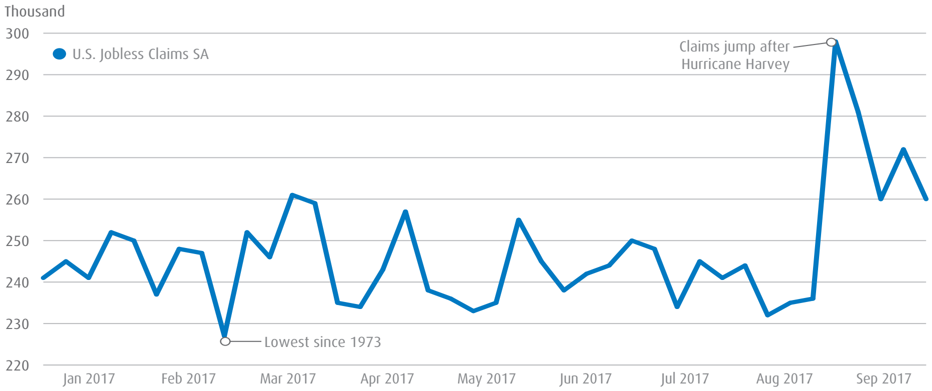
Municipal Insights

Hurricane season hits hard

Rebuilding after the devastating damage from recent hurricanes in Texas and Florida will be a challenge, but not something the two states can't overcome relatively quickly.

Less certain is the recovery period for Puerto Rico after the crippling effects of Hurricane Maria. The Commonwealth was already struggling with a myriad of demographic, financial and economic problems. The after-shocks of all three hurricanes will be felt in various ways across the country as recovery and rebuilding continue. Markets will be impacted by varying degrees as the aftermath feeds through to economic reports. However, even with multiple hurricanes, we do not foresee any long-term deterioration in credit quality for local issuers in Texas or Florida.

Jobless claims spike from hurricanes...but impact fading



Source: Labor Department

In our decades of experience analyzing U.S. municipalities, we have found them to be very resilient through times of poor management, economic recessions as well as natural disasters. Impacted areas will benefit from federal programs, state support, insurance payments and private contributions among other resources. These resources and the budgetary tools available to local governments support the high credit quality and stability we've experienced in the municipal market. For example, in the aftermath of Hurricanes Katrina and Sandy, there were no municipal bond impairments. We expect similar results following Hurricane Harvey and Irma. That being said, a healthy way to offset the risk of disastrous events is diversification. BMO's municipal strategy includes high diversification by state, sector, issuer and credit rating.

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In the short term, local governments may experience liquidity challenges as they face the costs of cleanup, emergency services, and infrastructure repair. However, these issuers will have the support of federal funding through the Federal Emergency Management Agency (FEMA), a federal program that provides up to 75% of costs with the State choosing to make-up any, or all, of the remaining 25%. Additionally, some local governments will sell notes to provide short-term liquidity while awaiting FEMA reimbursements. We saw this after Hurricane Sandy hit the east coast. Governments also typically experience an increase in sales tax revenues as rebuilding takes place and families begin to purchase items lost in the disaster. Ultimately, many local entities benefit from a stronger tax base following natural disasters as residents opt to upgrade their properties during the rebuild.

With the recent uptick of headline events, municipal investors should be reminded of the importance of diversification, particularly geographic and sector.

Investors in Texas bonds may benefit from additional security features like the Texas Permanent School Fund and Permanent University Fund. In Texas, many school district bonds benefit from a guarantee program called the Texas Permanent School Fund. The Permanent School Fund (total assets of about $40 billion) is currently guaranteeing over 3,000 school districts with a total par of $74 billion in debt outstanding across the state. Additionally, the Texas Permanent University Fund, with $20 billion of assets, is a public endowment supporting The University of Texas and Texas A&M University.

With the recent uptick of headline events, municipal investors should be reminded of the importance of diversification, particularly geographic and sector. While hotly debated, the future cost of natural disasters may increase due to global climate change. Professionally managed portfolios can provide investors with diversification and lower return volatility during challenging periods.

Illinois: Education matters

Recently, after months of negotiations, the State of Illinois passed a school-funding bill providing financial relief for all school districts in the state, including Chicago Public Schools (CPS). All school districts will receive funding through an "evidence-based" funding formula. This formula includes 27 elements — class size, books, technology, librarians, etc. — that establish an adequacy target for every school. That is, how much should it cost to provide a quality education for students in a given district? Additionally, the State threw in an extra $350 million for education funding in 2018.

While many districts across the state will benefit from the new funding, Chicago Public Schools have the most to gain. The additional state funding closes the gap in the district's 2018 budget and provides pension relief. Additionally, the State will begin picking up a portion of CPS pension costs just as the State provides funding for all other school districts within the State. In all, CPS will receive about $325 million in state funding for 2018 from new revenue under the evidence-based funding formula, which includes $221 million for pensions. CPS also received the authority to raise an additional $130 million through local property taxes for pension purposes. All in all, the legislation is a significant credit positive for Chicago Public Schools.

Moody's Investor Service raised their outlook on the CPS bonds to Stable from Negative after the passage of the education funding bill. The rating agency confirmed its B3 general obligation rating. Moody's acknowledges CPS' liquidity position remains challenged, but the $325 million in additional state aid will prevent further deterioration in its financial position over the next year. The municipal market reacted positively to the news with significantly improved pricing and lower yields for Chicago Public School bonds. For example, long maturity CPS bonds yielding about 7% this past June are now yielding about 5%.

Credit bits

Chicago refunding debt

The City of Chicago is expected to present an ordinance to the City Council in mid-October for approval to sell $2.3 billion in bonds. The new debt was authorized by legislation passed in a recent State of Illinois spending plan. The new deal will advance refund existing GO and sales tax debt, saving taxpayers millions of dollars in interest costs by issuing lower yielding bonds relative to the outstanding debt. The new legislation allows for home rule municipalities in the State to designate certain tax revenues received directly from the State to a special, limited-use entity. The limited-use entity is legally and structurally insulated from the City of Chicago. This structure should shield the bonds from bankruptcy and offer a lower cost-financing vehicle for lower-quality issuers in the State.

Illinois and Chicago rating round-up

	Moody's/S&P/Fitch
State of Illinois	Baa3/BBB-/BBB
City of Chicago	Ba1/BBB+/BBB-
Chicago Public Schools	B3/B/B+

Market commentary

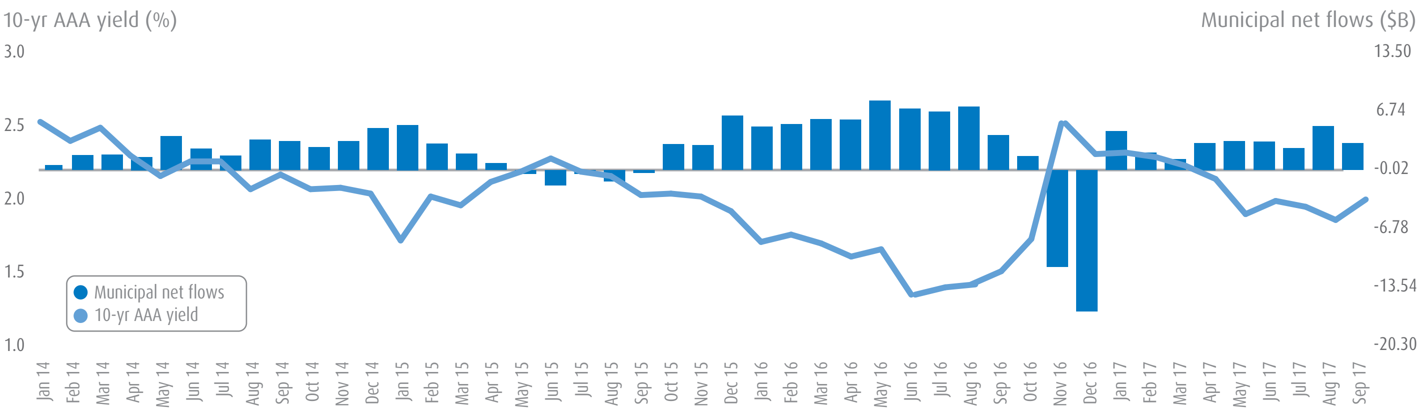
October yields increase on improving economy and fed outlook

The Bloomberg Barclays Municipal Bond Index returned a negative 0.51% in September as the outlook for further Federal Reserve (Fed) tightening grew. This was a hit to year-to-date municipal market performance; however, municipal bonds still returned a solid 4.66% through September 30. Treasury and municipal bond curves flattened in September as the Fed announced a slow unwind of its balance sheet and continued to indicate its readiness to increase the Federal Funds Rate for a third time this year, likely at their December meeting. If raised, this will be the fifth increase since December 2015, putting the Fed Fund Target Rate at 1.50% (upper bound). Over the month, Treasury yields increased 22, 21 and 13 basis points (bps), for the 5, 10 and 30-year spots, respectively. Municipal yields increased in line at 23, 14, and 14 bps, respectively.

The Federal Reserve (Fed) announced a slow unwind of its balance sheet and continued to indicate its readiness to increase the Federal Funds Rate for a third time this year, likely at their December meeting.

Through September, municipal bond funds and ETFs have had net inflows of about $28 billion with municipal issuance down 17% year-to-date. With muni demand outstripping supply, municipal bonds have outperformed other fixed income sectors. The ratio of the 10-year municipal bond yield to the Treasury yield has fallen from 95% at the beginning of the year to 81% at the end of September — munis richer by 14 ratios. This is also apparent in returns, as the Municipal Bond Index outperformed a similar duration U.S. Government Index by 117 basis points (4.66% vs. 3.49%). The Municipal Bond Index also outperformed the Bloomberg Barclays Aggregate Index by about 152 basis points.

Municipal/ETF fund flows with yield



Source: Thomson Reuters

Sector performance

With the selloff in rates, higher quality bonds underperformed BBB-rated bonds for the month. The Bloomberg Barclays Muni BBB-rated Index returned 0.05% while the AAA-rated index returned a negative 0.62%. Year-to-date, the BBB index outperformed higher quality bonds by about 330 basis points. An overweight in lower quality bonds would have been a significant help to portfolio performance so far this year.

Supply and demand

Municipal issuers sold about $26 billion in bonds last month, down about 34% from September 2016. Refunding deals dropped 26% from a year earlier. Yields on the long-end of the curve are about 50 basis points higher than a year ago, making it much more unlikely for issuers to realize savings by refunding outstanding debt. Additionally, there are fewer outstanding deals to refund after last year's activity. New money issuance was also low at $11 billion, down 32% from last year. Year-to-date total issuance is $284 billion, down 17% from the same period last year.

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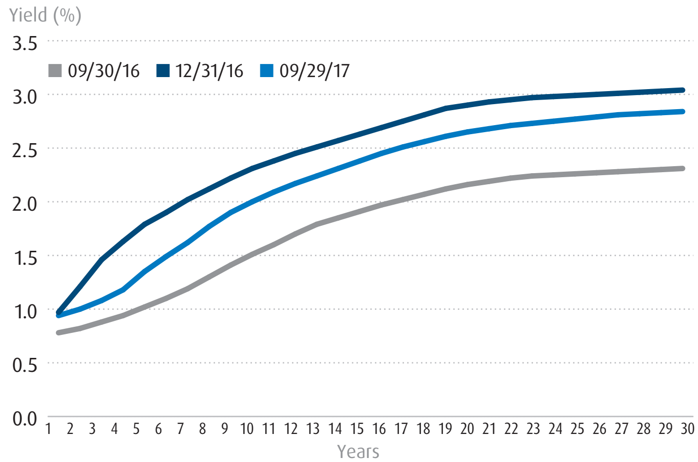
Strong inflows into municipal funds and ETFs continued over the month, despite slightly negative performance. Over the past month, $2.3 billion flowed into municipal funds and ETFs. Year-to-date we are at $28 billion of net inflows. This is a trend we are seeing across U.S. fixed income products. For example, U.S. taxable bond funds and ETFs have seen $267 billion in net flows year-to-date; almost double the same period last year. If investors are fearful of rising interest rates, they are certainly not showing up in bond fund flows. Equity funds and ETFs have seen $148 billion in net flows YTD.

Yield curve

Municipal yields rose in unison with Treasury rates over the month. Treasuries rallied on North Korean news before selling off with a reduction in global tension, improving domestic economic data, and the impact from hawkish Fed comments at their recent meeting. For the month, returns were negative across the yield curve, with the short duration, 1-year spot the best performer at -0.12%. The Bloomberg 5 and 15-year Indices were not far behind at -0.33% and -0.32%, respectively. You can see in the yield curve chart that while yields have fallen by about 25 basis points this year, they are still about 45 basis points higher than last year.

Municipal yields rose in unison with Treasury rates over the month.

AAA municipal yield curve



Source: Thomson Municipal Market Monitor

Strategy overview

Duration

- We went shorter in June and maintained that level through the summer. With a hawkish Fed and ongoing economic growth, we see little benefit of being long the benchmark at this time. With a recent jump in average hourly earnings and a 16-year low unemployment rate for U.S. workers, we believe wage pressures bare close scrutiny.
- The market is currently pricing in a 75% probability for a Fed hike this December. With a continuation of sub-2% core inflation at this time, our concern for higher interest rates is focused on maturities eight years and shorter. As such, we have a significant amount of short, floating rate notes in the funds.

Curve

- Retaining barbell structure with municipal floating rate notes on the short-end of the curve and fixed coupon bonds on the longer end of the fund's investment horizon. We earn more incremental credit spread on the longer end but remain short duration. We will continue to monitor inflation expectations for a reduction to our long-end exposure; however, the latest reports suggest a continuation of this strategy.
- Daily and weekly tax free floating rate notes remain at elevated yields providing attractive yields to interest rate sensitive investors. The weekly municipal floating rate index (SIFMA rate) is at 0.94% versus 0.84% in September 2016.

Credit and structure

- Lower-quality bonds posted the best performance year-to-date. With the help of our seasoned analysts, we continue to look for undervalued A and BBB rated bonds. The higher yield of the lower quality bonds helps the long-term performance of these bonds. However, with very tight credit spreads, we are finding very few opportunities.

Sector

- Repeal and replace of Obamacare is dead in 2017, but will return in 2018 reconciliation. In the meantime, the President could take action to make incremental changes through executive order and through regulatory means. We will continue to monitor the political situation, but we are very comfortable with our hospital bond holdings.

Performance

Fund performance as of September 30, 2017

Fund/Index	Share class	Inception date	Ticker	Returns as of September 30, 2017 (%) 1-month	Q3	YTD	1-year	3-year	5-year	10-year	Since inception	Expense ratios (%)[1] Gross	Net
BMO Ultra Short Tax-Free Fund[2]	A NAV	05/27/14	BAU.S.X	0.06	0.18	0.85	0.81	0.52	0.58	—	0.94	0.64	0.55
BMO Ultra Short Tax-Free Fund[2]	A OFFER[3]			-1.98	-1.86	-1.21	-1.25	-0.16	0.17	—	0.69		
BMO Ultra Short Tax-Free Fund[2]	I	09/30/09	MUISX	0.08	0.35	1.04	1.16	0.78	0.83	—	1.19	0.39	0.30
Blended Benchmark[4]				0.40	0.43	0.80	0.60	1.83	3.16	—			
BMO Short Tax-Free Fund[2]	A NAV	05/27/14	BASFX	-0.08	0.52	2.26	1.09	1.26	—	—	1.67	0.78	0.56
BMO Short Tax-Free Fund[2]	A OFFER[3]			-2.10	-1.51	0.17	-0.94	0.58	—	—	1.25		
BMO Short Tax-Free Fund[2]	I	11/29/12	MTFIX	0.03	0.65	2.38	1.25	1.45	—	—	1.84	0.53	0.41
Bloomberg Barclays Short (1-5 Year) Municipal Index				-0.32	0.49	2.27	1.18	1.16	—	—			
BMO Intermediate Tax-Free Fund[5]	A NAV	05/27/14	BITAX	-0.22	1.20	4.20	0.89	2.77	2.65	4.61	4.42	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	A OFFER[3]			-3.69	-2.36	0.57	-2.65	1.55	1.92	4.25	4.27		
BMO Intermediate Tax-Free Fund[5]	Y	02/01/94	MITFX	-0.22	1.20	4.20	0.89	2.77	2.65	4.61	4.42	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	I	12/27/10	MIITX	-0.29	1.17	4.39	1.04	2.98	2.86	4.73	4.47	0.33	0.33
Bloomberg Barclays U.S. 1-15 Year Blend Municipal Bond Index				-0.46	0.93	4.17	0.97	2.63	2.52	4.15			

Other benchmarks as of September 30, 2017	Returns as of September 30, 2017 (%) 1-month	Q3	YTD	1-year	3-year	5-year	10-year
Bloomberg Barclays U.S. 1-10 Year Blend Municipal Bond Index	-0.51	0.73	3.72	1.00	2.20	2.12	3.77
Bloomberg Barclays U.S. Municipal Bond Index	-0.51	1.06	4.66	0.87	3.19	3.01	4.52

Source: Bloomberg Barclays and BMO Global Asset Management

Performance data quoted represents past performance and past performance is not a guarantee of future results. Investment returns and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Mutual fund performance changes over time and current performance may be lower or higher than what is stated. To receive the most recent month-end performance, call 1-800-236-3863. Returns quoted are pre-tax. Investor should consider his or her current and anticipated investment horizon and income tax bracket when making an investment decision as the illustration above does not reflect these factors. For more information about performance, please contact your investment professional. Total returns for periods of less than one year are cumulative.

[1] **Expenses for Class A shares are based on estimated amounts for the current fiscal year. Net expense ratios reflect contractual fee waivers and/or expense reimbursements if applicable, made by BMO Asset Management Corp., the investment adviser (Adviser). The Adviser may not terminate these fee waivers and/or expense reimbursements prior to December 31, 2017 without the consent of the Board of Directors, unless the investment advisory agreement is terminated. Without these contractual waivers, the Fund's returns would have been lower.**

[2] Performance data quoted prior to the inception of the Class A shares is the performance of the Fund's Investor Class (Class Y). Class A Offer reflects a sales load charged at the time of initial investment. On June 2, 2017, the Fund's Class Y shares were converted to Class A shares. The Fund no longer offers Class Y shares.

[3] Offering Price (MOP) returns for the BMO Ultra Short Tax-Free Fund and the BMO Short Tax-Free Fund include the maximum sales charge of 2.00%. Offering Price (MOP) returns for the BMO Intermediate Tax-Free Fund include the maximum sales charge of 3.75%. Net Asset Value (NAV) returns exclude this charge, which would have reduced returns.

[4] The Blended Benchmark: 50% Bloomberg Barclays 1-Year Municipal Bond Index and 50% iMoneyNet Money Fund Tax Free National Retail Index.

[5] Performance data quoted prior to the inception of the Class A shares is the performance of the Fund's Investor Class (Class Y). Class A Offer reflects a sales load charged at the time of initial investment. Performance data quoted prior to 12/27/10 (inception of Class I of the Fund) is the performance of the Fund's Investor Class (Class Y), not adjusted for any differences in the expenses of the classes.

Market data for the journey

Valuation data as of September 30, 2017

AAA yields (%)				
		Change		
Year	Current	1-month	3-month	1-year
2	1.00	0.15	-0.06	0.18
5	1.35	0.23	0.00	0.33
10	2.00	0.14	0.01	0.49
30	2.84	0.14	0.05	0.53

Source: InvestorTools® Perform

Cross-market values (%)[1]		
	Current (1-year averages)	
Year	Muni/treasury	Muni/corporate
2	67 (82)	67 (70)
5	70 (78)	70 (73)
10	86 (92)	79 (82)
30	99 (100)	86 (85)

Sources: InvestorTools® Perform and Bloomberg

Yield curve data as of September 30, 2017

Slope changes (%)				
		Change		
	Current	1-month	3-month	1-year
Wkly - 2s	0.55	-0.15	-0.03	-0.10
2 - 5s	-0.14	0.23	0.00	0.33
2 - 10s	1.00	-0.01	0.07	0.31
2 - 30s	1.84	-0.01	0.11	0.35

Source: InvestorTools® Perform

Performance by maturity (%)			
Year	1-month	3-month	1-year
3	-0.33	0.54	1.20
5	-0.69	0.68	1.14
10	-0.58	1.06	0.82
22+	-0.70	1.24	0.53

Source: Barclays Point

Credit data as of September 30, 2017

Current rating spreads (%)[2]		
	Current (1-year averages)	
Year	AAA–A	AAA–BBB
2	0.21 (0.19)	0.48 (0.45)
5	0.41 (0.39)	0.72 (0.70)
10	0.53 (0.56)	0.88 (0.90)
30	0.53 (0.58)	0.85 (0.90)

Source: InvestorTools® Perform

Performance by quality (%)			
Rating	1-month	3-month	1-year
AAA	-0.62	0.71	0.48
AA	-0.56	0.85	0.72
A	-0.49	1.23	0.80
BBB	0.05	2.78	3.29

Source: Barclays Point

BMO Funds Tax-Free Suite

	Ticker			
Fund name	Class A	Class Y	Class I	Premier Class
BMO Tax-Free Money Market Fund	—	MTFXX	—	MFIXX
BMO Ultra Short Tax-Free Fund	BAU.S.X	MUYSX	MUISX	—
BMO Short Tax-Free Fund	BASFX	MTFYX	MTFIX	—
BMO Intermediate Tax-Free Fund	BITAX	MITFX	MIITX	—

[1] Cross-market values represent the ratio of tax-free municipal yields to taxable Treasury yields. The percentage in the parentheses represents that average of this ratio over the prior twelve months.
[2] The current rating spread is the difference between the benchmark AAA municipal yield curve and the associated rating benchmark (either A or BBB) for the appropriate maturity time frame. The percentage in the parentheses represents the spread over the prior twelve months.

All investments involve risk, including the possible loss of principal.

You should consider the Fund's investment objectives, risks, charges, and expenses carefully before investing. For a prospectus and/or summary prospectus, which contain this and other information about the BMO Funds, call 1-800-236-3863. Please read it carefully before investing.

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Keep in mind that as interest rates rise, prices for bonds with fixed interest rates may fall. This may have an adverse effect on a Fund's portfolio.

Interest income from Tax-Free Fund investments may be subject to the federal alternative minimum tax (AMT) for individuals and corporations, and state and local taxes.

Credit risk is the possibility that an issuer will default on a security by failing to pay interest or principal when due. Lower credit ratings correspond to higher credit risk.

Municipal bonds are subject to risks including economic and regulatory developments in the federal and state tax structure, deregulation, court rulings, and other factors.

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Bloomberg Barclays 1-10 Year Blend Municipal Bond Index is an unmanaged index of municipal bonds rated BBB or better with 1 to 12 years to maturity.

Bloomberg Barclays U.S. Municipal Bond Index is an unmanaged index of a broad range of investment-grade municipal bonds that measures the performance of the general municipal bond market.

Blended Benchmark consists of 50% Bloomberg Barclays 1 Year Municipal Bond Index and 50% iMoneyNet Money Fund Tax Free National Retail Index. Money Fund Report Averages™ is an arithmetic average of performance for all money market mutual funds tracked within this category. Money Fund Report Averages™ is a service of iMoneyNet, Inc. (formerly IBC Financial Data). The Bloomberg Barclays 1-Yr Municipal Bond Index is the 1-year component of the Bloomberg Barclays Municipal Bond Index, which is an unmanaged index composed of long-term tax-exempt bonds with a minimum credit rating of Baa.

Bloomberg Barclays Short (1-5 Year) Municipal Index includes investment-grade tax-exempt bonds that are issued by state and local governments and have maturities of 1 to 5 years.

Bloomberg Barclays U.S. 1-15 Year Blend Municipal Bond Index is the 1-15 year Blend component of the Bloomberg Barclays Municipal Bond Index, which is an unmanaged index composed of long-term tax-exempt bonds with a minimum credit rating of Baa and a range of maturities between 1 and 17 years.

Investments cannot be made in an index.

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