

FOR PROFESSIONAL CLIENTS/QUALIFIED INVESTORS/QUALIFIED CLIENTS/SOPHISTICATED INSTITUTIONS/NON-NATURAL QUALIFIED INVESTORS ONLY

BlackRock

No time to yield

A case for putting cash to work with bond ETFs



Key points

1

Yields are higher today than they were 10 years ago. If inflation indicators continue to fall, the time of elevated cash rates may be drawing to a close.

2

Investors are choosing bonds in record numbers, with 2023 global bond ETF inflows at \$333 billion.

3

But investors are still significantly underweight to fixed income, with a 25% average allocation, based on EMEA industry assets under management.

4

We believe investors may still want to consider moving back into fixed income because, historically, the market has tended to price in rate actions before they occur.

5

ETFs can be a powerful tool for investors as they recalibrate their fixed income allocations.



Introduction

Interest rates are now at the highest levels they have been in the last decade, helping to make bonds more attractive to investors who had been sitting on the sidelines the past couple of years as bonds endured significant volatility.¹ In 2023, global bond ETF inflows rose 25%, hitting a record \$333 billion.² In the fourth quarter alone, global inflows were up 42% over the third quarter.³

Even with ongoing volatility in economic data and bond markets, we believe that investors may still want to consider moving back into fixed income. Why? The signs of market change may be coming into focus: despite the uneven and halting descent in inflation around the world, global central banks may still be nearing the end of a tightening cycle designed to quell the most significant surge in inflation in decades — a cycle that made cash attractive.⁴ A pivot to rate cuts from central banks later in 2024 — and already underway in emerging economies such as Brazil — is still being debated, but current yield levels may portend an opportunity in fixed income.⁵

We continue to believe central banks will ultimately shift their posture and markets will return to an era of less restrictive monetary policy. In our view, policy loosening is still not a question of “if” but “when,” and investors, accordingly, may want to consider moving back to fixed income. History tells us that investors can miss out on locking in higher yields if they wait for a clear, definitive answer on rate cuts.⁶ Instead of trying to time the markets (which is near impossible), investors may consider beginning to move ahead of announced changes in central bank policy rates, increasing fixed income exposure by putting cash to work with bonds.

1 Source: Bloomberg, as of 31 March 2024. EURIBOR 1 month at 3.9%, compared with previous peak at 5.2% as of 30 Sept. 2008. **2** Source: BlackRock Global Business Intelligence, as of 31 Dec. 2023. Flows for fixed income ETFs globally totaled \$265 billion in 2022, compared with \$333 billion in 2023. Previous annual record was in 2021 with \$282 billion. **3** Source: BlackRock Global Business Intelligence, as of 31 Dec. 2023. Flows for fixed income ETFs globally in the third quarter of 2023 totaled \$69 billion vs. \$99 billion in the fourth quarter. **4** Source: US Bureau of Labor Statistics, as of 31 Dec. 2023. US annual CPI rose from 0.1% as of 31 May 2020 to a peak of 9.1% as of 30 June 2022. Current rate as of 31 Dec. 2023 is 3.4%. European Central Bank, based on HICP Overall Index, as of 31 Dec. 2023. Euro area inflation rose from -0.3% as of 31 Dec. 2020 to a peak of 10.6% as of 31 Oct. 2022. Current rate as of 31 Dec. 2023 is 2.9%. **5** Source: Bloomberg, Banco Central do Brasil, as of 31 March 2024. First rate cut since June 2020 occurred in August 2023. Subsequent rate cuts have followed with Selic interest rates at 10.75%, as of 31 March 2024 vs. 13.75% in August 2023. **6** Source: Bloomberg, based on comparing the 5-year US Treasury Index (GT5 Govt) with Fed funds rate (FDTR Index) from 1 Jan. 2000 to 29 Feb. 2024. **Past performance does not guarantee future results.**

Authors



Stephen Laipply

Global Co-Head of iShares Fixed Income ETFs



Brett Pybus

Global Co-Head of iShares Fixed Income ETFs



Darren Wills

APAC Head of iShares Fixed Income ETFs



Hui Sien Koay

APAC Head of iShares Fixed Income Product Strategy



Vasiliki Pachatouridi

EMEA Head of iShares Fixed Income Product Strategy



Karen Veraa

US Head of iShares Fixed Income Product Strategy

We expect investors to take a more dynamic approach to asset allocation in this new market regime and leverage all the tools available. We believe bond ETFs are among the most powerful tools within the investor tool kit because they can offer the efficiency and precision needed to navigate this market environment.

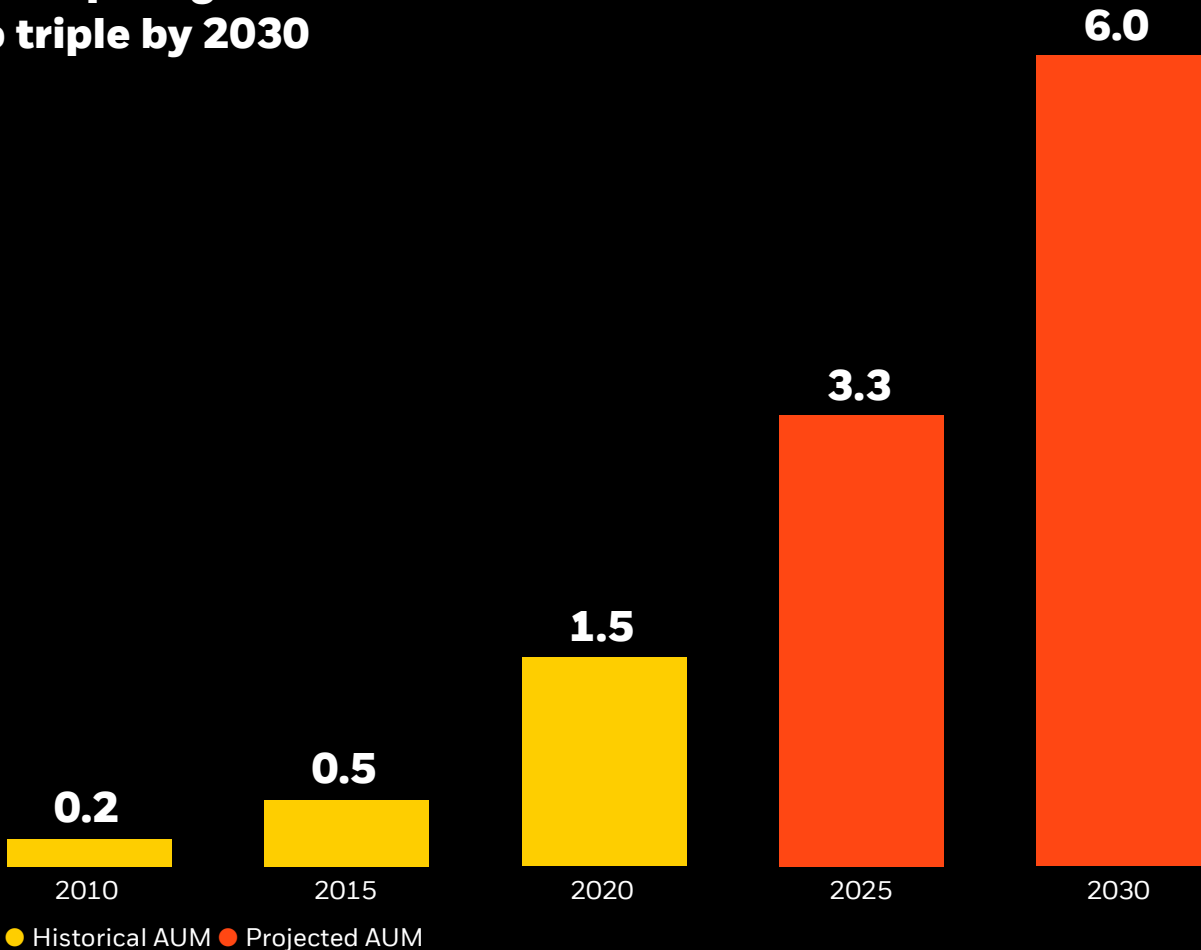
Bond ETFs are increasingly resonating with investors — reaching \$2 trillion in assets in July 2023. We believe this market will triple to \$6 trillion by 2030 as more investors view ETFs as a powerful way to access the bond market (Figure 1).

In this paper, we will discuss the opportunity within bonds and why investors may want to consider moving now to capture these decades-high yields, get cash off the sidelines, and employ efficient, precise tools such as bond ETFs in this new market regime.

We expect bond
ETFs to triple to
\$6T
by 2030

Figure 1: Actual and projected growth of global bond ETF AUM (USD trillions)

We expect global bond ETF assets to triple by 2030



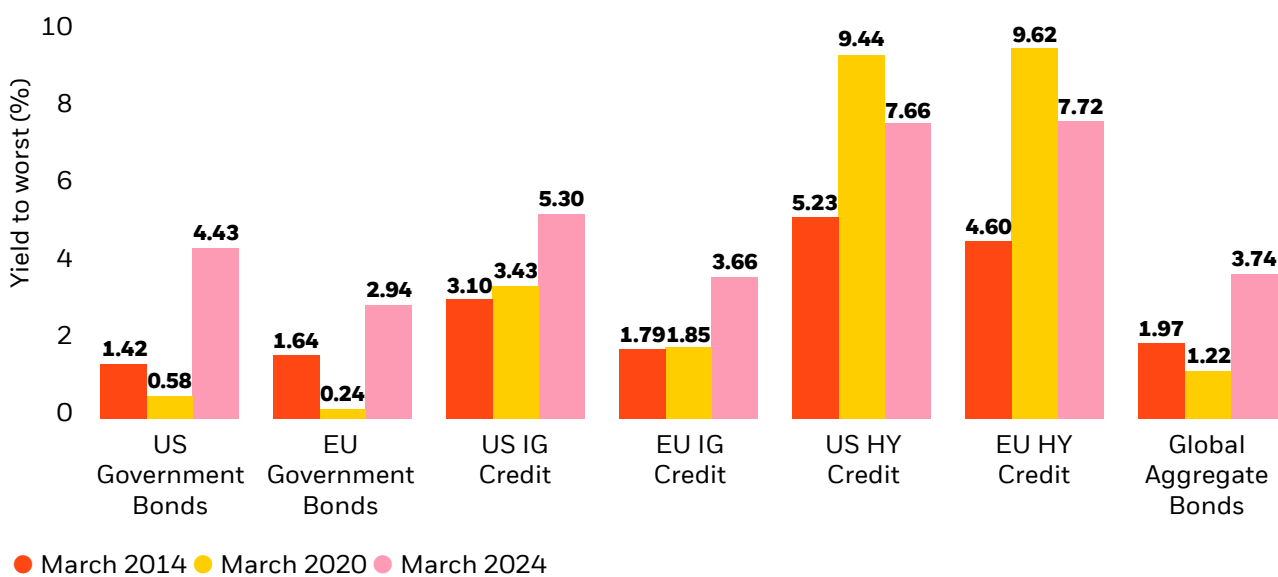
Source: From proprietary research. BlackRock projections as of 31 March 2024. Subject to change. The figures are for illustrative purposes only and there is no guarantee the projections will come to pass.

Seek to capture higher rates

Promising trends are popping up for investors who are looking past the clouds of uncertainty on timing. **Bond yields are higher today than they were a decade ago (Figure 2).** Relative to both recent history and even 10 years ago, investors are still able to lock in highly attractive yield levels. Figure 2 shows yield levels on different indices at the end of March in 2014, 2020 (at the onset of the COVID-19 pandemic), and in 2024.

Figure 2: Yield levels of global fixed income exposures (%), 2014-2024

Yields today are at decade-high levels



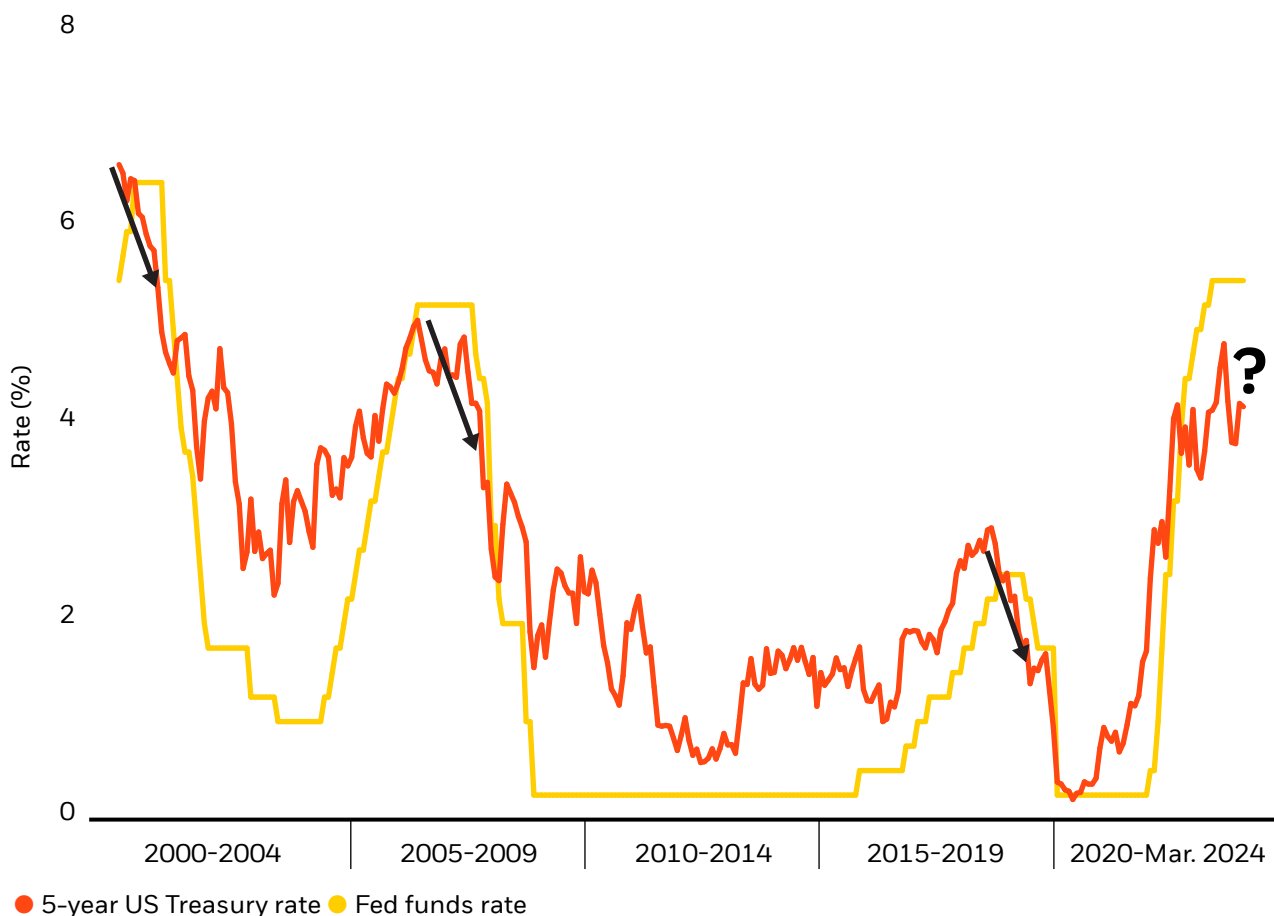
Source: Bloomberg, as of 31 March 2024. Yield to worst as of 31 March 2014, 29 March 2020, and 31 March 2024. Indices used: US Treasuries: ICE US Treasury Core Bond Index; EU Government Bonds: Bloomberg Barclays Euro Treasury Bond Index; US Corporates: Markit iBoxx USD Liquid Investment Grade Index; EU Corporates: Bloomberg Euro-Aggregate Corporate Index; US High Yield: Markit iBoxx USD Liquid High Yield Index; EU High Yield: Markit iBoxx Euro Liquid High Yield Index; Global Aggregate: Bloomberg Global Aggregate Bond Index. **Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

With inflation indicators generally still falling (albeit haltingly and unevenly, depending on the region), the time of elevated cash rates may ultimately be coming to an end. We believe this means investors may want to consider moving back to fixed income. The market will continue to debate the timing of rate cuts, but few would debate that cuts will eventually come if inflation continues to moderate and policy becomes ever more restrictive as a result.

Historically, longer term yields have moved ahead of policy shifts (Figure 3). Investors who wait for a definitive answer may miss the opportunity to capture yields at these levels. And while history may not repeat, volatile data in inflation and economic activity have kept yields elevated even as central banks continue to signal that rate cuts are still under consideration, providing a potentially attractive entry point for investors.

Figure 3: Five-year US Treasury rate compared to Fed funds rate (%), 2000-2024

Historically certain bond rates have tended to fall before the Fed starts to cut



Source: Bloomberg, from 1 Jan. 2000 to 31 March 2024. Price returns based on monthly data comparing the 5-year US Treasury Index (GT5 Govt) with Fed funds rate (FDTR Index).





From history, we also know that when central banks implement pauses, bond markets have tended to do well as Figure 4 below illustrates. We believe investors could benefit from getting ahead of potential interest rate cuts.

Figure 4: Bonds vs. cash 12-month returns (%) after last rate hike of each Fed hiking cycle

Bonds have historically delivered stronger performance during hold periods



Source: BlackRock, Bloomberg as of 31 March 2024. Reference to Bloomberg US Treasury Bill 1-3 Months Index (LD12TRUU) as a proxy for cash, Bloomberg US Aggregate Bond Index (LBUSTRUU), and Bloomberg Global Aggregate Bond Index (USD hedged) (LEGATRUH). The figures shown relate to past performance. 12-month performance shown from the last rate hike of a cycle: 1 Feb. 1995, 25 March 1997, 16 May 2000, 29 June 2006, 19 Dec. 2018, 27 July 2023. The 2023 pause period represents returns from 27 July 2023 to 31 March 2024 since it has not yet reached 12-months. **Past performance is not a reliable indicator of current or future results. Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index.**

Time to get off the sidelines?

The volatile markets of the past few years caused many investors to, understandably, move money into a less volatile asset – cash. Rising interest rates on the back of the central banks' aggressive rate hikes in 2022 and 2023 rewarded investors for holding cash – with yields in US Treasury Bills now hovering near 5.25% and Euro Short-Term Rates at close to 4%.⁷ Over \$1 trillion poured into money market funds globally in 2023, and the amount of cash held worldwide in money market funds sat at \$9.2 trillion through year-end, up 19% from 2022.⁸

Bonds are called fixed income for a reason. Historically bonds have served a significant role in portfolios: to generate income and provide portfolio diversification. While cash has provided income temporarily during this tightening cycle, cash has not provided the same level of potential ballast and portfolio diversification against riskier assets such as equities. In typical, upward-sloping yield curve environments, where short-term bonds yield less than longer-term bonds, longer-dated instruments can provide more income to a portfolio. Figure 5 shows that we have re-entered a period where excess cash could hurt portfolio returns as investors are missing out on returns elsewhere.

⁷ Source: Bloomberg, based on Bloomberg Barclays US Treasury Bill Index and EURIBOR 1 month, as of 29 Feb. 2024. ⁸ Source: Simfund for US money market funds; Broadridge for non-US money market funds, both as of as of 31 Dec. 2023; Total funds for 2023 using all sources were \$9.283 trillion, while total funds for 2022 were \$7.747 trillion.

Over

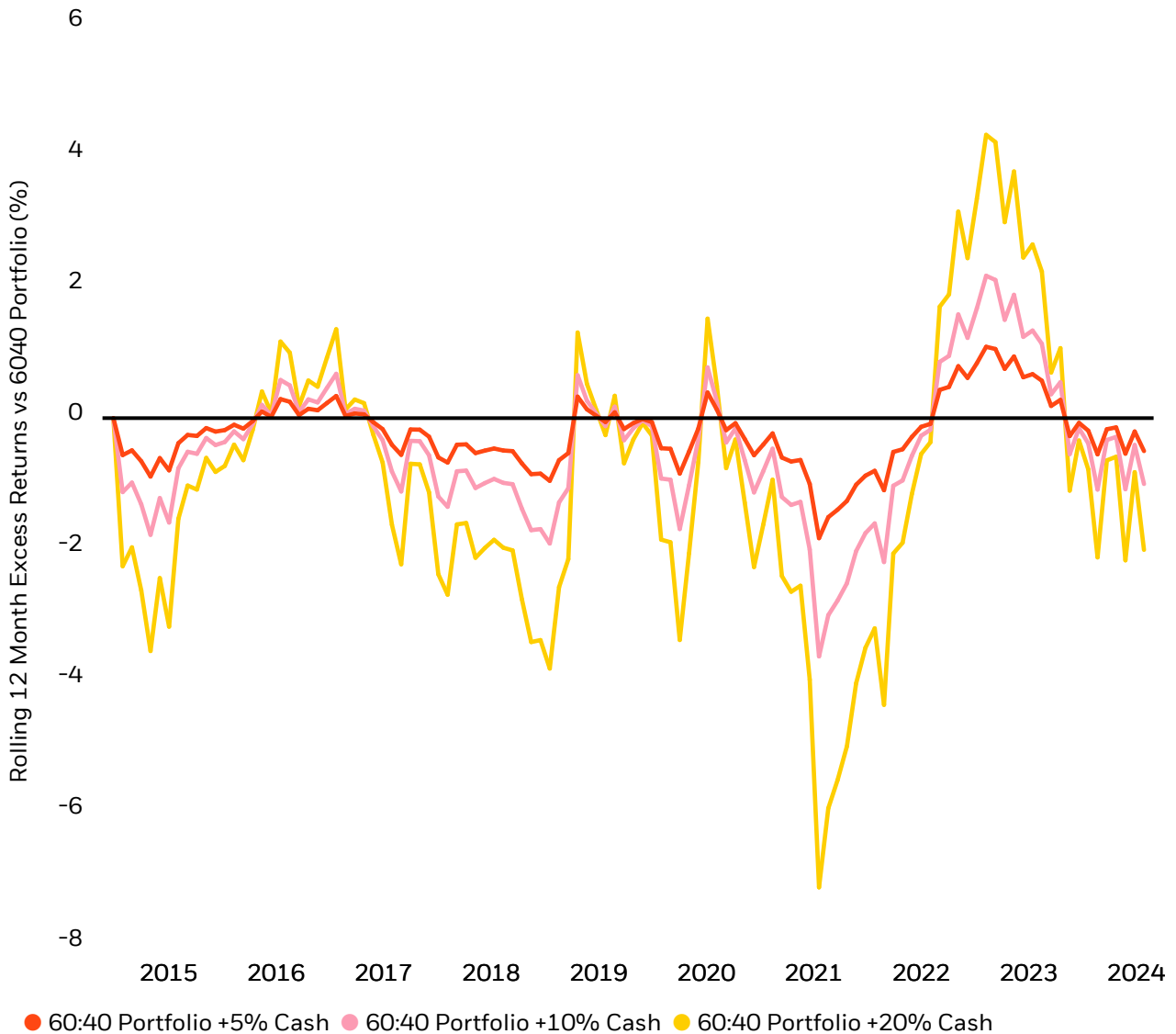
\$1T

poured into money market funds globally in 2023



Figure 5: Rolling 12-month excess return on a 60/40 portfolio (%), 2014-2024

Portfolios with varying cash amounts shows excess cash weighs on excess returns over the long-run

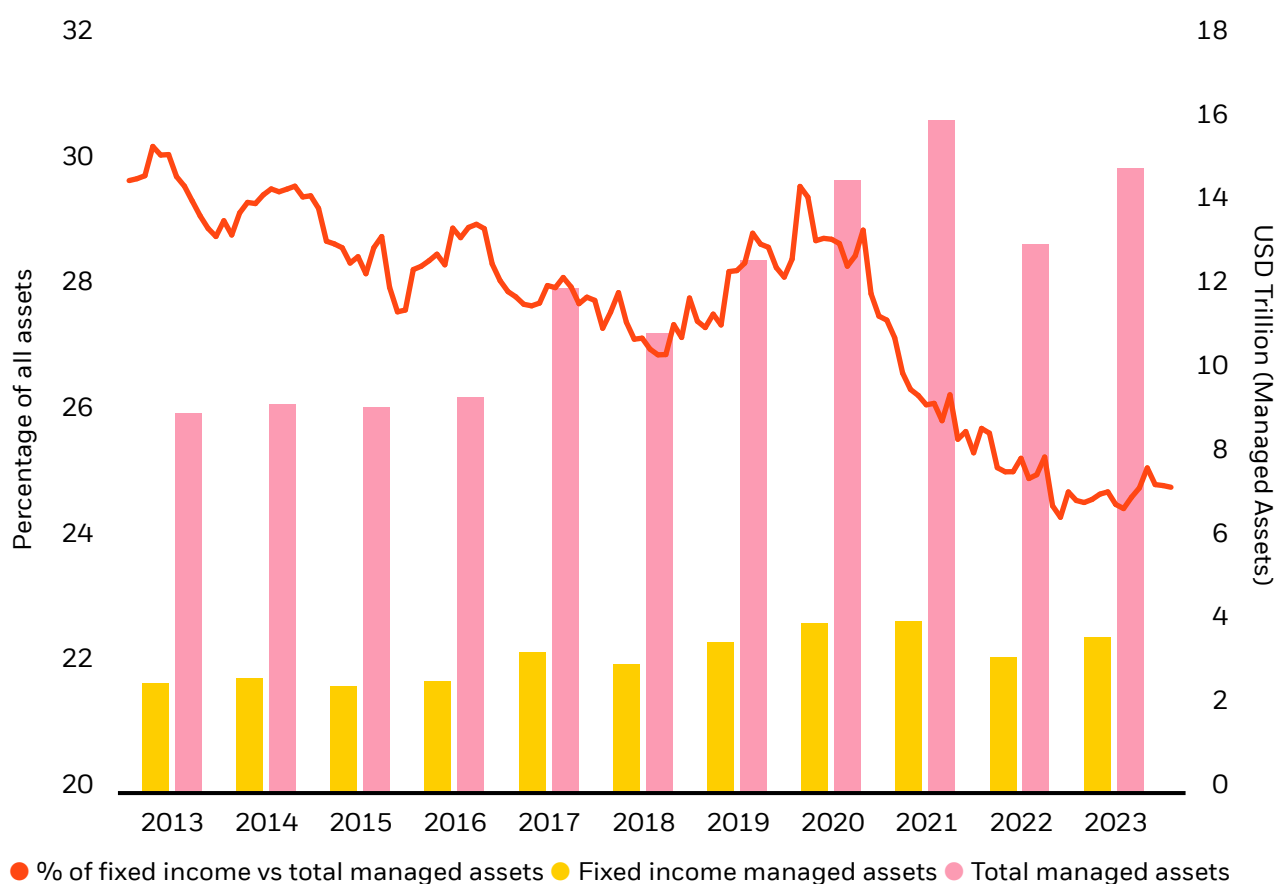


The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.** Source: BlackRock, MPI, Morningstar. Time Period: 28 Feb. 2014 to 29 Feb. 2024. 60/40 Portfolio based on 60% MSCI ACWI Index, and 40% Bloomberg Barclays Global Aggregate Index. Cash is represented by Bloomberg US Treasury Bill 1-3 Month Index. Data Frequency: month. Currency: USD. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. This information demonstrates, in part, the firm's Risk/Return analysis. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action.

Portfolios have room for bonds. Many investors are still significantly underweight to fixed income, with a 25% average fixed income allocation, based on European industry assets under management (Figure 6). The allocation has fallen from 30% at the start of March 2020, as the COVID-19 pandemic began, and it is far below the “60/40” portfolio allocation often referenced in balanced portfolio discussions. Although the 60/40 allocation itself may not be right for every investor, we believe investors on average may want to consider holding more fixed income than they currently do depending on factors like the investors themselves, their goals, and their tolerance for risk.

Figure 6: EUR domiciled fixed income assets as percentage of industry assets, 2013-2023 (%)

Bond fund assets reach lowest levels in the past decade



Source: Broadridge for Mutual Fund data, GBI iShares for ETFs, as of 31 Jan. 2024, and Hedge Fund Research (HFR) for Global Hedge Funds as of 31 Dec. 2023. Closed ended funds excluded.

How to get back into bonds

Harnessing the power of bond ETFs

For investors considering bonds again, how could they implement their fixed income allocation?

1

Utilise a bond investing toolkit. There are many ways to invest in fixed income including: individual bonds themselves, mutual funds, closed-end funds, separately managed accounts, and bond ETFs. An investor's specific circumstances, including investment objectives, holding period, tax position, and investing platform (e.g., brokerage account vs. retirement account), can help determine the ultimate choice of exposure.

2

Adopt a portfolio mindset. The new yield landscape means that there are now many opportunities in fixed income for investors to pursue. In an effort to build durable, resilient portfolios, investors are now able to use low-cost index exposures at the core, while employing active strategies to seek enhanced returns. For example, index bond ETFs are liquid, transparent, and efficient, making them good building blocks for the core of a portfolio. At the same time, active bond ETFs can augment this portfolio by providing the potential for enhanced return and diversification of opportunities.

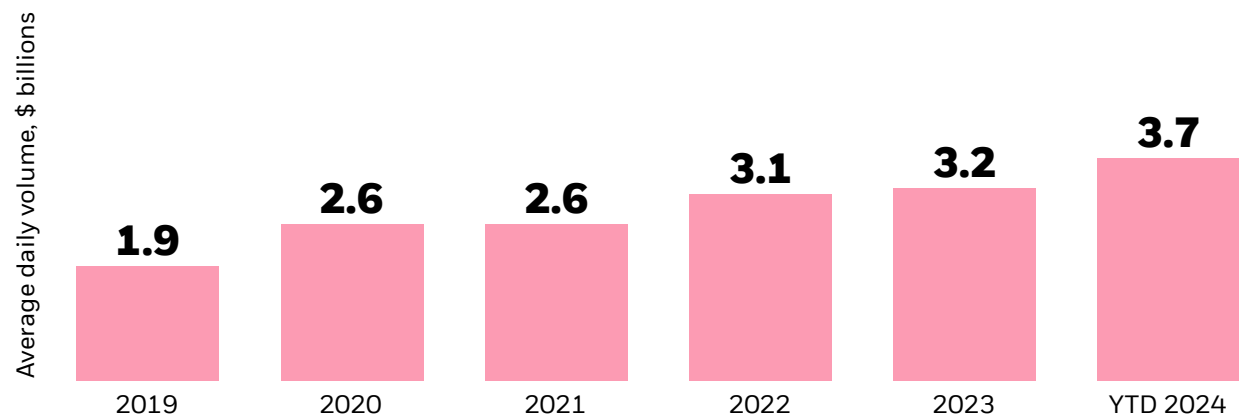


Why bond ETFs can be a good fit for the new market regime

We believe bond ETFs will be a tool of choice for investors as they recalibrate their fixed income allocations and implement whole portfolio solutions using index and active strategies. As bond ETFs have grown in assets and liquidity (Figure 7), they have become increasingly integrated into the fixed income marketplace and have helped catalyse an evolution in bond market structure. Advances in electronic trading and algorithmic pricing of individual bonds have helped improve transparency and liquidity in underlying bond markets. Even more importantly, bond ETFs have revolutionised the way investors access fixed income exposure. Investors may now buy and sell portfolios of thousands of bonds through ETFs with a single click, often for just pennies in trading costs.⁹ These exposures run the gamut of liquid sovereigns to emerging markets across duration, sector, and credit quality, helping provide investors with a robust and highly efficient toolkit for portfolio construction.

Figure 7: UCITS bond ETF average daily trading volume (USD billions), 2019-Q1 2024

UCITS bond ETF trading has grown at a rate of 14% since 2019



Source: big xyt, from 1 Jan. 2019 to 31 Mar. 2024. Based on annual trading volumes of all UCITS bond ETFs. The compound annual growth rate from 2019-2023 was 14%.

⁹ Source: Bloomberg. Average bid/ask spreads over the past 30 days (as of 29 Feb 2024) of the 25 largest global bond ETFs by assets under management were 0.01%.

Investors can benefit from bond ETF innovation. With over 2,300 bond ETFs globally, investors today have more choices and tools than ever.¹⁰ Newer bond ETFs are slicing the fixed income marketplace into ever more granular exposures that can be blended into highly customisable portfolios. Many strategies featured in newer bond ETFs were previously available only to larger investors at high cost and great difficulty, if at all. The breadth of the fixed income ETF toolkit provides the flexibility to suit almost any investor income/return objective and risk profile.

- Investors may now build portfolios either broadly through aggregate bond ETFs, or in a more tailored manner across sectors, maturities, and credit ratings.
- Investors may choose from traditional perpetual funds or defined maturity funds (the global iShares iBonds suite). iBonds ETFs are the first fixed maturity ETFs launched globally. This innovative suite combines the best features of individual bonds and ETF investing offering investors an efficient tool that is designed to trade like a stock, diversify like a fund, and mature like a bond.
- The development of exposures such as interest rate and inflation-hedged, defined outcome products and actively managed funds allow for even more robust portfolio construction by introducing potential excess return, income, and hedging opportunities than with traditional index exposures alone.

Investors will decide for themselves how to best allocate their fixed income exposure based on investment objectives and risk profiles. We believe the ever-evolving bond ETF universe provides ample tools to create the right portfolio solution.

10 Source: BlackRock Global Business Intelligence, total number of bond ETFs globally is 2,392, as of 31 March 2024.

iBonds ETFs
are designed
to trade like a
stock, diversify
like a fund,
and mature
like a bond

Conclusion

After a profoundly challenging period in the bond market brought on by global inflation and resulting aggressive central bank tightening, we believe that there is a compelling case for moving off the sidelines and back into fixed income for the long-term. While yields may continue to oscillate with changing economic conditions, they remain at attractive levels not seen in decades and therefore now provide investors with a tremendous opportunity to retool, rebalance, and reduce risk in portfolios for the future.

The granularity, efficiency, and versatility of fixed income ETFs make them an effective tool for fortifying portfolios with fixed income exposure.

The Appendix shows ways that bond ETFs can be used by investors to deploy cash and address several scenarios. No matter what specific prescription investors choose, we believe the opportunity to fortify portfolios is here and it is compelling.

Contributors

Boutheina Ben Fekhet
Anna Day
Emily Fredrix Goodman
Gladys Liu
Ursula Marchioni
Heidy Suwidji
Charlotte Tribley

Appendix

Investors who are recalibrating their bond portfolios may be confronted with a range of macro environments going forward. Will central banks keep policy restrictive for too long and tip the economy into a hard landing and recession? Or will they actually “land the plane” in the idealistic soft-landing scenario?

No matter how investors expect near- and long-term markets to unfold, bonds have returned as a key ingredient in portfolios, and low-cost bond ETFs could be an effective transition vehicle from cash.

In this section, we explore three scenarios: (i) whether the global economy will pull off a “soft landing”; (ii) whether restrictive monetary policy results in the economy tipping into recession; or (iii) whether the economy slows while inflation persists resulting in further future rate hikes.

We believe that in each of these scenarios, at least some movement out of cash and into longer maturities is warranted. Depending on the scenario, investors may also increase or decrease credit risk.

We consider different ETFs that investors may wish to explore depending on their view on the markets and which portfolio outcome they are seeking.



Scenario 1: Central banks engineer a soft landing

In this ‘goldilocks’ scenario, we see falling inflation and central banks starting to gradually cut rates and re-steepen/normalise the yield curve to become upward-sloping once again.

In this scenario, investors could consider balancing the belly of the curve with high-quality, longer-duration bonds and higher income asset classes. We look to duration exposures in a range of 3-7 years, which may offer a good trade-off between current yield and potential upside valuation gains as rates fall. Additionally, for investors seeking higher income, high yield credit and risk assets in general could become much more attractive with lower refinancing risk and positive economic growth helping to contain default risk.

Scenario 2: Central banks cut rates given fears of recession

In a hard landing/recessionary scenario, both growth and inflation may recede rapidly, which may lead to a sudden decrease in policy rates. Such a scenario could harm risk assets and historically has triggered a flight to quality in which the longest maturity instruments should benefit from falling yields.

Investors may not want to abandon ballast just because short-term rates are higher. Cash likely will not provide the same potential ballast as bonds, so investors believing that such a scenario is more likely could consider at a minimum “barbell” their current cash allocation with long duration instruments to help cushion risk assets and provide equity diversification. Investors may consider holding high quality assets like government bonds and higher quality credit exposures.

Scenario 3: Central banks hike again

For those investors who believe that inflation will persist and that central banks will maintain or even enhance restrictive monetary policy – even at the cost of deteriorating economic growth, it may make sense to continue owning shorter maturity instruments (both nominal and inflation protected) which may help insulate investors from further increases in policy rates and stickier inflation.

With current inverted yield curves, where short-term interest rates are higher than long-term interest rates, we believe shorter-duration maturities could offer attractive yields versus cash and could support those seeking capital preservation. Like the prior scenario, investors may want to consider holding high quality assets like US treasuries and higher quality credit exposures.

Important information

This document is marketing material. Before investing please read the Prospectus and the PRIIPs KID available on www.ishares.com/it, which contain a summary of investors' rights.

Risk Warnings

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time and depend on personal individual circumstances.

Regulatory Information

This material is for distribution to Professional Clients (as defined by the Financial Conduct Authority or MiFID Rules) only and should not be relied upon by any other persons.

This document is marketing material.

In the UK and Non-European Economic Area (EEA) countries: this is issued by BlackRock Advisors (UK) Limited, which is authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL, Tel: +44 (0)20 7743 3000. Registered in England and Wales No. 00796793. For your protection, calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock.

In the European Economic Area (EEA): this is issued by BlackRock (Netherlands) B.V. is authorised and regulated by the Netherlands Authority for the Financial Markets. Registered office Amstelplein 1, 1096 HA, Amsterdam, Tel: 020 – 549 5200, Tel: 31-20-549-5200. Trade Register No. 17068311 For your protection telephone calls are usually recorded.

In Israel: this is issued by BlackRock Investment Management (UK) Limited, authorised and regulated by the Financial Conduct Authority. Registered office: 12 Throgmorton Avenue, London, EC2N 2DL. Tel: + 44 (0)20 7743 3000. Registered in England and Wales No. 02020394. For your protection telephone calls are usually recorded. Please refer to the Financial Conduct Authority website for a list of authorised activities conducted by BlackRock.

In Italy: For information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in Italian.

For investors in Israel

BlackRock Investment Management (UK) Limited is not licenced under Israel's Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 5755-1995 (the "Advice Law"), nor does it carry insurance thereunder.

For investors in Switzerland

This document is marketing material.

This document shall be exclusively made available to, and directed at, qualified investors as defined in Article 10 (3) of the CISA of 23 June 2006, as amended, at the exclusion of qualified investors with an opting-out pursuant to Art. 5 (1) of the Swiss Federal Act on Financial Services ("FinSA").

For information on art. 8 / 9 Financial Services Act (FinSA) and on your client segmentation under art. 4 FinSA, please see the following website: www.blackrock.com/finsa.

Any research in this document has been procured and may have been acted on by BlackRock for its own purpose. The results of such research are being made available only incidentally. The views expressed do not constitute investment or any other advice and are subject to change. They do not necessarily reflect the views of any company in the BlackRock Group or any part thereof and no assurances are made as to their accuracy.

This document is for information purposes only and does not constitute an offer or invitation to anyone to invest in any BlackRock funds and has not been prepared in connection with any such offer.

© 2024 BlackRock, Inc. All Rights reserved. BLACKROCK, BLACKROCK SOLUTIONS and iSHARES are trademarks of BlackRock, Inc. or its affiliates. All other trademarks are those of their respective owners.