

## Extended Commentary

BLACKROCK GLOBAL FUNDS (BGF)  
BGF Global Allocation Fund

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### Market & Portfolio Performance

The BGF Global Allocation Fund (\$A shares) posted a net return of -10.51% for the quarter, and underperformed both its reference benchmark which returned -8.87% and the average of its Morningstar Asset Allocation Global Flexible (USD) peer group, which returned -8.91% for the same period. Year-to-date, the Fund returned -7.89%, and underperformed both its reference benchmark\* which returned -4.43% and the average of its Morningstar Asset Allocation Global Flexible (USD) peer group, which returned -7.11% for the same period.

Over the quarter, an overweight (relative to the benchmark) within equities detracted from performance as equity markets broadly declined. Notably, an overweight in Russia and stock selection in Brazil weighed on returns. Offsetting this was strong stock selection, notably in the US, as well as an overweight in Japan, which contributed to performance. From a sector perspective, stock selection in materials (lead by gold-related securities) contributed to performance although this was partially offset by an overweight in the sector. An underweight to financials also contributed to performance. Stock selection in energy and an underweight in consumer staples detracted from performance.

An underweight (relative to the benchmark) in fixed income detracted from performance, notably due to security selection in the United States. From a currency perspective, an underweight in the US dollar detracted from performance.

\*Reported portfolio performance over the quarter was positively affected by the timing differential between the Fund and its benchmark.

### Portfolio Activity & Positioning

During the quarter, the BGF Global Allocation Fund's overall equity allocation increased from 64% to 65% of net assets. On a sector basis, the Fund increased its weightings in information technology (+0.6%), materials (+0.4%), utilities (+0.4%), and reduced its exposure to energy (-1.0%). The Fund's allocation to fixed income increased from 28% to 29% of net assets. Within fixed income, the Fund increased exposure to Australian government bonds (+1.3%) and US Treasuries (+1.1%), and decreased exposure to USD foreign corporate bonds (-1.1%) and USD convertible

bonds (-0.5%). Reflecting the above changes, the Fund's cash equivalents decreased from 8% to 6% of net assets.

Compared to its reference benchmark, BGF Global Allocation Fund was overweight equities (+5%), underweight fixed income (-11%), and overweight cash equivalents (+6%). Within the equity segment, the Fund was underweight the US and (-2.2%), Europe (-1.6%), and overweight Asia (+6.2%), notably Japan (+3.6%), and Brazil (+0.7%). On a sector basis, the Fund was overweight materials (+5.0%), energy (+3.3%), telecom services (+2.6%), health care (+0.9%), information technology (+0.8%), and utilities (+0.8%). The Fund's sector underweights included financials (-2.7%), consumer staples (-2.6%), consumer discretionary (-1.9%), and industrials (-0.5%). As for currency exposure, the Fund was overweight the Brazilian real (+2.3%), Singapore dollar (+1.8%), Canadian dollar (+1.0%), and Russian ruble (+0.7%), and was underweight the U.S. dollar (-5.6%), Euro (-4.0%), and Japanese yen (-2.7%). The Fund also had overweight positions in several small Asian currencies, including the Hong Kong dollar, Malaysian ringgit, and Indian rupee.

### Global Economic Overview

The US debt ceiling controversy, Standard & Poor's decision to cut the US's credit rating, worries about the solvency of certain European countries and the region's banking system, and concerns about slowing growth in Asia all contributed to the worst quarterly performance for global stocks since the fourth quarter of 2008 – the period immediately subsequent to Lehman Brothers' bankruptcy.

Perhaps more disconcerting for investors, was the fact that equity market deterioration accelerated as the quarter wore on. Not only did September mark the worst monthly performance for global stocks (the MSCI World posted a return on -8.6%) so far in 2011 but that it marked the fifth consecutive monthly decline in a row. September also marked the worst single monthly performance since May 2010.

Further, certain asset classes such as gold, which investors had previously viewed as a "safe haven" performed poorly during certain portions of Q3'11, with bullion prices falling nearly 11% in the month of

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September. Global bonds helped offset equity weakness, posting a modest gain of over 2% during Q3'11, but even fixed income wasn't immune to the September sell-off, as the Citigroup World Government Bond Index declined nearly -2% during the quarter's final month.

As strategists reduce global GDP forecasts and analysts revise down next years' earnings estimates, investors are questioning whether Europe, and by extension the US, can avoid a "double dip" recession. Perhaps the more important question that investors should be asking themselves, however, is whether such concerns are already reflected in stock prices. We are becoming increasingly convinced that they are. In the US, for example, the 1-year forward price/earnings (P/E) multiple for the S&P 500 stood at 11.0x on September 30 2011, slightly less expensive than the 1-year forward P/E of 11.1x in March 2009 when world stock markets bottomed.

While it would be premature to presume with certainty that euro area governments will collaborate in time to prevent a banking crisis in the region, recent investor behaviour indicates that there is little optimism for avoiding wide-scale contagion. While we concede that lower economic growth across Europe appears difficult to avoid, we believe that pressure is building on Europe's political leaders to take all necessary action to support the banking system across the continent. Longer term challenges, such as persistent intra-European trade imbalances, can only be addressed through greater fiscal coordination.

Because of the perceived safety they provide in terms of lower volatility, developed market government bonds and cash equivalents remain in favour with many investors. It is our belief, however, that long-term investors should be thinking about the concept of "safety" as the likelihood of receiving a positive real rate of return on their investments over their particular time horizon – not simply defining safety in terms of nominal short-term price stability.

To clarify this point, we emphasise that real yields (nominal government bond yield minus the local inflation rate) are materially negative in the US, UK, most of Europe, China, India, Russia and in many countries across Southeast Asia and the Middle East. In other words, when the yields on government bonds and cash equivalents are lower than local inflation levels, investor portfolios constrained to those asset classes may suffer purchasing power declines in real terms, though the nominal value of such accounts appears stable.

In order for investors to meet long-term objectives and experience positive real rates of return, we believe that the best opportunities continue to lie primarily in high-quality equities and certain commodity-oriented

investments. We have been focusing our efforts on equities that pay a competitive dividend yield, coupled with the prospect of stable growth in earnings.

## **Allocation Strategies**

### **US Equity (34% of portfolio)**

Our view on US equities remains constructive. Headwinds dominate the headlines, as slow economic growth, high unemployment, political deadlocks, and a stubbornly weak housing market are always at the forefront of investors' minds. Nevertheless, share price performance doesn't necessarily move in lock-step with the broader economy and we believe the market has done its part in discounting these headline risks in the form of low P/E multiples.

A sovereign induced recession in Europe would clearly impact global growth and the US would not be immune. While recent stock market behaviour has sometimes mimicked its performance after Lehman Brothers' demise in September 2008, several important factors today make the US economy more recession resistant now relative to then. These differences include a recapitalized banking sector, record cash levels on corporate balance sheets, modest inventory levels, and a lean workforce. In sum, corporations are better positioned to absorb pressure to both sales and margins than they were in 2008.

### **Non-US Equity (31% of portfolio)**

We remain overweight non-US equities relative to our benchmark, due primarily to our strategic long-term bias in favour of the emerging economies over those in the developed world. Non-US equities performed particularly poorly during Q3'11, due to sovereign default risks in Europe, coupled with concerns about decelerating Chinese growth.

The severity of the Q3'11 market sell-off has left valuations at low levels in most non-US markets. Single digit P/E multiples exist across many European markets on a forward calendar year basis and dividend yields can range from 6-8%, depending on the sector. Meanwhile, single-digit one-year forward P/E multiples now exist in several countries across Asia, including South Korea, China, Hong Kong, and Thailand. From our perspective, these latter regions are particularly interesting because long-term economic growth prospects are higher in many Asian economies than either the US or Europe.

We increased our existing overweight in Japanese equities during Q3'11. Much of this increased exposure involved adding to existing positions in the portfolio. Additions were made on a stock-by-stock basis, but we also feel comfortable with this added exposure from a top-down perspective, since Japan is one of the few developed market economies likely to experience accelerating GDP as it continues to recover from the earthquake in March. Europe, the UK,

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and the US, meanwhile, are likely to continue to face various growth headwinds.

#### **US Fixed Income** (12% of portfolio)

Despite a credit rating downgrade by Standard & Poor's, US Treasuries posted strong returns during the quarter, particularly at the long-end of the yield curve. During the quarter, 2-year Treasuries advanced 0.5%, while 30-year Treasuries jumped 31%. In the 10-year Treasury space, prices rose 12%, with the yield dipping down to just 1.9% on September 30 after touching 60-year lows intra-quarter (1.7% on September 22). Clearly, the premium that investors placed on liquidity trumped any lingering concerns about the US's ability to pay its near-term obligations.

Notwithstanding the fact that Treasury bonds have historically benefited from investors' "flight to quality" during periods of volatility, we do not find much long-term value along any portion of the US Treasury curve at this time. As a simple example, yields on 5-year US Treasuries were under 1% on September 30 while year-over-year core consumer price inflation (CPI) rate was 2%. This implies that yields on 5-year Treasuries are not keeping pace with baseline inflation on a pre-tax basis, and real yields on an after-tax basis are decidedly negative. In our opinion, the long-term case against Treasuries becomes even stronger when considering that headline CPI exceeded 3.9% year-over-year as of September 30.

Another challenge for the long-term outlook of the Treasury market is the fact that the US Federal government has exhibited a lack of discipline as it relates to fiscal policy. Lack of budgetary restraint suggests that annual US budget deficits may extend into the future, which would lead to a rising tide of Treasury bond issuance for many years to come. Meanwhile, future Treasury demand, particularly at current negative real yields, remains questionable. In addition, since a substantial portion of Treasury market demand in recent years has come from foreign central banks, the future purchasing power of the USD matters when these investors evaluate Treasuries.

In US corporate credit, the portfolio holds about 2% in investment grade bonds, 2% in convertibles bonds, and less than 1% in high yield. High grade corporates experienced widening spreads but mostly stable prices during Q3'11. US corporate balance sheets remain unusually strong and we feel comfortable holding certain high quality corporate paper. In our view, however, dividend-paying equities usually offer competitive, and in some instances superior, yields relative to corporate bonds but have much greater capital appreciation potential despite higher volatility. Convertible bonds have been a material percentage of our portfolio since late 2008, however, we have been trimming our exposure recently due to improved valuations and declining liquidity. Lastly, we remain

extremely selective in high yield, due to the deterioration of underwriting standards in the earlier half of the year. Declining liquidity in the high yield market has also caused us to pause when considering this asset class, despite the fact that spreads widened in the space during Q3'11.

#### **Non-US Fixed Income** (17% of portfolio)

We continue to find select opportunities in emerging market sovereign debt in Brazil, along with smaller positions in Malaysia and Indonesia, and ultra-short duration bonds in Hong Kong, Singapore, and to a lesser degree, Mexico. While we acknowledge that inflation remains a risk to various emerging market bonds, our strategy has been to keep duration short as we anticipate that rising currency values will more than compensate for potential inflation risks. In non-US credit, we maintain modest overweights to corporate and convertible bonds in emerging Asia, Latin America, and Eastern Europe, however, we trimmed this exposure during Q3'11.

We continue to avoid nearly all European peripheral sovereign bonds, due to the possibility of future debt restructurings. Sovereign debt yields of the core European economies remain unattractively low and those bonds are also not immune from contagion due to the tangled nature of the euro zone's banking system. We hold a modest position in medium-term German bunds, while we continue to avoid Italian, French, and Spanish sovereigns. We are overweight UK gilts, which we increased marginally during the quarter.

#### **Cash\*\*** (6% of portfolio)

The risk of falling bond prices means that cash will continue to function as a zero-duration fixed income component of the portfolio and can be used as a source of liquidity in the event of further market volatility.

\*\*The reference benchmark does not contain a cash component and therefore, the fund's entire cash position at any given time represents an overweight.

#### **Currency Strategies**<sup>†</sup>

We maintain underweight positions in US dollar, euro, sterling, and yen. We lowered our EUR weighting during the quarter, causing our underweight to the common currency to widen to nearly 4%. Pressure on the EUR periodically arises depending, primarily, on the degree to which progress is made or lost on a comprehensive solution to the area's peripheral debt crisis. Other long-term headwinds that continue to impact all major Western currencies including the EUR, is the general lack of GDP growth, elevated budget deficits, and high debt/GDP levels. Pressure on the EUR is mitigated to some degree by the fact that the currency actually has a yield, whereas USD, GBP, and JPY do not. Despite trading in a range relative to USD that has been anywhere between 1.28 and 1.48 YTD, investors may find it interesting to note that on

September 30 the EUR/USD cross was at 1.34 – almost exactly where it stood on January 1.

We also remain underweight the USD and GBP, as both of these currencies suffer from the same unattractive macro characteristics mentioned above in regard to the Western world. Both the USD and GBP also have two additional factors that are likely to negatively impact the long-term values of these currencies. Unlike Europe and Japan, the US and the UK chronically run large trade deficits with the rest of the world. Perhaps even more important to their outlook, however, is the apparent willingness of both the US Federal Reserve and the Bank of England to attempt to aggressively monetise their respective debt levels through periodic “quantitative easing” and related strategies.

Meanwhile, many emerging market countries have been experiencing relatively rapid growth rates, large capital inflows, and elevated levels of inflation. Slowing global GDP, however, particularly in China, could start to negatively impact these otherwise favourable macro trends. In periods of heightened volatility, global investors are likely to continue to turn to USD and JPY in order to close out their “carry trades” (USD and JPY yield nothing, so many investors borrow in those currencies to buy assets denominated in others).

Nevertheless, many emerging market economies, particularly in Southeast Asia, have built up formidable FX reserves, the vast majority of which are denominated in USD. This means that those central banks will be able to sell USD to buy their own currencies in the FX market, should the need arise, putting a “floor” under their exchange rates relative to the greenback. In the interim, short-term rates in the emerging world pay us a yield for our patience. We generally receive no yield from the developed world’s major currencies. It is our view that because of the higher yields emerging currencies offer, along with more disciplined central banks, superior GDP growth rates, and healthier national balance sheets, capital will continue to flow toward these countries and away from the West over time. We particularly favour Asian currencies such as Singapore dollar, Chinese renminbi, Indian rupee, Malaysian ringgit, and Hong Kong dollar. We also favour various “commodity currencies”, such as Brazilian real, Canadian dollar, Russian ruble, and Australian dollar.

*\*Actively managed as part of the fund’s investment strategy.*

## Sector Highlights

### Sector Overweights

#### **Materials** (9% of portfolio)

The majority of our exposure in this sector remains in gold ETFs and in the equities of gold mining companies, with smaller exposures in silver, platinum, and palladium. Despite a very weak September, gold

was actually up 8% for the quarter. We took the opportunity to re-balance some of our gold positions during Q3’11, lowering our exposure to gold ETFs, while adding to our positions in gold miners. This decision was driven by low valuations in the mining stocks, coupled with the likelihood of accelerating dividend yields. The latter factor may drive further interest in mining shares, as yield-starved retail investors can receive cash flow from gold mining stocks while they cannot from owning gold ETFs or bullion. In addition to precious metals, we also have a preference for “input sectors” of the emerging markets, including exposure to base metals such as iron ore, and to a lesser degree copper and steel.

#### **Energy** (10% of portfolio)

Despite a difficult quarter for the energy sector during Q3’11, we continue to maintain a favourable outlook on this sector over the long-term. Our bullishness is due to the expectation that demand from Asia, the Middle East, and Latin America for petroleum, coal, and natural gas will more than compensate for the slack demand from the US and Europe. In addition, a relative lack of capital investment across the energy sector in recent years (particularly in petroleum) may cause supply constraints to send prices higher should macroeconomic growth surprise on the upside. Valuations in the sector are favourable on a 1-year forward P/E basis and dividend yields in the sector are above those of the broader market. During Q3’11 we added to our positions in some major European integrated oil companies, certain exploration & production names, and a few of the refiners.

#### **Telecommunication Services** (5% of portfolio)

Telecommunications shares endured losses during the quarter, but generally held up better than the broader market. The sector’s resilience is due, in large part, to superior dividend yields and strong recurring cash flows, relative to almost all other sectors in the market. September’s painful slide in global equity markets caused excellent valuations within the sector to become even more attractive, especially in Europe, where dividend yields on certain names in core Euro zone economies increased to anywhere between 8-12%. Though revenue growth across developed market telecom names remains flat in comparative terms, most telecom companies in the developed markets operate in very oligopolistic settings, with limited competition and extremely high barriers to entry. In a slow growth world, we feel the dividend yields telecoms offer are enticing, particularly when compared to local government bond yields.

#### **Healthcare** (7% of portfolio)

Demographic trends in OECD countries favour increased use of both pharmaceuticals and medical devices as the population ages, which bodes well for future sales volumes. Despite concerns about future

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pricing pressures as a result of recently passed US health care reform and European austerity packages, valuations are very reasonable across the sector. The pharmaceutical industry, in particular, offers some of the highest dividends available across all sectors, though the group continues to be confronted with patent expiry challenges and product pipeline concerns.

#### **Utilities** (3% of portfolio)

Although a modest overweight relative to benchmark, the fund's absolute weighting in utilities continues to be low. Our utility purchases were modest during over the past three months, but our exposure to the sector moved to a net overweight position due to the fact that utility stocks weathered the Q3'11 market correction better than any other sector.

#### **Information Technology** (9%)

Over the quarter, we added to positions within software and also benefitted from market appreciation in certain stocks in that industry. Meanwhile, we reduced our exposure to semiconductors, on concerns that this industry has historically performed well in the early part of economic expansion and that we are likely past the mid-point in the recovery cycle. In addition, now that we are several months past the nuclear accident in Fukushima, we are sensitive to the possibility that inventory levels may be building across the semiconductor space.

#### **Sector Underweights**

##### **Financials** (8% of portfolio)

Sovereign debt issues, regulatory concerns, increases in capital requirements, and continued economic uncertainty all combined to maintain downward pressure on banks during Q3'11. Underperformance was most notable in Europe, given continued concerns about peripheral debt exposure. For US banks, concerns about trading losses and a flattening yield curve put pressure on earnings expectations. Financial shares were the second worst sector performer during Q3'11 and remain our largest underweight. Notably, a meaningful percentage of our overall financial exposure is targeted toward the insurance industry, as

well as banks that specialise in custody functions and trust services.

##### **Consumer Discretionary** (4% of portfolio)


Consumer spending has been surprisingly strong, at least as it pertains to the US, but concerns linger that this higher spending has come at the expense of US consumer savings, not higher wages. Global luxury goods suppliers had been very strong performers prior to May, but concerns about a possible slowdown in top-tier Chinese spending has hurt share performance the past several months. We remain cautious on the luxury segment, preferring names with balance sheet strength and control over their brands' distribution networks. We have de-emphasised mass market retailing but maintain exposure in certain mainstream restaurants.

##### **Consumer Staples** (4% of portfolio)

The relatively defensive nature of most consumer staples names has caused valuations in this sector to rise to a significant relative to the broader market. As of September 30, the 1-year forward P/E multiple on consumer staples names averaged 14.6x globally, versus just 11.4x for the MSCI World Index. Some names in the space, however, have high dividend yields. As a result of heightened volatility, we continue to write covered calls on certain names in the sector in an effort to secure high single-digit/low double-digit returns for our shareholders, in an otherwise low return environment. The opportunity cost for our covered call strategy is that we risk sacrificing even higher possible returns if consumer staples stocks rally sharply higher. Names that we prefer to hold in this sector are very company specific.

##### **Industrials** (6% of portfolio)

Our industrials weighting remained nearly unchanged during Q3'11 although we did take the opportunity to add marginally to certain German names. The German index, the DAX, was one of the worst performing equity indices during the period, and we took the opportunity to either initiate positions or add to existing holdings in shares of many world class Industrial names in the engineering and auto industries.



Performance shown as at 30 September 2011 in USD on a NAV price basis with income reinvested. Performance figures are calculated net of annual fees. Fund benchmark: Composite MSCI World/CWGBI. Data sourced from Bloomberg as at 30 September 2011. This material is for distribution to Professional Clients and should not be relied upon by any other persons. All financial investments involve an element of risk. Therefore, the value of your investment and the income from it will vary and your initial investment amount cannot be guaranteed. Past performance is not a guide to future performance and should not be the sole factor of consideration when selecting a product. The Fund invests a large portion of assets which are denominated in other currencies; hence changes in the relevant exchange rate will affect the value of the investment. The fund typically invests in smaller company shares which can be more unpredictable and less liquid than those of larger company shares. BlackRock Global Funds (BGF) is an open-ended investment company established in Luxembourg which is available for sale in certain jurisdictions only. BGF is not available for sale in the US or to US persons. Product information concerning BGF should not be published in the U.S. It is recognised under Section 264 of the Financial Services and Markets Act 2000. BlackRock Investment Management (UK) Limited is the UK distributor of BGF. Most of the protections provided by the UK regulatory system, and the compensation under the Financial Services Compensation Scheme, will not be available. A limited range of BGF sub-funds have a reporting fund status A sterling share class that seeks to comply with UK Reporting Fund Status requirements. Subscriptions in BGF are valid only if made on the basis of the current Prospectus, the most recent financial reports and the Simplified Prospectus which are available on our website. Prospectuses, Simplified Prospectuses and application forms may not be available to investors in certain jurisdictions where the Fund in question has not been authorised. Issued by BlackRock Investment Management (UK) Limited (authorised and regulated by the Financial Services Authority). Registered office: 12 Throgmorton Avenue London EC2N 2DL. Registered in England No. 2020394. Tel: 020 7743 3000. For your protection, telephone calls are usually recorded. BlackRock is a trading name of BlackRock Investment Management (UK) Limited. Issued in Switzerland by the representative office, BlackRock Asset Management Switzerland Limited Claridenstrasse 25, PO Box 2118, CH-8022 Zurich, Switzerland, from where the Company's Prospectus, Simplified Prospectus, Articles of Association, Annual Report and Interim Report are available free of charge. Paying Agent in Switzerland is JPMorgan Chase Bank, National Association, Columbus, Zurich Branch Switzerland, Dreikönigstrasse 21, CH-8002 Zurich. For further information, the prospectus, simplified prospectuses, annual report and semi-annual report can be obtained free of charge in hardcopy form from the Austrian paying agent: Raiffeisen Zentralbank Österreich AG, A-1030 Vienna, Am Stadtpark 9. Issued in Hong Kong by BlackRock (Hong Kong) Limited. In Singapore, this information is issued by BlackRock (Singapore) Limited. The Fund is only available to institutional and accredited investors as permitted under the Singapore Securities and Futures Act and not to the retail public in Singapore. This factsheet is for information purposes only and does not constitute an offer of shares in the Fund in Singapore. For your protection, telephone calls are usually recorded. This material is for information purposes only and does not constitute an offer of shares in any of the BlackRock Global Funds. You should consider carefully whether the investment is suitable for you. BGF has been registered on the official list of the Financial Supervision Commission (Komisja Nadzoru Finansowego) for distribution in Poland. Issued in Poland by the representative office BlackRock Investment Management (UK) Limited, Oddzia w Polsce. Paying agent in Poland is Bank Handlowy w Warszawie SA, ul. Senatorska 16, 00-950 Warsaw, Poland.

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