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Investment Strategy

2022 Market Outlook

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Table of Contents

2022 Market Outlook

Investors Should Prepare for the Second Derivative

S&P 500 Price Target 5,300; EPS Target $245

In other words, we expect US stocks to once again post positive results in 2022 – albeit less positive – but positive, nonetheless.

While US stocks enter 2022 with undeniable earnings and price strength, they are once again challenged with equally matched skepticism, rhetoric and fear based on our interactions with clients. More succinctly stated, the "Wall of Worry" and most doubted bull market in our collective careers continues to roll on. Yet, we cannot ignore the fact that equities have exhibited a massive recovery in the past few years and are very overdue for a respite, in our view. However, many of the variables defining the eventual diminished return structure of stocks continue to be measured and diagnosed in a decidedly binary negative fashion instead of recognizing and believing the more likely path of these variables/metrics/subjects. Namely, "less positive," NOT the pre-destined overly negative and pessimistic tone that has engulfed investing for more than a decade, in our view.

The following is a list of select "issues" facing investors heading into 2022. And we believe most investors remain too negatively predisposed in order to admit or accept the more likely trend for most, if not, all of these listed issues is: less positive versus binarily negative.

1) **Monetary Stimulus** – See Exhibits 2-4 on page 6

Fact: The Fed is STILL pumping unprecedented liquidity into the system, YES, the taper is on to the tune of $15 billion per month. But the balance sheet will EXPAND by more than $400 billion until the taper concludes.

2) **Interest Rates and Bond Yields** - See Exhibits 5-12 on pages 7-8

Fact: Stocks can rise alongside bond yields. In fact, when rates rise from excessively low levels (which is the current predicament), it means that the economy is IMPROVING – and that is a good thing.

3) **Inflation and Supply Chains** – See comments and Exhibits 13-17 on pages 9-11 for inflation and comments and Exhibits 45-48 on pages 21-25 for supply chains

Fact: Traditional inflation measures are already showing preliminary signs of decelerating heading into 2022. There is no doubt that the supply chain kerfuffle is likely to persist, but we would take the "under" in terms of duration (as consensus believes the worst, proclaiming a 12-18-month duration). In fact, we believe a supply glut could occur as early as the second half of 2022 – the exact opposite of what occurred in 2009 following the financial crisis when supply greatly outstripped demand. Furthermore, we believe a massive structural change in supply chains is well under way, one that will result in a steady flow of onshoring and increasingly efficient inventory and manufacturing operating functions. Simply stated, we believe US companies will pivot aggressively the next several years toward increased domestic, technology-driven manufacturing that will ultimately become more efficient, and dare we say – disinflationary.

4) **Earnings Growth** – See Exhibits 18-24 on pages 12-13

Fact: We have long stated our belief that stocks lead earnings which lead the economy. So far, the 2020 to-date market trajectory is following that script to a "T." The deceleration of earnings growth is well documented. However, we continue to believe that most investors lack perspective, namely that growth remains a net positive and analysts and companies alike continue to UNDERSTATE expectations in a "hedge" against being too positive – "just in case" the fear trade and overall negativity winds up being correct.

Bottom Line: An accommodative Fed, excessively low interest rates, potential peaking inflation and supply chain fears, and positive earnings growth REMAINS a very good recipe for equities – PERIOD.

Positive Equity Returns Do Not Mean a Straight Line Higher

We continue to believe US stocks are in the early stages of transitioning towards an earnings-driven/more fundamentally defined performance trajectory, especially relative to the heavily laden, momentum trading strategies that have defined much of the performance the past few years. This “transition”, however, traditionally brings with it “less positive performance” and more volatile trends (see Exhibits 25-26 on page 14). As such, we believe a transition to more active portfolio management will become an increasingly important tactic for portfolio managers in the quarters and years ahead. In fact, the market is already displaying such trends (see Exhibits 27-28 on page 15). For instance, an overwhelming majority of stocks in the S&P 500 Index in 2021 (~90%) experienced a traditional price correction, (10% or more) while the broader index to-date has only endured a 5.2% drawdown (See Exhibits 29-30 on page 15). What does this mean? One of our primary tenets of investment strategy and portfolio management has always been that the stock market is a market of stocks. To that end, we remain perplexed that so many of our compatriots, competitors and colleagues remain consumed with the temptation and “need” to call for an index level correction of 10% or more. Yes, a correction for the index is coming at some point (see Exhibits 31-33 on page 16). But timing the market does not work, in our view. We continue to believe that low turnover and “stay invested” strategies win over time (see Exhibits 34-36 on page 17) and that the more correction fodder out there, the more of a “law of diminishing returns” of such prognostications will unfold (in fact, it already is in our view). Simply stated, corrections occur when no one is calling for one – period. As such, we believe there remain way too many “chicken littles” out there heading into 2022.

Again, returns of 20%-plus in successive years has even the most ardent bulls (such as us) worried about a pullback, let alone a cyclical bear market on the horizon. To be clear, we firmly believe the ~34% pullback in Feb/Mar 2020 was the “much needed” cyclical bear market to reset the next 10 years of our 20–25-year bull market that we have been calling for since 2010 (see Exhibits 37-38 on page 18). However, we do not believe the returns registered in 2020-2021 are sustainable. Instead, we believe US stocks will likely enter a more traditional return structure to the tune of high-single-digit gains the next few years as moderation, normalization and consistency become predominant and realistic (Exhibits 39-40 on page 19). Yes, this transition is likely to be difficult, and will probably display a range of calendar year returns from single-digit percentage losses to double-digit gains. It is for these reasons that we continue to favor high quality, GARP and dividend growth strategies across all sectors, styles and sizes (see Exhibits 41-44 on page 20).

<u>Bottom Line</u>: Our secular bull market thesis for US stocks remains alive and well. 2022 will be a year of less positive, yet positive, nonetheless. Think of it as a much-deserved respite of sorts. Undoubtedly the fear, rhetoric and negativity will continue to garner most of the headlines and dialogue from clients. However, we choose to stick with realities of low interest rates, positive earnings and still VERY doubtful investor sentiment that will continue to propel US stocks higher. The more fundamentally disciplined and focused that investors are as it relates to stocks, themes, stories, products and services in 2022, the better served they will likely be, in our view. In other words – LESS about the indices and benchmarks – and MORE about underlying stocks. Yes, this probably means more work, but such is the reality in our increasingly efficient society and business world as we head into 2022 and beyond.

S&P 500 Price Target 5,300; EPS Target $245

The S&P 500 index has rallied 25% YTD through 11/17/21 and is now up 109% since the COVID-19 low on March 23, 2020, which marked the start of the current bull market. The recovery in US stocks has experienced ebbs and flows with multiple rotations occurring along the way among value/growth, cyclicals/defensives, and reopening/stay-at-home, developments we expect to continue in the coming months. Incessant fears and correction worries related to inflation, supply chain constraints, rising yields, legislative uncertainty, and peak growth, to name a few, have also been prevalent among investors during the recovery, and are things we also expect to persist. Ultimately though, we believe any price weakness resulting from these concerns will prove to be buying opportunities as the positive fundamentals underpinning US stocks remain in place, in our view. Indeed, corporate earnings results have far exceeded expectations so far this year with S&P 500 companies posting record levels of EPS growth, surprises, and beat rates during the first and second quarters, and Q3 earnings also tracking to exceed Street forecasts with 2021 & 2022 annual estimates being revised higher by analysts. On top of that, the US economic growth outlook remains solid and could improve further as the impact of the COVID-19 pandemic continues to decelerate. Finally, we believe the Fed taper and potential rate hikes will ultimately prove to be longer-term non-issues for US stock market performance given the points mentioned above.

As we enter the final months of the year, we anticipate that earnings will persist in surpassing expectations, ultimately leaving consensus estimates too low relative to actuals. Therefore, we fully anticipate that the S&P 500 will achieve and maybe even surpass our 2021 year-end targets of 4,800 and $210, respectively. Looking ahead, we expect similar conditions to prevail, albeit to a lesser extent relative to the gains and growth rates of the past two years. As a result, we are forecasting a 2022 year-end price target of 5,300 and an EPS target of $245 for the S&P 500. These estimates imply a 21.6x P/E ratio (a 1.3x drop from our 2021 estimates) and a roughly 10.4% price gain with another 16.7% of earnings growth for the S&P 500.

Exhibit 1: 2021 & 2022 S&P 500 Targets

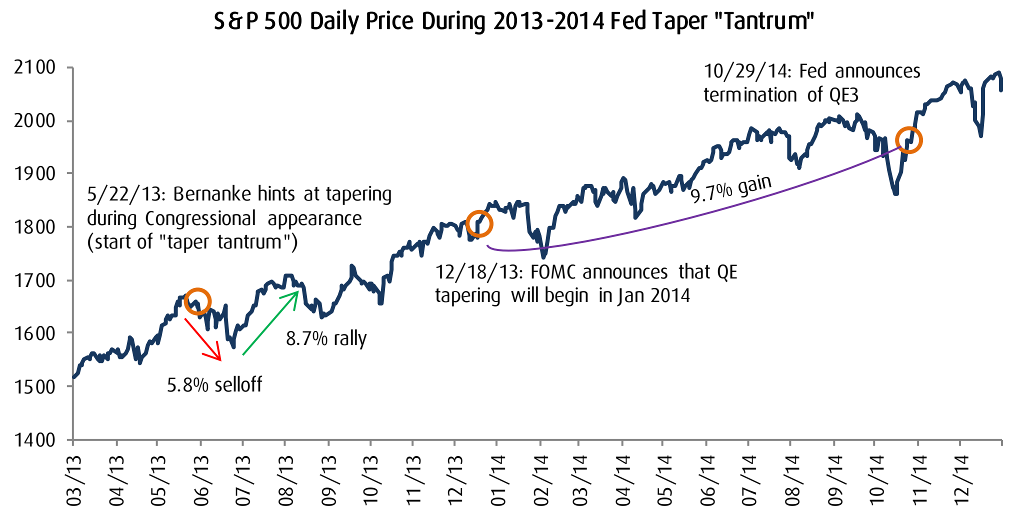
Price Target			
Model	**Category**	**2021E**	**2022E**
Dividend Discount Model	Fundamental	4,800	5,300
Fair Value Price-to-Earnings Model	Valuation	4,550	5,100
Expected Return*		2.4%	13%
Latest S&P 500 Close		4,689	4,689
Price Target		4,800	5,300
Earnings Per Share Target			
Model	**Category**	**2021E**	**2022E**
Macroeconomic Regression Model	Macro	$177	$260
Bottom Up Mean Consensus Expectation	Fundamental	$203	$221
Normalized EPS	Mean Reversion	$185	$191
Expected EPS Growth		50%	16.7%
Prior Year S&P 500 EPS**		$140	$210
EPS Target		$210	$245
Implied P/E		**22.9x**	**21.6x**

*Based on 11/17/2021 closing price.
**Based on our prior-year EPS target if EPS is not fully reported for index.
Source: BMO Investment Strategy Group.

1) Monetary Stimulus

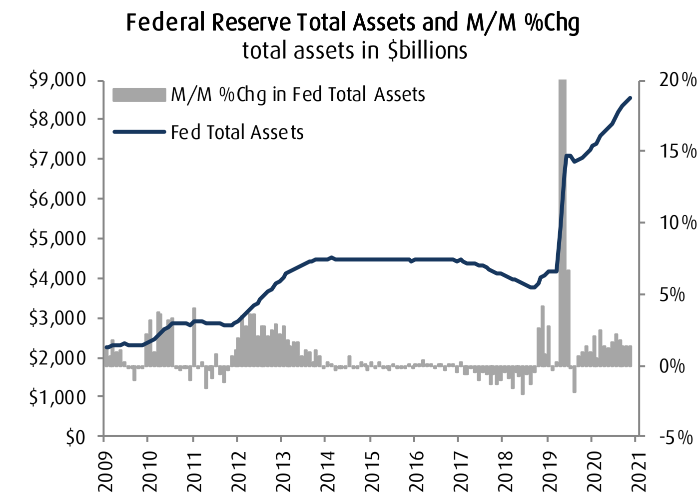
- Fed tapering has already been announced and no, we do not think the reduction of the asset purchase program will cause any sort of prolonged havoc as it relates to US stock market performance once tapering officially begins in the coming weeks.
- Remember, the "taper tantrum" of 2013 actually represented a buying opportunity (Exhibit 2).
- Even as the Fed begins reducing the pace of bond purchases, the size of its balance sheet will remain very large for quite some time, which should continue to be supportive of stocks (Exhibit 3).
- There is no denying that quantitative easing periods have coincided with strong gains for US stocks with the S&P 500 averaging a 19.6% annualized price return during all four of the Fed's QE programs. However, even when the Fed was not purchasing bonds, the S&P 500 still managed to log a decent 7.8% annualized price return (Exhibit 4).

Exhibit 2: 2013 'Taper" Tantrum Actually Represented a Buying Opportunity



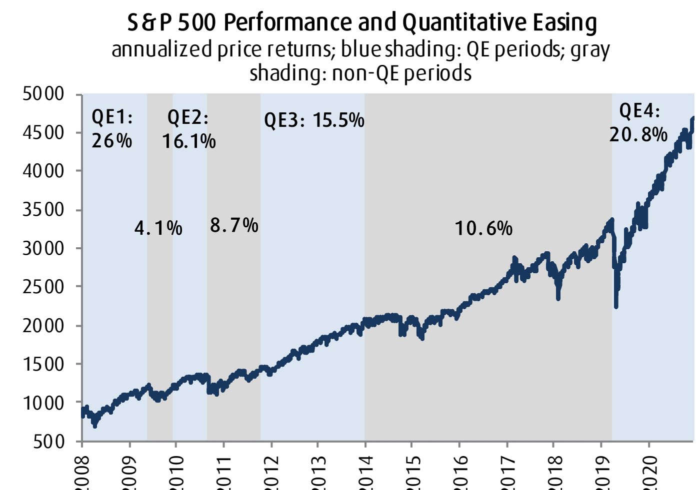
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 3: Fed Balance Sheet Will Still Be Very Large During Taper and Even Post-QE, Which Should Be Supportive of US Stocks



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 4: QE Periods Have Coincided With Outsized Gains, but S&P 500 Has Still Logged Decent Annualized Returns Without Fed Stimulus

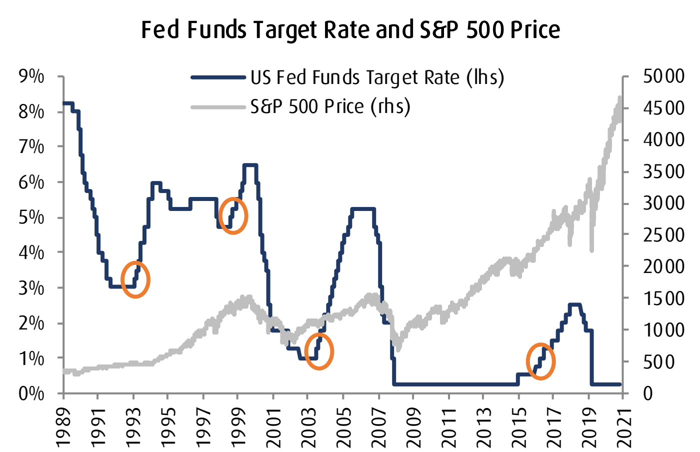


Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

2) Interest Rates and Bond Yields

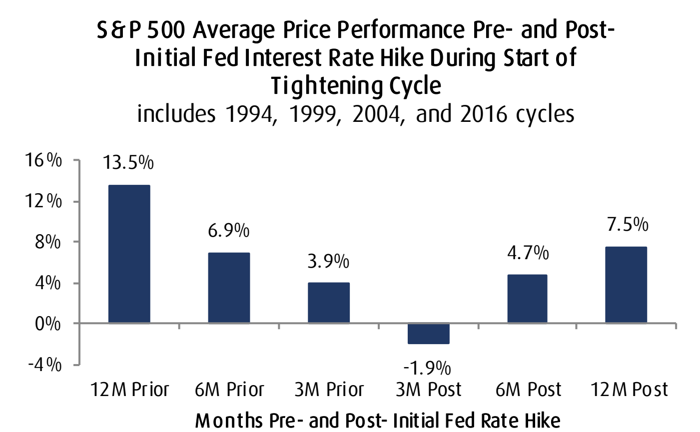
- The market is pricing in a rate hike by mid-2022, which would kick off the first tightening cycle in ~five years (Exhibit 5). Yes, US stocks have struggled in the initial three months after the Fed's first interest rate hike of the cycle with the S&P 500 logging a 1.9% average loss. However, the index has done fairly well thereafter, gaining 7.5%, on average, in the subsequent 12 months (Exhibits 6 & 7).
- The US 10Y Treasury yield has ticked higher this year, up ~50 bps YTD, and has unsurprisingly caused worries among investors and market pundits alike, as it relates to future US equity performance.
- Let's put things into perspective. Interest rates have largely been stuck in a low range since the Great Financial Crisis ("GFC"), and any further increase would likely still leave rates at historically low levels, especially relative to the pre-GFC average (Exhibit 8). In addition, the current 2022 US 10Y Treasury yield forecast of 2.1% remains below the post-GFC average of 2.2%.
- Rising rates have coincided with stronger market price returns, particularly when rates increase from low levels. Going back to 1990, the S&P 500 has posted a 16.1% average price return during periods of rising y/y rates compared to a 6.1% gain during periods of falling y/y rates. When the US 10Y Constant Maturity Treasury yield increased from a below-average level, price returns were even stronger with the S&P 500 registering a 23% gain, on average (Exhibit 9).
- The S&P 500 has averaged a one-year gain of 19.2% when the US 10Y Treasury yield jumped by 50-100 bps y/y, which is the range that the 2022 yield forecast currently implies (Exhibit 10).
- Our work shows that the broader market and the Technology sector can register solid gains during rising interest rate cycles (Yes – Tech). In fact, annualized returns for Tech have actually eclipsed those of the market during five of the prior seven periods of increasing rates and is currently outpacing the S&P 500 in the present cycle, which started at the end of July '20 (Exhibits 11 & 12).

Exhibit 5: A Fed Interest Rate Hike Seems Likely in 2022



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 6: US Stocks Perform Pretty Well Following Start of Fed Tightening Cycle After Initial 3-Month Consolidation Period



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

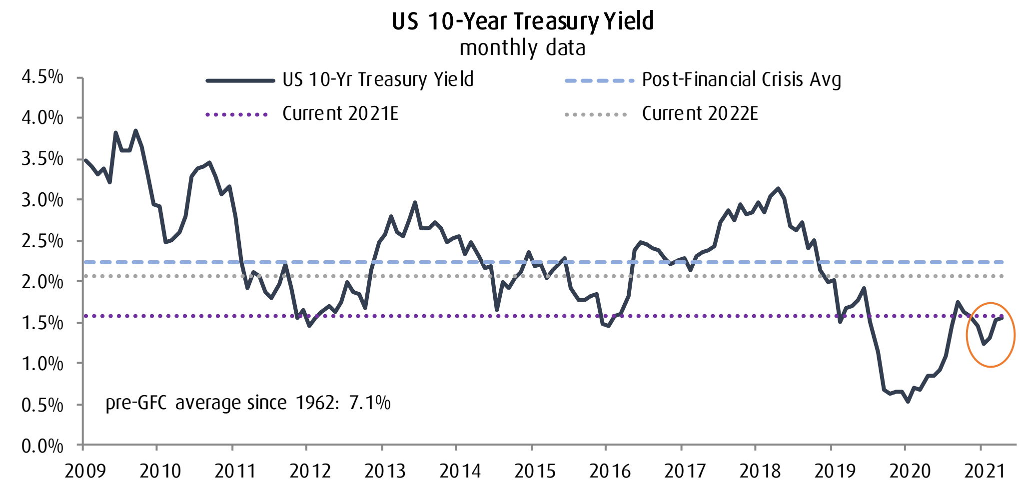
Exhibit 7: During Prior Tightening Cycles, S&P 500 Has Posted a 7.5% Avg Gain 12M Post-Initial Rate Hike

S&P 500 Price Performance Pre- and Post-Initial Fed Interest Rate Hike During Start of Tightening Cycle

Date of Initial Rate Hike in Tightening Cycle	12M Prior	6M Prior	3M Prior	3M Post	6M Post	12M Post
2/4/1994	4.5%	4.7%	2.7%	-3.9%	-2.4%	1.9%
6/30/1999	21.1%	11.4%	5.5%	-6.6%	6.7%	6.0%
6/30/2004	17.1%	2.8%	1.2%	-2.3%	6.4%	4.4%
12/14/2016	11.4%	8.6%	6.0%	5.0%	8.2%	17.7%
Average	**13.5%**	**6.9%**	**3.9%**	**-1.9%**	**4.7%**	**7.5%**

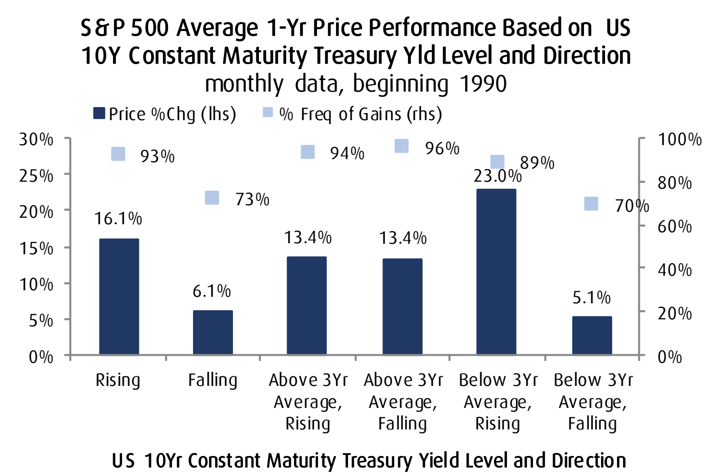
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 8: US 10Y Treasury Yield Has Ticked Higher, but Remains Well-Below Historical Averages



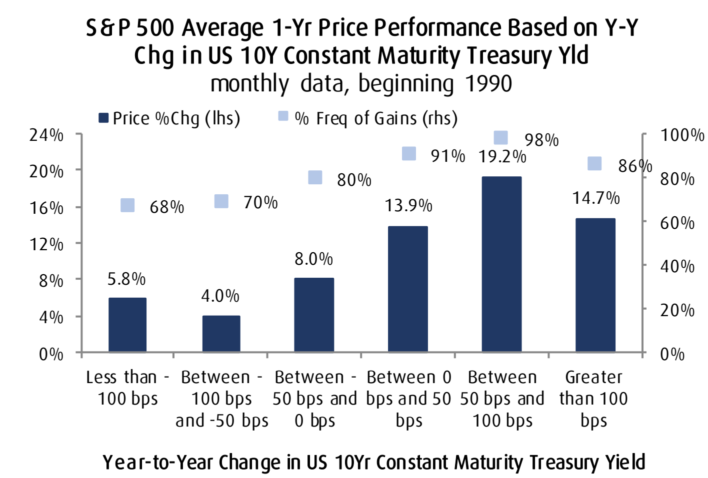
Source: BMO Capital Markets Investment Strategy Group, Bloomberg, FRB.

Exhibit 9: S&P 500 Performs Better When Yields Increase, Particularly When Yields Increase From Low Levels



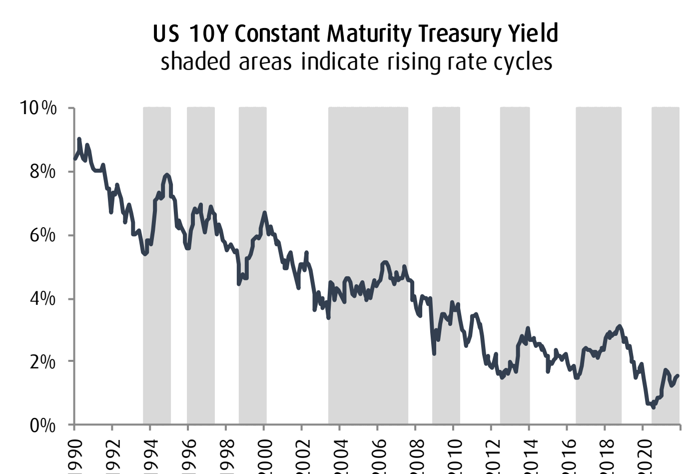
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 10: S&P 500 Typically Registers Strongest Gains When US 10Y Treasury Yield Increases Between 50 and 100 bps Y-Y



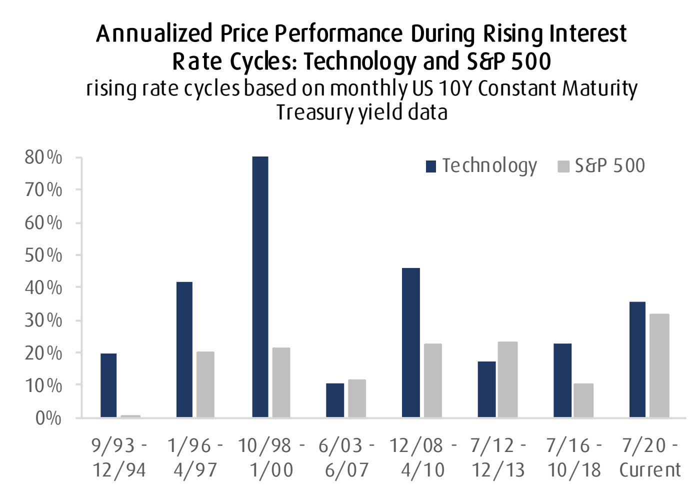
Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 11: There Have Been Several Protracted Periods of Rising Rates



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 12: Tech and Broader Mkt Log Solid Gains in Rising Rate Cycles

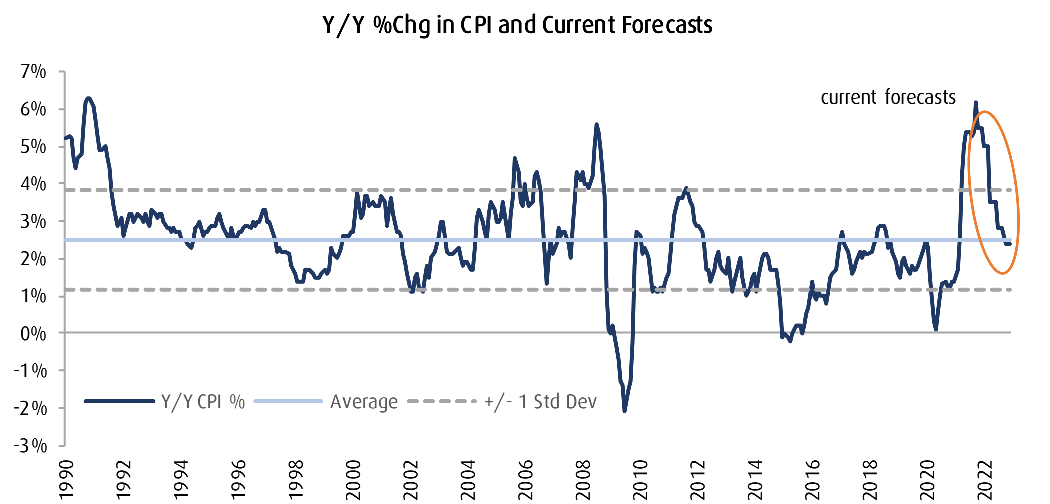


Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

3) Inflation

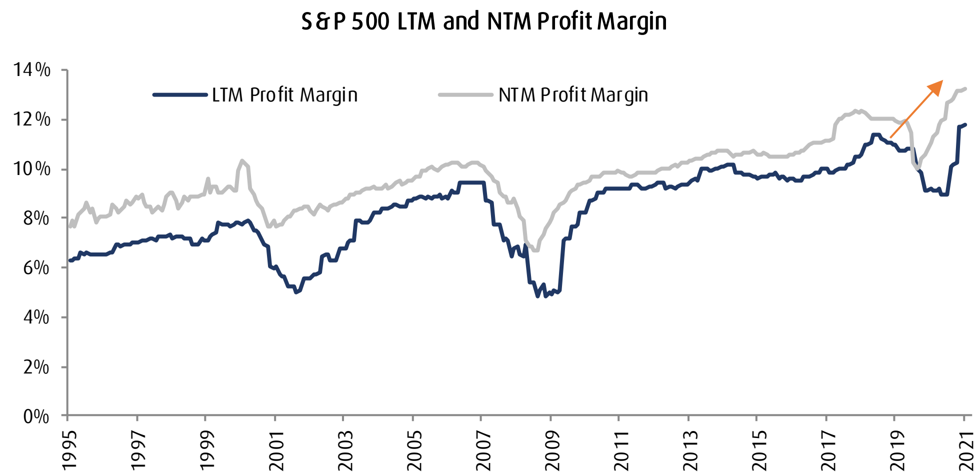
- October CPI came in hotter than expected, pushing the yearly rate up to 6.2%, the highest in nearly 31 years. That being said, inflation forecasts are implying that CPI has likely peaked, as estimates indicate a sharp drop in the coming quarters with the yearly rate forecasted to end 2022 at 2.4% (Exhibit 13).
- Despite the uptick in inflation this year and corresponding fears among investors that these higher prices could have a detrimental impact on companies' margins, S&P 500 LTM profit margins, in aggregate, have held steady with forecasts implying that margins could expand, not compress, over the next 12 months (Exhibit 14).
- Given the yearly CPI rate and current inflation forecasts through 2022, the next cycle is likely a falling y/y CPI, not rising CPI, in our view. As such, we identified 12 falling inflation cycles since 1990 and examined US equity performance (Exhibit 15). Our work shows that the average falling CPI cycle lasted 13 months and displayed a 2.5 pct. point downtick in inflation from beginning to end. During these 12 cycles, the S&P 500 registered an average annualized price change of 10.5%.
- Based on our client interactions, one of the big concerns in the market right now is that estimates are severely underestimating the inflation potential. While we do not necessarily agree with this notion, we thought it could be informative to check how S&P 500 performance, earnings, and profit margins fared during historical annual periods where actual inflation overshot year-end forecasts (Exhibit 16).
- We found that average S&P 500 calendar year price returns were substantially lower when actual inflation ended higher-than-forecasted inflation compared to the when inflation undershot its estimates, 5.7% vs. 15.9%, on average respectively. However, our work also shows that earnings growth and profit margins held up just fine during those annual periods where actual inflation surpassed forecasts. In fact, on average, S&P 500 profit margins slightly expanded, and earnings growth was notably better during periods of "hotter than anticipated" inflation, something that we believe investors are not necessarily positioned for heading into next year based on our client conversations (Exhibit 17).
- As such, even if CPI were to overshoot current forecasts for 2022, we do not believe this would (one) lead to the disastrous impact on the fundamental backdrop for US stocks or (two) cause some sort of market meltdown along the way that some investors seem to be suggesting.

Exhibit 13: Yearly CPI Rate Spiked to Its Highest Print in Nearly 31 Years, but Forecasts Suggest Inflation May Have Reached the Peak



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, BLS.

Exhibit 14: S&P 500 Profit Margins Have Largely Held Steady Despite Rising Inflation



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver.

Exhibit 15: Given Current Annual CPI Rate and Inflation Forecasts, the Next Cycle Is Likely to Be a Falling Y/Y CPI One

Falling CPI Cycles and S&P 500 Annualized Price Performance

based on y/y %change in CPI; 12 total cycles since 1990

cycles are defined where there is at least a 6-month trend in the overall y/y change in the CPI rate

Start	End	Duration (months)	CPI @ Start	CPI @ End	Percentage Point Change in CPI	S&P 500 Annualized Price % Change
11/30/1990	1/31/1992	14	6.3%	2.6%	-3.7	22.6%
6/30/1993	5/31/1994	11	3%	2.3%	-0.7	1.4%
5/31/1995	12/31/1995	7	3.2%	2.5%	-0.7	28.0%
12/31/1996	4/30/1998	16	3.3%	1.4%	-1.9	35.6%
5/31/2001	6/30/2002	13	3.6%	1.1%	-2.5	-19.7%
3/31/2003	3/31/2004	12	3%	1.7%	-1.3	32.8%
9/30/2005	10/31/2006	13	4.7%	1.3%	-3.4	11.2%
7/31/2008	7/31/2009	12	5.6%	-2.1%	-7.7	-22.1%
12/31/2009	11/30/2010	11	2.7%	1.1%	-1.6	6.4%
9/30/2011	10/31/2013	25	3.9%	1%	-2.9	23.5%
6/30/2014	4/30/2015	10	2.1%	-0.2%	-2.3	7.7%
7/31/2018	2/28/2019	7	2.9%	1.5%	-1.4	-1.9%
	Average	**13**	**3.7%**	**1.2%**	**-2.5**	**10.5%**
	Median	**12**	**3.3%**	**1.4%**	**-2.1**	**9.4%**
					Std Dev	**19.0%**
					Risk Ratio	**0.55**

Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, BLS.

Exhibit 16: Historically, When Annual Inflation Ended Higher-Than-Anticipated Inflation, Earnings Growth and Profit Margins Stayed Firm, on Average, While US Stocks Registered a 5.7% Average Annual Gain

Annual Periods since 1993 in which Actual Inflation Ended Higher-Than-Anticipated Inflation
actual inflation: y/y %chg in CPI; anticipated inflation: y/y %chg in Philly Fed Livingston Survey NTM Mean CPI Dec Forecast

Year End	Forecast Year	Actual Inflation minus Anticipated Inflation	Y/Y %Chg in CPI	S&P 500 Annual Profit Margin	Y-Y Chg in Profit Margin	S&P 500 Annual EPS	Y/Y %Chg in Annual EPS	S&P 500 Annual Price %Chg
1993	1994	0.33%	2.7%	6.0%	0.77%	$ 31.75	18.0%	-1.5%
1995	1996	1.30%	3.3%	6.8%	0.14%	$ 40.63	7.8%	20.3%
1998	1999	1.59%	2.7%	7.6%	0.65%	$ 51.68	16.7%	19.5%
1999	2000	0.57%	3.4%	7.5%	-0.08%	$ 56.13	8.6%	-10.1%
2001	2002	0.86%	2.4%	6.8%	1.55%	$ 46.04	18.5%	-23.4%
2003	2004	1.21%	3.3%	8.6%	0.89%	$ 67.68	23.8%	9.0%
2004	2005	0.15%	3.4%	8.7%	0.16%	$ 76.45	13.0%	3.0%
2006	2007	1.91%	4.1%	8.1%	-1.16%	$ 82.54	-5.9%	3.5%
2008	2009	0.82%	2.7%	6.3%	1.51%	$ 56.86	14.8%	23.5%
2009	2010	0.56%	1.5%	8.7%	2.44%	$ 83.77	47.3%	12.8%
2010	2011	2.14%	3.0%	9.2%	0.46%	$ 96.44	15.1%	0.0%
2015	2016	1.57%	2.1%	9.2%	0.31%	$ 106.26	5.8%	9.5%
2016	2017	0.06%	2.1%	10.1%	0.86%	$ 124.51	17.2%	19.4%
2017	2018	0.07%	1.9%	11.3%	1.18%	$ 151.60	21.8%	-6.2%
				Average	**0.69%**		**15.9%**	**5.7%**

Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB, BLS.

Exhibit 17: S&P 500 Profit Margins Appeared to Have Held Up Just Fine During Past Years When Actual Annual Inflation Exceeded the Forecasted Inflation Rates

Annual Change in S&P 500 Profit Margin, EPS, and Price When Actual Annual Inflation Is Higher/Lower Than Anticipated Inflation
actual inflation: y/y %chg in CPI; anticipated inflation: y/y %chg in Philly Fed Livingston Survey NTM Mean CPI Dec Forecast

	Y-Y Chg in Profit Margin	Y/Y %Chg in EPS	Y/Y Price %Chg
Actual Inflation > Anticipated Inflation	0.69%	15.9%	5.7%
Actual Inflation < Anticipated Inflation	-0.46%	-1.7%	13.8%

Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB, BLS.

4) Earnings Growth

- There is no denying that Q2 marked the peak in y/y quarterly EPS growth, meaning that the quarters ahead will inevitably represent a deceleration. It is important to note, however, that quarterly growth is forecasted to be firmly positive over the next five periods with a reacceleration estimated to occur in the back half of 2022 (Exhibit 18).

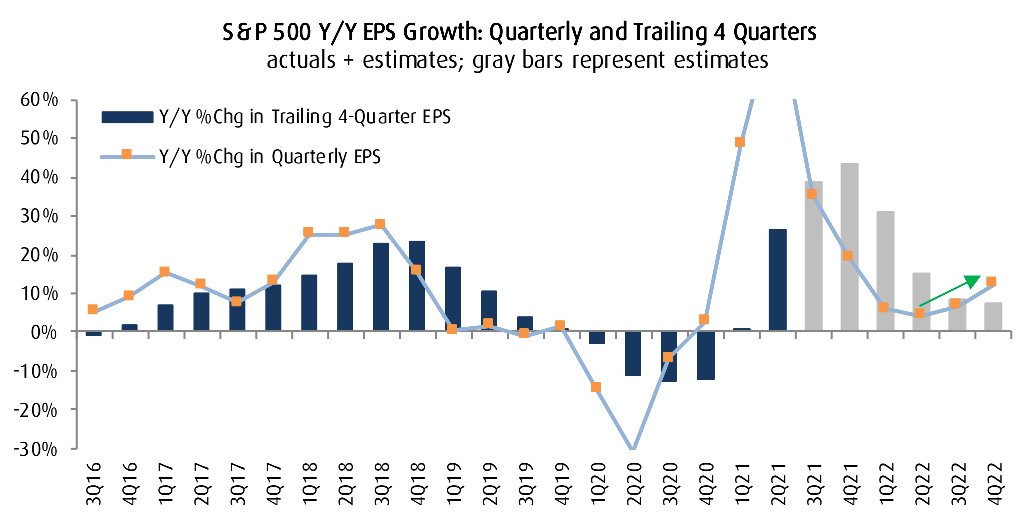
- On a trailing four-quarter basis, S&P 500 y/y earnings growth is not expected to peak until Q4'21 with the index forecasted to register high-single-digit growth, at the least, through 2022.

- Our blended earnings model, which averages LTM and NTM growth, is still on the rise and just climbed to a new record high of ~28%. Our work shows that blended EPS growth in the 20-30% range has historically coincided with a 17.6% average one-year S&P 500 price return going back to 1990 (Exhibits 19 & 20). More important, our model is likely to remain in double-digit territory throughout most of 2022 based on current estimates, which suggests to us that healthy market gains can be quite achievable.

- The breadth of upward EPS revisions has decelerated as of late, but 60% of FY2 EPS revisions in the past two months for S&P 500 companies have still been positive, above the historical average of 53%, with S&P 500 bottom-up 2022 consensus EPS continuing to tick higher, albeit at a slower pace (Exhibits 21 & 22).

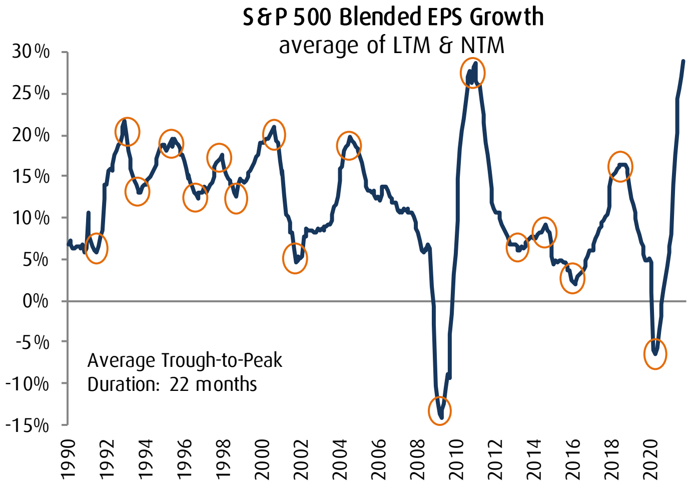
- Over the past five quarters, analysts have revised their quarterly EPS forecasts higher leading into each reporting period, a stark contrast to the estimate reductions that typically occur, and likely a result of the extreme cuts made amid the pandemic heights (Exhibit 23). That being said, companies have been surpassing these already-elevated end-of-quarter forecasts at staggering rates (in excess of 20%) in recent periods, highlighting the strength of corporate earnings, but also the persistent trend among analysts of understating expectations, something we expect to continue into 2022 (Exhibit 24).

Exhibit 18: Quarterly EPS Growth Expected to Reaccelerate During the Back Half of 2022



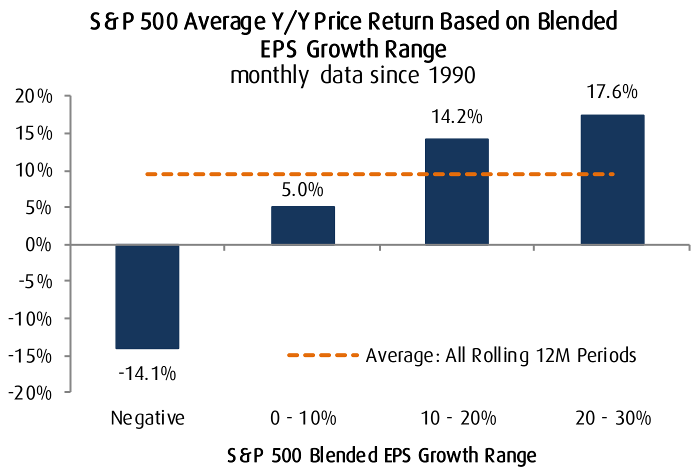
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 19: Our Blended Earnings Growth Model Reached a New Record High and Is Still Rising



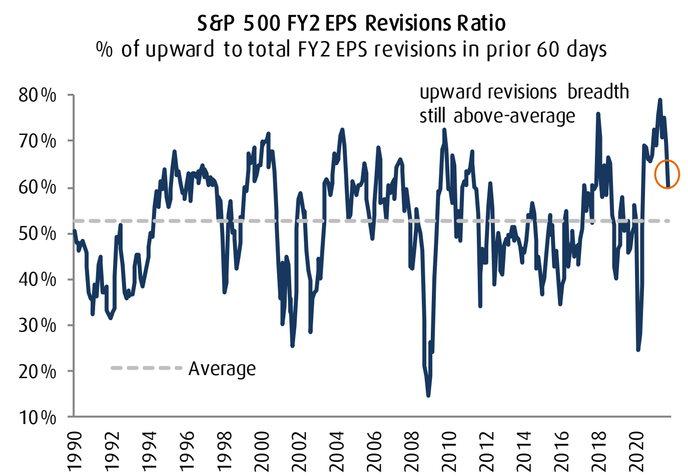
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 20: Double-Digit Blended EPS Growth Has Coincided With Double-Digit Average One-Year Price Returns



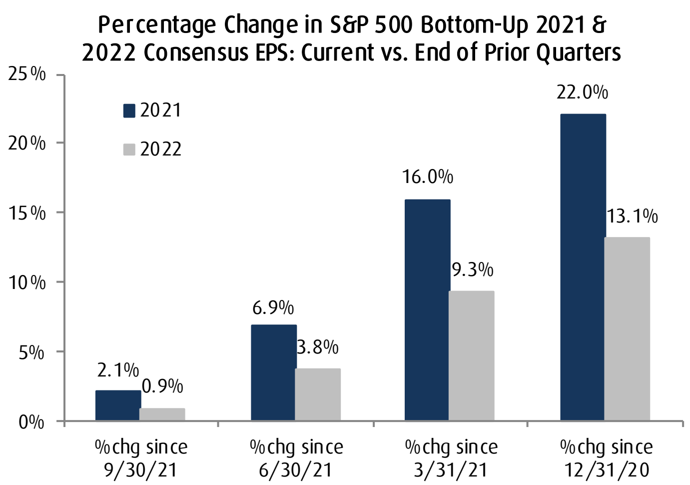
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 21: Breadth of Positive FY2 EPS Revisions for S&P 500 Companies Has Decelerated, but Remains Above its Historical Average



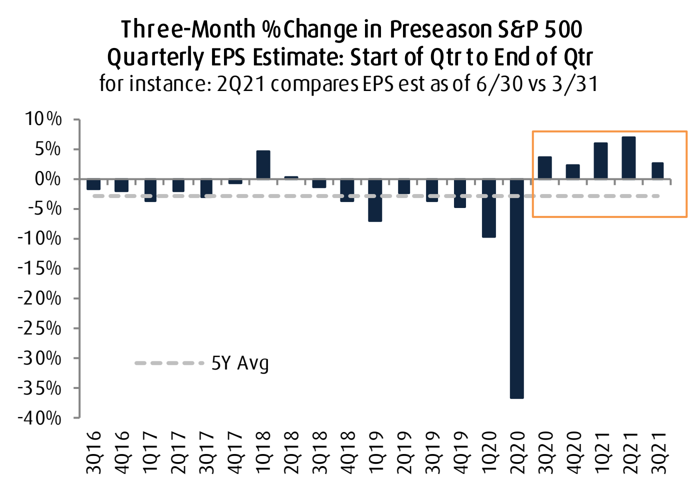
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 22: 2022 Consensus EPS for S&P 500 Has Continued to Tick Higher, Albeit at a More Conservative Pace Than Earlier in 2021



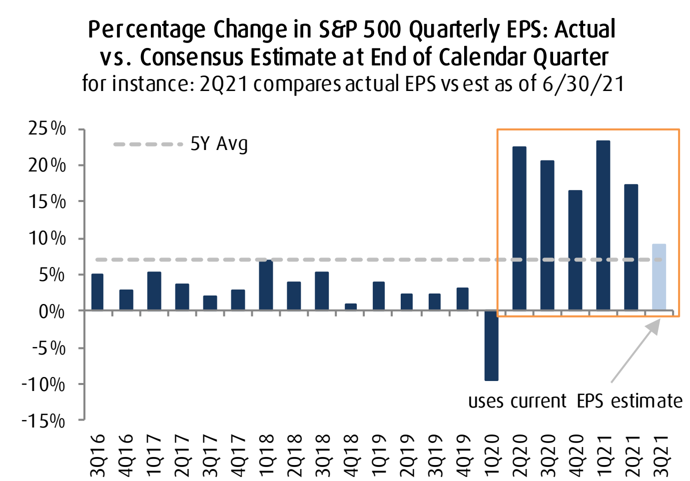
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 23: In Past Five Quarters, Analysts Have Revised EPS Estimates Higher Leading Into Reporting Period, a Deviation From Norm



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 24: Companies Have Been Beating These Already Elevated Earnings Expectations at a Staggering Rate



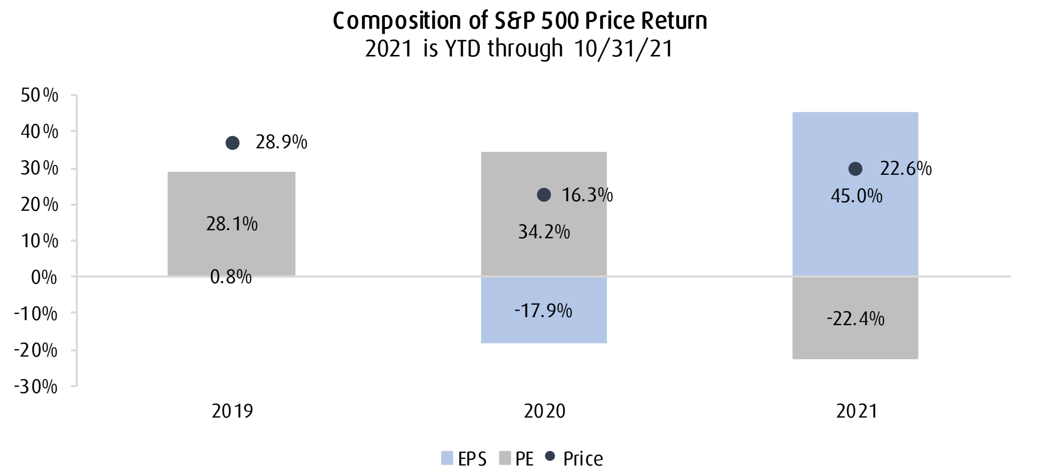
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Positive Equity Returns Do Not Mean a Straight Line Higher

An Earnings-Driven Market and Its Performance Implications

- Earnings growth has taken the reins from P/E expansion as the major driver of market performance this year, a trend we expect to continue in the coming months (Exhibit 25).
- An EPS-driven market requires a sharper focus compared to one driven by P/E expansion, which is what many investors have become used to. Why? According to our work, which is detailed in Exhibit 26, EPS-driven periods tend to coincide with lower average one-year price returns, more dispersed returns, and a higher frequency of losses and >10% declines.
- Diving a bit deeper and looking solely at EPS-driven periods in which S&P 500 EPS growth was 10% or more (an environment we anticipate given our 2022 year-end EPS target of $245), performance results noticeably improved. For instance, the average S&P 500 one-year price return in an earnings-driven environment with double-digit EPS growth is 7.7% with a ~75% probability of gains, 45% of which are >10% gains. This marks a substantial improvement from the 4.9% average gain, ~66% hit rate, and ~38% probability of >10% gains for EPS-driven periods generally.
- This anticipated environment of EPS-driven gains and 10%+ EPS growth represents a positive backdrop for US stocks, but at the same time, requires a sharper focus on the individual merits of stocks/sectors/industries in order to generate alpha compared to a P/E-driven one, in our view.

Exhibit 25: Unlike in Recent Years, Earnings Are Driving Returns in 2021, Not P/E Expansion



Source: BMO Capital Markets Investment Strategy Group, FactSet, Bloomberg.

Exhibit 26: An EPS-Driven Market Requires a Sharper Focus

Analysis of Rolling Monthly One-Year S&P 500 Price Performance Periods by Return Driver
since 1955

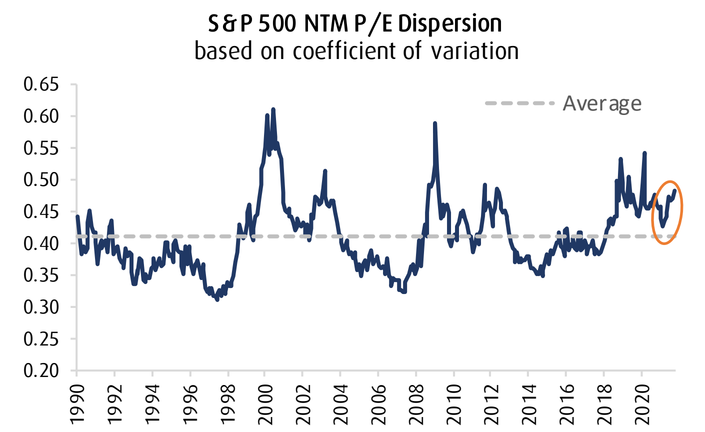
Statistic	PE Driven	EPS Driven	EPS Driven with 10%+ EPS Growth
% of Time Occurs	43.5%	56.5%	41.8%
Average Trailing One-Year Return	14.1%	4.9%	7.7%
Standard Deviation	17.0%	13.8%	13.5%
Coefficient of Variation	1.21	2.82	1.76
Probability of Positive Return	82.8%	66.4%	75.2%
Probability of 10% Decline or Worse	8.6%	15.5%	10.1%
Probability of 10% Gain or Better	66.8%	37.7%	45.4%

Source: BMO Capital Markets Investment Strategy Group, FactSet, Bloomberg.

Stock Selection Will Become Increasingly Important

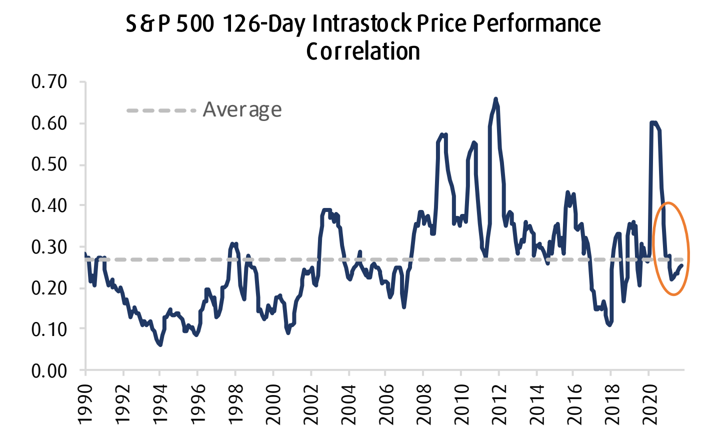
- NTM P/E dispersion among S&P 500 stocks has increased to its highest level since the onset of the pandemic back in March 2020, and stands well above its historical average, signaling to us that there may be distinct winners and losers in the index based on their earnings outlooks (Exhibit 27).
- 126-day intrastock price performance correlation across the S&P 500 index moved sharply lower during the middle part of 2021 and remains below average, indicating that these stocks are still moving rather independently from a directional standpoint (Exhibit 28).
- These two characteristics are pointing to a market environment conducive for stock-pickers.

Exhibit 27: Valuation Differentiation Across SPX Stocks Is Increasing



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 28: Intrastock Performance Correlation Has Dropped Below Avg

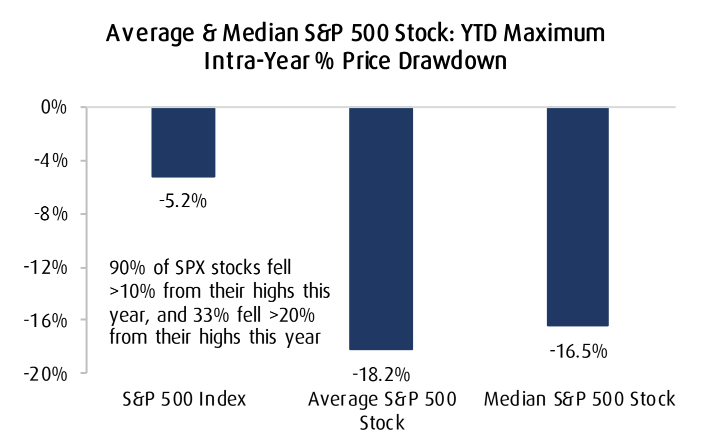


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Correction Rhetoric Galore

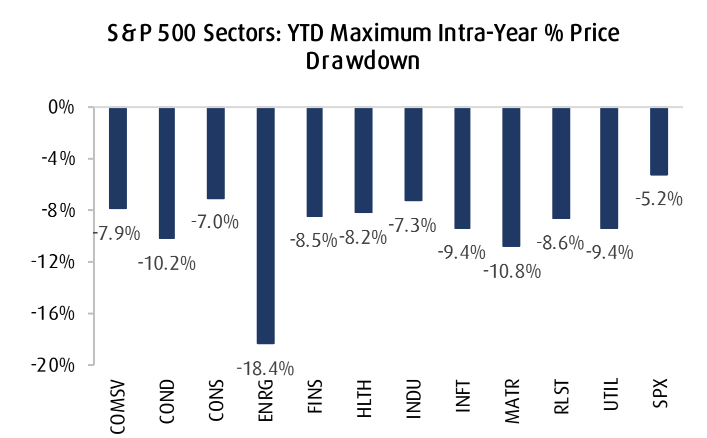
- A market correction occurs every 15.5 months, on average, and it has been ~20 months since the S&P 500 last experienced one (Exhibit 31). Yes, a 10% peak-to-trough price decline will eventually occur, and probably when we least expect it. Therefore, investors should stick to their investment discipline as history shows that US stocks typically rebound quite well following corrections, especially in the subsequent three months (Exhibits 32 & 33).
- The maximum intra-year drawdown for the S&P 500 in 2021 has been a mere 5.2%. Although there has been no index-level correction, looking below the surface tells a different story. The maximum peak-to-trough drawdown in 2021 for the average and median S&P 500 stock were 18.2% and 16.5%, respectively (Exhibit 29). In fact, ~90% of S&P 500 stocks have fallen >10% from their highs and 31% have dropped >20% from their highs. Even at the sector level, drawdowns were more severe than the broader market as eight of 11 sectors exhibited a pullback of >8% (Exhibit 30).

Exhibit 29: No Index Correction, but a Different Story at Stock Level



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 30: Most Sectors Have Exhibited a Drawdown of At Least 8%



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

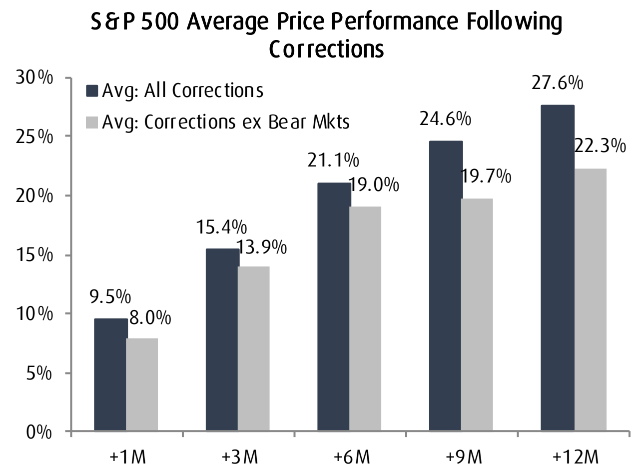
Exhibit 31: Price Corrections Occur Every 1.3 Years On Average

S&P 500 Price Corrections Since 1945
Correction: peak-to-trough decline of 10% or greater
Bear markets in bold

Start Date	End Date	Duration (days)	% Decline	Days Since Last Correction
2/5/1946	2/26/1946	21	-10.1%	
5/29/1946	**10/9/1946**	**133**	**-26.6%**	**92**
2/11/1947	5/19/1947	97	-14.7%	125
7/24/1947	2/14/1948	205	-14.1%	66
6/15/1948	**6/13/1949**	**363**	**-20.6%**	**122**
6/12/1950	7/17/1950	35	-14.0%	364
1/5/1953	9/14/1953	252	-14.8%	903
9/23/1955	10/11/1955	18	-10.6%	739
8/2/1956	2/12/1957	194	-14.8%	296
7/15/1957	**10/22/1957**	**99**	**-20.7%**	**153**
8/3/1959	9/28/1960	422	-13.6%	650
12/12/1961	**6/26/1962**	**196**	**-28.0%**	**440**
8/22/1962	10/23/1962	62	-10.5%	57
2/9/1966	**10/7/1966**	**240**	**-22.2%**	**1205**
9/25/1967	3/5/1968	162	-10.1%	353
11/29/1968	**5/26/1970**	**543**	**-36.1%**	**269**
4/28/1971	11/23/1971	209	-13.9%	337
1/11/1973	**10/3/1974**	**630**	**-48.2%**	**415**
11/7/1974	12/6/1974	29	-13.6%	35
7/15/1975	9/16/1975	63	-14.1%	221
9/21/1976	3/6/1978	531	-19.4%	371
9/12/1978	11/14/1978	63	-13.6%	190
10/5/1979	11/7/1979	33	-10.2%	325
2/13/1980	3/27/1980	43	-17.1%	98
11/28/1980	**8/12/1982**	**622**	**-27.1%**	**246**
10/10/1983	7/24/1984	288	-14.4%	424
8/25/1987	**12/4/1987**	**101**	**-33.5%**	**1127**
1/2/1990	1/30/1990	28	-10.2%	760
7/16/1990	**10/11/1990**	**87**	**-19.9%**	**167**
10/7/1997	10/27/1997	20	-10.8%	2553
7/17/1998	8/31/1998	45	-19.3%	263
7/16/1999	10/15/1999	91	-12.1%	319
3/24/2000	**10/9/2002**	**929**	**-49.1%**	**161**
11/27/2002	3/11/2003	104	-14.7%	49
10/9/2007	**3/9/2009**	**517**	**-56.8%**	**1673**
4/23/2010	7/2/2010	70	-16.0%	410
4/29/2011	10/3/2011	157	-19.4%	301
5/21/2015	8/25/2015	96	-12.4%	1326
11/3/2015	2/11/2016	100	-13.3%	70
1/26/2018	2/8/2018	13	-10.2%	715
9/20/2018	12/24/2018	95	-19.8%	224
2/19/2020	**3/23/2020**	**33**	**-33.9%**	**422**
Avg: All Corrections		191	-19.6%	464
Avg: Corrections ex Bear Mkts		122	-13.9%	448

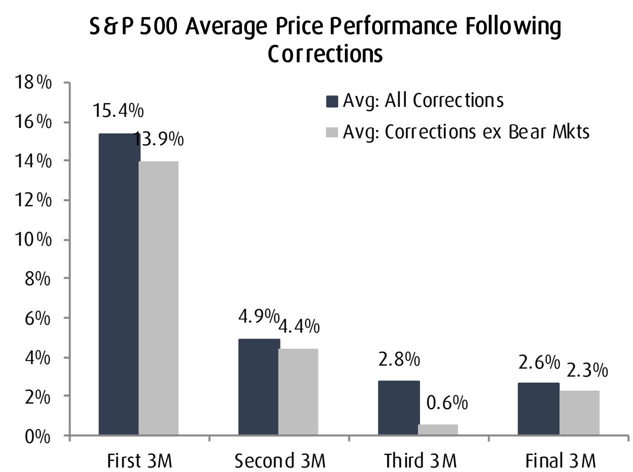
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 32: Stocks Typically Rebound Well Following Corrections



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 33: First 3M Post-Correction Tend to Coincide With Best Gains

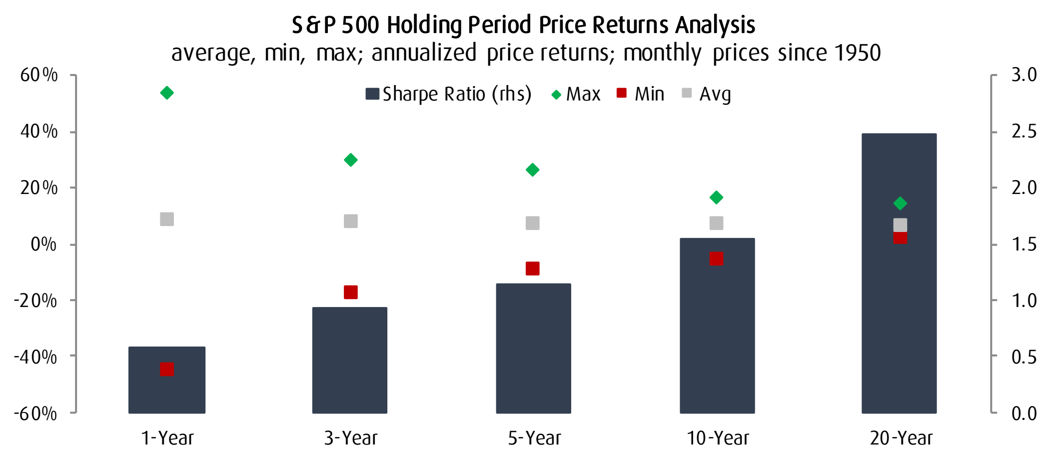


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Stay Invested Rather Than Trying to Time the Market

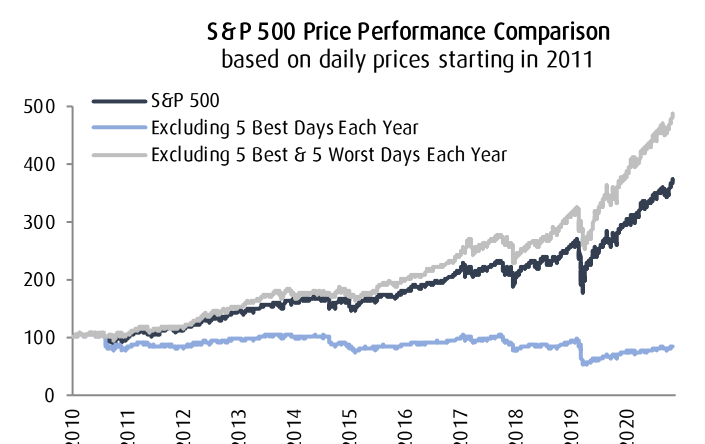
- Successfully timing the market on a consistent basis is an extremely difficult task and even the slightest missteps can have a significant performance impact. Since the end of 2010, the S&P 500 has delivered a 12.9% annualized price return. Excluding the five best performance days each year would bring that return down to -1.6%, while excluding the five worst days would lift the return to 32.7% (Exhibits 35 & 36).
- Obviously, missing the worst days would be ideal, but history has shown that most of these days tend to occur unexpectedly, making them nearly impossible to predict. Even if an investor times the market in a way to avoid both the five best and worst days, the annualized return would still only be 280 bps higher than staying invested throughout the period. As such, we continue to believe it is more beneficial for investors to maintain investment discipline instead of trying to time the market.
- Poor performance in any one period does not invalidate buy and hold strategies. Our work shows that longer investment horizons have historically produced superior risk-adjusted returns. For instance, we examined rolling monthly price returns since 1950 for one-, three-, five-, 10-, and 20-year holding periods. Although average returns across the investment horizons were relatively similar, the range of returns varied considerably with shorter holding periods the most volatile and longer holding periods much smoother. As such, the Sharpe ratios for longer holding periods are more favorable than those for shorter periods. Yes, longer time horizons will lower the chances of capturing outsized gains, but these holding periods also tend to avoid extreme losses (Exhibit 34).

Exhibit 34: Longer Holding Periods Do Not Necessarily Hinder Investment Returns



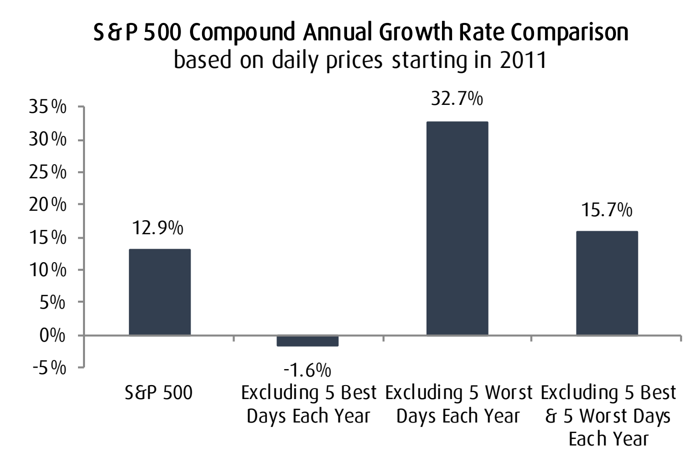
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 35: Market Timing Is Very Difficult and Missteps Can Be Costly



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 36: Missing Best & Worst Days Can Have a Significant Impact

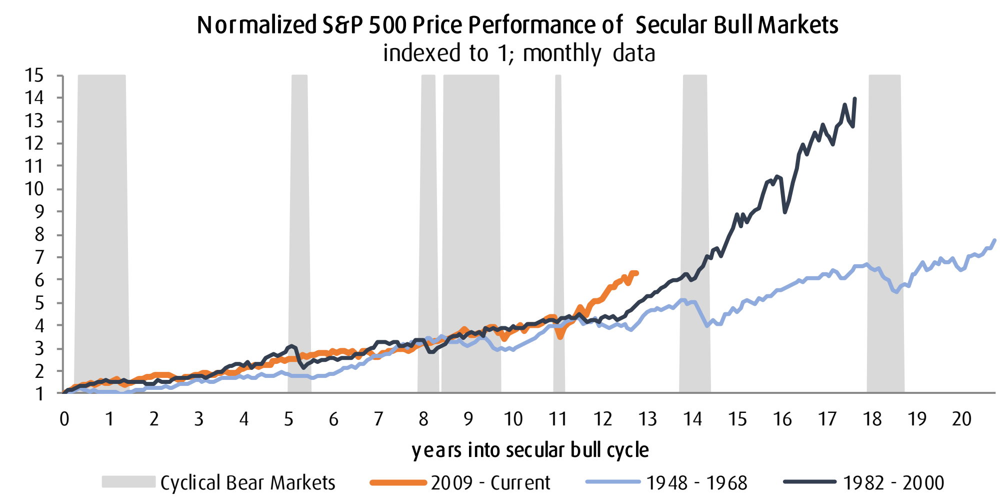


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Secular Bull Market Remains Intact as It Progresses Further Into Its Second Half

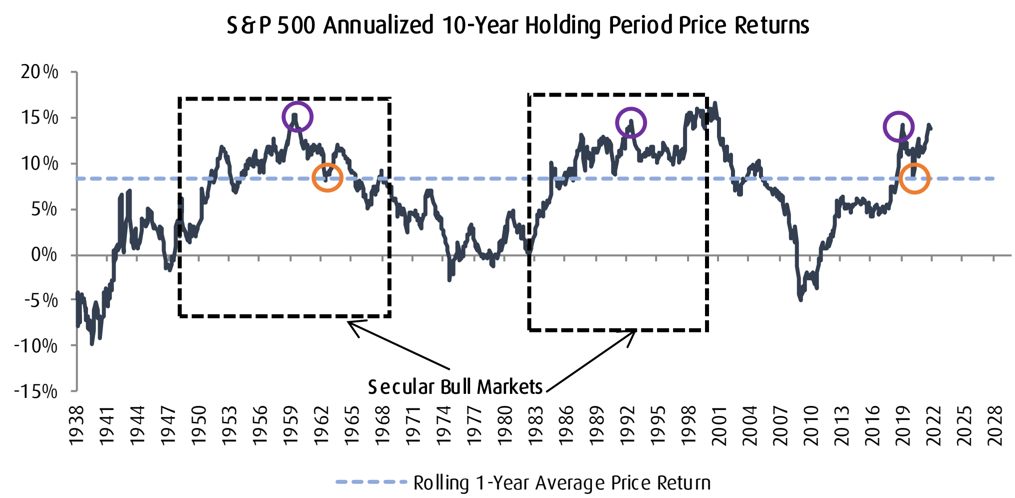
- The secular bull market is alive and well as it heads toward its 13th year.
- While there is certainly no perfect historical comparison that can be used to lay out the road map for stocks in the future, the current bull appears to be following a similar path of the 1982-2000 secular bull in terms of price trajectory (Exhibit 37).
- Longer-term performance trends obviously suffered as a result of the pandemic-induced selloff in early 2020 with the 10-year annualized holding period price return for the S&P 500 sharply dropping near the rolling one-year average return level. However, the 10-year annualized performance trend has rebounded since then and recently climbed to a new high for this secular bull market cycle, surpassing its prior longer-term price trend from February 2019 – a positive sign for the secular bull, in our view (Exhibit 38).

Exhibit 37: Path of Secular Bull Market On Track With 3/23/20 Marking the Crescendo That Reignited It



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 38: 10Y Annualized Price Gains Rising Again After Rebounding Off One-Year Avg Return Level

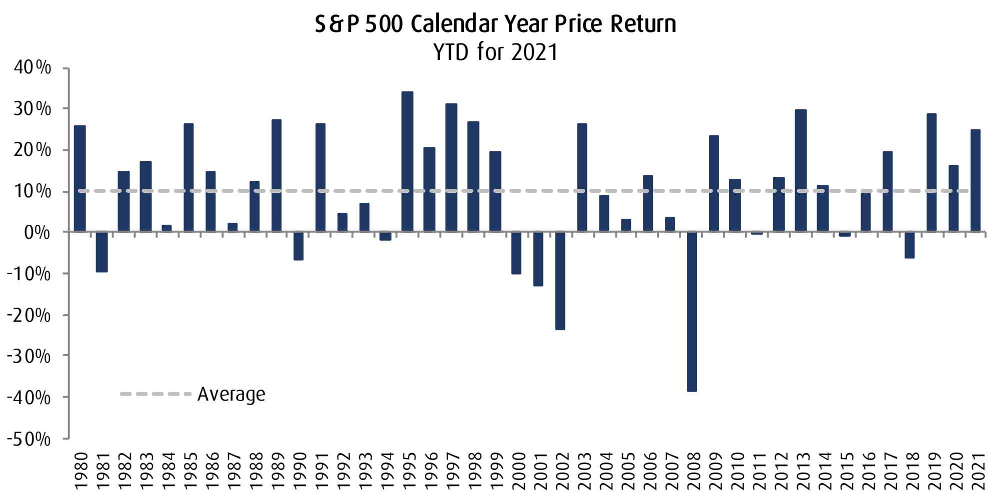


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Outsized Annual Price Gains Likely to Return Closer to Historical Norms

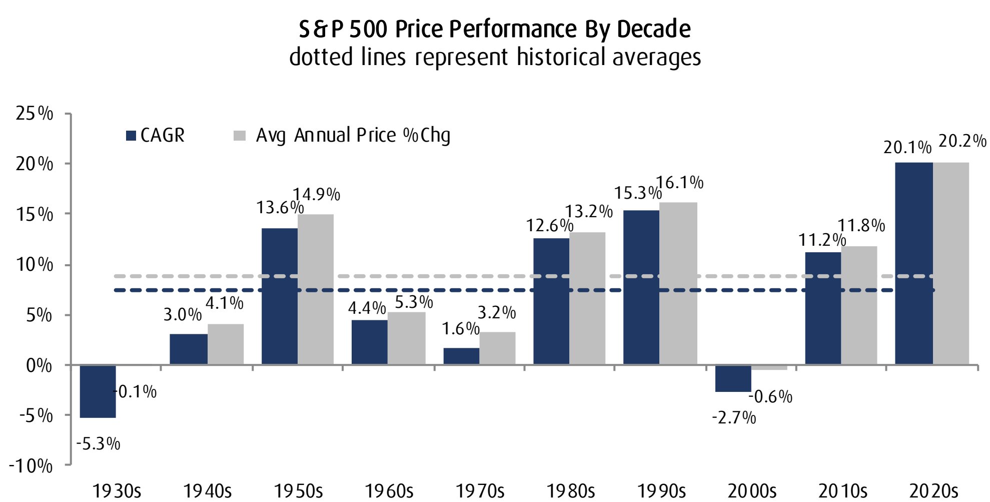
- While our year-end price forecast for the S&P 500 index likely positions US stocks to exhibit a fourth consecutive year of double-digit percentage returns, we do believe the path of market returns is in the early process of moderating and normalizing closer to historical norms (Exhibit 39).
- Preliminary returns for the 2020s are obviously on track for one of the strongest decades in history – but are not unprecedented (Exhibit 40). Given our belief that US stocks are in the early stages of transitioning to a more fundamentally driven and earnings defined environment in which returns are traditionally more subdued and at times volatile, the broader trends of historical performance match well and reinforce the potential for more subdued, but still positive returns for the rest of the decade.

Exhibit 39: S&P 500 Annual Price Returns in Past Three Yrs Have Been Well Ahead of 10% Historical Avg



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 40: Annual Price Gains Will Likely Revert Back to More Normalized Return Levels at Some Point

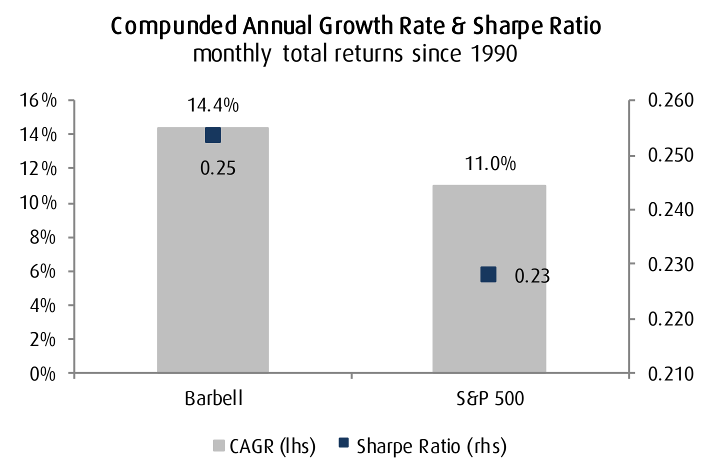


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Utilizing a Barbell Strategy – High Quality GARP + High Quality Dividend Growth/Yield

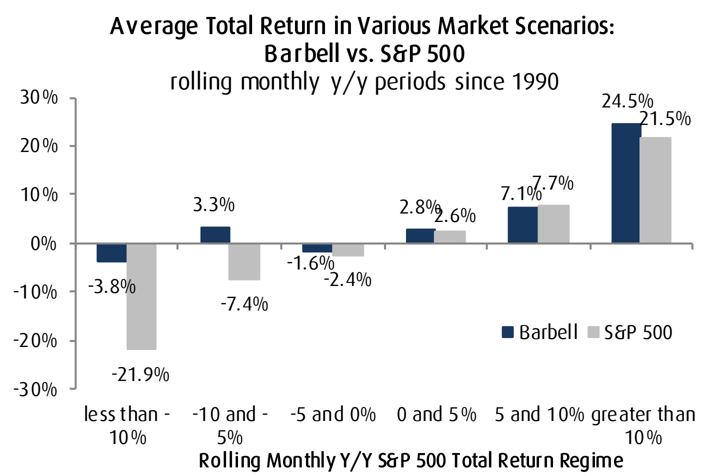
- With price returns for 2022 likely to be more subdued and more volatile than those seen so far YTD according to our work, we decided to highlight our barbell investment approach, which combines high quality growth-at-a-reasonable price (GARP) and high quality dividend growth and yield equally, as we believe it can be a valuable strategy in this type of environment.
- This barbell strategy has produced an above-market long-term CAGR and more attractive risk-adjusted total returns compared to the S&P 500 (Exhibit 41). When examining rolling monthly one-year periods since 1990, we found that a high quality GARP + high quality dividend barbell can help mitigate losses during market declines and also participate in the upside during periods of strength (Exhibit 42). A barbell approach has also fared better than the overall market during periods of elevated VIX levels and rising y/y volatility, a backdrop we do expect to unfold in 2022 (Exhibit 43).
- The current sector composition of the barbell is pretty diverse with exposure to both cyclicals and defensive groups, and nine of the 11 GICS sectors being represented (Exhibit 44). Industrials and Financials have the largest weights, comprising ~27% and ~19% of the barbell, while Energy and Utilities do not have any stocks currently passing our screening parameters for the strategy.
- High Quality GARP: S&P stock rank of A-, A, or A+; FY2 PE < SPX median; FY2 EPS Growth > SPX median; High Quality Dividend Growth/Dividend Yield: S&P stock rank of A-, A, or A+; 1Y div growth > SPX median; Div yld > SPX median; No div cuts in last 5 years; FCF yld > div yld

Exhibit 41: Barbell Approach Has Produced Attractive Long-Term CAGR



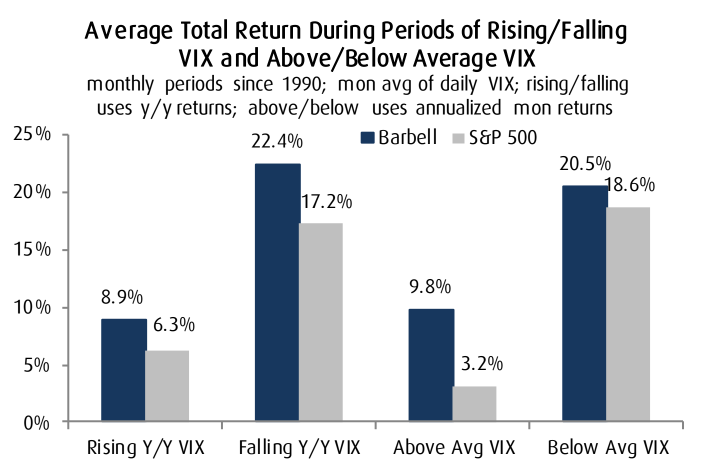
Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P, IBES.

Exhibit 42: Barbell Can Mitigate Losses and Also Participate in Upside



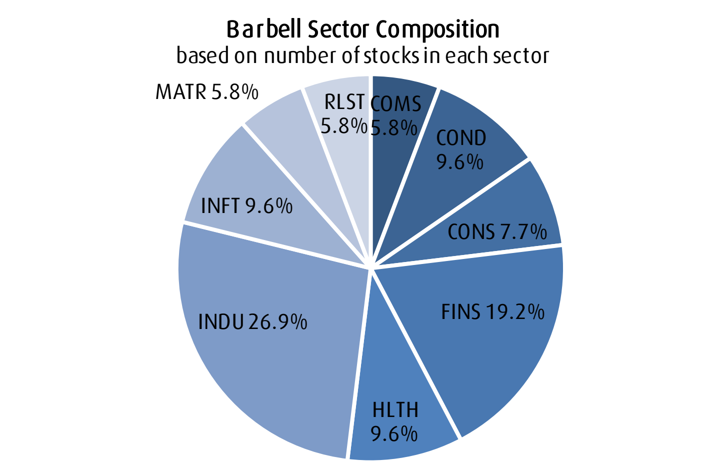
Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P, IBES.

Exhibit 43: Barbell Can Help Combat Rising and Elevated Volatility



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P, IBES.

Exhibit 44: Pretty Diverse Sector Composition for Our Barbell Strategy



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P, IBES.

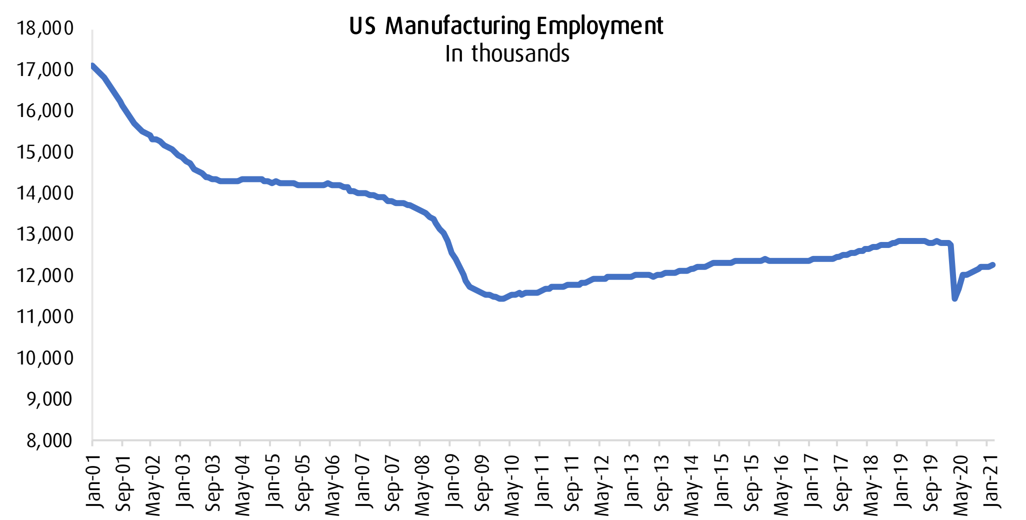
Thematic Focus: Supply Chain Woes – Reality Bites

Evolution of the Supply Chain Contains Differing Degrees of Momentum

COVID-19 Has Exposed the Worst Case in the Global Supply Chain

COVID-19 has brought the inherent issues of the global supply chain to the forefront c 18 months into the pandemic, consumers are still facing shipping delays and inflated prices, while companies are scrambling to restock their products ahead of the holiday season. Labor shortages, lack of raw materials, and port congestions are only some of the factors contributing to an unprecedented supply chain fallout, which is not expected to recover until sometime in 2022. However, global supply chain disruptions have occurred in the past including the 2010 Iceland volcanic eruption and 2011 Japanese tsunami, but not to this extent nor length. In fact, this time around, supply chain disruptions are prompting a fundamental shift in manufacturing processes. While the pandemic certainly exposed the frailty of the global supply chain, a closer examination suggests that an overreliance on China with respect to manufacturing, labor and raw materials is how the current situation differs from the past. US companies began manufacturing in China ~40 years ago as a source of cheap labor, and in the last couple of decades, US manufacturing employment has continued to fall (Exhibit 45). During the same period, China has become a global industrial powerhouse with its highly efficient manufacturing facilities, myriad of raw materials, robust labor force and strong port infrastructure, accounting for almost 15% of global exports in 2020, as per the UNCTAD. In addition, its huge population and growing middle class has made it an attractive place for companies to do business – in 2020, China's e-commerce sales totaled \$2.4 trillion, dwarfing US' \$792 billion.

Exhibit 45: US Manufacturing Employment Has Been Falling Steadily Since 2001



Source: BMO Capital Markets Investment Strategy Group, BLS.

This much we know. But where do we go from here and how will companies attempt to minimize the literal and figurative "bite" that has transpired?

Frankly, the pendulum has swung too far. As such, moderation, normalization, and common sense all point toward a structural, if not secular change in supply chain management. We believe at least part of the answer is already under way – ***onshoring***.

Onshoring / Reshoring Has Become a More Viable Option

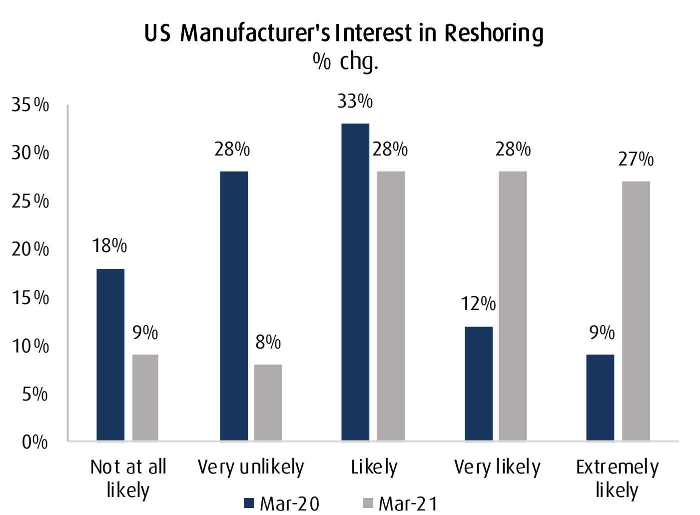
Certain Industries Are More Likely to Move Back Home

In the US, the effects of COVID-19 combined with a rise in nationalism have led to onshoring (or reshoring) emerging as one of the solutions to address the supply chain issues, e.g., by bringing manufacturing back home. According to Thomas' 2021 State of North American Manufacturing Report, US manufacturer's interest in reshoring significantly increased as of March 2021 with 83% of the polled manufacturers indicating they are extremely likely to reshore, compared to 54% a year prior (Exhibit 46). The arguments for reshoring are clear: proximity to customers / markets, supply chain optimization, less lead times, increase in domestic jobs and technological advances, but the complexity of the global supply chain needs to be factored in when considering this move. Incentives provided by the government in the form of direct funding, tax breaks, and legislation could determine which industries are more susceptible to moving back home. For example, certain manufacturing processes that produce components critical to national security, such as aerospace and defense, personal protective equipment, medical devices, and pharmaceuticals will likely receive stronger and near-term support. Also, high tech manufacturing including computers, electronics, electrical equipment and components which have high R&D budgets and potential security breach concerns will be beneficiaries as the government looks to strengthen areas that were previously outsourced abroad. Exhibit 47 shows how certain sectors added new suppliers in the face of supply chain challenges last year.

Reshoring Poses Certain Challenges

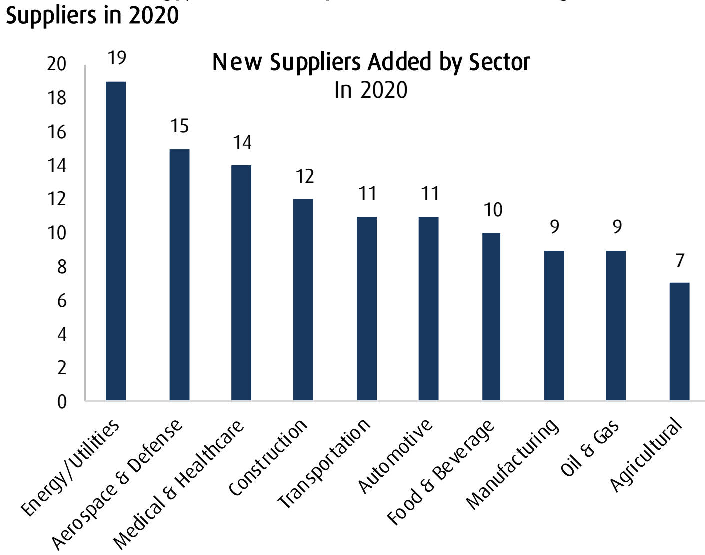
Reshoring is not without its challenges – higher costs for labor and materials, lack of infrastructure and skilled labor, and increased automation to cut production costs. The decades of relying on Chinese manufacturing has significantly reduced US manufacturing footprint, and along with it, the expertise and labor skills. There will be significant upfront costs to build up the infrastructure necessary to match the levels of efficiency and expertise achieved abroad and as such, companies must provide advanced training to build a technically skilled workforce. Another consideration is environmental regulations. Chinese companies are permitted to use certain processes that are being phased out and / or banned in the US, for instance, plating chemicals, which are used in a number of industries including aerospace and defense, automotive, machine parts, and medical devices. As environmental rules become more stringent under the Biden administration, companies will have to spend millions of dollars to set appropriate measures in place to control pollution, an added cost to the factors mentioned above.

Exhibit 46: Significant Increase in Reshoring Interest in the US



Source: BMO Capital Markets Investment Strategy Group, Thomas State of North American Manufacturing 2021 Annual Report.

Exhibit 47: Energy/Utilities Companies Added an Average of 19 New Suppliers in 2020



Source: BMO Capital Markets Investment Strategy Group, Thomas State of North American Manufacturing 2021 Annual Report.

Implications for Industries and Sectors

Industrials - Automotives: Revamp of The Supply Chain

From a reshoring perspective, we think automotives will be one of the earlier beneficiaries given its reliance on overseas suppliers for parts and components and its vertically integrated supply chain. The vulnerability of the auto supply chain was exposed during the pandemic as the supply of basic raw materials like steel, aluminum and resin became unreliable and prices were incredibly volatile. Factory shutdowns, soaring labor and transportation costs, and tariff wars exacerbated the situation and led to longer lead times, which the automotive supply chain was not equipped to deal with, especially when consumer demand bounced back in the fourth quarter of 2020. More recently, the global microchip shortage has delayed production of vehicles across the industry. As such, the industry is likely in need of a fundamental restructuring to reduce the level of interdependency and increase resilience to future disruptions. If some of the suppliers along the automotive supply chain were to be brought closer to home, the chance of risk in terms of transportation and materials could potentially be reduced. Specifically in North America, there is the newly minted USMCA which spells out terms of trade between the US, Mexico and Canada, conducive to certain sectors such as autos. Mexico, in addition to cheap labor cost, has a large manufacturing base including major Original Equipment Manufacturers (OEMs) and Tier I and Tier II organizations. Ontario is currently the only place in North America where five major automakers build vehicles – Fiat Chrysler, Ford, General Motors, Honda, and Toyota – and Ford and GM continue to invest in plants in Canada to build new vehicles, particularly autonomous and electric vehicles (EVs).

No More Just in Time (JIT)

Another side thought: on top of where they manufacture, companies may be reconsidering how they make the vehicles. Just in time production, which was developed by Toyota in the early 1970s and popularized by Dell in the 90s, has been the standard in manufacturing, for a variety of reasons such as strict inventory management and lower costs. However, this system only works when all the elements along the supply chain are in perfect unison. The disruption caused by the pandemic and the model's lack of flexibility and ability to scale up (or down) has proved that going forward, companies are more likely to switch to 'Just available production' whereby stockpiled inventory and alternative sources of materials are the norm. Ford and Toyota announced they are stockpiling larger quantities of critical semiconductors and Nissan plans to revamp its inventory management model after grappling with supply chain "fragility".

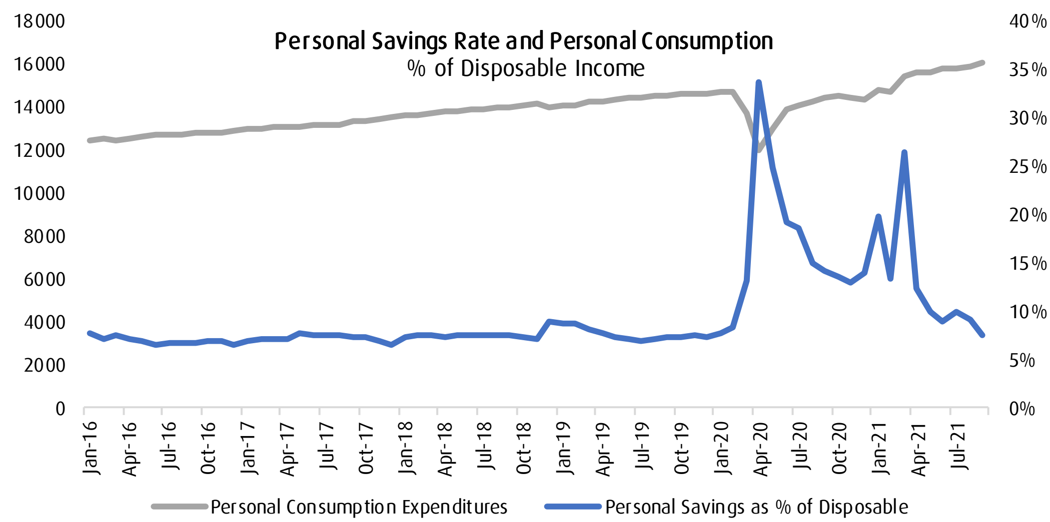
Potential Supply Glut in Semiconductors? We Think the Answer Is *YES*

On the flip side, could there be sectors where a supply glut is possible? The semiconductor industry experienced one of its worst supply chain challenges in 2020 as the pandemic forced many chipmakers to suspend production, predominantly in Southeast Asia where pandemic-induced shutdowns occurred early at the onset. With the rise of electric cars, digitization and 5G wireless, semiconductors are now indispensable components across industry lines. Lead times, which measure how long it takes to obtain a semi component from when the order is placed, increased overall for 75% of all semiconductor parts in the past year, according to IHS Markit. Industry insiders and market analysts generally expect the global ship shortage will drag on into 2022 and even 2023 as robust end market demand exceeds supply. However, as consumer demand rebounded at the end of 2020 and chipmakers moved to ramp up production in early 2021, total inventory at the world's nine biggest chip makers hit a record high of $65 billion at the end of June, according to Nikkei Asia, conjuring the possibility of a parts bottleneck precipitating an inventory glut. Because of the expected continued demand, chipmakers have been stockpiling raw materials to drive production, and as such, there could be a point in 2022 where the relationship between supply and demand reverse. Several companies, including Ford, in its 3Q 2021 earnings press release, noted there were significant increases in semiconductor availability in the quarter compared to the previous quarter, as mentioned also by GM. BMO Research notes in its 3Q Semiconductor earnings review that there is finally easing in the supply chain for broader semis, besides PCs, while semiconductor shortages are also easing up for the automakers.

Prospects for the Retail Sector Are Actually Positive

Another sector that has been heavily disrupted by the supply chain is consumer retail. Supply chain woes from shipment delays due to bottlenecks at factories, ports, and on containerships sent costs skyrocketing, squeezed margins, and created inventory shortfalls, and as the holiday shopping season approaches, retailers are setting expectations for limited availability and potential delays. However, we do not believe the prospects for the sector are as dire as one may expect. First off, consumers are spending more than ever – the sector was hit hard by pandemic shutdowns in mid-2020 but consumer spending rebounded quickly as shopping resumed online and in stores. In fact, our work shows consumer spending reverted to pre-pandemic levels by the summer of 2020 and has continued to rise (Exhibit 48). Secondly, consumers are well aware of supply chain delays, and are looking to return to physical stores at a faster pace than ever. Coresight Research notes the majority of consumers will adopt an omni-channel strategy and shop at brick and mortar, as well as online, to complete their holiday purchases. Lastly, contrary to belief, retailers continue to open physical stores – retailers announced 4,969 store openings so far in 2021, which represents a 58.3% increase over last year, according to Coresight Research. A recent in-depth research report by BMO Capital Markets research analyst, Simeon Siegel, and his team supports this point, i.e., the benefits of shifting to DTC (even amid meaningful ecommerce growth) became a brand enhancing and image elevating benefit in the last decade, but not the total revenue and margin lift that everyone expects, and in fact, brick and mortar generates higher gross margins. In addition, while the supply chain crunch has limited inventory, retailers are getting a boost in profitability because of the ability to charge higher prices, which in turn is elevating margins across the board for retailers.

Exhibit 48: Personal Consumption Expenditures Continue to Rise



Source: BMO Capital Markets Investment Strategy Group, FactSet, BEA.

Demand for Space Outstripping Supply of Industrial Storage

As hundreds of thousands of shipping containers start making their way to land after facing record backlog at US ports, demand for space to store the goods in these containers are outstripping the available warehouse capacity. Warehouse vacancy in the US has reached a record low of 3.6%, according to CBRE, a commercial real estate services and investment firm, whereas a 15% availability rate is ideal for operating efficient supply chains. Warehouses in the port of Los Angeles, the largest port in North America, have recorded the lowest vacancy ever at 1%, and warehouse vacancy at ports in central and northern New Jersey are at around 2%. As such, land around ports is becoming increasingly in demand and prices are spiking, while distribution centers, which store the goods arriving from warehouses and serve as a middleman before the goods are sent out to brick and mortar businesses, are in high demand. Large retailers are acquiring or developing their own fulfillment or distribution centers as a long-term investment to meet the increasing demand from online shopping and e-commerce. Industrial real estate in recent years has been one of the best-performing sectors in US property markets – according to data analytics firm Green Street, property values in the sector grew 39% over the last 12 months, compared to 20% growth in all commercial property, during the same period. The 25 largest retailers owned 155 million square feet in industrial space at the end of 2020, a more than 5x increase from 10 years ago, according to CoStar, and while leases still constitute the majority of real estate, the gap is certainly narrowing. Adding in the fact that many organizations will no longer rely on 'just in time' inventory and keep extra supplies, materials, and goods on hand, the usage of storage space will continue to grow, bolstering demand for industrial space and land.

Conclusion

There is no denying that supply chain disruptions have generated escalated inflation, earnings and operational fears among companies and consumers alike. While the "supply-chain-blame-game" is sure to be a consistent theme heading into 2022 to mask other inefficiencies or issues, we continue to believe the most important variable to gauge is duration. In other words, it is not "if," but "when" the supply chain bottlenecks transition from excess demand to oversupply. Furthermore, the most likely outcome of these disruptions almost has to be onshoring, which will ultimately generate better operating efficiencies and more consistent growth expectations from North American companies.

Sectors, Size, and Style Recommendations

US Sector Opinions

Exhibit 49: US Sector Opinion Summary

Sector	Opinion	Index Weight	Target Weight	BMO Investment Strategy Group Headline
Communication Services	MW	10.8	11.0	Classic investment barbell with Media and Telecoms on the value/dividend side and Entertainment and Interactive Media & Services on the growth side; 3 C's= Cash + Content + Cannibalism
Consumer Discretionary	OW	12.8	13.5	Not just an AMZN + TSLA story despite these stocks comprising half the sector; Earning growth set to accelerate further in 2022; Focus on best in brand names
Consumer Staples	UW	5.6	4.0	Solid US economic backdrop remains a headwind; Be selective with a focus on Food & Staples Retailing
Energy	MW	2.8	3.0	Surge in crude oil has led to ENRG outperformance, but is unlikely to be sustained longer-term as forecasts indicate supply/demand dynamics will be well-balanced in 2022; Fundamentals still in recovery mode
Financials	OW	11.2	13.0	Improving economy + rising rates should be tailwinds; Attractive valuations and rebound in shareholder distributions also positives; Focus on scale – money center banks, brokers, asset managers
Health Care	MW	12.8	12.0	Valuations relative to overall market are well-below historical norms, but quality attributes have been deteriorating; Look to products – biotech, drugs, and devices
Industrials	OW	8.1	8.5	Can continue to benefit from the economic recovery and market rotations into cyclicals; Tilt toward domestic-oriented names; Should be a primary beneficiary of infrastructure spending
Information Technology	MW	28.4	27.5	5 buckets: secular, structural, cyclical, defense (dividends), and hyper-growth; Stock selection is key; Maintain secular growth positions, while using other areas for alpha generation
Materials	OW	2.6	3.5	Profitability and free cash flow have substantially rebounded; Another potential beneficiary of infrastructure spending; Stay diversified- select base metals, paper, and chemicals
Real Estate	MW	2.6	2.5	**Upgrade from Underweight:** FFO growth improving; Dividend growth turning a corner and starting to accelerate; More sensitive to economy than other yield proxies
Utilities	UW	2.3	1.5	Uptick in rates likely to hinder returns; Offers healthy yield, but dividend growth has notably waned

Source: BMO Capital Markets Investment Strategy Group; Key: OW: Overweight, MW: Market Weight, UW: Underweight

Key Sector Changes

- **Real Estate to Market Weight from Underweight**

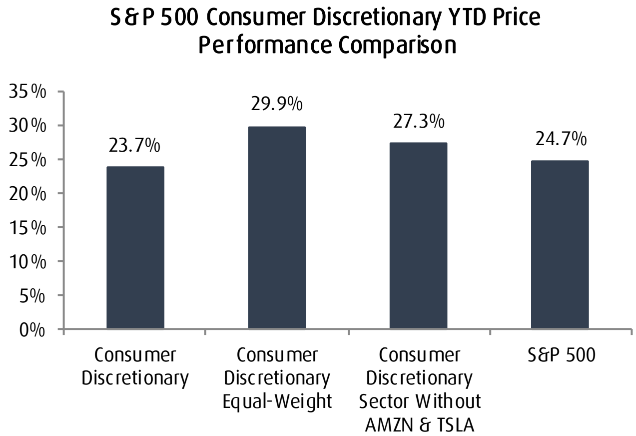
Exhibit 50: S&P 500 Annual Sector Performance

Year	COMSV	COND	CONS	ENRS	FINL	HLTH	INDU	INFT	MATR	RELS	UTIL	SPX
1990	-17.7%	-14.9%	12.4%	-1.4%	-42.1%	14.1%	-10.2%	0.3%	-13.9%		-7.3%	-6.6%
1991	7.9%	38.3%	38.4%	2.4%	43.8%	50.2%	26.0%	6.6%	21.5%		16.0%	26.3%
1992	11.0%	17.5%	3.0%	-2.3%	19.8%	-18.1%	6.8%	0.6%	7.2%		0.3%	4.5%
1993	10.8%	12.8%	-6.3%	11.2%	7.8%	-11.0%	15.8%	20.5%	10.5%		7.8%	7.1%
1994	-8.4%	-9.9%	6.8%	-0.4%	-6.4%	10.2%	-4.8%	19.1%	3.3%		-17.2%	-1.5%
1995	37.3%	18.2%	36.2%	26.0%	49.6%	54.5%	35.9%	38.8%	17.3%		25.2%	34.1%
1996	-2.2%	10.5%	23.2%	21.7%	31.9%	18.8%	22.7%	43.3%	13.4%		0.2%	20.3%
1997	37.1%	32.3%	30.5%	22.0%	45.4%	41.7%	25.0%	28.1%	6.3%		18.4%	31.0%
1998	49.3%	39.6%	13.9%	-2.0%	9.6%	42.3%	9.3%	77.6%	-8.0%		10.0%	26.7%
1999	17.4%	24.1%	-16.6%	16.0%	2.3%	-11.6%	19.9%	78.4%	23.0%		-12.8%	19.5%
2000	-39.7%	-20.7%	14.5%	13.2%	23.4%	35.5%	4.5%	-41.0%	-17.7%		51.7%	-10.1%
2001	-13.7%	1.9%	-8.3%	-12.3%	-10.5%	-12.9%	-7.0%	-26.0%	1.0%		-32.5%	-13.0%
2002	-35.9%	-24.4%	-6.3%	-13.3%	-16.4%	-20.0%	-27.6%	-37.6%	-7.7%	-15.1%	-33.0%	-23.4%
2003	3.3%	36.1%	9.2%	22.4%	27.9%	13.3%	29.7%	46.5%	34.8%	20.8%	21.1%	26.4%
2004	16.0%	12.1%	6.0%	28.8%	8.2%	0.2%	16.0%	2.1%	10.8%	21.9%	19.6%	9.0%
2005	-9.0%	-7.4%	1.3%	29.1%	3.7%	4.9%	0.4%	0.4%	2.2%	7.4%	12.8%	3.0%
2006	32.1%	17.2%	11.8%	22.2%	16.2%	5.8%	11.0%	7.7%	15.7%	36.8%	16.9%	13.6%
2007	8.5%	-14.3%	11.6%	32.4%	-20.8%	5.4%	9.8%	15.5%	20.0%	-20.5%	15.8%	3.5%
2008	-33.6%	-34.7%	-17.7%	-35.9%	-56.9%	-24.5%	-41.5%	-43.7%	-47.0%	-45.0%	-31.5%	-38.5%
2009	2.6%	38.8%	11.2%	11.3%	14.8%	17.1%	17.3%	59.9%	45.2%	20.8%	6.8%	23.5%
2010	12.3%	25.7%	10.7%	17.9%	10.8%	0.7%	23.9%	9.1%	19.9%	28.0%	0.9%	12.8%
2011	0.8%	4.4%	10.5%	2.8%	-18.4%	10.2%	-2.9%	1.3%	-11.6%	7.9%	14.8%	0.0%
2012	12.5%	21.9%	7.5%	2.3%	26.3%	15.2%	12.5%	13.1%	12.2%	16.2%	-2.9%	13.4%
2013	6.5%	41.0%	22.7%	22.3%	33.2%	38.7%	37.6%	26.2%	22.7%	-1.5%	8.8%	29.6%
2014	-1.9%	8.0%	12.9%	-10.0%	13.1%	23.3%	7.5%	18.2%	4.7%	26.1%	24.3%	11.4%
2015	-1.7%	8.4%	3.8%	-23.6%	-3.5%	5.2%	-4.7%	4.3%	-10.4%	1.2%	-8.4%	-0.7%
2016	17.8%	4.3%	2.6%	23.7%	20.1%	-4.4%	16.1%	12.0%	14.1%	0.0%	12.2%	9.5%
2017	-6.0%	21.2%	10.5%	-3.8%	20.0%	20.0%	18.5%	36.9%	21.4%	7.2%	8.3%	19.4%
2018	-16.4%	-0.5%	-11.2%	-20.5%	-14.7%	4.7%	-15.0%	-1.6%	-16.4%	-5.6%	0.5%	-6.2%
2019	30.9%	26.2%	24.0%	7.6%	29.2%	18.7%	26.8%	48.0%	21.9%	24.9%	22.2%	28.9%
2020	22.2%	32.1%	7.6%	-37.3%	-4.1%	11.4%	9.0%	42.2%	18.1%	-5.2%	-2.8%	16.3%
2021	24.5%	26.1%	8.4%	50.6%	34.2%	17.6%	20.0%	28.9%	22.3%	32.8%	6.7%	24.8%

Source: BMO Capital Markets Investment Strategy Group. Performance calculated through 11/17/21. REITs are used as a historical proxy for the Real Estate sector, which was officially established in Sept. 2016.

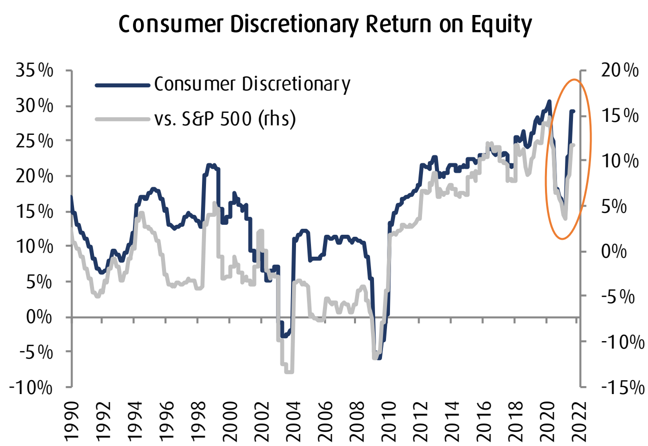
Overweight: Consumer Discretionary

Exhibit 51: Consumer Discretionary Equal Weight Index Is Outpacing Its Market Cap Weighed Counterpart So Far in 2021



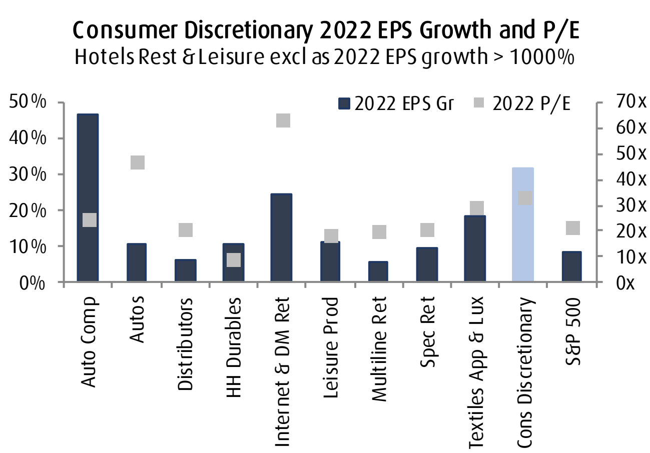
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 52: Swift Profitability Rebound Recorded by COND Sector



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 53: Consumer Discretionary Stocks Forecasted to Post 2022 EPS Growth 4x That of Broader Market



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Perspective: Consumer Discretionary Is NOT Just an Amazon and Tesla Story

- Despite Amazon and Tesla accounting for nearly 50% of S&P 500 Consumer Discretionary, these two stocks should not be the singular focus for investors when researching the sector.
- While Consumer Discretionary is essentially a market performer YTD at the time of writing, a hypothetical sector without AMZN & TSLA would yield a YTD price return that is more than three percentage points higher.
- In addition, the S&P 500 Consumer Discretionary Equal Weight index is currently outpacing its market cap weighted counterpart by more than six percentage points YTD, indicating that many stocks are performing well. In fact, almost 60% of stocks in the sector are posting above-market price returns in 2021.

Fundamentals: Discretionary ROE Has Sharply Rebounded and Moving Closer to Its All-Time High

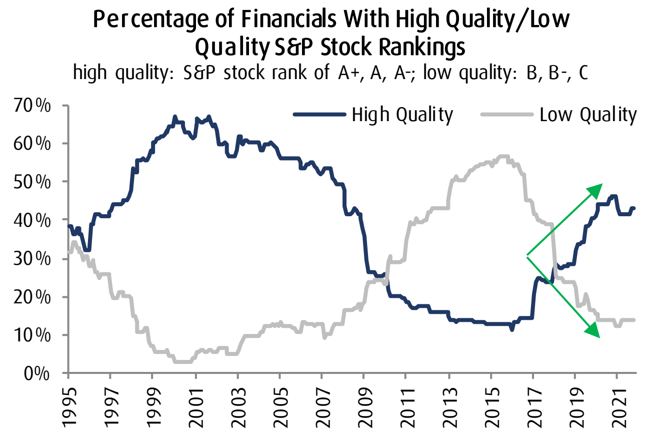
- After plummeting to a ten-year low amid the pandemic, return on equity for the Consumer Discretionary sector has sharply rebounded in recent quarters, and is quickly approaching its record high set toward the end of 2019.
- While the profitability rebound for Discretionary stocks has eclipsed the recovery rate for the overall market, relative ROE has a bit more room to accelerate in order to reach its all-time high, potentially leaving more profitability upside in the group.

Fundamentals: For Investors Seeking Growth, Consumer Discretionary May Be the Place to Search

- Consumer Discretionary is estimated to grow 2021 earnings by 68% and register a 32% growth clip in 2022, which is the second highest among sectors after Industrials.
- For investors seeking growth, Consumer Discretionary may be a good place to search as seven of its nine industries are expected to grow 2022 EPS at an above-market pace with Auto Components, Internet & Direct Marketing Retail, and Textiles Apparel & Luxury Goods leading the way.
- Despite these high EPS growth numbers, not all industries have a premium multiple. Household Durables, Leisure Products, and Multiline Retail all have NTM P/E ratios <20x.

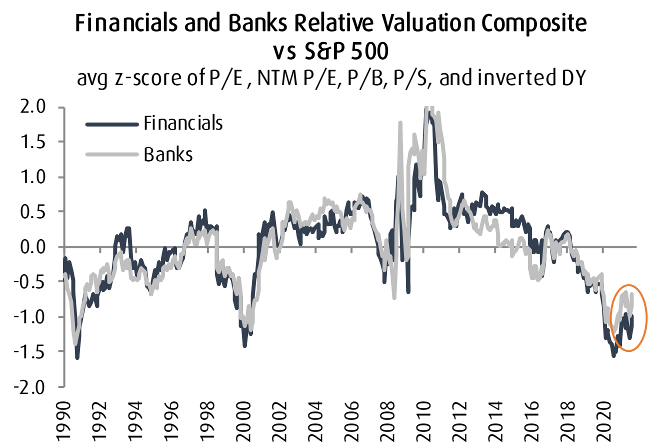
Overweight: Financials

Exhibit 54: S&P 500 Financials Represents a Hefty Portion of the High Quality Trade



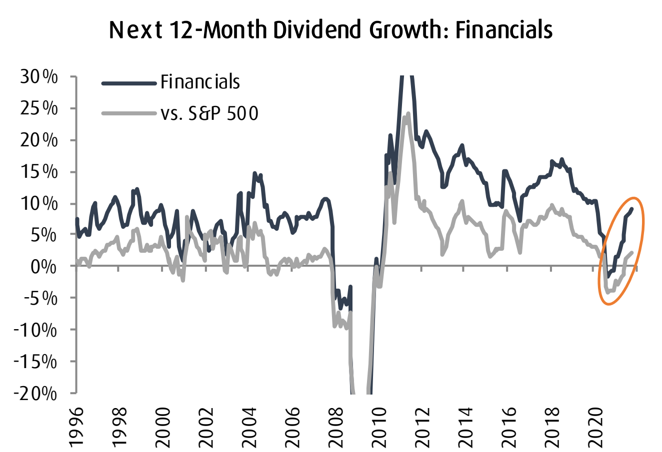
Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P.

Exhibit 55: FINS and Banks' Valuations vs. S&P 500 At Substantial Discounts to Historical Averages



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 56: Sharp Recovery in NTM Dividend Forecasts for FINS



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Perspective: An Investor Shift Toward High Quality Should Benefit Financials as Nearly 50% of Sector Is Comprised of High Quality Stocks

- Over the past six years, there has been a significant shift in the quality composition of S&P 500 Financials, with S&P stock rankings of A+, A, or A- currently comprising ~43% of the sector (vs. ~13% in 2015), and stock rankings of B, B-, or C now making up just 14% (vs. ~55% in 2015).
- This transition toward high quality within Financials, in our view, has been a testament to the fundamental improvement in the group from a leverage, cash flow, and dividend growth perspective.

Fundamentals: Financials and Banks, In Particular, Continue to Be Excellent Value Propositions

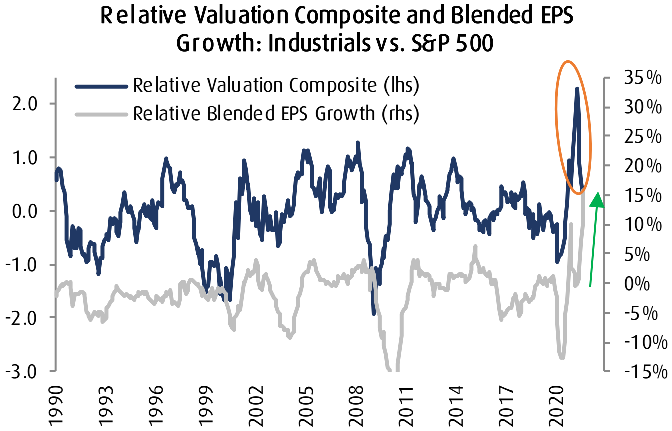
- Financials continue to be one of the most attractive S&P 500 sectors from a valuation standpoint.
- Our relative valuation composite for Financials and Banks, the largest industry within the sector, both sit well below historical norms at around 1.0 and 0.7 standard deviations lower than their averages going back to 1990, and are still not far off their recessionary levels.
- While tough y/y comps will likely limit EPS growth for the group in the coming quarters, we still expect corporate earnings to surprise to the upside and annual bottom-up EPS to tick higher throughout the year, which should provide support for Financials' valuations.

Fundamentals: Dividend Growth Expectations for the Next 12 Months Accelerating for Financials

- We believe a recovery in shareholder distributions could provide a notable tailwind for Financials in 2022.
- Dividend growth for Financials has already substantially improved with 55 dividend increases occurring so far this year, more increases than any other S&P 500 sector.
- Looking ahead, Financials are expected to grow dividends per share by 9.2% over the next 12 months, the second-highest clip across sectors after Consumer Discretionary. The forward DPS trend has also been a positive attribute for the group. The NTM dividend growth forecast for Financials has accelerated since the latter part of 2020 and has now surpassed the S&P 500 clip for four straight months.

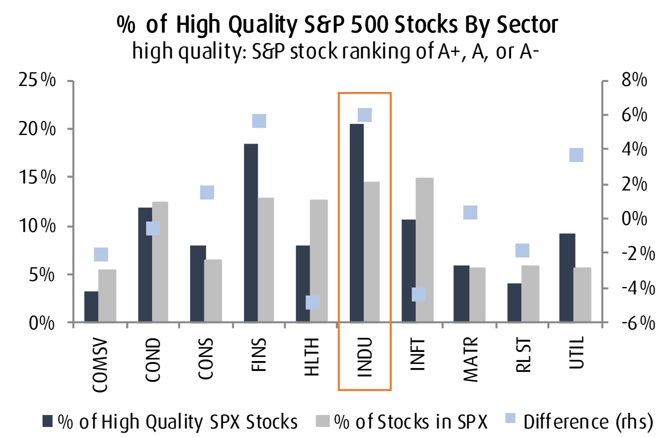
Overweight: Industrials

Exhibit 57: INDU Relative Valuation Contraction Has Been Biggest On Record



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 58: Industrials Comprise More High Quality Stocks Than Any Other S&P 500 Sector



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P.

Exhibit 59: Be Selective in INDU With a Tilt Toward US Exposure

S&P 500 Industrials Comparison: Domestic vs. Foreign

median values; Domestic/Foreign based on Industrials stocks with 5Y avg foreign sales exposure less than/greater than sector %

	Industrials Stocks: Domestic Exposure	Industrials Stocks: Foreign Exposure
Avg 5Y Foreign Sales Exposure	15.6%	48.5%
FY2 P/E	20.4x	22.8x
FY2 EPS Growth	12.3%	11.8%
Return on Assets	8.5%	6.1%
Return on Equity	24.5%	15.9%
EBIT Margin	17.2%	16.6%
Free Cash Flow Yield	3.7%	3.4%

Source: BMO Capital Markets Investment Strategy Group, FactSet.

Fundamentals: Relative Valuation for Industrials Has Seen Significant Contraction, While Blended Earnings Growth Continues to Accelerate Against Market Rate

- The robust corporate earnings backdrop for Industrials should help support these stocks in the months ahead. Blended EPS growth for Industrials is in a firm uptrend relative to the overall market and the sector is currently estimated to top all S&P 500 groups in terms of calendar year earnings growth for both 2021 and 2022.
- Rising earnings and positive revisions, along with the recent relative price weakness among Industrials' stocks, have improved our valuation composite for the sector vs. the S&P 500 to a 0.13 z-score. In fact, this five-month downtick in Industrials' relative valuation represents the sharpest contraction on record, based on our work.

Fundamentals: A Shift Toward High Quality Stocks Should Benefit Industrials

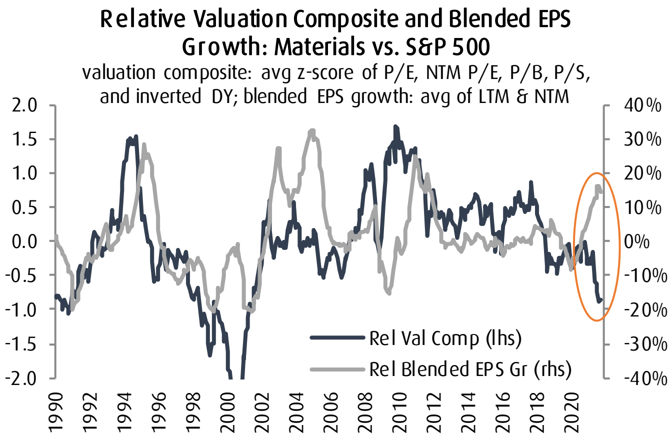
- As we have discussed in our commentary in recent months, we believe investors should be tilting their portfolios to high quality stocks heading into 2022 as market volatility picks up and the investor anxiety quotient moves higher.
- Industrials should be a primary beneficiary of a shift toward high quality as ~21% of S&P 500 constituents with S&P stock rankings of A+, A, or A- come from this sector, more than any other group.
- And while Industrials do have the second most number of S&P 500 constituents (after Technology), comprising 14.5% of the index, its high quality representation is 6.1 percentage points above that number, the largest delta of any sector, which further emphasizes the high quality tilt in Industrials.

Perspective: Fundamentals for Industrials With Primarily US Exposure Appear More Attractive Than Foreign Exposure Counterparts

- We continue to hold an Overweight recommendation on the S&P 500 Industrials sector overall, but given the diversity of the group, we believe investors should also be picking their spots when adding exposure to the sector.
- From our perspective, a tilt toward the more domestically oriented companies should be beneficial as our work shows that these names have largely superior underlying fundamentals compared to their counterparts with heavier foreign sales exposure.

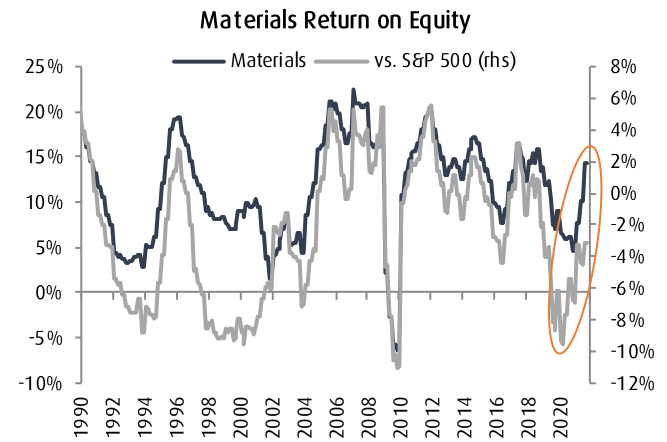
Overweight: Materials

Exhibit 60: Sharp Underperformance During Most of 2H Plus Solid LTM EPS Growth Has Left MATRS Multiples at Substantial Discounts



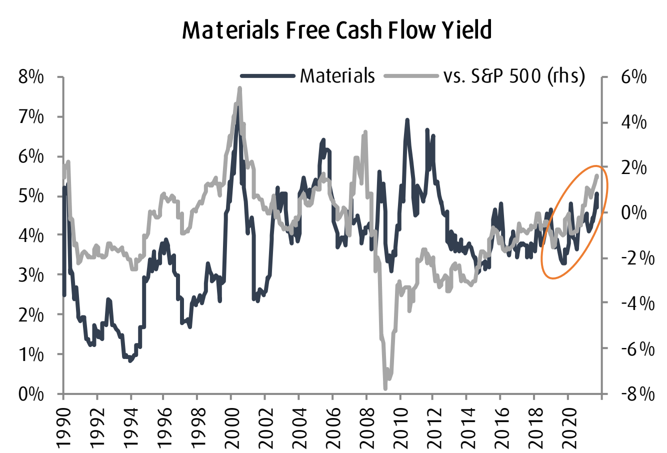
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 61: Materials Return on Equity Continues Its Recovery



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 62: Free Cash Flow Generation Among Materials' Stocks Still Gaining Steam



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Perspective: Relative Valuations for Materials Near 20-Year Lows as Blended EPS Growth Holds Firm

- Materials blended earnings growth has continued its upward trend versus the S&P 500 and now stands at its highest rate since 2011. And although EPS growth in the coming quarters is set to decelerate due to tough y/y comps, we are still bullish on the earnings outlook for the group, especially given the $1 trillion infrastructure bill just passed by the House, which could provide a tailwind for Materials' 2022 EPS.
- Solid earnings growth combined with sharp underperformance through most of the back half of 2021 versus the overall market has pushed relative valuation for Materials to its lowest levels in 20 years.

Fundamentals: Profitability for Materials Approaching Previous Cycle Highs

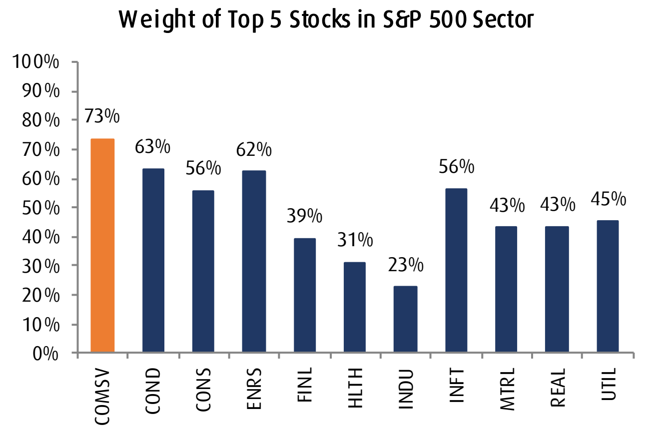
- Return on equity for the Materials sector remains in recovery mode after plummeting to 10-year lows during the height of the pandemic.
- Profitability has strongly rebounded since troughing back in Q4'20 with ROE quickly approaching prior cycle highs.
- On a relative basis versus the S&P 500, Materials return on equity is still well-below its historical average, leaving much more upside for profitability even to just return to more normalized levels compared to the overall market.

Fundamentals: Materials Relative Free Cash Flow Yield Versus S&P 500 Has Increased to its Highest Level Since 2008

- Cash flow generation has been a standout attribute for Materials this year and we expect this trend to continue into 2022. The sector is displaying an above-market free cash flow yield that continues to rise relative to that of the S&P 500.
- In fact, free cash flow yield for Materials has increased to its highest level since 2012, while its FCF yield relative to the overall market has risen to levels not seen since 2008.

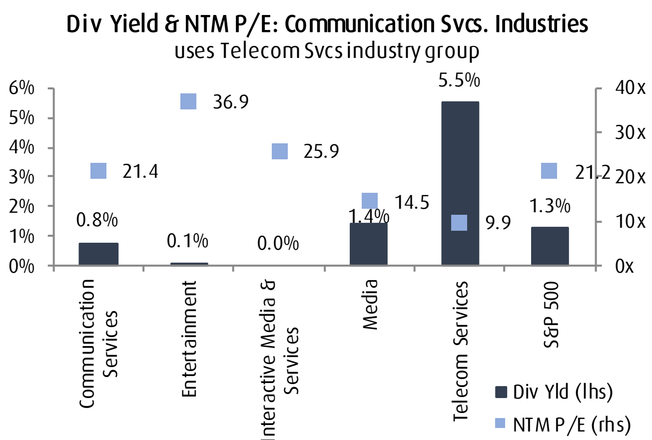
Market Weight: Communication Services

Exhibit 63: COMS Is the Most Heavily Concentrated S&P 500 Sector



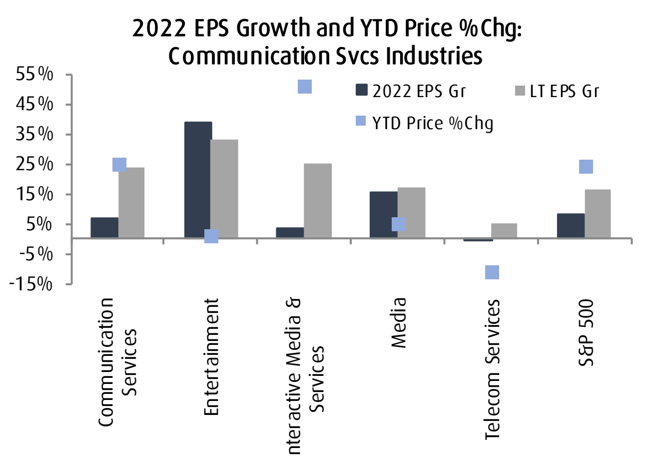
Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P

Exhibit 64: Telecoms Offer a Strong Dividend Yield at a Reasonable Price, While Media Could Be a Value Proposition



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 65: Interactive Media & Svcs Has Driven YTD Returns, While Entertainment Has Lagged Despite Strong Growth Properties



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Perspective: Top Five Stocks in Communication Services Make Up 73% of Sector, More Than Any Other Group

- Communication Services is the most concentrated S&P 500 sector with the top five stocks – Alphabet, Meta, Disney, and Netflix – constituting ~73% of the group. As a result, the sector can be particularly vulnerable to sharp moves in and out of these secular growth names especially given the frequent market rotations among style strategies this year.

- We remain very bullish on Communication Services over the longer-term but from an investment strategy standpoint for 2022, we would advise investors to maintain positions in some of the key secular growth stocks, while searching for names outside of the big five in order to generate alpha.

Fundamentals: Communication Services Is its Own Investment Barbell With Media and Telecom Services on the Value Side...

- As we have discussed since the GICS reclassification in 2018, Communication Services can essentially be described as a barbell with growth stocks on one side and value/dividend payers on the other side.

- Telecom Services and Media fall on the value side of the barbell. Telecoms could be an attractive opportunity for those investors looking for yield at a reasonable price as the industry offers a 5.5% dividend yield while trading at a 9.9x NTM P/E multiple.

- Media also has a solid dividend yield of 1.4%, slightly above the S&P 500 yield and trades at a substantial valuation discount to the market.

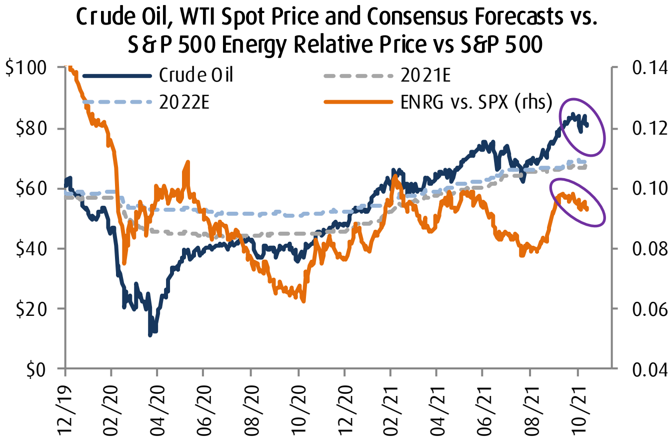
Fundamentals: ... And Entertainment and Interactive Media and Services on the Growth Side of the Barbell

- Interactive Media & Services, the largest industry within Communication Services, has been a major driver of the sector's returns in 2021 with the group up more than 50% YTD. Secular growth names, like Alphabet, have been key contributors to not only price returns, but also the 25%+ EPS long-term growth rate for the industry.

- Entertainment, which includes stocks like Netflix and Disney, are part of the growth side of the barbell. The industry is forecasted to grow 2022 EPS by 39%, highest in Communication Services, and is on pace to register a 51% growth rate in 2021.

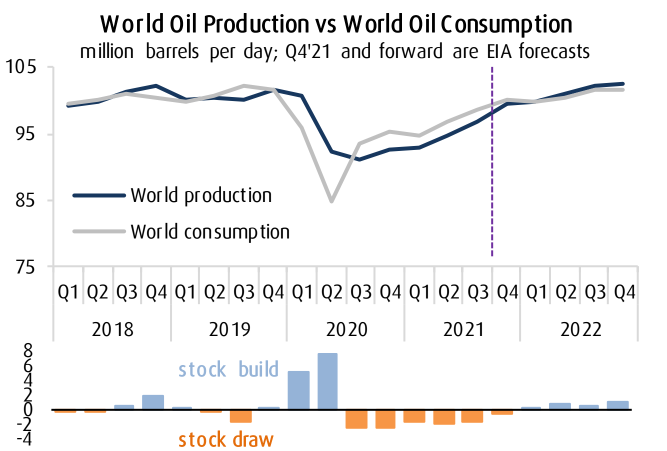
Market Weight: Energy

Exhibit 66: Crude Oil Estimates Suggest Prices Will Wane in 2022



BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 67: Oil Consumption Slated to Exceed Production For 6th Straight Quarter in Q4, but Then Turn More Balanced in 2022



Source: BMO Capital Markets Investment Strategy Group, FactSet, EIA.

Exhibit 68: After Last Five Demand > Supply Cycles, WTI Price Declined in the Subsequent 12M Each Time, and ENRG Trailed SPX

S&P 500 Energy Relative Price Performance During and After Excess World Oil Demand Cycles

*Q4'21 based on EIA forecast

		Performance During Excess Demand Cycle		Performance 12M Post Cycle	
Start to End of Cycle	Total Stock Draw	WTI Price %Chg	ENRG Price %Chg vs SPX	WTI Price %Chg	ENRG Price %Chg vs SPX
Q4'01 - Q1'03	-8.72	32.5%	8.7%	15.2%	-4.7%
Q4'06 - Q2'08	-10.21	122.5%	62.7%	-50.1%	-14.5%
Q3'10 - Q4'11	-3.17	30.7%	17.5%	-7.1%	-11.1%
Q3'12 - Q4'13	-3.24	15.8%	-6.2%	-45.9%	-21.4%
Q1'17 - Q2'18	-3.98	38.0%	-20.1%	-21.1%	-24.3%
*Q3'20 - Q4'21**	*-11.43*	*105.7%*	*0.1%*		
Avg (ex curr)	**-5.9**	**47.9%**	**12.5%**	**-21.8%**	**-15.2%**

Source: BMO Capital Markets Investment Strategy Group, FactSet, EIA.

Performance: The Surge in Crude Oil Has Pushed Prices Substantially Above 2021 & 2022 Target Price Forecasts

- The price of crude oil has surpassed the $80 threshold for the first time since 2014. With that said, however, it is important to point out that consensus target price forecasts have not moved significantly higher despite the surge in prices YTD.
- In fact, current forecasts for WTI crude stand at $67 and $69 for year-end 2021 and 2022, respectively, which would imply a $12-14 drop from the $81 price of crude right now.
- Therefore, we expect this bout of momentum-driven outperformance from Energy stocks to eventually subside, with the sector performing more in line with the broader market in the coming months – a development that we may have already started to see in recent weeks.

Fundamentals: EIA Projecting That World Oil Consumption and Production Will Become More Balanced in 2022 With Forecasts Suggesting a Stock Build

- World oil consumption is expected to eclipse oil production for the sixth straight quarter in Q4, according to forecasts from the EIA, which has certainly been a major factor in the surge in oil prices and subsequent Energy outperformance.
- However, the EIA forecasts that Q4'21 will mark the end of the current excess oil demand cycle as the group projects that world oil consumption and production will become more balanced in 2022.

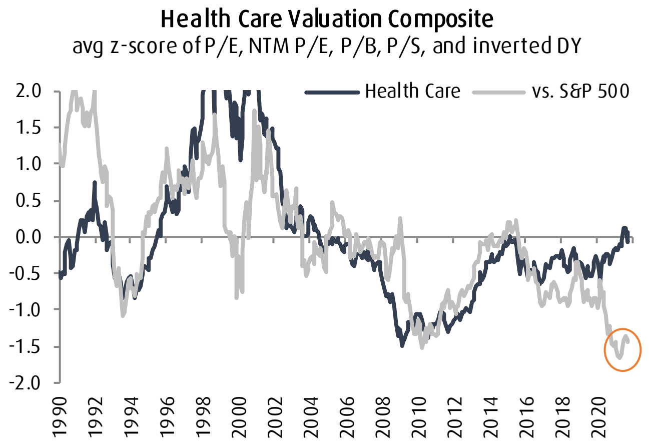
Perspective: Be Wary of Piling Into Energy as the Sector Typically Underperforms Following the End of Excess World Oil Demand Cycles

- Our analysis of EIA world oil consumption and production data since 1997 shows there have been five prior cycles in which consumption outstripped demand for > four straight quarters. During those periods, WTI increased ~48%, on average, while S&P 500 Energy outpaced the market by >12 pct pts.
- After the end of the cycle, oil prices were lower in the NTM each time with an average drop of 22%, while Energy lagged the S&P 500 by 15 pct pts. Now, we are not calling for this degree of underperformance in 2022. We simply wanted to point out this trend and caution the investors hoping to pile into Energy and expecting similar gains to 2021. We do believe Energy will give back some gains in the months ahead as the aforementioned oil dynamics play out, but likely end next year as a market performer as the sector's profitability and cash flow continues to recover.

BMO Capital Markets

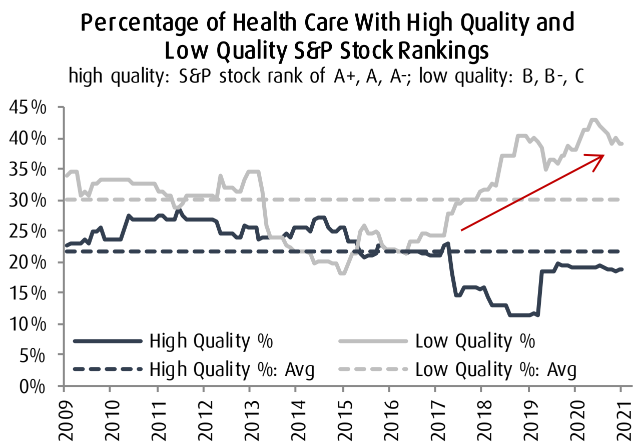
Market Weight: Health Care

Exhibit 69: Relative Valuations for Health Care Still Sit Below Prior Cycle Lows



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 70: Low Quality Stock Count Has Increased in HLTH Group



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P.

Exhibit 71: Pharma Offers Above-Mkt Dividend Yield at a Discount, While HC Providers & Svcs Could Be a 2022 GARP Play

S&P 500 Health Care: Industry Snapshot
excludes Health Care Technology which has only one constituent

Industry	2020 Price %Chg	YTD Price %Chg	NTM P/E	Div Yield	2022 EPS Growth
Biotechnology	5.9%	0.2%	10.7	2.7%	-2.6%
HC Equip & Supplies	17.7%	18.1%	29.9	0.8%	4.5%
HC Prov & Svcs	10.2%	27.8%	15.3	1.2%	6.5%
Life Scie Tool & Svcs	32.8%	31.1%	33.9	0.2%	-5.4%
Pharma	4.5%	16.0%	14.0	2.5%	4.9%
Health Care	**11.4%**	**17.7%**	**17.2**	**1.5%**	**2.9%**
S&P 500	**16.3%**	**24.7%**	**21.2**	**1.3%**	**8.1%**

Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Fundamentals: Health Care Valuations Look Appealing Especially on a Relative Basis Against the Overall Market

- Absolute valuation for Health Care is in line with historical norms, but when measured against the broader market, valuation for the sector sits at a significant discount to its historical average since 1990 and is below prior cycle lows.
- With Health Care performance trailing the S&P 500 in the past three months and throughout most of 2021, relative multiples have collapsed, leaving our relative valuation composite at a z-score of -1.5.
- Across the 11 S&P 500 sectors, Health Care is tied with Consumer Staples for the most inexpensive sector valuation versus the market, based on our relative valuation composite model.

Perspective: 39% of Health Care Stocks Rank as Low Quality, While Only 19% Are High Quality

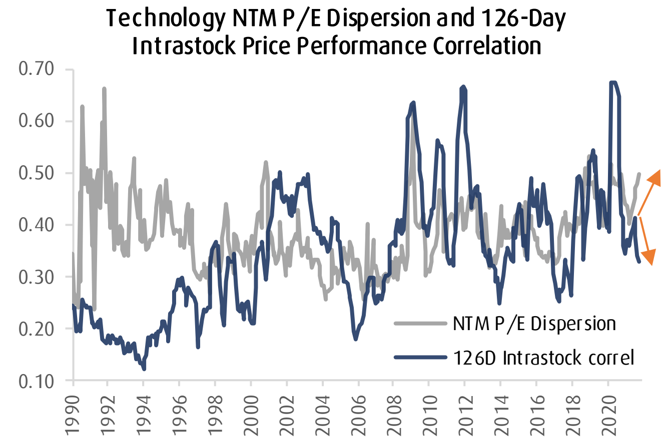
- Over the past four years, the percentage of S&P 500 Health Care with low-quality S&P stock rankings has notably increased, while the percentage of stocks with high quality rankings has moved slightly lower – not an attractive trend for the sector, in our view.
- High-quality currently makes up just 19% of the Health Care sector, below the 10-year average of 22%. Meanwhile, low quality stocks represent 39% of the group, compared to its 10-year average of 30%.
- This quality composition of Health Care suggests to us that investors need to be very selective when adding exposure.

Performance: Similar to 2020, Life Sciences Tools & Services Is Topping Gains YTD, While Biotech Is Significantly Lagging

- Similar to 2020, Health Care is trailing the S&P 500 in 2021 with performance among industries fairly dispersed. Life Sciences Tools & Services is once again leading gains in the sector, while Biotech is a substantial underperformer.
- Dividend yield-seeking Health Care investors may want to look to the Pharmaceuticals industry, which offers a ~120 bps dividend yield advantage compared to the overall sector and has a forward P/E that is three multiple pts below the sector.
- Health Care Providers & Services appears to have GARP attributes with a discounted NTM P/E and estimated 2022 EPS growth rate that tops all Health Care industries.

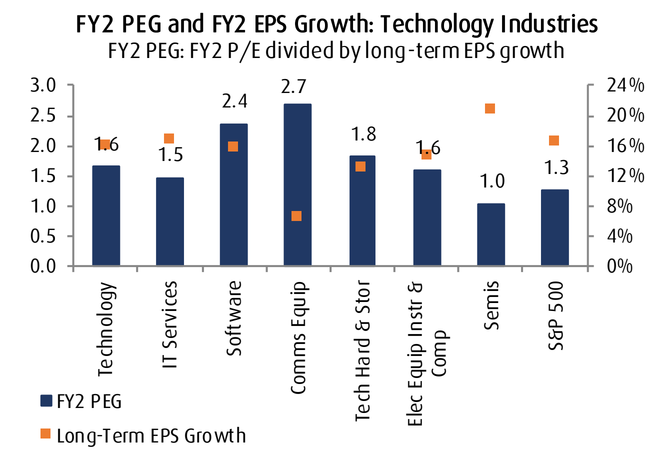
Market Weight: Information Technology

Exhibit 72: Rising P/E Dispersion + Falling Intrastock Performance Correlation = Stock Selection



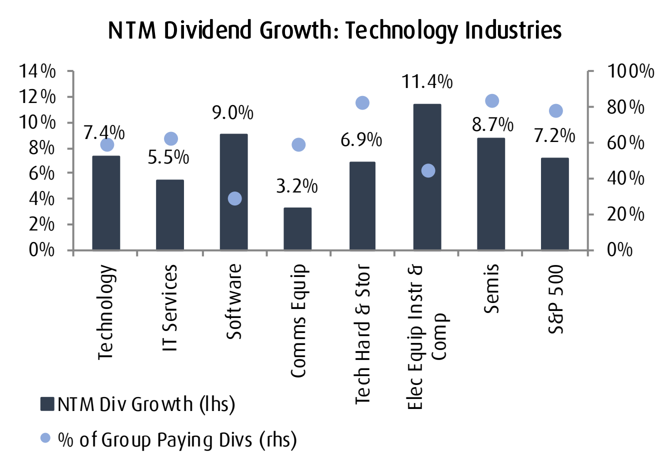
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 73: Pick Your Spots in Tech as Each Industry's Attributes May Appeal to Different Types of Investors



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 74: There Are Solid Dividend Payers Among Tech Stocks



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Perspective: Sector Characteristics Suggest an Active Approach Should Be Used Within Technology

- While we have a MW recommendation on Technology and believe investors should maintain a level of sector exposure in their portfolios that is roughly in line with the S&P 500 index weighting, sector dynamics indicate to us that an active investment strategy should be utilized for the group.
- NTM P/E dispersion among Information Technology stocks has increased to its highest level since October 2020, while the 126-day intra-stock performance correlation in the sector has dropped to a three-year low -both of which represent attributes conducive for stock-pickers.

Fundamentals: Semiconductors Industry Could Provide Growth-At-A-Reasonable-Price Opportunity

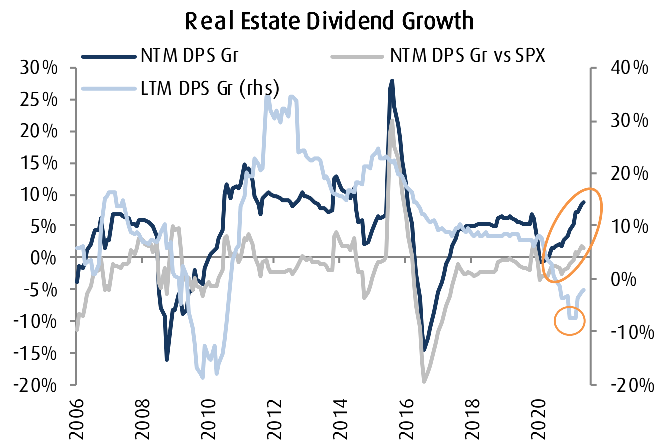
- Technology is an area of the market in which investors should be picking their spots, in our view, and each industry's characteristics may appeal to specific types of investors.
- From our perspective, Semiconductors & Semis Equipment represents an excellent GARP opportunity not solely within Tech, but across the entire market. Semis has a projected long-term EPS growth rate of 21%, well above that of the S&P 500 and highest among all Technology industries, while also having a FY2 PEG ratio of 1.0, lowest across industries.
- Overall, we currently favor Technology names with stable and consistent growth as opposed to the more speculative growth stocks without a history of steady earnings.

Fundamentals: Dividend Growth – The Forgotten Opportunity

- Many clients that we interact with do not think of Technology stocks when it comes to dividend growth, which is why we consider it a forgotten opportunity.
- Roughly 60% of Tech pays out a dividend, and analysts are forecasting that the sector will grow dividends at a 7.4% clip over the next 12 months.
- In fact, dividend payers exist in every Technology industry. For instance, in the two largest industries by number of constituents – Semis and IT Services – 84% and 63% pay dividends, respectively, and they are expected to grow their dividends 8.7% and 5.5%, respectively, in the next 12 mos.

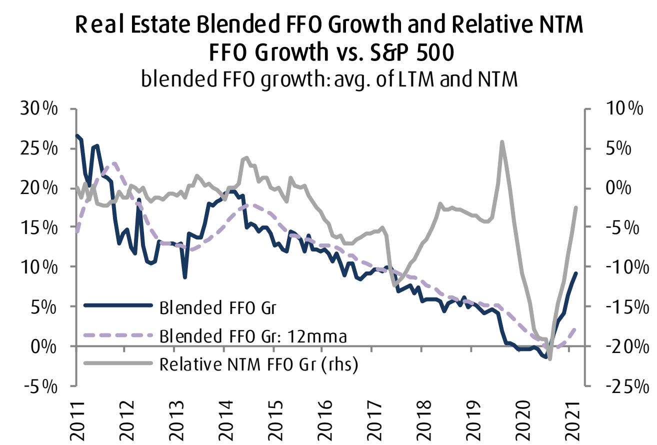
Market Weight: Real Estate (Upgrading to Market Weight from Underweight)

Exhibit 75: NTM Dividend Growth Expectations for Real Estate Surpass Overall Market



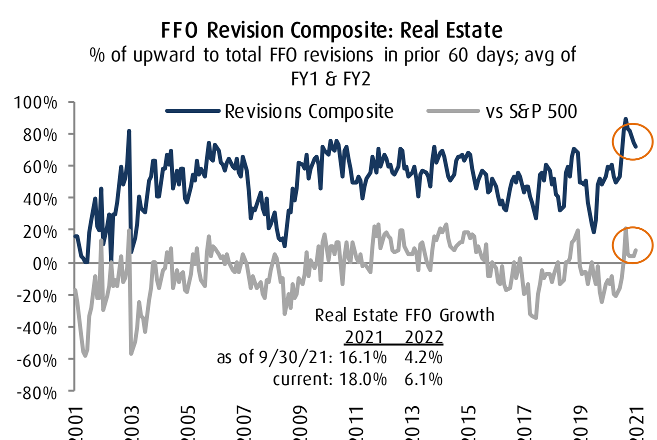
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 76: LTM FFO Growth Rising Again and Recently Eclipsed 12M Moving Average Rate



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 77: Positive Revisions Breadth Helping Lift FFO Growth



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P.

Fundamentals: Real Estate Dividend Trends Look to Be Turning the Corner as LTM DPS Growth Troughs and NTM DPS Growth Forecasts Accelerate

- Dividend trends represent a key attribute for Real Estate stocks. As a result of the pandemic, many REITs either cut or suspended their dividend payouts sending the sector's y/y LTM DPS firmly in negative territory. However, there are clear signs of improvement on the dividend front for the group, and it is one of the reasons we decided to upgrade Real Estate to MW, from UW.
- The y/y %chg in LTM DPS looks to have troughed in June, and has now improved for four consecutive months. More important, dividend forecasts have been steadily increasing with current estimates implying growth of nearly 9% over the next 12 months, which would once again eclipse the S&P 500 DPS growth clip after a long stretch of lagging.

Perspective: Next 12M FFO Growth Has Rebounded and Continues to Accelerate

- Blended FFO growth for the S&P 500 Real Estate sector moved back into the positive earlier this year and has been consistently rising toward a double-digit clip, recently surpassing its 12-month moving average in the process, which is typically a positive signal for the future trajectory.
- The NTM FFO growth forecast for Real Estate has sharply rebounded in recent months and continues to accelerate relative to the overall market. The sector looks set to eclipse the NTM EPS growth rate for the S&P 500 if the current trend persists.

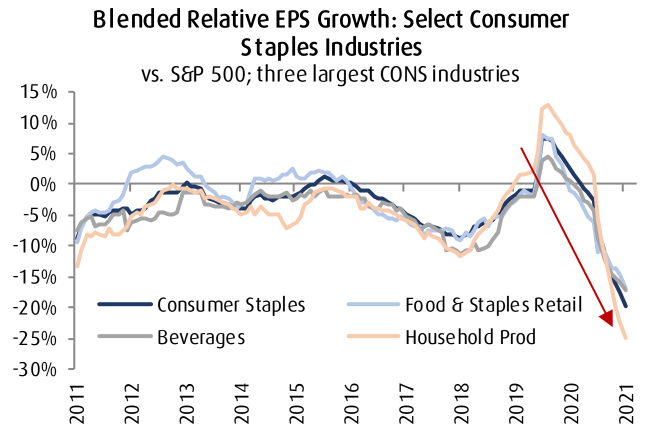
Fundamentals: 70% of FY1 & FY2 FFO Revisions Are Still Positive, Setting Up a Solid Backdrop for FFO Growth Heading Into 2022

- Although the revisions composite for Real Estate has come down slightly from its record high in June, more than 70% of FY1 and FY2 FFO revisions have been upward in the past 60 days, which sets up a solid backdrop for FFO growth heading into 2022.
- This positive revisions breadth among Real Estate companies has helped boost 2021 and 2022 FFO growth rates, which have exhibited upticks of almost two full percentage points since the end of September.

BMO Capital Markets

Underweight: Consumer Staples

Exhibit 78: CONS Sector Lagging SPX EPS Growth By ~20 Pct Pts

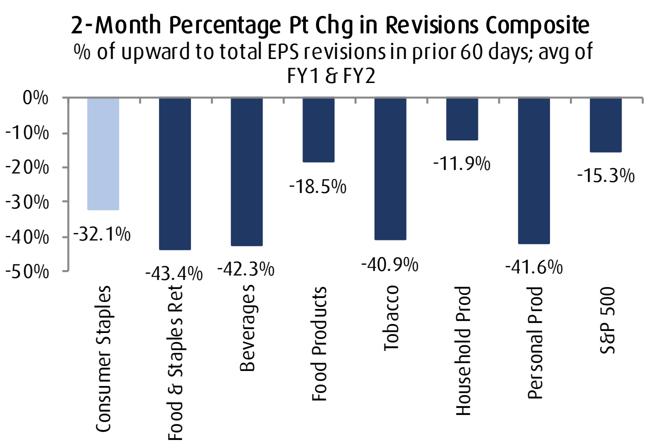


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Fundamentals: Earnings Growth Was a Standout During Height of Pandemic, but Has Noticeably Faded Since

- Consumer Staples was one of the standouts during the pandemic in terms of earnings growth as shoppers stocked up on food, cleaning supplies, and household products.
- However, this dynamic has quickly changed amid the swift economic recovery, and blended EPS growth for Consumer Staples and its largest industries – Beverages, Food & Staples Retailing, and Household Products – have steadily declined relative to the broader market growth clip.
- Blended earnings growth for Staples currently trails the S&P 500 by ~20 percentage points.

Exhibit 79: Every CONS Industry Has Exhibited a Double-Digit Pct Pt Downtick in Their EPS Revisions Composite Over Past Two Mos

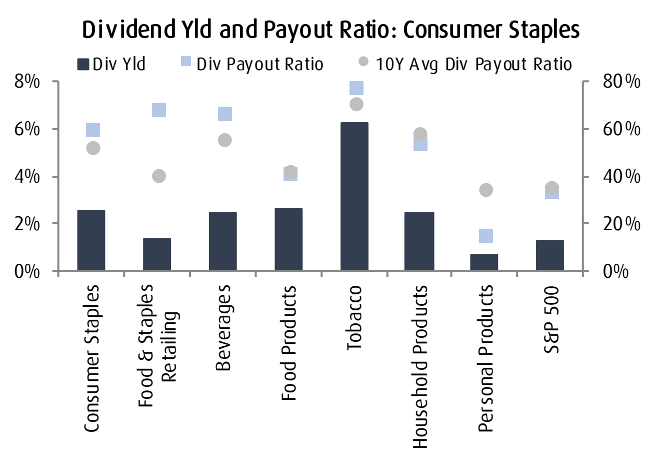


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Perspective: Breadth of Positive Annual Earnings Revisions Has Significantly Declined in Past Two Months

- The breadth of positive annual EPS revisions has noticeably declined for Consumer Staples and its industries over the past two months. Our revisions composite model, which measures the percentage of upward revisions to FY1 & FY2 EPS in the past 60 days dropped by 32 percentage points for Consumer Staples in the past two months, the most severe decrease of any S&P 500 sector and more than double the downtick exhibited by the overall market.
- At the industry level, Food & Staples Retailing, Beverages, Tobacco, and Personal Products recorded revisions composite declines of >40 pct pts in the past two months.

Exhibit 80: Payout Ratio for Consumer Staples Has Risen Well Above Its 10Y Avg and is Close to Double the SPX Payout Ratio



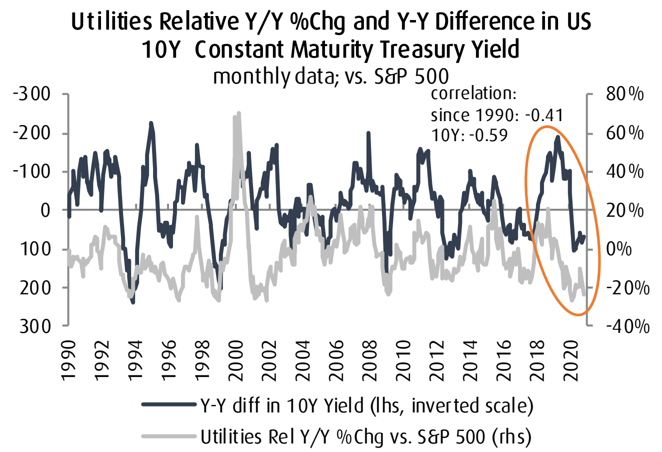
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Perspective: Consumer Staples Offers Above-Market Dividend Yield, Also Has an Elevated Payout Ratio

- Consumer Staples has maintained an attractive dividend yield of 2.5%, well above the 1.3% yield for the S&P 500, with the Beverages, Food Products, Tobacco, and Household Products industries each offering 2%+ dividend yields.
- While yield continues to be a key attribute for stocks within Consumer Staples, it is also important to monitor the payout ratio, which has risen to 61% for the sector overall, higher than its 10-year average of 53%, and well above the 34% ratio exhibited by the market. This could bring about a potential area of concern surrounding dividend sustainability if earnings are not able to keep pace or eclipse dividend growth in the sector.

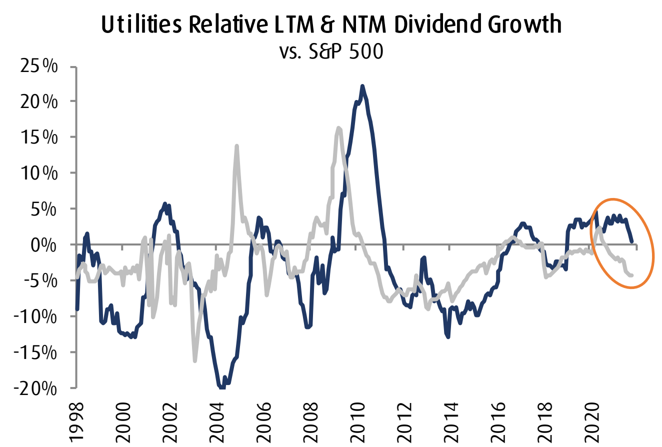
Underweight: Utilities

Exhibit 81: Inverse Correlation Between 10Y Treasury Yield and Utilities Relative Performance Does Not Bode Well for the Sector



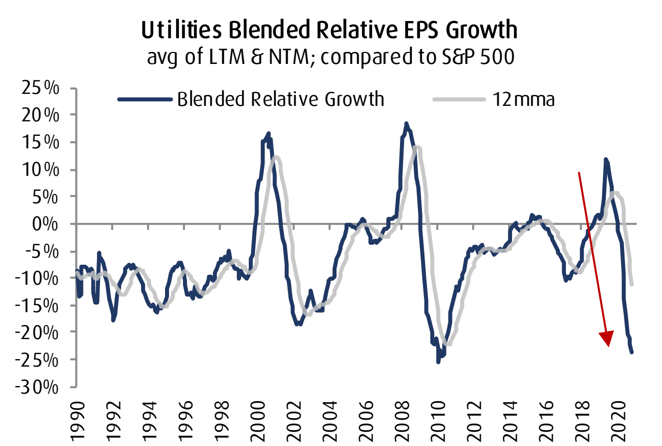
Source: BMO Capital Markets Investment Strategy Group, FactSet, FRB.

Exhibit 82: Utilities NTM Dividend Growth vs. Market Drops to Lowest Level Since Early 2018



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 83: UTIL Earnings Growth Deteriorating Relative to S&P 500



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Performance: Historically, a Rising Y/Y US 10Y Treasury Yield Environment Has Hindered Utilities Performance

- While we are not expecting a huge spike in interest rates in 2022, we do expect rates to grind higher as the economy continues to improve and the Fed eventually begins the tightening cycle.
- Utilities relative performance is likely to be hindered in this rising US 10Y Treasury yield environment as indicated by the inverse correlation of -0.59 between Utilities relative y/y performance vs. the S&P 500 and the y/y difference in the US 10Y Constant Maturity Treasury yield for the past 10 years.
- With that said, surges in volatility could lead to short-term moves into Utilities, and an accelerated shift toward clean energy may also provide a temporary boost to select Electric Utilities names. Ultimately though, we believe the yield backdrop and subpar fundamentals will make the sector an underperformer again in 2022.

Perspective: No Improvement in Utilities Dividend Growth Expected in Next 12 Months

- Over the last 12 months, Utilities stocks have grown their dividends by roughly 2.6% versus the year prior, essentially in line with the S&P 500 clip. That being said, LTM DPS growth for Utilities looks to be easing, while the market rate is clearly accelerating, which should inevitably push the relative trend into the red pretty soon.
- No improvement in dividend growth looks to be on the horizon for Utilities as NTM DPS forecasts imply little to no uptick versus the LTM clip. On a relative basis, the Utilities NTM dividend growth forecast is in a downward trend versus the S&P 500 estimated clip and now trails it by more than four percentage points, the biggest delta since early 2018.

Fundamentals: Utilities Blended Relative EPS Growth Sinking Toward Record Lows

- Blended relative earnings growth for Utilities peaked back in May 2020 at around 12%. However, as the economy and corporate earnings overall improved, Utilities EPS growth has steadily declined ever since with October marking the 17th consecutive month of falling growth compared to the market rate, and seven straight months in negative territory.
- Utilities blended earnings growth currently trails that of the S&P 500 by nearly 24 percentage points and approaching the record lows set in 2010.

US Size and Style – More Tug Than War

Exhibit 84: US Size and Style Opinions

Sector	Opinion	Comments
Large cap (LC)	MW	Picture of consistency in terms of earnings growth, cash flow and dividends; tilt toward higher quality and domestic
Mid cap (MC)	MW	Looking more and more like large cap – especially in terms of improving cash flow and earnings consistency
Small cap (SC)	MW	Earnings growth is starting to lead the size category, but consistency of upward revisions will be needed to maintain pace
Value	MW	Longer-term bottom remains in preliminary stages; avoid deep/low quality value
Growth	MW	Less about outsized growth and more about secular/structural and consistent growth, e.g., high quality

Source: BMO Capital Markets Investment Strategy Group; Key: OW: Overweight, MW: Market Weight, UW: Underweight

2022 Likely to Be Another Year of Moderation for Size and Style

One of the more consistent criticisms we received from last year's US Market Outlook was our decision to equal weight all size and style categories. Turns out, we were correct after all, with growth and value exhibiting their most conjoined performance since 2014 and small, mid, and large caps on track for their least dispersed returns since 2012. We see no reason to think differently heading into 2022. Indecision and "short-termism" by investors remain the largest culprits in our view, as most still want to make the "big call" to move into value, let alone small-cap. Keep in mind, both size and style cycles traditionally last for several years. Frankly, the fundamental environment that we believe is setting up for 2022 does not support that longer-term shift in our view. For instance, when growth is scarce, growth outperforms. With growth rates becoming "less positive" – such claims will undoubtedly gain traction. However, when interest rates rise, value stocks typically do better. Therein lies the quandary – in a market that will have BOTH next year – investors should OWN both, in our view. To be clear, a longer-term shift to both small-cap and value is coming, but not until a transition period takes place, one that unwinds that multi-year pattern of growth and large-cap stocks – which is certain to take more one year.

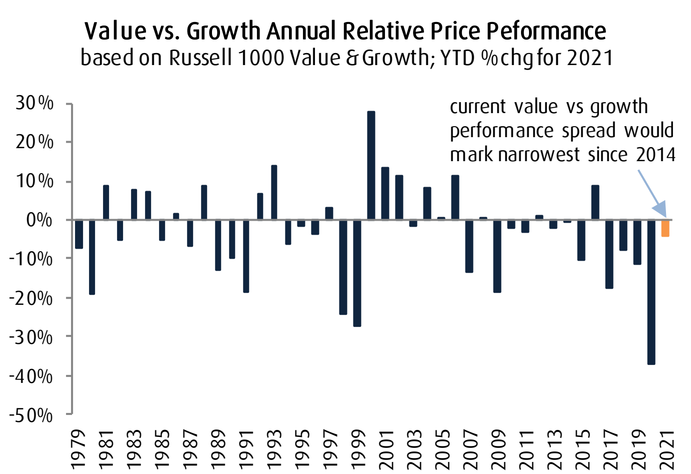
No Reason to NOT Own BOTH Value and Growth

While the value and more traditional cyclical parts of the stock market are beginning to show signs of life with broader value indices potentially drawing out a significant bottom relative to growth, we believe it is too soon to anoint an all value trade at current levels.

Continue to Diversify Across Market Caps

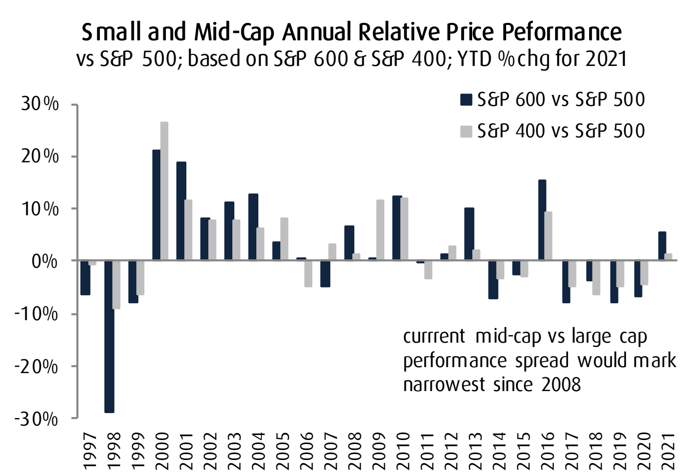
Strong cash flow and consistent earnings and dividend growth within large cap stocks should be used to balance binary moves in small- and mid-cap stocks during periods of back-and-forth momentum. Furthermore, small-cap earnings could be potentially too high heading into 2022, while mid-caps too low – representing revision risks in respective directions.

Exhibit 85: Value and Growth Performance Have Seen Ebbs & Flows in 2021 With Current Annual Spread On Track to Be Narrowest Since '14



Source: BMO Capital Markets Investment Strategy Group, FactSet, Russell.

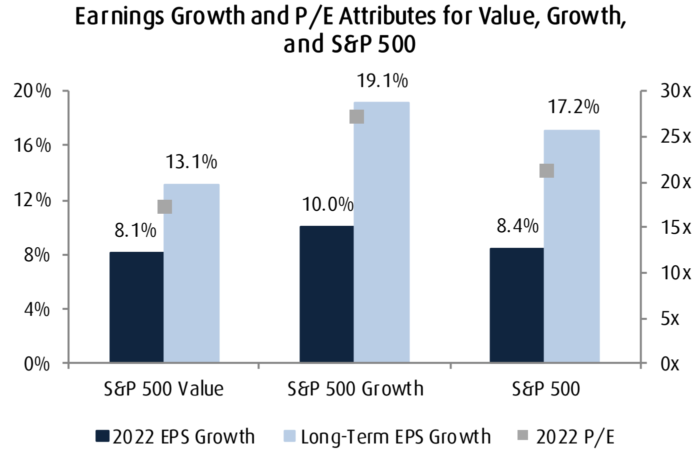
Exhibit 86: Small Caps Set to Outpace Large Caps for First Year Since '16, Wile Mid Cap Performance Spread Pacing for Lowest Since '08



Source: BMO Capital Markets Investment Strategy Group, FactSet.

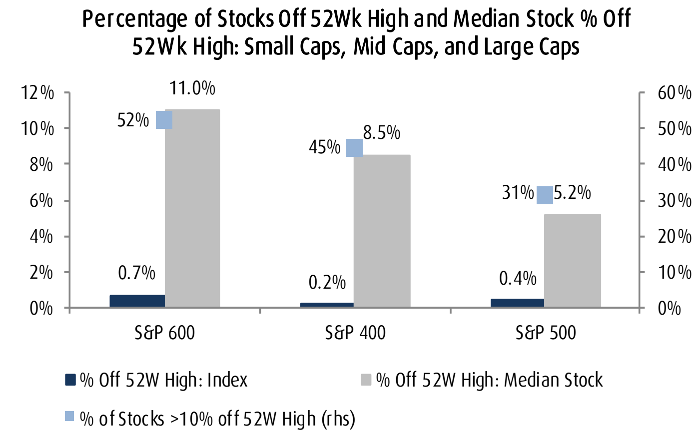
Value, Growth and Size Dynamics

Exhibit 87: Growth or Value? How About Some of Both; Growth Still Providing Earnings Growth, Value Still Offering Value



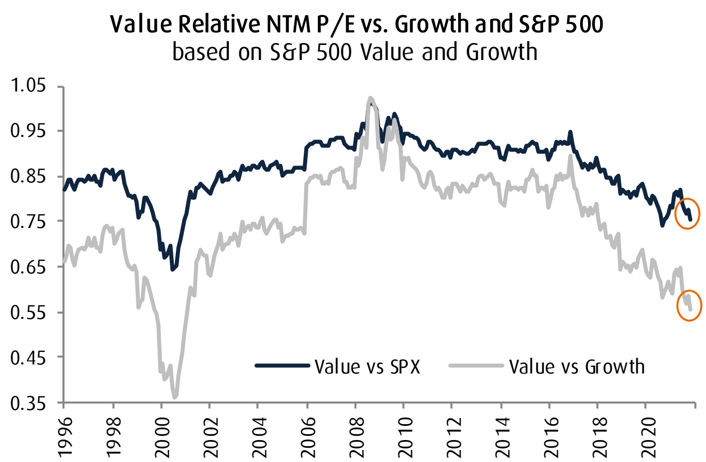
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 88: Yes, Market Indices Are Right Near All-Time Highs, but Many Individual Stocks Are Not



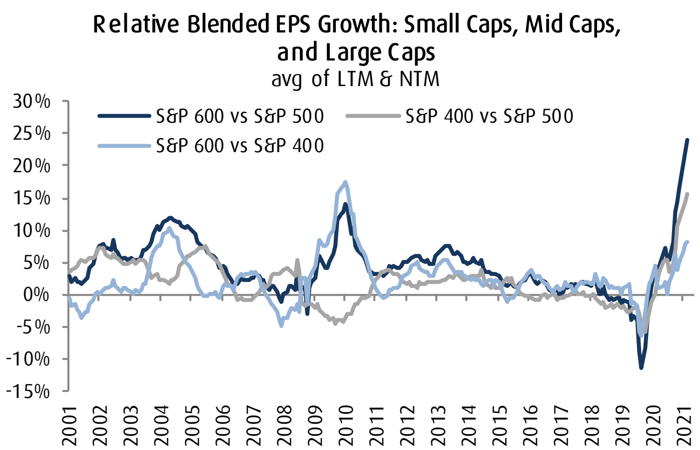
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 89: Despite Pockets of Strong Price Gains for Value This Year, NTM P/E Still Near 20Y Lows Relative to S&P 500 and Growth P/E



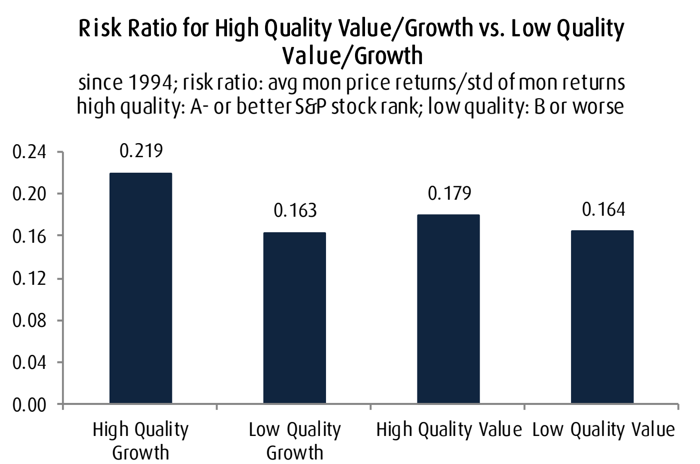
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 90: Small Caps Leading Blended Earnings Growth, but Mid-Cap Growth Also Accelerating Relative to S&P 500 Rate



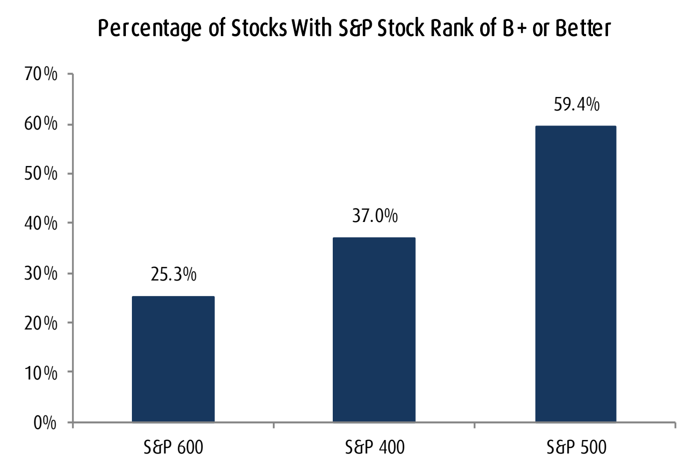
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 91: High Quality Tilt Across Styles Makes a Difference



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES, S&P.

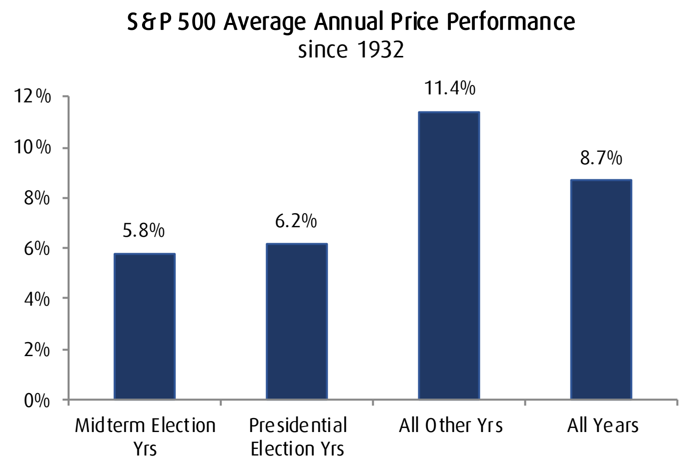
Exhibit 92: Quality Stocks Also Exist in Small- and Mid-Cap Space



Source: BMO Capital Markets Investment Strategy Group, FactSet, S&P.

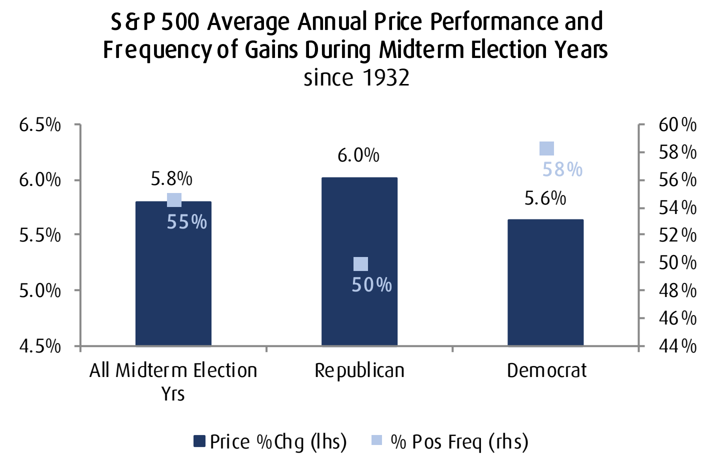
Addendum – A Look at S&P 500 Index Performance During Mid-Term Election Years

Exhibit 93



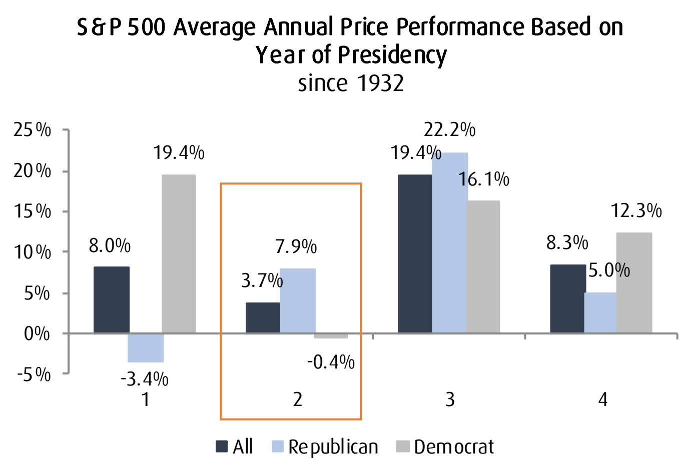
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 94



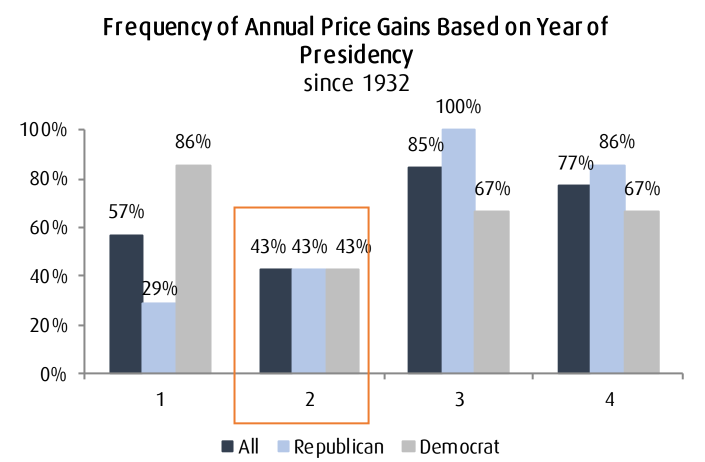
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 95



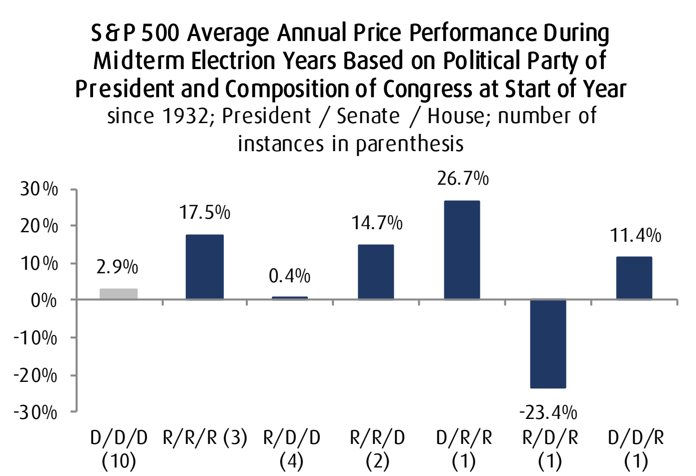
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 96



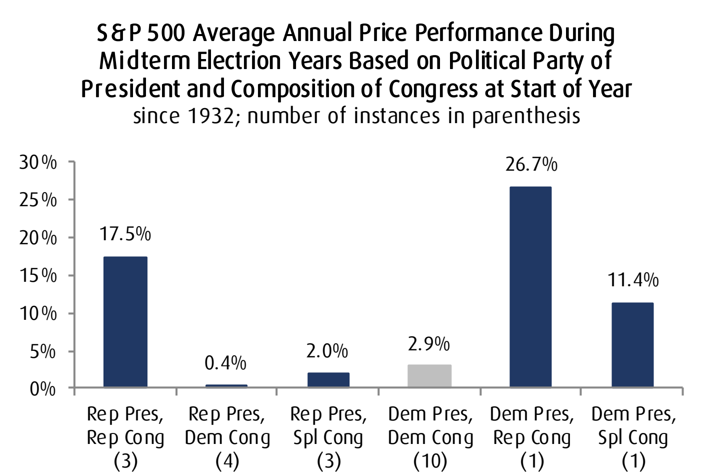
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 97



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 98



Source: BMO Capital Markets Investment Strategy Group, FactSet.

2022 Market Outlook – Canada

Another Year of Solid Gains as Canada Keeps Pace With the US

S&P/TSX Price Target 24,000; EPS target $1,500

We expect Canadian stocks to track US performance once again, but at a slightly more moderate pace, posting a return just shy of 10% in 2022 based on our 2021 price target of 22,000. However, a double-digit return is still very possible, in our view. In fact, back-to-back double-digit returns are a very common occurrence. The TSX posted three consecutive years of double-digit annual returns from 1995 to 1997, four consecutive double-digit returns from 2003 to 2006, and two double-digit price returns in 2009 and 2010. Akin to the current market environment, these periods were all post-recession rallies that extended beyond expectations. Indeed, risk may be tilted to the upside, in our opinion.

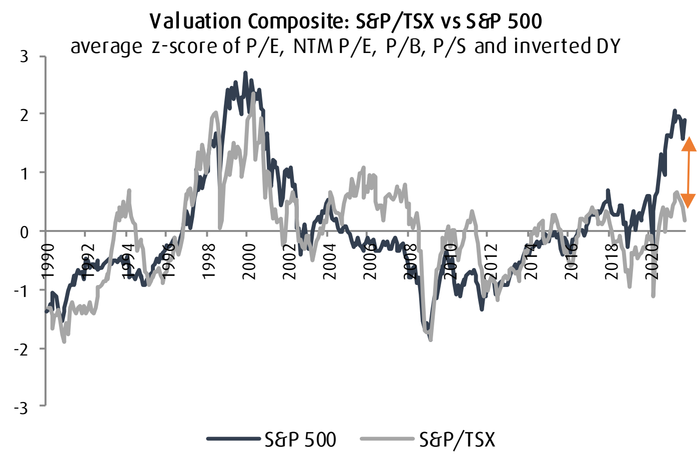
Canada has long represented a strong inflationary hedge and could benefit in the near term from inflationary pressures given its outsized exposure to both the Energy and Materials sectors. However, we expect these impulses to ebb in 2022 along with the supply chain issues, which could turn into a glut in the second half of the year, thereby mitigating this advantage. Overall, the US is likely to remain the main engine of global growth in 2022 and Canada is likely to climb the "Wall of Worry" alongside its neighbour to the south, particularly when it comes to monetary policy, rising interest rates, inflationary pressures, and slowing earnings growth. Yet, ultimately, like the United States we believe the returns will continue to be positive as the market comes to terms with the transition back to a more normalized environment. Yes, as America goes, so goes Canada.

The following is a list of Canada-specific key advantages and issues heading into 2022 that can help delineate investing within the broader North American market.

The Canadian Value Proposition Remains in Play

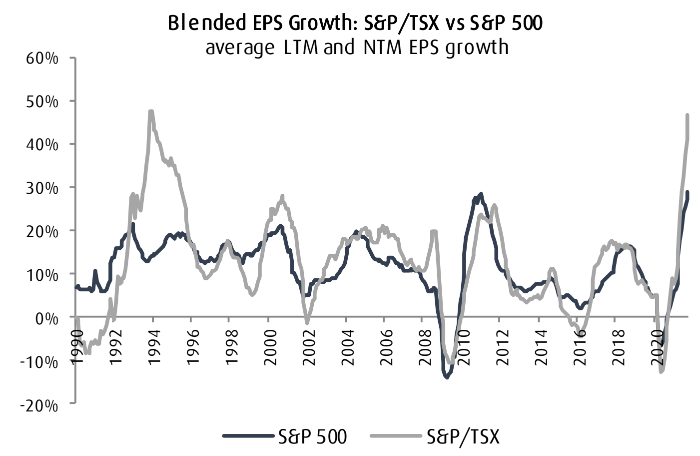
Thanks in big part to an epic earnings recovery that has even outpaced its neighbour to the south, Canadian equities are showing a record valuation divergence against the US (Please see Exhibit 99 for a visual on depth of valuation divergence between Canada and the US). While there is no doubt that the sector weight differences have played a significant role in this divergence and will likely continue to do so, our work suggests there remains significant value opportunities in Canada, especially relative to the US. In fact, Energy remains a deep value sector in Canada especially relative to global energy peers. The Canadian Materials sector is now in discount territory given its heavy weight in gold, which has seen a sharp compression in valuations despite gold prices being relatively stable and historically a strong inflation hedge. Even outside these resource sectors, both Canadian Financials and Consumer Discretionary trade at relative discounts to their US peers despite showing similar growth profiles and having relatively strong US growth exposure (Please see Exhibit 100 for a visual on the similar pace of earnings growth between Canada and the US). As such, we believe many value opportunities exist within Canadian equities, especially relative to the US, and that investors should continue to look to Canada as an attractive value proposition with significant US growth exposure.

Exhibit 99: Record Valuation Divergence = Opportunity



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 100: TSX Earnings Rebound Has Outpaced US

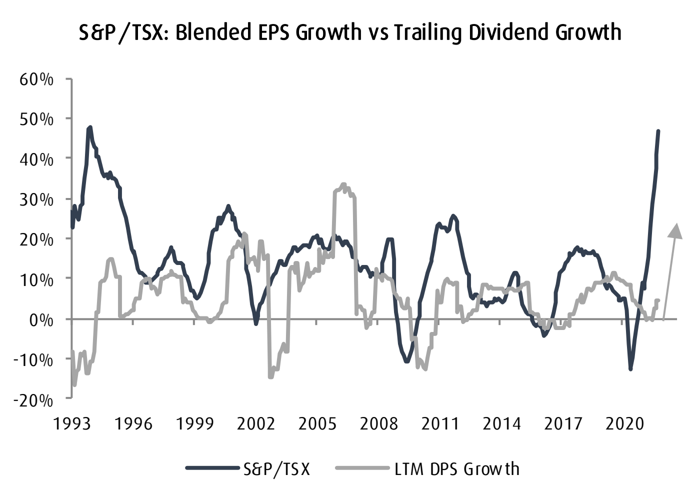


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Phase 2 of the Canadian Recovery = Corporate Actions and Dividends

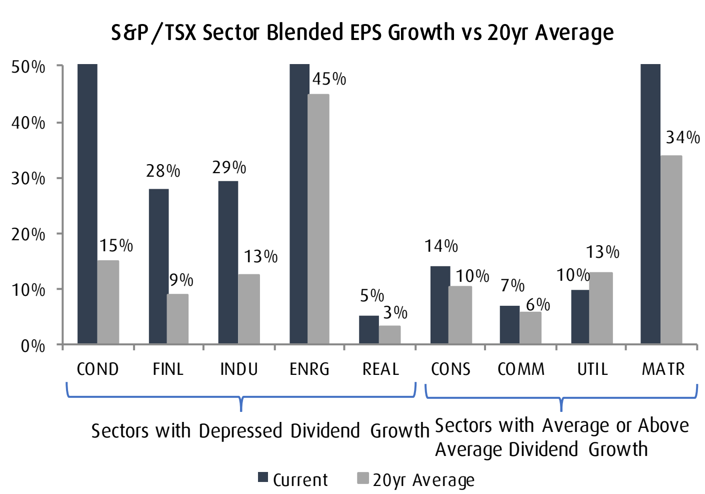
We have made it abundantly clear over the past several quarters – if not years – that from our perspective, a return of dividend growth and share buybacks is one of the key signs of a return to normalcy for Canadian equities. In fact, dividend and cash distribution was a significant area of concern in the early part of the pandemic, with corporations shifting to a more defensive cash preservation mode with companies cutting investment spending and slowing distribution growth while building cash balances. While 2021 saw a stabilization of distributions at these more depressed levels, the TSX also exhibited an epic positive surprise cycle that has translated into one of the sharpest earnings rebounds on record. This, according to our work, is likely to generate an impressive, if not ambitious dividend growth cycle that could see overall dividend growth surge well above historical averages over the next 12-24 months (Please see Exhibit 101 for a visual on the strong leading relationship of earnings growth to dividend growth which points to record-setting dividend growth in the next 12-24 months). As such, we believe investors should begin positioning in areas that are likely to increase dividends and share buybacks, which is likely to be a key theme as we head into 2022 and beyond. (Please see Exhibit 102 for a visual on cyclical advantage when it comes to dividend growth as we head into 2022).

Exhibit 101: Record Earnings Growth Cycle Will Equal Record Dividend Growth Cycle



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 102: Cyclicals Poised to Lead Dividend Growth

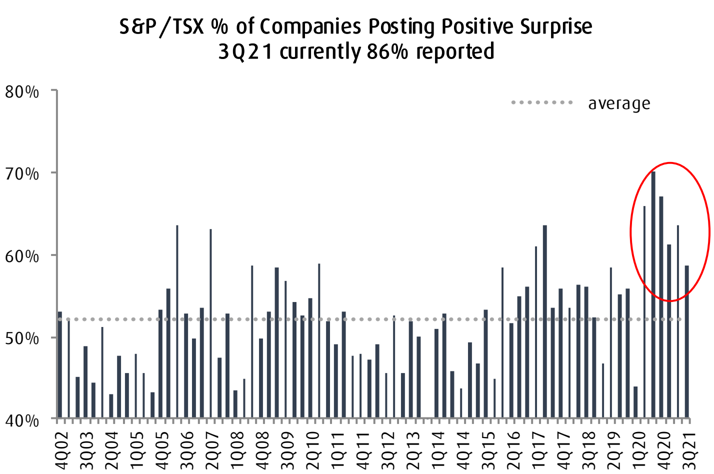


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Stock Picking Paramount as Earnings Surprise Cycle Ends

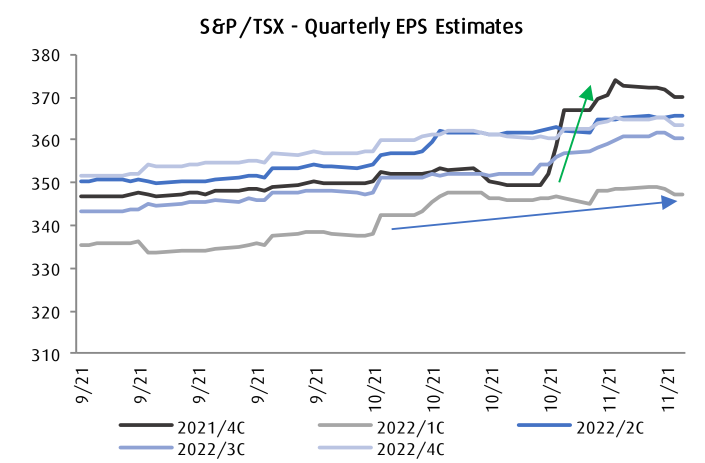
While the 2021 earnings recovery has certainly been epic (Exhibit 103); we do not expect to see the same level of broad-based earnings surprise throughout 2022; instead we believe surprises are more likely to come from corporate actions including dividend increases, share buybacks and even M&A activity. Are analysts still being too pessimistic on earnings? In our opinion, yes. (Please see Exhibit 104 for a visual on the relatively slow pace of upward revisions to 2022 estimates compared to the sharp positive EPS revisions to 4Q21 estimates). However, the breadth of upward FY1 & FY2 EPS revisions has decelerated and is at its lowest level since the surprise cycle started. Furthermore, our top-down S&P/TSX 2022 EPS target is now only slightly above the bottom-up S&P/TSX consensus 2022 EPS estimate, a pattern that is still above historical trends, but more in line with typical for revisions than 2021. (Exhibit 105). From our perspective, this is what a normalized earnings environment looks like. As such, the inevitable end of the positive surprise cycle and the slowing of earnings momentum does not mean an end to the bull market. Instead this transition will likely bring less positive performance – but yes, still positive performance – and an increasing level of importance on active portfolio management and stock picking. A trend that we believe has already started, as seen by falling price correlations, rising NTM PE dispersion and the slowing of the surprise cycle. (Please see Exhibit 106 for a visual on the rising valuation dispersion).

Exhibit 103: One of the Longest Positive Surprise Cycles on Record



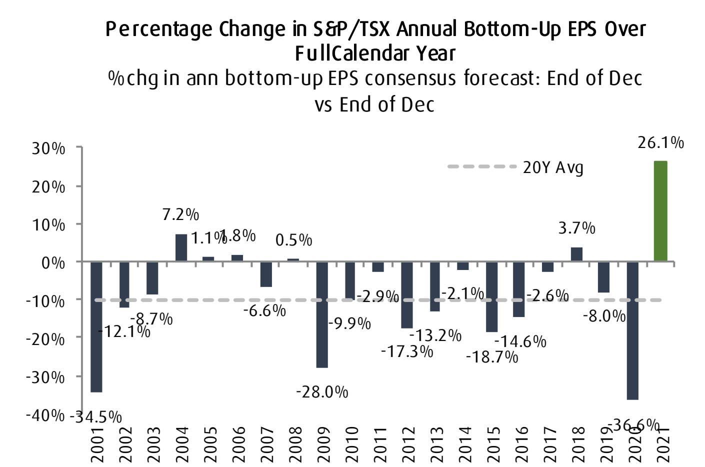
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 104: 2022 Estimates Have Continued to Lag



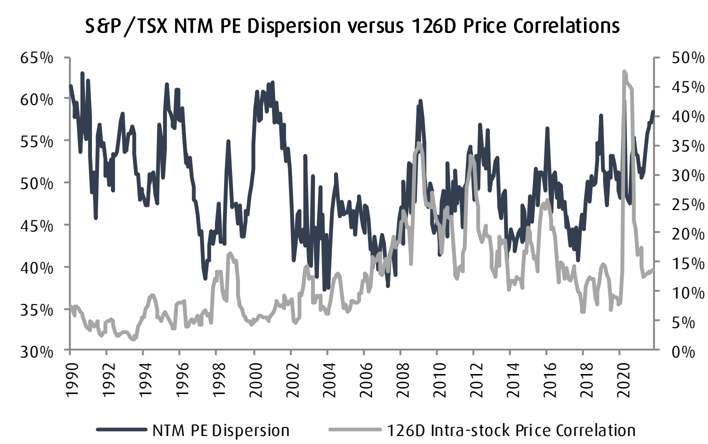
Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 105: Typical Earnings Environment Sees Estimates Revised Down by Almost 10% From Initial Estimates



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Exhibit 106: Valuation Dispersion Has Increased Dramatically Over the Last Several Months

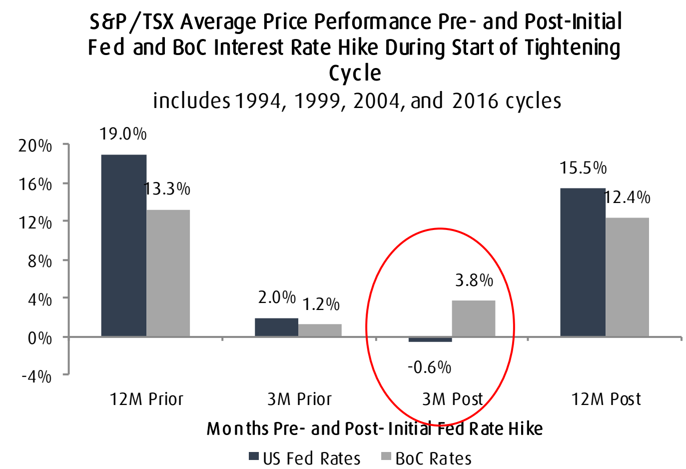


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Follow the Fed, not the Bank of Canada

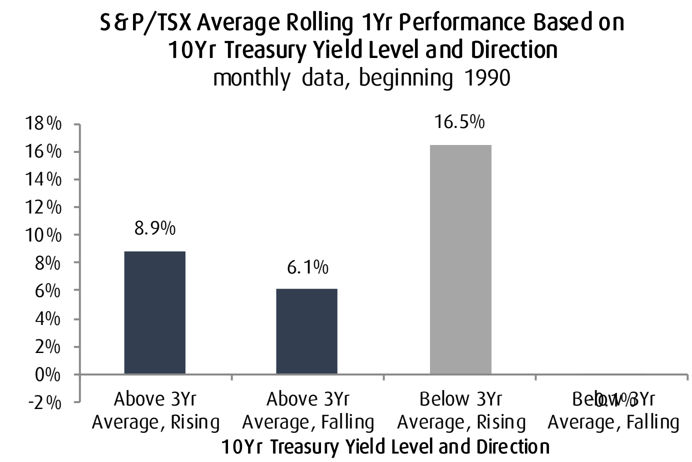
The market is pricing in a US rate hike by mid-2022 and a Bank of Canada rate hike even earlier. While it may be tempting to watch the Bank of Canada for the start of the tightening cycle, our work shows that the market reacts more to the Fed than the Bank of Canada. In fact, the TSX has historically shown no significant reaction to an initial Bank of Canada rate hike, with the TSX posting average returns three months after the initial Bank of Canada Rate hike. Much like US stocks, Canadian stocks have struggled in the initial three months after the Fed's first interest rate hike of the cycle with the S&P/TSX logging a 0.6% average loss. The start of the tightening cycle often sees near-term sentiment shift. However, longer term the index has done well thereafter, gaining 15% on average in the subsequent 12 months. Furthermore, as we have said many times, rising rates are not an impediment to market returns. In fact, since 1990, the TSX has posted its best performance during periods of rising interest rates, particularly when they are rising and below the 3-year average (Please see Exhibits 107-108 for a visual on performance around monetary policy changes and performance when long-term rates are rising).

Exhibit 107: Market Shows Greater Reaction to Initial Fed Hike, While No Notable Reaction Around Bank of Canada Initial Hikes



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

Exhibit 108: Rising Rates Are Typically the Best Rate Environment for Canadian Equities



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

S&P/TSX Price Target 24,000; EPS Target $1,500

Canadian and global markets saw one of the sharpest recoveries on record in 2021, with the TSX hitting new all-time highs and earnings consistently beating expectations for six consecutive quarters. Although this sharp recovery is unlikely to be matched in 2022, we believe Canadian equities can still approach double-digit growth in 2022. In fact, we forecast that the S&P/TSX will rise 9% (from current levels) and reach 24,000 by 2022 year-end, which marks another new all-time high. Our expectation is based on the assumptions of a more normalized cost-of-equity (DDM model) and a market multiple (PE model) that is in line with historical average. Overall, our 2022 outlook assumes a return to normalcy and a transition to a more earnings-driven environment, which is likely to see greater bouts of volatility and increasing importance of stock selection. Yes, our base-line assumptions show interest rates are likely to continue to trend high, inflation is likely to remain elevated but settle from current levels, consensus oil prices show a retreat from current levels and earnings growth ultimately returning to more historical trends.

On the earnings front, we forecast $1,500 for 2022 S&P/TSX EPS, a more moderate 7% earnings growth after an almost 80% jump in earnings in 2021. Our expectation assumes that companies will build on the earnings recovery displayed in 2021, as supply chain disruptions ease, inflationary pressures subside, and economic trends adjust to the post pandemic world. Overall, our earnings and price targets imply an end of year trailing PE multiple of just 16x, in line with the long-term historical average and remaining well below the S&P 500 in 2022.

Exhibit 109: 2021 & 2022 S&P/TSX Targets

Price Target			
Model	**Category**	**2021E**	**2022E**
Dividend Discount Model	Fundamental	22,400	23,800
Fair Value Price-to-Earnings Model	Valuation	21,600	24,400
Expected Return*		1.6%	10.8%
Latest S&P/TSX Close		21,653	21,653
Price Target		22,000	24,000
Earnings Per Share Target			
Model	**Category**	**2021E**	**2022E**
Macroeconomic Regression Model	Macro	$1,080	$1,100
Bottom Up Mean Consensus Expectation	Fundamental	$1,380	$1,480
Normalized EPS	Mean Reversion	$1,240	$1,350
Expected EPS Growth		77%	7%
Prior Year S&P/TSX EPS**		$790	$1400
EPS Target		$1400	$1500
Implied P/E		**15.7x**	**16.0x**

*Based on 11/17/2021 closing price.
**Based on our prior year EPS target if EPS is not fully reported for index.
Source: BMO Investment Strategy Group.

Sectors, Size, and Style Recommendations

Canadian Sector Opinions

Exhibit 110: Canadian Sector Opinion Summary

Sector	Opinion	Index Weight	Target Weight	BMO Investment Strategy Group Headline
Communication Services	MW	4.6	4.5	Remains our favourite yield play, despite challenges of yield strategies. Given secular dividend growth, recent underperformance provides timely longer-term opportunity
Consumer Discretionary	OW	3.5	4.0	Cyclical with long outperformance tail suggests persistent outperformance. Overweight names with strong US growth exposure
Consumer Staples	MW	3.6	3.5	Food Inflation is a near-term tactical advantage, but sector is a classic defensive sector
Energy	MW	13.4	13.0	Deep value sector, strong cash generation, risk of commodity price running its course is high
Financials	OW	31.7	33.0	Steadfastly maintaining holdings in the broader sector; however, we prefer those companies with strong US platforms – especially within the banks (commercial banking + wealth management)
Health Care	MW	1.0	1.0	Significant price correction and still present regulatory tailwinds within Cannabis suggest neutralized position.
Industrials	OW	11.8	13.0	Well-positioned for cyclical recovery. Focus on the rails, select manufacturers and waste companies – especially those leveraged to the US. Unwinding supply chain issues could be another tailwind
Information Technology	MW	11.5	11.0	No denying the fundamental momentum, but rate of change in terms of performance is under way; remain increasingly selective – harvest gains on outsized upside moves and buy dips on downside overreactions
Materials	OW	11.4	12.0	We remain slightly overweight the Materials sector with a focus on base metals, and companies with strong operating efficiency and cash flow generation
Real Estate	MW	3.1	3.0	**UPGRADE from Underweight:** Stronger-than-expected earnings environment; also our work has shown Real Estate to be less interest sensitive then other high yielding sectors, particularly since 2002
Utilities	UW	4.4	2.0	Rising yields, low organic growth and high payout ratios are a tough combination

Source: BMO Capital Markets Investment Strategy Group. Key: OW: Overweight, MW: Market Weight, UW: Underweight

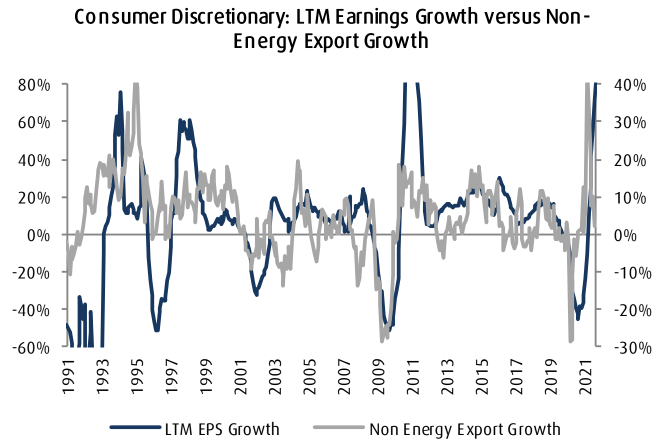
Exhibit 111: S&P/TSX Annual Sector Performance

Year	COMSV	COND	CONS	ENRS	FINL	HLTH	INDU	INFT	MATR	RELS	UTIL	S&P/TSX
1990	-12.6%	-25.1%	-11.4%	-10.5%	-21.7%	-21.3%	-24.3%	2.8%	-19.3%		-2.4%	-18.0%
1991	21.5%	14.0%	21.4%	-19.0%	21.1%	61.5%	-10.5%	55.9%	-3.6%		1.3%	7.8%
1992	-11.2%	-1.2%	0.9%	3.5%	-11.9%	-14.2%	-11.1%	20.0%	-1.5%		-4.4%	-4.6%
1993	16.4%	21.0%	4.0%	33.1%	27.8%	5.6%	27.6%	18.6%	56.8%		19.1%	29.0%
1994	-1.8%	-11.6%	-1.8%	-7.1%	-6.1%	13.4%	3.0%	-7.2%	4.1%		-9.6%	-2.5%
1995	2.7%	0.6%	19.4%	15.2%	14.1%	62.3%	13.7%	34.0%	7.6%		6.3%	11.9%
1996	30.9%	25.4%	15.2%	36.8%	49.9%	30.1%	30.4%	21.7%	9.7%		22.4%	25.7%
1997	39.2%	28.4%	16.2%	3.1%	49.8%	-11.1%	19.2%	40.1%	-26.2%		38.2%	13.0%
1998	21.1%	6.7%	23.6%	-30.4%	0.6%	-0.3%	-11.2%	7.6%	-12.3%		-4.0%	-3.2%
1999	85.0%	-0.5%	13.3%	26.2%	-13.0%	13.1%	4.1%	188.8%	12.4%		-30.6%	29.7%
2000	22.5%	9.5%	38.1%	46.3%	45.6%	3.8%	28.2%	-31.1%	-8.9%		42.6%	6.2%
2001	-29.6%	1.7%	27.4%	6.1%	1.3%	15.2%	5.5%	-62.1%	8.9%		6.4%	-13.9%
2002	-21.9%	-21.3%	0.9%	12.7%	-5.0%	-42.8%	-31.3%	-64.8%	5.5%		2.1%	-14.0%
2003	12.6%	19.5%	18.9%	23.6%	24.4%	1.3%	21.1%	67.0%	26.0%		19.9%	24.3%
2004	8.2%	8.3%	9.3%	28.7%	16.5%	-17.4%	0.2%	11.5%	5.7%	11.2%	5.0%	12.5%
2005	9.7%	8.6%	-2.2%	61.3%	20.5%	-3.5%	16.5%	-15.8%	13.9%	20.0%	33.1%	21.9%
2006	16.4%	13.2%	3.9%	3.2%	15.9%	-0.7%	12.7%	27.3%	38.0%	23.5%	2.1%	14.5%
2007	16.2%	1.8%	-6.8%	5.0%	-4.6%	-27.1%	8.6%	48.1%	29.1%	-11.6%	6.9%	7.2%
2008	-27.4%	-37.5%	-7.8%	-36.3%	-39.0%	-34.4%	-26.9%	-54.3%	-27.1%	-45.2%	-24.0%	-35.0%
2009	0.7%	11.1%	6.1%	35.0%	38.3%	28.6%	23.7%	44.3%	33.4%	35.0%	12.7%	30.7%
2010	16.2%	21.8%	8.3%	10.0%	6.3%	50.3%	14.4%	-11.6%	35.8%	26.4%	12.6%	14.4%
2011	19.0%	-17.9%	4.8%	-12.3%	-6.6%	49.6%	2.0%	-52.6%	-21.8%	1.1%	1.6%	-11.1%
2012	6.4%	18.7%	20.4%	-3.6%	12.8%	24.1%	12.7%	-3.2%	-6.9%	16.2%	-0.8%	4.0%
2013	8.1%	39.5%	21.4%	9.9%	19.1%	71.7%	34.9%	36.2%	-30.6%	0.5%	-8.6%	9.6%
2014	10.5%	26.4%	46.9%	-7.8%	9.8%	30.2%	20.0%	34.0%	-4.5%	18.0%	11.3%	7.4%
2015	-1.0%	-3.5%	11.0%	-25.7%	-5.5%	-15.8%	-12.5%	14.8%	-22.8%	3.1%	-7.8%	-11.1%
2016	9.9%	8.2%	6.1%	31.2%	19.3%	-78.6%	20.7%	4.4%	39.0%	4.1%	12.7%	17.5%
2017	9.9%	20.4%	6.4%	-10.0%	9.4%	32.7%	17.9%	16.2%	6.3%	5.8%	6.2%	6.0%
2018	-5.3%	-17.7%	0.6%	-21.5%	-12.6%	-16.6%	-3.9%	12.5%	-10.6%	-2.8%	-13.4%	-11.6%
2019	8.2%	13.1%	12.8%	16.2%	16.9%	-11.4%	23.6%	63.5%	22.1%	17.4%	31.6%	19.1%
2020	-8.3%	14.4%	2.8%	-30.8%	-2.9%	-23.6%	15.3%	80.3%	19.5%	-13.0%	10.6%	2.2%
2021	16.6%	16.7%	18.8%	45.2%	30.2%	-2.3%	19.7%	35.2%	5.1%	29.6%	3.6%	24.2%

REITs are used as a historical proxy for the Real Estate sector which was officially established in Sept. 2016.
Source: BMO Capital Markets Investment Strategy Group. Performance calculated through 11/17/21.

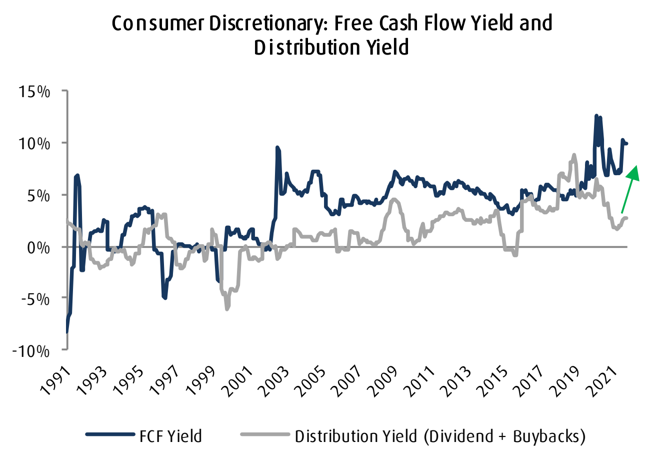
Overweight: Consumer Discretionary

Exhibit 112: Transitioning to Trend Growth



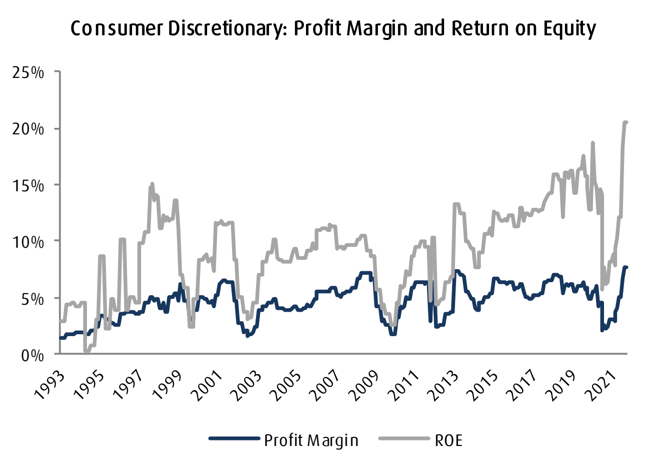
Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 113: Poised for Distribution Growth



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 114: Margin and Profitability Are Key



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Consumer Discretionary = Transitioning to Trend Growth

- Yes, the sharp earnings recovery is likely behind us for Consumer Discretionary.
- Revision trends have reverted to historical averages, positive earnings surprises are not likely to be as broad based and non-energy export growth has now fallen to historical averages.
- However, this does not mean Consumer Discretionary is set to underperform. Instead, while growth is certain to slow from the blistering pace in 2021, we continue to expect earnings to post above-market levels of growth. Particularly as supply chain issues unwind in the quarters ahead.

Consumer Discretionary = Cash Generation Sets Stage for Distribution Growth and Corporate Actions

- While earnings growth is certain to slow, cash generation is likely to remain strong. Indeed, the sector has seen a broad improvement in profitability metrics and cash generation as companies shifted to operational defense and a focus on efficiency.
- As such, we believe the sector is well positioned for a return to normalcy and is poised for a strong dividend growth cycle and even potential increase in M&A.

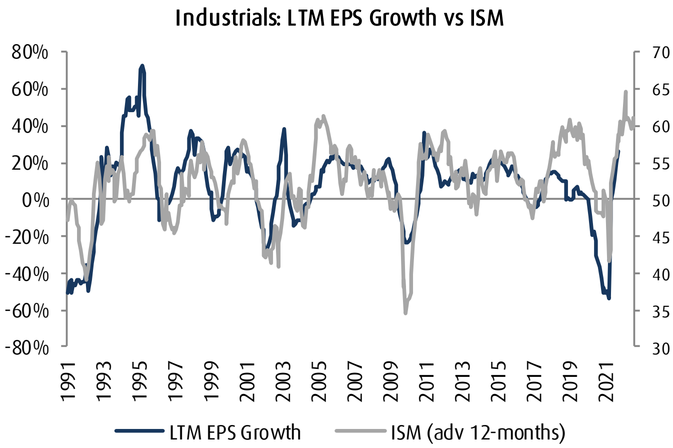
Consumer Discretionary = Focus on Quality

- Certainly, broad Consumer Discretionary profitability and profit margins are likely to peak within 2021; however, the ability of companies to maintain margins will be key to outperformance in our opinion. As such we believe stock selection is becoming increasingly important and investors should focus on quality and operational efficiency within the sector.

Overall, we continue to believe US revenue exposure is likely to be the key area of strength and investors should also remain selective and overweight companies with relatively high US growth exposure.

Overweight: Industrials

Exhibit 115: Earnings Still on the Clear Upswing

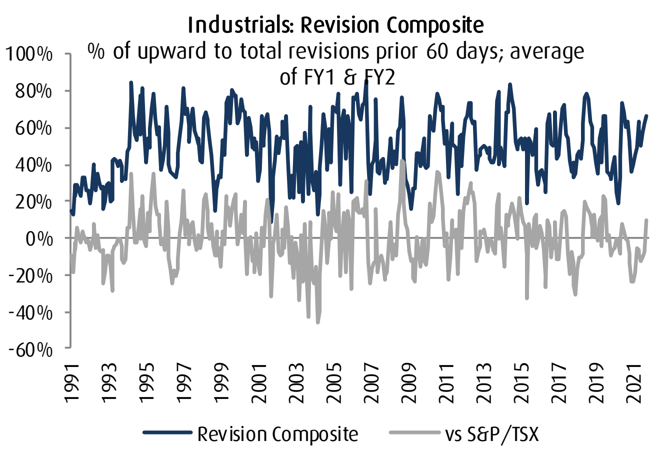


Source: BMO Capital Markets Investment Strategy Group, FactSet, ISM.

Industrials = Earnings Still on the Upswing

- Unlike Consumer Discretionary, Industrial earnings are still on the clear upswing and are likely to maintain record levels of growth over the next 12 months and beyond.
- While valuations are certainly stretched within the sector, the depth and breadth of the earnings recovery is clearly going to be strong and may even beat relatively modest expectations, in our opinion.

Exhibit 116: Revisions Trends Point to Positive Surprises

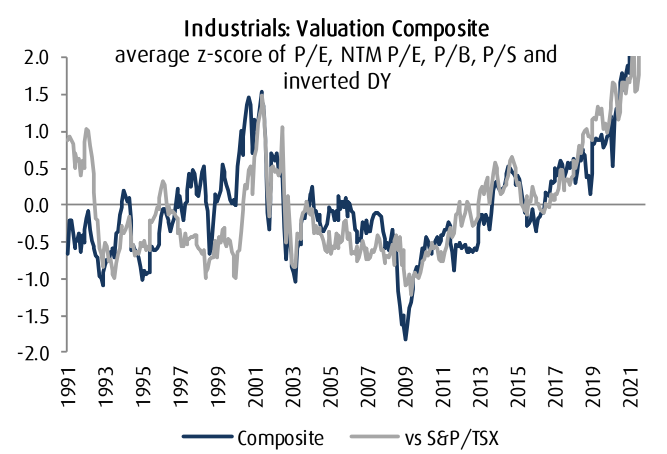


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Industrials = Positive Surprise Mantle Shifts to Industrials

- Industrials revision trends are improving just as supply chain visibility begins to improve, a trend we believe is likely to persist into 2022.
- Our work shows improving revisions are highly correlated with positive surprises. This suggests estimates may be too modest and the sector is likely poised for a positive surprise cycle, which will be a key tailwind for the sector.

Exhibit 117: Yes, Valuations Are Expensive



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

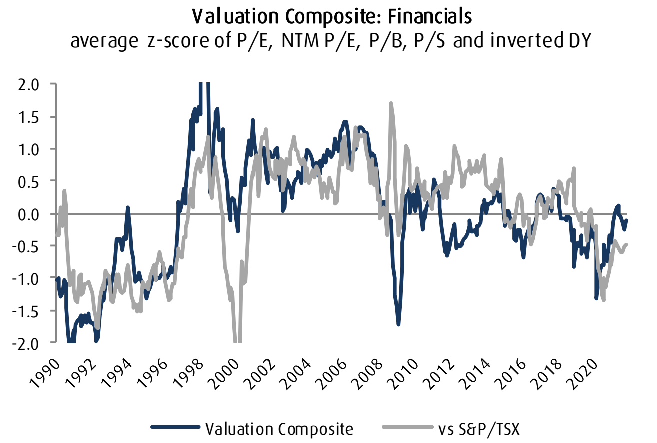
Industrials = Expensiveness Is Key Point of Caution

- While Industrials are certainly an expensive sector, we believe the delayed earnings recovery has been a major factor.

As such, given the strong cyclicality of the sector, strong profitability, and cash generation, we are Overweight the sector and believe investors should focus on areas with strong earnings growth, including the rails, select manufacturers, and waste companies – especially those leveraged to the US.

Overweight: Financials

Exhibit 118: Valuations Remain Relatively Attractive

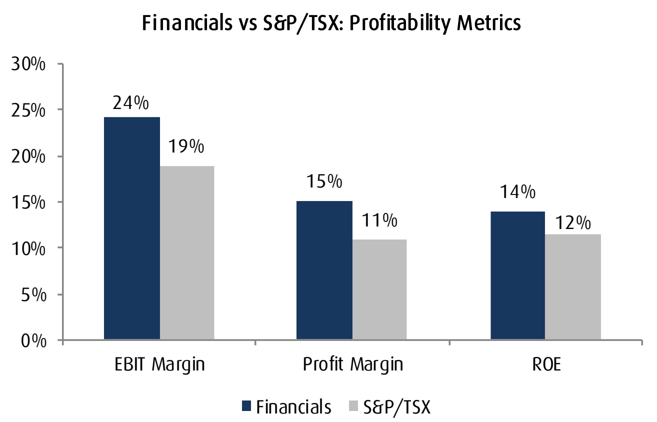


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Financials = Valuations Have Reverted, but Still Attractive

- Negativity surrounding Financials has been a consistent and overarching theme since 2008 and even with a banner year like 2021 remains in discount territory.
- Even after the current stretch of outperformance, which we view more as a reversion from excess loan loss/pandemic-based pessimism and regulatory restrictions, the Financials sector still has room to grow with recent distribution restrictions lifted and high CET1 ratios, in our opinion.
- Furthermore, the sector offers compelling relative value versus both large US banks and regionals, in our opinion

Exhibit 119: Operating Metrics Are Strong

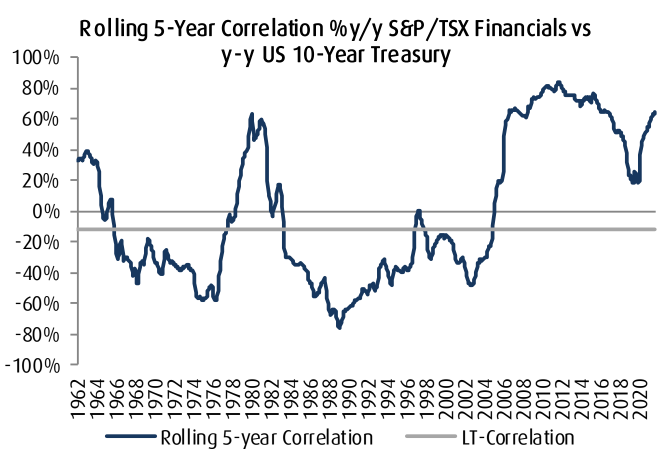


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Financials = Operational Metrics Are Consistently Strong

- With record loan loss reversals, overall profitability within Financials has been relatively stable and consistently above the market. Combined with relatively low valuations, Financials remain fundamentally well positioned for the continued recovery and should continue to grow dividends and deploy capital.

Exhibit 120: Financials Are Positively Correlated to Interest Rates



Source: BMO Capital Markets Investment Strategy Group, FactSet, Haver, FRB.

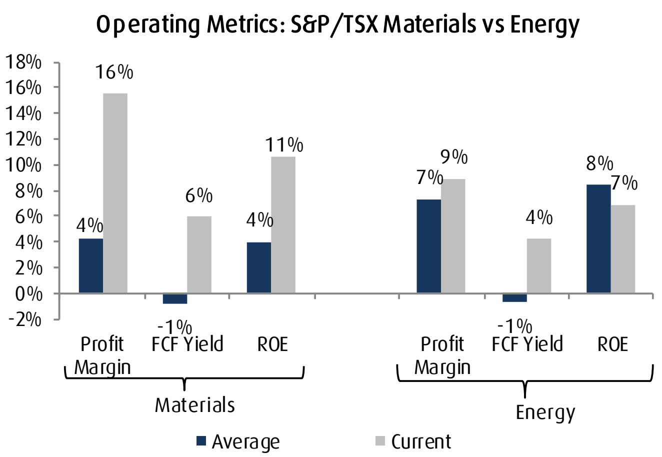
Financials = Rising Rates Are Positive for Financials

- To be clear, rising long-term interest rates are not an impediment for Financials returns or outperformance. In fact, in a low interest rate environment, with plenty of liquidity, rising interest rates are positive for Financials.
- The rolling 5-year correlation between year-over-year Financials price returns and year-over-year change in 10-year treasuries has been consistently positive since 2005, including relative to the TSX. Yes, the correlation of Financial price returns and interest rates were sharply negative prior to 2002 but have since swung sharply positive as interest rates have been consistently low since the 2001/2002 period.

While we are steadfastly maintaining our holdings within our highest conviction Canadian sector, we prefer those companies with stronger US platforms - especially within the banks (commercial banking + wealth management).

Overweight: Materials

Exhibit 121: Operating Efficiency: Materials > Energy

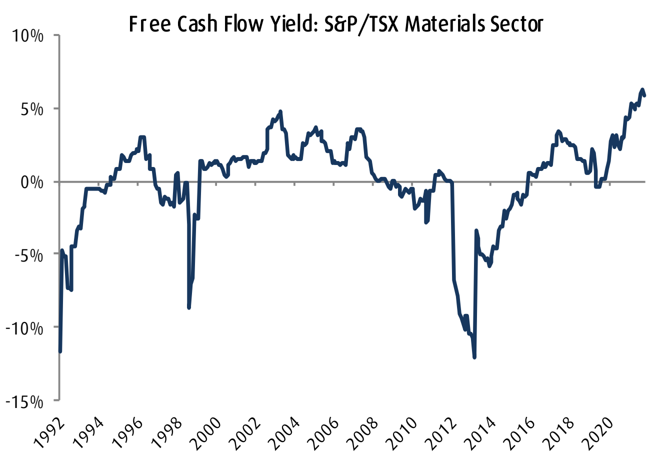


BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Materials = Operationally Strong

- The Materials sector is further along in restructuring and restoring operating efficiency than the Energy sector, in our opinion.
- In fact, our models show profit margins, free cash flow generation, and profitability are all well above historical averages for the Materials sector.

Exhibit 122: Record Setting Cash Flow

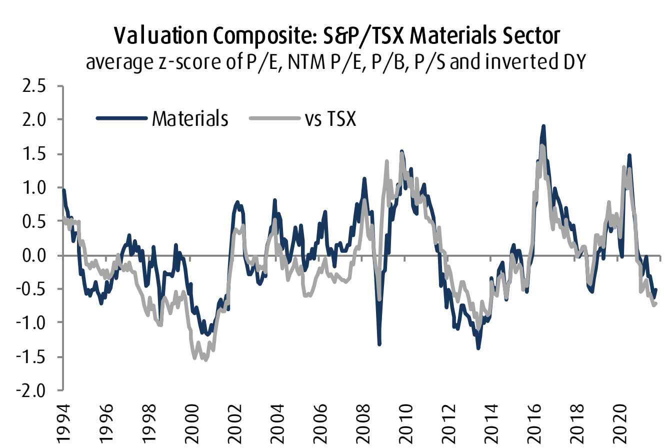


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Materials = Cash, Cash, Cash

- Yes, the structural shift toward operating efficiency has clearly translated into operating performance as the sector is now generating a record level of cash.

Exhibit 123: Materials Is Still a Value Sector



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Materials = Relative Value

- While the Energy sector is certainly a deep value sector, the Materials sector also offers strong relative value. In fact, our valuation composite, which is a z-scored average of several valuation metrics, has been below the long run average since December 2020. Furthermore, price to book between the overall Materials sector and the Materials sector excluding gold companies are now in line as gold companies have underperformed and base metals companies rallied.

We remain slightly overweight the Materials sector with a focus on base metals, and companies with strong operating efficiency and cash flow generation.

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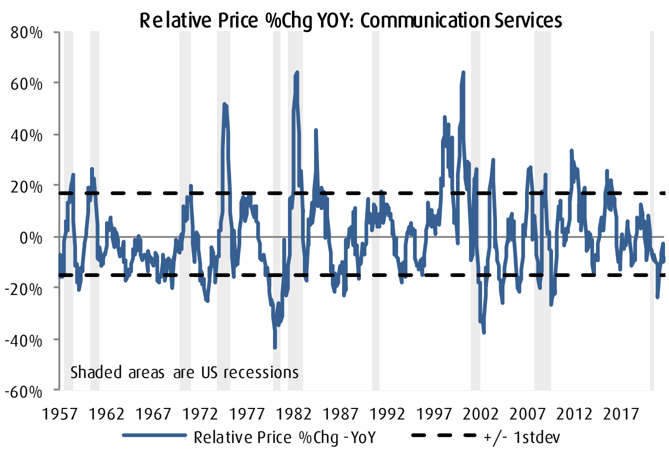
Market Weight: Communication Services

Exhibit 124: Sharpest Underperformance Since 2009

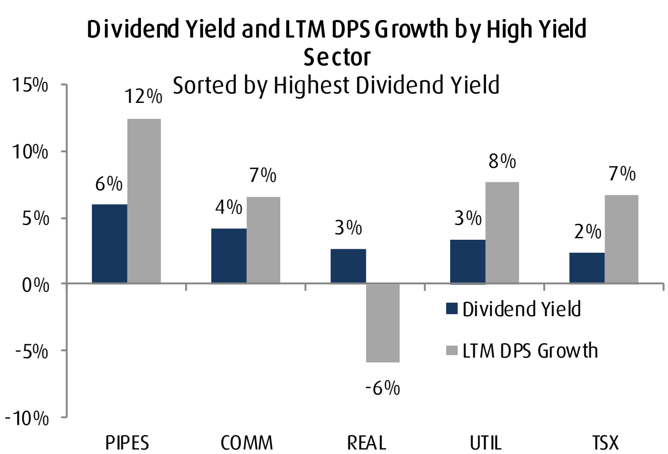


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Communication Services = Challenges Priced In

- Despite broad underperformance versus the other high-yield sectors over the last 12 months and since the March 23, 2020 lows, Communication Services remains our preferred equity income sector in Canada.
- Many of the challenges from unbundling, over-regulation, and recent slowing in roaming revenue are largely priced in, in our opinion.

Exhibit 125: Communications = Strong Yield and Dividend Growth

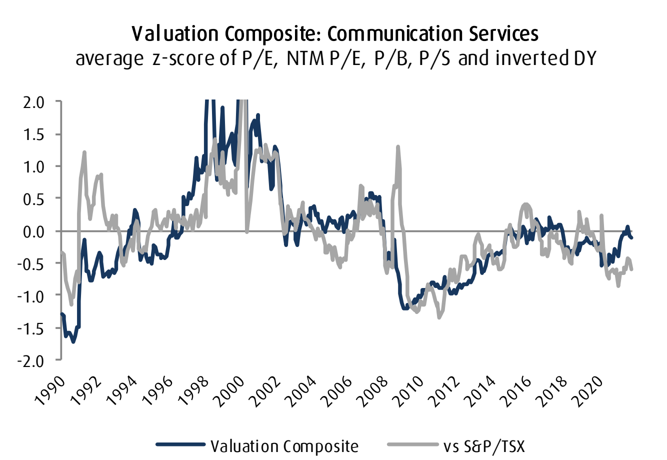


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Communication Services = Preferred Income Sector

- Overall, despite some near-term challenges, we believe Communication Services continues to offer the better risk/reward among the high-yielding sectors given the longer-term consistency of the sector. In fact, our work has shown Communication Services has many of the hallmarks of a sector with sustainable long-term dividend growth potential, while still offering among the highest yields in the TSX.

Exhibit 126: Valuation Stable and Below Market



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

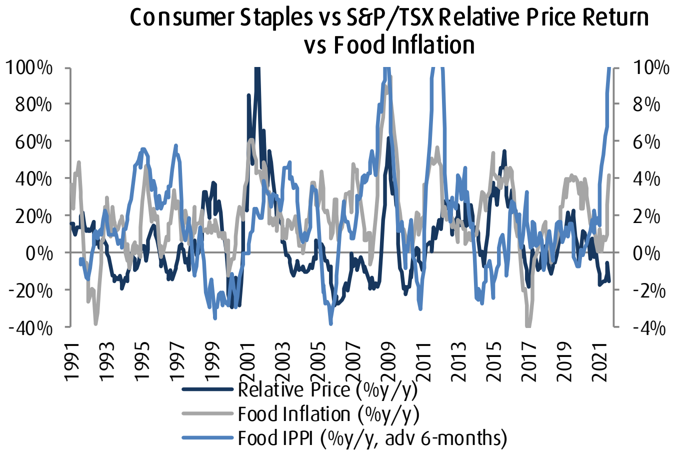
Communications Services = Value

- Indeed, metrics like declining profitability and a mature growth profile are certainly reasons for caution (hence the Market Weight). Nonetheless, we believe much of this is priced in with our valuation composite only at its long-term average and near a cycle low relative to the TSX.

We view this sector as a stable source of income, including a dividend growth profile that can organically exceed the other income-based sectors.

Market Weight: Consumer Staples

Exhibit 127: Food Inflation Is Typically a Strong Positive

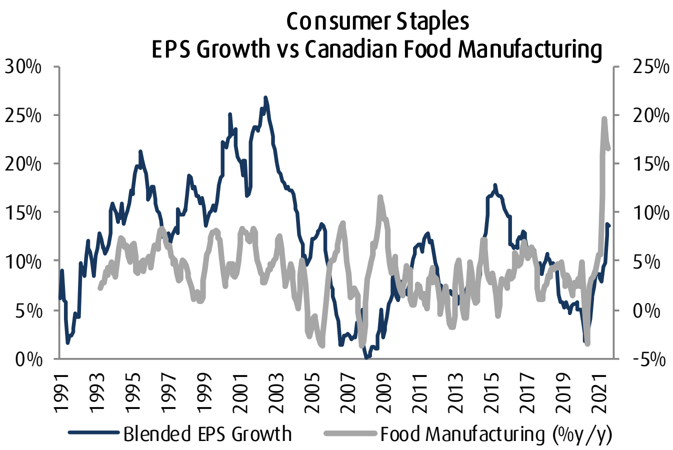


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Consumer Staples = Tactical Tailwinds

- While Consumer Staples is a classic defensive sector that posts its best relative performance when the economy is contracting, our work shows food inflation is typically a very strong tactical positive for the sector.
- In-store food inflation is now at the highest level since 2015. More importantly the food industry producer price index, which typically leads up to 6 months, is at the highest level since 2012.

Exhibit 128: Consumer Staples = Peaking Earnings Recovery

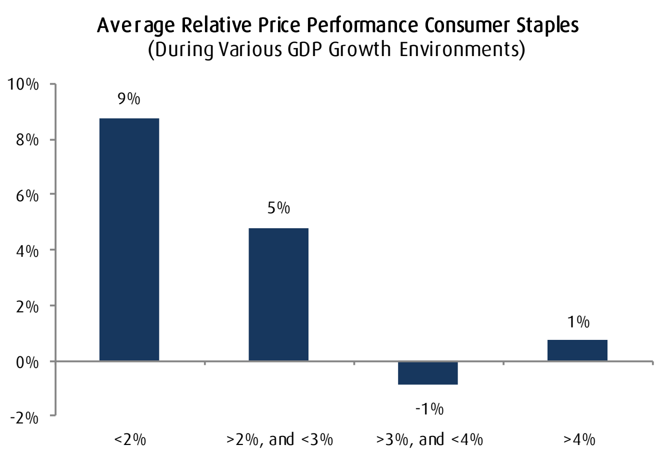


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Consumer Staples = Earnings Recovery Is Peaking

- Blended Earnings growth, which measures the average of LTM and NTM EPS growth, is on a clear up trend. Rebounding food manufacturing and food inflation all point to continued earnings recovery in the months and quarters ahead.

Exhibit 129: Consumer Staples = Classic Defense



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

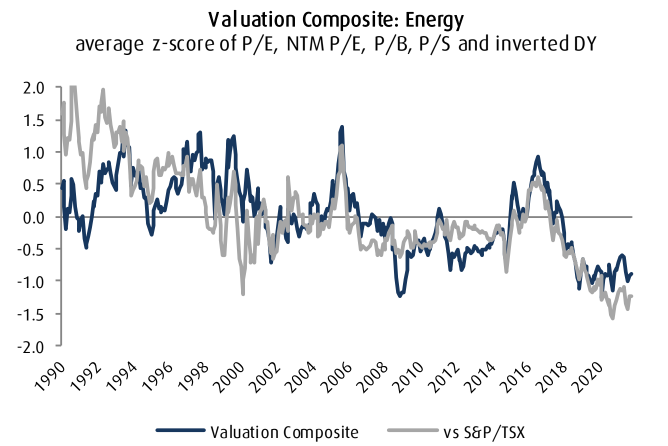
Consumer Staples = Defense

- Consumer Staples is a classic defensive sector posting its best relative performance when economic activity is depressed.
- As such, we remain cautious on the sector heading into 2022, especially given the 2022 consensus GDP growth estimates are in the 4% range.

There are some clear tailwinds that point to near-term strength; however, we remain broadly selective within the sector given its traditional defensive nature.

Market Weight: Energy

Exhibit 130: Energy Remains Deep Value Sector

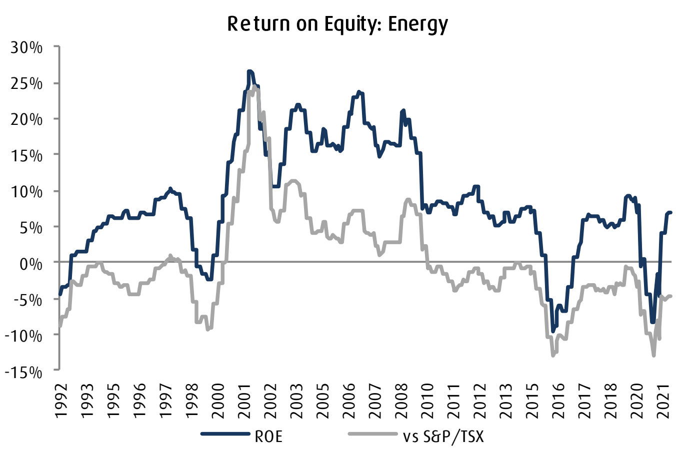


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Energy = Deep Value Sector

- Despite the strong outperformance this year, valuations have remained stable as price performance has only kept pace with improved earnings and profitability.
- There remains a lot of room for valuation expansion. Indeed, the sector remains a deep value sector, in our opinion, suggesting limited buy-in to the current commodity price rally.

Exhibit 131: Profitability Has Recovered

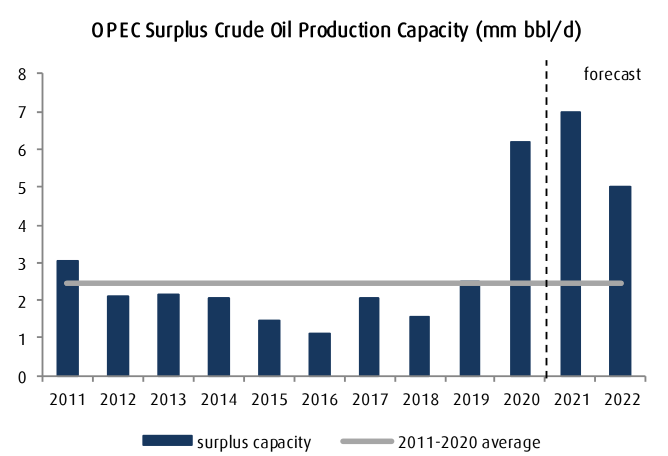


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Energy = Profitability Has Rebounded

- Profitability within Energy has struggled in recent years and likely remains challenged given regulatory, environmental and demand headwinds. However, the sector has made many hard-earned structural changes from more cautious capital spending to better cash flow management, and as such, created a stronger underpinning to benefit from periods of elevated oil prices.
- As such, we believe the Energy sector is well positioned for dividend distributions and corporate actions in 2022.

Exhibit 132: Spare Production Capacity Is a Risk



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

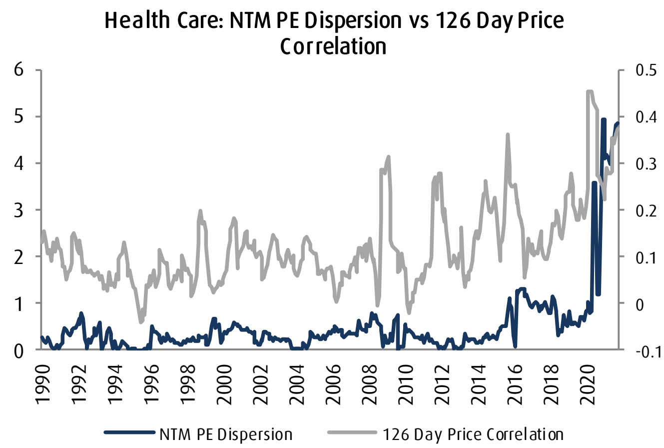
Energy = Supply/Demand Dynamics Key Underlying Risk

- Epic stimulus has pushed oil demand to outstrip supply for five consecutive quarters, the longest and deepest supply imbalance since the 2006-2008 pre-financial crisis period. However, our work suggests there remains significant global supply capacity with production discipline and unity remaining key to continued energy price strength. While supply imbalances can certainly last for an extended period, this is significant risk to continued outperformance.
- WTI fell by almost 50% 12 months after the 2006-2008 supply imbalanced reversed, from Jun 2008 to Jun 2009.

We remain Market Weight the sector with a defensive tilt toward cash flow.

Market Weight: Health Care, Technology

Exhibit 133: High Correlation, With High Fundamental Dispersion



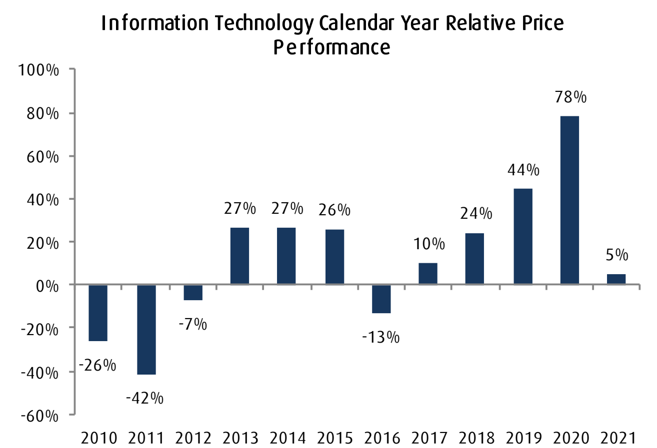
BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Health Care = Be Selective

- Price correlations with the Health Care sector have spiked to near record highs as the sector has seen broad underperformance. However, we have also seen a sharp spike in valuation dispersion, suggesting to us that investors should be more selective.

As such, we believe investors should be more selective within the Health Care sector, with a focus on fundamentals and growth potential.

Exhibit 134: Technology = Secular Outperformance

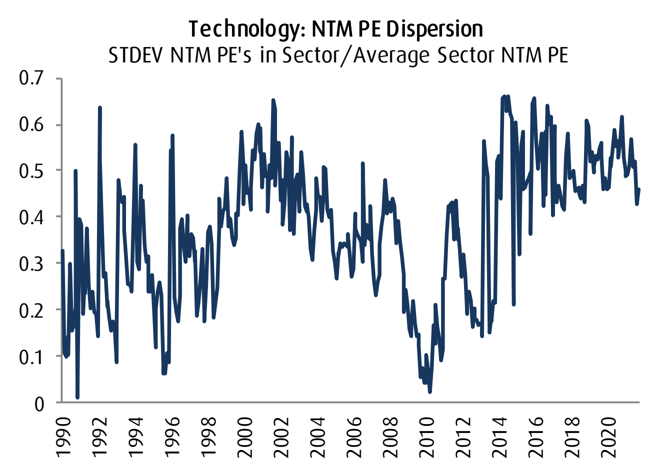


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Technology = Balance Between Secular Growth and Elevated Valuation

- There is no doubt that Technology has been a key area of strength in both the US and Canada over the last eight years. Indeed, secular growth trends continue to favour the sector.
- As such, it is very difficult to be underweight the sector despite elevated valuations and contrarian performance indicators.

Exhibit 135: Technology = Elevated Valuation Dispersion



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

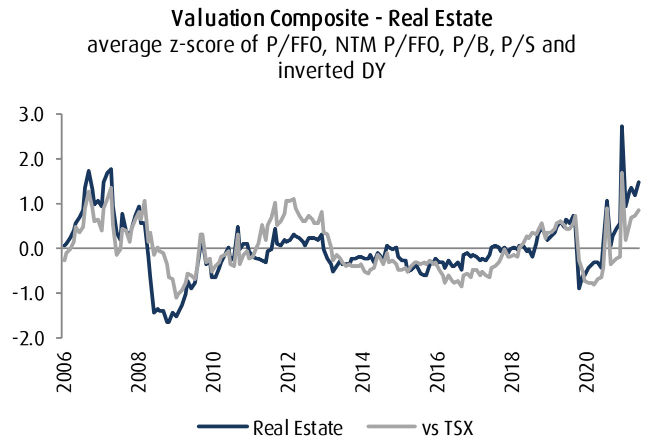
Technology = Be Selective

- Elevated valuation dispersion suggests a more active approach is warranted within the Technology sector.

We prefer the US for diversity; very select positions in Canada that are levered to secular trends.

Market Weight: Real Estate (Upgraded to Market Weight from Underweight)

Exhibit 136: Outperformance = Rise in Valuations

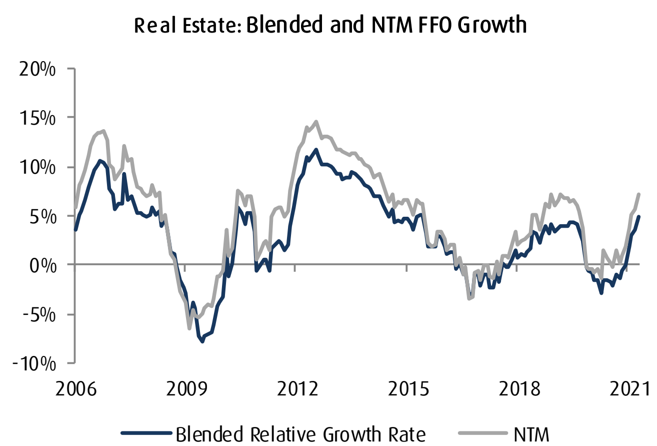


BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Real Estate = Outperformance Has Pushed Valuations Higher

- The Real Estate sector has been a clear beneficiary of the re-opening trade as the sector has been among the best performing sectors in 2021. However, expectations have outstripped earnings which have been slower to recover, pushing valuations to the highest levels since 2007.

Exhibit 137: Earnings Are Recovering

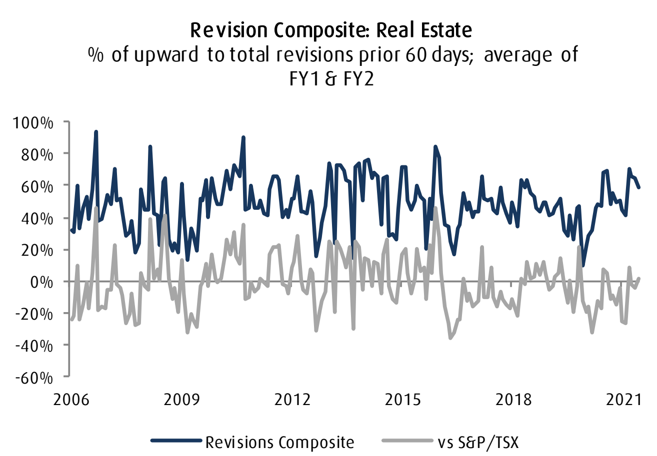


Source: BMO Capital Markets Investment Strategy Group, FactSet.

Real Estate = Early Stages of Earnings Recovery

- While the sector may look expensive, our work suggests that earnings are in fact recovering faster than we previously expected. The earnings recovery is still likely in the early stages of the recovery and could reach double-digit levels as the economy continues to re-open, thereby justifying current valuations.

Exhibit 138: Revision Trends Point to Positive Surprises



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

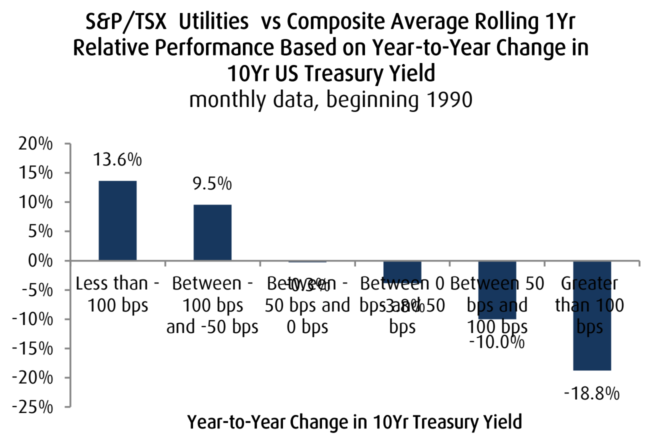
Real Estate = Could See Positive Surprises in 2022

- Yes, expectations have been on the upswing, with our revision composite (which measure the breadth of FY1 and FY2 EPS revisions) firmly above 50%.
- Our work shows improving revisions are highly corelated with positive surprises.

We are upgrading the Real Estate sector to Market Weight from Underweight due to the stronger-than-expected earnings environment. Additionally, our work has shown Real Estate to be less interest-sensitive than other high-yielding sectors, particularly since 2002.

Underweight: Utilities

Exhibit 139: Utilities = Challenged When Rates Rise

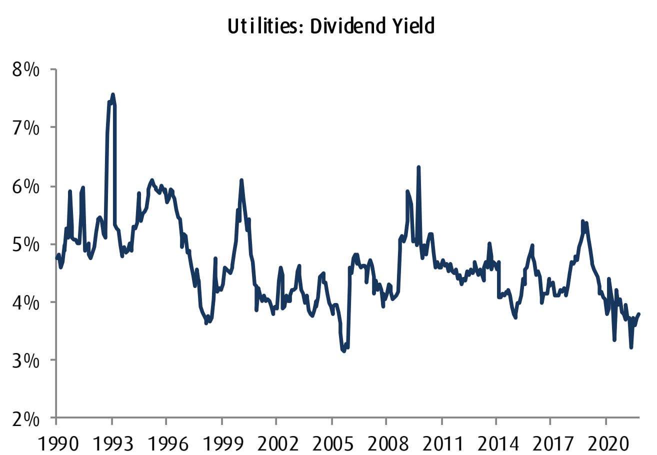


Source: BMO Capital Markets Investment Strategy Group, FactSet, FRB.

Utilities = Ultimate Rate Sensitive Sector

- Utilities is the most classic rate sensitive sector, posting its best relative performance when interest rates are declining sharply and underperforming when interest rates start to stabilize and creep higher.

Exhibit 140: Utilities = Yield Advantage Is Diminished

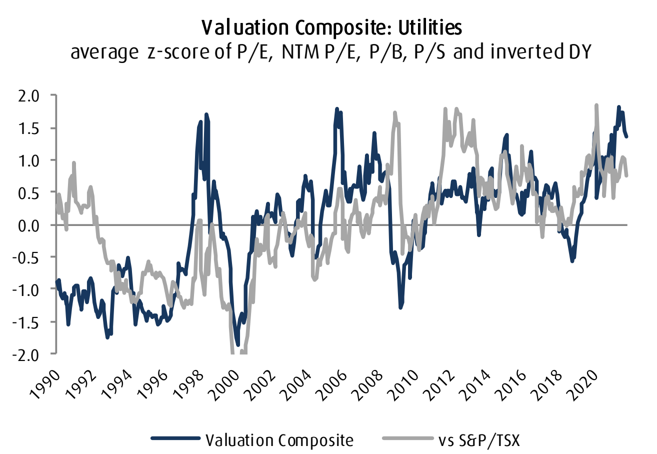


Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Utilities = Yield at Cycle Low

- As the sector has become increasingly expensive, the dividend yield has also compressed to cycle lows. Indeed, we believe there are more attractive areas to gain yield in the portfolio with significantly less risk from rising interest rates.

Exhibit 141: Utilities = Elevated Valuations



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES.

Utilities = Relatively Expensive

- Our z-scored valuation composite remains well above the one-standard deviation level, with Utilities among the most expensive sectors in the TSX.

As such, rising yields, low organic growth and high payout ratios are a tough combination. Areas to focus on would be renewables and non-regulated Utilities.

Canadian Size Opinions

Exhibit 142: Canadian Size Opinions

Sector	Opinion	Comments
Large cap	MW	Valuations are generally more expensive than small cap. However, earnings growth remains more stable and profitability is strong. Resource sectors display significantly higher quality metrics than small cap.
Small cap	MW	Relatively attractive valuations, but lower quality resource names add risk. Meanwhile, the non-resource small-cap names are likely to remain a key area of strength.

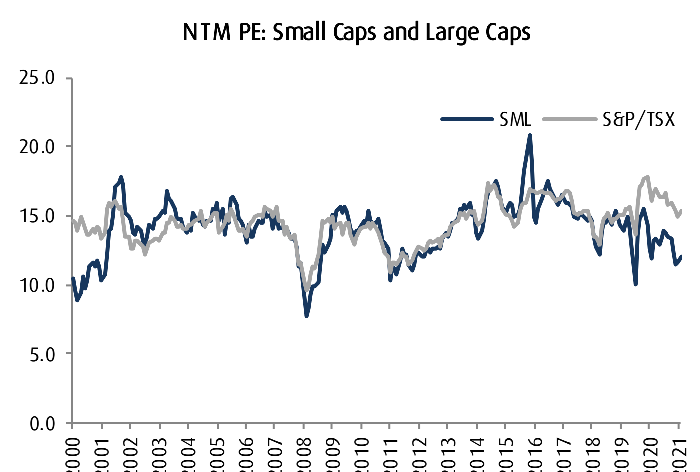
Key: OW: Overweight, MW: Market Weight, UW: Underweight
Source: BMO Capital Markets Investment Strategy Group.

Large Cap Over Small Cap

- Canadian small cap earnings continue to lag large cap stocks owing to continued profitability difficulty within the small cap resource space. Yes, small cap resource stocks have higher commodity price beta; however, the large cap resource sectors offer much greater fundamental consistency and stability.
- Traditionally, small cap and large cap stocks have seen valuations largely in line. As such, given the recent divergence, we believe valuations are likely set to converge over the coming quarters leaving significant room for multiple expansion within the small cap universe, particularly as the recovery matures and market normalizes.

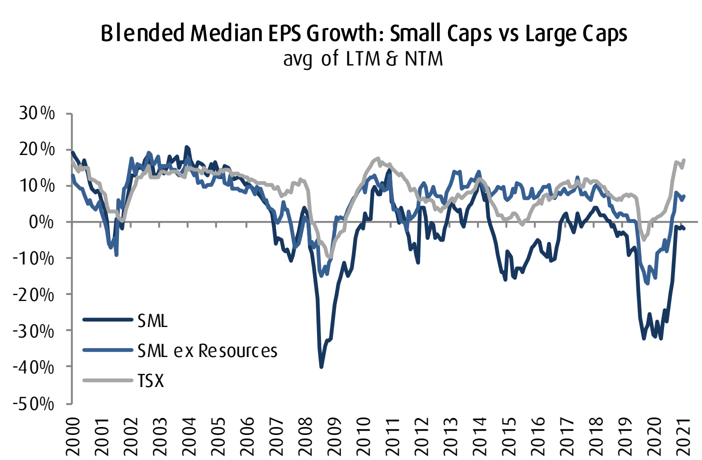
Bottom Line: While we remain somewhat cautious and neutral with respect to small cap versus large cap given our more defensive positioning within the heavy weighted Energy and Materials sectors, we acknowledge there is still likely plenty of room for small cap stocks to outperform over the coming quarters, especially for the sectors outside of resources. Furthermore, there remains significant room for fundamentals and valuations to catch up with large cap stocks as the economy continues to recover and markets normalize. As such, given our more defensive positioning within the resources sectors, we are market weight small caps more broadly. However, we believe there remain many opportunities within non-resource based small cap stocks. (See July 22, 2021 Snapshot for details)

Exhibit 143: Valuation Divergence Set to Converge in 2022?



Source: BMO Capital Markets Investment Strategy Group, FactSet.

Exhibit 144: Large Cap Growth Remains Stronger and More Consistent



Source: BMO Capital Markets Investment Strategy Group, FactSet, IBES

Implementation Strategies:

Investment Strategy Portfolios:

US Equity PLUS Portfolio	3Q/2021 Report
Large Cap Canadian PLUS Portfolio	3Q/2021 Report
US Large Cap Disciplined Value Portfolio	3Q/2021 Report
North American Dividend Growth Portfolio	3Q/2021 Report
Canadian Anything but the Big 3 Portfolio	3Q/2021 Report
US All Cap Portfolio	3Q/2021 Report

US Strategy Portfolios:

US Tactical Equity Portfolio	3Q/2021 Report
US Dividend Growth Portfolio	3Q/2021 Report
US SMID-Cap Portfolio	3Q/2021 Report

Exhibit 145: Model Performance Statistics – Investment Strategy Portfolios

Portfolio	YTD	2020	2019	2018	Live Portfolio Launch	Model Portfolio Inception
US Equity PLUS	26.8%	17.0%	35.4%	-7.9%	14.1%	14.3%
Benchmark: 75% SPX, 25% TSX	24.8%	15.7%	31.0%	-7.5%	12.6%	12.6%
US Large Cap Disciplined Value	25.1%	1.2%	30.9%	-12.3%	13.6%	13.0%
Benchmark: Russell 1000 Value	22.0%	2.8%	26.5%	-8.3%	11.9%	11.2%
CDN Equity PLUS ($CAD)	24.2%	10.8%	25.6%	-4.5%	15.5%	10.8%
Bench. ($CAD): 2/3 TSX, 1/3 SPX	22.5%	9.3%	23.6%	-4.6%	12.7%	8.9%
North American Dividend Growth	24.7%	5.4%	34.4%	-9.2%	15.0%	16.8%
Benchmark: 40% TSX, 60% SPX	25.2%	14.1%	30.7%	-9.3%	15.2%	15.3%
40/60 Dividend Aristocrats	23.1%	5.4%	30.1%	-8.1%	12.7%	12.8%
CDN Anything but the Big 3($CAD)	19.7%	14.2%	25.2%	-5.5%	17.5%	13.7%
S&P/TSX ($CAD)	23.4%	5.6%	22.9%	-8.9%	13.8%	9.9%
S&P 500	24.0%	18.4%	31.5%	-4.4%		
S&P/TSX ($CAD)	23.4%	5.6%	22.9%	-8.9%		

Source: Source: BMO Capital Markets Investment Strategy Group. Performance as of October 31, 2021. Performance is stated in USD, unless otherwise noted.

Exhibit 146: Model Performance Statistics – US Strategy Portfolios

Portfolio	YTD	2020	2019	2018	Live Portfolio Launch	Model Portfolio Inception
US Tactical Equity	24.4%	18.1%	31.4%	-2.4%	17.1%	18.3%
US Dividend Growth	23.8%	5.0%	32.4%	-7.8%	12.3%	13.4%
US SMID-Cap	26.5%					
S&P 500	24.0%	18.4%	31.5%	-4.4%	17.1%	17.4%
DVY	25.9%	-4.9%	22.6%	-6.3%	9.4%	9.4%
S&P 1000	22.8%				3.1%	23.3%

Source: BMO Capital Markets Investment Strategy Group. Performance as of October 31, 2021. Performance is stated in USD, unless otherwise noted.

Please Note: The performance numbers listed above are derived from our model portfolios. As such, they are not AIMR compliant nor have they been properly audited and are gross of fees unless otherwise stated.
For further performance numbers please see our latest quarterly performance report.

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Buy	Outperform	51.8 %	28.4 %	58.2 %	54.3 %	59.5 %	57.7%
Hold	Market Perform	46.9 %	20.9 %	38.8 %	44.4 %	39.1 %	37.5%
Sell	Underperform	1.3 %	57.1 %	3.0 %	1.3 %	1.3 %	4.8%

* Reflects rating distribution of all companies covered by BMO Capital Markets Corp. equity research analysts.

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Prior BMO Capital Markets Rating System

(April 2013 - October 2016)
http://researchglobal.bmocapitalmarkets.com/documents/2013/rating_key_2013_to_2016.pdf

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