

iSHARES ESG GLOBAL BOND INDEX FUND

iShares®
by BLACKROCK®

FUND UPDATE

28 February 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)	-1.22	-3.32	-2.82	-2.23	-	-	0.34
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.24	-3.33	-2.86	-2.40	-	-	0.33
Outperformance (Gross of Fees)	0.02	0.02	0.04	0.17	-	-	0.00
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	-1.24	-3.36	-2.85	-2.42	-	-	0.09
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.24	-3.33	-2.86	-2.40	-	-	0.33
Outperformance (Net of Fees)	0.01	-0.03	0.01	-0.03	-	-	-0.24

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.

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Performance Summary

Market Review

US

US Treasury rates were volatile in February on the back of Federal Reserve (Fed) hawkishness and geopolitical tensions. Initially, rates sold off at the start of the month due to a higher-than-expected CPI report and hawkish commentary from various Fed members. This brought the 2-yr and 10-yr rates to as high as 1.61% and 2.05%, levels last seen in February 2020 and July 2019, respectively. Against this hawkish backdrop, the market priced as much as seven rate hikes in 2022 around mid-month. However, towards the end of the month, 10-yr rates rallied by around 15 bps after Russia invaded Ukraine. The move lower in rates was driven by flight to safety flows into Treasuries, as well as a pricing-out of extreme central bank hawkishness. Real rates rallied sharply as breakevens rose due to a spike in energy prices. US crude oil prices jumped 9% to above \$100 a barrel, the highest level since 2014, while European natural gas prices surged 50% from already historically elevated levels. Such high energy prices will exacerbate already high supply-driven inflation in the near term. This complicates the dilemma central banks were already facing – and the policy confusion.

By month end, markets returned to pricing in roughly six rate hikes in 2022, and the level of rates was roughly unchanged from the start of the month, as the selloff in rates was offset by the rally late in the month. The minutes to the January FOMC meeting provided little to no forward guidance about the policy rate path, including whether the Fed would deliver a 50 bp rate hike in March. During this time market expectations were 50/50 on a 50 bp rate hike, and since the onset of heightened geopolitical turmoil, expectations are now around 20%.

On the economic data front, we received blockbuster jobs report with 467,000 jobs gained, along with cumulative revisions of 709,000 jobs for the November and December. This solid report suggests continued tightness in the US labor force, particularly given wages that continue to increase. For example, the January report saw average hourly earnings rise at 0.73% month-over-month and 5.7% year-over-year, which is impressive growth relative to recent history. The unemployment rate was little changed at just under 4%. More than anything else, the data provided more evidence that the labor markets remain solid, and if anything in need of more workers, despite an evolving domestic (and indeed global) economy that is in transition.

Consequently, the economic outlook overall raises new questions and challenges for global policymakers.

Headline CPI data printed at a strong 0.6% month-over-month and came in at 7.5% year-over-year, the greatest increase over a 12-month period since February 1982. We expect for Core PCE inflation to potentially migrate to the 2.5% to 3.5% range by year-end, as many of the logistical bottlenecks loosen up over time, alongside base-effect dynamics. Our view is that the need to move policy persistently and aggressively away from overly accommodative conditions, and toward a more neutral and appropriate stance, executing on this pivot is going to be a real challenge for policymakers.

Eurozone

Markets were rocked in February by geopolitical events as Russian forces attacked Ukraine. International leaders responded with a series of sanctions, with the most impactful ostensibly the freezing of Central Bank of Russia's FX reserves and cutting off Russia from SWIFT in a "matter of days". Germany broke from decades of policy to announce funding a 2% NATO commitment and to fund the arming of Ukraine military through a EUR 100bn special defence fund. The country will also change its energy policy to include the acceleration of renewable and supplementary coal and gas reserves.

A significant escalation of the Ukraine crisis was not priced into markets coming into 2022, resulting in risk-off moves over the month. The Euro Stoxx ends the February down 3.23%, while the S&P is down 3.14%. From a macro perspective, surging oil prices (Brent +11.5% over February, ending the month at \$98) raise stagflation risks, adding to central banks' dilemma.

German bond yields moved sharply higher in the first half of the month, given the more hawkish stance from the ECB at their February 3rd policy meeting. While in December, Lagarde laid out the expected pace of QE purchases over 2022, in February the ECB opened the door for recalibration in March. The stance changed from previous meetings, where the ECB had pushed back firmly on the possibility of rate hikes in 2022. The market immediately priced in further rate hikes for 2022. The escalation of the Ukraine crisis saw some yield retracement from the highs however, with 25bps of hikes by the end of the year now priced. The yield on the 10-year German bund finished the month at 0.13%, up from 0.00% at the end of January. Sovereign spreads pushed wider throughout the month, driven by both the hawkish ECB stance and the Ukraine crisis. Spreads on 10-year French government debt rose 6bps to 47bps, while spreads on 10-year Italian debt rose 29bps to 157bps.

Macro indicators in Europe continued to improve, with February PMIs (Purchasing Managers Index, surveyed before the significant escalation in Ukraine) coming in significantly ahead of consensus estimates, led by strength in services. The Eurozone composite PMI for February was 55.8, up from 52.3 in January. Indicators are also pointing to an easing of supply chain disruptions, which should feed through to German industrial production in the coming months.

Inflation prints continued to surprise to the upside, with French inflation printing at 4.1% YoY, up from 3.3% in January and above the consensus of 3.7% YoY. The main driver was energy prices which rose 21% YoY with food prices and services prices also rising 1.9% YoY. The French inflation report is the first read of European inflation in February, and with the ECB governing council meeting on March 10th, further inflation upside surprises add pressure to speed up policy normalisation. The crisis in Ukraine complicates the reaction function, given the uncertainty comes alongside further upward pressure on energy prices.

UK

February was a shocking month as tensions between Russia and Ukraine escalated to war. The conflict is still in its early stage and ramifications to the global political order are not yet quantifiable as further developments continue to appear at a rapid rate. It is clear there are significant economic and financial implications as sanctions imposed from Western nations have all but cut Russia from the global financial system. Russia responded by opting to withhold key commodities from export, such as oil and food which exacerbated supply concerns that've continued to linger throughout the UK's economic recovery. In light of this environment, bond yields were highly volatile with UK government bonds

concluding the month slightly higher due largely to upward movements in the first half of the month after the Bank of England (BoE) raised its key interest another 25 bps. The market ended February expecting interest rates to rise above 1.5% by the end of the year.

On the 3 February, the BoE voted to increase the base rate by 0.25% to 0.5%. Whilst the Monetary Policy Committee (MPC) voted 5-4 for the 25bps hike, opposing members felt a tighter monetary policy stance was warranted and judged a 50bps increase to the base rate was preferable. Hawkish action from the central bank prompted a sell-off in UK government bonds, particularly at the short end of the curve. By mid-February, UK 2-year yields increased 49bps, accompanied by a 29bps rise in 10-year yields, reaching levels not seen since 2018. However, this trend quickly reversed upon the outbreak of conflict between Russia and Ukraine inspired capital flight toward higher rated securities and government bonds in a wave of risk off sentiment. The MPC also voted to begin running down its stock of government and corporate bonds with a timeline to complete this end close of 2023. The MPC advised they will no longer reinvesting maturing assets, in addition to utilizing redemptions and active sales to reduce its stock. However, the timeline on actioning some of these points remains conditional for when the bank rate reaches 1% in addition to economic conditions.

Inflationary pressure continues to mount as Headline CPI increased from 5.4% to 5.5% in February, the largest publication in 30 years. Household energy bills will see a significant increase in April and inflation readings are likely to climb higher as an estimate by the BoE predicted a peak of 7.25% in April. Upon escalation of the Russia-Ukraine conflict, global energy markets were thrown into turmoil with oil prices surging to more than \$100 per barrel. Gas prices also increased steeply, including UK natural gas prices which could further add to the cost burden faced by both households and businesses. There is a great deal of uncertainty as to how sustained these, and any further, price increases may be. BoE policymaker Michael Saunders communicated that it is too early to suggest what impact these developments could have on monetary policy, but acknowledged the risk of stronger, more persistent inflationary pressure overshoot is higher than the February Monetary Policy Report suggested.

The release of UK Composite PMI confirmed a sharp improvement to an 8-month high of 59.9, reflected in both manufacturing and services as the Omicron wave subsided. However, input costs rapidly increased over the period leading to the sharpest upward move in charge inflation on record. The UK labour market remained tight as UK unemployment was unchanged at 4.1% in the three months to December 2021 whilst average weekly earnings increased by 4.3%. Despite wages increasing at a high rate, in light of increasing cost pressure on both household and businesses, decreasing consumer spending power is likely to be a key trend to monitor over the coming months.

Japan

Japan Government Bond (JGB) yields rose mainly at the 20Yr point, and the 10Yr JGB yield ended the month 1 bp higher. Bond yields continued to rise in major overseas bond markets on growing expectations that the ECB will raise interest rates before the end of this year, in addition to the US. JGB yields also rose with greater expectations for potential adjustments in the BOJ's own yield curve control policy.

Q4 GDP data showed a solid recovery, but the spread of the Omicron variant is likely to act as a downside factor again in the following Q1 2022 GDP print. The growth rate is likely to fluctuate significantly due to restrictions on behaviour and supply-side constraints. In the medium term, however, there are no major concerns about exports and capital investment, and production is showing signs of recovery. The overall inflation levels remained weak, hitting modestly higher at +0.2% YoY in January. While energy-related prices have risen, the impact of the reduction in phone bills continued to be a major downward factor. The unemployment rate remained relatively low at 2.7% in December.

The BOJ conducted fixed-yield unlimited buying operations for three current issues of 10Yr bonds when the yield rose and approached the fixed yield rate of 0.25%. Towards the end of the month, bond yields were under slight downward pressure as Russia launched its full-scale invasion of Ukraine.

Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.81	9.09
Modified Duration (Years)	7.41	7.48
Norminal Yield (%)	1.60	1.66
Convexity	0.85	0.87

Quality

	Fund %	Benchmark %
Aaa	41.8	41.8
Aa	15.0	15.2
A	28.2	28.0
Baa	12.9	13.4
Ba	-	0.0
NR	2.1	1.6

Maturity Exposure

	Fund %	Benchmark %
< 5	41.32	40.03
5 - 10	35.01	34.99
>= 10	23.66	24.99

Country Exposure

	Fund %	Benchmark %
US	36.29	39.23
Japan	14.50	14.49
Germany	4.66	4.63
France	5.52	5.49
UK	5.35	5.13
Italy	3.43	3.33
Canada	3.41	3.41
Other	26.83	24.30

ESG Sector Score

	Fund	Benchmark
Treasuries	5.86	5.84
Government Related	6.56	6.58
Corporates	6.88	6.50
Securitized	7.72	7.54

ESG Score Breakdown

	Fund	Benchmark
Environmental	5.42	5.34
Social	7.11	7.07
Governance	6.27	6.25

Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.15	1.23

Top 10 Issuers held by ESG score

	ESG Score
SWEDISH COVERED BOND CORP	10.0
ADOBE INC	10.0
BANCO BILBAO VIZCAYA ARGENTARIA SA	10.0
BANK OF NOVA SCOTIA	10.0
BERLIN HYPAG	10.0
BUNGE LIMITED FINANCE CORPORATION	10.0
CAISSE DE REFINANCEMENT DE L HABITAT	10.0
COMPAGNIE GENERALE DES ETABLISSEMENTS MICHELIN SCA	10.0
COUNCIL OF EUROPE DEVELOPMENT BANK	10.0
CRH FINANCE DAC	10.0

Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	18.4
JAPAN (GOVERNMENT OF)	13.9
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	4.2
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.0
FRANCE (REPUBLIC OF)	3.2
ITALY (REPUBLIC OF)	3.2
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.9
GERMANY (FEDERAL REPUBLIC OF)	2.7
UNIFORM MBS	2.7
UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (GOVERNMENT)	2.6

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	545 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 31 October 1997, however the Fund has been made available to clients investing indirectly through master trust or wrap accounts from 1 April 2010. Please note that pricing information displayed on BlackRock website from the date of the Fund's actual inception up to and including 31 March 2010 has been calculated before fees, whilst prices on and after 1 April 2010 will be reported on an after fees basis.

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