



# **Fresno County Employees' Retirement Association Global Government Bond Mandate**

**Scott Thiel, Deputy Chief Investment Officer of Fundamental Fixed Income**  
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## 1. Introduction to BlackRock

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# Firm culture and structure reinforce our client-centric approach

## Independent asset manager focused only on clients

- ▶ Established in 1988 and public since 1999 (NYSE: BLK)
- ▶ Independent Board of Directors
- ▶ No proprietary trading
- ▶ Group dedicated to corporate governance

## Deep understanding of regulatory requirements

- ▶ Manage portfolios for clients subject to varied and complex regulatory regimes
- ▶ Operate on behalf of investors under 50 regulatory authorities worldwide
- ▶ Significant experience managing portfolios for official institutions and governments

## BlackRock Solutions® foundation for managing risk

- ▶ Deliberate, diversified and scaled risk enables us to invest with conviction in pursuit of alpha
- ▶ Internally developed risk tools and analysis offered directly to clients as a service
- ▶ Reinforces transparency and our responsibility to clients

## History of innovation and evolution to better serve investors

1970s	<ul style="list-style-type: none"><li>• Pioneered index and quantitative investing</li></ul>
1980s	<ul style="list-style-type: none"><li>• Created the First Term Trust (closed-end fund)</li><li>• Initiated fixed income and international indexing</li></ul>
1990s	<ul style="list-style-type: none"><li>• Created the industry's first target date fund</li><li>• Introduced exchange-traded funds under World Equity Benchmark Shares (WEBS) brand (now iShares® ETFs)</li></ul>
2000s	<ul style="list-style-type: none"><li>• Launched BlackRock Solutions® for risk management and advisory services</li><li>• Enhanced capabilities by strengthening equities, and adding alternatives, real estate, passive, and scientific investments</li><li>• Launched Financial Markets Advisory business</li></ul>
2010s	<ul style="list-style-type: none"><li>• Engaged by US and European governments for critical risk assessments and banking sector stabilization strategies</li><li>• Launched BlackRock Investment Institute</li><li>• Introduced Global Capital Markets desk</li><li>• Launched first target maturity fixed income ETF</li><li>• Created an index to track sovereign credit risk (BlackRock Sovereign Risk Index)</li></ul>

Timeline includes history from predecessor entities

# Depth of investment resources maximizes performance potential

## Organization drives idea and analysis sharing

- ▶ 124 investment teams located in 17 countries connect through a common culture and operating platform\*
- ▶ The BlackRock Investment Institute (BII), our internal investor forum, facilitates sharing and debates insights
- ▶ Daily global meeting for BlackRock's 1,900+ investment professionals to discuss markets, portfolio positioning and ongoing trends
- ▶ Chief Investment Officers ensure rigorous, deliberate and repeatable investment processes

## Investors potential benefit from scale of infrastructure

- ▶ Global trading function seeks to enable increased access to liquidity and produces trading efficiencies, improving execution
- ▶ Capital Markets Group leverages scale and breadth of platform to help maximize allocations and to seek alpha opportunities in primary markets
- ▶ Dedicated Risk & Quantitative Analysis (RQA) professionals partner with portfolio teams to monitor and analyze risk
- ▶ Proprietary **Aladdin**<sup>®</sup> platform integrates portfolio management, risk analytics, trading and operations

\*Data as of 31 March 2014

### Built to generate alpha

#### Collective expertise

Investment  
Research

Daily  
Global Meeting

BlackRock  
Investment  
Institute

Chief Investment  
Officers

#### Global infrastructure

Trading

Dedicated Capital  
Markets

Aladdin<sup>®</sup>

Risk &  
Quantitative  
Analysis

# Positioned to address client needs

## Breadth of capabilities enables outcome-based solutions tailored to individual client objectives

### \$4.59 trillion in assets under management

#### Equity

\$2.5 trillion

- Capabilities across investment styles: index, active fundamental, scientific and absolute return
- Global, regional and sector-specific investing

#### Fixed Income

\$1.3 trillion

- Manage strategies across benchmark types and styles: index, fundamental, model-based and absolute return
- Specialized experts covering all market sectors

#### Alternatives

\$117 billion

- Specialized capabilities across real estate, private equity, direct hedge funds, fund of hedge funds, infrastructure and renewable power
- Solutions-oriented approach extends to alternatives portfolio construction

#### Multi-asset

\$374 billion

- Outcome focused: target-date, balanced risk factor, and liability-driven investing
- Asset-class agnostic perspective facilitates unbiased market views, advice, and portfolio solutions

#### Cash

\$268 billion

- Recognized as 'go to' leader in credit and liquidity
- Flexible product range across multiple currencies

### Scalable services and infrastructure

#### Risk Management

- Centralized platform analyzes risk across asset classes
- Leverage for risk management, investment decision support and performance analytics

#### Advisory

- Advise public and private financial institutions on complex capital markets and balance sheet exposures
- Managed or advised on over \$8 trillion in asset and derivative portfolios

#### Transition Management

- Partner with clients to help save costs and reduce risks when changing investment exposures
- Executed over 3,000 individual transitions with assets totaling \$2.3 trillion over the past five years

#### Securities Lending

- Focus on research, technology and coordination with portfolio management functions that seek to deliver above market returns
- Covers securities in over 30 markets globally

#### Trading

- More than 50,000 trades per day across equity, fixed income, cash, currency and futures
- 24-hour global coverage across seven trading desks

AUM As of 30 June 2014

## 2. BlackRock Fundamental Global Bond Strategy

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Style / Process

# Why BlackRock for Global Government Bond Strategy

Multi-faceted platform helps maximize alpha generation

## Dedicated Global Bond Team

### Scott Thiel, Deputy CIO of Fundamental FI, leads a team of 10 focused on global bond mandates

- ▶ The global bond team are responsible for top down portfolio allocations, construction and guideline monitoring
- ▶ Separation of research and trading from portfolio management ensures consistent returns and diversified portfolios
- ▶ Each PM on the Global Bond team has a unique area of focus drawing ideas from the BlackRock platform

## Exploit Information Advantages

### Leverage the expertise of BlackRock research across markets

- ▶ Over 150 global sector specialists focused on fundamental research and trade idea generation
- ▶ Benefit from BlackRock's strong relationship with global corporations, central banks, DMOs and pension funds
- ▶ BlackRock Investment Institute helps the global bond team analyze key market moving themes

## Superior Market Access

### Insights benefit from dedicated trading and capital markets teams

- ▶ All portfolio trades are executed by globally integrated trading desks
- ▶ Global Capital Markets desk partners with issuers and counterparties to ensure healthy access to issues and to create customized investment opportunities

## Risk Aware Approach

### Best in class risk management systems allow for real time customized risk analysis

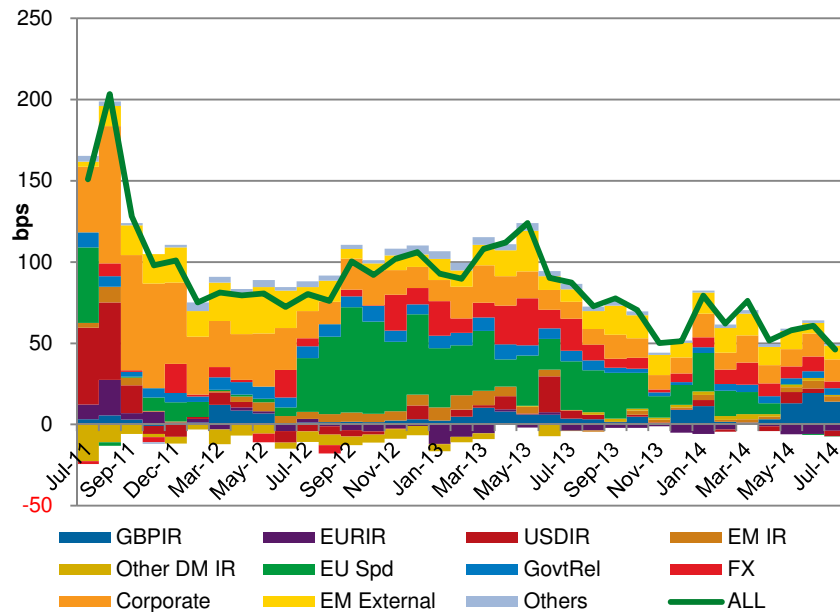
- ▶ Independent Risk and Quantitative Analytics (RQA) team provide independent oversight of Global Bond team
- ▶ Understanding portfolio risks across a number of factors remains a key focus given low market volatility
- ▶ We do not take concentrated bets in one market or name and instead focus on creating diversified portfolios

# An Investment Philosophy Focused On Consistent Risk-adjusted Returns

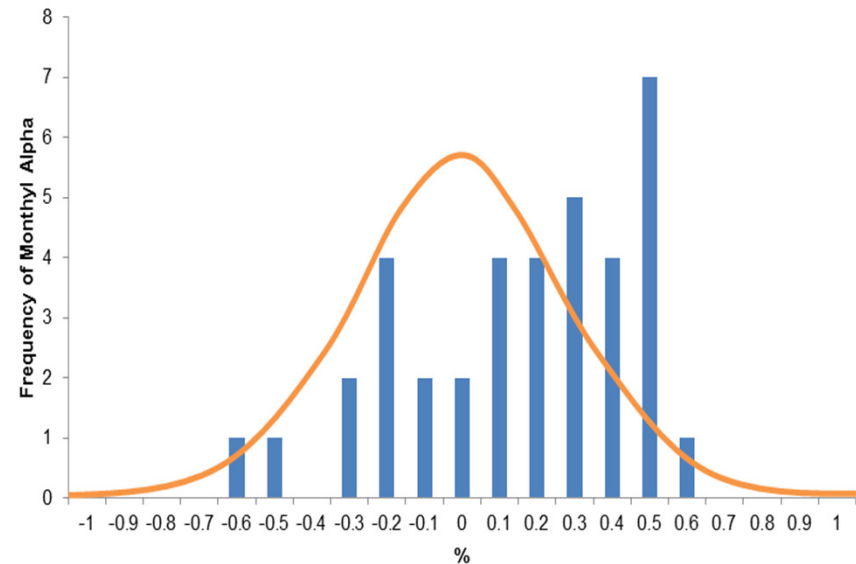
## Seek to generate consistent alpha and attractive risk-adjusted performance through changing market conditions

- ▶ We believe attractive long term results are best achieved by capturing positive alpha opportunities, avoiding negative alpha, mitigating tail risks, and ensuring effective diversification
- ▶ Alpha driven by duration, country selection, FX, sector rotation / security selection, and opportunistic allocations to off-benchmark sectors.
- ▶ Capturing alpha in up and down markets reinforces our goal to increase consistency and eliminate negative surprises

### Representative Portfolio Risk Decomposition\*



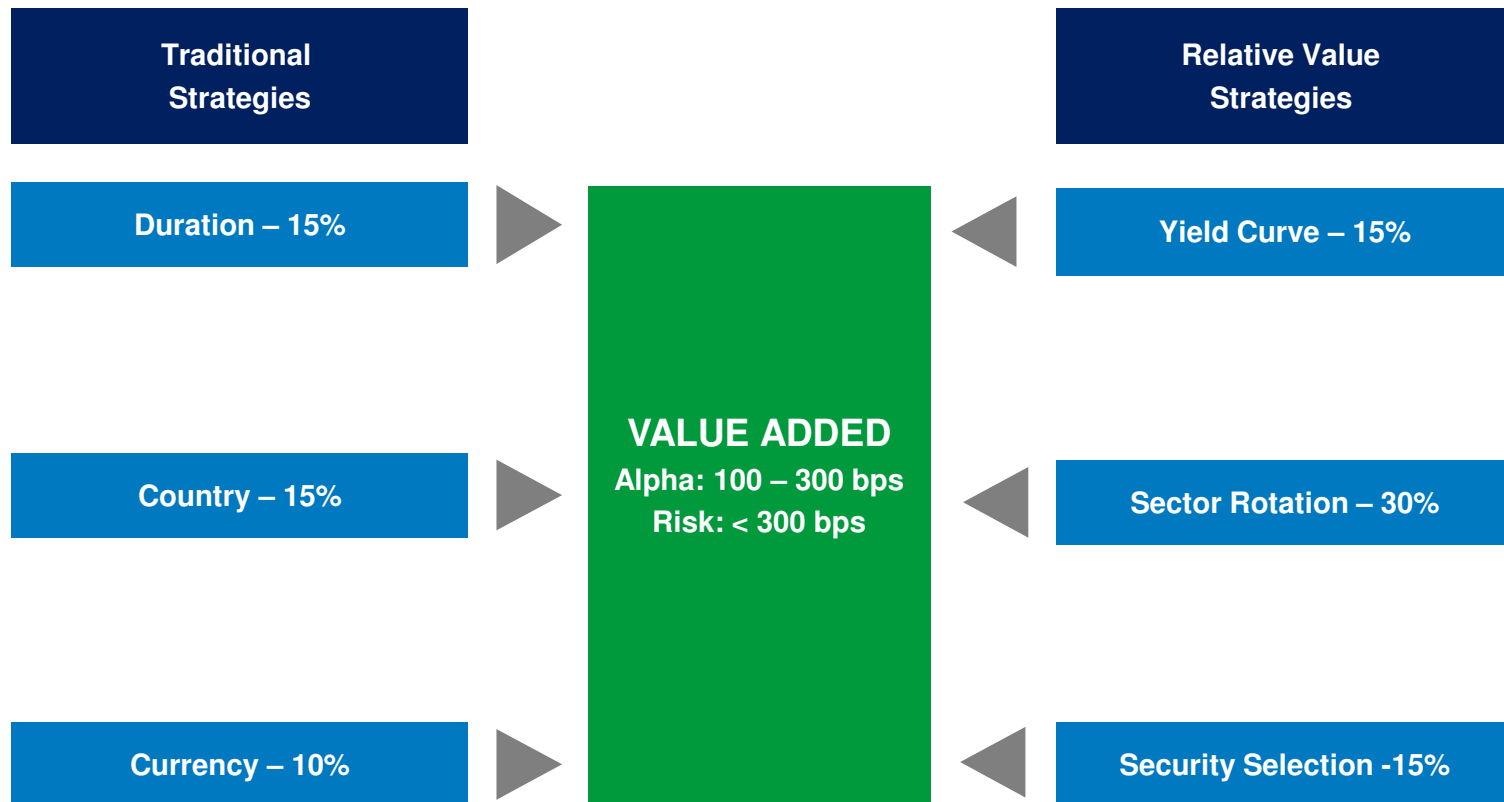
### Consistently Positive Returns



Source: BlackRock. Ex-ante risk decomposition based on internal risk model. Frequency distribution based on monthly returns of representative global government bond strategy from June 2011.

# Where Do We Add Value – Global Government Bond Strategy

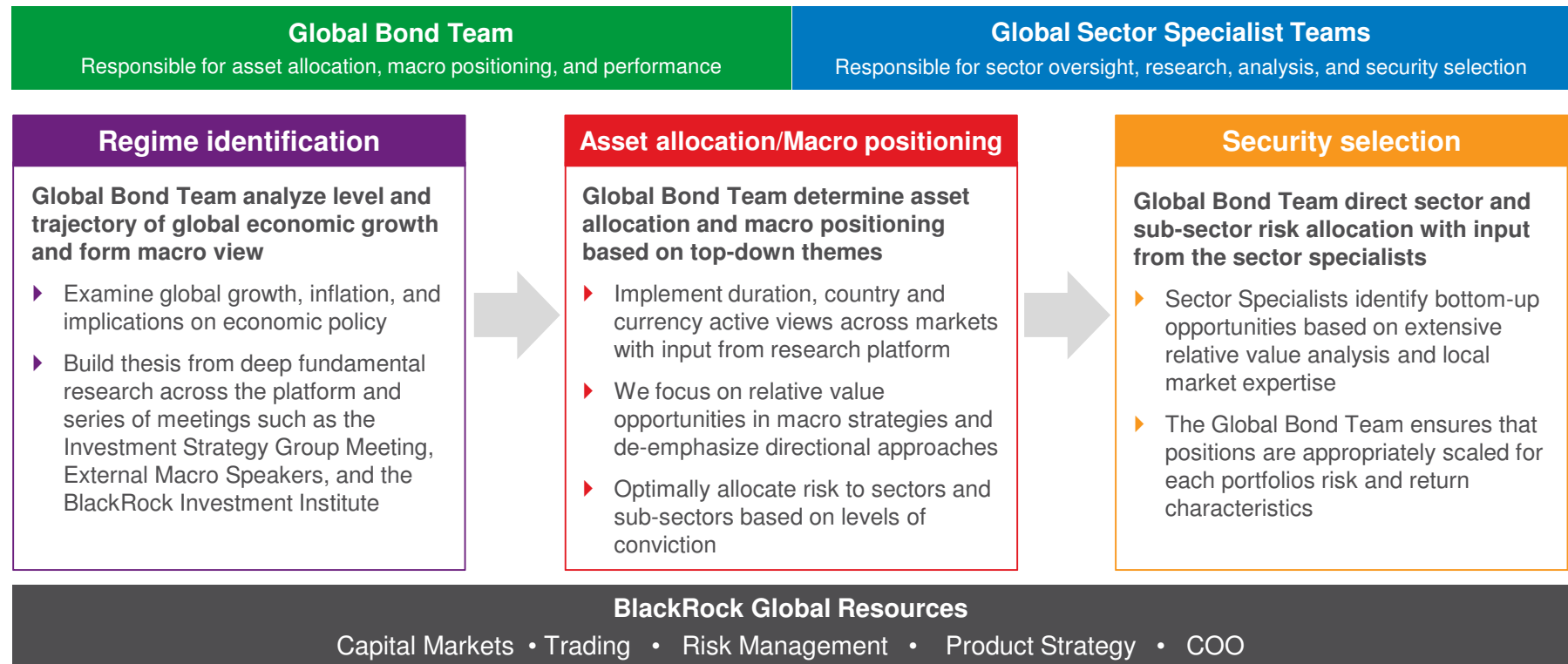
- ▶ BlackRock focuses on **exploiting relative value strategies**
- ▶ Diversified exposures are designed to deliver **consistent outperformance**
- ▶ BlackRock **uses traditional strategies in measured ways.**
- ▶ Process remains **flexible to take advantage of dislocations** such as the recent European periphery crisis.



# Global Bond Portfolio Construction Process

Process employs our best ideas across BlackRock’s global fixed income platform to:

- ▶ Establish the macro investment regime
- ▶ Budget risk to the highest quality alpha sources that help provide best risk-adjusted returns



Fundamental process for investing subject to change at discretion of Fundamental Fixed Income team

# Portfolio Construction / Trade Example

## Global Bond Team

Responsible for asset allocation, macro positioning, and performance

## Global Sector Specialist Teams

Responsible for sector oversight, research, analysis, and security selection

### Regime Identification

Monetary policy divergence amongst developed market central banks

### Asset Allocation/Macro Positioning

Global Bond team determine implications to overall asset allocations / macro positioning

### Security Selection

Global Bond Team implement portfolio positions based on guidelines constraints and alpha targets

## Portfolio Construction

Portfolio construction is a *qualitatively* driven process led by Scott Thiel and supported by RQA daily risk output and correlation measures

### Duration/Curve

- Limits: +/- 2 years
- Sizing across markets is assessed by volatility and correlation to overall portfolio on ex-ante and ex-post basis.

### Country Selection

- Limits: +/- 20%
- Sizing across markets is assessed by volatility and correlation to overall portfolio on ex-ante and ex-post basis

### Currency

- Limits: +/- 3% per currency pair
- Positions include stop/loss mechanisms

### Sector Rotation

- Limits: +/- 20%
- Sizing across markets is further determined by volatility and correlation to overall portfolio

### Security Selection

- Limits: +/- 2% per corporate issue.
- Sizing across markets is further determined by volatility and correlation to overall portfolio

### Execution

- Reverse enquiry
- Opportunistic

Subject to change based on guideline constrains and alpha targets

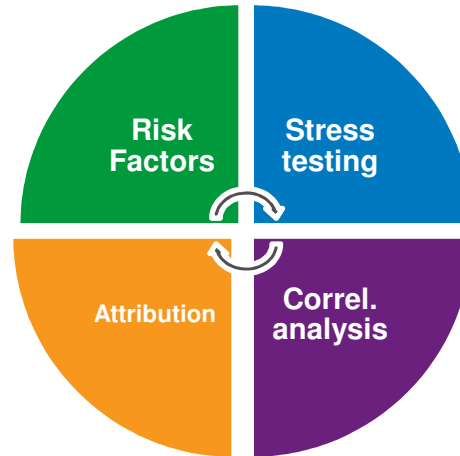
## High Conviction Views and Positioning

Trade	Description
Long GBP / Short UK Rates	<ul style="list-style-type: none"> <li>• Bullish view on UK growth outlook which could force the BOE to raise rates by late 2014. Current pricing assumes a benign rate hike cycle across 2015 and 2016.</li> </ul>
Short JPY / JGB Curve Flatteners	<ul style="list-style-type: none"> <li>• Japan's recovery has slowed more than expected as the impact of VAT tax increases serves to restrict the ability of the economy to hit the BOJ's 2% inflation target</li> <li>• We believe another round of stimulus will be needed in order to meet these objectives</li> </ul>
Long local EM local rates	<ul style="list-style-type: none"> <li>• Policy tightening in various EM countries will not be required or realized as inflation has likely peaked in a number of regions: e.g Brazil, South Africa, India and Turkey</li> <li>• As a counter we remain bearish on markets such as Poland and Hungary which appear priced closer to perfection</li> </ul>
European Financials	<ul style="list-style-type: none"> <li>• Further action by the ECB will serve to help European financial names re-capitalize and replenish balance sheets. Valuations in peripheral sovereigns do not look attractive from a valuation prospective and we maintain flat positions.</li> <li>• Preference for subordinated Tier 1 capital focused on core European debt</li> </ul>
US Curve Flatteners	<ul style="list-style-type: none"> <li>• We believe the front-end is most susceptible to a sell-off on the back of stronger than expected growth which could bring forward rate hike expectations.</li> <li>• Given this view we have implemented larger US curve flattening bias expecting the front-end to lead any sell-off with the long end supported by positive technical and a lower terminal rate</li> </ul>

Note: Positioning is representative and may not match all portfolios due to different guideline limitations, or risk/return objectives. Please refer to portfolio review materials for positioning specific to an individual portfolio.

# Rigorous Portfolio Risk Management

Risk & Quantitative Analysis Group (RQA) partners with global bond team to analyze and manage portfolio risk



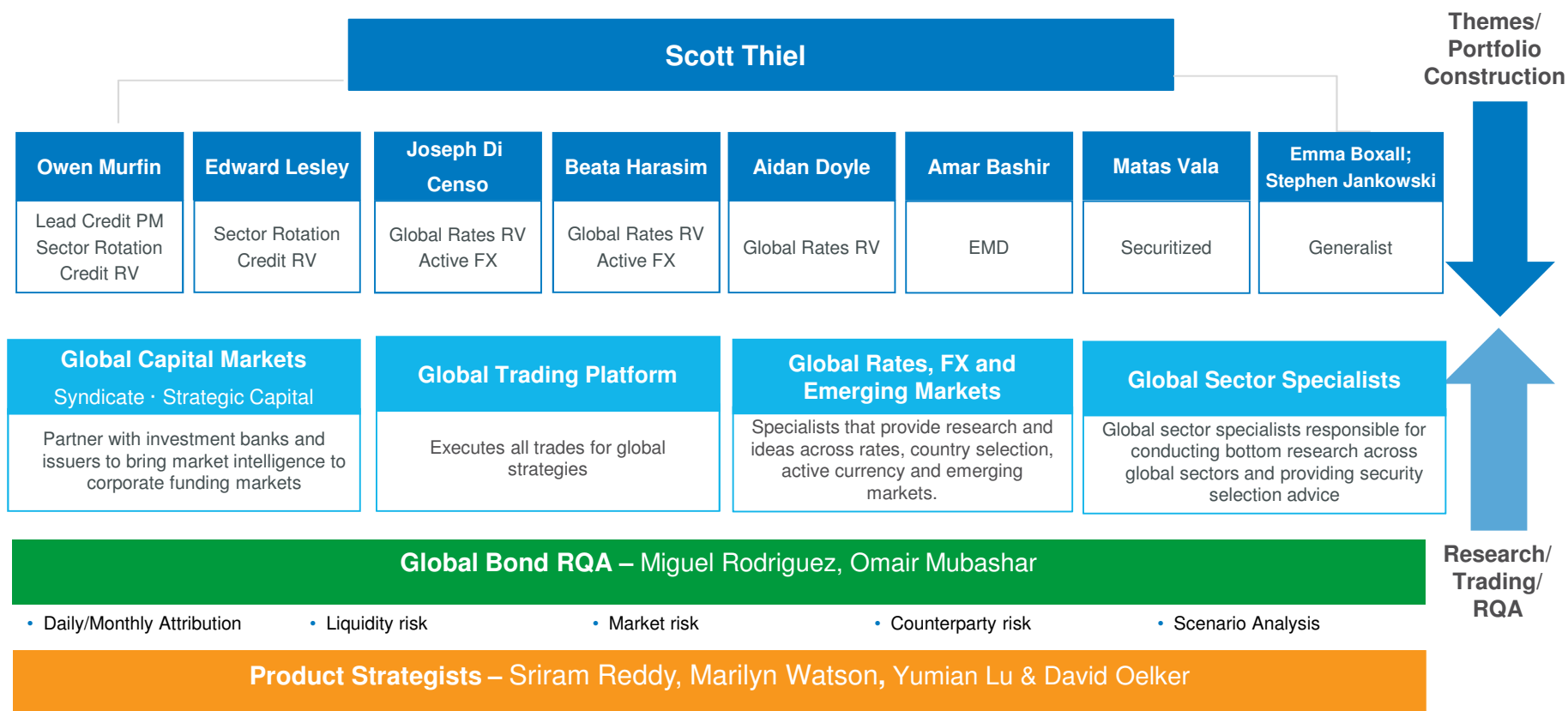
Risk Factors	Stress testing	Correlation analysis	Daily Attribution
<ul style="list-style-type: none"> <li>• Provide real time portfolio level risk updates across a variety of metrics</li> <li>• DxS and Spread duration fund profiles across currencies are used more frequently in global credit portfolios.</li> <li>• Weekly meetings to discuss current risk exposures in fund</li> </ul>	<ul style="list-style-type: none"> <li>• Analyze impact of actual and hypothetical scenarios (e.g. fiscal cliff, escalation of European debt crisis, etc.) on portfolio</li> <li>• Full flexibility to use historical market moves as well as specify custom shocks</li> <li>• Adjust portfolio positioning based on results</li> </ul>	<ul style="list-style-type: none"> <li>• Analyze ex-ante and ex-post correlations among trades, strategies and factors using various time horizons and weighting schemes</li> <li>• Limit correlations to ensure diversified sources of risk and alpha, which allows portfolio to outperform regardless of market conditions</li> </ul>	<ul style="list-style-type: none"> <li>• Daily attribution provided at a security level</li> <li>• Detailed weekly and monthly reports are provided to the global bond team</li> </ul>

### 3. BlackRock Fundamental Global Bond Strategy

Investment Team

# Dedicated Team that Leverages the Full Breadth of BlackRock's Resources

- **Scott Thiel** is the head of global bond strategies and Deputy CIO of Fundamental Fixed Income.
- Scott and the global bond team are responsible for top down allocations and rely on our global investment teams for bottom up security specific research and on-going portfolio surveillance
- Individual PM's focus on specific regions and/or sectors and work closely with the Investment Teams to source ideas for the global bond team



# Insight Advantage: Harnessing the Benefits of a Truly Global Research Platform

## Global team generating investment ideas based upon deep fundamental research

- ▶ Dedicated research teams covering all corners of the global fixed income landscape
- ▶ Organized geographically and by industry to drive deep knowledge of sector specific factors
- ▶ Partnering with sector specialists to generate investment ideas – focus on driving idiosyncratic alpha

## Leverage BlackRock's relationships across global central banks, DMOs, official institutions and pension plans to help set top down portfolio themes

- ▶ Achieve greater understanding of current stage in an economic cycle and imminent changes in global monetary policies

Global Sector Specialists Platform				
<i>Approximately 150 sector specialists focusing on bottom up opportunities across the globe. Global opportunity set with a local perspective</i>				
<b>US Credit</b> (NYC)	<b>European Credit</b> (LON)	<b>Asia Credit</b> (SIN/SYD/TOK)	<b>Emerging Markets</b> (LON/NYC)	<b>Global Securitized</b> (NYC/LON)
<b>Doug Oare • Sarah Thompson • Rob Wartell</b> <i>Team Leaders</i>	<b>Michael Phelps • Stefano Donati</b> <i>Team Leaders</i>	<b>Neeraj Seth • Sumit Bhandari</b> <i>Team Leaders</i>	<b>Sergio Trigo Paz • Amer Bisat</b> <i>Team Leaders</i>	<b>Randy Robertson • Ron Sion</b> <i>Team Leaders</i>
26 Research Professionals	10 Research Professionals	9 Research Professionals	14 Research Professionals	12 Research Professionals
<b>Credit Sector Specialists</b> <i>Partner with credit research to generate investment ideas and execute transactions</i>			<b>Global Rates/Sovereign</b> (NYC/LON/SIN/TOK/SYD)	<b>Municipals</b> (NYC/Princeton)
			<b>Pavan Wadhwa</b> <i>Team Leader</i>	<b>James Pruskowski</b> <i>Team Leader</i>
			17 Research Professionals	16 Research Professionals

Note: Number of research analysts as of 31 March 2014 and may include portfolio managers where there is material overlap

## Experienced Team and Proven Track Record

Over US \$36.4 billion in AUM managed across aggregate, government, corporate and total return strategies

Strategies can be customized to specific alpha targets and guidelines:

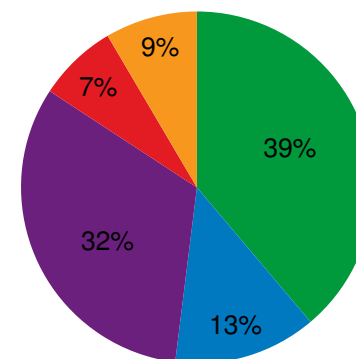
- Over 80% of assets managed on behalf of institutions
- Alpha Targets: 25 – 300 bps / Total Return
- Hedged or unhedged strategies
- Customized benchmarks

### Global Bond Rep Account Performance

	1 Yr. Active (%)	IR	3 Yr. Active (%)	IR
Global Aggregate	+1.90	3.23	+1.28	1.24
Global Government	+2.20	3.29	+1.41	1.24
Global Corporate	+2.24	2.76	+1.38	1.17
Global Total Return/FIGO	+6.91	N/A	+6.19	N/A

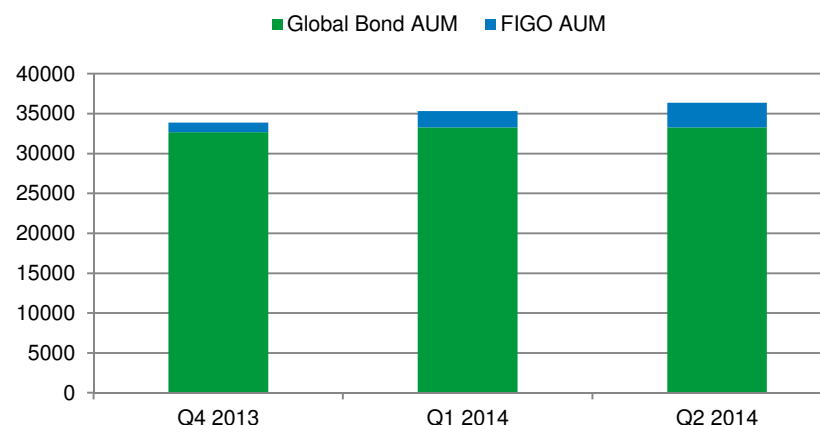
Source: BlackRock, AUM as of 30/6/14 and performance as of 30/6/14

### Distribution of Global Bond and FIGO AUM (%)



■ Global Agg ■ Global Government ■ Global Credit ■ Short duration/Other ■ FIGO

### Global Bond Team AUM (\$mm)

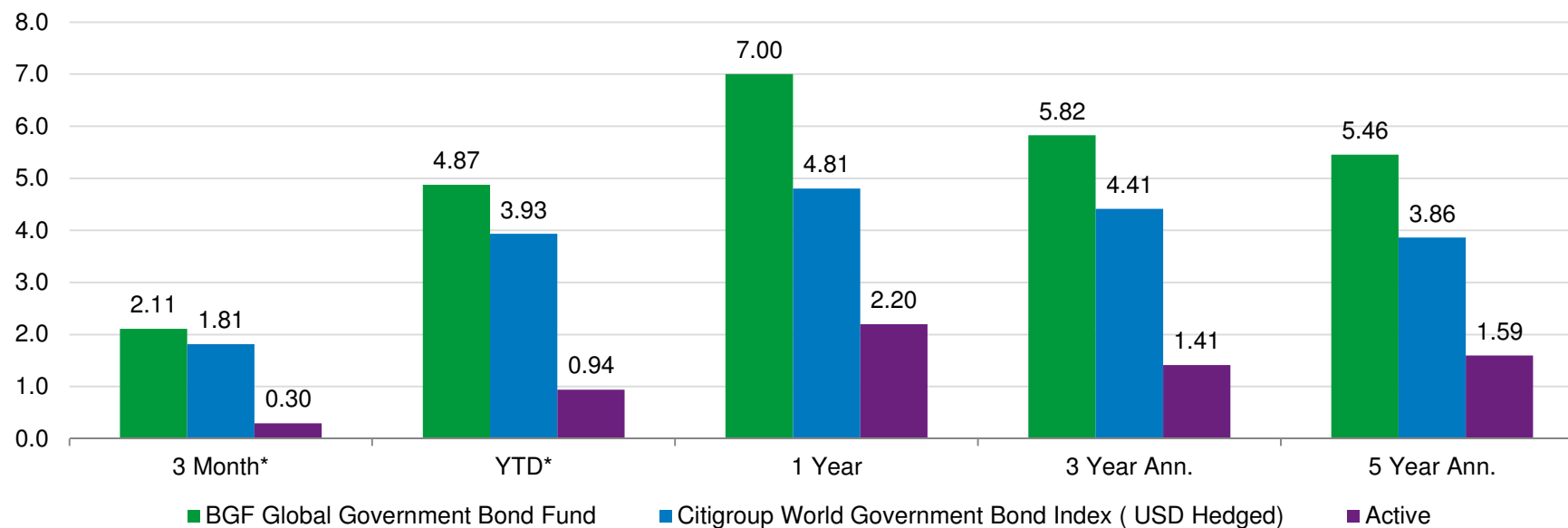


## 4. Track Record and Positioning

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## Strong Track Record Representative Portfolio Performance

### Total Return (USD %) - As of 30 June 2014



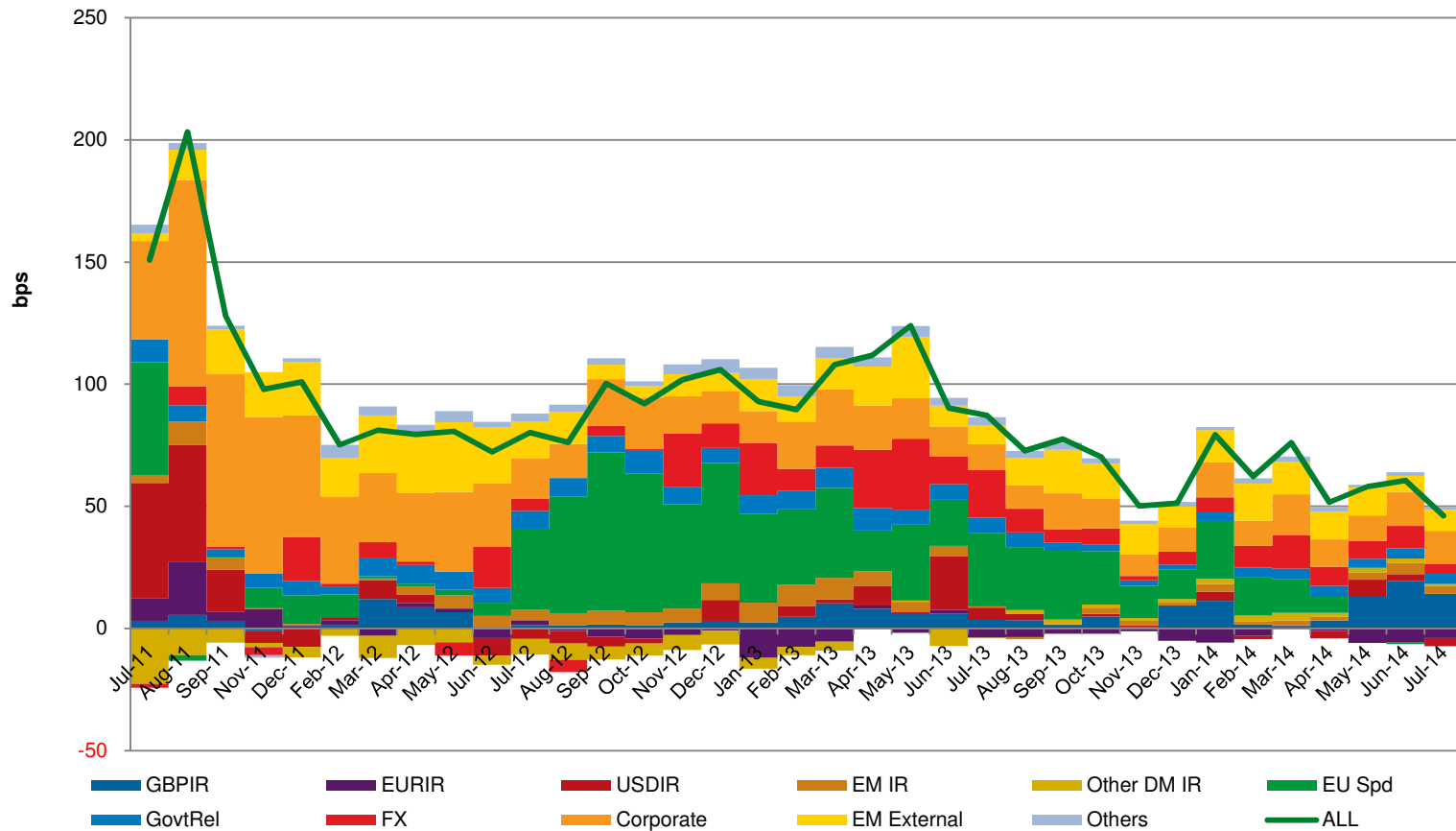
	1 Year	3 Year Ann	5 Year Ann
Active Return (%)	2.20	1.41	1.59
Tracking Error (%)	0.63	1.09	1.01
Info Ratio	3.3	1.3	1.6

\*Data 12 months or under is not annualised. Past results are not necessarily indicative of future results. USD share class performance is shown here, gross of management fees and expenses, on a NAV basis with income reinvested. Source: BlackRock.

# Well Diversified and Dynamic Risk Allocation

## Representative Portfolio Active Risk Decomposition

Marginal Contributors to Active Risk (1 standard deviation ex-ante TE, bps)

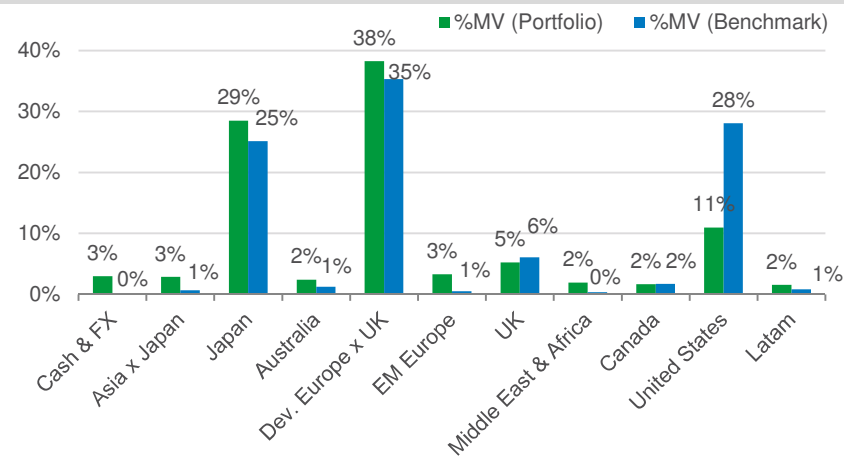


Source: BlackRock internal system, 1 standard deviation ex-ante TE, as of July 21, 2014

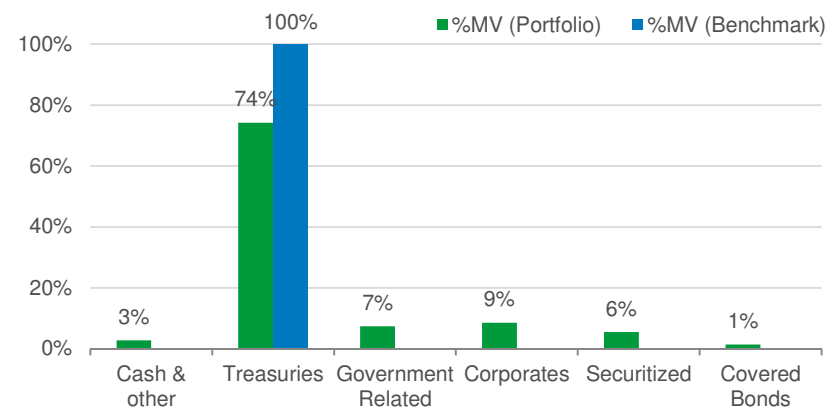
# Representative Portfolio Characteristics

Mandate Summary		
Alpha target	100 – 200bps outperformance over a market cycle	
Tracking Error	Typically 0.5% - 2%, subject to max limit 3%	
Benchmark	Citigroup World Govt Bond Index USD Hedged	
Notable Constraints	<ul style="list-style-type: none"> <li>• Max 30% non-government exposure</li> <li>• Max 20% high yield</li> <li>• Max 10% non-IG EM</li> <li>• Max 15% active currency exposure</li> </ul>	
Inception	May 1987	
Overview	Portfolio	Benchmark
Duration	5.83	6.79
Yield	1.79	1.30
OAS	61	19
Average Quality (Moodys/S&P)	A1/A+	

## Regional/Country Allocation vs. Benchmark (%MV)



## Sector Allocation vs. Benchmark (%MV)

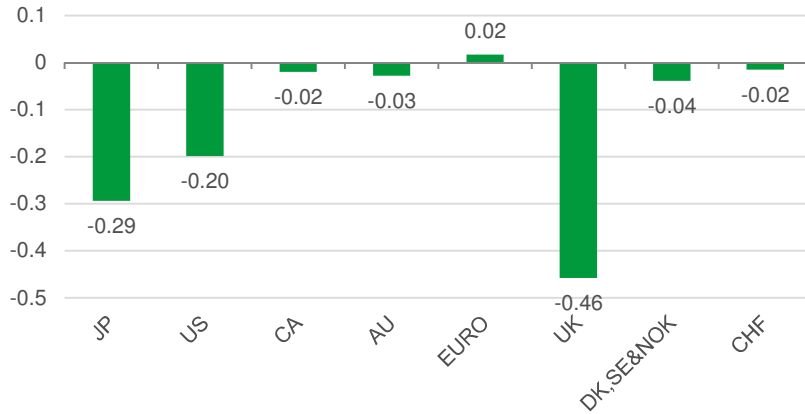


Source: BlackRock, as of 30 June 2014; positions do not necessarily represent current or future holdings.

# Representative Portfolio Characteristics

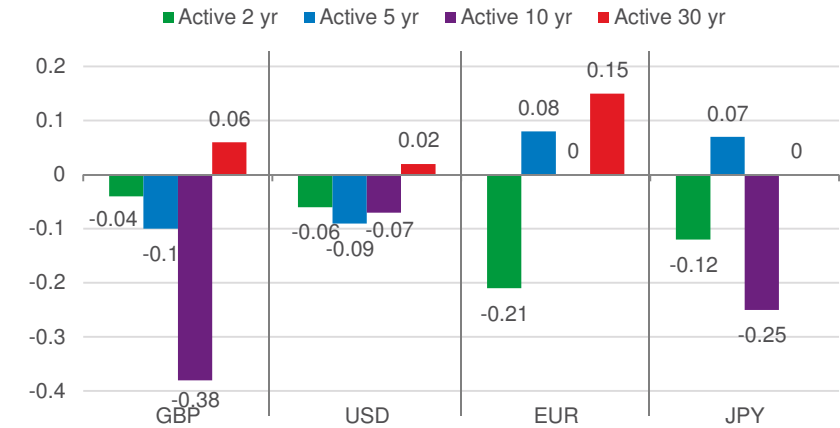
## Active Interest Rate Exposure – Developed Markets

Active duration contribution, years



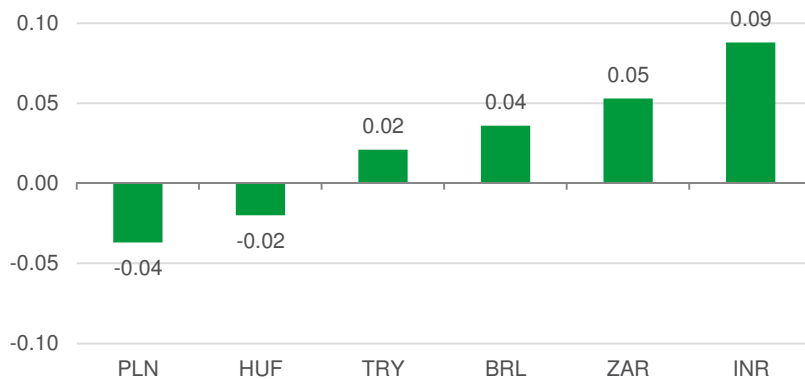
## Active Curve Positions – G4 Rates

Active duration contribution, years



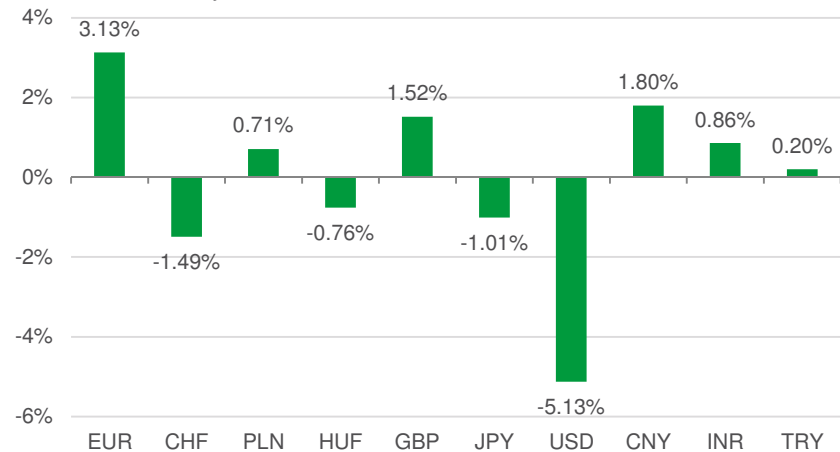
## Active Interest Rate Exposure – Emerging Markets

Active duration contribution, years



## Active FX Exposure (%MV)

Fund base currency: USD



Source: BlackRock, as of 31 May 2014; positions do not necessarily represent current or future holdings. \* Includes Slovenia and non-European/Supranational Euro bond issuers

# Representative Portfolio Characteristics

## Portfolio Diversification

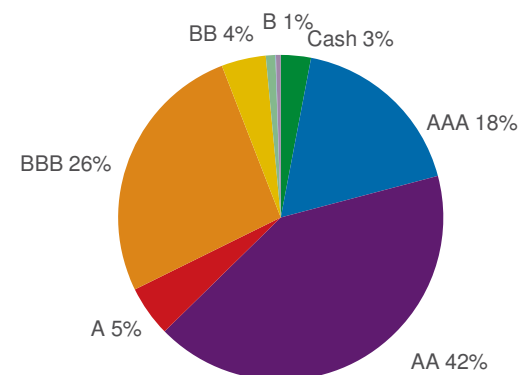
### Top 10 Overweight Issuers

	Portfolio %	Index %	Difference
JAPAN (GOVERNMENT OF)	28.50%	25.15%	3.35%
SLOVENIA (REPUBLIC OF)	2.22%		2.22%
INDIA (REPUBLIC OF)	1.90%		1.90%
ITALY (REPUBLIC OF)	9.86%	7.99%	1.88%
PETROBRAS	1.20%		1.20%
QUEENSLAND	1.00%		1.00%
NEW SOUTH WALES	0.75%		0.75%
STICHTING GAZ CAPITAL	0.64%		0.64%
CNH INDUSTRIAL NV	0.60%		0.60%
CALIFORNIA	0.55%		0.55%
<b>% Total</b>	<b>47.22%</b>	<b>33.14%</b>	<b>14.09%</b>

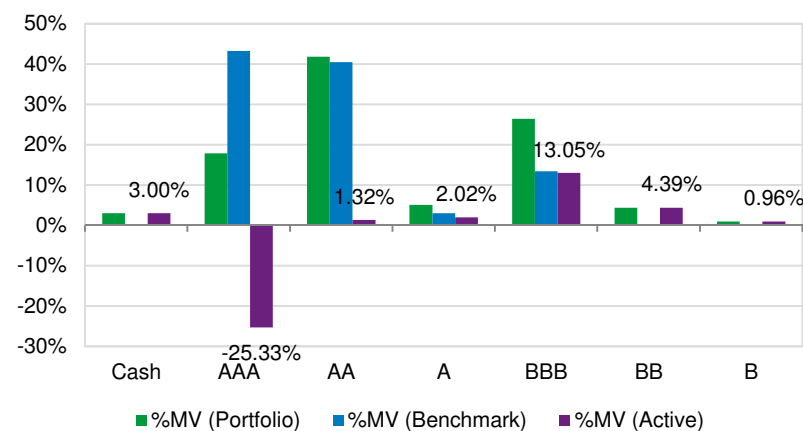
### Top 10 Underweight Issuers

	Portfolio %	Index %	Difference
UNITED STATES	6.21%	28.09%	-21.88%
GERMANY	2.10%	6.60%	-4.50%
UNITED KINGDOM	3.18%	6.08%	-2.90%
AUSTRIA	0.25%	1.35%	-1.11%
NETHERLANDS	1.15%	2.15%	-1.01%
AUSTRALIA	0.67%	1.28%	-0.61%
POLAND		0.54%	-0.54%
MEXICO	0.37%	0.82%	-0.45%
SWEDEN		0.44%	-0.44%
MALAYSIA		0.41%	-0.41%
<b>% Total</b>	<b>13.93%</b>	<b>47.76%</b>	<b>-33.85%</b>

## Credit Quality Allocation

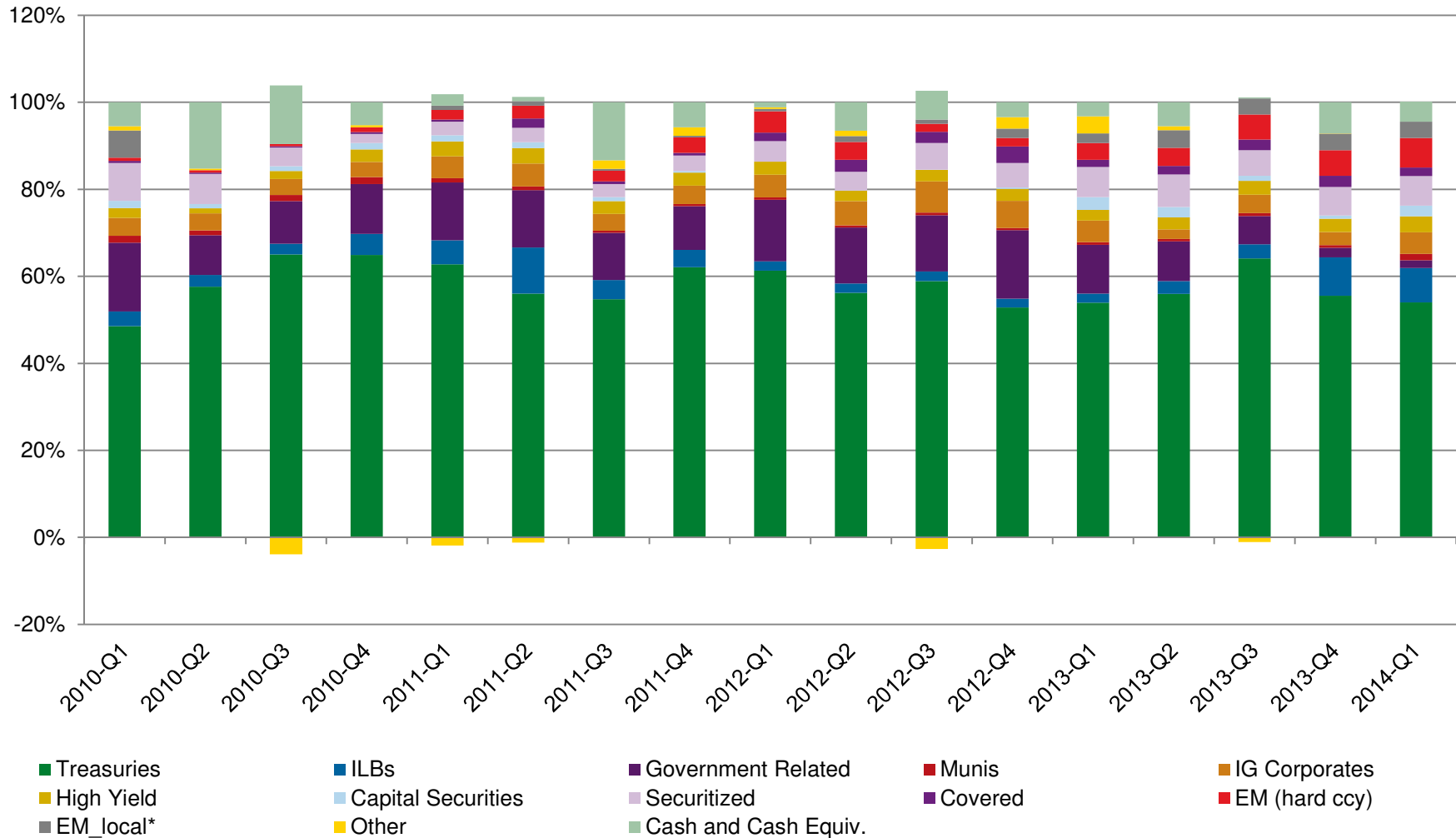


## Credit Quality vs. Benchmark



Source: BlackRock, as of 30 June 2014; positions do not necessarily represent current or future holdings.

# Historical Allocations



Source: BlackRock as of March 31, 2014

# Appendix

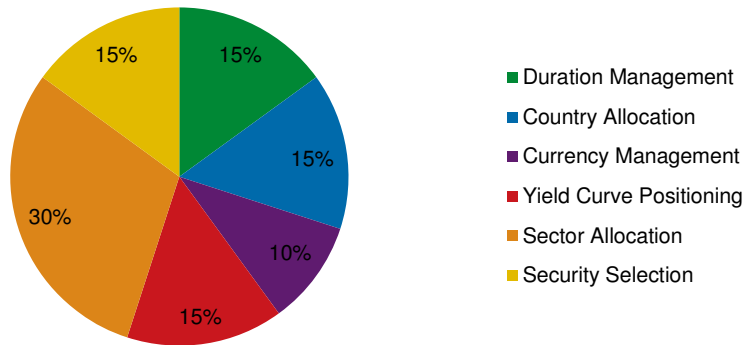
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## A. Sources of Alpha and Guidelines

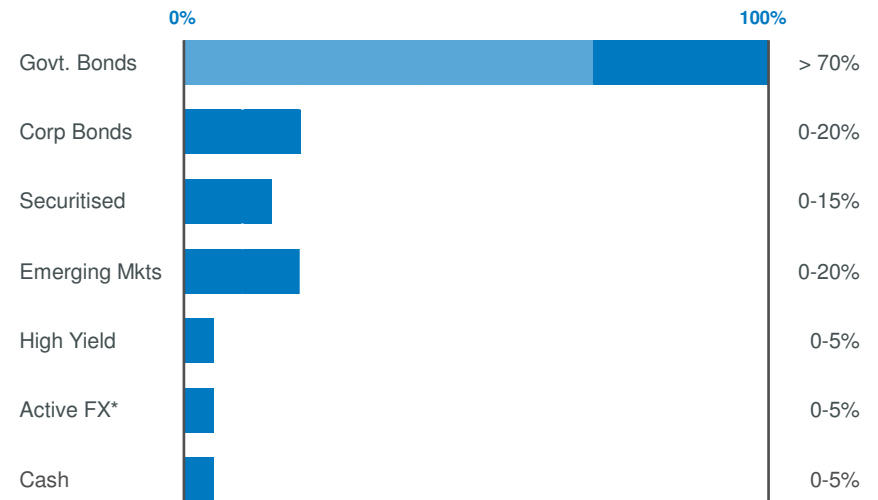
# Global Government Bond Strategy

## Typical Parameters

### Expected Alpha Sources



### Portfolio asset allocation – typical ranges (in %)



### Typical Risk Parameters (Tracking Error)



### Representative Portfolio Profile

<b>Investment Universe</b>	Focus on government and government related bonds with tactical allocation to corporate
<b>Duration</b>	Typical deviation +/- 20% relative to index
<b>FX</b>	USD hedged fund with active FX positions, typically < 15% net currency exposure in base currency
<b>Credit Quality</b>	Typical average rating A or higher

Source: BlackRock; Data as of 31 March 2014; Note: The above represent **typical** parameters and expectations, which may be subject to change.

# Appendix

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## B. Sample Macro and Credit Research

## Macro Scenario Analysis – Italy, Spain

### Baseline medium to long-term fundamental outlook :

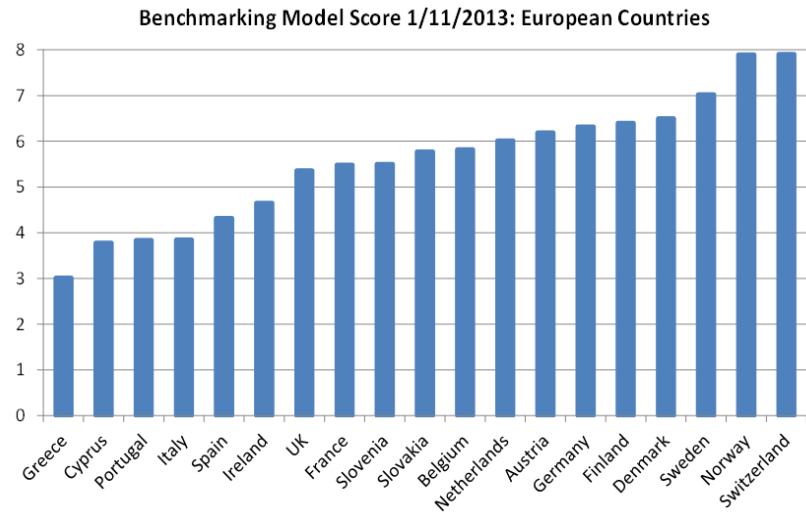
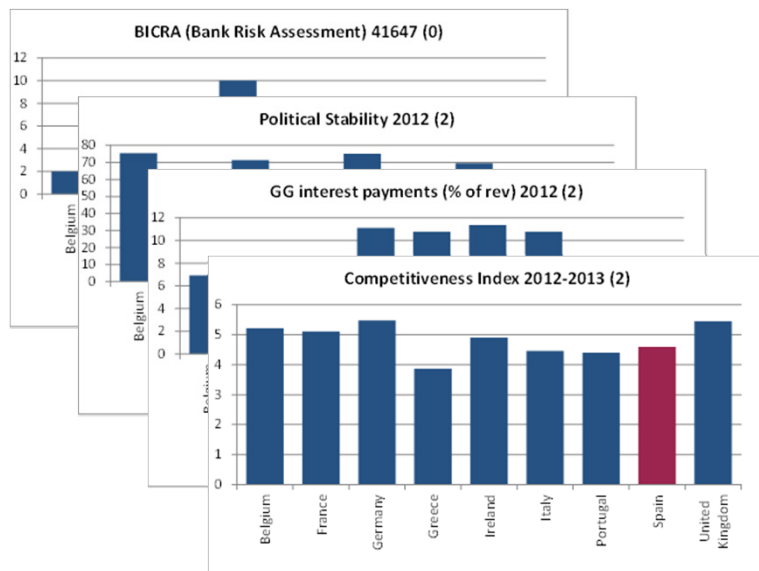
- ✓ **Italy Baseline:** “hope and change, but risks of politics as usual” – new govt to kick start reforms, but there are implementation risks given the same parliamentary majority, hence we expect a moderate progress challenged, but increasing unemployment, lack of credit and slow creation of new wealth, along with low potential growth to continue to weigh on debt sustainability
- ✓ **Spain Baseline:** – “gradual rebalancing” – progress on reforms stable political outlook but more fragmented political landscape following elections in 2015; return to growth but rate hampered by slow progress in reducing UE, continued private sector deleveraging and gradual return to a healthy banking sector & hence credit provision; slow progress on stabilizing fiscal debt dynamics

Upside Risks	Italy		Spain	
	Likelihood	Impact	Likelihood	Impact
<u>Current govt implements deeper structural reforms</u> and implementation risks prove to be lower than expected	Medium	High	Medium	High
<u>Faster and/or more pronounced recovery</u> than expected e.g. driven by stronger base/cyclical effect, or even better than expected export performance on the back of global growth and a commensurate pick up in private consumption/investment	Low	Medium	Medium	Medium
<u>Acceleration in Euro area policy</u> e.g. more pressure on countries to reform and effective support provided to get funding to the real economy, or substantially more accommodative monetary policy	Low	High	Low	High

Upside Risks	Italy		Spain	
	Likelihood	Impact	Likelihood	Impact
<u>Complete lack of confidence in major parties and institutions</u> , impacting governability and ability to implement reforms	Medium	High	Low	High
<u>Expected recovery does not materialize</u> impacting unemployment, social cohesion, fiscal sustainability and banks solvency	Low	Medium	Low	Medium
<u>Contagion from renewed stress in the periphery</u> (e.g. Greece) and weak Euro area policy response leading to intense pressure on spreads and/or loss of market access	Low	High	Low	High

# Sovereign Credit Benchmarking and Relative Value Model

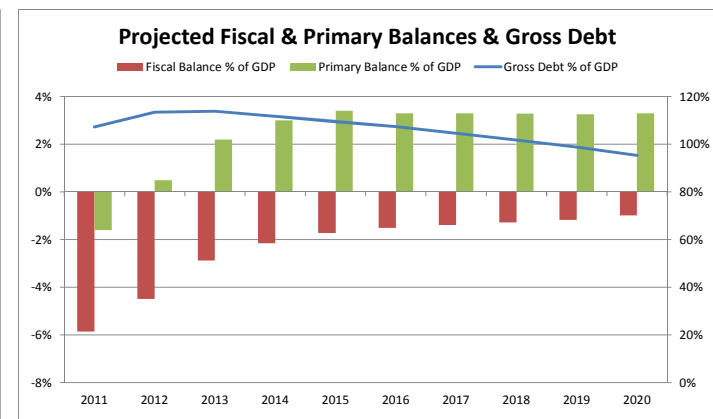
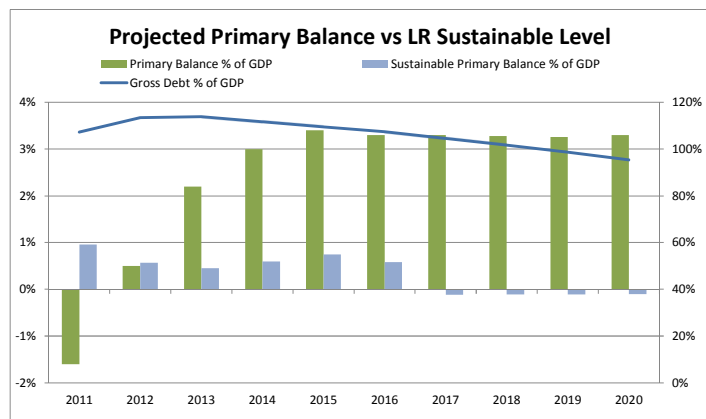
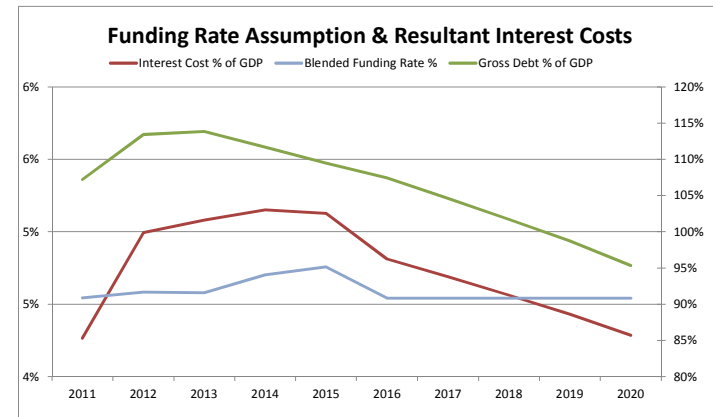
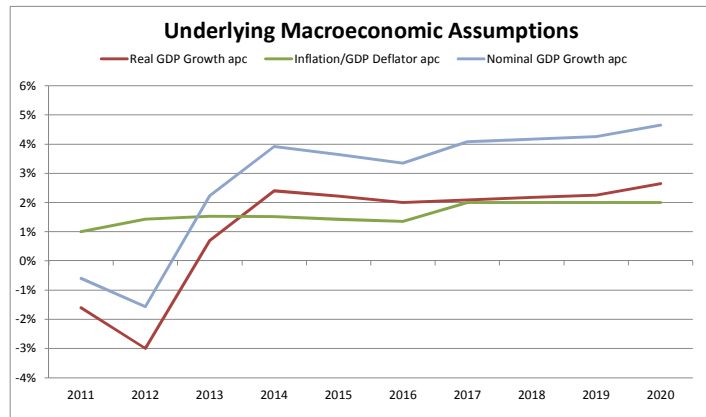
- ▶ Our proprietary benchmarking model is derived from 23 forecasts and forward-looking key indicators of economic outlook/health, fiscal finances & flexibility, institutional & political strength, and potential stress (household & banking sector).
- ▶ These metrics are collated to produce an overall model score for each sovereign and each is weighted according to our current view on its relative importance; which can vary depending on such factors as the region and the point in the economic cycle.
- ▶ The resultant score is used to benchmark sovereigns and provides the basis for decisions on relative value. However, this model is intended as a tool to be used in conjunction with fundamental credit analysis, and is not meant to replace qualitative judgment. The model benefits from input from the broader research and investment team in determining weights and also challenging the model results.



Source: BlackRock

# Fiscal Sustainability Cash Flow Model

- ▶ This tool projects the future path of fiscal deficits, public debt and financing requirements under various growth, fiscal consolidation, and cost of debt scenarios
- ▶ The models are updated regularly using actual official fiscal data, various market and official economic forecasts and our internal view on the most likely path of these inputs
- ▶ The models allow us to track the progress achieved by governments in their march towards debt sustainability, estimate the impact of various policy announcements, or analyse the impact of more adverse economic scenarios



Source: BlackRock

# Relative Value Scorecard (Issuer Level)

**BLACKROCK** US Credit Research - Telecom Page Last Updated: 6/13/12 Analyst: Doug Oare Sector Specialist: Brian Lysiak

Credit Ranking - Major Names				BLK Credit Views			Key Fundamental Factors					Relative Value			Holdings					
Ticker	Name	Ratings		Credit View	Risk To View	Credit Direction	Industry Assess.	Comp. Position	Mgmt. Quality	Financial Position	Key Ratio	Strategic View	Tactical View	Spread		3m Δ% Equity	Value (\$ Index)	6/11/12		
		MDY	SBP											Cur	Chg			BLK	Bench	Active
VZW	Verizon Wireless	A2	A-	Strong Like	Low	Improving	Favorable	Strong	Strong	Strong	0.1x	Strong Over	Market	144	64	N/A	10,122	0.024	0.012	0.012
VZ	Verizon Comm.	A3	A-	Strong Like	Medium	Stable	Favorable	Strong	Strong	Mixed	1.3x	Strong Over	Market	129	28	7.5%	40,719	0.081	0.100	-0.019
T	AT&T	A2	A-	Dislike	Medium	Stable	Favorable	Strong	Mixed	Mixed	1.8x	Strong Under	Market	135	40	9.2%	61,331	0.077	0.158	-0.081
VOD	Vodafone	A3	A-	Strong Like	Medium	Improving	Mixed	Strong	Strong	Mixed	1.6x	Underweight	Underperform	122	26	-1.8%	15,427	0.016	0.027	-0.011
FRTEL	France Telecom	A3	A-	Strong Like	Low	Stable	Mixed	Strong	Strong	Strong	1.9x	Underweight	Underperform	209	89	-13.0%	10,038		0.022	-0.022
AMXMM	America Movil	A2	A-	Strong Like	Medium	Stable	Favorable	Strong	Strong	Strong	1.0x	Overweight	Market	200	46	8.9%	13,697		0.029	-0.029
DT	Deutsche Telekom	Baa1	BBB+	Like	Medium	Stable	Mixed	Strong	Strong	Strong	2.2x	Underweight	Underperform	210	49	-10.5%	11,651	0.007	0.023	-0.016
TELEFO	Telefonica	Baa1	BBB	Dislike	Medium	Stable	Mixed	Strong	Strong	Mixed	2.5x	Underweight	Market	588	248	-22.5%	11,901	0.018	0.021	-0.003
AMT	American Tower	Baa3	BB+	Like	Medium	Stable	Favorable	Strong	Strong	Weak	5.0x	Strong Over	Outperform	283	58	7.1%	4,704	0.037	0.008	0.029
CCI	Crown Castle (secu)	A2	NR	Like	High	Stable	Favorable	Strong	Strong	Weak	6.8x	Overweight	Market	237	(16)	3.5%		0.031		0.031
QUS	Qwest Corp.	Baa3	BBB-	Like	High	Stable	Unfavorable	Mixed	Mixed	Strong	1.8x	Overweight	Market	368	66	N/A	4,850	0.004	0.007	-0.003
BRITEL	British Telecom	Baa2	BBB	Strong Dislike	Low	Improving	Unfavorable	Weak	Strong	Mixed	3.7x	Strong Under	Underperform	214	(52)	-5.2%	5,438		0.014	-0.014
TITIM	Telecom Italia	Baa2	BBB	Strong Dislike	Low	Stable	Mixed	Mixed	Weak	Mixed	3.0x	Overweight	Market	634	229	-14.8%	11,002	0.007	0.017	-0.010
CTL	CenturyLink	Baa3	BB	Dislike	High	Stable	Unfavorable	Mixed	Strong	Mixed	2.8x	Strong Under	Market	460	104	-4.9%	15,917	0.023	0.028	-0.005
Average:													281	70						

Conviction Views	
Overweight QUS Corp Front End Paper, Short Holdco CTL	
Buy VZ on issuance	
Expected Supply	Comments
Telefonica	Opportunistic as market opens
BCE	\$2-3bn acquisition financing
Verizon	\$2bn refinancing
BLK Watchlist Names	Comments
CenturyTel	Industry concerns

\*Key Ratio = 2012E Adj. Net Debt/EBITDA

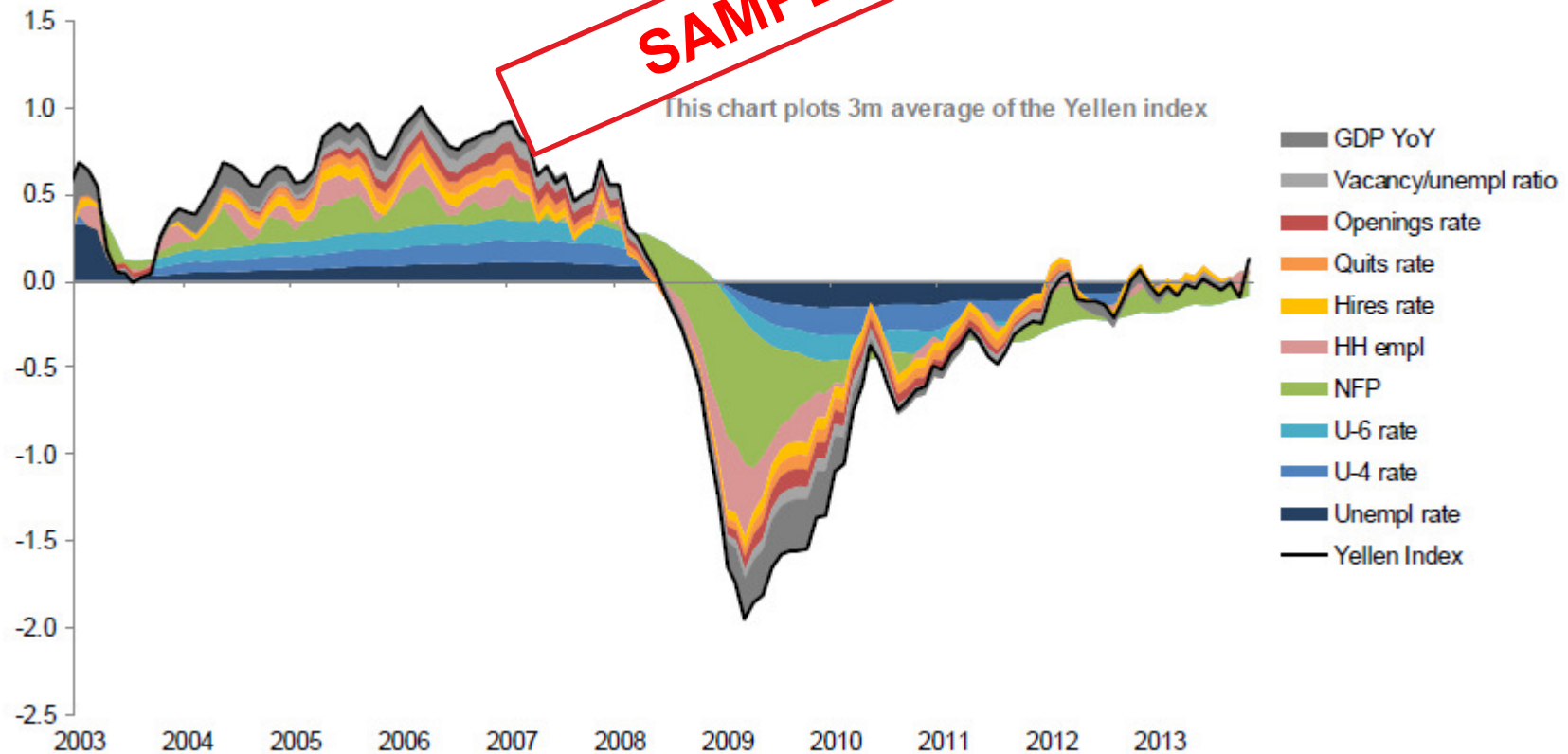
Key Sector Views	
Relative Value:	Fair
Recommendation:	Underweight
BLK Weighting:	0.336
Bench Weighting:	0.475
Sector OAS:	243
3M Excess Return:	-297

Industry Factors	
Average Rating:	BBB1
Credit Trend:	Stable
Event Risk:	Low/Neutral
Supply Risk:	Low
Equity Trend:	Positive

Equity Market Perf vs. MS Top 100	
Date:	6/8/2012
Index Ticker:	SSTELSX
1 Month:	5%
6 Month:	14%
12 Month:	15%

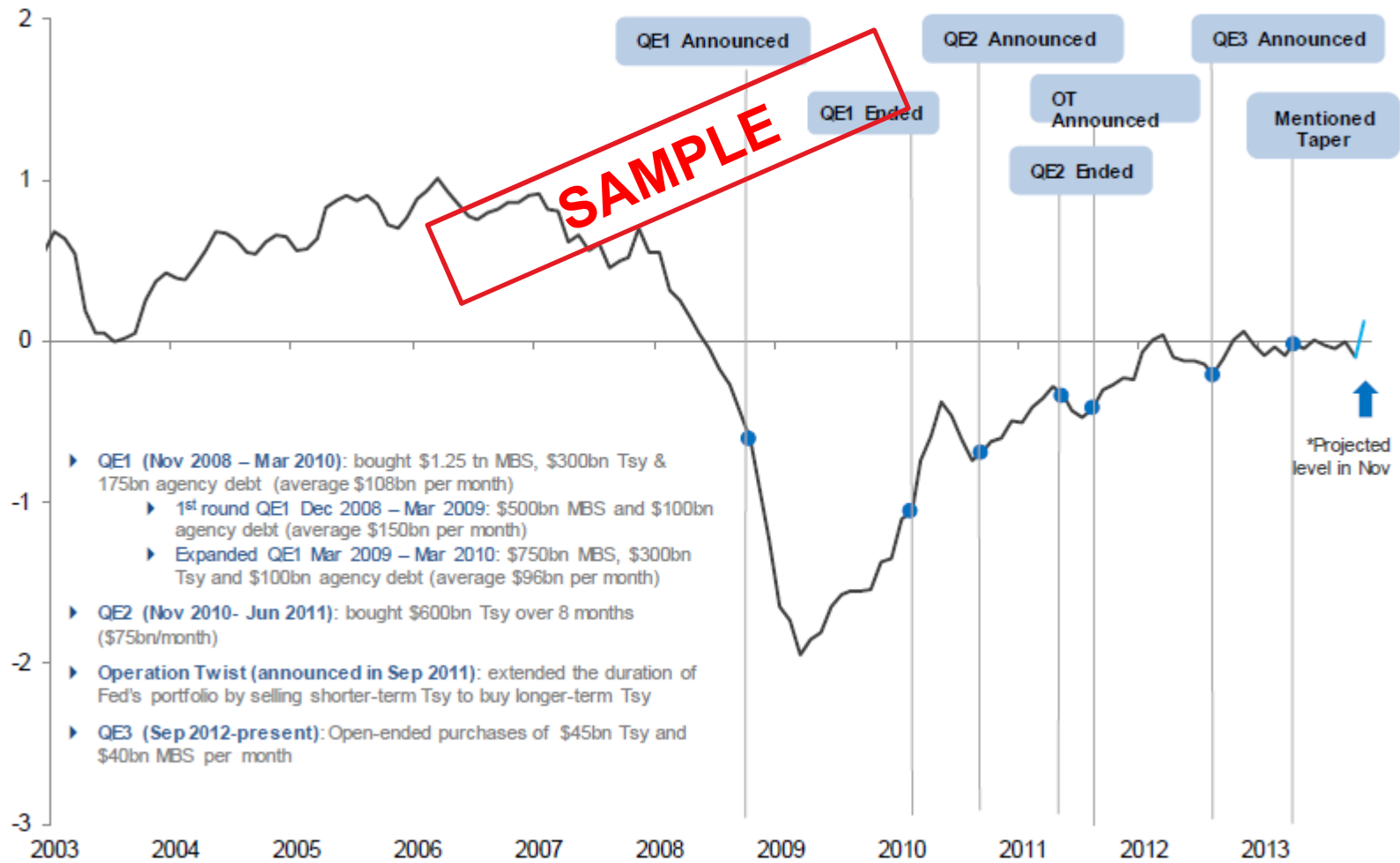
# Yellen Index (our proprietary index to gauge US employment condition)

	Jun	Jul	Aug	Sep	Oct	Nov (proj)*	3M Average
Yellen Index	-0.07	-0.05	-0.02	0.05	-0.33	0.64	0.12



\* Projected Yellen Index = Non-JOLT components \* 1.02 (Note: JOLT data is released with a 2-month delay)  
 1.02 is the beta of the Yellen index vs. Non-JOLT components regression using the past 10 years of data. R-square of the regression is 97%.

# 3 month Average of Yellen Index



# Appendix

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## C. Sample Risk Management Output

## Risk Management Does Not Mean Risk Avoidance

Risk should be...:

**Deliberate**

**Diversified**

**Scaled**

These are core principles of good portfolio construction which enable to deliver sustainable alpha over the long-term.

# Fixed Income Risk Management Summary

## BGF World Bond Fund (WB1)

Benchmark: Barclays Global Aggregate Index (USD Hedged) (LGAINXUSDH)

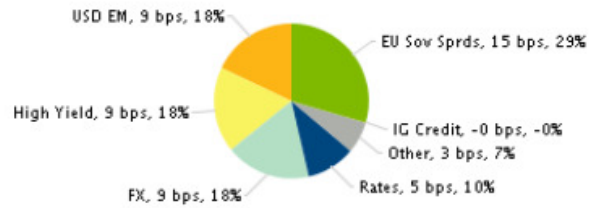
Portfolio Risk: 2.16% Benchmark Risk: 2.14% Active Risk: 0.52% Tail ES Multiplier: 1.16 Portfolio Beta: 0.98 NAV: 1,097,578,345

Tue, 25 Feb 2014

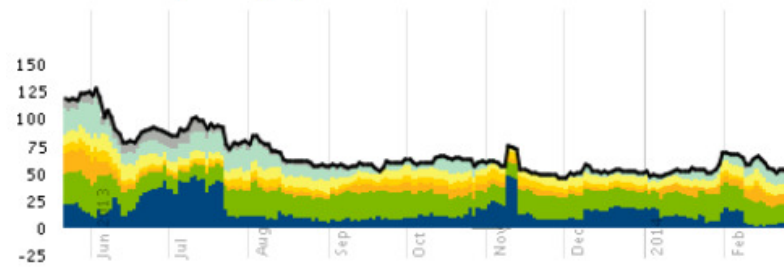
432 Assets

Base Currency: USD

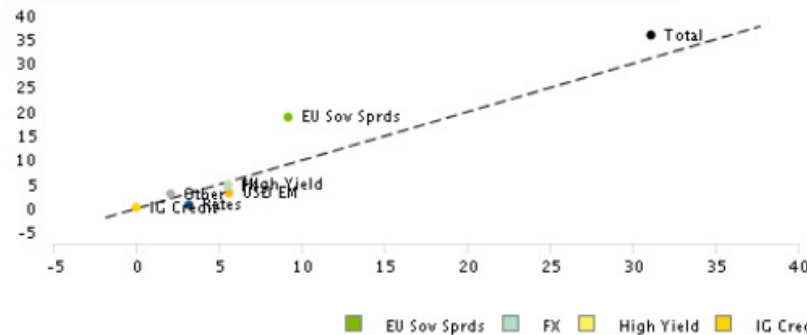
### Active Risk Contributions



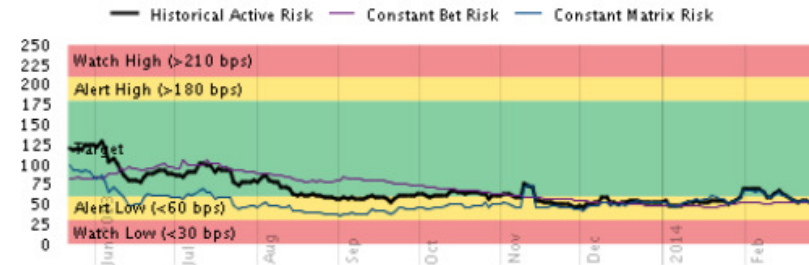
### Active Risk Decomposition (bps)



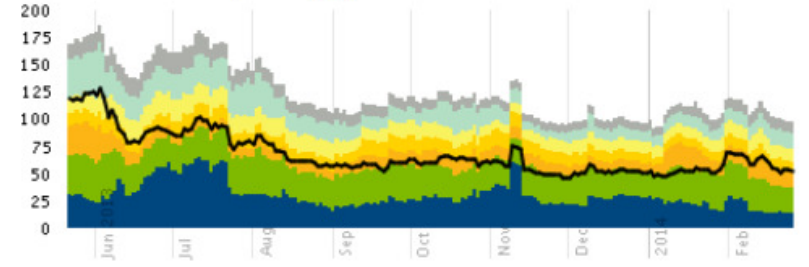
### Analytical Expected Shortfall (X-axis) vs. Tail Expected Shortfall (Y-axis) (1M)



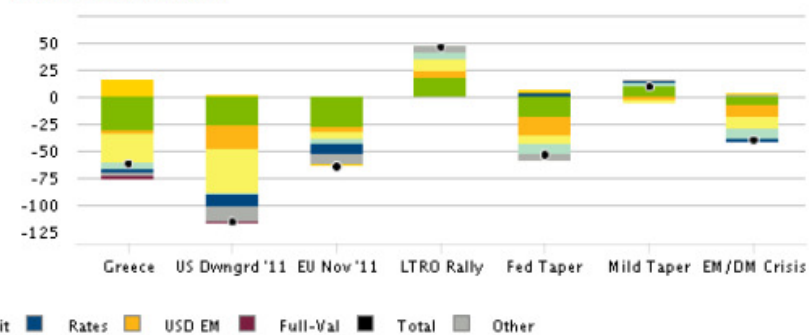
### Active Risk, Constant Bet Risk & Constant Matrix Risk (bps)



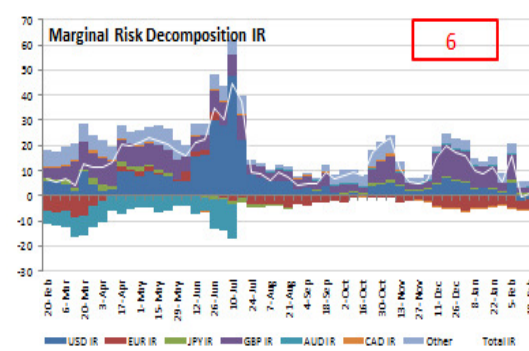
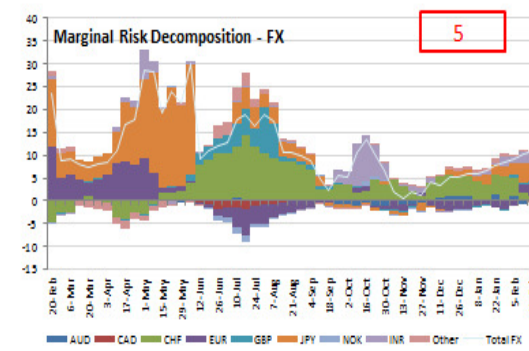
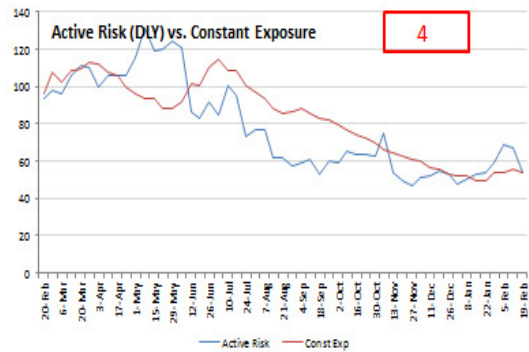
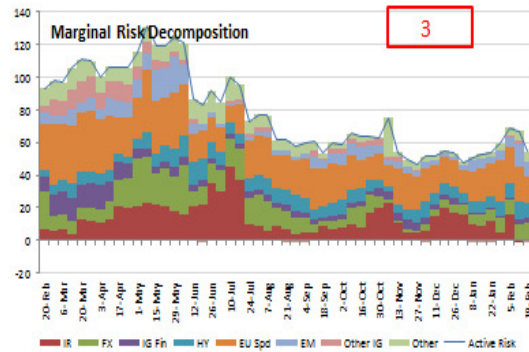
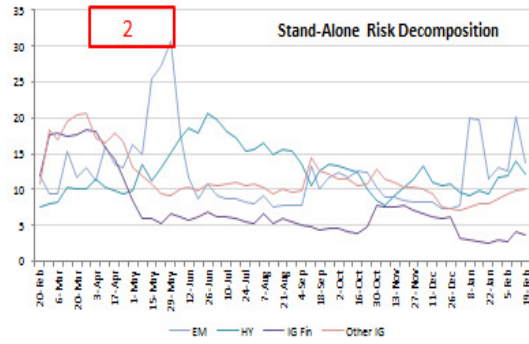
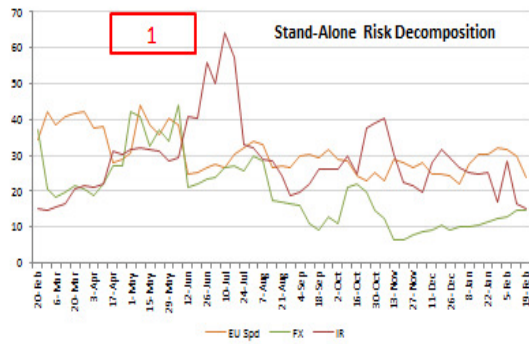
### Stand-Alone Risk Decomposition (bps)



### Stress Scenarios (bps)



# Active Risk Decomposition



Risk allocation helps determine the sources of risk:

- Major risk groups: EU Spreads, EM, Rates and FX
- High yield and investment grade credit and EM are expected high risk contributors in the spreads bucket
- In the rates bucket, long EUR Sovereign and short core rates are both positive risk contributors.

Time series of the marginal risk decomposition demonstrates the shifts of portfolio managers' areas of risk taking.

# Stress Testing

- Stress testing allows us to simulate and analyze tail events to identify a fund’s vulnerabilities.
- Stress tests give the loss (in bps) to a portfolio under specified extreme scenarios.

## Stress Scenarios Include:

- ✓ Historical Stress Periods
- ✓ Custom Specified / Implied Market Shocks
- ✓ Hybrid Scenarios
  - Scaled historical scenarios
  - Reverse stress testing

## Stress P&L for a Multi-strategy Hedge Fund

	Historical Scenarios		BII Scenarios					Custom Scenario
	Crash 08 [Sep 12- Nov 03 2008]	May-Jun 2013 Sell off	Growth	Inflation	Nemesis	Stop n go	Separatism	EM Global Sell Off
Investment Grade Corporate Spreads	-70	-6	41	26	-113	7	3	-13
High Yield Corporate Spreads	12	3	-6	-4	21	0	-10	3
Emerging Market Spreads	-55	-17	21	11	-30	6	10	-11
EUR Sovereign Spreads	-12	-20	83	51	0	17	-48	-39
Government Interest Rates	-7	8	-14	3	3	-5	0	4
Foreign Exchange	-29	-10	34	65	-30	0	7	-12
Inflation	-30	-5	1	27	-13	3	1	-8
Other	-15	-6	0	-6	4	1	3	-4
<b>Total</b>	<b>-213</b>	<b>-49</b>	<b>160</b>	<b>166</b>	<b>-158</b>	<b>29</b>	<b>-35</b>	<b>-81</b>

### Nemesis 2013

- HY Spreads +750 bps
- 10Y Tsy -100 bps
- World Equity -40%

### Credit Spreads Widen

1. HY spreads widen by 60% of current level.
2. IG spreads widen by about 50% of current level.

# Mandate Surveillance: Scenario Analyses

## Global Corporates Account Stress Tests

Portfolio/ Group	US\$ NAV (MM)	Dur Gap	SDur Gap	Tracking Error	Russia Crisis (% P/L)	LTCM (% P/L)	WTC (% P/L)	Recession (% P/L)	TsyBackup (% P/L)	MtgSellOff (% P/L)	Credit 07 (%P/L)	Crash 08 (%P/L)	Inflation (%P/L)
Global Mutual Funds	1,962	-0.45	0.26	0.54	-0.46	-0.18	-0.25	-4.11	0.01	0.07	-1.15	-3.28	1.07
WB1	1,098	-0.48	-0.3	0.52	-0.34	-0.2	-0.26	-3.83	-0.03	-0.12	-0.84	-2.9	0.99
Fund #1	76	-0.37	0.59	0.5	-0.36	-0.22	-0.19	-4.21	-0.27	0.02	-1.61	-2.65	1.24
Fund #2	41	-0.43	-0.13	0.53	-0.47	-0.21	-0.25	-3.95	0.11	0.12	-1.26	-2.25	1.09
Fund #3	447	-0.49	0.91	0.65	-0.8	-0.14	-0.25	-4.78	0.04	-0.02	-1.52	-4.54	1.06
Fund #4	82	-0.52	0.94	0.58	-0.91	0.05	-0.18	-4.44	0.11	0	-1.95	-4.2	1.18
Fund #5	140	-0.1	2.03	0.56	-0.08	-0.27	-0.29	-4.3	-0.31	0	-1.55	-2.89	1.53
Fund #6	16	-0.54	0.16	0.36	-0.12	-0.28	-0.19	-1.88	0.11	0.08	-0.92	-0.36	0.89

Risk Group	Stress PnL
Spreads	-207
Rates	-16
EUR Sovereign Spreads	-11
Other Int Rates	-2
DEM Int Rates	11
GBP Int Rates	2
CEE Int Rates	5
JPY Int Rates	-2
USD Int Rates	-17
AUD Int Rates	-2
Foreign Exchange	-30
Inflation	-30
Volatility	-2
PnL not attributable to factors	-4
<b>Total</b>	<b>-290</b>

### Portfolio Level Stress Test

Global Corporates Representative Account Under Crash 08 Scenario



# Mandate Surveillance: Scenario Analyses

## Global Corporates Account Stress Tests

Portfolio/ Group	US\$ NAV (MM)	Dur Gap	SDur Gap	Tracking Error	Russia Crisis (% P/L)	LTCM (% P/L)	WTC (% P/L)	Recession (% P/L)	TsyBackup (% P/L)	MtgSellOff (% P/L)	Credit 07 (%P/L)	Crash 08 (%P/L)	Inflation (%P/L)
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### Portfolio Level Stress Test

Global Corporates Representative Account Under Crash 08 Scenario



# Appendix

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## D. Market Outlook

## Four Themes for '14 – Summary

**The starting point for fixed income is more favourable than last year – but diversification is key because this is still a low-yield world with stark fundamental differences across economies...**

### 1. Which way now? Central banks at an inflection point:

- ▶ Ultimately exit will be challenging: holdings of USTs and Gilts, and record inflows into bond funds creates risk of overshoot; a reduction in global liquidity will have unintended consequences across assets
- ▶ Macro environment is improving, albeit below trend and with no sign of inflation or deflation
- ▶ Diverging central bank policies will keep rates and FX volatility elevated
- ▶ Core government yields will likely continue to rise over the year – but the steepness of yield curves provides a cushion against negative returns

### 2. Breaking tradition - Europe's deleveraging:

- ▶ Deleveraging is changing the European credit markets – creating new opportunities in subordinated bonds
- ▶ Negative net supply is positive for European financials
- ▶ Accommodative ECB supports peripheral sovereigns

### 3. Finding the balance – bondholders vs shareholders

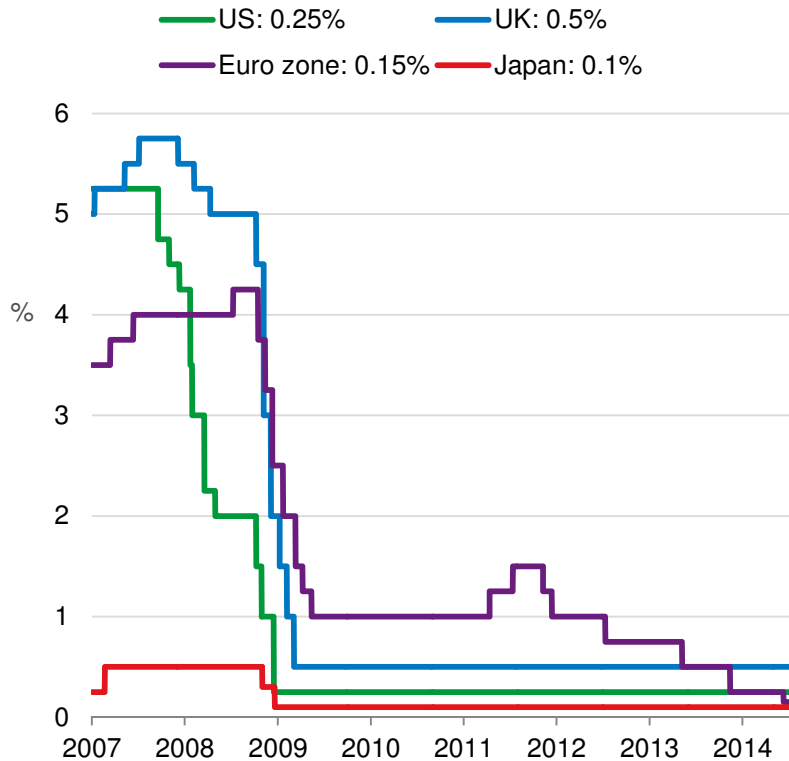
- ▶ Watch for pension fund de-risking in the long-end after 2013's equity rally / rate sell-off
- ▶ Low corporate default rates and plenty of liquidity but increased event risk in the US as companies start to favour shareholders over bondholders
- ▶ Down the capital structure offers better value: high yield fundamentals still solid even if structural questions are emerging

### 4. One size doesn't fit all – emerging market debt:

- ▶ Increase of idiosyncratic risk, coupled with a withdrawal of Fed liquidity, creates relative value opportunities
- ▶ ... but FX-driven volatility will stay high

# 2014: the start of monetary policy divergence

## 2007 to present: coordinated easing actions



Source: DataStream, BlackRock, as of 15 July 2014

## 2014: central bank divergence

### Federal Reserve



Started 'tapering' and dropped unemployment threshold; forward guidance to keep front-end rates low. Debate over terminal Fed funds rate

### Bank of England



Will the BOE be the first major central bank to raise rates given the strong economic recovery?

### ECB



Delivered further rate cut, new TLTRO, and discussing potential ABS purchase programme. Will these be enough?

### Bank of Japan



Ambitious 2% inflation target; likely further QE expansion?

### Emerging markets



Some emerging market central banks have finished raising rates as external imbalances adjust

United States

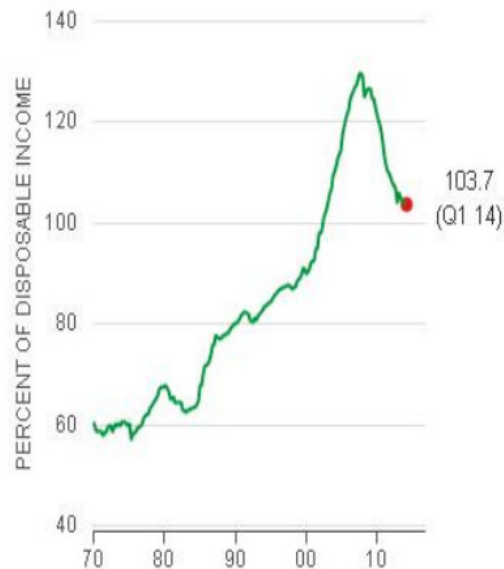
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# US fundamentals improving

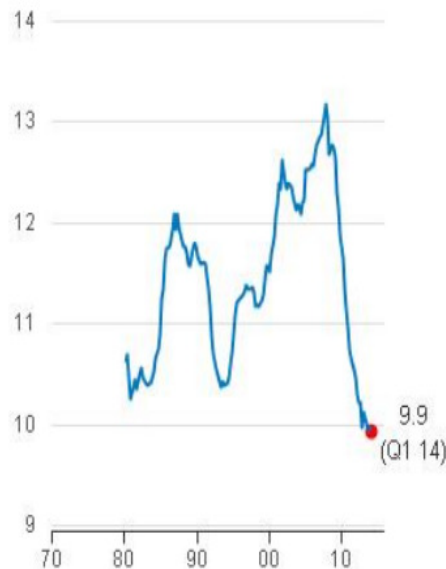
## (1) Households' financial situation looking a whole lot better

### Household debt at decade low while net worth hits record high

**Debt Outstanding**  
% of Disposable Income



**Debt Repayments**  
% of Disposable Income



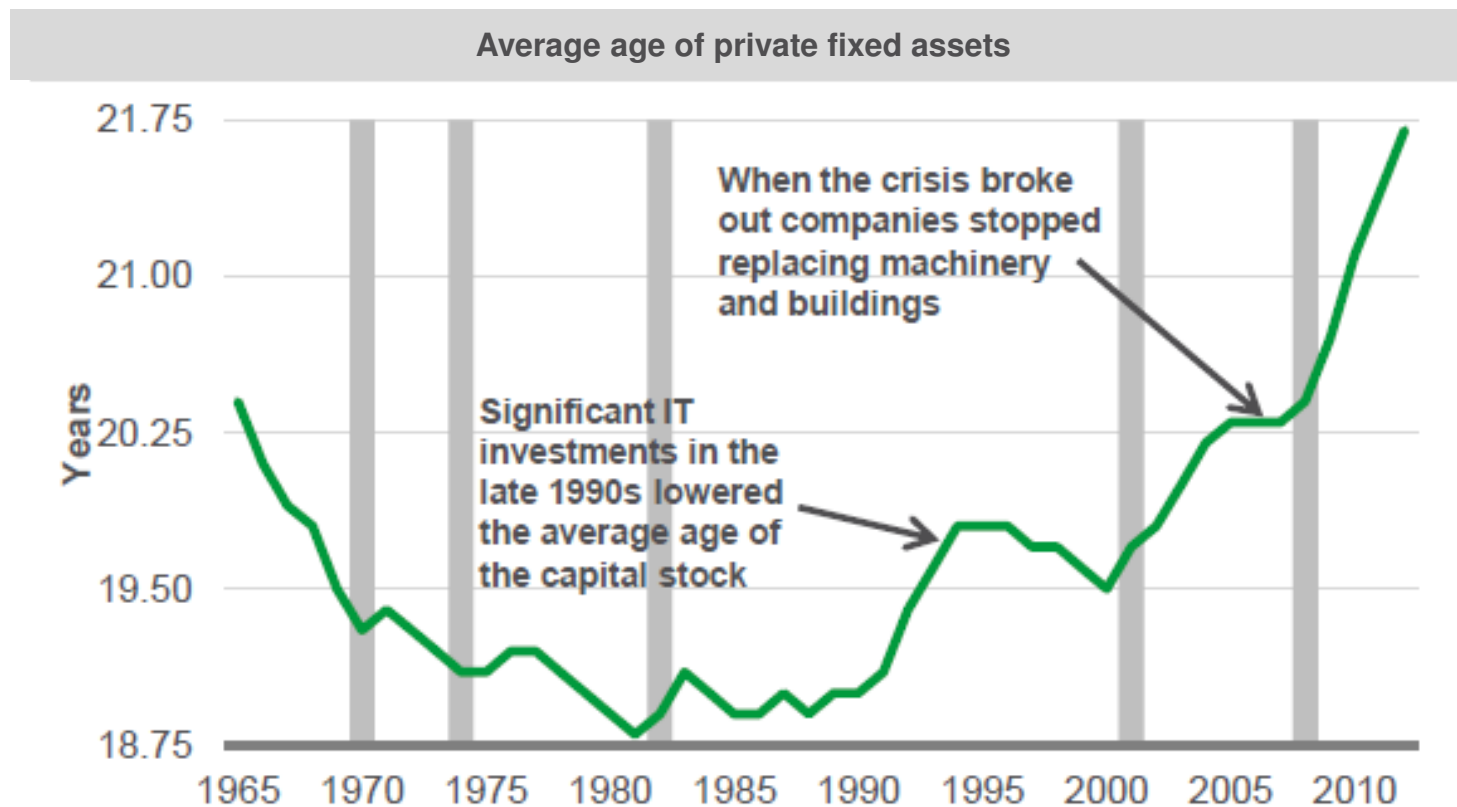
**US Household Net Worth \$Trillions**



- ▶ Significant progress on deleveraging – process now more or less complete?
- ▶ And household net wealth now 12% higher than pre-crisis peak

Sources: BlackRock Investment Institute, Thomson Reuters Datastream, as of June 2014

## (2) US business investment should pick up from here

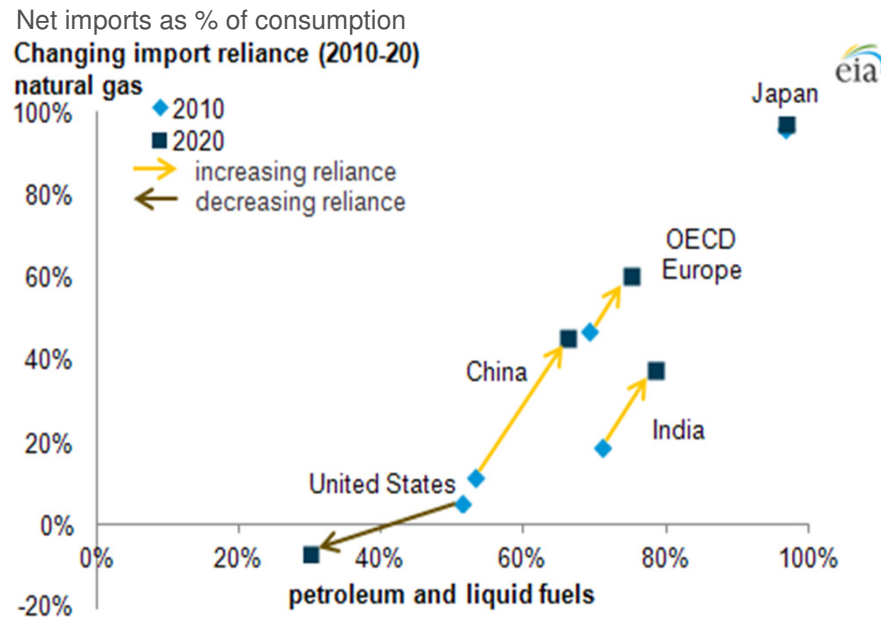


- ▶ US capital stock ageing – both fixed business assets and also housing
- ▶ Easy credit conditions and growing confidence should support investment

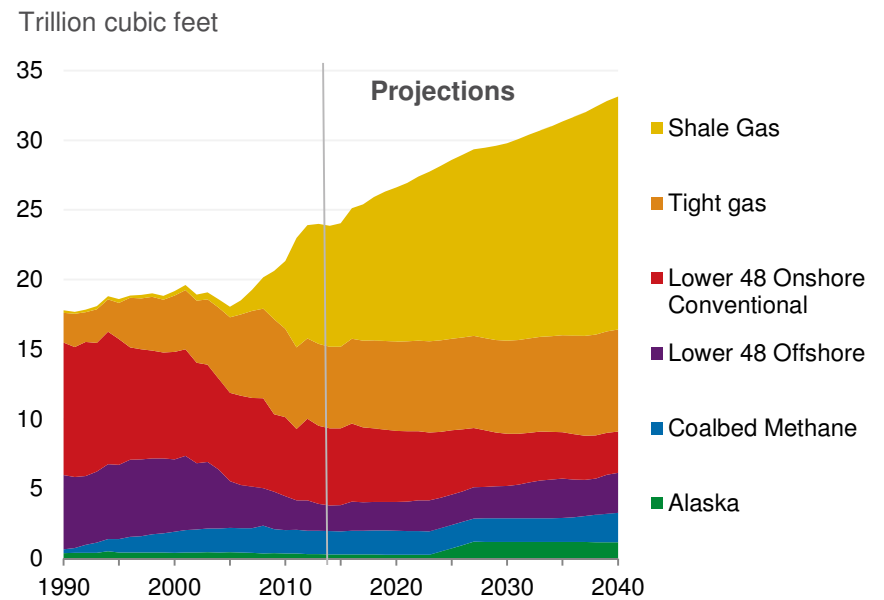
Source: Deutsche Bank, January 2014

### (3) And energy revolution is a game changer

#### US- Declining Energy Import Reliance



#### US Natural Gas Production by Source



- ▶ In 2010, US became world's biggest natural gas producer.
- ▶ U.S. liquid fuels net imports (as a share of consumption) is projected to decline from 40% in 2012, to 25% by 2016. The United States is also projected to become a net exporter of natural gas by 2018.

Source: U.S. Energy Information Administration (EIA), Annual Energy Outlook 2014 January 2014

# The US economy is much closer to normal than at any time in the past five years...

The FOMC is much closer to its goals than at any time in the past five years

How far is the FOMC from its goals? Distance from goals since 2006



The distance of the economy from the FOMC's goals can be measured with a simple objective function:

$$\text{Distance from goals} = (\text{Inflation} - \text{Target Inflation})^2 + (\text{Unemployment Rate} - \text{Long-run Unemployment Rate})^2$$

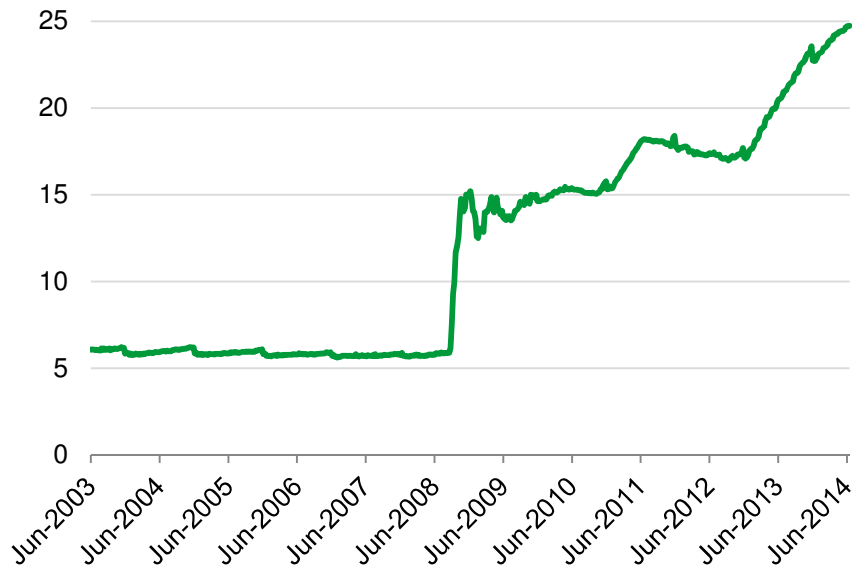
- **Target Inflation = 2%; Long-run Unemployment Rate = 5.4%** (midpoint of FOMC projections),

Source: James Bullard (President of St. Louis Fed) presentation at Tennessee Bankers Association Annual Meeting, 9 June 2014; Bureau of Economic Analysis, Bureau of Labour Statistics.  
\* Core PCE Inflation and Unemployment Rate as of April 2014 were 1.4% and 6.3% respectively

# ...however the monetary policy stance remains far from normal

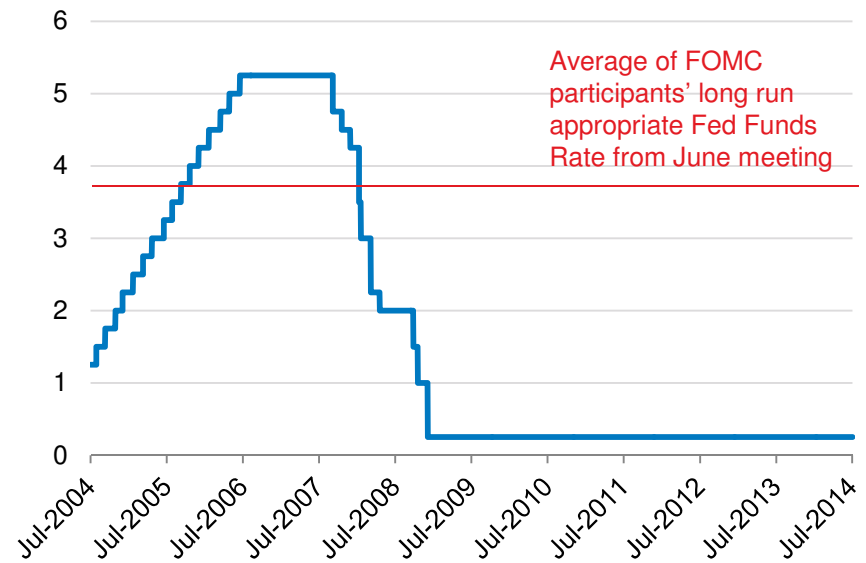
## The Fed's balance sheet remains large

Assets at all Federal Reserve Banks (% US GDP)



## The policy rate remains low

Effective Fed Funds Rate (%)

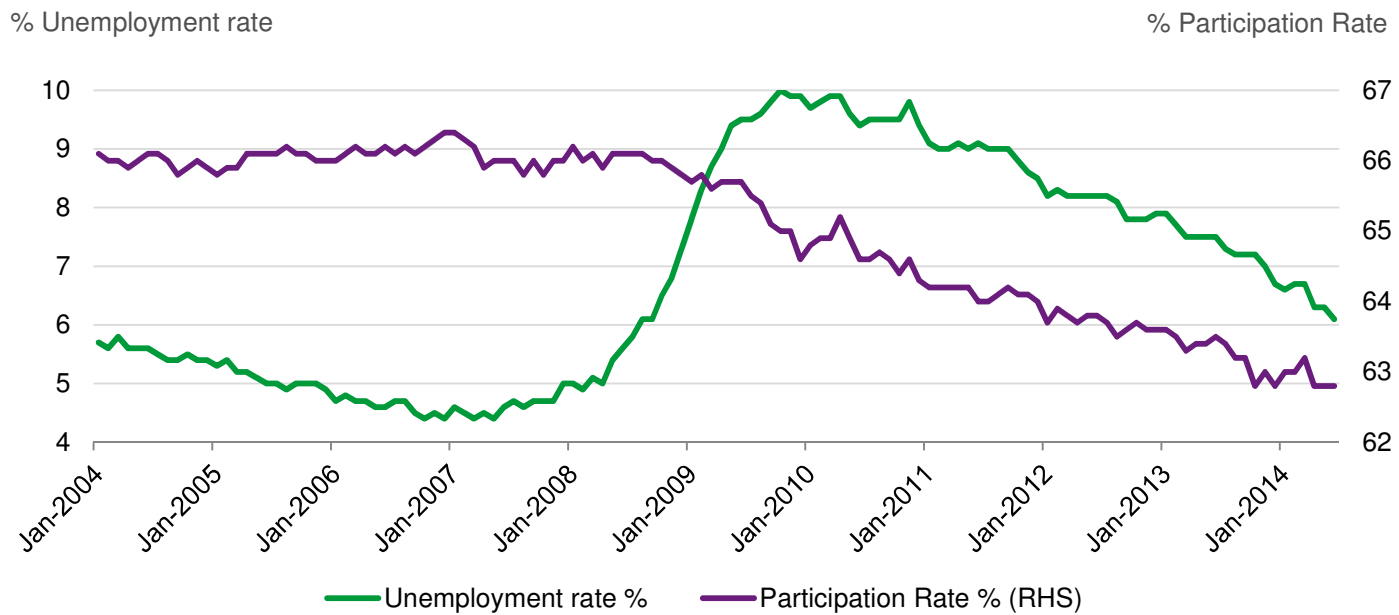


Source: Thomson Reuters Datastream, Federal Reserve, BlackRock, as of 15 July 2014

# What's keeping the FOMC from policy normalisation?

## 1) 'Significant slack' in US labour markets

### Unemployment rate has been dropping - but more people have dropped out of workforce

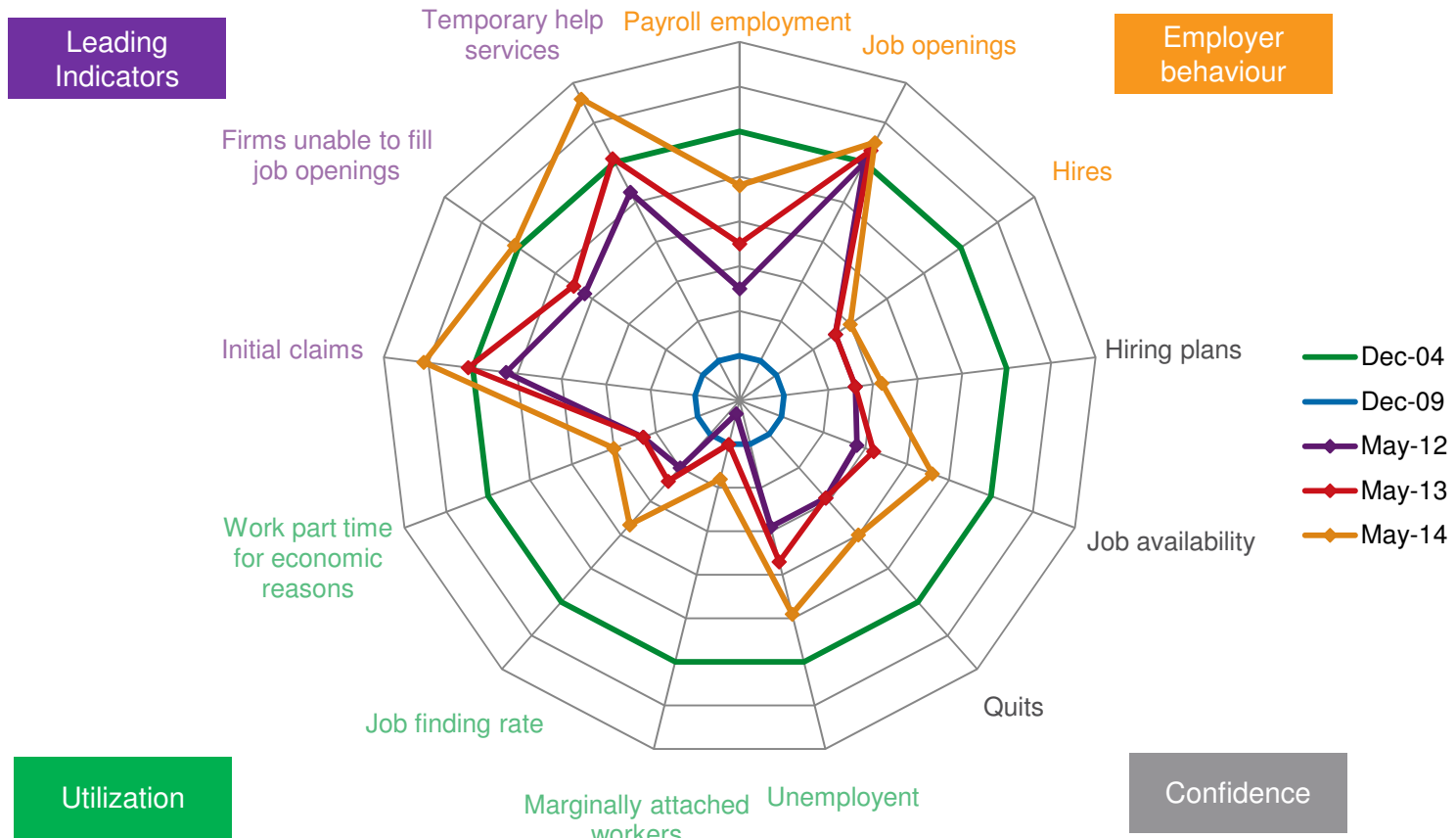


Source: Thomson Reuters Datastream, BlackRock, as of June 2014

# What's keeping the FOMC from policy normalisation?

## 1) 'Significant slack' remains in US labour markets

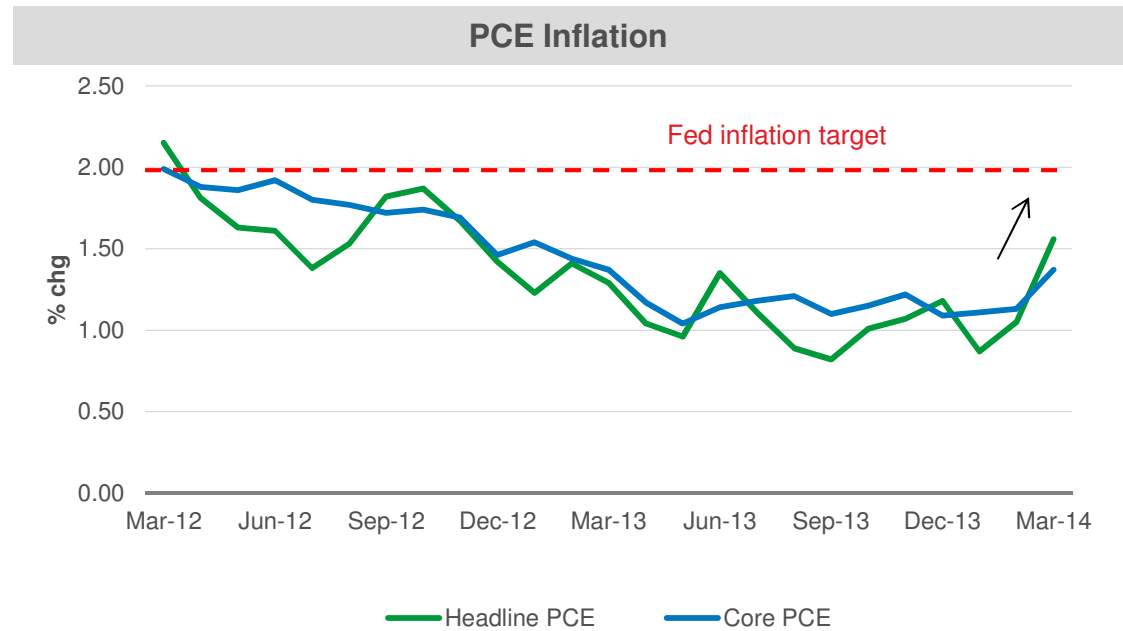
The US Labour Market in One Chart



Source: Federal Reserve Bank of St. Louis, Bureau of Labor Statistics, Conference Board, National Federation of Independent Business; Last observation: May 2014. BlackRock.

# What's keeping the FOMC from policy normalisation?

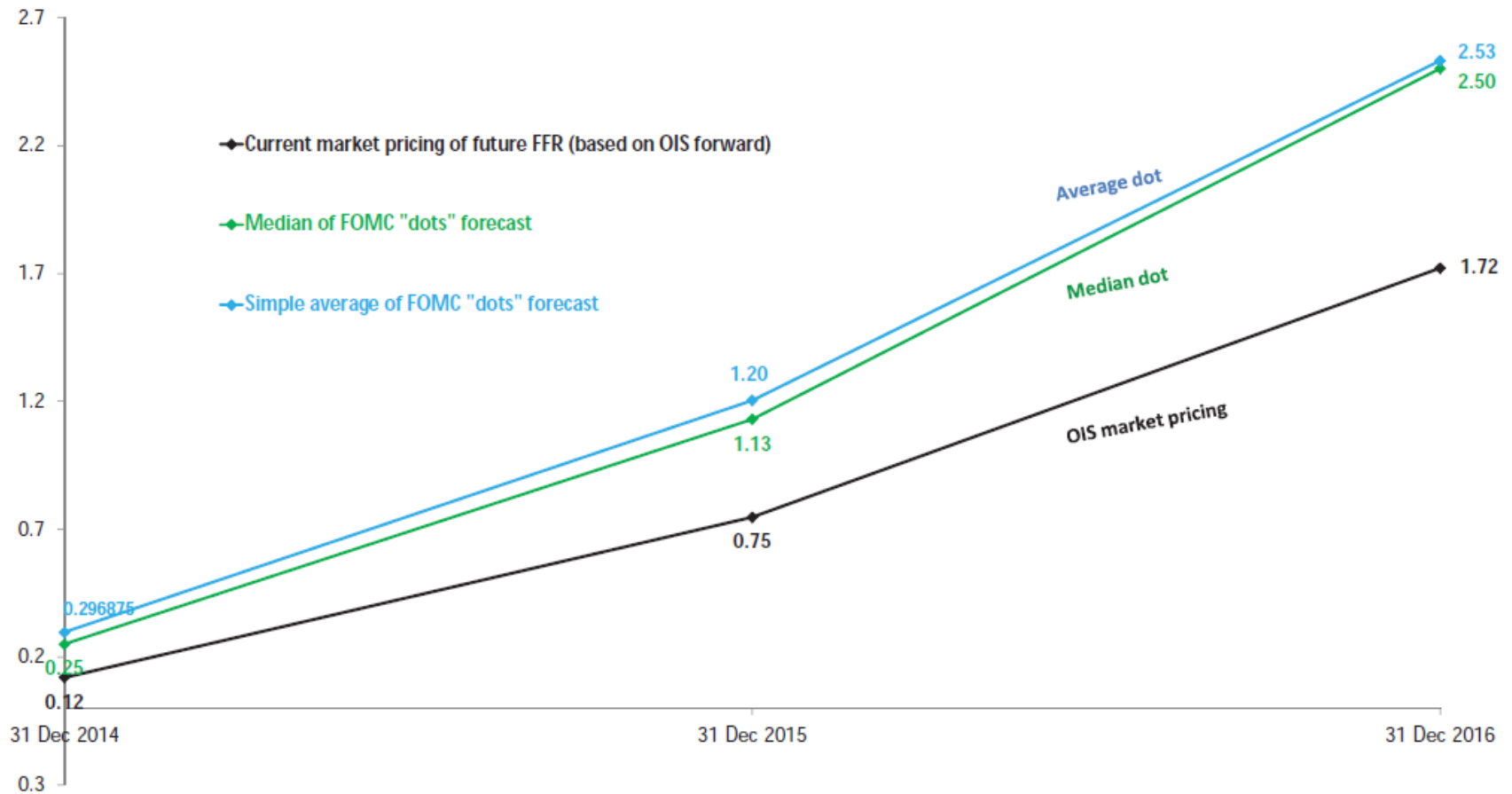
## 2) Inflation is low and below target, albeit on the rise



Source: Bureau of Economic Analysis, as of April 2014

# Current market pricing implies a more benign policy regime than the FOMC's projections

Fed Funds Rates Implied by OIS Forward and Fed's "Dots" Projection

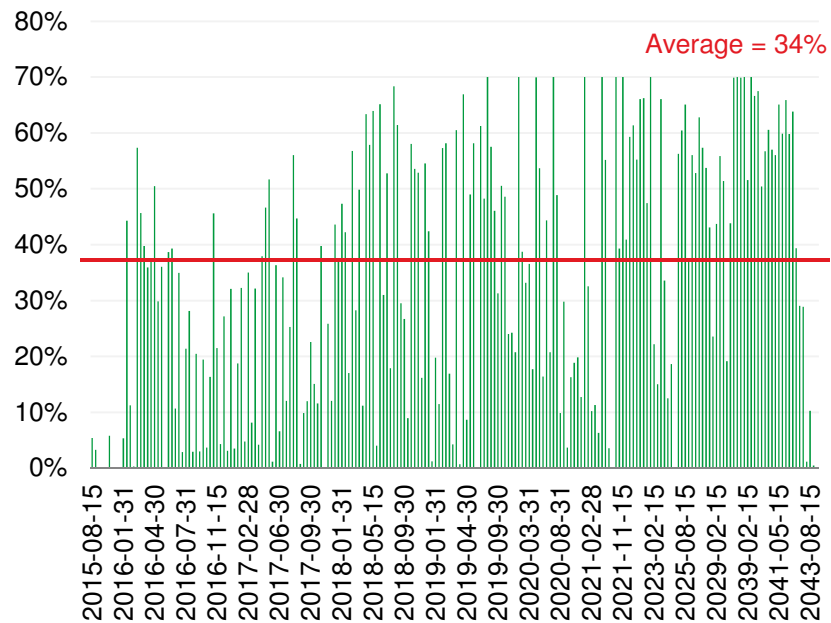


Sources: BlackRock, as of 15 July 2014

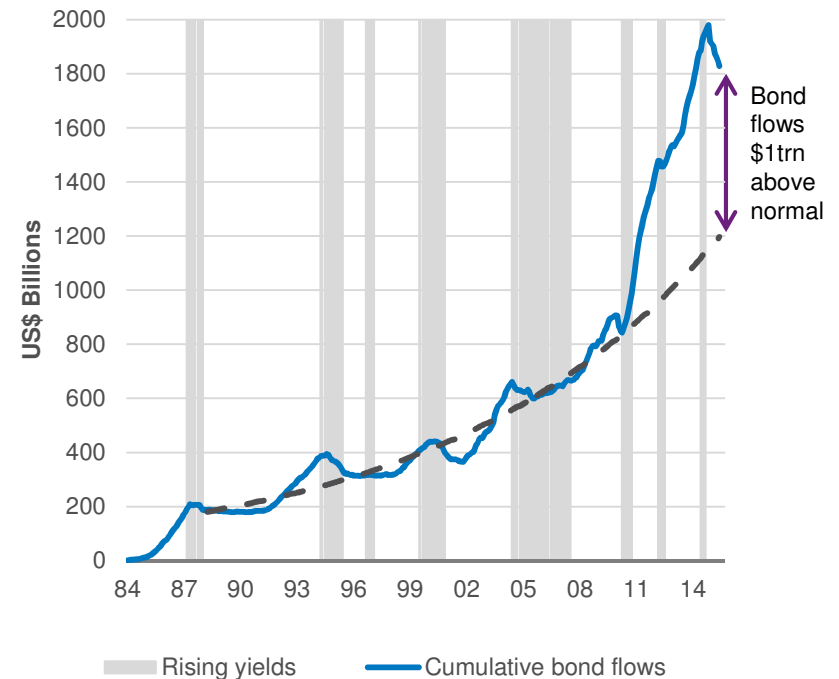
# The challenge of monetary policy normalisation creates risk of overshoot

Exiting extraordinary monetary policy won't be straightforward, given central bank holdings...

Fed holdings of T-notes/bonds across maturities, % outstanding



...and record inflows in the past few decades



Source: Chart 1 left, Federal Bank of New York, 19 July 2014. Chart 2 right, Bloomberg, DB, data as at January 2014.

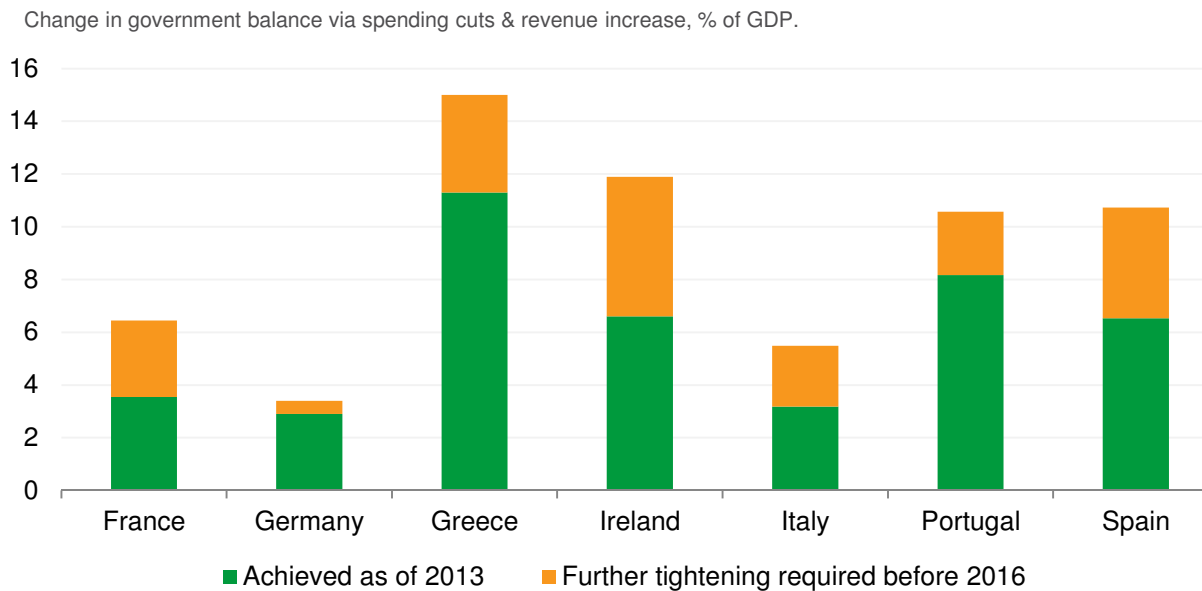
Europe

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## Fiscal adjustment has happened

- ▶ Much of the fiscal adjustment required has happened. The pace of consolidation is expected to slow down and the negative impact on GDP should diminish in the next few years

### Planned fiscal consolidation 2009-2016 vs. completed as of 2013



Source: National MoFs, European Commission, BlackRock, as of November 2013

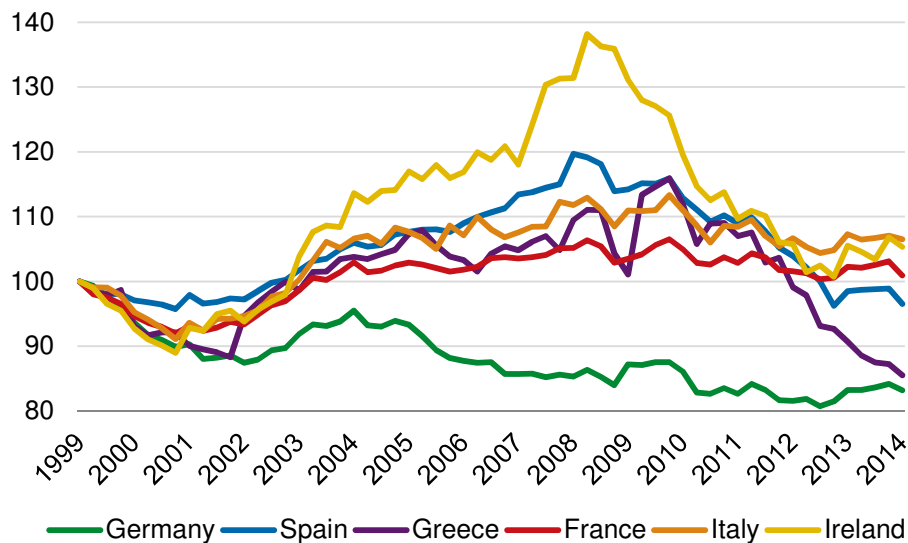
# Periphery economies regaining lost competitiveness and current account deficits have disappeared

- ▶ Greek unit labour costs have fallen by 30% vs Germany since crisis
- ▶ Ireland & Spain have closed half of the gap that widened over 2000's

- ▶ In most cases (Spain, Ireland, Portugal) this is largely due to better exports, not just weaker imports from recession

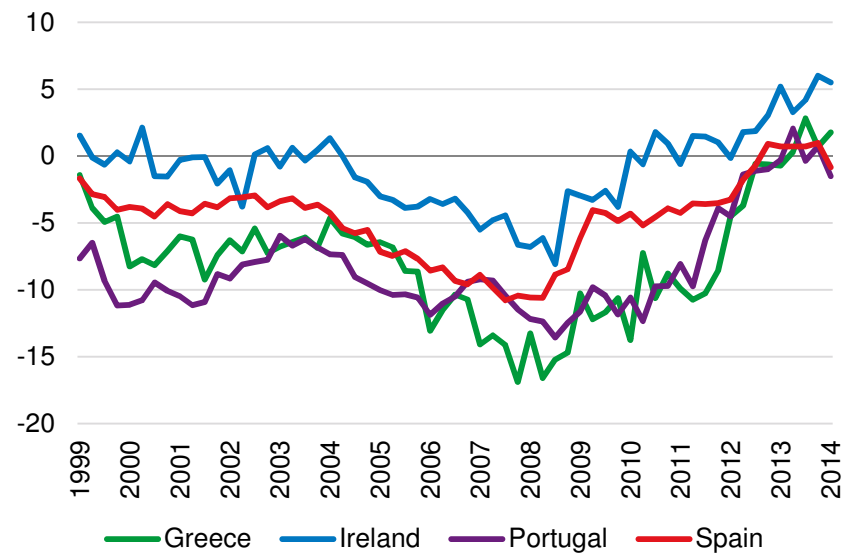
## Eurozone Competitiveness

Unit Labour Costs, Index rebased to 100



## Current Account Balances

% GDP

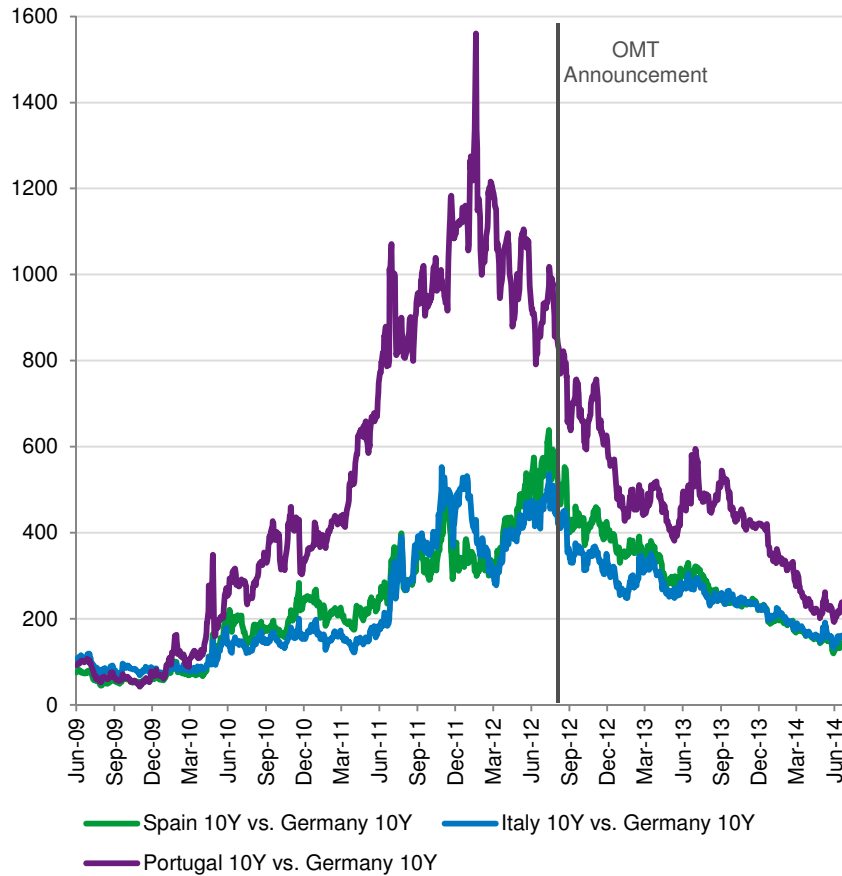


Source: Thomson Reuters Datastream, Eurostat, BlackRock, as of 16 July 2014

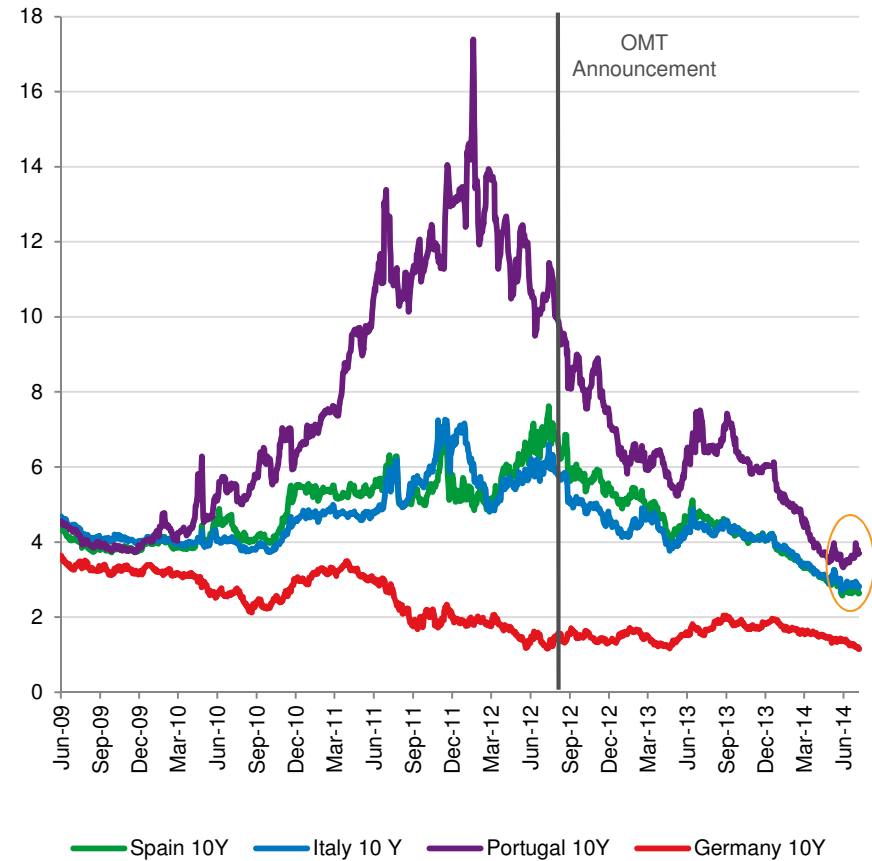
# Eurozone periphery bond yields are now close to their pre-crisis levels

## Eurozone Periphery Government Bond Spreads

Spread over German 10 year bond yield, bps



## Eurozone Periphery Government Bond Yields



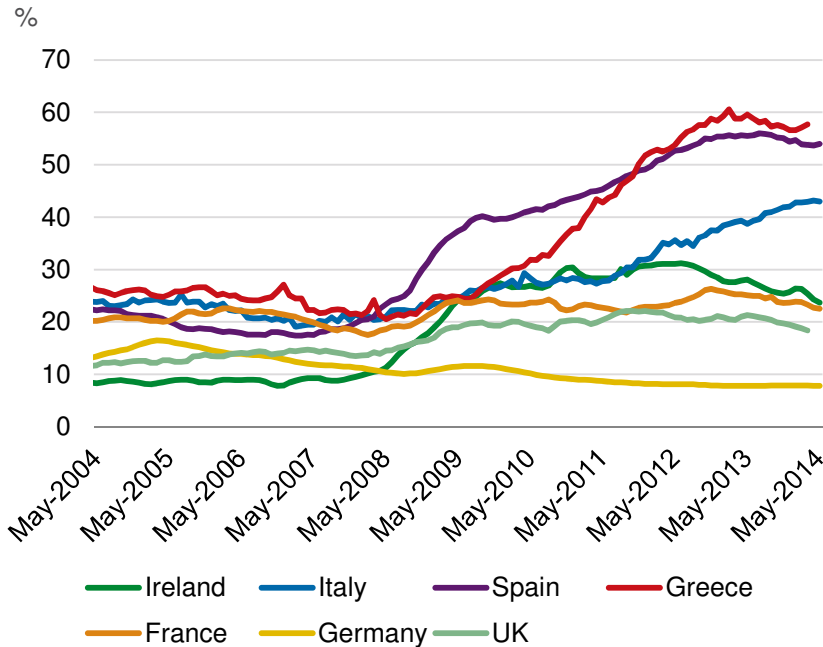
Source: Bloomberg, as of 18 July 2014

## But the crisis is *far* from over: 4 main structural challenges remain

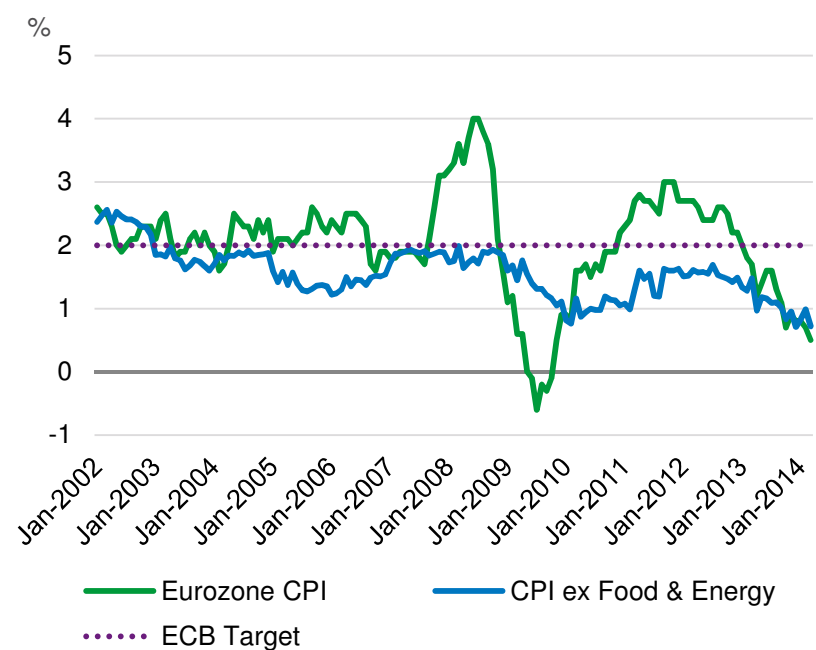
(1) **Unemployment is too high**—will growth be strong enough to reverse this?

(2) **Inflation is too low and falling**—if this continues the ECB will undertake more aggressive measures (eg., private asset purchases)

European youth unemployment rate



Disinflation will keep pressure on the ECB



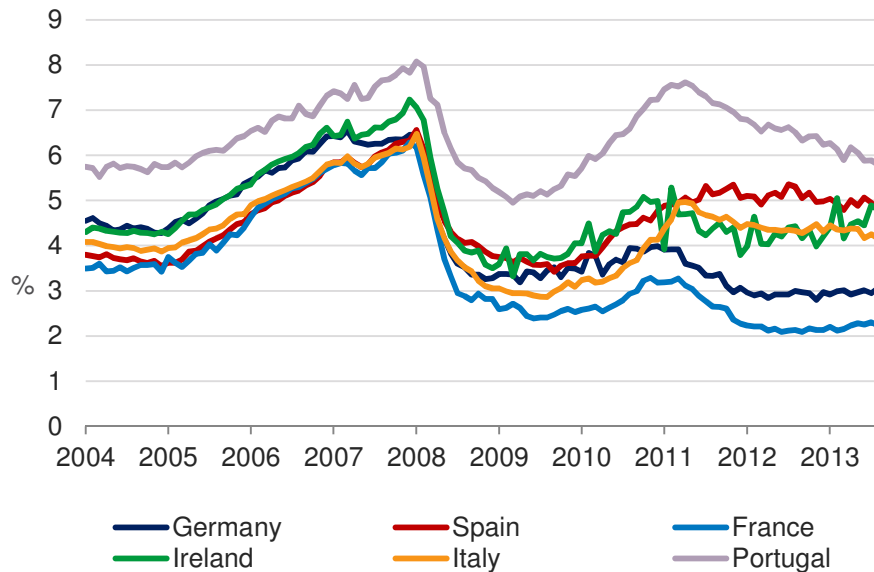
Source: Thomson Reuters Datastream, Eurostat, BlackRock, as of 16 July 2014

## Structural challenges remain...

(3) **Financial fragmentation: corporate lending rates still disparate**

### Eurozone Corporate Lending Rates

Loans to non-financial corporations up to 1 Million Euros

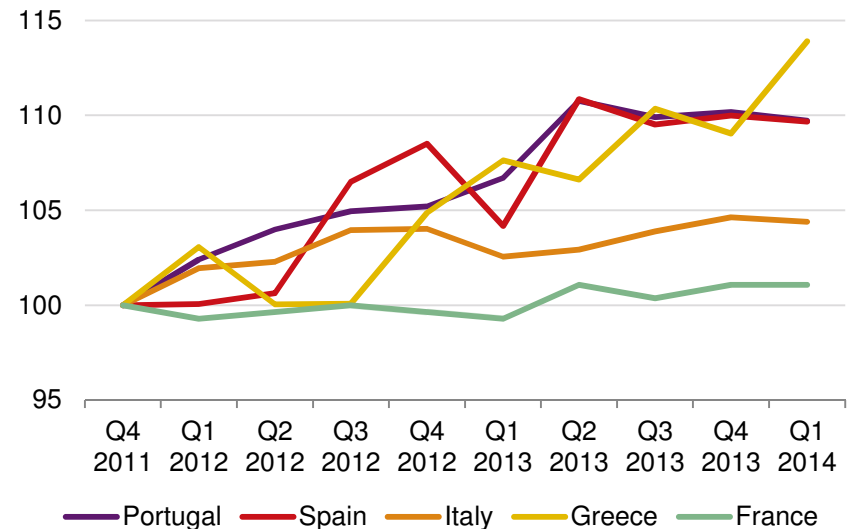


Source: ECB, Thomson Reuters Datastream, Eurostat, BlackRock, as of 16 July 2014

(4) **....and the core countries face their own problems**

### France and Periphery Export Performance

Export/GDP, Q4 2011=100



- ▶ Unlike periphery, France has done little to address competitiveness challenges
- ▶ And its economy remains overly skewed towards public sector

## The ECB delivered a series of policy measures during it's June meeting

- ▶ Disinflation is keeping the ECB in the easing camp
- ▶ The Bank delivered a series of expected policy measures during its June meeting:
  - ▶ Cutting the main refi rate to 0.15% and taking the deposit facility rate to negative at -0.10% making it the first major central bank to charge commercial banks for depositing money with it.
  - ▶ New targeted longer-term refinancing operations (TLTRO) operations
  - ▶ No sterilisation of liquidity generated through the Securities Markets Programme (SMP)
  - ▶ A potential new ABS purchasing programme (QE)

ECB policy options and what has been delivered in the June 2014 meeting		
Options	Decision	Action
Refinancing rate cut	√	From 0.25% to 0.15%
Negative deposit rate	√	From 0% to -0.1%
Lending facility rate cut	√	From 0.75% to 0.4%
Extension of Main Refinancing Operations (MRO) full allotment	√	Until December 2016
End of SMP sterilization	√	EUR 16bn liquidity freed
Creation of Targeted LTROs	√	Initial amount of EUR 400bn
ABS purchase programme	Discussed	'To intensify preparatory work'
Full Quantitative Easing	?	'Will discuss that when the time comes'

Source: RBS, BlackRock, as of June 2014

## Motivation for TLTRO—addressing fragmentation via the funding channel

**Targeted TLTRO:** 4y at refi rate+10bps (25bps initially)

- ▶ Impact on credit growth is unclear - it will depend on the demand and willingness to lend to SMEs
- ▶ Beneficial for corporates' funding costs, helping deleveraging where needed
- ▶ Peripheral banks will benefit more from net interest margin boost given their higher funding costs
- ▶ Banks with corporate geared loan books and greater wholesale reliance will take more advantage of the TLTRO, in particular, Italian, Portuguese and Spanish banks
- ▶ Potentially more issuance in capital securities, taking advantage of lower yields

### What can banks do with the free money?

**Spanish banks: sovereign debt carry trades with the TLTROs or a return to corporate lending?**

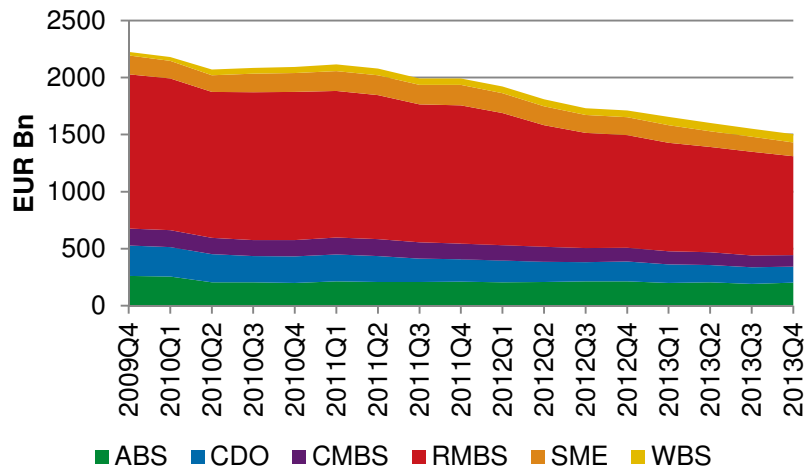
	TLTRO cost	Spain govt yields	Corp loan rate	Margin on govt carry trade	Margin on corp. loan
2012	1.00%	3.2% (3yr)	6.23%	2.20%	5.23%
Now	0.25%	0.48% (2yr)	4.77%	0.23%	4.52%

Source: BAML, as of June 2014

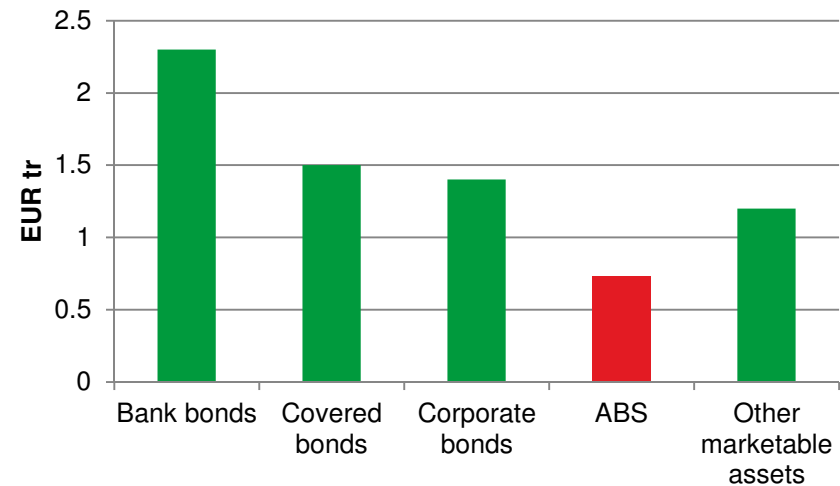
# Effectiveness of an ABS purchase programme?

- ▶ ECB Collateral report: EUR 7.1trillion of eligible collateral
- ▶ European ABS comprises just EUR 730bn, this includes EUR 330bn of “retained” issuance
- ▶ There is not a large “free float” of ABS, and secondary trading is limited
- ▶ Practical difficulties, including the fact that securitisation is not evenly used across the Eurozone countries
- ▶ Danger of crowding out the existing private buyer base

Total European Securitized Products Outstanding



ECB Eligible non-government collateral



Source: JPM ABS research

# Impact of the ECB's Asset Quality Review on European Banks

## Asset Quality Review

- ▶ Assessment of collateral valuations and coverage levels
- ▶ Conducted by the ECB and national regulators, covering Eurozone banks representing 85% of Eurozone assets
- ▶ €3.72trillion of assets were selected, equivalent to 58% of total Risk-Weighted-Assets across the banks.
- ▶ Pass-mark: 8% Common Equity Tier 1 ratio

**The ECB's balance sheet assessment is generally credit positive for the European banking sector as it will enhance transparency, comparability and eventually strengthen banks' solvency levels (ex-ante impact)**

**The exercise has already resulted in precautionary measures by some banks which have raised capital and improved their provision coverage.**

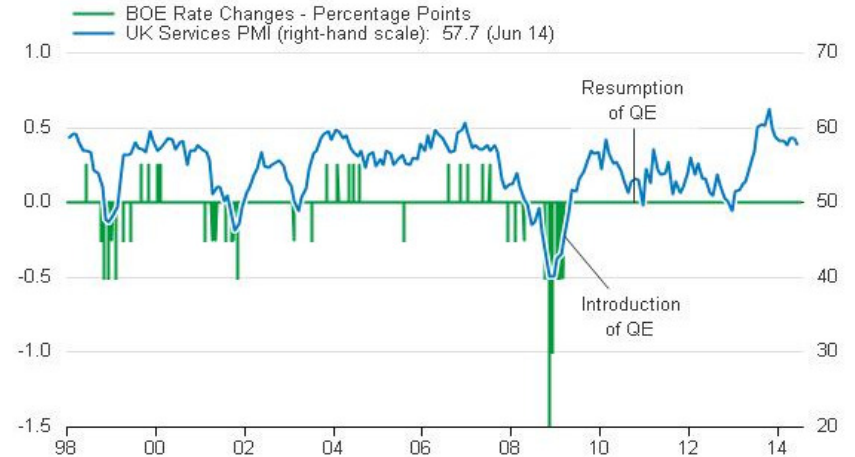
# UK – strong economic indicators are calling for a rate hike. Wage growth is the only box not ticked...

## Unemployment rate dropping

ILO Headline Rate %



## Exceptionally strong PMI



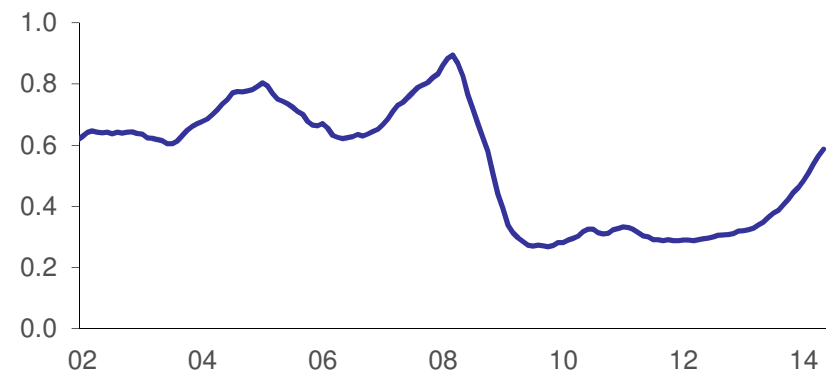
## Wage growth has been less impressive...

Wage Growth, CPI Inflation, BoE Policy Rate%



## ...but this is against the backdrop of strength in almost every other labour market indicator

Labour Market Tightness (Vacancies per Unemployed)



Source: Thomson Reuters Datastream, Markit, ONS, BlackRock, as of July 2014

Japan

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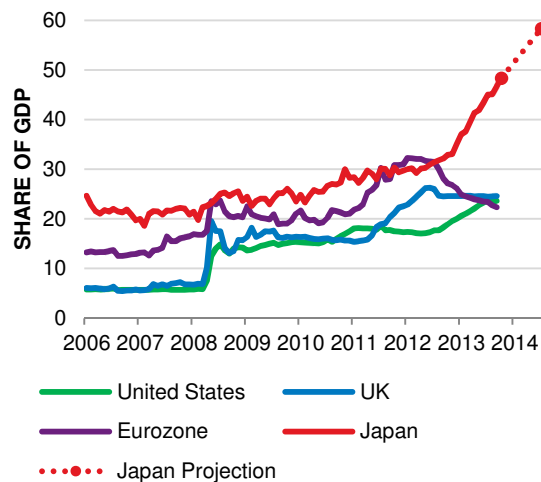
# Abe's three arrows



## #1 Monetary Expansion

- ▶ BoJ is the only remaining central bank aggressively expanding its balance sheet
- ▶ BoJ balance sheet is set to reach 58% of GDP by the end of 2014

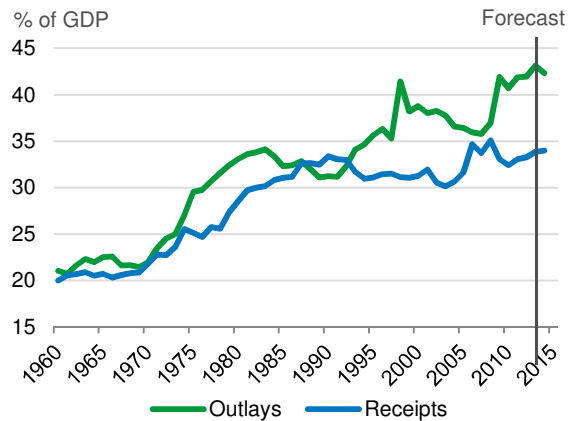
Central Bank Balance Sheets



## #2 Fiscal Consolidation

- ▶ Japan's gross debt-to-GDP ratio stands at 243% - the highest in the G7.
- ▶ Raising consumption tax from 5% to 8% in April, and again to 10% in Oct 2015, to broaden tax base
- ▶ Spending cuts will be needed too

Japan Government Spending and Receipts



## #3 Future Growth Strategy

Ultimately, the 3rd arrow will be key to raising Japan's potential growth rate and fiscal sustainability

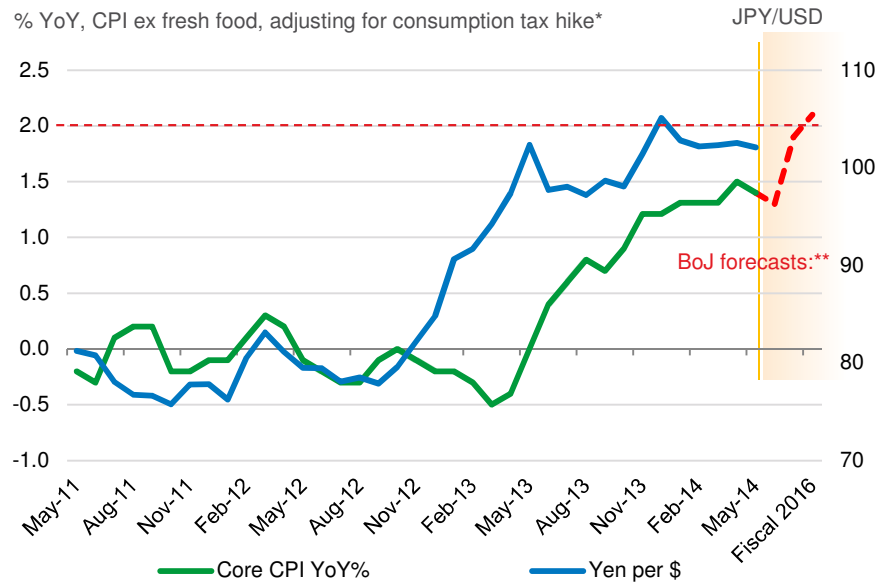
### Key priorities for 2014

- ▶ Trans-Pacific Partnership Ratification
- ▶ National strategic areas (March)
- ▶ Foreign workers (March)
- ▶ Corporate tax reform (June)
- ▶ Wage increase expected (March)
- ▶ GPIF reform
- ▶ Re-launch of nuclear power plans if safety can be confirmed

Source: BlackRock Investment Institute, Central Banks, Industrial Competitiveness Council, OECD forecast as of March 2014

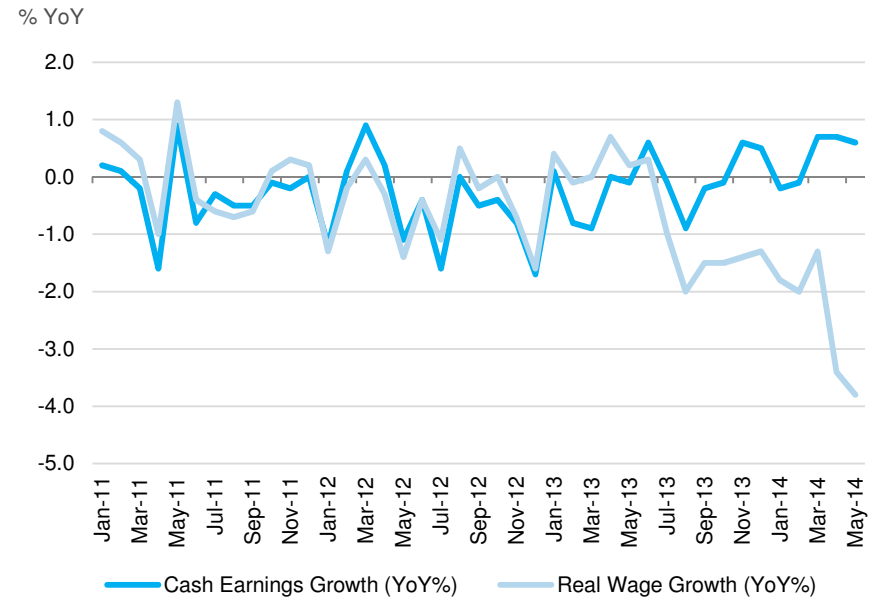
# Wage growth is key to achieving the BoJ's 2% inflation target

## Weaker yen helps spur inflation



- ▶ BoJ's confidence lies in their judgment that Japan's output gap is zero - so any rise in demand should spur inflation.
- ▶ A weaker yen could help - yet the broader economic impact is limited as exporters have shifted manufacturing overseas.

## Wage growth is still muted



- ▶ Wage growth is key to rekindling demand and inflation. Recent salary hikes by big companies such as Toyota (and labour shortages in construction) are encouraging.
- ▶ The key question? Will small- and medium-sized enterprises (which provide 70% of jobs) follow? This could take time.

Source: Bank of Japan, Japan Ministry of Health, Labour and Welfare and Statistics Bureau, BlackRock, as of 18 July 2014.

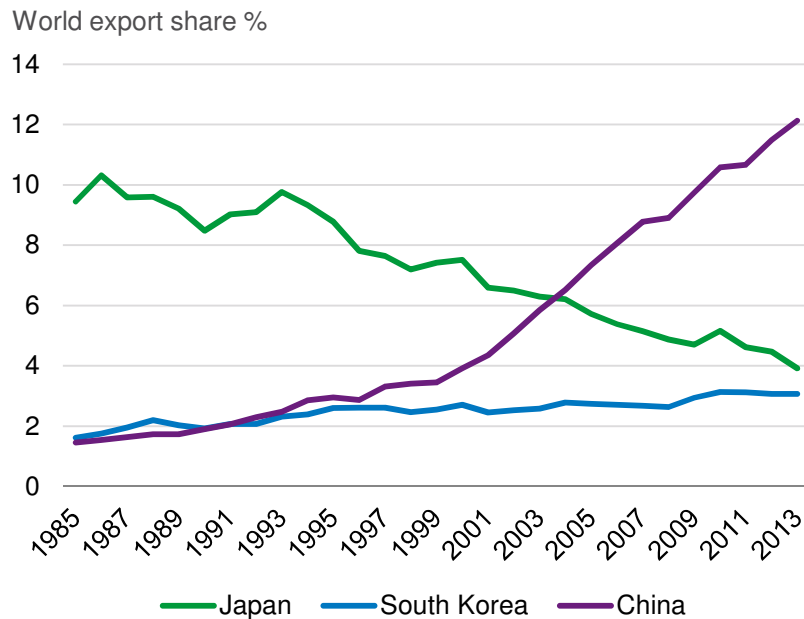
\*The Consumer Tax in Japan was raised to 8% in Apr. 2014 from 5%, affecting CPI numbers released after April 2014

\*\*BoJ majority median forecasts: 2014 1.3%, 2015 1.9%, 2016 2.1%

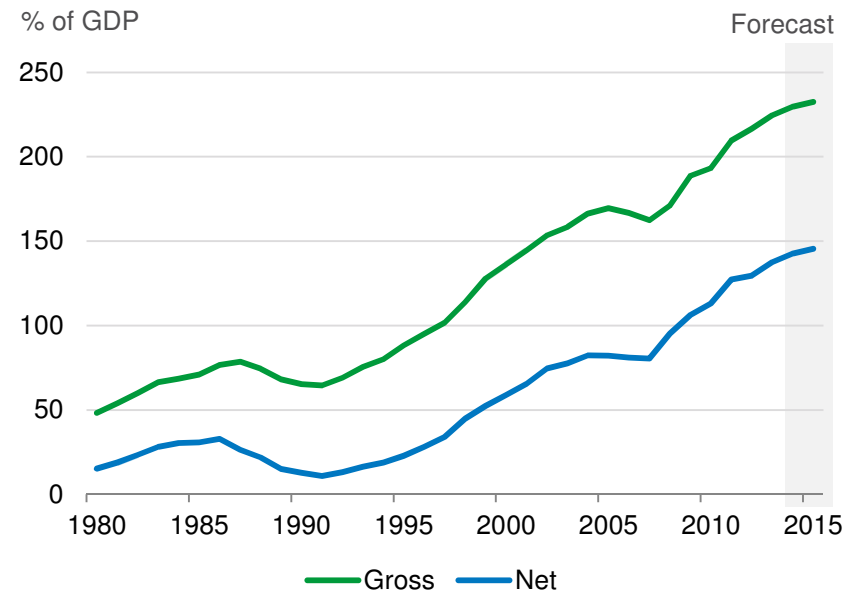
# Abenomics need to address Japan's two largest challenges: Geostrategic and fiscal

- Emergence of China has been the underlying impetus for radical reset of Japanese policy
- Need nominal and real growth to improve, to make debt burden sustainable
- Demographics unhelpful – working age population to fall by 8% over next decade

### Japan Share of World Exports



### Japan Public Debt



Source: IMF, BlackRock Investment Institute, OECD Economic Outlook, as of 15 July 2014

## Emerging markets

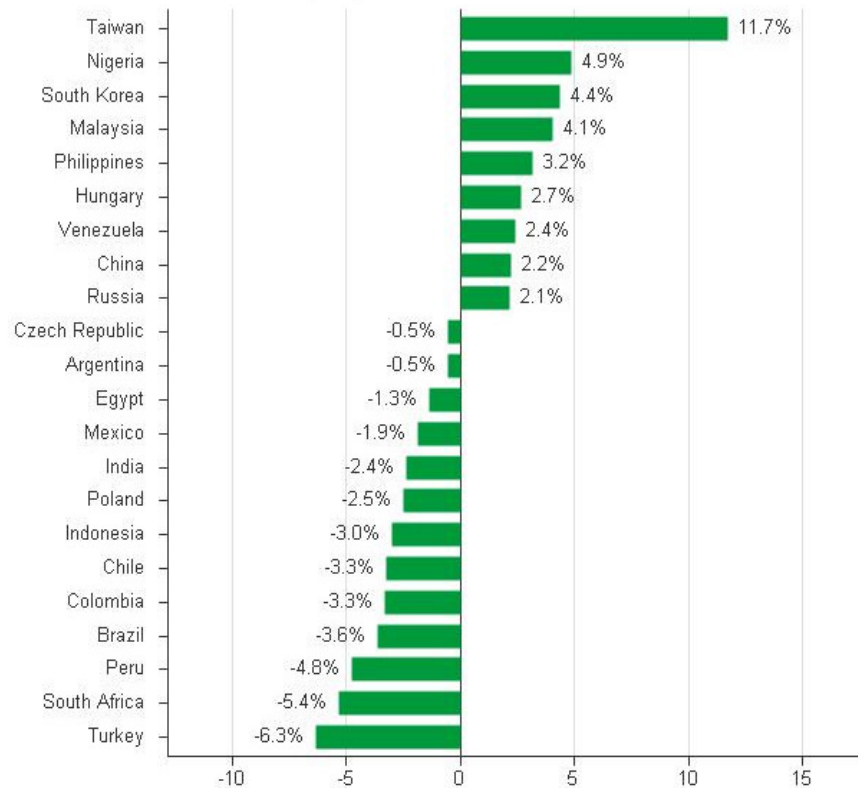
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# Emerging economies do not share the same risks

- ▶ Fundamentals (and therefore vulnerabilities) vary widely across EMs
- ▶ Countries most reliant on external financing may struggle – but long-term growth dynamics continue to favour EMs

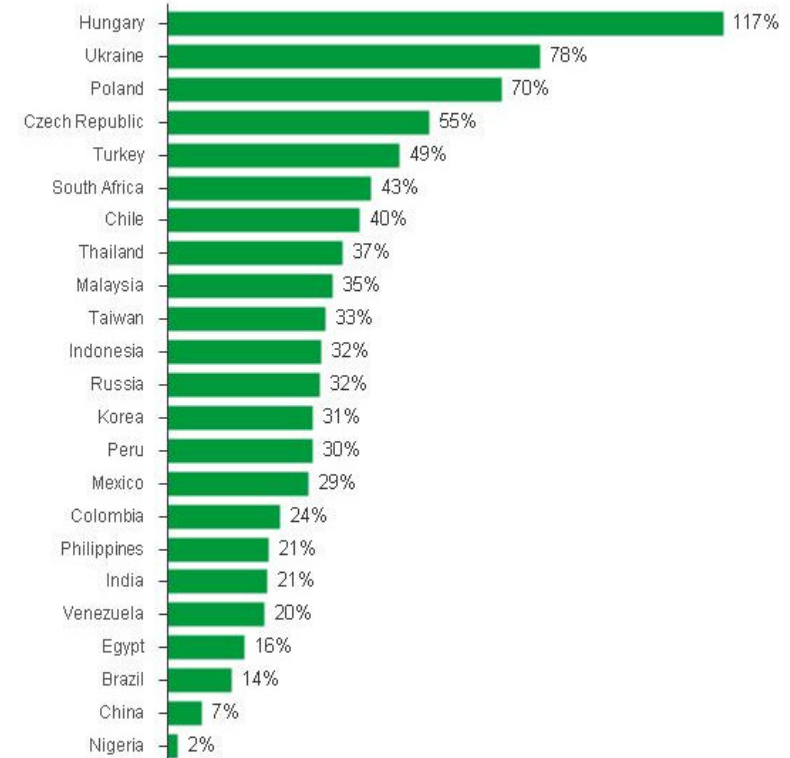
## Emerging Current Account Balances

Percent of GDP (2014)



## Emerging External Debt Ratios

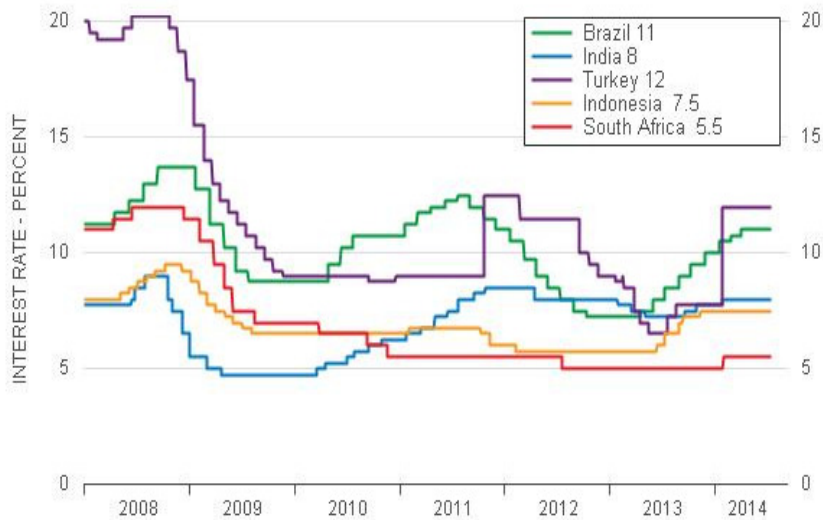
External Debt - % of GDP, 2014



Source: Thomson Reuters Datastream, IMF, Oxford Economics, BlackRock, as of July 2014

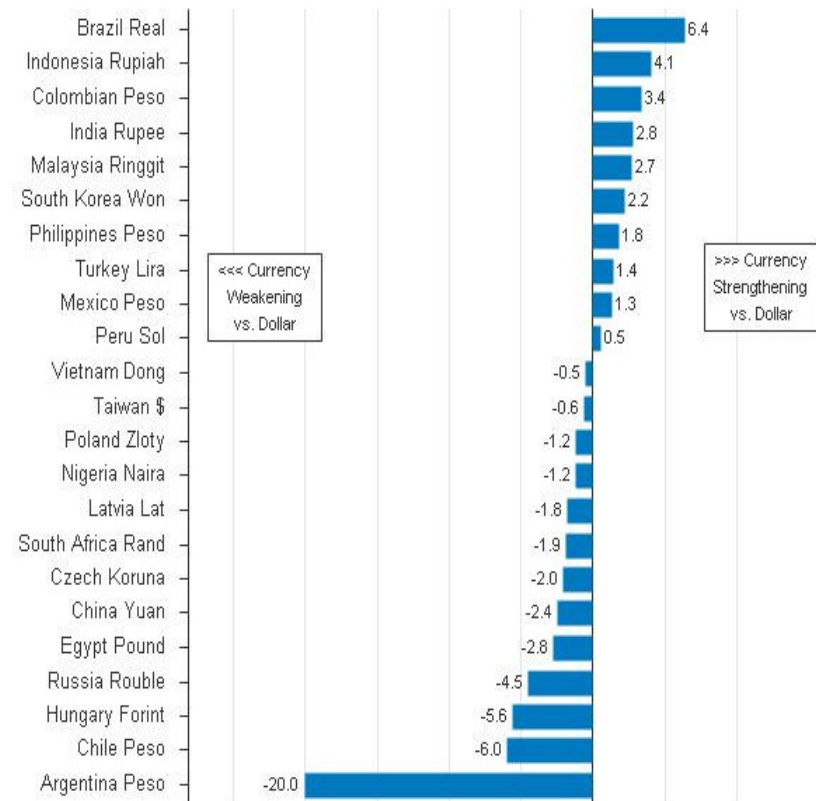
# Some emerging market central banks are done with rate hikes. Further adjustments are more likely to be via FX

## 'Fragile Five' – Central Bank Rates



## Emerging FX Performance Year to Date

Percent Change in Dollar Spot Rate in Calendar Year

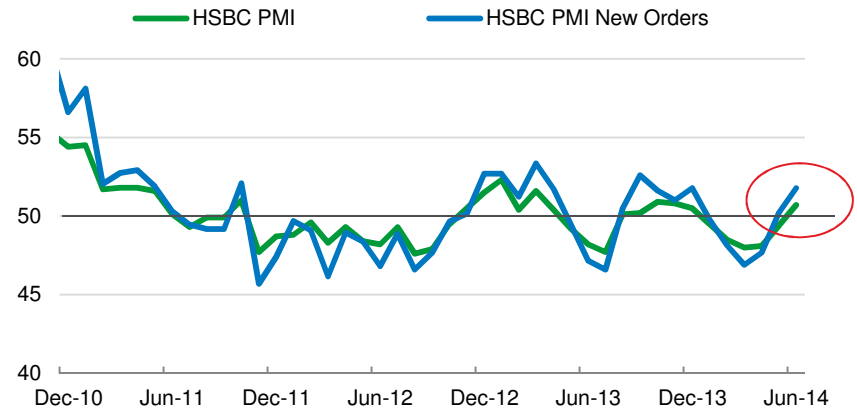


Source: Thomson Reuters Datastream, BlackRock, as of 17 July 2014

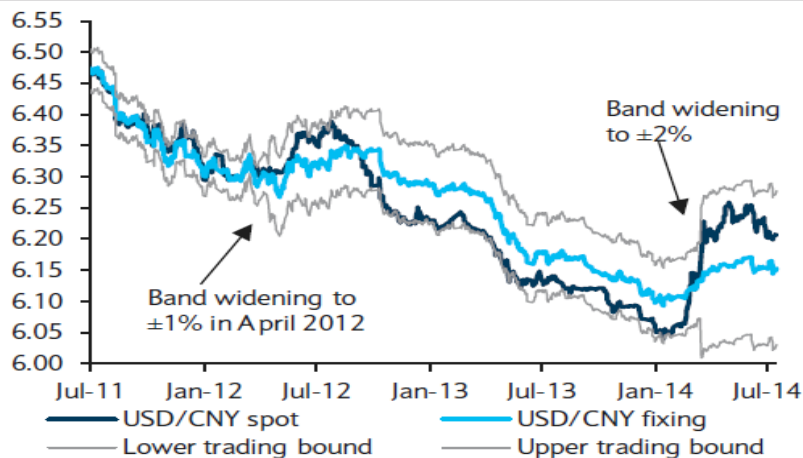
# China – policy easing restarts growth

- ▶ Authorities reaffirmed commitment to 7.5% growth target
- ▶ PBoC delivered a series of ‘targeted’ RRR cuts for rural banks, small banks and larger commercial banks
- ▶ More infrastructure investments, housing restrictions relaxed and Loan-to-Deposit Ratio (LDR) rules eased to boost loans

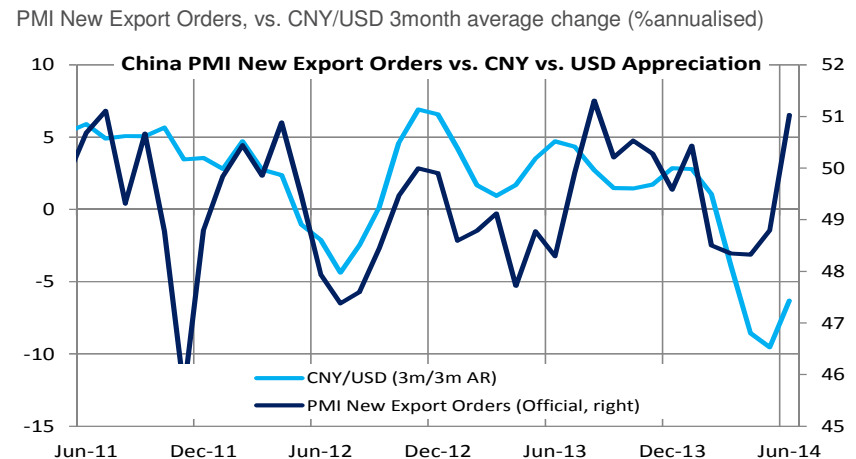
## Current recovery in manufacturing PMI driven by new orders, not just policy direction alone



## CNY has weakened against USD since start of 2014



## Export orders signal for CNY to start appreciating again



Source: Bloomberg, HSBC, Barclays, BlackRock, as of July 2014

## Conclusion

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## In conclusion...

- **Flexibility** is the key to coping with a low-yield environment
- **Monetary policy divergence** means very different opportunities across bond markets
- **Major ingredients for global recovery now in place:**
  - Cyclical recovery in developed economies finally taking hold
  - Necessary reform process and rebalancing of demand underway in the US, Europe, Japan and China
- **Emerging markets** are not one bloc and there is value in bottom-up country differentiation
- **But still major questions for investors:**
  - Can these reform and adjustment processes be sustained?
  - Will there be enough demand - especially if deficit countries adjust more rapidly than surplus countries?
  - And crucially - how much of this recovery is already priced in by markets?

# Appendix

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## E. Biographies

# BlackRock Global Bond Portfolio Team

## Scott Thiel

Deputy CIO of Fundamental Fixed Income and Head of Global Bond Strategies

**Scott Thiel**, Managing Director, is BlackRock's Deputy Chief Investment Officer of Fixed Income, Fundamental Portfolios, and Head of European and Global Bonds. He is a member of the Fixed Income Executive Committee and the EMEA Executive Committee. Mr. Thiel is a member of BlackRock's Leadership Committee.

Prior to joining BlackRock in 2002, Mr. Thiel was a Vice President at Goldman Sachs & Co. During his thirteen years there, he was responsible for developing strategies in both US and international interest rate and derivative markets for institutional money managers.

Mr. Thiel earned a BA degree in American history from Princeton University in 1987.

## Owen Murfin, CFA

Portfolio Manager – Head of Global Credit Strategies

**Owen Murfin, CFA**, Managing Director, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. He is a senior portfolio manager on the Global Bond Portfolio Team and is responsible for overseeing global credit strategies across global bond portfolios as well as serving as the lead portfolio manager for dedicated global corporate bond portfolios.

Mr. Murfin's service with the firm dates back to 2002, including his years with Merrill Lynch Investment Managers (MLIM), which merged with BlackRock in 2006. At MLIM, Mr. Murfin was a fixed income portfolio manager responsible for non-government securities within global aggregate and global corporate portfolios. Prior to joining MLIM, Mr. Murfin worked at Goldman Sachs Asset Management, managing global credit portfolios.

Mr. Murfin earned a BSc degree in chemistry from University College London in 1997.

## Joseph Di Censo, CFA, CAIA

Portfolio Manager – Economist, Global Rates, FX

**Joe Di Censo, CFA, CAIA**, Managing Director, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. He is a senior portfolio manager on the Global Bond Portfolio Team and is responsible for helping develop to down themes within the portfolio as well as active positioning across country selection, global rates and FX.

Prior to joining BlackRock in 2011, Mr. Di Censo was a member of the Monetary and Capital Markets Division of the International Monetary Fund (IMF) in Washington D.C. He served as a financial sector expert to IMF teams working on the European sovereign debt crisis, and advised policymakers in India, Indonesia, Japan, and Korea. In addition, Mr. Di Censo was a lead author of the Global Financial Stability Report. Prior to his work at the IMF, Mr. Di Censo was a Senior Vice President at Lehman Brothers, where he spent nine years as a member of the global asset allocation research team. In that role, he contributed to fundamental and quantitative investment strategies across US, European, and Asia fixed income markets as well as the broader research platform. He was also an author of Lehman's flagship fixed income research publication, *Daily and Weekly Global Relative Value*.

Mr. Di Censo has an MA degree in economics from the University of Pennsylvania and received a BS degree, magna cum laude, from Georgetown University's School of Foreign Service in 1998.

## BlackRock Global Bond Portfolio Team

### **Amar Bashir, CFA** Portfolio Manager

*Amar Bashir, CFA, Director, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. He is a senior portfolio manager on the Global Bond Portfolio Team and is responsible for overseeing the emerging market investment strategies across the global bond portfolios as well as serving as the lead portfolio manager for the team's dedicated Canadian Fixed Income and High Alpha/Performance institutional separate mandates.*

*Mr. Bashir's service with the firm dates back to 2002, as an analyst in the Portfolio Compliance Group. He joined the Portfolio Management Group in 2006. Mr. Bashir earned a BSc degree in economics, with a concentration in finance and electronic commerce, from the University of Pennsylvania in 2002.*

### **Beata Harasim, CFA, CAIA** Portfolio Manager

*Beata Harasim, CFA, CAIA, Vice President, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. She is a portfolio manager on the Global Bond Portfolio Team and is focused on active FX idea generation and implementation across global bond portfolios.*

*Ms Harasim began her career at BlackRock as a member of the graduate program in 2008. Ms Harasim has earned a MA in finance and banking from the Warsaw School of Economics in 2008.*

### **Aidan Doyle** Portfolio Manager

*Aidan Doyle, Associate, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. He is a portfolio manager on the Global Bond Portfolio Team and is focused on global rates relative value idea generation and portfolio implementation.*

*Mr. Doyle began his career at BlackRock in 2010. Mr. Doyle earned a BA degree in Economics, with honors, from Trinity College Dublin in 2009 and an MSc degree in Finance from the Imperial College London in 2010.*

### **Edward Lesley** Portfolio Manager

*Edward Lesley, Associate, is a member of the Fundamental Fixed Income platform within the International Fixed Income group. He is a portfolio manager on the Global Bond Portfolio Team and is focused on implementation of bottom up credit ideas generated by Global Sector Specialists..*

*Mr. Lesley began his career at BlackRock in 2010 and was previously a Banks Analyst within Fundamental Fixed Income. Mr. Lesley earned a BA degree in Philosophy, Politics and Economics, with honours, from the University of Warwick in 2010..*

# BlackRock Global Bond Product Strategy Team

## **Sriram Reddy**

Product Strategist – Global Bond Strategies

*Sriram Reddy, Director, is a member of the Product Strategy Team within BlackRock's Fixed Income Portfolio Management Group. He is a product strategist focusing on global bond strategies.*

*Prior to moving to his current role in 2010, Mr. Reddy was a member of the Global Client Group in Singapore, responsible for developing and maintaining institutional relationships with the firm's clients throughout the South East Asia region. Mr. Reddy's service with the firm dates back to 2005, including his years with Barclays Global Investors (BGI), which merged with BlackRock in 2009. At BGI, he worked within the Transition Management Group most recently as a transition strategist for the Asia Pacific region. Prior to BGI Mr. Reddy worked for RTL Capital conducting research on long only investment strategies.*

*Mr. Reddy earned a BA degree in economics from Johns Hopkins University in 2004.*

## **Marilyn Watson**

Product Strategist – Global Bond Strategies

*Marilyn Watson, Director, is a member of the Product Strategy Team within BlackRock's Fixed Income Portfolio Management Group. She is a product strategist focusing on global bond strategies.*

*Ms. Watson joined BlackRock in January 2011 from the Bank of England, where she worked as an economist and deputy agent in the Monetary Policy Division. Prior to joining the Bank of England in 2009, she spent two years as a global investment strategist and six years selling FX derivatives at JPMorgan Asset Management and JPMorgan Investment Bank respectively.*

*Ms. Watson earned an MA degree in economics from Cambridge University in 1999.*

## **Yumian Lu**

Product Strategist – Global Bond Strategist

*Yumian Lu, Associate, is a member of the Product Strategy Team within BlackRock's Fundamental Fixed Income Portfolio Management Group. She is a product strategist focusing on global bond strategies.*

*Ms. Lu's service with the firm dates back to 2011. Prior to moving to her current role in 2012, Miss Lu was a member of the Financial Institutions Group, responsible for managing relationships with the firm's insurance clients. Prior to joining BlackRock, Miss Lu was an institutional salesperson at Deutsche Bank's Sales & Trading division in Hong Kong from 2008 to 2010, covering Greater China clients.*

*Ms. Lu earned a Msc degree in risk and finance from the London School of Economics in 2011, and a BA degree in economics from the University of Cambridge in 2008.*

# Fresno County Employees' Retirement Association

## BlackRock Relationship Manager

### **Jeremy Watt**

Relationship Manager – Institutional Client Business

*Jeremy Watt, Director, is a member of the US and Canada Institutional team within BlackRock's Institutional Client Business. He is responsible for developing and maintaining relationships with institutional investors, including public and private pension plans, foundations and endowments.*

*Mr. Watt's service with the firm dates back to 1996, including his years with Barclays Global Investors (BGI), which merged with BlackRock in 2009. At BGI, he was a senior client relationship officer for the US Institutional Client Service Group. Mr. Watt began his career at BGI as a senior data analyst before serving as a project manager for BGI's Global Market Data Group. Prior to joining BGI, Mr. Watt was a fund accountant and a securities operations analyst at Invesco.*

*Mr. Watt earned a BA degree in business studies from Charles Sturt University.*

# Appendix

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## F. Disclosures

## Important notes

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