

iSHARES ESG GLOBAL BOND INDEX FUND

iShares®
by BLACKROCK®

FUND UPDATE

30 June 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)	-1.62	-4.69	-9.31	-9.31	-	-	-2.05
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.62	-4.67	-9.41	-9.39	-	-	-2.08
Outperformance (Gross of Fees)	0.00	-0.02	0.10	0.08	-	-	0.03
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	-1.64	-4.74	-9.40	-9.49	-	-	-2.29
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-1.62	-4.67	-9.41	-9.39	-	-	-2.08
Outperformance (Net of Fees)	-0.02	-0.06	0.01	-0.10	-	-	-0.21

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

The month of June saw a resurgence in volatility after a brief reprieve, as the market's focus toggled between persistently high inflation prints and growing fears around a potential recession. Bond markets witnessed substantial volatility – the US 10Y yield moved higher by 57 bps in the middle of the month, and then fell by 61 bps over the final 2 weeks to close June relatively flat at 3.01%. Equities continued to sell off with the S&P down over 8% on the month and ~20% YTD, making it the worst first half decline since 1970.

With respect to monetary policy, Fed speakers at the beginning of June suggested 50 bp hikes in June and July would create sufficient near-term tightening under the assumption that monthly inflation prints would decelerate. However, a surprisingly strong CPI print released the week prior to the June 15th FOMC meeting forced the Fed to accelerate its hiking path, raising rates by 75 bps. While the committee "does not expect moves of this size to be common," they have raised guidance for the path of hikes for the rest of the year – potentially into restrictive territory in 2022 – and will be looking for compelling evidence that inflation pressures are abating before considering a pause. Importantly, the Summary of Economic Projections revealed an acknowledgment that restoring price stability will require some economic pain, likely in the form of higher unemployment.

Elsewhere on the economic data front, we received a solid jobs report in the form of 390,000 jobs gained in May, albeit a slowdown from the 516,000 gained in April. Unemployment remained little changed at 3.62% for the third month in a row as the pace of recovery continues to slow since the start of the year. Other parts of the economy also showed moderation, namely weak retail sales figures, a decline in housing starts, and weaker PMI data. Additionally, consumer confidence has fallen precipitously over the course of the month as inflation takes its toll on household spending and sentiment.

In the second half of the year, we anticipate additional uncertainty and a challenging investment environment. The Fed has become a single mandate institution aimed at fighting entrenched inflation, even if it's against slower growth with markets highly sensitive to data prints, particularly inflation, and the forward evolution of monetary policy.

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- Unit Prices

Eurozone

Recession fears took centre stage in June, as economies showed increasing signs of slowing, and expectations for central bank policy tightening continued to increase on the back of broadening inflation risks. While the Eurozone Purchasing Managers Index (PMI) remained above 50 (in expansionary territory), the index fell from 54.8 in May to 51.9 in June, its lowest level since February 2021. Details of the PMI report indicate further weakness ahead, with the output component of the manufacturing PMI falling to 49.3, and the forward-looking new orders component falling 4 points to 44.7, signalling further weakness in manufacturing activity in the months ahead. Companies mentioned several factors for their gloomier outlook, including headwinds from the rising cost of living, concerns over energy and food supply amid the Ukraine war, tightening financial conditions, ongoing supply chain shortages (often linked to China's lockdowns), and a broader diminishing of economic growth prospects.

Despite the weakening growth backdrop, rates continued to move higher given persistently high inflation, led by the front-end of the yield curve. Markets are now pricing 145bp of rate rises from the European Central Bank (ECB) by the end of 2022, and 228bp by the end of 2023. The yield on the 10-year German bund rose sharply in the first half of the month, reaching a high of 1.77%, before retracing somewhat to finish the month at 1.33%.

The ECB meeting on 9th June pre-announced a 25bp hike to interest rates in July. Flexibility was left for subsequent interest rate hikes, with the ECB indicating more substantial hikes (e.g. 50bp) may be warranted if the medium term inflation outlook persists or deteriorates. In response to this more hawkish tone from the central bank, Sovereign spreads rose substantially with the spread on 10-year Italian government debt rising to 242bp amid fears of fragmentation within the Eurozone. This led the ECB Governing Council to convene at an ad hoc meeting on June 15th, committing to flexibility in reinvesting redemptions coming due in the PEPP portfolio, with a view to preserving the functioning of the monetary policy transmission mechanism, and a commitment to a new anti-fragmentation instrument. Ultimately, Sovereign spreads stabilised with the spread on 10-year Italian government debt ending the month lower at 193bps.

Headline Euro area inflation (HICP) rose to a new record of 8.65% year-on-year in June, slightly above consensus, with Food and energy once again driving the strength. Core inflation eased slightly however, falling to 3.7% YoY, largely driven by German transport subsidies which will unwind in September.

UK

In a similar fashion to the global landscape, Sterling bonds remained under pressure and resulted in a steep increase in yields for both government and widening of corporate bond spreads. Key culprits behind the sharp sell off were elevated inflation data in addition to increasingly hawkish rhetoric from central banks signalling further tightening to come. The Bank of England (BoE) hiked interest rates to their highest levels in 13 years. In this environment, the market narrative shifted from higher inflation concerns to slowing growth risks as the moderation of UK's growth became more apparent.

UK inflation rose from 9.0% to hit a new 40-year high of 9.1% in May. Food and energy prices drive the upward surge, greatly exacerbated by the fallout from the war in Ukraine. In light of more persistent inflation reports, the BoE revised near term inflation forecasts, estimating inflation to increase to 11% by October 2022. Against this backdrop the bank hiked interest rates for a fifth successive time to 1.25%. Officials further stated they would "act forcefully" in the wake of further heightened figures, suggesting they remain open to larger hikes in future should they be necessary. Such comments have raised concerns that the intensity of focus on dampening down inflation lead to central banks tightening beyond the recessionary precipice. Both the short and long ends of the gilt market have seen a material rise in yields, the 10-year gilt yield reached an eight-year high of 2.65% over the month but managed to recover toward the period's close.

The BoE's Monetary Policy Committee (MPC) acknowledged UK inflation is being driven by UK specific forces. Core consumer goods prices were rising faster in the UK than in the US or eurozone whilst service prices increased quicker than in the eurozone. Sterling was weaker against both the US dollar and euro given rising fears about a potential trade war with the EU, adding to input costs which remain at elevated levels as supply weakness persists. This suggests a risk that "self-sustaining momentum" in inflation could persist despite a weakening economic environment.

Recession fears began to creep into the market as concerns around the hit to consumers' spending power in the face of high inflation began to be reflected in faster data outturns. This caused a turning point in the market's expectations for future rate hikes. Inflation pricing over the month finally began to moderate, driven by expectations of a growth slowdown, taking some of the heat out of the inflation market. Effects of such rhetoric are beginning to pay off as medium-term UK inflation expectations fell considerably over the course of June. 5-year breakeven decreased from 4.48% to 3.70%, one of the most notable decreases in the past decade.

Japan

Japanese Government Bond yields slightly rose mainly via long-end with 10Yr yield ending the month 1bp lower. The 10Yr moved within a narrow range, while the 5-9Yr rose slightly and the 10Yr+ rose and steepened relatively significantly. The 10Yr tested 0.25% in the middle of the month due to upward pressure on yields in overseas bond markets and the accelerating depreciation of the yen against the dollar amid persistently high US inflation figures and continued hawkishness by the Fed and ECB. Toward the end of the month, concerns around global economic slowdown increased downward pressure on yields in the US and Europe, but the impact on the domestic bond market remained relatively minor.

The overall inflation ex-perishable food recovered to +2.5% YoY in May as energy and food prices continued to be high, but also the impact of the reduction in phone bills, which had been a major downward factor started to fade. The unemployment rate remained relatively low at 2.6% in May.

The BOJ conducted the fixed-yield JGB-buying money market operation at 0.25% for 10-year for all business days and conducted temporary purchases of JGBs in a wide range of maturities while also increasing the amount of purchases in order to defend the yield curve control. In addition, in response to the malfunctioning of the bond futures market, the Bank announced the unlimited purchase operations on the 7-year CTD bonds for all business days for the time being, as well as the relaxation of requirements for complementary supply in this zone.

Treasury yields also moved higher post CPI led by the front end which advanced 40bps over the month. The high inflation print boosted expectations for the FOMC to deliver a 75bps rate hike versus previously expected 50bps. The committee, despite previously telegraphing that a 75bps point hike was off the table, obliged with Powell noting in the press conference that 75bps hikes were unusual, but not off the table for their next meeting. In the statement of economic projections, the committee reduced its growth outlook while increasing its unemployment forecast which stoked hard landing fears amongst market participants.

Against this backdrop, credit spreads moved to the widest levels of the year with the BBG Credit Index widening to 143bps, resulting in a monthly excess return of -151bps. Over the quarter the index posted a total return of -6.90% which marks the second consecutive quarter of negative returns. Ahead of earnings season, with more companies providing negative guidance, analysts have lowered their 2Q YoY earnings growth estimates from 5.9% at the start of the quarter to 4.3%. Six sectors are projected to report YoY earnings growth led by the energy and materials sectors while five sectors are expected to report YoY earnings declines led by financials. In the primary market issuance printed at \$91.2bn which is much lower than the ~\$125bn expected by the street. Similar to May, tumultuous markets kept many issuers on the sidelines. In respect to credit sub-sectors, the best-performing sectors were foreign local government, supranationals, construction machinery, consumer products and supermarkets. The worst-performing were gaming, tobacco, cable satellite, sovereigns and paper. AA rated bonds fared the best across the investment grade quality spectrum, while BBB fared the worst.

Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.71	8.86
Modified Duration (Years)	7.11	7.09
Normal Yield (%)	2.80	2.82
Convexity	0.88	0.90

Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	18.7
JAPAN (GOVERNMENT OF)	13.0
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.9
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	4.5
ITALY (REPUBLIC OF)	3.1
FRANCE (REPUBLIC OF)	3.0
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.9
UNIFORM MBS	2.6
FEDERAL HOME LOAN MORTGAGE CORPORATION	2.4
GERMANY (FEDERAL REPUBLIC OF)	2.1

Top 10 Issuers held by ESG score

	ESG Score
BANK OF NOVA SCOTIA	10.0
INTER-AMERICAN DEVELOPMENT BANK	10.0
AKZO NOBEL NV	10.0
BANCO BILBAO VIZCAYA ARGENTARIA SA	10.0
BUNGE LIMITED FINANCE CORPORATION	10.0
COMPAGNIE GENERALE DES ETABLISSEMENTS MICHELIN SCA	10.0
COUNCIL OF EUROPE DEVELOPMENT BANK	10.0
CRH FINANCE DAC	10.0
DNB BANK ASA	10.0
DNB BOLIGKREDITT AS	10.0

Quality

	Fund %	Benchmark %
Aaa	43.0	43.7
Aa	14.8	14.4
A	28.2	27.3
Baa	13.0	12.9
Ba	0.0	0.0
NR	1.0	1.6

Maturity Exposure

	Fund %	Benchmark %
< 5	40.79	40.82
5 - 10	33.84	32.73
>= 10	25.37	26.45

Country Exposure

	Fund %	Benchmark %
US	41.27	41.40
Japan	13.60	13.40
Germany	4.17	4.42
France	5.31	5.18
UK	5.12	4.80
Italy	3.40	3.16
Canada	3.40	3.53
Other	23.73	24.12

ESG Sector Score

	Fund	Benchmark
Treasuries	6.36	6.35
Government Related	6.35	6.34
Corporates	5.78	5.61
Securitized	5.50	5.44

ESG Score Breakdown

	Fund	Benchmark
Environmental	5.52	5.41
Social	7.08	7.06
Governance	6.38	6.36

Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.28	1.33

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	513 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 30 April 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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