Fixed income market update

July 2019

BMO Fixed Income

1001 Brickell Bay Dr.
Suite 2100
Miami, Florida 33131

bmogam.com/USFixedIncome

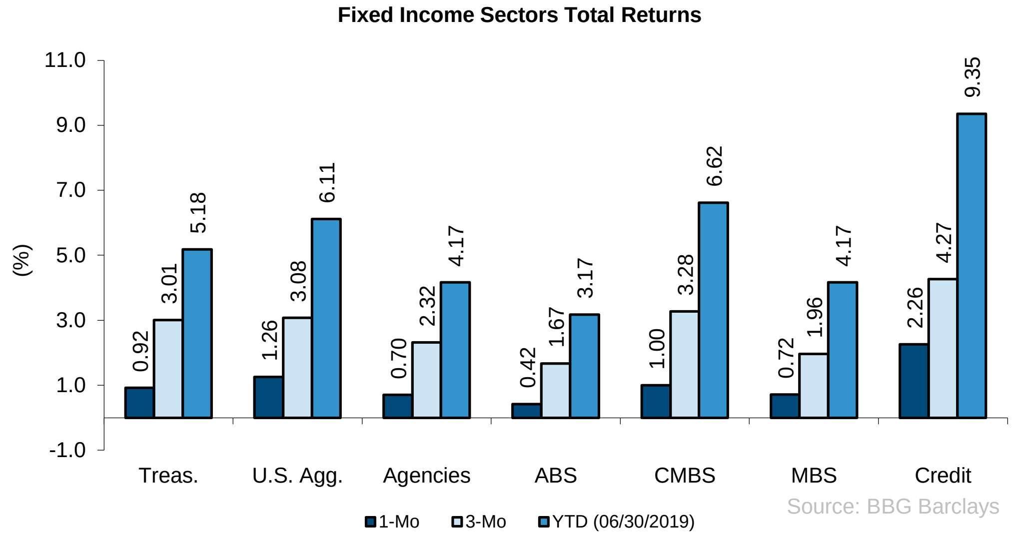
BMO Global Asset Management

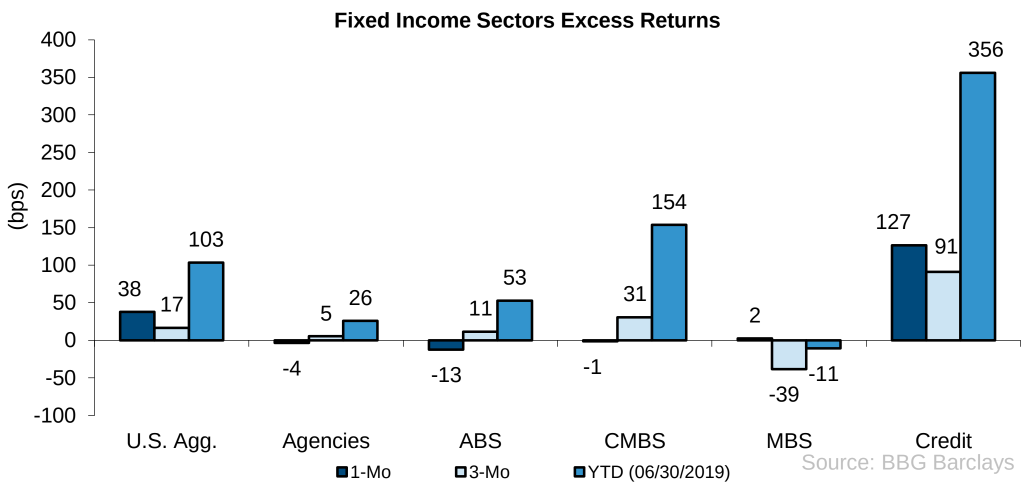
Fixed income market update

- For the quarter ended June 30, 2019, the Bloomberg Barclays U.S. Aggregate Bond Index returned 3.08%. Year to date, the index has returned 6.11%.

- U.S. Treasuries returned 3.01% during the quarter as the yield on the 10-year U.S. Treasury declined to 2.00% at the end of June from 2.41% at the end of March. For the quarter, long Treasuries (+6.03%) outperformed intermediate Treasuries (+2.36%.)

- Mortgage-backed securities (MBS) returned 1.96% during the quarter, underperforming Treasuries by 39 basis point on a duration-adjusted basis. The option adjusted spread (OAS) of the Bloomberg Barclays U.S. Mortgage Index widened 11 basis points during the quarter, ending the period at 46 basis points.



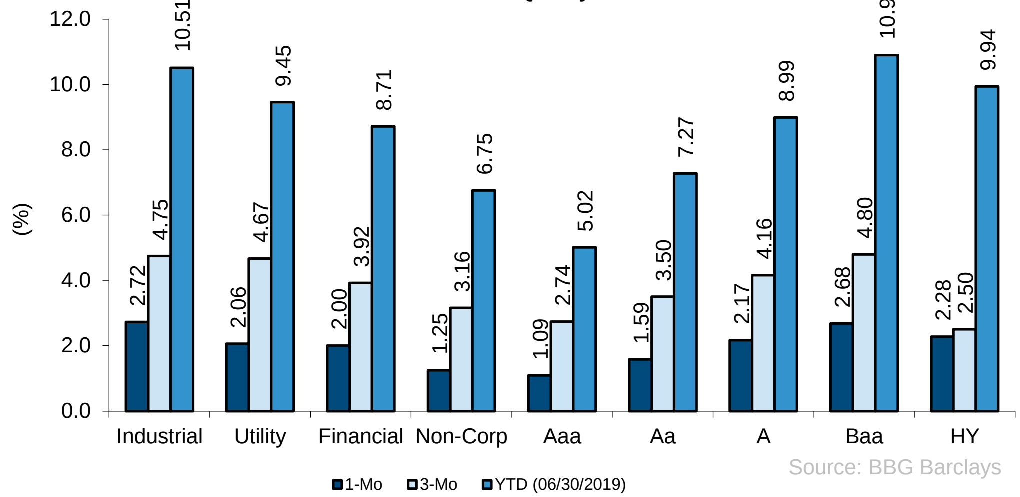


Fixed income market update (continued)

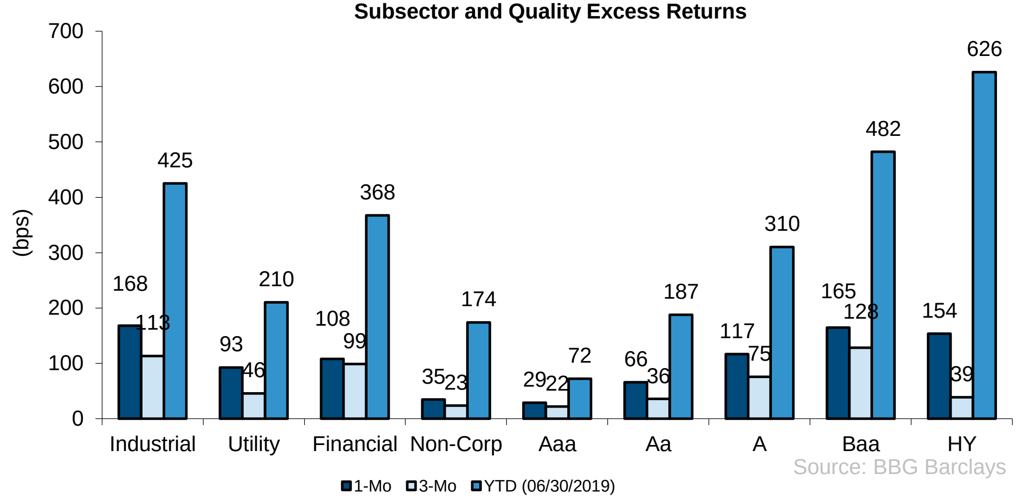
- Credit securities returned 4.27% for the quarter, outperforming Treasuries by 91 basis points on a duration-adjusted basis. The OAS of the Bloomberg Barclays U.S. Credit Index ended the period at 109 bps, 4 basis points tighter than at the end of March. For the quarter, long credit (+7.02%) outperformed intermediate credit (+2.99%) by 122 basis points on a duration-adjusted basis.

- For the quarter, on a duration-adjusted basis, industrials delivered 113 basis points of excess return, outperforming financials, utilities and non-corporates by 14, 67 and 90 basis points, respectively.

- BBB rated securities delivered 128 basis points of excess return for the quarter, outperforming AAA, AA and A rated securities by 106, 92 and 53 basis points of excess return, respectively. High yield delivered 39 basis points of excess return for the quarter.



Source: BBG Barclays

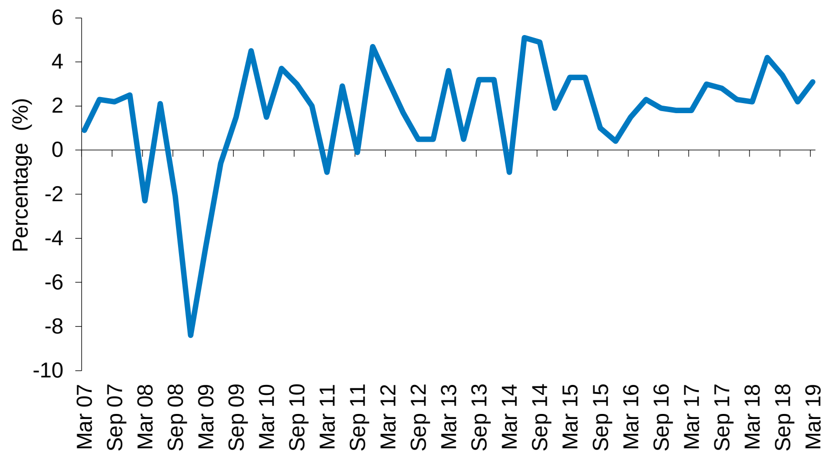


Source: BBG Barclays

Economic update

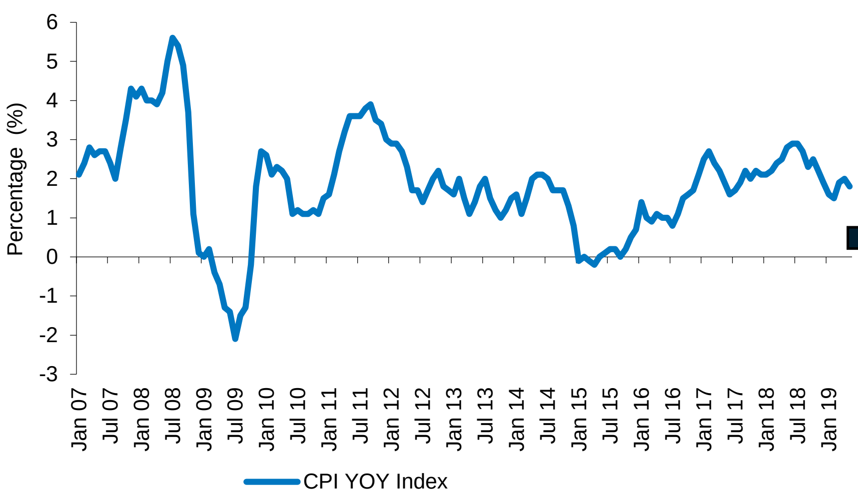
First quarter GDP growth was unrevised at 3.1%. Business investment rose to +3% versus the prior reading of +1%, while inventory growth declined modestly from the prior reading. Consumer spending was revised down from 1.3% to 0.9%. Consensus for second quarter GDP growth remains at 2.6% and the consensus expectation for the full year 2019 has decreased to 2.5% from 2.6%. The International Monetary Fund (IMF) revised its projection higher for U.S. growth in 2019 to 2.6% while projecting growth would slow to 2.0% in 2020.

Gross Domestic Product (GDP)



Source: Bureau of Economic Analysis

Consumer Price Index (YoY)

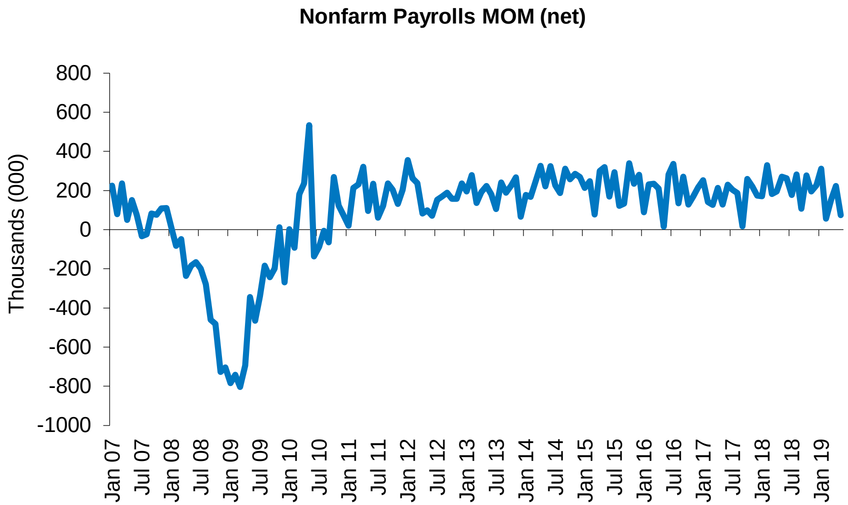


Source: Bureau of Labor Statistics

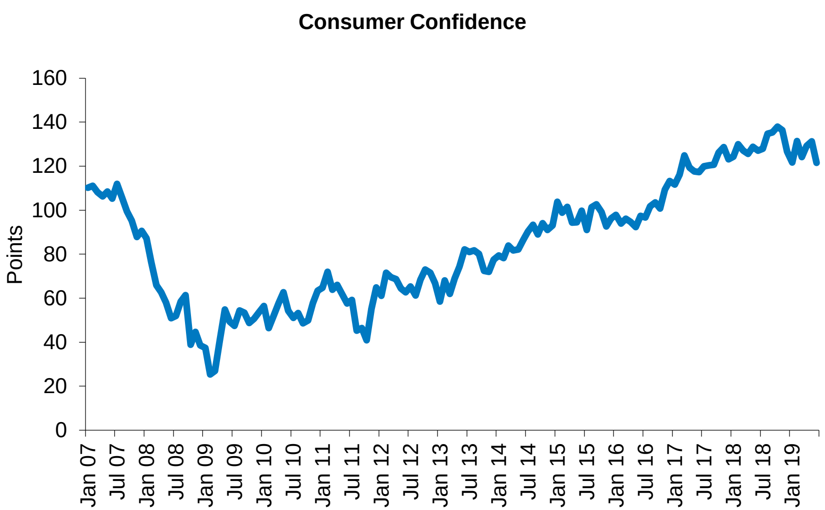
The Consumer Price Index (CPI) rose 0.1% in May and 1.8% for the trailing year; this figure represents a continued decline of inflation in recent months. Core CPI, which excludes the impact of food and energy, rose by 0.1% for the fourth consecutive month and 2.0% for the trailing year. Core PCE, the Fed's preferred inflation gauge, rose 0.2% for May and rose 1.6% for the trailing year, below the Fed's 2% target, and unchanged from April.

Economic update (continued)

May non-farm payrolls increased by only 75,000 jobs, below market expectations for 180,000 new jobs and figures were revised downward for the prior two months by 75,000 jobs. The unemployment rate in the U.S. remained unchanged at 3.6%, the lowest level in 50 years, and the underemployment rate declined from 7.3% to 7.1%. The labor participation rate remained unchanged at 62.8% and average hourly earnings rose 3.1% for the trailing year, below the 3.2% expectation.



Source: Bureau of Labor Statistics



Source: Conference Board

The Conference Board Consumer Confidence Index® declined to 121.5, significantly below the prior month's reading of 131.3 and the expectation of 131.1. The June reading was the lowest since 2017. Within the survey, there was a notable decline in respondents expecting economic conditions to improve near-term (from 21.4% to 18.1%) and labor market conditions to improve (from 18.4% to 17.3%).

Economic and market perspective

- Shifting expectations around monetary policy globally and trade tensions dominated market news in June.
- The tariffs that President Trump announced on all imports from Mexico at the end of May were scuttled before implementation as Mexico agreed to institute more stringent border security. The threat of those tariffs had impacted risk-off sentiment at the end of May and their negation improved sentiment when announced in June. Mexico also officially ratified the United States-Mexico-Canada Agreement (USMCA) in June. In doing so, Mexico became the first country to formally agree to the trade deal negotiated to replace NAFTA.
- Unlike with Mexico, trade tensions with China persisted through the month. In reference to a trade deal with China, Treasury Secretary Steven Mnuchin raised hopes of a resolution when he said that “we were about 90% of the way there and I think there’s a path to complete this.” Over the final weekend of the month at the G-20 summit in Japan, President Trump and President Xi of China agreed not to impose new tariffs and to restart trade talks; part of the arrangement allows Huawei to resume buying from U.S. companies.
- Two oil tankers were attacked in June in the Gulf of Oman. The United States believes that Iran is responsible for the attacks. Further, Iran shot down a U.S. drone in June, prompting additional fears of expanding Middle East tensions. Reports indicated that President Trump initially authorized a retaliatory strike before rescinding the order. Instead, the U.S. instituted further economic sanctions on top of already existing sanctions and reportedly engaged in cyber attacks against Iran. In part due to fears of escalation in the Middle East, oil prices rose almost 10% in in June, from $53 a barrel to nearly $59 a barrel.
- Mario Draghi, President of the European Central Bank (ECB), suggested that the ECB could further ease policy if the economic outlook in Europe did not improve. Later in June, Euro-area core inflation was reported and rose only 1.1% for the month, enhancing expectations that the ECB would cut rates. Current expectations are for a rate cut at the ECB’s September meeting. The ECB’s next meeting is on July 25 and will be closely monitored for additional indications on forthcoming policy changes.

Outlook and conclusions

- The Federal Open Market Committee met June 18 – 19 with markets expecting no policy change, but looking for indications regarding the July 30-31 meeting. As expected, the Fed did not adjust the Fed Funds rate, but hinted at shifting policy looking forward. The Fed removed the word "patient", which it had used to characterize its stance on policy normalization, and replaced it with a perspective that it would "closely monitor" developments; this is seen as a lean towards future rate cuts. The Fed's dot plot, which captures Fed governors views of future Fed Funds Rates, showed a meaningful shift downward of individual expectations of future rates, but due to the preponderance of those expecting rates in the current range of 2.25 – 2.50% there was no change in the median.

- In the press conference after the minutes were released, Chairman Powell referred to the Fed's "one overarching goal: to sustain the economic expansion." In response to a question, the Chairman responded that "in a world where you are closer to the effective lower bound… it's wise to react, for example, to prevent a weakening from turning into a prolonged weakening. In other words, sort of, an ounce of prevention is worth a pound of cure." This response, the general tone of the meeting and subsequent Fed member speeches have reinforced market expectations of a rate cut coming soon. As of the end of June, Fed Funds futures projected a 100% probability of a rate cut at the July meeting with approximately a 25% chance of a 50 basis points cut.

- In our view, given the Fed's reluctance to disappoint markets, absent a compelling positive development on trade (unlikely) or economic data (possible), the Fed will likely deliver the rate cut the market expects in July. In this repositioning, the Fed has pulled the range for longer interest rates lower. While we have believed that U.S. economic data would remain more resilient than feared, which to-date has been the case, this has not translated to the U.S. rates market largely due to the Fed's actions. We expect the Fed's repositioning to accommodation to support credit going forward. However, we would not argue that credit is cheap given the current landscape and we are cautious that future volatility is underpriced. With the move lower in rates and tighter in spreads, fixed income delivered stronger returns than what most would have expected in the first half of 2019. It is unlikely the second half will offer similar returns, though a newly accommodative Fed and reasonable fundamentals are likely to support the asset class looking forward.

Fixed income returns as of June 30, 2019

	Total Return (%)			Excess Return (%)		
	Month-to-Date	Quarter-to- Date	Year-to- Date	Month-to-Date	Quarter-to- Date	Year-to- Date
U.S. Aggregate	1.26	3.08	6.11	0.38	0.17	1.03
U.S. Treasury	0.92	3.01	5.18	-	-	-
Intermediate	0.83	2.36	3.99	-	-	-
Long	1.34	6.03	10.98	-	-	-
TIPS	0.86	2.86	6.15	-	-	-
Agencies	0.70	2.32	4.17	-0.04	0.05	0.26
U.S. MBS	0.72	1.96	4.17	0.02	-0.39	-0.11
ABS	0.42	1.67	3.17	-0.13	0.11	0.53
CMBS	1.00	3.28	6.62	-0.01	0.31	1.54
U.S. Credit	2.26	4.27	9.35	1.27	0.91	3.56
Intermediate	1.49	2.99	6.65	0.64	0.53	2.46
Long	3.90	7.02	15.44	2.60	1.75	6.14
Industrial	2.72	4.75	10.51	1.68	1.13	4.25
Utility	2.06	4.67	9.45	0.93	0.46	2.10
Financial	2.00	3.92	8.71	1.08	0.99	3.68
Non-Corporate	1.25	3.16	6.75	0.35	0.23	1.74
Aaa	1.09	2.74	5.02	0.29	0.22	0.72
Aa	1.59	3.50	7.27	0.66	0.36	1.87
A	2.17	4.16	8.99	1.17	0.75	3.10
Baa	2.68	4.80	10.90	1.65	1.28	4.82
High Yield	2.28	2.50	9.94	1.54	0.39	6.26
Floating Rate Notes	0.30	0.96	2.60	0.10	0.23	1.25

Source: Bloomberg Barclays

Disclosures

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

This is not intended to serve as a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. Information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. This publication is prepared for general information only. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. It does not have regard to the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek advice regarding the appropriateness of investing in any securities or investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Investment involves risk. Market conditions and trends will fluctuate. The value of an investment as well as income associated with investments may rise or fall. Accordingly, investors may receive back less than originally invested. Investments cannot be made in an index. **Past performance is not necessarily a guide to future performance.**

Taplin, Canida & Habacht, LLC is a registered investment adviser and a wholly owned subsidiary of BMO Asset Management Corp., which is a subsidiary of BMO Financial Corp. BMO Global Asset Management is the brand name for various affiliated entities of BMO Financial Group that provide investment management and trust and custody services. Certain of the products and services offered under the brand name BMO Global Asset Management are designed specifically for various categories of investors in a number of different countries and regions and may not be available to all investors. Products and services are only offered to such investors in those countries and regions in accordance with applicable laws and regulations. BMO Financial Group is a service mark of Bank of Montreal (BMO).

BMO Asset Management Corp., BMO Investment Distributors, LLC, BMO Private Bank, BMO Harris Bank N.A. and BMO Harris Financial Advisors, Inc. are affiliated companies. BMO Private Bank is a brand name used in the United States by BMO Harris Bank N.A. BMO Harris Financial Advisors, Inc. is a member FINRA/SIPC, an SEC registered investment adviser and offers investments, advisory services and insurance products. Not all products and services are available in every state and/or location.

You should consider the Fund's investment objectives, risks, charges and expenses carefully before investing. For a prospectus, which contains 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.

Investment products are: **Not A Deposit | Not FDIC Insured | No Bank Guarantee | May Lose Value**

C11 #8700184