

# iSHARES ESG GLOBAL BOND INDEX FUND



FUND UPDATE

30 September 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)	-3.55	-3.89	-12.83	-12.86	-3.71	-	-3.11
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-3.54	-3.92	-12.96	-12.97	-3.74	-	-3.15
Outperformance (Gross of Fees)	-0.01	0.04	0.13	0.11	0.03	-	0.04
iShares ESG Global Bond Index Fund (Net of Fees) (Class D)	-3.56	-3.94	-12.97	-13.04	-3.93	-	-3.34
Bloomberg Barclays MSCI Global Agg SRI Select ex-Fossil Fuels Index 100% AUD Hedged	-3.54	-3.92	-12.96	-12.97	-3.74	-	-3.15
Outperformance (Net of Fees)	-0.03	-0.01	0.00	-0.07	-0.19	-	-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 September, the market was once again defined by a backdrop of continually high inflation prints and hawkish central banks 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 79bps, to close the month at 4.28%. 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 64 bps to close the month at 3.83%. US. Equities fared poorly, with the S&P500 dropping by -9.2% in September as markets braced for continued monetary policy tightening.

A strong inflation print in September showed strength across both goods and services. Headline CPI rose by 0.12% in August, bringing the YoY gain to 8.3%, lower than what we had seen in July. However, core CPI was the surprise with a monthly increase of 0.57%, bringing the year over year gain to 6.3%, higher than the 5.9% seen last month. The main story was shelter inflation which rose 0.69% this month (after 0.54% in July) with strength coming in both the rental and the owners' equivalent rent categories. Rental inflation is currently running at 6.7% which is the highest in almost 4 decades. Following the strong inflation print, The Fed raised rates by 75bps during the September FOMC meeting, bringing the Fed Funds rate to 3-3.25%. With this latest hike, the Fed has raised rates a total of 300 bps over a 7-month period which is the fastest tightening since 1980s. The Statement of Economic Projections (SEP) that accompanied the rate rise provided details on the projected path ahead. By end of 2022, the Fed estimates the funds rate to be at 4.4% up 100bps from their June projection. This would imply another 75bps in November and 50bps in December. By end of 2023, the estimated Fed funds rate is at 4.6% up from 3.8% projected in June – implying another 25bps of hiking in 2023 before reaching terminal rate. During the press conference, Chair Powell homed in on the “higher for longer” narrative and “will do what it takes” to control inflation. He repeated that there will be some economic pain to businesses and households in the process of lowering inflation but that is needed for bringing inflation down.

## Eurozone

The “front-loading” of rate hikes continued in Europe in September, with the ECB raising rates by a historic 75bps in the face of persistently high inflation. The ECB committed to raising rates further, but how much and for how long remain key questions facing investors – and will be dependent on incoming data. Downward revisions to its growth forecasts accompanied the policy move, although in contrast with market expectations, a recession is not the Bank’s base case. Over the month, German 10-year rates rose from 1.54% to 2.11%. Sovereign spreads ended the month little-changed, with the spread on 10-year French debt unchanged at 61bps, and on 10-year Italian debt rising 5bps to 240bps.

A ‘mini budget’ announced by UK Chancellor Kwarteng tabled the biggest set of tax cuts in 50 years, at a time when the Bank of England (BoE) is aiming to bring down inflation by curbing activity. This monetary and fiscal discord alarmed markets, sparking an aggressive sell-off in UK assets and a crisis of confidence in the UK bond markets. 5-year UK government bond yields traded above their Italian and Greek counterparts, while 30-year yields breached 5% momentarily, a psychological level and post ‘08 high. The BoE subsequently intervened to restore stability, temporarily stepping in to buy long-dated bonds and triggering a 100bp rally in 30-year bonds. The purpose of the BoE’s move will be “to restore orderly market conditions” with the size dependent on “whatever scale is needed”, in increments of £5bn in conventional 20y+ gilts. With purchases set to continue until 14th October, importantly, the BoE will also delay its planned sales of gilts to end-October – an ostensible shift to quantitative easing (QE) rather than the planned move to quantitative tightening (QT).

Italian voters went to the polls in September, electing a right-led coalition government headed by Giorgia Meloni (Brothers of Italy). Brothers of Italy’s main economic policy message is for a bigger role for the state, protection of national champions, government ownership of strategic assets and for national interests to be defended above EU interests. Meloni has taken a more fiscally conservative stance recently, warning against excessive fiscal deficits. Pending large Next Generation EU (NGEU) disbursements create a major incentive for the next Italian PM to stick to the rule-book and not clash with the EU, at least in the near term. The key steps to watch are the choice of the finance minister and the new government’s first budget law.

Euro area Inflation surprised to the upside in September, rising to 10.0% YoY, up from 9.1% YoY in August. Core inflation also came in strong at 4.8% YoY, as inflation continues to broaden out to food and service prices. Energy inflation also increased on the month, driven in part by higher fuel prices in Germany as household support measures ended, as well as increases in household energy bills across the euro area (with France and Spain the notable exceptions).

European composite PMIs fell to 48.2 in September, down from 48.9 in August and in line with expectations. Manufacturing continues to be the weak spot, with new orders and future output both down significantly on the month. PMIs also confirmed the German economy is headed for recession, if not already there, with the composite falling to 45.9. Indicators also showed that price pressures remain high, with rising energy prices causing a renewed acceleration of input cost inflation in both manufacturing and services. Supply bottle necks continue to improve however, slowly unwinding a major headwind for the manufacturing sector.

## UK

The Monetary Policy Committee (MPC) raised its policy rate by 0.5% to 2.25%, a 14-year high. The Bank of England (BoE) now expects a recession to start in the fourth quarter, yet it warned of further tightening to contain inflation, which it expects to increase to 13%. Macro-economic indicators further indicated slowing growth, with most recent PMI indicators reflecting contracting economic activity. Chancellor Kwasi Kwarteng’s mini budget announcement placed fiscal credibility under a spotlight and put the Bank of England in a difficult situation, having to engage in Quantitative Easing for financial stability reasons. This created substantial bond market volatility, as markets towards month end reacted to an opposing policy mix of fiscal expansion and monetary tightening.

The Chancellor’s mini-budget on 23 September introduced a series of unfunded spending commitments, spooking market participants, as the measures were a) above-and-beyond what was expected; b) deemed to be badly targeted; c) not matched with detailed savings or supply-side reforms and d) presented as the first step in a programme of lower taxes. This was quickly interpreted as a material change to the projected path of the UK’s structural budget deficit, and a risky approach when also putting in place the Energy Price Guarantee which leaves the public finances exposed to movements in natural gas prices. BoE Governor, Andrew Bailey, publicly stated that “the MPC will not hesitate to change interest rates by as much as needed to return inflation to the 2% target” in response to the demand impulse from the government measures.

In the bond market, the renewed rise in developed market global rates that we have seen since mid-summer accelerated after the event, understandably led by the gilt market. The market priced in the need for a more aggressive central bank reaction, with the Bank Rate priced to reach up to 6.25% and sterling falling close to parity against the dollar. In a statement, Governor Andrew Bailey noted that the BoE was monitoring developments in the financial markets “very closely”. The UK 2-year yield increased from 3.02% to 4.23% and 10-year rose from 2.80% to 4.10% by September’s close. The rapid move higher in government borrowing costs across the curve triggered sizable collateral calls for liability-driven investment (LDI) strategies, which in turn has caused selling of gilts and credit to raise cash. The Bank of England intervened on 28 September to prevent this forced selling from becoming so disorderly that it caused broad financial instability. Toward the beginning of October the market was pricing in a terminal rate of 5.7%.

## Japan

Japanese Government Bond yields rose mainly via 10yr zone with 10 year yield ending the month 2.5bp higher at 0.245%. The Japanese bond yield also came under upward pressure as bond yields in the U.S. and European markets trended higher on the back of 75bps rate hike by both U.S. and European Central Banks. In addition, Stronger-than-expected price indexes in the U.S. and a large upward revision of policy rate forecasts by members of the FOMC compared to the previous meeting also contributed to the upward trend in yields in overseas bond markets, and domestic bonds also came under upward pressure in yields, especially in the super-long-term sector.

The BOJ continued to conduct unlimited-denomination operations on all business days to keep the yield on 10-year JGBs at 0.25%. At the policy meeting, the BOJ maintained its monetary policy and decided to gradually terminate the Covid financial assistance operation toward March 2023 instead of immediately ending. Against this backdrop, the yen continued to weaken in the dollar-yen market, testing the upper 145-yen level, and the government intervened to buy the yen for the first time in 24 years.

The overall inflation ex-perishable food was +2.8% YoY in August, remained above the central bank’s 2% target for a fifth straight month as energy and food prices continued to be high. The unemployment rate remained relatively low at 2.5% in August.

### Risk Characteristics

	Fund	Benchmark
Average Maturity (Years)	8.69	8.72
Modified Duration (Years)	6.95	6.85
Normal Yield (%)	3.71	3.64
Convexity	0.89	0.89

### Top 10 Issuers (%)

	Weight (%)
UNITED STATES TREASURY	19.5
JAPAN (GOVERNMENT OF)	13.0
FEDERAL NATIONAL MORTGAGE ASSOCIATION	5.2
CHINA PEOPLES REPUBLIC OF (GOVERNMENT)	4.8
CASH & EQUIVALENTS	3.1
ITALY (REPUBLIC OF)	2.8
FRANCE (REPUBLIC OF)	2.8
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION 2	2.7
FEDERAL HOME LOAN MORTGAGE CORPORATION	2.7
UNIFORM MBS	2.5

### Top 10 Issuers held by ESG score

	ESG Score
BANK OF NOVA SCOTIA	10.0
INTERNATIONAL FINANCE CORP	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
CNH INDUSTRIAL CAPITAL CANADA LTD	10.0
COMPAGNIE GENERALE DES ETABLISSEMENTS MICHELIN SCA	10.0
COUNCIL OF EUROPE DEVELOPMENT BANK	10.0
CRH FINANCE DAC	10.0

### Quality

	Fund %	Benchmark %
Aaa	44.0	44.4
Aa	14.0	13.6
A	28.8	27.9
Baa	12.9	12.6
Ba	0.0	0.0
NR	0.3	1.6

### Maturity Exposure

	Fund %	Benchmark %
< 5	40.90	41.19
5 - 10	32.37	32.05
>= 10	26.73	26.77

### Country Exposure

	Fund %	Benchmark %
US	45.54	42.47
Japan	13.63	13.37
China	6.10	5.94
Germany	4.02	4.28
France	5.06	5.08
UK	4.47	4.13
Italy	3.09	2.96
Canada	3.57	3.51
Other	14.51	18.27

### ESG Sector Score

	Fund	Benchmark
Treasuries	6.35	6.34
Government Related	6.46	6.46
Corporates	5.76	5.57
Securitized	5.42	5.38

### ESG Score Breakdown

	Fund	Benchmark
Environmental	5.58	5.47
Social	7.05	7.04
Governance	6.37	6.35

### Green Bonds Exposure

	Fund %	Benchmark %
Green Bonds	2.25	1.37

## 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	512 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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