

Low Volatility Strategy

BMO Low Volatility Canadian Equity ETF (ZLB)

BMO Low Volatility U.S. Equity ETF (ZLU, ZLU.U)

BMO EXCHANGE TRADED FUNDS

▶ Target low risk broad market exposure

The trade-off between risk and return remains at the heart of portfolio construction and investing. Particularly following the market downturn of 2008, investors have become more aware of portfolio risk levels in addition to returns. They are questioning how much risk is in their portfolio and how it will affect their returns. Our low volatility strategy allows investors to target a specific portfolio risk level that is lower than the broad market, and potentially shelter their investments from market uncertainty.

Studies have shown that less volatile or defensive stocks have outperformed the broad market over the long term, as less volatile stocks may benefit from a smaller decline during market corrections while still increasing during advancing markets. Additionally, low volatility stocks tend to be more mature and have a higher dividend yield, and as a result both ZLB and ZLU have a higher dividend yield than their broad markets. The larger dividend yield helps to minimize swings in portfolio value.

Studies have also noted that higher volatility stocks underperform over time, as investors are willing to pay a premium for "lottery tickets", high risk - high reward stocks that often do not meet expectations. Investors have been attracted to these glamour stocks, preferring short term big winners over long term steady performers.

To develop the low volatility strategy, we focus on the beta of a security. Beta is defined as the stock's sensitivity to broad market movements, where the broad market is assigned a value of 1.00. A lower beta, where the beta is less than 1.00, is viewed as less risky than the broad market.

▶ Beta: the stock's sensitivity to broad market movements

Implementation of the Low Volatility Strategy

The initial portfolio screen ensures only larger, more mature companies are considered for inclusion. For ZLB, the selection universe consists of the 100 largest and most liquid securities in Canada. Stocks are ranked by their beta, and the lowest 40 betas are selected. For ZLU, the lowest 100 betas from a universe of U.S. large cap stocks are included in the portfolio. ZLU and ZLU.U offer unhedged exposure in Canadian and U.S. dollar units respectively.

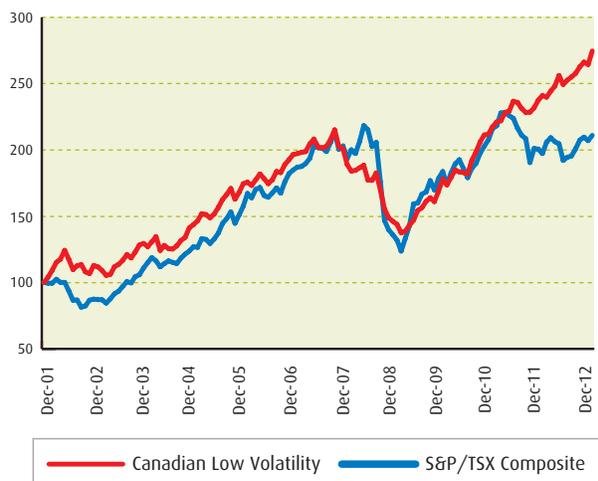
The portfolios are also rebalanced semi-annually, where the security weights of the existing holdings are adjusted to reflect changes in their beta or market sensitivity.

Performance Profile

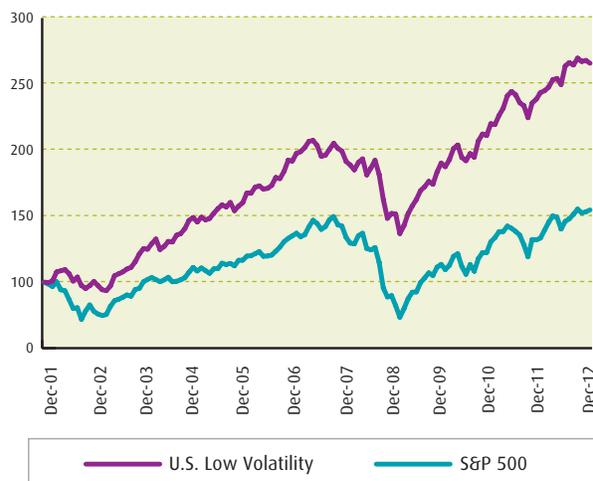
As the following charts illustrate, the low volatility strategy has outperformed the broad market over longer time periods. The strategy had much less of a decline than the broad market during the major correction of 2008. An additional benefit is the reduced risk level of the portfolio, which lessens the swings in performance. Over the same period, we have observed the added benefit of an even better risk adjusted return, as the returns are less volatile. So not only does the lower volatility strategy have a higher return over the period, the risk adjusted return further favours the strategy.

Low Volatility vs Broad Market Indices Dec. 2001 - Dec. 2012

Canada Low Volatility vs S&P/TSX Composite



U.S. Low Volatility vs S&P500



Source: Bloomberg & Factset

► Reduce your portfolio's risk profile and diminish the impact of market corrections

The strategy has strong portfolio construction benefits due to both the superior long term returns and the reduced risk profile. As investors look to diversify to mitigate portfolio risks, ZLB and ZLU can be used as a core portfolio holding as it has a lower risk target than the broad market. ZLB and ZLU can also be used as tactical trading vehicles, where in periods of greater market uncertainty, a more defensive portfolio may be appropriate.

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