REPRINTED FROM OCTOBER 28, 2019

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Outperforming Over the Long Run with Significantly Lower Risk

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SECTOR — GENERAL INVESTING

TWST: Please introduce the funds you manage at BMO and what they aim to offer investors.

Mr. Corris: Today, we are talking about the BMO Low Volatility Equity Fund and the BMO Global Low Volatility Equity Fund. Both of these funds are defensively oriented and aim to offer significant upside participation along with meaningful downside protection and, as a result, outperform the market over the long run with significantly lower risk.

TWST: How do you characterize current market conditions in terms of the level of volatility you're seeing?

Mr. Corris: We see that volatility has been rising slightly in the last few months, and we expect there to be elevated levels of volatility going forward. We think the drivers of that volatility include a market near all-time highs, an economic recovery that many people think is nearing late cycle, increased political volatility, especially as we lead up to the elections, and volatility potentially from Federal Reserve policy and interest rate changes. All of those conditions could lead to more volatility going forward.

TWST: How does your strategy, process or amount of turnover change as the volatility level rises or falls?

Mr. Corris: Our strategy is designed to outperform in a rising volatility environment, which is generally when markets are falling, because one of the stated goals of the strategy is to reduce risk and provide downside protection by focusing on higher-quality securities. We employ a low-turnover strategy because risk levels tend to be fairly persistent from period to period, and we don't significantly change our turnover levels unless the risks that we see in the market start rapidly changing.

TWST: So the current market uncertainty is kind of an advantage for you in terms of outperforming your peers?

Mr. Corris: Correct. We see increasing uncertainty and increasing volatility as an environment where risk reduction should add significant value, and that tends to create a very good environment for our strategies.

TWST: Can you walk us through your stock-picking and evaluation process? What are the indications you look at to determine which stocks are more or less vulnerable in a high-volatility market?

Mr. Corris: We have a number of tools to help us with stock selection. One of the criteria that we focus on is the riskiness of the stock. In our strategy, the first consideration is how to build a lower-risk portfolio, which considers both the risk of the individual stocks as well as how they co-vary with the other names in the portfolio. The goal is to build more than just a portfolio of low-risk stocks but to build a low-risk portfolio.

Secondarily, we have an expected returns model where we identify stocks that we believe are fundamentally strong and may be undervalued while still having positive investor sentiment behind them. And our research has shown that these types of stocks can help with alpha generation as well as with risk reduction. When we put the process together, our stock selection approach is to buy low-risk stocks and stocks that help diversify the risk of the portfolio while also having high expected returns and high quality.

TWST: You said you have low turnover. Can you give us a closer look at that and exemplify when was the last time you bought a holding, and when did you sell, trim, and why?

Mr. Corris: This is typically a low-turnover strategy as risk characteristics tend to be persistent. When we add names to the portfolio, it's typically because we are replacing a name that has had an increase in risk and is no longer as defensive as we thought or where the return potential of that stock has fallen. And the names we add are ones that we believe are low risk, diversifying to the portfolio or whose expected return potential has increased.

TWST: What are some of the specifics you look at to determine a stock's risk level, and could you exemplify that with one of your recent buys or sells?

Mr. Corris: We use a number of different techniques to evaluate the risk of a company. We have five risk models that are constructed in different ways to evaluate the forward-looking risk of each company. One of the inputs will be the historical risk of the company. Our data and research have shown that riskier companies in the past tend to be riskier companies in the future.

There are other characteristics of companies that help predict forward-looking risk as well. For example, smaller companies tend to be riskier than larger companies, highly levered companies can be more risky than less levered companies, and cyclical stocks in energy, materials and industrials tend to be riskier than REITs and utilities.

One example of a company that we own is **AutoZone** (NYSE:AZO). The majority of **AutoZone's** business is reselling auto parts directly to consumers. They are a stable company that has consistently outperformed their estimates, and their business model helps explain why we think they're low risk. Their business of selling to consumers is fairly stable because there's always demand for auto parts replacements.

Highlights

David Corris discusses the BMO Low Volatility Equity Fund and the BMO Global Low Volatility Equity Fund. Mr. Corris describes these funds as being defensively oriented. He says the funds aim for significant upside participation and meaningful downside protection. Mr. Corris notes that he's seen rising volatility in the market over the last few months. His strategy outperforms when volatility is rising because he focuses on reducing risk and higher-quality securities.
Companies discussed: AutoZone (NYSE:AZO); Waste Management (NYSE:WM); Baxter International (NYSE:BAX); Bright Horizons Family Solutions (NYSE:BFAM) and Ameren Corp. (NYSE:AEE).

hire us for risk reduction, we believe that the best way to do that is to ignore the benchmark and focus on absolute portfolio exposures.

We ensure diversification through security position limits and sector limits, so for example, we limit 25% of the portfolio in any individual sector. Our individual security positions are generally not going to be more than 2% to 2.5% of the portfolio. That ensures that we have a well-diversified portfolio with broad exposure to low-risk stocks. The U.S. low-volatility equity strategy uses a large-cap universe, whereas the global low-volatility strategy uses an all-cap universe.

TWST: How vulnerable is the fund to the China trade war?

Mr. Corris: It does not have a significant impact on the fund. Because most of the companies that have more exposure to China trade would be higher risk in the first place, we are less likely to own them. Instead, the types of companies we tend to own are utilities, REITs, consumer staples, insurance and other defensive stocks that typically don't have much exposure to China trade.

TWST: Where is your conviction strongest among your holdings if you had to recommend two or three stocks to investors?

Mr. Corris: The strongest conviction we have is in the low-volatility anomaly itself, meaning that a lower-risk portfolio will outperform the benchmark over the long term with significantly less variation along the way. We also have conviction that this investment process leads to desired outcomes that benefit our clients. With that said, we do have conviction in our portfolio holdings as well.

"One of the distinctive things about our low-volatility strategy is that we don't tether the portfolio weights to the benchmark. One of the assumptions behind low-volatility investing is that cap-weighted benchmarks are not efficient."

And in some ways, it can be countercyclical, because when the economy has a downturn, consumers may choose to buy fewer new cars and instead service their existing cars. As a result, **AutoZone** has been stable, growing, and this countercyclical element makes them an all-weather type of company. For example, in 2008 and 2009, during the great financial crisis, they actually grew their revenue. And that I think is a good proof statement of how they can be an attractive growth company in normal times but also a defensive company in uncertain times.

TWST: What are the portfolio's cap size and industry weightings?

Mr. Corris: One of the distinctive things about our low-volatility strategy is that we don't tether the portfolio weights to the benchmark. One of the assumptions behind low-volatility investing is that cap-weighted benchmarks are not efficient. We have extensive research that shows that lower-volatility portfolios outperform cap-weighted benchmarks over the long run. As a result, when our clients

Beyond **AutoZone**, another example would be **Waste Management** (NYSE:WM). They are the largest public waste management company nationally. They've demonstrated that they can achieve mid-single-digit revenue growth with low-single-digit earnings growth in a consistent, organic manner. They also have a stable business model, and while they're technically considered an industrial company, in many ways, they behave as a utility. We view them as a fundamentally strong and highly stable business that will do well in all types of market environments, including a recession.

Another holding is **Baxter** (NYSE:BAX), a medical devices company that has been growing sales in the low single digits and earnings in the mid-single digits and has stable cash generation since they focus on nondiscretionary medical products. Because their products are nondiscretionary, there will always be consistent demand for the types of products that they're delivering, and their business model will exhibit less economic cyclicality than other parts of the market.

TWST: Is dividend yield something that you take into account?

Mr. Corris: Dividend yield is not something that we specifically target in choosing our companies. We have found that many of the companies that we believe are good investments happen to also offer strong dividends. That's because the types of characteristics we look for, such as business stability and strong cash flows, tend to allow companies to offer strong dividends as well. Conversely, strong dividends help make a stock more defensive and less risky. I would describe it more as an outcome of our process than something we are explicitly targeting, but income generation is another reason why these strategies can be attractive to investors.

1-Year Daily Chart of AutoZone

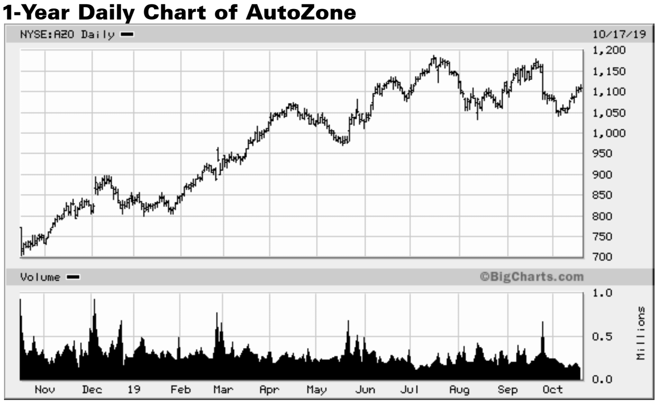

Chart provided by www.BigCharts.com

TWST: Can you tell us about your sell discipline and exemplify where you might have lightened up or sold specific companies?

Mr. Corris: Our sell discipline is just a mirror of our buy discipline. Just like we buy companies that we believe are becoming lower risk or higher expected return, we will sell companies when we believe they are becoming higher risk or will have a lower expected return.

One example recently would be utilities. Our research has shown that utilities have become expensive relative to the market and that they may be slightly riskier than normal because of these valuations. So while utilities tend to be a fairly common holding within low-volatility strategies, we have been cutting back on our utility weight because of their slightly weaker risk/return profile. An example would be **Ameren** (NYSE:AEE), a utility that we have been trimming although we do continue to hold it.

TWST: So when it comes to risk versus reward, how do growth stocks compare to value when it comes to lower volatility?

Mr. Corris: Many of the stocks that we hold tend to be value stocks because utilities, REITs and staples are traditionally value stocks and because growth stocks have been on such a significant run recently and have become more expensive and, therefore, riskier than they were in the past. However, we also own plenty of growth stocks that we believe are low risk.

"Our sell discipline is just a mirror of our buy discipline. Just like we buy companies that we believe are becoming lower risk or higher expected return, we will sell companies when we believe they are becoming higher risk or will have a lower expected return."

1-Year Daily Chart of Waste Management

Chart provided by www.BigCharts.com

TWST: What would you say is the most unknown or underfollowed stock that you hold?

Mr. Corris: One example of a lesser-known holding is **Bright Horizons Family Solutions** (NYSE:BFAM). They offer employer-sponsored child care. Their revenue growth has been in the high single digits, their earnings growth has been in the mid-double digits, and their business model is stable because employers would not cut off the child care benefit, even during a recession. It's also a business that tends to have longer-term contracts with employers and becomes a locked-in part of the employee benefit package, which again makes it a defensive holding.

TWST: Overall, when you look into 2020, what's your broad view? What are the tailwinds you see ahead and headwinds that worry you?

Mr. Corris: We believe that the U.S. economy is still in good shape, and we are not calling for a recession. We believe that the economy still has room to grow, but it is probably later in the cycle than earlier.

As a result, we believe it's important to be thinking about quality and defensive holdings while recognizing that it's also important to stay fully invested in the market and continue investing in equities that have upside potential. We think that the low-volatility strategies are very well-positioned for this type of environment because they will provide meaningful upside participation in the event that the economy and the market continue doing well, which is our base case, but they also serve to hedge the risk for an investor because they will be more defensively oriented, and in the event of a market decline, the low-volatility strategies should provide downside protection.

We are not forecasting recession, but we do forecast increased volatility going forward for the reasons I mentioned earlier, such as potential slowing in economic growth, monetary policy uncertainty, and political and geopolitical risk. While the market has rebounded very nicely in 2019, we encourage investors not to forget that in the fourth quarter of 2018, the market had a fairly significant correction, as people became concerned about economic growth. These types of environments periodically happen, and a low-volatility strategy positions investors well if that volatility should reappear.

TWST: Is there anything else you would like to discuss or any topics that we missed?

Mr. Corris: I would add that low-volatility strategies are valuable to investors for other reasons beyond their risk/return profile. Not only are downside protection and capital preservation important goals of investing, but individual investors have other objectives that low-volatility strategies help with.

One would be cash spending or cash investment. One of the challenges for many investors is the need to periodically withdraw money from the market or invest money back into the market. More volatile strategies — including passive indexing — lead to an increased risk of putting money into the market at market highs or withdrawing from the market at market lows. By having a more consistent return profile over time, low-volatility strategies can be beneficial for individuals that have cash management needs.

Also, most investors exhibit behavioral tendencies to invest more money when times are good and to become fearful and withdraw money when times are bad. Research has shown that over the long run, individual investors lag the market return because they buy and sell at the wrong time. We believe that a low-volatility strategy dampens the behavioral urges to invest at the wrong time of the cycle and allows investors to compound more capital that way. So we think that the risk/return profile of the strategy as well as how it accommodates investor cash flow management needs and mitigates their behavioral investment impulses all add value to investors.

TWST: Thank you. (VSB)

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