Income Watch

Multi-Manager Navigator Distribution fund income update

Edition 14 – May 2021

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Telephone calls may be recorded.

Key risks

The value of investments and any income from them can go down as well as up and investors may not get back the original amount invested.

The information, opinions, estimates or forecasts contained in this document were obtained from sources reasonably believed to be reliable and are subject to change at any time.

Since COVID-19, income payments have been under intense scrutiny and pressure from a number of angles. Given the importance of income to many of our clients, and its role as a key driver of total returns for all investors, we are regularly sharing our observations and relevant factual information with you.

Executive Summary – May 2021*

- Fund again maintains top decile income status within the IA Mixed Asset 20-60% Equity sector for regulatory yield – regulatory (historic) yield for C Inc class is 4.8% as at 30th April 2021
- Fund is no. 1 for income since launch
- For the fund's last financial year to 31st August 2020, income fell by just under 20%
- The first half of the current financial year continued to see impact from the lock-downs etc. but there are signs in some areas of nascent recovery in recent months
- Strong recovery in total return performance from March 2020 lows continues
- For the first time since COVID-19 hit we have seen no cuts to dividends this month
- BMO estimate of yield of current portfolio for year ahead is 3.9% but will improve should Darwin return to the dividend register shortly as expected

*Source for all data referred to is LIM, periods to 30-Apr-21

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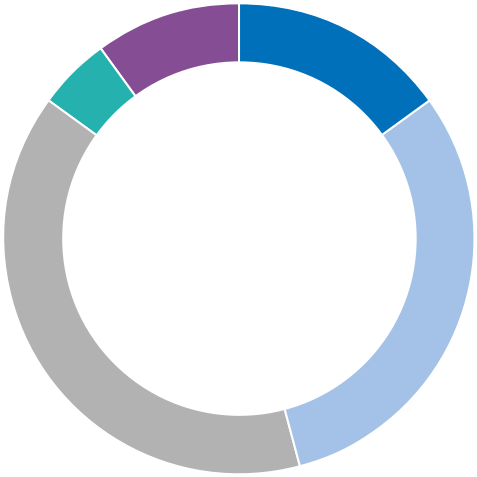
How your fund and its income is made up: What makes up the yield of the Distribution portfolio?



Asset class	% of Income
UK equities	15%
Cash	0%
Overseas equities	31%
Bonds	39%
Property	5%
Specialist	10%

A Truly Diversified Income Portfolio comprised of:

- **32** fund holdings,
- From **26** providers
- Covering **5** major asset classes and more than 10 different underlying areas
- With over **2,000** underlying sources of income!

Comment on each major asset class:

1. **Equities (makes up 46% of the overall portfolio yield)** – we expect a mild improvement income from equities as economies re-open and regulatory restrictions on dividends ease.

2. **Bonds (makes up 39% of the overall portfolio yield)** – we expect a stable outlook from the bond portfolios as strategic funds use their broad brief to avoid duration issues that will hit corporate and government bond funds should they materialise.

3. **Property (makes up 5% of the overall portfolio yield)** – our selection of less economically sensitive assets, many with upward rent review potential, give us optimism for a gently improving income from this section of the portfolio. We also expect Darwin to recommence dividend payments within the next 3 months which will add a significant boost to income.

4. **Specialist (makes up 10% of the overall portfolio yield)** – the mix of care homes, music royalties and infrastructure equity should give stable to improving income from here.

5. **Cash (makes up 0% of the overall portfolio yield)** – we expect to continue to run very low cash balances whilst interest rates are close to zero, and if we need to protect the fund against short term volatility will try to do so using futures.

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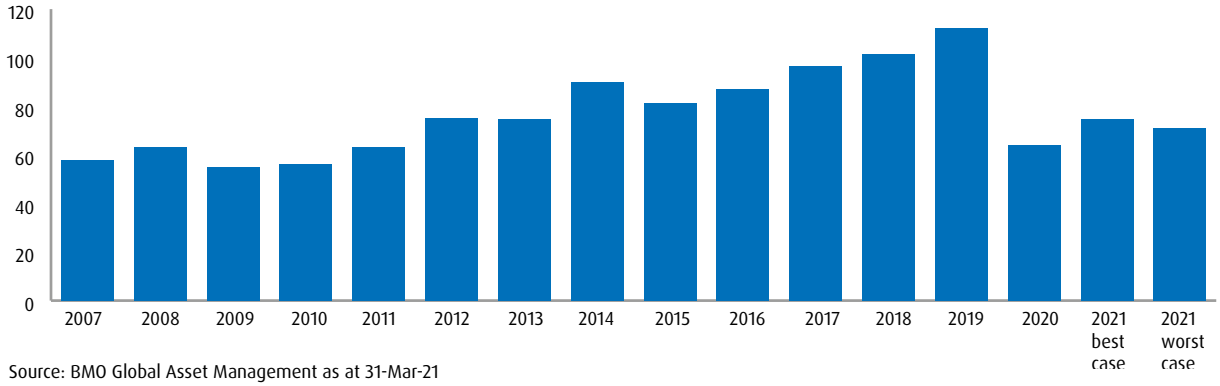
A closer look at some of the growing income stories:

UK Dividends (full year basis)



Source: BMO Global Asset Management as at 31-Mar-21

Survey evidence on equity dividend is showing signs of improvements, especially when forward looking. This chart from Link shows that in both their best and worst case scenarios 2021 income from dividends and share buy-backs combined should surpass 2020 for the UK. More information from this survey appears on page 4.

Looking back, a review of income changes during the year of COVID-19 – Mar-20 to Mar-21

In total we have seen	115	dividends declared in the fund holdings since March 2020
Of these dividends:	34	have increased year on year
	62	have decreased year on year
	19	are unchanged year on year
If you're 'glass half full':	46%	of all dividends declared are flat or higher year on year
If you're more 'glass half empty':	70%	of all dividends declared are flat or down year on year
Of the dividends that increased YoY,	17%	was the average rate of increase
Of the dividends that decreased YoY,	-30%	was the average rate of decrease

Source: BMO Global Asset Management as at 31-Mar-21

Looking ahead what is the income outlook?

Equity Dividend Outlook:
Industry Surveys – latest news and views

Surveys: Link Asset Services Q1 2021 – UK Equity dividends forecast improved the worst case scenario, but trimmed the best case for a range of between +0.9 to +5.6% in 2021.

Their quarterly survey focusses on dividends in the UK only.

- Looking back on a year of Covid – pay outs have fallen by 41.6% on an underlying basis with cuts and cancellations totalling £44.8 billion
- In Q1 2021, dividends saw the slowest decline in 12 months and were down 26.7% YoY. This compares to the trough in Q2 2020 when dividends were down 48.2% YoY
- They see 2025 as a realistic target for reaching pre-pandemic pay out levels.

Surveys: Janus Henderson Q4 2020 – Report to end Q4 2020

- Between April and December 2020, dividend cuts and cancellations totalled $220bn but $965bn of dividends were still paid out
- Banks accounted for 1/3 of global dividend cuts by value; the next worst affected sector was oil producers
- 60% of consumer discretionary companies cancelled or cut payouts
- Payouts fell 12.2% in 2020 overall

Outlook for 2021

- The key word is "uncertain" but they expect dividends to recover from Q2 onwards having fallen in Q1. Profits will rebound far quicker than dividends, as with any economic recovery.
- The best case scenario is a 5% increase to a total of $1.32tn, an underlying increase of 2%
- The worst case scenario is a fall of 2% on a headline basis, equating to an underlying fall of 3%

Surveys: AJ Bell March 2021 – Their more up-to-date survey using data to the end of February reported an expected 19% increase in dividends for the FTSE 100 index in 2021 with £73.8bn of payments – enough for a dividend yield of almost 4%.' The aggregate of dividends paid and restored has now exceeded the value of those cut or cancelled over the past 12 months' they said.

Equity Dividend Outlook:
Regulatory position – what is the backdrop?

Regulatory Aspects: Banks restart dividends – During February 2021 Britain's largest banks were permitted to resume dividends after a year's pause, after the PRA removed its veto in December.

Regulatory Aspects: IA Equity Income Fund Requirements Relaxed – the IA announced during April 2020 that it has temporarily relaxed the need for Equity Income funds to have a yield of 90% of the FTSE All-Share Index yield for 12 months. The position will be reviewed in June 2021.

Regulatory Aspects: On 19 May 2020 the UK Government announced that companies accessing the Large Business Interruption Loan Scheme for £50m or more will be required to suspend dividends. Some companies are now paying back subsidies which should help the dividend recovery.

Our view

BMO MM Team Comment on the Surveys and Regulations:

We expect the global dividend outlook for your diversified fund to be better than the UK-focussed surveys, but some of the same impact of the third wave of COVID-19 will cloud the short term for some overseas markets. We also note the more recent UK reports are more positive. We also expect the regulatory environment for resuming dividends to improve.

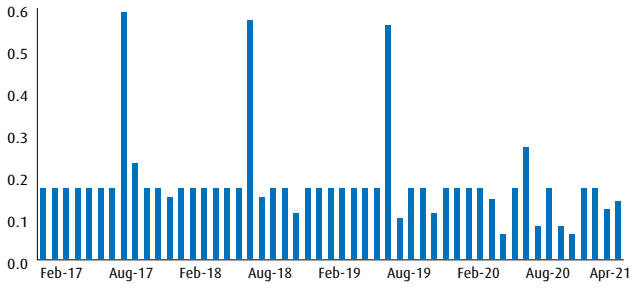
Continued

Fund's up-to-date income history

May 2021 update on the BMO MM Navigator Distribution Fund's Monthly Income units:

The chart below shows the monthly pence per unit payments, up to and including the amount for the end of April ex-dividend date, which will be paid at the end of May. The amount expected to be paid is 0.1432 pence per unit. An increase on last month.

BMO Multi-Manager Navigator Distribution M Income XD rates

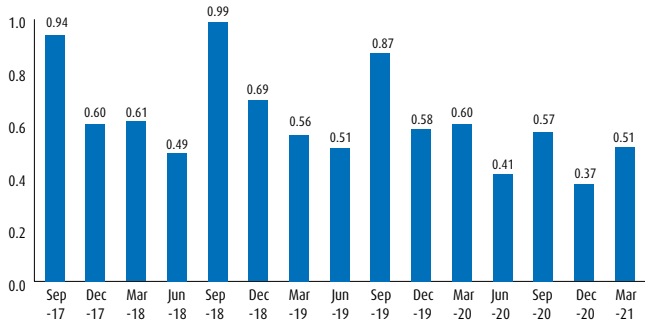


Source: BMO Global Asset Management as at 30-Apr-21

The chart below shows the quarterly pence per unit payments for the last three years for the C Inc share class, up to and including the ex-dividend amount for the end of February of 0.510 pence, due to be paid at the end of May. We intend to continue to pay out as much income as we have at each quarter.

It is our intended policy to keep paying the smoothed monthly income amount from our fund whenever possible, or if necessary, a smaller sum (representing all income received) will be paid out.

BMO Multi-Manager Navigator Distribution C Inc XD rates



Source: BMO Global Asset Management as at 31-Mar-21

Outlook

We are still experiencing a changeable environment for dividend and income payments. Each month some are up year-on year and others down. The Covid-19 impact will continue to impact payments for some time regrettably, with cuts still possible. Subsequent growth could still be impacted further by the third wave. However, we can then look to the impact of the vaccine roll-outs, huge government support programmes and relaxation of government dividend bans over the rest of 2021. Please watch this report for continued updates on payment trends and get in touch if You need any further clarification.

There is the usual further caveat in that it is possible for already declared income payments to be cancelled.

BMO MM Navigator Distribution Fund:

Detailed Analysis of Underlying Funds going XD since our last report:

Since our last report, 7 of the fund's 32 underlying holdings have gone ex-dividend. All of this income will form part of the next monthly and quarterly dividend rates for the Distribution fund. The summary table below shows the dividend rate and a comparable rate from the equivalent payment twelve months ago to highlight the change in payout rates.

- 6 have increased, on average by 30%, albeit flattered by a large increase from Ashmore
- 0 have decreased, for the first time since the Pandemic hit
- 1 is unchanged

Following the difficult phase for income assets when Covid-19 hit, we have seen a recovery in absolute returns and also, since the vaccine approvals in early November 2020, improving peer group rankings.

Rob Burdett, co-head Multi-Manager

End April / Start May

SEDOL	Fund Name	XD date	Pay Date	Latest Rate (p)	YoY Prev Rate (p)	% change
SUPR LN	Supermarket Income REIT	16-Apr	21-May	1.465	1.46	0.34%
TFIF	TwentyFour Income Fund	22-Apr	07-May	1.91	1.9	0.53%
BYP24Z1	Schroder US Income Maximiser Z Inc	20-Apr	18-Jun	0.7443	0.7409	0.46%
B46M9G6	Ashmore EM Total Return I D	04-May	18-May	0.30494	0.115429	164.18%
SQN LN	KKV Secured Loan Fund					
BYSYZN9	Fidelity Global Enhanced Income A W IM	01-May	18-Jun	0.47	0.47	0.00%
B8BG8H5	TwentyFour Dynamic Bond M IC	04-May	28-May	35.7665	30.8794	15.83%
THRL LN	Target Healthcare	13-May	28-May	1.68	1.67	1%

Source: BMO Global Asset Management as at 30-Apr-21

This month's news from the Fund's underlying holdings and beyond

- LXI REIT invested further proceeds of the recent raise of £125m, including ALDI and Dobbies stores on Net Income Yields of 5.45% over 29 years with RPI links. Numis commented 'The company has continued to achieve near-total rent collection despite the wider market backdrop, highlighting the quality of the portfolio and helping to underpin the 6.0p dividend target for the current financial year to March 2022, which equates to a 4.6% yield and a 4.3% increase on the pre-Covid rate of 5.75p. In our view LXi remains a core buy amongst long income REITs, supermarket assets with an average lease length of 19 years and 100% inflation linked rents.'
- Bond Markets Continue to Heal – Neuberger Bermann note that 'after hitting $130 billion in 2020, the value of bonds and loans defaulting so far this year is only around $2 billion. In leveraged loans, the 3.8% default rate for 2020 was less than half that of 2009. Our latest forecast for 2021 is that loan defaults will top out at 1.89%, similar to the average of the pre-pandemic decade.' If they are right, the credit markets are underpinned by the recovery. Interest rates and inflation remain the things to watch.
- Montanaro UK Income – observations on income from recent meeting: Their focus for 2021 is to increase the yield, and so they've added/increased some of their higher yielding sectors (e.g.: housebuilders and asset managers) as well as some specific higher yielding names like Admiral. In 2020, there was a 52% drop in dividends in the Numis small cap index. The fund saw a similar drop but they now expect a 58% bounce back in dividends for 2021. This is up from their estimate of 40% at beginning of the year because of companies' earnings coming in ahead of expectations and also because of changes made to the portfolio.

Portfolio actions taken and comments around them:

- We have continued to maintain our overweight position in UK assets while the funds 'natural underweight' to the US (as a result of the lack of yield on offer) has been beneficial as US equities have struggled, led by the growth sectors such as technology.
- We have continued to add to Liontrust Global Income, predominately funded by reducing BNY Mellon US Equity Income.
- We have added to duration by building our position in the iShares US Treasury 20+ years ETF. Further fixed income changes are expected in the coming months as a result of the recent sector review.
- Our overall positioning remains slightly cautious given the strong market moves higher over the past 12 months and while the economic outlook appears positive, uncertainty over inflation and interest rates appears set to be an ongoing threat to risk appetite.

Continued

Some Background Income Information:

Q Why have dividend payments come under pressure?

The unknown ultimate scope of the economic impact of the coronavirus pandemic and associated lockdowns etc. is causing some companies to prioritise retaining cash over distributing equity dividends. In some cases this has started to ease.

Q Do companies have to cut dividends?

In most cases it is voluntary, and many companies will want to preserve their dividend history through any relatively short-lived problem.

However, governments and central banks have forced certain industries to cease pay-outs and share buybacks. This has happened with the banking sector in the UK and Europe. This action did make it easier for boards in other sectors to cut or suspend dividends. In November the ECB said banks can resume dividend payments in Q1 2021 if their balance sheets show resilience.

There has also been pressure on companies that receive any state support in this crisis to suspend dividends. A number of major companies have repaid state aid, which should free up dividend policy.

Q Is the impact different in each asset class?

Equity dividends can be suspended, maintained, cut, deferred and even cancelled after they have been announced. They can of course also still potentially be increased.

Most bonds are contractual, so their interest payments cannot be cut unless agreed with the bond holders.

Funds enhancing income through covered call option writing may see some positive impact from the heightened volatility.

Summary and conclusions

These remain challenging times for all investors, and it is very unfortunate that income-seeking investors should be potentially amongst the most affected by the COVID-19 recession. The BMO MM Navigator Distribution Fund has seen price volatility, but the fund has recovered strongly in absolute terms since the March lows, and is making progress up the peer group too since then. Further recovery will be needed to fully recover the underperformance during the sharp falls during March of last year but with another strong quarter for the fund just finished, it would appear that the polarised markets of the last few years are showing signs of becoming more even-handed. Importantly the fund has been able to remain in the top decile for yield within the sector as it always have been since launch in 2007. In addition to that there is significant value in the portfolio at these levels which should see the capital base improve over time in our opinion.

Views and opinions have been arrived at by BMO Global Asset Management and should not be considered to be a recommendation or solicitation to buy or sell any companies that may be mentioned.

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