Fund Update

July 2020

The COVID-19 pandemic has had a significant impact – affecting financial markets, along with families and societies across the globe. In light of this unprecedented situation, we wanted to update you on our team's investment approach in managing the Educators Growth Fund ("the Fund") along with our outlook.

During times such as these, **it's important for investors to stick to a disciplined investment approach**. When markets become volatile, most investors are prone to overreact and sell at the wrong time by trying to time the market, ultimately locking in losses and not staying invested for any market recovery (which we have already witnessed since the March 2020 lows). Over the long term, markets are resilient and investors who stay invested should recover and be able to grow their wealth!

The Educators Growth Fund primarily invests in growth-oriented Canadian companies with strong fundamentals, attractive valuations and growing investor interest. Our team's investment approach combines the successful blend of fundamentally-driven investment beliefs with the consistency and rigour of quantitative implementation, bringing together the benefits of human and machine to create greater value for you. With that, we would like to begin by expressing our gratitude for your continued support and commitment during these uncertain times.

Remember, **it's about time in the market**, not timing the market.

Disciplined Investment Process

When considering companies to invest in, we analyze various characteristics for each company, such as:

Growth – when revenue and earnings consistently increase over time

Profitability – ultimately our investments must generate earnings, we do not look for unprofitable growth

Portfolio Managers

James Thai CFA, MSc
Portfolio Manager,
Disciplined Equities

Ariel Liang CFA, MS, LLM
Associate Portfolio Manager,
Disciplined Equities

Day to day portfolio management duties are carried out by James Thai and Ariel Liang. They are members of, and supported by, BMO Global Asset Management's Disciplined Equities Team:

- 11 Portfolio Managers
- 5 Analysts
- 6 Traders
- 18 years average industry experience

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Investor sentiment – positive mood among investors regarding the company, using measures such as price and volume trends

Value – valuation relative to peers is evaluated, we will not pay any price for growth

Quality of company management – strong management is key to ensuring companies allocate their capital responsibly and deliver value for shareholders

Our disciplined investment approach offers:

- efficient evaluation and comparison of hundreds of companies across multiple dimensions, giving us a broad universe to find hidden gems
- the removal of emotional biases resulting in a consistent implementation of the strategy
- models that are grounded in fundamental principles – we use the same metrics many fundamental investors use, not opaque black box techniques
- human oversight of all buy and sell decisions to safely prevent data anomalies from affecting the portfolio

This disciplined investment approach reduces the temptation to act on sudden price changes when there is no change to the underlying company fundamentals, allowing us to make sound investment decisions – a critical element to the success of long-term investing.

Performance and Positioning

The Fund's balanced approach to various market factors is designed so that clients can do well in most market environments, with the exception of extreme and swift market movements, low quality stock rallies and high volumes of takeover deals such as mergers and acquisitions.

In recent months, market volatility reached levels not seen since the 2008/2009 Great Financial Crisis, due to the impact of COVID-19 and the oil price war between Saudi Arabia and Russia. Consequently, the S&P/TSX Composite Index (S&P/TSX) fell over 30% at one point.

Since then, the Canadian stock market has soared nearly back to its pre-COVID-19 levels. Over this period, the Fund has slightly lagged the S&P/TSX, as profitable growth stocks have underperformed, while lower quality stocks have outperformed. These out performers include stocks with high leverage (debt levels) and low profitability.

For example, some stocks with these characteristics – smaller energy companies and gold producers – rebounded over 50% during this period. We don't believe these two areas will repeat their strong returns in the months and quarters to come, so we have ensured the Fund has little exposure in these segments. We expect to continue seeing signs of recovery in select stocks as the Canadian government unveils financial aid and tax deferrals to help small businesses. Once COVID-19 is in the rear-view mirror, we expect stocks that were unfairly cast aside, but continue to show attractive growth and reasonable valuation (when using metrics such as price to earnings or price to cash flow), will outperform as is typical during an economic recovery. We remain focused on identifying these investments.

Looking Forward

The Canadian economy shrank 8.2% (annualized) in the first quarter of 2020, and the second quarter will likely show a contraction of between 25% and 40%. Meanwhile, first quarter U.S. growth contracted only 5%, but we anticipate that the second quarter will show a contraction of as much as 40%. The good news is that third quarter data should show a double digit rebound as investors have their eyes on economic and earnings normalization into 2021 and 2022, which, coupled with near-zero interest rates, is contributing to our more optimistic outlook.

- Near zero interest rates means investors should pay a higher price for earnings when discounting future cash flows, all else being equal.
- Equity analysts mostly focus on predicting earnings over the next 12 months. Since we believe it will take at least a couple of years for the market to come back to normal, equity investors are looking past the 2020 weakness when buying stocks.
- Technology companies are experiencing the benefits of the new normal as COVID-19 reshapes our lives.

We think quantitative easing (when the Bank of Canada purchases financial assets to inject money into the economy) and fiscal policy (governments spending money or adjusting taxation to stimulate the economy) will remain the preferred tools in the year ahead, while lower-for-longer interest rates should persist, due to current debt levels. Over the medium term, we believe the Canadian dollar will face significant headwinds and we would expect it to sell off if market fluctuations resume this year.

As long-term investors, it is important to respond to what we

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believe are long-term shifts in not just our domestic economy but the global one. One such shift is related to U.S. crude oil prices which we expect to remain below US$40-45 per barrel for the foreseeable future. The recent collapse in demand may be an opportunity for the world to accelerate the transition to renewable energy sources. During this transition, energy producers with stronger balance sheets and cash flow generation abilities should be better positioned to invest for the future and generate more sustainable returns. As a result, we have updated the Energy exposure within the Fund to ensure that oil producers have a stronger focus on current cash flow, and less on oil reserve assets and potential production growth which could lead companies to walk away from those assets as they prove to become financially obsolete.

At BMO Global Asset Management we are continuously assessing ways to incrementally improve our clients' returns and/or reduce their risk. The update to our approach within the Energy sector is just one example of an enhancement to deliver stronger investment performance. We believe these changes will result in superior stock selection as they better reflect current operating conditions and focus on what is important to returns.

As disciplined investors integrating the complementary strengths of fundamental and quantitative analysis, **we continue to monitor the Fund and make prudent adjustments where necessary, while remaining confident and steadfast in the long-term success of our investment process**.

Our Commitment to You

At BMO we invest with a purpose – to boldly grow the good. Our focus is simple: to help our clients meet their investment goals, while also building a more sustainable and secure future for us all.

Thank you for your continued support and we hope you and your families are safe and well.

BMO Global Asset Management