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MUTUAL FUND PROFILE

How a Low-Volatility Fund Lives Up to Its Name Amid Stock Market Turmoil

By Sarah Max

The past couple of months have been anything but smooth sailing for investors, but sailing is how Ernesto Ramos describes how he and his colleagues use a combination of quantitative and fundamental investing at BMO Global Asset Management in Chicago.

"I think of the quantitative model as the sailboat; it's going to be the same no matter what," says Ramos, who founded the team behind the $250 million BMO Low Volatility Equity fund (ticker: BLVAX). "Then, just as sailors make adjustments to accommodate the weather, we use fundamental analysis to account for what the model does not see."

The BMO fund, launched in 2012, hasn't been impervious to the treacherous market conditions of late, but, true to its name, it has held up better than its peers and its benchmark. For the year through April 20, the fund is down about 10.5% versus the 12.7% decline for its benchmark, the Russell 1000 index. It ranks in the top 2% of its large-value peer group for year-to-date returns.

While it tends to lag behind the broader market in up markets, its low-volatility approach isn't a huge drag on returns. In 2019, the fund returned 24%. Over the past five years, it's up an average of 6.3%, better than 95% of its broad-based category. Its A shares carry a 5% load.

Born in Mexico City, Ramos studied math at the Massachusetts Institute of Technology and got a masters and Ph.D. in statistics at Harvard University. He was happily working as a programmer at a software company in the early 1990s when a quantitative investment firm recruited him. This eventually led to a position at Nicholas-Applegate Capital Management (now part of Allianz), where the firm's founder asked him to help launch an emerging market fund based on more-traditional stock picking. "I didn't know anything about fundamental investing at the time," says Ramos, who learned on the job, helping grow $2 million in seed capital to a $2 billion strategy.

Ernesto Ramos manages the BMO Low Volatility Equity fund.
Photograph by Taylor Glascock

Today, Ramos, 65, is part of a 13-person disciplined equity team at BMO that manages $18 billion across more than a dozen strategies by melding the best of both worlds—the scale and discipline of quantitative investing and the depth and nuance of fundamental analysis. In the case of the low-volatility fund, the quantitative model ranks stocks in the Russell 1000 based on three main characteristics: fundamentals, valuations, and market sentiment. From there, the team's fundamental analysts vet potential holdings for issues that wouldn't be picked up by the model.

"When you're a quantitative investor, you put all of your intellectual energy into building a model, and then you basically do what it tells you to do," says Ramos. "But the model often misses things that are negative because it can't possibly measure everything about a stock."

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Quantitative models also tend to have blind spots around company-specific developments, regime changes, and other sudden events—such as the economic tsunami caused by the Covid-19 pandemic. Ramos and his team haven't changed their models, but their fundamental analysis has put even greater emphasis on balance-sheet strength. "We're essentially nixing anything that is too levered," Ramos says. One place where the team rarely second guesses the model: sell signals. "Being quantitative means you have a sell discipline that is absolutely ruthless," he adds.

The portfolio of mid- and large-cap stocks by design looks very different from the benchmark, and, not surprisingly, tends to own more than its share of consumer defensive companies, which were recently 24% of assets. While the fund's top holdings include recent market leaders—such as Kroger (KR), Costco Wholesale (COST), PepsiCo (PEP), and Walmart (WMT)—these stockswere portfolio staples long before there was a run on toilet paper and snack foods.

"The high quality, low-risk stocks we've always owned are what you want to own in this situation," Ramos says.

The fund has owned retail goliath Walmart since 2013, and the stock scores near the top of the quantitative model for fundamentals and sentiment. "There is really only one retailer that is effectively competing with Amazon.com [AMZN] in the online space," he says, adding that Walmart has also adapted to the current environment by offering more online and pickup grocery services. "Plus they have all the bricks-and-mortar stores." Not surprisingly, balance-sheet strength means a lot right now, and in that respect Walmart also offers reassurance. Its $40 billion in debt could be nearly covered by one year's worth of earnings before interest, taxes, depreciation, and amortization, or Ebitda. The company has grown its revenue in 14 out of the last 15 years, Ramos notes, and it's hiring.

Another longtime holding, Eli Lilly (LLY), has been making headlines as one of many drugmakers looking to develop a treatment for Covid-19. That would be a great win, but the fund's position isn't predicated on this. Lilly's existing lineup should deliver stable earnings in 2020, and its balance sheet offers a key buffer. "Two years worth of Ebitda would cover their debt and then some," Ramos says.

One of the fund's largest holdings, Newmont (NEM), was trading in the high $30s when the fund added the position in June 2019. Shares in the world's largest gold miner have since nearly doubled as investors have bid up prices for assets tied to the yellow metal. At the same time gold offers a buffer against market losses, says Ramos, it should also continue to benefit as central banks "print money" to keep their economies afloat.

Picking defensive stocks, doing fundamental analysis, and not second-guessing sell signals are all part of the low-volatility equation, but there is one more critical component: how everything comes together. Ramos, who says he understands cooking better than he understands sailing, describes it as making the perfect dish: "It needs to be the right ingredients and the right combination for what you're trying to achieve."

As of 3/31/20, the Fund's A share's 1-year, 5-year and Since Inception (9/28/12) NAV performance was -8.87%, 4.43% and 8.47%, respectively.

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. The maximum sales charge (load) imposed on purchases (as a percentage of offering price) is 5.00% for Class A shares. The NAV performance does not reflect the deduction of the sales load or fee, and if reflected, the load or fee would reduce the performance quoted. Total expense ratio is 0.93 (gross) and 0.90 (net). 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. The fund recently experienced significant negative short-term performance due to market volatility associated with the COVID-19 pandemic.

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 contains this and other information about the BMO Funds, call 1-800-236-3863. Please read it carefully before investing.

Top 10 Holdings as of 3/31/20: Kroger Co. (3.00%), Newmont Corporation (3.00%), Costco Wholesale Corporation (2.80%), Walmart Inc. (2.60%), Eli Lilly and Company (2.60%), American Electric Power Company, Inc. (2.50%), Sprouts Farmers Markets, Inc. (2.50%), Waste Management, Inc. (2.30%), PepsiCo, Inc. (2.30%), Lockheed Martin Corporation (2.30%).

Morningstar ranking of the Fund in the large value category based on total return as of 3/31/20 for the 1-year, 3-year and 5-year time-frames was: in the 5 percentile group out of 1,220 funds, 3 percentile group out of 1,179 funds, and 9 percentile group out of 1,087 funds, respectively. **Past performance is no guarantee of future results.**

Investments cannot be made in an index.

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