

iSHARES ESG GLOBAL BOND INDEX FUND

iShares[®]
by BLACKROCK[®]

FUND UPDATE

31 August 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)	-2.83	-1.97	-9.63	-10.56	-	-	-2.06
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-2.84	-2.02	-9.77	-10.67	-	-	-2.10
Outperformance (Gross of Fees)	0.01	0.05	0.15	0.11	-	-	0.04
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	-2.85	-2.02	-9.75	-10.74	-	-	-2.29
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-2.84	-2.02	-9.77	-10.67	-	-	-2.10
Outperformance (Net of Fees)	-0.01	0.00	0.02	-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.

Performance Summary

Market Review

US

The month of August was defined against a backdrop of continually high inflation prints driving global sovereign yields higher, as markets moved to reprice the path of global monetary policy. In the United States, nominal yields on the UST 2-yr sold off by 55bps, to close the month at 3.45%, at one point touching 3.50% for the first time since 2007. Further out on the curve, the nominal yield on the UST 10-yr sold off to a lesser extent, but a still significant amount, of 48 bps to close the month at 3.15%. These were notable moves to be sure, though relatively benign when compared to moves in the UK and Europe where Gilts and Bunds cheapened by more than 95bps and 70bps, respectively, on the month. This comes on the back of a more acutely sustained energy price shock due to the war in Ukraine, which has caused inflation expectations to the upside, compared to opposite moves observed in the US. Equities fared poorly, with the S&P500 dropping by -4.2% in August as markets braced for continued monetary policy tightening.

While there wasn't an FOMC meeting in August, the Federal Reserve was still able to communicate their thought process, and emphatically so, in the yearly Jackson Hole Symposium on August 26th. Fed Chair Powell's remarks to the Jackson Hole conference, while light on detail, offered a clear policy message: the Fed is determined to bring inflation back to target, and this calls for higher rates for longer, even though that will likely damage the economy. This follows Fed rhetoric throughout the month which placed more of an emphasis on holding rates higher for longer, as opposed to front-loading hikes and then pivoting, as was previously anticipated. Pricing on the front-end of the yield curve shifted to reflect the change in messaging, and subsequently pushed the terminal rate higher and priced out 35bps of cuts from 2023. This deviates from July's FOMC which was interpreted by markets as being gently dovish.

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Data released throughout the month reflected a continuation to an already tight labor market, and robust inflation which has gripped markets this year. August's nonfarm payrolls print covering the month of July was universally strong. Nonfarm Payrolls came in at 528k against consensus estimates of 250k, a shocking beat that perhaps provided the Federal Reserve with evidence that they can continue to be aggressive with inflation. The unemployment rate shifted slightly lower to 3.5% from 3.6% with the labor force participation rate declining to 62.1% from 62.2%. Average hourly earnings surprised stronger with upward revisions. July average hourly earnings gained 0.5% MoM vs. 0.4% in June, leaving the yearly pace at 5.2%. Concerning inflation, US CPI YoY increased 8.5%, lower than consensus estimates that called for an 8.7% gain. The MoM CPI figure printed flat (0.0%) against estimates that called for a 0.2% advance. Excluding food and energy, the YoY figure was marked at 5.9%. This provided fodder for conversations that inflation may have peaked, but the headline figure was largely driven by a drop in energy prices.

Eurozone

Western central banks re-iterated their commitment to tighten monetary policy in the face of inflationary pressures. Hawkish comments from ECB members included "even if we enter a recession, we have little choice but to continue the normalisation path" (Isabel Schnabel) and "the broadening and deepening of our inflation problem generates the need to act forcefully" (Klass Knot). The strong rhetoric saw the probability of a 75bps hike in September reach 90% with 171bps of tightening forecasted across the final 3 meetings of the year, up 75bps through August.

The projected pace of hikes in 2023 increased with forecasted terminal rate around 238bps. Price action flattened curves although unlike US and UK markets, a positive spread remains between 10 and 2-year yields. Forward markets trended higher, 5Y5Y OIS moving above 2% suggesting the ECB may need to adopt restrictive monetary policy in the long term. The move saw 5Y5Y OIS real yields move into positive territory, a rarity since 2015 and a post-QE market.

Eurozone headline and core inflation printed higher at 9.1% and 4.3% respectively. Whilst energy price pressures eased marginally, droughts and European heatwaves added to food price pressures. Feeding into core prices, higher fixings compounded the sell-off in bonds, the German curve around 5bps higher with 10 year 1.55%. Given the voting rules in ECB meetings (one country, one vote) it's interesting to note the inflation divergence across member countries with Estonia up 25.2% versus France 6.5%. Whilst elevated inflation fixings are forecasted to continue with one-year swaps 8%, the markets expect a very sharp retracement after the influence of base affects with 1Y1Y currently 2.15%.

Energy prices softened in August after the EU met its gas storage filling goal two months ahead of target. Whilst storage helps insure against supply shocks and provides around 25% to 30% of fuel consumed through winter, continued flow remains vital. A reminder as to the uncertainty of future supply re-surfaced after Gazprom unexpectedly halted gas flow through Nord Stream for three-days of maintenance.

Forward looking data disappointed with August PMI's suggesting the economy is heading towards a recession. Falling from 49.9 to 49.2, lower demand and rising inventories increased the probability of the region contracting in the third quarter. The immediate reaction of eurozone government bonds was to sell-off, demonstrating that despite the risk of falling into recession, the market believes the ECB will continue tightening monetary policy.

UK

UK Government bonds underperformed their global peers as UK monetary policy continued to prioritise inflation control in the wake of high reports. Fears around the outlook for the domestic economy more widely, in addition to the country's fiscal position, weighed in on the currency and led to very poor performance in sterling. With the increase in October in the energy price cap now on the immediate horizon, setting average household bills to almost double, any near-term optimism has taken a hit.

Over the course of August, economic data continued to reflect the cost-of-living squeeze amid an inflationary backdrop. UK Inflation once again hit another multi-decade high, increasing from 9.4% in June to 10.1% in July,

whilst August Flash Composite PMI declined by 1.2 points, managing to remain in marginally expansionary territory at 50.9. The Bank of England (BoE) significantly downgraded its UK economic forecast from its previous assessment in May, following the new surge in gas prices that reflected the protracted war in Ukraine and cuts in gas supply to Europe. The BoE forecast the UK to enter recession in Q4 2022 and continuing throughout 2023, with growth remaining weak following its conclusion.

Whilst the macro growth outlook looks to deteriorate, the policy path from the BoE kept its priorities to curb inflation. BoE governor, Andrew Bailey, vowed last month that there would be "no ifs or buts" in the central bank's commitment to returning inflation toward its 2% target. Following through, the BoE raised its policy rate by 0.5% to 1.75% at the start of the month, the largest margin in close to 30 years. Even though the UK central bank now expects a recession to start in the fourth quarter, it warned of further tightening to contain inflation, which it expects to rise further to 13%.

Boris Johnson's resignation in July has put a block on further major policies being introduced until a new leader of the ruling Conservative Party is elected. Uncertainty has increased as to the fiscal future of the UK. Frontrunner, Liz Truss, differs from rival Rishi Sunak particularly in areas of favouring tax cuts and purporting unorthodox regulatory views including the proposed altering of the BoE's inflation mandate. Political uncertainty and a slowing economy weighed on the currency. The sterling to US dollar exchange rate fell to its lowest point in 2022.

Against this backdrop, government bond yields posted the largest monthly jump on record in August. Moves were most pronounced at the shorter maturity end, with 2-year and 5-year Gilt yields increasing 131 bps and 117 bps, respectively. Increasing yields at the mid-longer maturing end were also extreme by historic standards as illustrated by a 94 bps increase in 10-year gilt yields.

Japan

Japanese Government Bond yields fell mainly via 7yr zone with 10Yr yield ending the month 4.5bp higher at 0.22%. The Japanese bond market also came under upward pressure as bond yields in the U.S. and European markets trended higher on the back of a series of statements by U.S. FOMC members indicating a strong commitment to curbing inflation retreating Fed's early interest rates hike termination or early rate cut and a continued rise in inflation indicators in the eurozone. However, the change in yield curve shape was partly a reaction to the significant bull-steepening in the over 7-year portion of the curve and yields mainly rose around the 7-year mark.

The overall inflation ex-perishable food was +2.4% YoY in July, remained above the central bank's 2% target for a fourth straight month as energy and food prices continued to be high. The unemployment rate remained relatively low at 2.6% in July.

Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.71	8.82
Modified Duration (Years)	7.07	7.02
Normal Yield (%)	2.99	3.04
Convexity	0.88	0.89

Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	19.4
JAPAN (GOVERNMENT OF)	13.3
FEDERAL NATIONAL MORTGAGE ASSOCIATION	4.8
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	4.6
UNIFORM MBS	3.0
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.9
FRANCE (REPUBLIC OF)	2.8
ITALY (REPUBLIC OF)	2.7
FEDERAL HOME LOAN MORTGAGE CORPORATION	2.4
GERMANY (FEDERAL REPUBLIC OF)	2.0

Top 10 Issuers held by ESG score

	ESG Score
BANK OF NOVA SCOTIA	10.0
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	10.0
SOCIETE GENERALE SA	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
DEUTSCHE BOERSE AG	10.0

Quality

	Fund %	Benchmark %
Aaa	43.7	43.9
Aa	13.9	13.9
A	28.5	27.8
Baa	12.5	12.7
Ba	0.0	0.0
NR	1.4	1.6

Maturity Exposure

	Fund %	Benchmark %
< 5	40.78	40.84
5 - 10	32.89	33.29
>= 10	26.33	25.87

Country Exposure

	Fund %	Benchmark %
US	37.46	41.71
Japan	13.86	13.53
China	5.88	5.76
Germany	4.04	4.29
France	5.00	5.08
UK	4.72	4.46
Italy	2.99	2.95
Canada	3.45	3.59
Other	28.47	24.39

ESG Sector Score

	Fund	Benchmark
Treasuries	6.36	6.35
Government Related	6.33	6.34
Corporates	5.77	5.58
Securitized	5.44	5.39

ESG Score Breakdown

	Fund	Benchmark
Environmental	5.54	5.45
Social	7.08	7.04
Governance	6.36	6.34

Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.97	2.14

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	527 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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