Municipal Insights

Illinois makes the grade

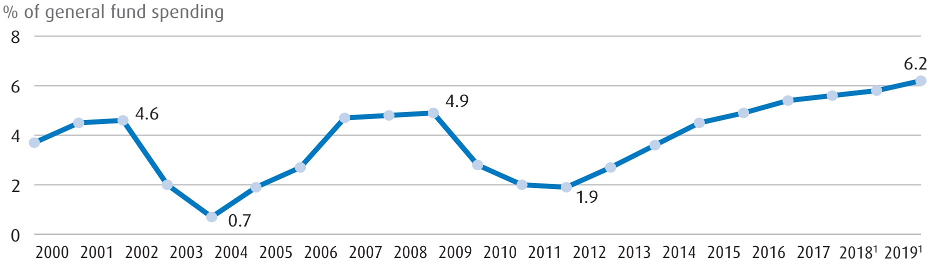
Last month, Moody's revised the outlook on the state of Illinois from negative to stable. The state has been given a reprieve from concerns that it may be the first state to fall below investment grade in recent history. State officials have the recent income tax hike and continued economic strength to thank. The outlook is now stable by all three major rating agencies with a low triple-B rating across the board. Immediately after the upgraded outlook, trading of Illinois bond issues jumped and prices appreciated relative to national bonds.

Only five states currently have a negative outlook — Louisiana, Mississippi, New Mexico, North Dakota and Oklahoma. There is no single theme across these states for the negative outlooks. New Mexico is faced with significant pension liabilities. Louisiana and Mississippi have been left behind in the nation's economic recovery with further complications by lower-than-average wealth levels. Lastly, North Dakota and Oklahoma contend with the volatility of energy dependent economies.

Apart from these few, states across the country are posting stronger financial performance with better-than-expected income tax receipts as well as strong sales tax revenues due to low unemployment and faster growth. The National Association of State Budget Officers reported that general fund revenues grew by about 5% in fiscal 2018, a result that was at or above estimates in 39 states. Additionally, states have been building reserves (rainy-day funds) steadily since the Great Recession (see below). Despite the overall stronger financial positioning, states are approaching the 2019 budget season with conservative growth rates for revenues, having not forgotten the lessons from the last recession. States with recent upgrades include Michigan (AA from AA-) and Minnesota (AAA from AA+). One important development we are watching is the impact that tariff-related export reductions may have on revenues. We expect progress on this front after mid-term elections later this year, but escalations could be troublesome.

Median rainy-day fund balance over time

% of general fund spending



[1] Figures for fiscal 2018 are estimated; figures for fiscal 2019 are projected based on governors' recommended budgets. Figures for fiscal 2018 exclude Georgia and Oklahoma. Figures for fiscal 2019 exclude Georgia, Oklahoma and Wisconsin.

Source: National Association of State Budget Officers

Municipal fixed income

Portfolio managers
Thomas Byron
Michael Montgomery
Brian Sipich, CFA
Robert Wimmel

Credit analysts
Michael E. Janik, CFA
Catherine M. Krawitz, CFA
Christopher Nowakowski, CPA
Andrew W. Tillman

One important development we are watching is the impact that tariff-related export reductions may have on revenues.

Contact us
1-844-266-3863
bmofunds.com
bmo-global-asset-management

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Back-to-school special

Municipal investors can still look to the higher education sector for investment opportunities. S&P reported that 91% of the rated private and 88% of the public higher education universe maintains stable credit outlooks. Large state flagship universities with strong strategic niches (e.g., health care, technology and engineering) have continued to see solid enrollment growth and financial support. However, some colleges will continue to be challenged by stagnating and declining enrollments as well as reductions in state funding. Investors should avoid institutions with substantial declines in enrollment, rising acceptance rates and those with low or weakening academic criteria. More broadly, higher education institutions in the Midwest and Northeast will be demographically challenged by declines in high school graduates. Problems will be more acute for small, private colleges that lack strong strategic positioning.

> Investors should avoid institutions with substantial declines in enrollment, rising acceptance rates and those with low or weakening academic criteria.

Over the past decade, successful higher education institutions have worked to raise their "brand value" to attract prospective students. Athletic and recreational facilities have seen significant upgrades and, more recently, we have seen an increase of bonds issued for new student housing and dining facilities. As institutions develop their brand value, we will likely see increased emphasis on research labs with strong ties to the corporate world and associated internship programs.

Schools that fail to increase their brand value will find it increasingly difficult to compete for shrinking federal and state dollars. Many will be forced to redefine themselves by narrowing course offerings or establishing a niche that offers value to students. Some institutions may choose to focus on pre-professional training. Other schools are looking for ways to realize savings by increasing the utilization of existing facilities through year-round course offerings instead of the traditional fall-spring academic year. Online learning will also play a significant role in cost savings while enabling students expanded learning opportunities and flexibility.

> We favor schools with good academic reputations, large state flagship universities and schools with strong strategic niches.

We think the majority of higher education institutions will adapt to the demands of current and future students. It's a sector where investors can find value by focusing on institutions that demonstrate strong demand characteristics, rising application levels, consistent acceptance and matriculation rates and broad geographic reach. We favor schools with good academic reputations, large state flagship universities and schools with strong strategic niches. We avoid schools experiencing substantial declines in enrollment, high or appreciably rising acceptance rates and those with low or weakening academic criteria. Additionally, a bit more caution is exercised in states with declining numbers of high school graduates, more common in the Midwest and Northeast.

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Market commentary

The best returns for municipal bonds in July were once again the shorter maturities, which have seen the only positive performance this year. While we did see positive returns across the curve in July, it was muted. The best performance was in the seven- to 10-year portion of the curve at about 0.40% return. The long-end of the curve eked out a 0.02% return for the month. Year-to-date, the one- to three-year portion of the curve returned about 1.15% versus a loss of 0.60% out long. Municipal bonds yet again outperformed other fixed income with the Bloomberg Municipal Bond Index returning 0.24%, besting the Bloomberg Treasury Index by about 60 basis points and the Bloomberg Aggregate Index by about 20 basis points. Low municipal bond issuance and ample demand continue to drive municipal outperformance.

July municipal issuance totaled $25 billion, bringing year-to-date issuance to $190 billion, a 15% decline versus the same period last year. The decline is due to the absence of prerefunding deals disallowed by last year's tax law changes. One positive note for supply was a monthly increase of almost 70% in new money issuance. Perhaps a sign that municipal issuers are less reluctant to fund new projects and take on more debt as financial conditions improve. Municipal fund flows continued their positive trend with about $3.8 billion of inflows in July, bringing year-to-date total inflows to $17 billion. Taxable bond funds posted strong inflows as well, while equity funds saw about $12 billion in outflows. The municipal supply and demand imbalance may continue through August as projections show the amount of money available from reinvestment of maturing bonds and coupons to be about $17 billion greater than the amount expected to be issued by municipalities.

The second quarter GDP estimate came in at 4.1%, within the range of expectations. As such, the bond market reacted with little fanfare. It did, however, reinforce the Federal Reserve's (Fed) thoughts on steering short-term interest rates higher over the rest of the year. At their August meeting, the U.S. central bank held the Fed Funds target rate steady at 1.75 to 2 percent as widely expected. However, they had a bullish assessment on the state of the U.S. economy. With this strength and slightly higher inflation, the current probability of a September rate hike is over 90% and the probability of an additional December hike is over 60%. While we continue to monitor the potential for trade wars to negatively impact future growth, we see few signs of that at this time. In the face of further rate hikes, we remain defensively positioned.

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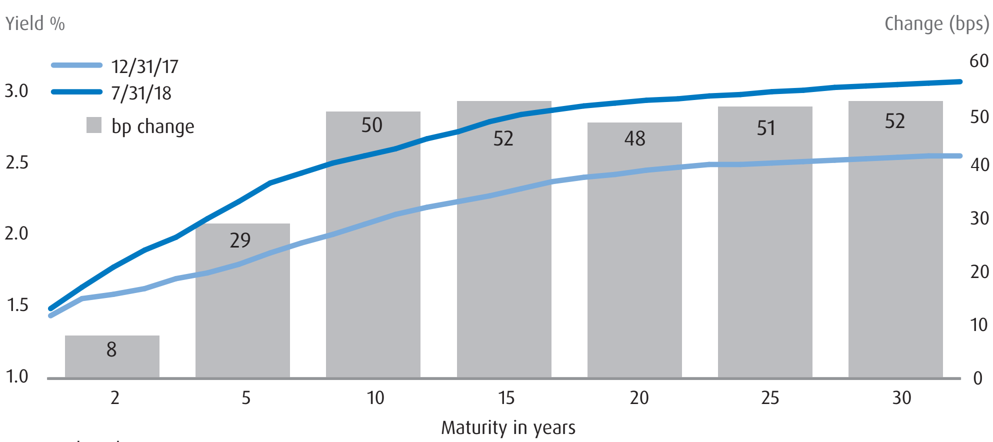
AAA government obligation yield curve 12/31/17 to 7/31/18



Source: Bloomberg

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Strategy overview

Duration

- Maintaining shorter portfolio duration than our benchmark and peers.
- Solid economic growth with 2Q GDP at 4.1% and July unemployment rate down to 3.9%.
- Increased Treasury issuance to fund the federal deficit continues to be a concern.
- We continue to scrutinize reports for any guidance on foreign central bank actions.

Curve

- The short end of the curve is very rich relative to taxable bonds due to good retail demand and low supply.
- At the early August meeting, the Fed reiterated its intent to gradually increase interest rates. The market probability of a hike in September is over 90% at this time. The probability for an additional hike in December is over 60%.
- As such, we continue to buy municipal floating-rate notes with mandatory puts of about three years.
- The three-year spot of the municipal curve is up 1.09% in year-to-date total return while the 10-year is down 0.35% in total return.
- The weekly municipal floating rate index (SIFMA rate) is at 1.29% (8/1/2018) versus 0.79% a year ago.

Credit and structure

- Lower quality, investment-grade bonds posted the best returns in July with the Bloomberg BBB Index returning 0.55% for the month. Year-to-date, the index has returned 0.95%, easily outperforming the Municipal Bond Index, which returned -0.01%.
- With historically tight lower quality spreads, we continue to be very selective in our purchases of BBB rated bonds.

Geography and sector

- We continue to favor revenue bonds and have been focusing on hospital bonds, higher education (see above) and transportation bonds. We are watching for fallout from recent tariff actions, but have not noted any excessive stresses on credit quality at this time.

Performance

Fund performance as of July 31, 2018

Fund/Index	Share class	Inception date	Ticker	Returns as of July 31, 2018 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Since inception	Returns as of June 30, 2018 (%) 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	BAUSX	0.18	0.82	1.01	0.72	0.71	—	0.95	0.29	0.89	0.67	0.66	—	0.94	0.64	0.55
BMO Ultra Short Tax-Free Fund[2]	A OFFER[3]			-1.87	-1.25	-1.05	0.03	0.29	—	0.73	-1.76	-1.17	-0.02	0.25	—	0.71		
BMO Ultra Short Tax-Free Fund[2]	I	09/30/09	MUISX	0.10	0.86	1.16	0.98	0.94	—	1.19	0.46	1.24	0.96	0.94	—	1.19	0.39	0.30
Blended Benchmark[4]				0.13	0.83	0.80	0.61	0.50	—		0.42	0.80	0.59	0.49	—			
BMO Short Tax-Free Fund[2]	A NAV	05/27/14	BASFX	0.11	0.75	0.90	1.09	1.60	—	1.53	0.57	0.99	1.15	1.56	—	1.53	0.76	0.55
BMO Short Tax-Free Fund[2]	A OFFER[3]			-1.92	-1.29	-1.14	0.40	1.20	—	1.17	-1.47	-1.05	0.46	1.16	—	1.17		
BMO Short Tax-Free Fund[2]	I	11/29/12	MTFIX	0.23	0.84	1.05	1.27	1.76	—	1.69	0.51	1.14	1.27	1.71	—	1.68	0.51	0.40
Bloomberg Barclays Short (1-5 Year) Municipal Index				0.30	1.07	0.48	1.08	1.23	—		0.66	0.60	1.09	1.23	—			
BMO Intermediate Tax-Free Fund[5]	A NAV	05/27/14	BITAX	0.21	0.13	1.16	2.28	3.23	4.24	4.30	0.66	1.62	2.36	3.07	4.30	4.30	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	A OFFER[3]			-3.26	-3.38	-2.38	1.07	2.50	3.87	4.14	-2.83	-1.95	1.14	2.34	3.92	4.15		
BMO Intermediate Tax-Free Fund[5]	Y	02/01/94	MITFX	0.21	0.13	1.16	2.28	3.23	4.24	4.30	0.66	1.62	2.36	3.07	4.30	4.30	0.58	0.56
BMO Intermediate Tax-Free Fund[5]	I	12/27/10	MIITX	0.23	0.27	1.40	2.52	3.49	4.39	4.36	0.73	1.86	2.63	3.30	4.44	4.36	0.33	0.33
Bloomberg Barclays U.S. 1-15 Year Blend Municipal Bond Index				0.32	0.25	0.60	2.19	2.96	3.84		0.85	1.01	2.29	2.85	3.89			

Other benchmarks as of July 31, 2018	Returns as of July 31, 2018 (%) 1-month	YTD	1-year	3-year	5-year	10-year	Returns as of June 30, 2018 (%) Q2	1-year	3-year	5-year	10-year
Bloomberg Barclays U.S. 1-10 Year Blend Municipal Bond Index	0.35	0.45	0.28	1.81	2.36	3.38	0.81	0.61	1.86	2.31	3.45
Bloomberg Barclays U.S. Municipal Bond Index	0.24	-0.01	0.99	2.69	3.77	5.04	0.87	1.56	2.85	3.53	5.06

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, 2018

AAA yields (%)				
		Change		
Year	Current	1-month	3-month	1-year
2	1.62	-0.02	-0.25	0.68
5	1.97	-0.02	-0.22	0.76
10	2.45	-0.01	-0.04	0.50
30	3.01	0.07	-0.08	0.27

Source: InvestorTools® Perform

Cross-market values (%)[1]		
	Current (1-year averages)	
Year	Muni/treasury	Muni/corporate
2	61 (70)	61 (69)
5	69 (73)	68 (72)
10	83 (85)	75 (77)
30	98 (97)	83 (84)

Sources: InvestorTools® Perform and Bloomberg

Yield curve data as of July 31, 2018

Slope changes (%)				
		Change		
	Current	1-month	3-month	1-year
Wkly—2s	1.73	0.57	0.81	-0.12
2—5s	-0.70	-0.02	-0.22	0.76
2—10s	0.83	0.01	0.21	-0.18
2—30s	1.39	0.09	0.17	-0.41

Source: InvestorTools® Perform

Performance by maturity (%)			
Year	1-month	3-month	1-year
3	0.33	1.27	0.44
5	0.39	1.66	-0.01
10	0.38	1.51	0.31
22+	0.02	1.58	1.85

Source: Barclays Point

Credit data as of July 31, 2018

Current rating spreads (%)[2]		
	Current (1-year averages)	
Year	AAA–A	AAA–BBB
2	0.19 (0.21)	0.46 (0.48)
5	0.38 (0.41)	0.70 (0.72)
10	0.47 (0.50)	0.82 (0.85)
30	0.49 (0.51)	0.81 (0.83)

Source: InvestorTools® Perform

Performance by quality (%)			
Rating	1-month	3-month	1-year
AAA	0.17	1.30	0.20
AA	0.20	1.39	0.59
A	0.28	1.54	1.47
BBB	0.55	2.20	3.85

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	BAUSX	—	MUISX	—
BMO Short Tax-Free Fund	BASFX	—	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 Municipal High Yield Index measures the USD-denominated, high yield, fixed-rate corporate bond market.

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.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

Personal Consumption Expenditures (PCE) Index measures the prices paid by consumers for goods and services without the volatility caused by movements in food and energy prices to reveal underlying inflation trends.

Basis point is equal to one one-hundredth of one percentage point (0.01%).

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