Whitepaper

BMO Strategic Fixed Income Yield Fund

This white paper discusses the BMO Strategic Fixed Income Yield Fund (the "Fund") and some of the components that make up the Fund. The Fund will seek to replicate the outcome of a diversified portfolio of structured interest rate notes.

Structured Notes

A structured note is a hybrid security that combines characteristics of fixed income instruments with derivatives. Approximately 75%-95% of the composition of structured note payouts are created using bonds, with the remainder composed of derivatives.

Structured Interest Rate Notes

Structured interest rate notes are a subset of structured products designed to provide exposure to different benchmark interest rates. They are typically issued by financial institutions and can be customized to meet the specific needs and views of investors regarding future interest rate movements. They are linked to a reference interest rate(s) and provide investors the opportunity to earn above market yields relative to traditional fixed-income securities of similar maturity and credit quality. Key benefits include:

- **Potential for Enhanced Returns:** Can potentially offer higher returns compared to fixed-income securities of similar maturity and credit quality.
- **Tailored Exposure:** Investors can gain exposure to specific benchmark interest rates.
- **Diversification:** Diversifies a traditional fixed income portfolio by providing exposure to multiple interest rate movements.

Different Structured Rate Swaps Explained

The BMO Strategic Fixed Income Yield aims to replicate up to four main types of structured interest rate notes through the use of structured rate swaps[1]. The portfolio is actively managed and will allocate to different swaps depending on the interest rate environment. For each swap, there is a funding leg (paid by the fund manager to the issuer/swap dealer, typically SOFR[2] + a spread) in exchange for contingent coupon payments.

Callable Range Accrual Swap

Designed to potentially earn an above market coupon for each day the reference benchmark rate stays within a pre-specified range. In addition, the issuer has the right, but not the obligation, to redeem the swap after the first year at par value.

KEY FEATURES

Interest (Coupon) Payments

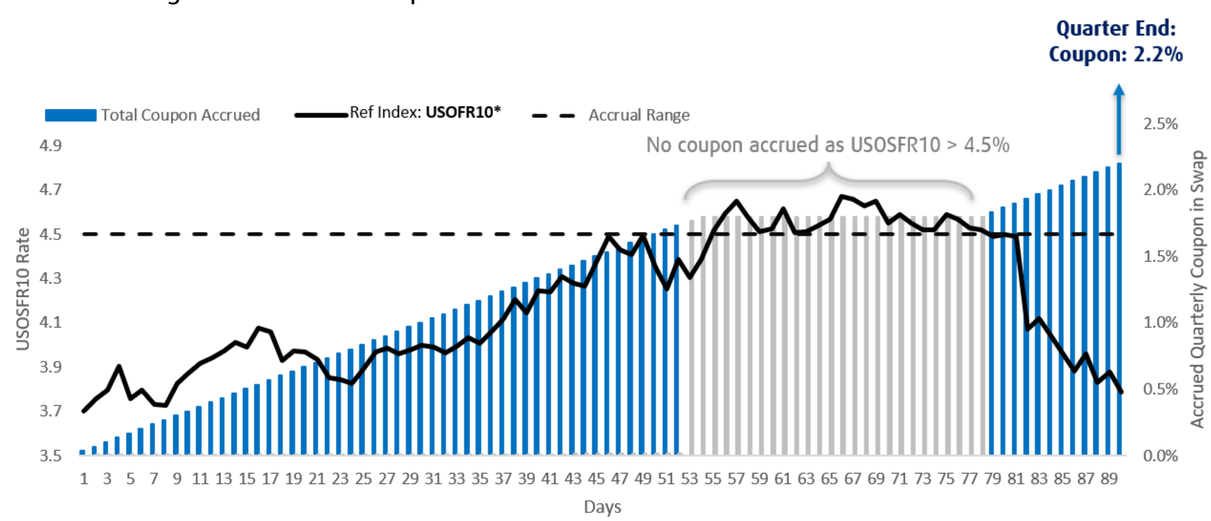
- **Range Accrual Mechanism**: The interest (coupon) payments depend on the performance of an underlying reference rate (typically a constant maturity swap (CMS) rate) staying within a predefined range. Interest accrues only for days where the reference rate remains within the range.
- **Accrual Days**: The interest each period is calculated based on the number of days the reference rate stays within the range.

Call Feature

- **Issuer Call Option:** Issuer has the right to call (redeem) the swap prior to maturity at specified dates. The issuer can repay the principal and any accrued interest, effectively ending the swap prematurely.

KEY BENEFITS

- **Potential for Enhanced Coupon:** Can potentially offer higher coupon compared to traditional fixed income securities of similar maturity and credit quality, especially if the reference rate stays within the predefined range for an extended period of time.



For illustrative purposes only.
*USOFR10: 10-year SOFR interest swap rate.

- **Customizable Exposure:** Can gain targeted exposure to interest rate movements and benefit from specific market views if market predictions of stable or falling rates become true.
- **Volatility Exposure:** Investors may be compensated in a high interest rate volatility environment through a combination of wider accrual ranges and/or higher coupon.

IMPACT OF MARKETS

Stable Rate Environment

- In a stable rate environment, the range accrual feature generates potentially consistent above market interest income as long as the reference interest rate stays within the predefined range.

Falling Rate Environment

- In a falling rate environment, the likelihood of the reference rate staying within the predefined range increases. As a result, the swap's interest payments are more likely to accrue, leading to higher potential coupon payments for investors.
- If interest rate falls substantially, there is a higher chance the swap will be called by the issuer/counterparty.

Callable Curve Steepener Swap

Designed to provide investors with exposure to the steepness of the yield curve while providing the issuer the right, but not the obligation, to redeem the swap prior to maturity under certain conditions. They are structured to capitalize on changes in the spread between short-term and long-term interest rates.

KEY FEATURES

Interest (Coupon) Payments

- **Yield Curve Steepness:** The coupon payments on a curve steepener swap are typically linked to the steepness of the yield curve. This involves the spread between interest rates of two specific maturities (typically the 30yr constant maturity swap rate and 2yr constant maturity swap rate).
    - The steepness of the yield curve refers to the difference between long-term and short-term interest rates. A steep yield curve means a larger positive difference between these two rates.

Call Feature

- **Issuer Call Option:** Issuer has the right to call (redeem) the swap prior to maturity at specified dates. The issuer can repay the principal and any accrued interest, effectively ending the swap prematurely.

KEY BENEFITS

- **Potential for Enhanced Yield:** Can potentially offer a higher contingent coupon that is based on the shape of the yield curve. The steeper the yield curve, the higher the contingent coupon subject to a cap and a floor.

- **First Year Fixed Coupon:** If the yield curve is inverted (short-term rate higher than long-term rate) at inception, the swap may offer a fixed first year coupon.

- **Customizable Exposure:** Allow investors to gain targeted exposure to the shape of the yield curve, benefitting in both bear steepening and bull steepening interest rate environments.

	Year 1 Q1	Year 1 Q2	Year 1 Q3	Year 1 Q4		Year 2 Q1	Year 2 Q2	Year 2 Q3	Year 2 Q4
30Y	3.6%	3.9%	4.5%	4.5%	Callable	4.0%	4.0%	4.5%	4.2%
2Y	4.5%	5.0%	5.1%	4.1%		4.1%	3.7%	3.2%	3.8%
Sprd	**-0.9%**	**-1.1%**	**-0.6%**	**0.4%**		**-0.1%**	**0.3%**	**0.3%**	**0.4%**
Cpn	2.5%	2.5%	2.5%	2.5%		0%	1.5%	2.5%	2.0%

For illustrative purposes only.

IMPACT OF MARKETS

Parallel Shift in the Interest Rate Curve[2]

- Callable curve steepener swaps pay interest based on the steepness of the yield curve. The impact of parallel shifts in the yield curve is muted for curve steepener swaps.

Flattening or Steepening Interest Rate Curve

- In a steepening rate environment, meaning the spread between short-term rates and long-term rates increase, this is very beneficial for the swaps as the size of the coupon payments increase, subject to a cap.
- If investors anticipate the yield curve to change from inverted (short-term rates higher than long-term rates) to a normal steep curve (short-term rates lower than long-term rates) in the future, the swaps can be very attractive due to the fixed first year coupon. However, if the yield curve does not steepen after the first year, investors may risk receiving no coupons in the subsequent years.

Callable Fixed-Rate Swaps

Pays a fixed interest rate (coupon) over its life and provides the issuer the right, but not the obligation, to redeem the swap prior to maturity under certain conditions.

KEY FEATURES

Interest (Coupon) Payments

- **Fixed Interest Rate:** Investors receive regular fixed coupon payments throughout the life of the swap. The interest rate is predetermined and remains constant regardless of market interest rate fluctuations.

Call Feature

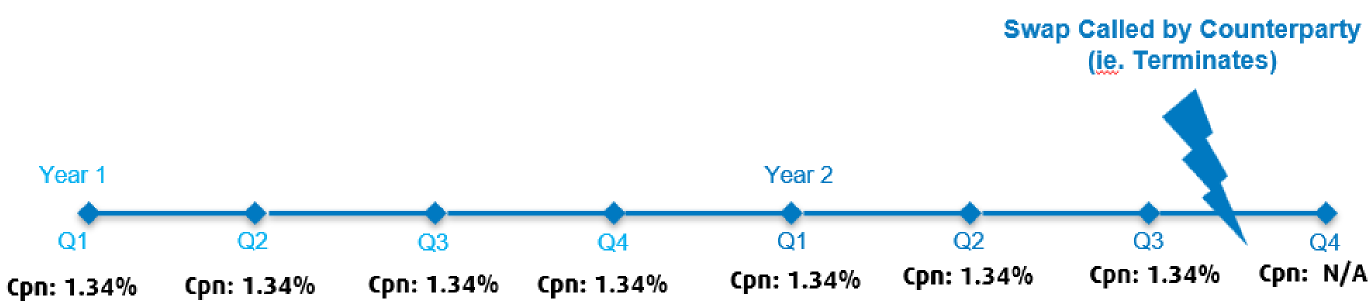
- **Issuer Call Option:** Issuer has the right to call (redeem) the swap prior to maturity at specified dates. The issuer can repay the principal and any accrued interest, effectively ending the swap prematurely.

Maturity Date

- The swap has a scheduled maturity date when the principal amount is due to be repaid, assuming the swap is not called earlier.

KEY BENEFITS

- **Potential for Enhanced Yield:** Often offer higher yields compared to traditional non-callable bonds of similar maturity and credit quality to compensate investors for the risk of the swap being called.
- **Predictable Income:** Investors receive regular fixed interest payments (unless the swap is called), potentially providing a predictable income stream.



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IMPACT OF MARKETS

Rising Rate Environment

- In a rising rate environment, issuers may be less likely to call the swaps since replacing them with new debt would result in higher interest payments for the issuer. This can allow investors to continue earning the fixed coupon. However, the coupon rate may be lower than the current prevailing market interest rate.

Extendible Step-Up Swaps

Designed to provide investors with the potential for higher interest rates over time while providing the issuer the right, but not the obligation, to redeem the swap prior to maturity under certain conditions.

KEY FEATURES

Increasing Coupons

- **Step-Up Interest Rate**: The interest rate on the swap increases (steps-up) by a known spread at specified intervals over the life of the swap for each year the swap is not called by the counterparty. For example, the swap may pay a fixed interest rate for the first few years and then a higher rate for subsequent periods.

Embedded Options

- **Issuer Extension Option:** The issuer has the right to extend the maturity of the swap at predetermined extension dates. If the issuer chooses to extend, the swap continues to pay interest, typically at a higher rate (step-up rate).

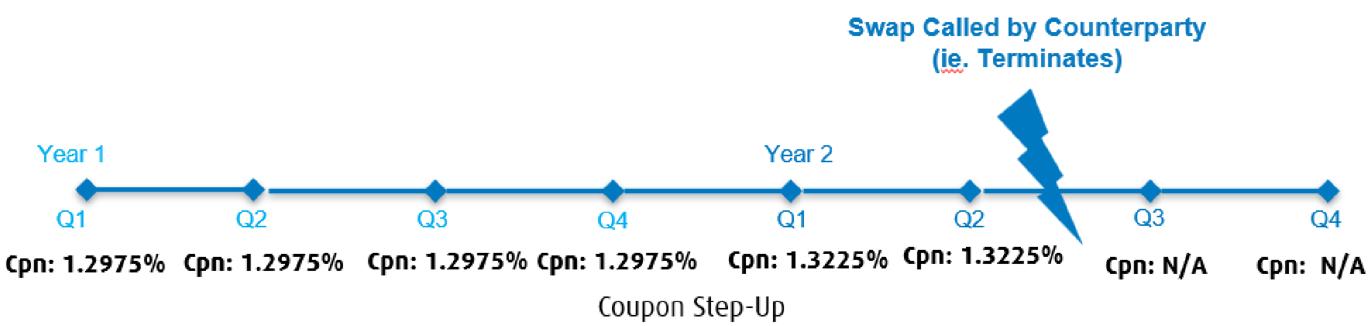
Initial and Extended Maturity Dates

- The swap has an initial maturity date and one or more extension dates. If the issuer does not extend the swap, it matures on the initial date. If extended, it matures on the extended date(s).

KEY BENEFITS

- **Potential for Enhanced Yield:** Typically offer higher initial yields compared to fixed-income securities of similar maturity and credit quality to compensate the investor for the potential variability in maturity and interest rate risk.

- **Increasing Income:** If the issuer extends the swap, the investor can benefit from higher interest (coupon) payments over time due to the step-up feature.



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IMPACT OF MARKETS

Rising Rate Environment

- In a rising rate environment, the step-up feature can be attractive to investors because it allows the swaps to offer progressively higher yields – aligning more closely with the increasing market rates.
- Issuers may be less inclined to call the swap and refinance at higher prevailing rates, and could therefore be more likely to extend the maturity, leading to increased coupons at each extension point.

Failing Rate Environment

- In a falling rate environment, investors will be able to collect the step-up coupon until the swap is called by the issuer.

Disclaimers

[1] Structured rate swap is the name given to the group of structured total return swaps used within the Fund. A total return swap is a derivative contract with a counterparty, where the receiver (the Fund) agrees to periodically pay a set rate to the counterparty (usually a large bank) in exchange for payments based on the returns of an underlying asset.

[2] Secured Overnight Financing Rate (SOFR): A daily, variable interest rate set by the U.S. Treasury that determines how much it costs banks to borrow money overnight. SOFR replaced LIBOR in June 2023.

[3] Parallel Shift in the Interest Rate Curve: When all interest rates across different maturities move by the same amount in the same direction, meaning the yield curve moves up or down by a uniform amount.

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