolio's interim financial report, proxy voting policies and procedures, proxy voting disclosure record and/or quarterly portfolio disclosure.

## Management Discussion of Fund Performance

*BMO Private Investment Counsel Inc. ("BPIC" or the "Manager"), the manager and portfolio manager, is responsible for the management of the overall business, investments and operations of the BMO Private Portfolios and has engaged BMO Asset Management Inc. ("BMO AM Inc." or the "sub-advisor") as the sub-advisor of BMO Private Diversified Yield Portfolio (the "Portfolio").*

### Investment Objective and Strategies

The Portfolio's investment objective is to provide income by investing primarily in a diversified portfolio of Canadian securities.

To achieve the Portfolio's objectives, the sub-advisor employs bottom-up security selection that is based on quantitative and traditional fundamental analyses that consider each company's projected earnings growth, cash flows, payout ratios, business fundamentals, balance sheet strength, credit ratings, relative valuation considerations and management quality. In order to help ensure the Portfolio is not overly sensitive to a particular line of business, the Portfolio will be diversified across various industries.

The Portfolio may invest in, but is not limited to investing in, common equities, preferred equity, income trusts, royalty trusts, real estate investment trusts, convertible debentures, and fixed income securities. The Portfolio may use derivative instruments, primarily options, to attempt to generate income in the Portfolio.

### Risk

The risks associated with an investment in the Portfolio remain as disclosed in the Portfolio's most recent simplified prospectus or any amendments and fund facts. During the period there were no changes to the Portfolio that materially affected the overall risk level associated with an investment in the Portfolio. On May 4, 2018, the Manager reviewed the Portfolio using the standardized investment risk classification methodology under National Instrument 81-102 *Investment Funds* and determined that the risk rating of the Portfolio had changed from "Medium" to "Low to Medium". There was no change to the investment objectives, strategies or management of the Portfolio associated with its new risk rating. The Manager reviews the Portfolio's investment risk level and reference index, if any, at least annually.

### Results of Operations

Over the 12-month period ended December 31, 2018, the Portfolio returned -6.49%, after expenses. The Portfolio's benchmark is the S&P/TSX Composite Index ("S&P/TSX"), which generated a -8.89% total return over the same 12-month period.

While the end of 2017 looked promising for Canadian equities, the first and fourth quarters of 2018 were particularly challenging as a result of fragile investor sentiment. The S&P/TSX, representing the performance of Canadian equities, fell 8.9%. Oil was under pressure in the latter half of the year as concerns arose over demand. Coupled with decelerating global economic

## BMO Private Diversified Yield Portfolio

---

growth and U.S. waivers for a number of countries to buy Iranian oil, oil experienced significant downward pressure in the fourth quarter as the West Texas Intermediate (“WTI”) oil price fell to levels last seen in 2017. Weaker economic data, particularly in the second half of 2018, along with rising interest rates and a flattening yield curve, weighed on investor sentiment given the potential for weaker consumer credit growth. Information Technology stocks were a bright spot, delivering high double-digit gains.

The Canadian preferred equity market, as measured by the S&P/TSX Preferred Share Total Return Index, declined 7.9% in 2018 as solid underlying economic performance was offset by continued uncertainties created by threats of global trade disputes. The Government of Canada five-year bond yield reached as high as 2.49% in October before volatility in equity markets drove interest rates back lower to close the year at 1.89%. Rate resets and floating floaters, which are more sensitive to movements in interest rates, underperformed the overall market, while perpetuums outperformed the benchmark despite a negative absolute total return.

Canadian Real Estate Investment Trusts (“REITs”) outperformed the S&P/TSX in 2018, posting a 6.3% gain relative to sizable losses by the broader equity market.

From a sector allocation perspective, security selection with common shares contributed to the Portfolio’s performance. Top individual contributors included overweight holdings in Rogers Communications Inc. and Parkland Fuel Corp. Rogers Communication Inc. reported solid earnings, which were supported by solid wireless results. Parkland Fuel Corp. completed a successful upgrade to its refinery plant and also benefited from favourable crack spreads (the differential between the price of crude oil and the price of products extracted from it), which enhanced fuel margins. The company also completed an acquisition that expanded its footprint in the Caribbean.

An underweight allocation to REITs detracted from the Portfolio’s performance as the sector outperformed the overall benchmark. Individual detractors included an overweight position in Dollarama Inc. and Energy sector holdings in ARC Resources Ltd. and Vermilion Energy Inc. Dollarama Inc. announced weak traffic results that impacted its same-store sales growth.

Furthermore, the company also experienced weaker-than-forecast gross margins as a result of higher freight cost and also likely from more intense competition. The Portfolio’s Energy sector detractors were negatively impacted by volatility in energy prices and fears over the potential for a slowdown in the economy.

The sub-advisor added several new holdings to the Portfolio during the period, including Nutrien Ltd. and NFI Group Inc. Restaurant Brands International Inc., the parent company for Tim Hortons, Burger King and Popeyes Louisiana Chicken, was also purchased. The company remains well positioned to continue its growth trajectory and should see net restaurant growth for all its brands in the United States, while also signing more franchisees and expanding internationally.

An existing holding in Rogers Communications Inc., the largest wireless carrier and a leading broadband internet provider in Canada, was increased. Approximately two-thirds of the company’s earnings come from its wireless segment, which is currently growing above-industry average as a result of increasing demand for wireless data. In addition, its ability to leverage bundle packages by combining different products allows the company to grow its overall subscriber base.

BCE Inc., Gildan Activewear Inc. and Cineplex Inc. were eliminated from the Portfolio. Cineplex Inc. reported continued weakness in box office sales, which has a negative ripple effect on estimates for its concession and media businesses. Furthermore, the potential disruption risk from premium video-on-demand should continue to overhang the industry. A position in Vermilion Energy Inc. was reduced in favour of better risk-reward opportunities.

*For information on the Portfolio’s longer term performance and composition, please refer to the Past Performance section and Summary of Investment Portfolio section of this report.*

### Recent Developments

The outlook for equity markets has changed dramatically over the course of the past year. The period began with optimism over the prospects for North American equities, buoyed by U.S. tax cuts, fiscal stimulus, global synchronized growth and accelerating earnings. By the end of the year, global economic and political risks were quite elevated, driven in large part by the trade dispute between the U.S. and China.

## BMO Private Diversified Yield Portfolio

---

However, the sub-advisor's bias continues to favour equities, with the recognition that while increased volatility should continue, there is positive potential stemming from a possible resolution of various outstanding global issues. Interest rate risk has softened somewhat, providing additional support for an extension of the current economic and market cycle.

The sub-advisor expects Canadian economic growth to moderate in 2019 as higher interest rates, new mortgage regulations and lower energy prices will likely slow the pace of economic activity. The risk of recession in the near term remains low given the low unemployment rate and the solid fundamentals backing the U.S. economy. In addition, softer domestic economic data along with weaker commodity pricing should work to keep the Bank of Canada more cautious in its ongoing effort to normalize interest rates. The sub-advisor expects interest rates to progressively increase, the pace of which will be dictated by economic data. The interest rate trajectory should continue to dictate the performance of the Canadian preferred equity market.

Reflecting this outlook, the sub-advisor has maintained the Portfolio's bias towards high-quality businesses in the Financials, Industrials and Consumer-oriented sectors that are able to grow free cash flow and dividend streams.

### *Independent Review Committee*

On June 6, 2018, the Portfolio's independent review committee (the "IRC") was increased to five members when Jacqueline Allen was appointed as an IRC member. On September 6, 2018, the Portfolio's IRC was increased to six members when Marlene Davidge was appointed as an IRC member.

### Related Party Transactions

BMO Trust Company, an indirect, wholly-owned subsidiary of Bank of Montreal ("BMO"), is the trustee (the "trustee") and BPIC is the manager of the Portfolio. From time to time, BPIC may, on behalf of the Portfolio, enter into transactions or arrangements with or involving other members of BMO Financial Group, or certain other persons or companies that are related or connected to the Portfolio (each, a "related party" and collectively, the "related parties"). The purpose of this section is to provide a brief description of any transaction

involving the Portfolio and a related party. In each instance where a conflict of interest is identified, it will be referred to the Portfolio's IRC. The primary focus of the IRC is to determine whether the proposed action of the Manager in respect of the conflict of interest matter achieves a fair and reasonable result for the Portfolio. The IRC has reviewed the related party relationships described below and has provided a positive recommendation that each relationship achieves a fair and reasonable result for the Portfolio.

### *Sub-advisor*

BPIC has hired BMO AM Inc., a related party, to provide investment advice and make investment decisions for the Portfolio's investment portfolio. BMO AM Inc. receives a sub-advisory fee based on assets under management, which is paid monthly. BMO AM Inc. is paid by BPIC.

### **Buying and Selling Securities**

During the period, the Manager relied on standing instructions provided by the Portfolio's IRC for any of the following related party transactions that may have occurred in the Portfolio:

- (a) investments in securities of BMO, an affiliate of the Manager;
  - (b) investments in a class of non-government debt securities and/or equity securities of an issuer during the period of distribution of those securities to the public and/or the 60-day period following the distribution period where BMO Nesbitt Burns Inc., an affiliate of the Manager, or any other affiliate of the Manager acted as an underwriter in the distribution;
  - (c) trades in debt securities in the secondary market with BMO Nesbitt Burns Inc., or any other affiliate of the Manager, who is trading with the Portfolio as principal; and
  - (d) inter-fund trades;
- (each, a "Related Party Transaction").

In accordance with the IRC's standing instructions, in making a decision to cause the Portfolio to make a Related Party Transaction, the Manager and the sub-advisor of the Portfolio are required to comply with the Manager's written policies and procedures governing

## BMO Private Diversified Yield Portfolio

the Related Party Transaction and report periodically to the IRC, describing each instance that the Manager and/or the sub-advisor relied on the standing instructions and their compliance or non-compliance with the governing policies and procedures. The governing policies and procedures are designed to ensure that each Related Party Transaction (i) is made free from any influence of BMO, BMO Nesbitt Burns Inc. or an associate or affiliate of BMO and/or BMO Nesbitt Burns Inc. and without taking into account any considerations relevant to BMO, BMO Nesbitt Burns Inc. or an associate or affiliate of BMO and/or BMO Nesbitt Burns Inc., (ii) represents the business judgment of the Manager and/or the sub-advisor, uninfluenced by considerations other than the best interests of the Portfolio, and (iii) achieves a fair and reasonable result for the Portfolio.

### *Brokerage Commissions*

The Portfolio pays standard brokerage commissions at market rates to BMO Nesbitt Burns Inc., an affiliate of the Manager, for executing a portion of its trades. The brokerage commissions charged to the Portfolio during the periods were as follows:

	<b>Period ended Dec. 31, 2018 (\$000s)</b>	<b>Period ended Dec. 31, 2017 (\$000s)</b>
Total Brokerage Commissions	1,017	594
Brokerage Commissions paid to BMO Nesbitt Burns Inc.	207	42

### *Wealth Management Fee*

Units of the Portfolio are only available through the wealth management service offered by BMO Financial Group. The trustee, a related party, and the Manager receive an annual fee from each investor for the wealth management service offered by BMO Financial Group. A tiered schedule is applied to calculate the annual fee for this service. The fee schedule starts at 1.95% and declines to 0.20% (depending on the nature and size of the investor's investment portfolio), and is calculated as a percentage of the assets under management. The actual wealth management fee payable by each investor is set out in BPIC's *Investment Management Fee Schedule* that is provided to the investor when the investor enters into an investment management agreement with the trustee and BPIC. The wealth

management fee is paid directly by the investor to the trustee and the Manager. The trustee may compensate financial institutions and securities registrants within BMO Financial Group for client referrals to the wealth management service.

### *Unitholder Services*

The Portfolio is provided with certain facilities and services by related parties. BPIC is the registrar of the Portfolio. The trustee and BPIC are paid by the Portfolio for fees relating to the custodial and administrative services they provide, respectively. Administrative services include fund accounting, record keeping and purchases/redemption order processing.

The fees charged to the Portfolio during the periods were as follows:

	<b>Period ended Dec. 31, 2018 (\$000s)</b>	<b>Period ended Dec. 31, 2017 (\$000s)</b>
Unitholder Services	287	274

### Management Fee

There is no management fee charged to the Portfolio. The trustee and the Manager receive an annual wealth management fee from investors for the wealth management service offered by BMO Financial Group.

## BMO Private Diversified Yield Portfolio

### Financial Highlights

The following tables show selected key financial information about the Portfolio and are intended to help you understand the Portfolio's financial performance for the periods indicated.

The Portfolio's Net Assets Per Unit <sup>(1)</sup>	Years ended December 31				
	2018	2017	2016	2015	2014
Net assets, beginning of period	\$ 19.27	18.06	16.19	18.23	17.39
<b>Increase (decrease) from operations:</b>					
Total revenue	\$ 0.68	0.65	0.65	0.68	0.68
Total expenses <sup>(2)</sup>	\$ (0.02)	(0.01)	(0.01)	(0.01)	(0.01)
Realized gains (losses) for the period	\$ 2.15	0.21	0.39	(0.43)	0.35
Unrealized gains (losses) for the period	\$ (3.81)	1.02	1.52	(1.56)	0.56
<b>Total increase (decrease) from operations <sup>(3)</sup></b>	<b>\$ (1.00)</b>	<b>1.87</b>	<b>2.55</b>	<b>(1.32)</b>	<b>1.58</b>
<b>Distributions:</b>					
From income (excluding dividends)	\$ —	0.03	0.03	0.03	0.03
From dividends	\$ 0.71	0.58	0.61	0.64	0.64
From capital gains	\$ —	—	—	—	—
Return of capital	\$ 0.03	0.04	0.06	0.05	0.04
<b>Total Annual Distributions <sup>(4)</sup></b>	<b>\$ 0.74</b>	<b>0.65</b>	<b>0.70</b>	<b>0.72</b>	<b>0.71</b>
<b>Net assets, end of period</b>	<b>\$ 17.31</b>	<b>19.27</b>	<b>18.06</b>	<b>16.19</b>	<b>18.23</b>

<sup>(1)</sup> This information is derived from the Portfolio's audited financial statements.

<sup>(2)</sup> Includes commissions and other portfolio transaction costs and withholding taxes.

<sup>(3)</sup> Net assets and distributions are based on the actual number of units outstanding at the relevant time. The increase/decrease from operations is based on the weighted average number of units outstanding over the financial period. This table is not intended to be a reconciliation of beginning to ending net assets per unit.

<sup>(4)</sup> Distributions were paid in cash or reinvested in additional units of the Portfolio, or both.

Ratios and Supplemental Data	Years ended December 31				
	2018	2017	2016	2015	2014
Total net asset value (000s) <sup>(1)</sup>	\$ 1,060,854	1,961,074	1,653,263	1,375,435	1,586,670
Number of units outstanding (000s) <sup>(1)</sup>	61,274	101,762	91,567	84,935	87,017
Management expense ratio <sup>(2)</sup>	%	0.04	0.04	0.04	0.03
Management expense ratio before waivers or management absorptions <sup>(2)</sup>	%	0.16	0.15	0.16	0.15
Trading expense ratio <sup>(3)</sup>	%	0.07	0.03	0.04	0.03
Portfolio turnover rate <sup>(4)</sup>	%	12.92	12.19	12.54	13.41
Net asset value per unit	\$ 17.31	19.27	18.06	16.19	18.23

<sup>(1)</sup> This information is provided as at December 31 of the period shown.

<sup>(2)</sup> Management expense ratio is based on total expenses (excluding commissions and other portfolio transaction costs) for the stated period and is expressed as an annualized percentage of daily average net asset value during the period.

<sup>(3)</sup> The trading expense ratio represents total commissions and other portfolio transaction costs expressed as an annualized percentage of daily average net asset value during the period.

<sup>(4)</sup> The portfolio turnover rate indicates how actively the Portfolio's investment manager manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Portfolio buying and selling all of the securities in its portfolio once in the course of the year. The higher a portfolio turnover rate in a year, the greater the trading costs payable by the portfolio in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of a portfolio.

# BMO Private Diversified Yield Portfolio

## Past Performance

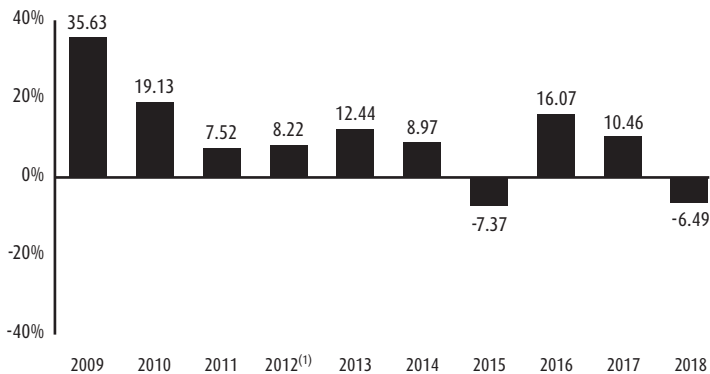
### General

The Portfolio's performance information assumes that all distributions made by the Portfolio in the periods shown were reinvested in additional units of the Portfolio and is based on the net asset value of the Portfolio.

The performance information does not take into account sales, redemption, distribution or other optional charges that, if applicable, would have reduced returns or performance. Please remember, how the Portfolio has performed in the past does not necessarily indicate how it will perform in the future.

### Year-by-Year Returns

The following bar chart shows the performance for each of the financial years shown and illustrates how the performance has changed from year to year. The bar chart shows in percentage terms how an investment made on the first day of each financial year would have increased or decreased by the last day of each financial year.



<sup>(1)</sup> On March 26, 2012, BMO AM Inc. became the sub-advisor of the Portfolio.

### Annual Compound Returns

This chart compares the historical annual compound returns of the Portfolio with the S&P/TSX Composite Index. The S&P/TSX Composite Index reflects the price movements of a floating list of companies on the Toronto Stock Exchange that meet Standard & Poor's criteria for inclusion in the index.

	1 yr %	3 yrs %	5 yrs %	10 yrs %
BMO Private Diversified Yield Portfolio <sup>††</sup>	(6.49)	6.23	3.89	9.85
S&P/TSX Composite Index	(8.89)	6.37	4.06	7.92

<sup>‡</sup>The Portfolio's return is after the deduction of expenses, while the benchmark does not include any costs of investing.

<sup>†</sup>On March 26, 2012, BMO AM Inc. became the sub-advisor of the Portfolio.

*A commentary on the market and/or information regarding the relative performance of the Portfolio as compared to its benchmark can be found under the Results of Operations section of this report.*

## BMO Private Diversified Yield Portfolio

### Summary of Investment Portfolio

as at December 31, 2018

Portfolio Allocation	% of Net Asset Value	Top 25 Holdings Issuer	% of Net Asset Value
Financials	22.6	Toronto-Dominion Bank, The,	5.3
Preferred Shares – Fixed/Floaters	21.7	Bank of Nova Scotia, The,	4.5
Energy	9.8	Royal Bank of Canada	4.5
Industrials	9.0	Brookfield Asset Management Inc., Class A	3.9
Real Estate	8.0	Rogers Communications Inc., Class B	3.5
Preferred Shares – Straight	6.5	Waste Connections, Inc.	2.9
Utilities	6.0	Canadian National Railway Company	2.7
Consumer Staples	4.0	Brookfield Infrastructure Partners L.P.	2.4
Materials	3.7	Manulife Financial Corporation	2.2
Communication Services	3.6	Enbridge Inc.	2.1
Cash/Receivables/Payables	2.1	Cash/Receivables/Payables	2.1
Consumer Discretionary	1.8	Allied Properties REIT	2.0
Fixed Income Fund	0.9	Suncor Energy Inc.	1.9
Preferred Shares – Floating Perpetual	0.3	Canadian Apartment Properties REIT	1.9
<b>Total portfolio allocation</b>	<b>100.0</b>	Morneau Shepell Inc.	1.8
		Alimentation Couche-Tard Inc., Class B	1.7
		RioCan REIT	1.7
		Nutrien Ltd.	1.6
		Algonquin Power & Utilities Corp.	1.5
		Intact Financial Corporation	1.5
		SmartCentres REIT	1.4
		Parkland Fuel Corporation	1.3
		Pembina Pipeline Corporation	1.3
		TransCanada Corporation	1.2
		North West Company Inc., The,	1.2
		<b>Top holdings as a percentage of total net asset value</b>	<b>58.1</b>
		<b>Total Net Asset Value</b>	<b>\$1,060,854,281</b>

*The summary of investment portfolio may change due to the Portfolio's ongoing portfolio transactions. Updates are available quarterly.*

**Manager**

BMO Private Investment Counsel Inc.  
1 First Canadian Place  
100 King St. W., 41st Floor  
Toronto, Ontario M5X 1A1

**Trustee**

BMO Trust Company  
1 First Canadian Place  
100 King St. W., 41st Floor  
Toronto, Ontario M5X 1A1

BMO Private Banking is part of BMO Wealth Management and is a brand name under which banking services are offered through Bank of Montreal, investment management services are offered through BMO Private Investment Counsel Inc., a wholly-owned indirect subsidiary of Bank of Montreal, and estate, trust, planning and custodial services are offered through BMO Trust Company, a wholly-owned subsidiary of Bank of Montreal. BMO Wealth Management is a brand name that refers to Bank of Montreal and certain of its affiliates in providing wealth management products and services.

This document may contain forward-looking statements relating to anticipated future events, results, circumstances, performance or expectations that are not historical facts but instead represent our beliefs regarding future events. 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 and other forward-looking statements will not prove to be accurate. 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 or implied in the forward-looking statements. Actual results may differ materially from management expectations as projected in such forward-looking statements for a variety of reasons, including but not limited to market and general economic conditions, interest rates, regulatory and statutory developments, the effects of competition in the geographic and business areas in which the Portfolio may invest and the risks detailed from time to time in the simplified prospectus of the BMO Private Portfolios. We caution that the foregoing list of factors is not exhaustive and that when relying on forward-looking statements to make decisions with respect to investing in the Portfolio, investors and others should carefully consider these factors, as well as other uncertainties and potential events, and the inherent uncertainty of forward-looking statements. Due to the potential impact of these factors, BMO Private Investment Counsel Inc. does not undertake, and specifically disclaims, any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by applicable law.

BMO (M-bar roundel symbol), BMO Private Banking registered trademarks, and BMO Wealth Management trademark are owned by Bank of Montreal, used under licence.

[www.bmoprivatebanking.com](http://www.bmoprivatebanking.com)

For more information please call 1-855-852-1026

**BMO**  **Wealth Management**  
**BMO Private Banking**