

Extended Commentary

BLACKROCK GLOBAL FUNDS (BGF)
BGF Global Allocation Fund

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Market & Portfolio Performance

The BlackRock Global Funds (BGF) Global Allocation Fund (\$A shares) posted a net return of +7.55% for the quarter and outperformed its benchmark index, which returned +6.99%.

An overweight (relative to the benchmark) within equities contributed to performance as equity markets broadly advanced over the quarter. Within equities, stock selection in Brazil, an overweight in Russia and an underweight in the European Union contributed to performance. From a sector perspective, stock selection and an underweight in Consumer Staples, as well as stock selection in Healthcare, contributed to performance. Stock selection in Financials also contributed, although this was partially offset by an underweight in the sector.

An underweight (relative to the benchmark) in fixed income contributed to performance. Within fixed income, security selection in the United States aided returns.

Portfolio Activity & Positioning

During the quarter, the BGF Global Allocation Fund's overall equity allocation remained at 64% of net assets. The Fund increased exposure to the US (+1.6%), which was offset by a decrease in Europe (-0.8%) and Asia (-0.8%). On a sector basis, the Fund increased its weightings in information technology (+0.9%), financials (+0.5%), and consumer discretionary (+0.4%) and decreased exposure to energy (-1.2%), telecommunication services (-0.8%), materials (-0.7%), and utilities (-0.4%). The Fund's allocation to fixed income decreased from 27% to 25% of net assets. Within fixed income, the Fund increased exposure to USD foreign corporate bonds (+1.2%), and reduced exposure to US Treasuries (-1.2%), convertible bonds (-0.6%), and Japanese government bonds (-0.4%). Reflecting the above changes, the Fund's cash equivalent holdings increased from 9% to 11% of net assets.

Compared to its reference benchmark, the BGF Global Allocation Fund was overweight equities (+4%), significantly underweight fixed income (-15%), and overweight cash equivalents (+11%). Within the equity segment, the Fund was overweight Asia (+4.1%), notably Japan (+2.9%), and Brazil (+1.1%), and

underweight Europe (-1.8%) and the US (-0.5%). On a sector basis, the Fund was overweight materials (+3.9%), energy (+2.0%), telecommunication services (+1.9%), information technology (+1.4), and health care (+1.3%), and underweight financials (-2.6%), consumer staples (-2.3%), consumer discretionary (-1.6%) and industrials (-1.0%). As for currency exposure, relative to its benchmark, the Fund was underweight the euro (-6.2%), Japanese yen (-4.2%), and British pound (-1.6%). The Fund was overweight the US dollar (+3.7%), Brazilian real (+2.7%), Singapore dollar (+1.5%), Russian ruble (+0.8%), and Canadian dollar (+0.7%), along with smaller overweights in several Asian currencies.

Global Economic Overview

Global equity markets began the year on a strong note with the MSCI World Index returning +11.6%, outpacing the +0.9% return of the Barclays Global Aggregate Bond Index. While investors' remain sceptical about the recent rally in equities, as evidenced by the continuation of flows into fixed income funds at the expense of equity funds, the first quarter of 2012 actually witnessed a subsiding of the market volatility that characterized much of 2011. Broadly speaking, the asset classes, sectors, and regions that outperformed in Q1'12 were those that underperformed in 2011.

The global economy faces many near-term challenges. In addition to concerns about the financial state of the peripheral nations in Europe, the US economic recovery remains fragile with only 2%-3% gross domestic product (GDP) growth, and concerns linger that China is in the midst of a soft patch in economic performance that could adversely affect overall global growth. In addition, elections in France, Greece, and the US, coupled with a once in a decade leadership change in China, all have the potential to deliver periodic bouts of market instability.

While each of these events is important in its own right, monetary policies in the developed world remain very loose with interest rates at historically low levels and central banks debating the potential for more quantitative easing. In the emerging economies, while outright quantitative easing is not being pursued, interest rates and bank reserve requirements are being steadily reduced.

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The combined goal of these monetary policies is to either stimulate growth and/or reduce the real interest rate earned in cash and government bonds. As a result, investors are having to rethink the cost of cash and find other investments that may introduce more portfolio volatility, but offer a better chance of growing purchasing power over a long-term time horizon.

We believe investors have a far better ability to observe price than to predict the future. In that respect, while equity prices are no longer at the bargain levels that were witnessed in September and October of last year, we still believe price remains much more in favour of the equity investor than the fixed income investor. Accordingly, we have chosen to maintain an overweight to global equities in the portfolio. Our positioning in fixed income and cash, while not the areas of the portfolio where we forecast the most attractive long-term returns, will nevertheless remain an integral part of the portfolio as we seek to mitigate volatility over the market cycle.

Allocation Strategies

US Equity (36% of portfolio)

The US economy delivered positive economic surprises in Q1'12 including a further decline in the unemployment rate. Interestingly, analysts' US earnings estimates had been trending steadily downward for months before a modest reversal in late March. Currently, estimates for this year's first quarter imply year over year growth of ~2% and essentially no growth from actual earnings that were produced in last year's fourth quarter. At this point, expectations for first quarter results have been set so low that companies may be able to beat such a drastically lowered hurdle. In March, 82% of S&P 500 companies that reported results beat estimates by an average of 8.5%. While low expectations may optically result in a positive earnings season, the real challenge may come in the second quarter and second half of the year, where bottom up estimates still show 8.4% growth in earnings for 2012.

While corporate earnings will be the focus of investor attention over the near-term, we believe corporate earnings are likely to post positive, albeit, slower growth rather than experience an outright decline. More importantly, valuations remain reasonable and corporations continue to show an increased willingness to return cash to shareholders both via share buybacks and dividends. The announcement by Apple in Q1'12 to pay its first dividend since 1995 is further evidence of this trend. With payout rates well below their historical averages, the potential for further increases in dividends makes US equities an appealing investment for investors who can absorb volatility and are looking for a superior alternative to low yielding fixed income instruments.

Non-US Equity (28% of portfolio)

Emerging market equities are off to a strong start in 2012 as renewed risk appetite among global investors caused the MSCI Emerging Markets Index to rally +14% in Q1'12. Despite profit-taking in select names in the portfolio, we remain overweight Asia and Latin America given the attractive valuation profile that many of the countries in these regions possess relative to the developed world. While economic growth rates in the emerging economies have slowed modestly, they are coming off a very high base and are still very attractive in absolute terms when compared to the developed world. In addition, monetary policy has become more accommodative in many emerging economies over the past few quarters and the lagged impact of those decisions could prove positive to economic growth and corporate earnings as the year progresses.

In Europe, although economic growth is likely to remain weak both in absolute terms and relative to the rest of the world, the European Central Bank's (ECB) long-term refinancing operations (LTRO) policies have materially reduced the possibility of a banking collapse that had unnerved investors for much of 2011. Notwithstanding the economic effects of further austerity measures in the peripheral economies, equity valuations in the region are at a steep discount to the global averages and thus present opportunities for long-term value investors. Recently, German automakers have reported record sales in China as stronger wage growth in the emerging world leads to a rise in luxury auto demand. This is a reminder that there is a difference between European economies and European companies. We remain underweight European equities at 10% of the portfolio, but remain vigilant for investment opportunities in companies with single digit price multiples, above average dividend yields, and exposure to emerging market consumer trends.

We remain overweight Japanese equities at 7% of the portfolio, but used the Q1'12 rally in Japanese stocks to pare back on positions in both export and domestically oriented industries. In February, the Bank of Japan (BOJ) announced that it was raising its inflation goal to 1% and increasing its asset purchase program by ¥10 trillion to ¥65 trillion. These policy changes weakened the yen which had a subsequently strong positive impact on sentiment for Japanese export stocks and the Japanese equity market in general. From a macro perspective, we continue to view Japan as an attractive market for investment. Japanese GDP is forecast to grow ~1.5% in 2012 after declining 0.75% in 2012. Growth should be stimulated by a ¥12 trillion supplemental budget for earthquake rebuilding (versus GDP of ¥500 trillion) along with increases in production as industries recover from the Tohoku earthquake and flooding in Thailand. Japanese equity valuations are among the cheapest in the world.

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US Fixed Income (10% of portfolio)

We remain underweight US Treasuries at 7% of the portfolio and reduced our position in Q1'12 as we sought out various areas of the corporate and non-US sovereign bond markets that could provide a more attractive risk/return profile. Recognizing that interest rates across the US Treasury curve are typically below the current rate of US headline inflation and thus provide very little purchasing power protection if held to maturity, US Treasuries continue to perform an important role in portfolio diversification. More specifically, in a world of rising correlations across asset classes, the ability of US Treasuries to provide negative correlation to global equities is an important characteristic that allows the overall Fund to deliver a more moderate level of risk.

While the year is still in its early stages, investors have begun to discuss the potential "fiscal cliff" facing the US economy at the beginning of 2013. It is estimated that the expiration of the Bush tax cuts, the payroll tax cut, and the implementation of the \$1 trillion sequester could provide a headwind of 2.5%-3.0% to growth for the US economy. Whether politicians will allow these policies to impact the US economy all at once remains to be seen, but any actions taken will need to be coordinated across parties and take place shortly after an election that could bring with it a change in the White House. Should the US government extend tax cuts in order to keep the economy growing without simultaneous actions to reduce long-term fiscal deficits, it is unclear how the US Treasury market will react. Even though the US does not possess the least attractive government debt/GDP ratio in the developed world, it is among the most reliant on foreigners to refinance its sovereign debt. While it is difficult to know exactly when these foreign investors will become disenchanted with the current state of the US government's finances, we must not assume their complicity will continue indefinitely.

We continue to hold 2%-3% of the portfolio in a diversified basket of US corporate and convertible bond securities. We have continued to reduce exposure convertible bonds on the back of strong performance in certain issues and selectively added to investment grade corporates with 3-5 year maturities as an alternative to US Treasuries that provide a more attractive risk/return tradeoff and allow us to take advantage of the financial strength of corporate balance sheets. We remain cautious on US corporate high yield as we believe much of the return in this market has been driven by a desire for yield in a low interest rate environment. Additionally, we are cognizant that the asset class possesses a high degree of correlation to our overweight in equities which reduces the diversification benefits of the asset class in the context of our portfolio.

Non-US Fixed Income (15% of portfolio)

We have modestly trimmed exposure in emerging market sovereign debt, but continue to find select opportunities in Brazil due to high real interest rates and a central bank that has been cutting interest rates and may continue to do so in an effort to spur economic growth. We also maintain smaller positions in Malaysia, Hong Kong, Singapore, and Mexico. While inflation remains a risk to various EM fixed income investments, our strategy has been to keep our duration short as we anticipate rising currency values will more than compensate for potential inflation risks. In non-US credit, the portfolio maintains modest overweights to corporate and convertible bonds in emerging Asia, Latin America, and Eastern Europe and took advantage of select opportunities to increase this exposure over the course of Q1'12.

We continue to avoid sovereign bonds in peripheral Europe due to the possibility of future debt restructurings and the inability for austerity measures alone to stabilize debt/GDP ratios. We hold a modest overweight position in intermediate-term German bunds and continue to overweight UK gilts, although we have recently begun to reduce this position as we believe the end of the most recent round of quantitative easing coupled with a more challenging fiscal environment could cause prices to come under pressure. In Canada, we maintain a modest position in intermediate-term sovereign debt given the more attractive yield characteristics that the Canadian bond market offers relative to US Treasuries.

Cash* (11% of portfolio)

The portfolio's cash weighting increased in Q1'12 as a result of profit taking in equities, convertible bonds, and select areas of the government bond market. With interest rates at historical lows across various regions, cash continues to function as a zero-duration fixed income component of the portfolio and a source of funds in the event of further equity 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[†]

The Fund's US dollar (USD) weighting increased over the course of the quarter and is back to an overweight relative to the benchmark. The increase in the Fund's USD weighting was partially a result of hedging a portion of the portfolio's Japanese yen (JPY) and euro (EUR) exposure back into USD. We believe the ongoing debt crisis in Europe and the possibility of further monetary stimulus from the European Central Bank could cause the EUR to weaken versus the USD. Accordingly, we remain underweight EUR at 6% of the portfolio. With respect to the JPY, our decision to hedge part of our currency exposure was based on our view that the currency was at very expensive

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levels relative to the USD and thus we sought ways to insulate the portfolio from a possible depreciation in the JPY. The Bank of Japan's announcement in February to target a 1% inflation level and increase their asset purchases was ultimately the catalyst for this depreciation in the JPY which caused these hedges to work quite favourably.

Longer-term, we favour a number of currencies of countries in Asia, led by China, but also including Taiwan, South Korea, Hong Kong, and Singapore, have built up formidable foreign exchange reserves, the vast majority of which are denominated in USD. Should they choose, these governments can draw on their reserves to mitigate any sharp declines in the value of their currencies (as occurred in the late 1990s) by buying their respective currencies in the global foreign exchange markets. In the interim, short-term rates in the emerging world pay us a yield for our patience which is in stark contrast to the limited yield prospects presented by the developed world's major currencies. In our view, superior GDP growth rates, healthy national balance sheets, and consistent trade surpluses, are likely to cause capital to flow toward these countries and away from the West over time.

Gold and gold mining equities remain approximately 4% of the overall allocation and represent our view that aggressive monetary policies from the world's developed market economies may continue in the near future and cause investors to seek out alternative asset classes as a store of economic value. With inflation rates exceeding short-term deposit rates across multiple regions around the world, it is our belief that gold will remain in demand as investors fear the future purchasing power losses of fiat currency.

[†] Actively managed as part of the fund's investment strategy.

Sector Highlights

Sector Overweights

Materials (8% of portfolio)

Slightly over half of our sector weighting continues to represent gold exchange-traded funds (ETFs) and gold mining equities. The gold price has experienced some volatility over the last two quarters with five swings of ~10% since peaking at \$1,900/ounce at the end of September 2011. Gold has been a long-term position in the portfolio and we believe it continues to play a valuable role in our portfolio construction. We believe that loose developed market monetary policies and ongoing European sovereign debt issues will direct investors to seek gold as a store of economic value. The recent trend of central banks buying gold for diversification purposes should also continue if the US Federal Reserve has to resort to another round of quantitative easing. In addition to precious metals, we also have a preference for "input sectors" of the global economy, including exposure to specialty chemicals

and base metals. In certain areas of the base metals space, we reduced exposure in Q1'12 after observing some seasonal weakness in demand out of China and will be re-evaluating more attractive entry points over the course of the year.

Energy (8% of portfolio)

This sector remains a long-term structural theme in the portfolio predicated on the belief that oil prices are likely to rise at rates that exceed broader inflation levels due to increasing services and materials pricing. Within the sector, we express our long-term energy views on oil through the global integrated companies that offer attractive multiples and favourable dividend yields. We also favour mid and large-cap exploration & production firms and coal equities due to the fact that coal prices currently trade at the short-term marginal cost of supply, creating a floor whereby producers will shut mines to support prices in the current environment. While natural gas producers do not represent a significant portion of our sector weighting, we have maintained positions with certain producers trading at inexpensive valuations that have the scale and balance sheet to weather the storm and therefore provide valuable optionality to a long-term (5+ year) bull case on natural gas based on fuel substitution both in the transport and utility industries.

Telecommunication Services (4% of portfolio)

Our weighting in this sector declined modestly in Q1'12 largely due to the sector's relative underperformance and also due to our trimming of exposure in both Europe and Japan. While above average dividend yields in many of the larger cap fixed line telecommunication services providers have lured investors, in many cases these dividend yields come at more expensive valuation levels. In Europe, weak operating metrics have caused many operators to cut their dividend and reconsider their payout ratios in the near-term. In the US, we remain positive on the tower companies given strong pricing power and high barriers to entry. We also favour telecommunication services providers in Asia where dividends are well covered and Latin America where recent legislative changes should benefit some of the largest operators in Brazil and Mexico.


Information Technology (11% of portfolio)

This was one of the best performing sectors in Q1'12 and now represents the largest absolute weighting in the portfolio. Despite the recent advance, we remain comfortable with our security selection and multi-year structural themes. Overall, we continue to favour industries that are best positioned to capitalize on explosive data growth and the need to move, store, and manage that data. Software is our largest industry weight and includes exposure within the video game segment where we believe growth prospects are not currently priced into current valuations.

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Communications equipment, a backbone enabler of moving the world's data, remains a preferred industry as well. We also favour companies that we believe are technology enablers of more efficient and cheaper smartphones.

Healthcare (7% of portfolio)

Demographic trends in developed countries favour increased utilization of both pharmaceuticals and medical devices as the population ages, which bodes well for future sales volumes. Despite concerns about future pricing pressures as a result of recently passed US health care reform and European austerity packages, valuations are reasonable across the sector. The pharmaceutical industry, in particular, offers some of the most attractive dividend yields available across all global sectors but trades at a discount (in terms of price/earnings) compared to other high-dividend yielding sectors, such as consumer staples and utilities.

Utilities (2% of portfolio)

This sector underperformed in Q1'12 as investors rotated into more cyclical areas of the market. Although we remain overweight the sector, our positioning is small in absolute terms and is a reflection of stock-specific stories that we favour including select names in emerging Asia where we believe recent alleviation of price controls may provide an earnings catalyst.

Sector Underweights

Financials (9% of portfolio)

We remain underweight developed market financial stocks due largely to extraordinarily low interest rates which continue to depress earnings and the continuation of the deleveraging process occurring in many developed markets which is likely to limit the growth potential for financial firms. In addition, we have become more cautious on financials in the emerging markets given the recent moderation in economic growth and the impact of wage inflation which we believe may negatively impact earnings growth. From an industry point of view, we favour the diversified financial service and capital markets companies given attractive valuations and the property and casualty insurers on a firming of the pricing environment. We are less favourable on real estate investment trusts (REITs) due to valuation and life insurers due to the prolonged low rate environment. We continue to underweight commercial banks given the low interest rate environment and the slow economic recovery translating into lower loan demand.

Consumer Staples (4% of portfolio)

This sector's rich valuation relative to the market has made it especially vulnerable to negative incremental news flow out of Europe and a slowing of economic


data in the US. Our largest holdings continue to reflect a bias towards US and European listed companies with significant exposure to emerging markets, strong balance sheets, and/or unique upside catalysts over the next 12 months. In a few instances, the above average dividend yields we can obtain coupled with attractive valuation has caused us to add to names that can serve as a better usage of capital than what we can obtain in the fixed income markets.

Consumer Discretionary (4% of portfolio)

Consumer spending has been surprisingly strong in the US, but the ability for this trend to persist will depend in large part on further improvements in the labour markets. Similar to consumer staples, the consumer discretionary sector trades at a premium to the overall market. Our activity in this sector during the quarter involved profit-taking in select names in Brazil and the US that have enjoyed strong starts to the year, and covered call writing on names where there is some near-term valuation concern.

Industrials (6% of portfolio)

This sector performed broadly in line with the market in Q1'12. Macroeconomic uncertainty leads us to believe that the sector may remain range bound in the near-term as companies hesitate to raise future earnings estimates. We remain modestly underweight the sector based on our bias towards emerging market growth and away from the developed market industrial activity that dominates global benchmarks. We are cautious on commercial and residential construction and capital spending in the developed markets. We also see mounting pressures on developed world government budgets hurting companies who rely on these governments as customers. This results in our underweight in defence companies, which will likely suffer from stagnant and potentially significantly declining defence expenditures over the coming decade. By contrast, we are favourable on railroads due to our bullish view on the growing global demand for coal and various agricultural products and Japanese industrials which are trading at large discounts to their earnings and book values.




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