

iSHARES ESG GLOBAL BOND INDEX FUND

iShares®
by BLACKROCK®

FUND UPDATE

31 December 2022

Investment Performance (%)

	1 Mth	3 Mths	YTD	1 Yr	3 Yrs	5 Yrs	Since Incep
iShares ESG Global Bond Index Fund (Gross of Fees) (Class E)	-1.38	0.55	-12.35	-12.35	-3.23	-	-2.73
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.40	0.53	-12.51	-12.51	-3.30	-	-2.77
Outperformance (Gross of Fees)	0.02	0.02	0.15	0.15	0.07	-	0.04
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	-1.40	0.50	-12.53	-12.53	-3.44	-	-2.96
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.40	0.53	-12.51	-12.51	-3.30	-	-2.77
Outperformance (Net of Fees)	0.00	-0.03	-0.03	-0.03	-0.14	-	-0.19

Past performance is not a reliable indicator of future performance. Performance for periods greater than one year is annualised. Performance is calculated in Australian dollars and assumes reinvestment of distributions. Gross performance is calculated gross of ongoing fees and expenses. Net performance is calculated on exit-to-exit price basis, e.g. net of ongoing fees and expenses. Gross returns are provided for products offered to wholesale clients only who may be subject to differential fees. Please refer to the Fund's product disclosure statement for more information.

Performance Summary

Market Review

US

In December, the Federal Open Market Committee (FOMC) raised the Federal Funds rate by 50 bps to a target range of 4.25% to 4.50%, a step down from the 75bps pace seen in the past four consecutive meetings. While the Fed slowed the pace of rate hikes, the Committee's median projection of a further 75 bps hike suggests monetary policy remains on a tightening path. In the accompanying press conference, Chair Powell's opening remarks drove a hard stance on the fight against inflation and the need for more evidence that inflation is abating. While the Fed clearly communicated vigilance, Powell recognized the lagged effects of policy, paving the way for a continued downshift in the pace of hikes if conditions warrant.

On the U.S. data front, the November Core CPI showed a second consecutive soft inflation print. Core CPI rose to 0.2% MoM, the smallest increase since August 2021, a sign of moderation. Headline CPI rose 0.1% MoM bringing the annual run rate to 7.1%, the smallest annual increase since December 2021. Details showed autos prices falling -1.3% MoM, with used cars seeing a steeper decline of -2.9% MoM. Owners-equivalent-rent and rent of primary residence ticked up to 0.68% and 0.77% MoM, respectively. Though rents increased after falling the previous month, we view this reading as positive as it provides supporting evidence that rents have likely peaked/are no longer accelerating sequentially, and thus the next phase will be deceleration — likely in early 2023.

In addition, the November jobs report showed that the US labor market is still strong, with 263k jobs added and the unemployment rate remaining at 3.7%. The labor participation rate, which fell to 62.1%, is still lower than pre-pandemic levels. Average hourly earnings rose by 0.55% m/m, up by 5.1% a year ago.

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- Fund Performance
- Unit Prices

Eurozone

Despite slowing the pace of the rate hikes, the last ECB meeting of the year provided a hawkish message with President Lagarde stressing the need to increase rates “significantly higher”. The deposit rate is now 2%, with speed of recent tightening (250bps in the last 6 months) unprecedented as ECB looks to subdue extremely elevated levels of inflation. Plans were also released to stop replacing maturing bonds from its Eur5trn balance sheet, reducing monthly reinvestments from its Asset Purchase Programme by Eur15bn starting in March with any revisions to the pace of reduction occurring from July.

Updated ECB staff projections reflected the hawkish rhetoric with inflation expected to stay above 2% until 2025. The forecast for 2023 inflation was increased to 6.3% from 5.5% with core (excluding energy and food) 4.2% from 3.4% despite notable improvements in energy markets and further easing of supply bottlenecks. GDP growth was revised down to 0.5% next year while the 2024 projection was unchanged 1.9%.

Markets reacted by increasing the projected terminal rate to around 3.30% (40bps higher) with 2 year German bonds witnessing one of their largest daily moves in history. The ECB is expected to raise rates by a similar increment in February with further hawkish rhetoric and Bank of Japan (BOJ) amending their yield control framework pushing the terminal rate closer to 3.50% at the end 2022. Excess reserves in the Eurozone fell to Eur4trn (from 4.5trn) after the latest repayment of TLTRO loans although there was little disruption in overnight markets with ECB Deposit Rate – ESTR spread stable around 10bps.

Assisted by the ECB rhetoric, BOJ monetary policy adjustment and resilient economic data curves moved materially higher through December. German 10 year bunds closed 2022 at yearly highs of 2.56% and although hawkish ECB initially saw the curves flatten further (2s10s -32bps) we finished the month -15bps. The talk of higher rates was negative for periphery assets, the spread between Italian and German 10 years bonds moving above 200bps with outright yield on 10yr BTP's 4.68%. Italian cabinet ministers were very vocal in criticising the ECB with Defence minister Guido Crosetto stating aggressive monetary policy makes ‘no sense’

Aiming to limit the volatility witnessed in natural gas markets this year EU energy ministers reached an agreement to cap gas prices in the eurozone when they hit 180 Eurs per MWh. More aggressive than earlier suggestions (240 Eur per MWh), the price would cap would have been triggered this summer when Europe needed to fill up gas storages pre-winter. Leaving room to circumvent the cap, Germany, who had opposed the policy agreed to the deal after safeguards were implemented allowing flexibility to remove the limit if there were gas shortages.

UK

UK economic highlights during December included a Bank of England (BoE) split decision rate hike, CPI showing possible signs of cooling, a positive month-on-month GDP number, and unemployment remaining near historic lows. The pound strengthened as GBP/USD hit 1.24, the highest level since mid-June. Bond yields trended higher throughout the month as the curve steepened with the 10-year gilt outperforming shorter dated bonds. 10-year gilt yields increased by just shy of 60bps while 2-year gilt yields increased by only 30bps. It was an important month to end the year as it gave some clues to the big questions of how much higher inflation may go and how the BoE would deal with it. Although the economic data proved better than expected, markets are forecasting a recession for 2023, technically having started in Q3 2022. The BoE has equally warned of economic challenges ahead.

The start of the month saw the latest monthly GDP reading grow at 0.5% following the previous two months of negative growth. Annual GDP also beat expectations growing at a pace of 1.5% while GDP for Q3 shrank more than first reported, revised to a decline of -0.3%. CPI showed signs of easing and the possibility that it peaked in November after coming in lower than expected at 10.7% YoY. Core inflation also came in lower at 6.3%, only the second downside miss of the year. The largest contributors to the decline were the drop in cost of petrol and used auto prices. The jobs market remained tight with the unemployment rate at 3.7%, in line with expectations.

The BoE raised interest rates by 50bps to 3.5%, highest since October 2008. Voting 6-3 to slow their pace from last month's meeting – the largest rate hike since 1989 – it was a three-way split for the divided bank. Two members dissented from hiking altogether while one member, Catherine Mann, favoured a larger hike of 75bps. Comments proved equally dovish with “considerable” uncertainties around the economic outlook. However, the BoE expects inflation to continue to fall gradually, and revised the GDP forecast for the fourth quarter of 2022 to a smaller decline of 0.1%.

Japan

JGB yield rose mainly via 6-15yr zone and 10Yr yield ending the month 16bp higher at 0.41%. In the Japanese bond market, on the back of the potential revision of the BOJ's yield curve control policy as well as accelerated inflation, 10yr yields were stuck around the 0.25% area that the BOJ is defending with the YCC until the BOJ meeting on 20th. After BOJ decided to expand the YCC band to +/-0.5% on December 20th monetary policy meeting, bond yields rose discontinuously, especially below 10-year.

The overall inflation ex-perishable food was +3.7% YoY in November, remained above the central bank's 2% target for an eight straight month and hitting four decade high as energy and food prices continued to be high. The unemployment rate remained relatively low at 2.5% in November.

The BOJ increased its planned monthly JGB purchases for January-March 2023 to 9 trillion yen, up sharply from the 7.3 trillion yen purchased from November 2022. Also, temporary purchases and increases in purchases were made through year-end while conducting unlimited bond purchase operations for 2-year and 5-year in addition to the 7-year and 10-year, resulting in a large purchase of over 17 trillion yen in December.

Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.46	8.66
Modified Duration (Years)	6.79	6.80
Normal Yield (%)	3.69	3.69
Convexity	0.84	0.86

Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	19.7
JAPAN (GOVERNMENT OF)	13.1
UNIFORM MBS	9.4
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	5.7
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.9
ITALY (REPUBLIC OF)	2.8
FRANCE (REPUBLIC OF)	2.7
GERMANY (FEDERAL REPUBLIC OF)	2.0
SPAIN (KINGDOM OF)	1.8
UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (GOVERNMENT)	1.8

Top 10 Issuers held by ESG score

	ESG Score
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	10.0
SOCIETE GENERALE SA	10.0
AKZO NOBEL NV	10.0
ASSICURAZIONI GENERALI SPA	10.0
BANCO BILBAO VIZCAYA ARGENTARIA SA	10.0
BUNGE LIMITED FINANCE CORPORATION	10.0
CNH INDUSTRIAL CAPITAL CANADA LTD	10.0
COUNCIL OF EUROPE DEVELOPMENT BANK	10.0
CRH FINANCE DAC	10.0
DANONE SA	10.0

Quality

	Fund %	Benchmark %
Aaa	43.4	43.7
Aa	13.8	14.0
A	29.7	28.2
Baa	12.7	12.6
Ba	0.0	0.0
NR	0.3	1.6

Maturity Exposure

	Fund %	Benchmark %
< 5	42.56	41.40
5 - 10	32.42	32.05
>= 10	25.03	26.55

Country Exposure

	Fund %	Benchmark %
US	41.42	41.60
Japan	13.70	13.71
China	5.68	5.84
Germany	4.27	4.42
France	5.12	5.17
UK	4.59	4.44
Italy	3.11	3.04
Canada	3.46	3.43
Other	18.64	18.34

ESG Sector Score

	Fund	Benchmark
Treasuries	6.32	6.34
Government Related	6.53	6.47
Corporates	5.67	5.50
Securitized	5.37	5.35

ESG Score Breakdown

	Fund	Benchmark
Environmental	5.58	5.47
Social	7.03	7.03
Governance	6.33	6.35

Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.34	1.44

About the Fund

Investment Objective

The Fund aims to match the return of the Bloomberg Barclays MSCI Global Aggregate SRI Select ex-Fossil Fuels index (AUD hedged) before fees less interest withholding taxes and the cost of currency hedging.

Fund Strategy

The strategy seeks to match the distribution of the risk-and-return factors of the index through a “stratified sampling” approach. This approach breaks the index into “cells” of securities that have similar factors of risk and return and then build a portfolio to match these cells. The factors we consider are interest-rate risk, credit risk and specific (security) risk.

Should be considered by investors who ...

- ▶ Seek broad exposure to global bonds.
- ▶ Seek a fund that uses a stratified-sampling approach so returns match those of the global bond market before fees and before the cost of currency hedging.
- ▶ Have a long term investment horizon.

Fund Details

iShares ESG Global Bond Index Fund (Class E)

APIR	BLK2319AU
Fund Size	485 mil
Buy/Sell Spread	0.10%/0.10%
Tracking Error (3 Years p.a.)	-

iShares ESG Global Bond Index Fund (Class D)

APIR	BLK4636AU
Management Fee	0.20%

[^]The actual inception of the Fund is 1 August 2019.

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