

# iSHARES ESG GLOBAL BOND INDEX FUND



## FUND UPDATE

31 July 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)	2.55	0.65	-6.99	-8.14	-	-	-1.17
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	2.51	0.61	-7.14	-8.26	-	-	-1.21
Outperformance (Gross of Fees)	0.05	0.03	0.15	0.12	-	-	0.04
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	2.54	0.60	-7.10	-8.33	-	-	-1.40
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	2.51	0.61	-7.14	-8.26	-	-	-1.21
Outperformance (Net of Fees)	0.03	-0.02	0.04	-0.07	-	-	-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.

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- Fund Performance
- Unit Prices

## Performance Summary

### Market Review

#### US

In July, investors primarily focused on the Federal Reserve's (Fed) hiking path amidst slowing economic data. Over the month, 10-year on-the-run (OTR) nominal rates moved ~36 bps lower, while 10-year OTR real rates rallied ~57 bps. The Federal Open Market Committee (FOMC), on Wednesday, July 27th, raised its policy interest rate by 75bps to continue the path of normalization. In addition, Chair Powell stated that we should not expect the same clear meeting-ahead forward guidance that we saw in past meetings, but "it likely will become appropriate to slow the pace of increases while we assess how our cumulative policy adjustments are affecting the economy and inflation." They're going to be data-dependent and make decisions meeting-by-meeting. The committee will continue to remain focused on fighting inflation and preventing higher inflation from getting entrenched as the labor market is now extremely tight.

In data, the June nonfarm payroll report added 372k jobs, another solid monthly gain, indicating the labor market remains strong. Details showed private employment led the gains with a 381k increase across most sectors over the month. Elsewhere in the report, labor force participation edged lower to 62.2% MoM, remaining well below the pre-pandemic level of 63.4% in February 2020. Taken together, the unemployment rate remained at 3.6% for the fourth month in a row. Average hourly earnings increased in 0.31% in June, moving the YoY rate down to 5.11%. In other data, the ISM manufacturing index moved lower to 53.0 points in June from 56.1 points in May, pointing to the slowest growth in factory activity since June 2020. The advanced estimate of Q2 GDP released on July 28th, 2022, showed a second consecutive decline at a 0.9% annualized rate. The print highlighted the increasing possibility of a recession as decades high inflation cooled the growth trajectory. The June CPI report showed another robust gain in core and headline series. Core CPI increased by ~0.7% MoM or ~5.92 % YoY. Details showed used cars and shelter prices contributed to the strong monthly gain. Taken together with the strong core print, energy and food prices continued to move higher, pushing headline CPI to increase 1.3% in June, moving the YoY rate to 9.1%.

## Eurozone

The ECB raised interest rates for the first time in 11 years as it aims to contain inflation running close to 10%. Despite previously indicating a 25bps move, the central bank surprised by raising rates 50bps, ending the period of negative interest rate policy. Influenced by the requirement to react dynamically, the ECB dropped forward guidance, instead adopting a meeting-by-meeting approach to interest rate decisions. With inflation unlikely to start falling until late summer markets forecast another 50bps hike in September with 50bps of further tightening forecasted by the end of the year. The ECB announced the creation of the Transition Protection Instrument (TPI), a new bond buying scheme aimed to prevent fragmentation across the Eurozone. Positioned secondary to PEPP, eligibility is based on rules including compliance with EU fiscal rules, absence of severe macroeconomic imbalances, fiscal sustainability and sound and sustainable macroeconomic policies.

Scheduled maintenance to the Nord Stream 1 gas pipeline was completed with worst-case scenario avoided as flows returned into Europe. Energy ministers from the 27 member states supported a voluntary 15% reduction in gas usage over the winter with European Commission President, Ursula von der Leyen stating the prospect of Russia cutting off all supplies to the EU is a "likely scenario". Supporting this theory, Gazprom announced flows would be reduced to 20% of capacity causing European gas prices to climb 30% in two days.

The break-up of the governing coalition party of Italy saw Prime Minister Mario Draghi resign, with early polling suggesting conservative parties led by the far-right Brothers of Italy are favourite to win the next election. BTP-Bund spreads indicate little sign of reaching 300bps as seen in previous elections, instead recent price action has seen the spread tighten to 213bps (from 240bps) after suggestions Brothers of Italy leader Giorgia Meloni plans to stick to European Union budget rules if she leads the next government. Market sentiment will come as a relief to the ECB with Italian political risk viewed as idiosyncratic and little risk of fragmentation at this point (Portugal-German 10yr spread unchanged through July).

Outside of ECB meetings, PMI's were a significant determinant to the direction of rates markets. Composite PMI, which measures activity at both services and manufacturing companies across the eurozone, fell to a 17-month low of 49.4, down from 52 in June. Sitting at contraction levels (<50), yields on sovereign bonds fell as the probability of a recession diminished the likelihood of ECB matching market expectations of rate hikes. Developments in energy markets reinforced the risks to growth with the German 10-year yield falling around 50bps to 0.81% in July with almost 90bps of hikes in 2022 removed from money market curves. Despite the flattening in front end curves, European rates remain at odds with US and UK rates markets, the latter forecasting cuts in 2023 whilst Europe is biased towards a small amount of tightening.

Inflows returned to active fixed income strategies with fall in yields a catalyst for investor sentiment to turn bullish on the asset class. Tilted towards credit and longer duration strategies, the velocity of change in 2022 has seen European investment grade credit spreads reach 230bps and yield on EuroAgg index rise 220bps. Macro-economic headwinds are likely to take greater precedence in the second half of the year and we are confident duration hedges can offer investors protection against deteriorating growth.

## UK

In UK fixed income, falling sovereign yields coupled with tighter credit spreads meant that high yield was the best performing fixed income sector. Gilt markets had their most sustained rally of the year as increasing recession risk came face to face with central banks aggressively raising rates to combat inflation. Prime Minister Boris Johnson resigned after he lost the support of his parliamentary party. Whilst market moves seem pre-occupied with global forces, fiscal differences between PM candidates' policies could impact inflation when the victor takes office.

Economic data over the course of July continued to reflect the cost-of-living squeeze being exerted by rising energy prices and the other more widespread price rises being experienced on a global basis. UK Inflation once again hit another multi-decade high, increasing from 9.1% in May to 9.4% in June. Consumer confidence figures remained at all-time lows, while retail sales growth was reported as negative in most recent data. The pinch to consumer real incomes could likely be increasingly felt into year

end with higher energy tariffs resets in October to further squeeze incomes. Purchasing Manager Index (PMI) surveys show declines of intake of new work for in addition to moderation of selling prices, even as cost inflation remains elevated, is squeezing margins for companies.

Weakening demand and heightened recessionary fears were echoed by some Bank of England (BoE) officials who warned that the domestic economy had 'deteriorated materially'. Chief Economist, Huw Pill, further elaborated on this point, stating he's not expecting the economy to grow for 'a year or so'. BoE Governor, Andrew Bailey, retained a focus on the materially worsening inflation situation and delivered messaging in line with increasing interest rate hikes. The BoE previously signaled at its June meeting that it would 'act forcefully' if it saw signs of persistent inflationary pressure. A narrative built over July that at its next meeting, the Monetary Policy Committee (MPC) could depart from 25 bps hikes, opting to raise the key rate a further 50 bps. The UK is now priced for another 150bps of rate hikes by early 2023, with rates then expected to fall from June onwards.

Whilst the MPC considers aggressive rate hikes against a gloomy economic outlook, markets reflected a growing risk-off sentiment. The tide began to turn as yields declined across the curve on government bonds, most visibly in the 10-year Gilt yield which fell 37 bps over the month to 1.86%. Albeit less pronounced, 2-year and 30-year Gilt yields declined by 13 and 16 bps, respectively.

On a political note, the UK Prime Minister will be expected to take office on 5 September 2022. Following rounds of voting from conservative Members of Parliament, the field was quickly narrowed from eight to two candidates, Rishi Sunak and Liz Truss. Economic policy is a key area of policy divergence, with future fiscal responses to a slowing economy now hinging on Boris Johnson's successor, and will have to be calibrated against the risk that they could further spur inflation.

## Japan

Japanese Government Bond yields fell mainly via 7yr zone with 10Yr yield ending the month 5bp lower at 0.175%. The Fed raised its policy rate by 0.75% for the second consecutive meeting and the ECB raised its rate by 0.5%, demonstrating its strong commitment to curbing inflation as inflation in the US and Europe continued to accelerate.

The overall inflation ex-perishable food was +2.2% YoY in June, remained above the central bank's 2% target for a third straight month 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 2.5% in June.

The BOJ maintained its monetary policy. In the Outlook Report, the BOJ lowered its GDP growth forecast for FY2022, while it raised its core CPI forecast to 2.3%, but continued to expect a sharp slowdown in the CPI over the next fiscal year. The core-core CPI (excluding fresh food and energy) is expected to remain in the low 1% range through FY2022 and FY2023. At the press conference, Governor Kuroda strongly denied the possibility of any policy revisions.

### Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.72	8.92
Modified Duration (Years)	7.06	7.08
Normal Yield (%)	2.44	2.52
Convexity	0.85	0.87

### Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	19.1
JAPAN (GOVERNMENT OF)	12.9
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.7
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	4.4
FRANCE (REPUBLIC OF)	3.1
ITALY (REPUBLIC OF)	3.0
UNIFORM MBS	2.9
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.9
FEDERAL HOME LOAN MORTGAGE CORPORATION	2.3
GERMANY (FEDERAL REPUBLIC OF)	2.1

### Top 10 Issuers held by ESG score

	ESG Score
KLEPIERRE SA	10.0
AKZO NOBEL NV	10.0
BANCO BILBAO VIZCAYA ARGENTARIA SA	10.0
BANK OF NOVA SCOTIA	10.0
BUNGE LIMITED FINANCE CORPORATION	10.0
COUNCIL OF EUROPE DEVELOPMENT BANK	10.0
CRH FINANCE DAC	10.0
DEUTSCHE BOERSE AG	10.0
DNB BANK ASA	10.0
DNB BOLIGKREDITT AS	10.0

### Quality

	Fund %	Benchmark %
Aaa	43.2	43.7
Aa	14.9	14.4
A	28.0	27.5
Baa	12.8	12.7
Ba	0.0	0.0
NR	1.0	1.6

### Maturity Exposure

	Fund %	Benchmark %
< 5	40.57	40.16
5 - 10	35.03	34.66
>= 10	24.40	25.18

### Country Exposure

	Fund %	Benchmark %
US	37.75	41.30
Japan	13.54	13.45
Germany	4.15	4.40
France	5.39	5.19
UK	5.16	4.77
Italy	3.28	3.07
Canada	3.44	3.60
Other	27.27	24.22

### ESG Sector Score

	Fund	Benchmark
Treasuries	7.35	7.35
Government Related	7.18	7.16
Corporates	6.08	5.79
Securitized	5.31	5.48

### ESG Score Breakdown

	Fund	Benchmark
Environmental	5.53	5.44
Social	7.08	7.05
Governance	6.38	6.36

### Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.22	1.36

## 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	538 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%

<sup>^</sup> 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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