Municipal
Insights

Tax reform

The municipal market was blindsided by tax reform proposals recently released by the House and Senate GOP.

While the tax-exemption of municipal bonds remains intact, a significant portion of the municipal market could disappear next year under the current GOP proposals. Specifically, the House plan would eliminate private activity bonds (PABs) and advance refunding bonds. The Senate plan calls for the elimination of only the advance refunded bonds. On average, these sectors combined have accounted for about 25% of tax-exempt issuance over the past ten years. More recently, the percentage has been closer to 40% due to the increase in advance refunding deals with prevailing low interest rates. With the threat of that size of decline in tax-exempt issuance, munis rallied quickly the first few trading days after the proposals' release with long municipal yields dropping over 20 basis points (bps).

We could speculate on whether the language will be in finalized legislation, however, the market has to assume it is a possibility. As such, we may see a year-end spike in advance refunding deals, which we would view as a buying opportunity if municipal yields increase on the outsized supply. With regard to private activity bonds, under the House plan, all PABs issued after 2017 would have to be taxable bonds. This sector comprises bonds issued for qualified 501(c)(3) organizations (nonprofits) including many hospitals, airport terminal facilities, low-income housing and higher educational facilities.

The market was not surprised by several other items in the proposals that could impact the municipal market. Lowering the corporate tax rate to 20% was widely expected. This could reduce purchases of municipal bonds by banks and by property & casualty (P&C) insurance companies. Combined, banks and P&C companies own about 25% of outstanding tax-exempt bonds and tend to prefer longer maturity bonds. This decline may cause a reduction in demand for long munis, but we are skeptical on that outcome at this time. Banks and P&C companies buy munis not only for the tax-exemption, but also for diversification in a very safe asset class.

Under both proposals, the highest personal income tax rate will stay close to the current 39.6% level — 38.6% under the Senate proposal, and the House proposal would be unchanged at 39.6% for incomes above $1 million. Either proposal is positive for municipal bond demand. Additionally, with many existing itemized deductions being capped or eliminated, tax-exempt municipal demand may increase for retail buyers.

This mixed bag of potential changes will cause volatility in the municipal market over the next couple of months. GOP leaders would like to see final legislation by year-end. As mentioned, the muni market has outperformed due to the potential drop in municipal supply with the elimination of advance refunding bonds and PABs. We will see how a final plan develops as Senate and House GOP leaders mix and match provisions of each proposal to ensure passage. Stay tuned!

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Credit commentary

The credit health of states in the U.S. is at a crossroads. Eleven states have a negative rating outlook by Moody's or S&P; only one state has a positive outlook. State officials are challenged on both the revenue and expenditure side of the income statement. With the slowly growing economy and tighter labor markets, state budget officials are expecting modest revenue growth in 2018 from improving income tax and sales tax receipts. On the other hand, pension costs continue to be a growing burden as pension funds roll back their return assumptions. Pension funding continues to be a threat to the fiscal well-being of many states. States have largely been unable to change existing pension benefits, and for those that can, changes are met with legal action. This has led some states to balance budgets by raiding "rainy day" reserves and looking for one-off savings.

While states have benefited from the slow trudge higher of the economy, the recovery has not been the same across the country. Energy dependent states have not realized the same gains as states with more diversified economies. The recent stabilization in oil prices and the growing number of operating rigs should provide near term benefits for lagging energy states including Alaska, Louisiana, New Mexico, North Dakota and Oklahoma. More broadly, public officials are looking for innovative ways to increase revenues through the expansion of the sales tax base more in line with today's e-commerce economy.

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As for now, the continued sluggish growth in revenues is being eclipsed by more rapidly growing fixed costs leading to the negative outlooks noted in the table below. Eleven states have negative outlooks while four have already been downgraded over the past year. As mentioned, the energy dependent states are under stress due to the decline in oil prices a few years ago. Other states face various issues including pension funding, political infighting, tax cuts with no offsetting revenue sources and fundamental changes in state economies. To stay ahead of potential downgrades and price deterioration from these challenges, BMO GAM's municipal team monitors regional economic trends along with state financial profiles when assessing risk at the state and local level.

State ratings — November 2017

State	Moody's	S&P	State	Moody's	S&P	State	Moody's	S&P
Alabama	Aa1	AA	Kentucky [1]	Aa3	A+	North Dakota [1]	Aa1	AA+
Alaska	Aa3	AA	Louisiana	Aa3	AA-	Ohio	Aa1	AA+
Arizona [1]	Aa2	AA	Maine	Aa2	AA	Oklahoma	Aa2	AA
Arkansas	Aa1	AA	Maryland	Aaa	AAA	Oregon	Aa1	AA+
California	Aa3	AA-	Massachusetts	Aa1	AA	Pennsylvania	Aa3	A+
Colorado [1]	Aa1	AA	Michigan	Aa1	AA-	Rhode Island	Aa2	AA
Connecticut	A1	A+	Minnesota	Aa1	AA+	South Carolina	Aaa	AA+
Delaware	Aaa	AAA	Mississippi	Aa2	AA	South Dakota [1]	Aaa	AAA
District of Columbia	Aa1	AA	Missouri	Aaa	AAA	Tennessee	Aaa	AAA
Florida	Aa1	AAA	Montana	Aa1	AA	Texas [1]	Aaa	AAA
Georgia	Aaa	AAA	Nebraska [1]	NR	AAA	Utah	Aaa	AAA
Hawaii	Aa1	AA+	Nevada	Aa2	AA	Vermont	Aaa	AA+
Idaho [1]	Aa1	AA+	New Hampshire	Aa1	AA	Virginia	Aaa	AAA
Illinois	Baa3	BBB-	New Jersey	A3	A-	Washington	Aa1	AA+
Indiana [1]	Aaa	AAA	New Mexico	Aa1	AA	West Virginia	Aa2	AA-
Iowa [1]	Aaa	AAA	New York	Aa1	AA+	Wisconsin [1]	Aa1	AA
Kansas [1]	Aa2	AA-	North Carolina	Aaa	AAA	Wyoming [1]	NR	AA+

[1] Denotes issuer credit rating, no general obligation debt outstanding

Only one state has positive outlook: Michigan by S&P

Shaded states denotes negative rating outlook by one or both rating agencies:
S&P: AK, CT, KS, KY, LA, MS, NM, VA
Moody's: AK, IL, LA, MS, NM, ND, OK

Market commentary

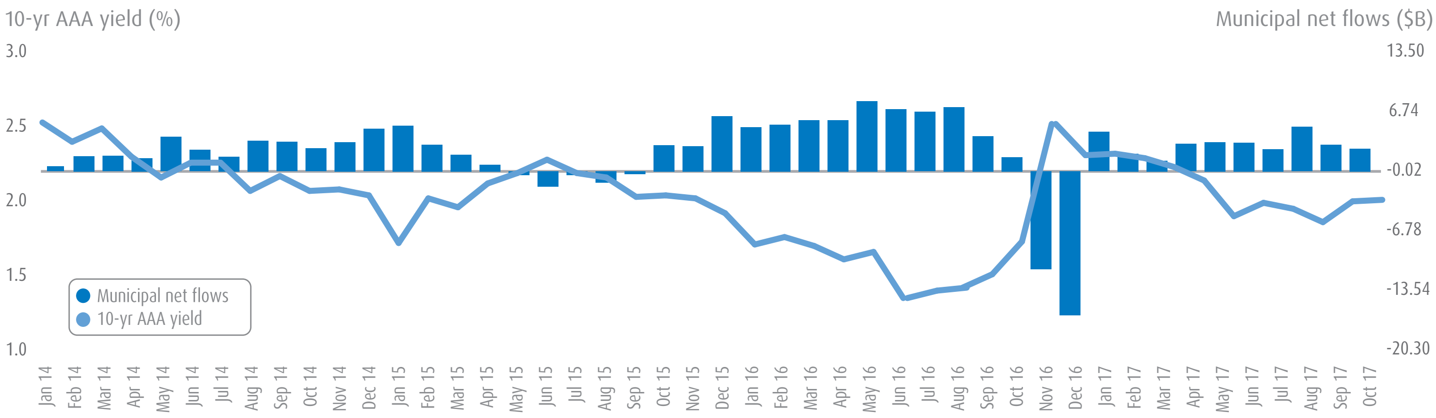
October muni curve flattens slightly on Fed expectations

The Bloomberg Barclays Municipal Bond Index returned a positive 0.24% in October as the treasury and municipal market yield curves flattened slightly. Year-to-date performance increased to a robust 4.92% through October 31. Municipal yields increased 7 bps in the five-year spot and decreased slightly on longer maturities. This type of movement in yields is known as a "yield curve flattening" where the spread between short- and long-term interest rates decreases. Shorter maturity yields were pressured by an anticipated increase in the Federal Funds Rate for a third time this year in December. This potential hike would move the Fed Fund Target Rate to a 1.25% to 1.50% range. Longer fixed income maturities were helped by the decline of inflation we have seen year-to-date as well as scant evidence for future increases.

The continuing supply and demand imbalance in the municipal market (discussed on the next page) is causing significant outperformance of municipal bonds versus other fixed income sectors. For example, the ratio of the ten-year municipal bond yield to the treasury yield has fallen from 95% at the beginning of the year to 84% at the end of October — munis richer by 11 ratios. This is also apparent in returns, as the Municipal Bond Index outperformed a similar duration U.S. Government Index by 141 bps (4.92% vs. 3.58%). The Municipal Bond Index also outperformed the Bloomberg Barclays Aggregate Index by about 172 bps.

The continuing supply and demand imbalance in the municipal market is causing significant outperformance of municipal bonds versus other fixed income sectors.

Municipal/ETF fund flows with yield



Source: Thomson Reuters

Sector performance

With yield curve flattening, higher quality bonds underperformed BBB-rated bonds for the month. The Bloomberg Barclays Muni BBB-rated index returned 0.38% while the AAA-rated index returned 0.19%. Year-to-date, the BBB index outperformed higher quality bonds by about 350 bps. Much of this outperformance is attributable to quality spread tightening; however, the BBB index has a significant yield advantage over the AAA index. This yield advantage feeds into the total return of the index over the year.

Supply and demand

Municipal issuers sold about $35 billion in bonds last month, down about 34% from October 2016. Refunding deals dropped 52% from a year earlier. New money issuance, however, was slightly higher than last year at approximately $17 billion, up 3% from last year. Year-to-date total issuance is $322 billion, down 18% from the same period last year.

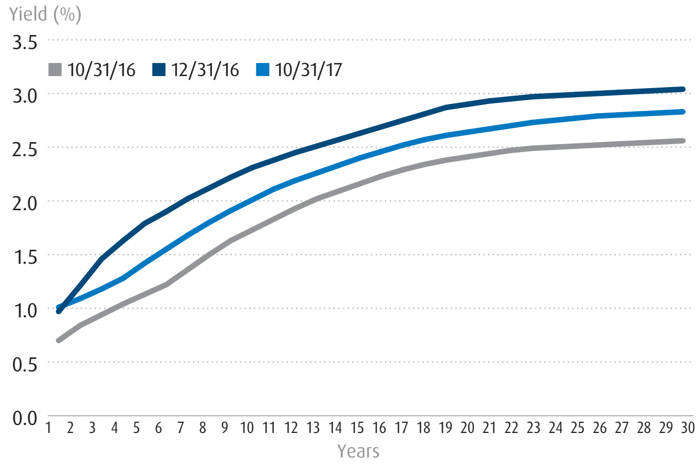
With more talk about a potential Fed hike in December, recent flows have been positive for shorter municipal funds and negative for longer funds.

This year's trend of strong inflows to municipal funds and exchange-traded funds (ETFs) continued in October. Over the past month, $2.6 billion flowed into municipal funds and ETFs. Year-to-date, tax-exempt net flows are at $30 billion. That is down almost 50% from the historically strong flows we saw last year for this period, but still represents solid demand for the tax-exempt market. With more talk about a potential Fed hike in December, recent flows have been positive for shorter municipal funds and negative for longer funds. Equity funds and ETFs have seen $162 billion and taxable bond funds $314 billion in net inflows year-to-date.

Yield curve

For the month, returns were flat to slightly negative in the one- to five-year portion of the municipal curve, while longer bonds saw returns slightly better than the coupon return — that is, some positive price performance along with the income that accrued over the month. The best performance in the Bloomberg Barclays Indices was the 22+ year index at 0.47%.

AAA municipal yield curve



Source: Thomson Municipal Market Monitor

Strategy overview

Duration

- We remain slightly short our benchmarks and peer groups due to a potential December Fed hike, ongoing economic growth with solid labor market and perhaps some nascent signs of upward wage movement.
- The market is currently pricing in an 85% 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. We are maintaining exposure to short, floating rate notes in the funds.

Curve

- Barbell structure with municipal floating rate notes on the short end 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.
- 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 0.92% versus 0.63% in October 2016.

Credit and structure

- Lower-quality bonds posted the significant outperformance year-to-date. Most of this was due to spread tightening, that is, relative price appreciation versus high quality bonds. Due to compressed spreads, we are finding very few opportunities at this time.

Sector

- We continue to monitor the President's actions to encumber Obamacare. Changes through executive order and/or regulatory means could be negative for the hospital sector. However, we are very comfortable with our hospital bond holdings.

Performance

Fund performance as of October 31, 2017

Fund/Index	Share class	Inception date	Ticker	Returns as of October 31, 2017 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Since inception	Returns as of September 30, 2017 (%) Q3	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	0.07	0.92	0.82	0.50	0.58	N/A	0.94	0.18	0.81	0.52	0.58	—	0.94	0.64	0.55
BMO Ultra Short Tax-Free Fund[2]	A OFFER[3]			-1.98	-1.15	-1.24	-0.19	0.17	N/A	0.69	-1.86	-1.25	-0.16	0.17	—	0.69		
BMO Ultra Short Tax-Free Fund[2]	I	09/30/09	MUISX	0.09	1.13	1.18	0.79	0.83	N/A	1.19	0.35	1.16	0.78	0.83	—	1.19	0.39	0.30
Blended Benchmark[4]				0.02	0.80	0.70	0.45	0.41	—		0.43	0.60	1.83	3.16	—			
BMO Short Tax-Free Fund[2]	A NAV	05/27/14	BASFX	0.11	2.37	1.30	1.20	—	—	1.66	0.52	1.09	1.26	—	—	1.67	0.78	0.56
BMO Short Tax-Free Fund[2]	A OFFER[3]			-1.91	0.28	-0.74	0.51	—	—	1.25	-1.51	-0.94	0.58	—	—	1.25		
BMO Short Tax-Free Fund[2]	I	11/29/12	MTFIX	0.02	2.40	1.35	1.32	—	—	1.81	0.65	1.25	1.45	—	—	1.84	0.53	0.41
Bloomberg Barclays Short (1-5 Year) Municipal Index				-0.02	2.25	1.26	1.11	—	—		0.49	1.18	1.16	—	—			
BMO Intermediate Tax-Free Fund[5]	A NAV	05/27/14	BITAX	0.22	4.43	1.89	2.59	2.65	4.59	4.42	1.20	0.89	2.77	2.65	4.61	4.42	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	A OFFER[3]			-3.28	0.79	-1.64	1.38	1.93	4.23	4.26	-2.36	-2.65	1.55	1.92	4.25	4.27		
BMO Intermediate Tax-Free Fund[5]	Y	02/01/94	MITFX	0.22	4.43	1.89	2.59	2.65	4.59	4.42	1.20	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	0.24	4.63	2.03	2.83	2.86	4.71	4.47	1.17	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				0.14	4.32	1.94	2.50	2.51	4.12		0.93	0.97	2.63	2.52	4.15			

Other benchmarks as of October 31, 2017	Returns as of October 31, 2017 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Returns as of September 30, 2017 (%) Q3	1-year	3-year	5-year	10-year
Bloomberg Barclays U.S. 1-10 Year Blend Municipal Bond Index	0.07	3.79	1.67	2.08	2.10	3.73	0.73	1.00	2.20	2.12	3.77
Bloomberg Barclays U.S. Municipal Bond Index	0.24	4.92	2.19	3.04	3.00	4.50	1.06	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 October 31, 2017

AAA yields (%)

		Change		
Year	Current	1-month	3-month	1-year
2	1.09	0.09	0.15	0.25
5	1.42	0.07	0.21	0.29
10	2.01	0.01	0.06	0.28
30	2.83	-0.01	0.09	0.27

Source: InvestorTools® Perform

Cross-market values (%)[1]

	Current (1-year averages)	
Year	Muni/treasury	Muni/corporate
2	68 (79)	69 (69)
5	70 (77)	72 (72)
10	84 (91)	79 (81)
30	98 (99)	87 (86)

Sources: InvestorTools® Perform and Bloomberg

Yield curve data as of October 31, 2017

Slope changes (%)

		Change		
	Current	1-month	3-month	1-year
Wkly - 2s	0.68	0.02	-0.10	-0.29
2 - 5s	-0.18	0.07	0.21	0.29
2 - 10s	0.92	-0.08	-0.09	0.03
2 - 30s	1.74	-0.10	-0.06	0.02

Source: InvestorTools® Perform

Performance by maturity (%)

Year	1-month	3-month	1-year
3	-0.03	0.07	1.31
5	-0.03	-0.09	1.56
10	0.22	0.35	2.27
22+	0.47	0.74	2.64

Source: Barclays Point

Credit data as of October 31, 2017

Current rating spreads (%)[2]

	Current (1-year averages)	
Year	AAA–A	AAA–BBB
2	0.21 (0.19)	0.48 (0.46)
5	0.41 (0.40)	0.72 (0.71)
10	0.53 (0.56)	0.88 (0.91)
30	0.53 (0.58)	0.85 (0.91)

Source: InvestorTools® Perform

Performance by quality (%)

Rating	1-month	3-month	1-year
AAA	0.19	0.16	1.58
AA	0.23	0.30	1.98
A	0.26	0.70	2.29
BBB	0.38	1.85	4.40

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.

An investment in money market funds is neither insured nor guaranteed by the Federal Deposit Insurance Corporation. You could lose money by investing in the Fund. Although the Fund seeks to preserve the value of your investment at $1.00 per share, it cannot guarantee it will do so. The Fund may impose a fee upon sale of your shares or temporarily suspend your ability to sell shares if the Fund's liquidity falls below required minimums because of market conditions or other factors. An investment in the Fund is not a deposit of BMO Harris Bank N.A., or any of its affiliates, and is not insured or guaranteed by the FDIC or any other government agency. The Adviser has no legal obligation to provide financial support to the Fund, and you should not expect that the Adviser will provide financial support to the Fund at any time.

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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