Municipal
Insights

Bond insurers... and then there were two

In late June, Standard & Poor's completed its review of the bond insurance industry, affirming the financial strength ratings for Assured Guaranty (Assured) and Build America Mutual (BAM) at "AA" and downgrading National Public Finance Guarantee (National) to "A" from "AA-". The rating agency's review focused on the growth prospects of the municipal insurance industry and the ability of multiple insurers to profitably compete.

National has subsequently announced that it was abandoning its efforts to insure new business, essentially putting itself into run-off mode. The insurer's expectation is that it would be unable to effectively compete with the lower rating. S&P's downgrade of National was driven by its struggle to gain market acceptance, a weak business risk profile, limited market penetration and low pricing relative to Assured and BAM. Though S&P noted that National's claims paying ability was at a "AAA" level, in downgrading National, S&P demonstrated that a weak market position could overshadow adequate levels of claims paying resources in the assignment of a rating to a bond insurer.

National was one of only three bond insurers writing new municipal bond insurance. With National's withdrawal, only Assured and BAM remain in an industry that, prior to the financial crisis, had seven "AAA" rated bond insurers and insured over 50% of new municipal issues. Growing business volumes over the past several years has been difficult for the industry due in large part to low interest rates. Ultimately, higher interest rates and credit spreads will be needed to lift bond insurance penetration of new issuance from the 5-6% range that has been experienced over the past several years.

S&P affirmed BAM's "AA" rating noting that market position will be important for BAM's future rating as well. S&P observed that BAM has very strong claims paying resources, is gaining market acceptance and is achieving good pricing relative to Assured. Longer-term, BAM's rating stability will depend on its ability to maintain underwriting discipline, avoid claim payments, increase business production and attain profitability.

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Credit

Assured's strong competitive position given its market leading position, a history of strong credit discipline and a strong level of claims paying resources supported the "AA" rating affirmation by S&P. Though Assured is the industry leader, its ratings are potentially susceptible to pressure due to its large $4.9 billion exposure to Puerto Rico bonds, though the insurer's substantial claims paying resources of $12.1 billion helps to mitigate this risk.

BMO GAM will look to purchase securities with bond insurance particularly when price differential is minimal between uninsured and insured pieces to benefit from the added layer of protection and liquidity provided.

Bond insurance will continue to provide investors with a number of benefits including debt service protection from default over the life of the bonds, enhanced liquidity, price stability and creditor rights advocates. However, given the challenges facing the industry, particularly slow business growth for BAM as well as Assured's exposure to Puerto Rico bonds, the rating stability for both insurers is uncertain. BMO GAM will look to purchase securities with bond insurance particularly when price differential is minimal between uninsured and insured pieces to benefit from the added layer of protection and liquidity provided. However, assessing the underlying credit quality of bonds remains tantamount to prudent municipal bond investing.

Market share of insured par six-months ended (%)

	6/30/2017	6/30/2016
Assured Guaranty	59.4	53.6
Build America Mutual	35.4	43.5
National Public Finance	5.2	2.9

Source: Thomson Reuters

Texas, land of opportunity

The State of Texas ranks second with respect to gross domestic product (GDP) amongst U.S. states—behind California but just ahead of New York. If Texas were a country, its economy would rank close to the top ten globally. As for growth of the economy amongst states, Texas had the fastest growing economy from 2012 to 2015, growing at an average 3.9% annual pace. The rapid population growth over the past decade and strong economy puts Texas in an enviable position among states. The economy continues to diversify from energy markets. For example, Toyota North American just opened a billion-dollar, state-of-the-art headquarters on a 100-acre campus in Plano, Texas.

Texas is in an enviable position among the states with a growing resource base that will continue to support the state's spending on infrastructure and services.

Texas is one of seven states that do not levy an income tax, making sales tax revenues one of the most important revenue sources for the state. Sales tax receipts made up 56% of all states' revenues in 2016. Sales tax revenue growth has recently been more volatile, some citing e-commerce, lower wage growth and changing consumer habits as the main causes. The State Comptroller reports that 1% of all tax receipts come from e-commerce and that, while e-commerce is a concern, business cycles and changing consumer habits are of greater concern. Sales tax receipts had been off to a slow start (4% increase year over year for May) and coming in below budget until June and July when the state realized a 9% and 10% increase, respectively. Oil and natural gas production accounts for most of the rebound with consumer spending following.

Texas is in an enviable position among the states with a growing resource base that will continue to support the state's spending on infrastructure and services. The state and its municipal entities provide a multitude of high quality bonds for municipal investors. Additionally, the lack of a state income tax makes the bonds more attractive for out-of-state investors as yields are not driven lower by undue demand from in-state investors. Texas ranked second in overall municipal bond issuance in 2016. We continue to find many opportunities in mid-quality credits located within the fast-growing metropolitan areas of Texas.

Market commentary

Summer doldrums, muni rebound

The market has scaled back its expectations for another Fed hike this year according to probabilities derived from fed funds futures and the swap markets.

The Bloomberg Barclays Municipal Bond Index returned 0.81% in July, a rebound from June's surprisingly negative return of -0.36%. Year-to-date performance remains solid at 4.40%. Going forward, the market has scaled back its expectations for another Federal Reserve (Fed) hike this year according to probabilities derived from Fed funds futures and the swap markets. The Fed will have a significant amount of economic data to help make a decision before the December meeting, which could move them in either direction. However, economic releases, to date, point to a continuation of the slow but steady growth of the U.S. economy. The most recent jobs report showed U.S. payrolls rose by 209,000 in July and the jobless rate fell to 4.3%, tying a 16-year low. Average hourly earnings came in at 2.5% year-over-year—higher than in the aftermath of the recession but under the 10-year average. Second quarter U.S. GDP came in at 2.6%, up from 1.4% in the first quarter, not too hot and not too cold. As such, we see little reason at this time for the Fed to change course and should become less accommodative this year and the next. With a continuation of strength in Europe, we will keep our sights on statements from global central bankers as well as the U.S. Fed.

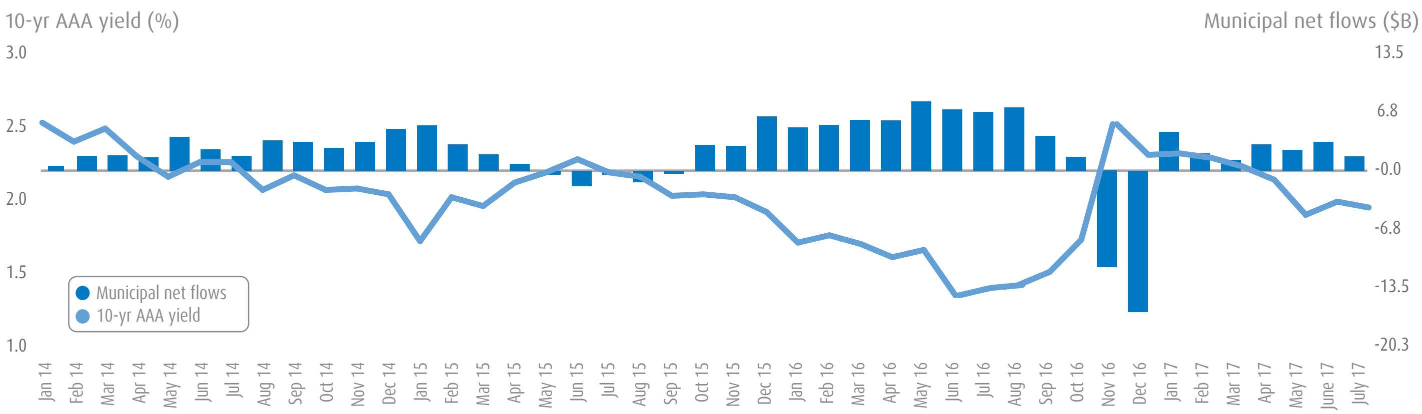
Sector performance

The month saw significant outperformance in BBB-rated bonds. The Bloomberg Barclays Muni BBB-rated Index returned 1.29% while the AAA-rated Index returned 0.73%. For the year-to-date, the BBB Index outperformed higher quality bonds by about 170 basis points. An overweight in lower quality bonds would have been a significant help to portfolio performance so far this year. The BBB index performance was helped by a large rebound in prices of State of Illinois bonds after the state legislature passed a budget in early July, overriding a veto by the Governor. Generically, State of Illinois general obligation bonds have tightened by about 100 basis points. The Bloomberg Barclays Illinois Index posted the best total return of all municipal indices at 1.78%.

For the year-to-date, the BBB index outperformed higher quality bonds by about 170 basis points. An overweight in lower quality bonds would have been a significant help to portfolio performance so far this year.

High yield munis underperformed investment grade indices returning 0.66% for the month. Performance was dragged down by sell-offs of tobacco bonds (-0.22%) and high-yield Puerto Rico bonds (-1.67%).

Municipal/ETF fund flows with yield



Source: Thomson Reuters

Supply and demand

Municipal issuers sold about $23 billion in bonds last month, down about 20% from July 2016. Refunding deals dropped 53% from a year earlier. Current yields on the long-end of the curve are about 60 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 solid at $12 billion, up 10% from last year. Year-to-date total issuance is $222 billion, down 13% from the same period last year.

Strong inflows into municipal funds and ETFs continued over the month, despite relatively modest performance. Over the past month, $1.6 billion flowed into municipal funds and ETFs. Year-to-date, we are at a $19 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 $220 billion in net flows year-to-date, over 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 $143 billion in net flows YTD.

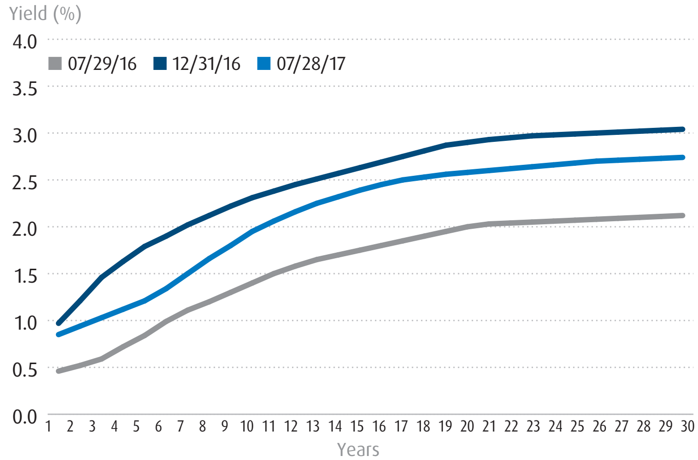
U.S. taxable bond funds and ETFs have seen $220 billion in net flows year-to-date, over double the same period last year.

Yield curve

You can see in the yield curve chart that while yields have fallen by about 30 basis points this year, they are still about 60 basis points higher than last year.

Municipal yields were lower over the month, by about 10 basis points six years and in, and 5 basis points out longer. We did have a brief sell-off with rising yields at the beginning of July, but reversed quickly with direction from the Treasury market. For the month, the best returns were on the 20-year portion of the curve, which returned 0.98%. The Bloomberg Barclays 10 Year Index was not far behind and returned 0.93%. You can see in the yield curve chart that while yields have fallen by about 30 basis points this year, they are still about 60 basis points higher than last year.

AAA municipal yield curve



Source: Thomson Municipal Market Monitor

Strategy overview

Duration

- We went shorter in June and maintained that level in July. The municipal market continues to hover near this year's low yields, and we see little benefit of being long the benchmark at this time. The media continues to focus on globally "improving" economies, particularly the European Union. We will have to see how this thought in the market develops before making additional duration changes.
- Over the month, the market has lowered their expectations for a Fed hike this year. However, we think the market continues to believe that the Fed will begin to trim its balance sheet this fall. With sub-2% core inflation at this time, most of our concern for higher interest rates is for 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 duration neutral/short. 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 0.82% versus 0.44% in July 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. Also, price appreciation on undervalued bonds helps longer-term performance as well.

Sector

- With a failure of the Senate to pass any health care legislation, Obamacare appears to be sticking around for the time being. It is unclear if the Senate will take another look at passing a GOP bill after their summer recess. With insurers raising premiums due to the uncertainties and an unfriendly Whitehouse, Obamacare will continue to face headwinds. The municipal hospital sector has benefited from Obamacare, and will continue to face unknowns in this environment. However, we are very comfortable with our selection of hospital bonds.
- State of Illinois GO bonds were the best performing bonds in July as the state legislature passed a budget, overriding Governor Rauner's veto. The state's bonds are significantly less attractive than earlier in the year due to passage of the budget.

Performance

Fund performance as of July 31, 2017

Fund/Index	Share class	Inception date	Ticker	Returns as of July 31, 2017 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Since inception	Returns as of June 30, 2017 (%) Q2	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	0.73	0.78	0.51	0.58	—	0.94	0.30	0.86	0.50	0.60	—	0.95	0.64	0.55
BMO Ultra Short Tax-Free Fund[2]	A OFFER[3]			-1.98	-1.33	-1.27	-0.18	0.17	—	0.69	-1.75	-1.20	-0.19	0.19	—	0.69		
BMO Ultra Short Tax-Free Fund[2]	I	09/30/09	MUISX	0.18	0.88	1.03	0.79	0.84	—	1.20	0.36	1.01	0.75	0.84	—	1.19	0.39	0.30
Blended Benchmark[4]				0.13	0.68	0.46	0.42	0.40	—		0.17	0.42	0.38	0.39	—			
BMO Short Tax-Free Fund[2]	A NAV	05/27/14	BASFX	0.20	1.94	0.67	1.33	—	—	1.66	0.72	0.66	1.30	—	—	1.65	0.78	0.56
BMO Short Tax-Free Fund[2]	A OFFER[3]			-1.82	-0.14	-1.35	0.64	—	—	1.23	-1.32	-1.37	0.61	—	—	1.21		
BMO Short Tax-Free Fund[2]	I	11/29/12	MTFIX	0.32	2.03	0.83	1.48	—	—	1.83	0.66	0.71	1.45	—	—	1.80	0.53	0.41
Bloomberg Barclays Short (1-5 Year) Municipal Index				0.43	2.21	0.63	1.22	—	—		0.56	0.47	1.11	—	—			
BMO Intermediate Tax-Free Fund[5]	A NAV	05/27/14	BITAX	0.66	3.66	0.13	2.94	2.66	4.72	4.43	1.66	-0.43	2.79	2.83	4.72	4.42	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	A OFFER[3]			-2.87	0.04	-3.36	1.71	1.93	4.35	4.27	-1.86	-3.90	1.56	2.09	4.35	4.26		
BMO Intermediate Tax-Free Fund[5]	Y	02/01/94	MITFX	0.66	3.66	0.13	2.94	2.66	4.72	4.43	1.66	-0.43	2.79	2.83	4.72	4.42	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	I	12/27/10	MIITX	0.68	3.89	0.45	3.21	2.91	4.84	4.48	1.72	-0.19	3.05	3.05	4.84	4.47	0.33	0.33
Bloomberg Barclays U.S. 1-15 Year Blend Municipal Bond Index				0.73	3.97	0.44	2.88	2.60	4.28		1.64	-0.15	2.70	2.70	4.28			

Other benchmarks as of July 31, 2017	Returns as of July 31, 2017 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Returns as of June 30, 2017 (%) Q2	1-year	3-year	5-year	10-year
Bloomberg Barclays U.S. 1-10 Year Blend Municipal Bond Index	0.68	3.67	0.62	2.42	2.21	3.92	1.39	0.16	2.24	2.26	3.93
Bloomberg Barclays U.S. Municipal Bond Index	0.81	4.40	0.26	3.55	3.10	4.60	1.96	-0.49	3.34	3.26	4.60

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 July 31, 2017

AAA yields (%)				
		Change		
Year	Current	1-month	3-month	1-year
2	0.94	-0.12	-0.04	0.42
5	1.21	-0.14	-0.20	0.37
10	1.95	-0.04	-0.19	0.55
30	2.74	-0.05	-0.28	0.62

Source: InvestorTools® Perform

Cross-market values (%)[1]		
	Current (1-year averages)	
Year	Muni/treasury	Muni/corporate
2	70 (86)	66 (71)
5	66 (81)	66 (74)
10	85 (93)	78 (81)
30	94 (99)	83 (84)

Sources: InvestorTools® Perform and Bloomberg

Yield curve data as of July 31, 2017

Slope changes (%)				
		Change		
	Current	1-month	3-month	1-year
Wkly - 2s	0.53	0.09	0.08	-0.38
2 - 5s	-0.14	-0.14	-0.20	0.37
2 - 10s	1.01	0.08	-0.15	0.13
2 - 30s	1.80	0.07	-0.24	0.20

Source: InvestorTools® Perform

Performance by maturity (%)			
Year	1-month	3-month	1-year
3	0.44	0.69	0.56
5	0.74	1.31	0.81
10	0.93	2.32	0.50
22+	0.97	2.98	-0.31

Source: Barclays Point

Credit data as of July 31, 2017

Current rating spreads (%)[2]		
	Current (1-year averages)	
Year	AAA–A	AAA–BBB
2	0.20 (0.18)	0.47 (0.45)
5	0.39 (0.39)	0.70 (0.70)
10	0.52 (0.55)	0.87 (0.89)
30	0.53 (0.58)	0.85 (0.88)

Source: InvestorTools® Perform

Performance by quality (%)			
Rating	1-month	3-month	1-year
AAA	0.73	1.76	0.02
AA	0.78	1.97	0.22
A	0.79	2.15	0.18
BBB	1.29	2.68	1.39

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.

BMO Asset Management Corp. is the investment adviser to the BMO Funds. **BMO Investment Distributors, LLC is the distributor of the BMO Funds**. Member FINRA/SIPC

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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