

Product Review

iShares U.S. Treasury Bond (AUD Hedged) ETF

ISSUE DATE 21-12-2023

Key information

FUND MANAGER	BLACKROCK INVESTMENT MANAGEMENT (AUSTRALIA) LIMITED
ASSET CLASS	FIXED INTEREST
SECTOR	GLOBAL BONDS
SUB SECTOR	GOVT - PASSIVE
INVESTMENT TYPE	EXCHANGE TRADED FUND ('ETF') LISTED ON THE AUSTRALIAN SECURITIES EXCHANGE ('ASX')
PDS OBJECTIVE	THE FUND AIMS TO PROVIDE INVESTORS WITH THE PERFORMANCE OF THE UNDERLYING INDEX, BEFORE FEES AND EXPENSES (INCLUDING THE COST OF HEDGING).
UNDERLYING FUND	ISHARES \$ TREASURY BOND UCITS ETF AUD HEDGED
INDEX PROVIDER	ICE DATA INDICES, LLC
UNDERLYING INDEX	ICE U.S. TREASURY CORE BOND INDEX, HEDGED INTO AUSTRALIAN DOLLARS
DERIVATIVE USE	MAY BE USED TO MANAGE RISK AND RETURN (CANNOT BE USED TO LEVERAGE THE FUND)
SECURITIES LENDING	NO (HOWEVER THE UNDERLYING FUND MAY ENGAGE IN SECURITIES LENDING)
LISTING DATE	SEPTEMBER 2023
FUND SIZE	\$1.52M

Fees & costs (% per annum)

MANAGEMENT FEES AND COSTS	0.15
PERFORMANCE FEE COSTS	-
NET TRANSACTION COSTS	0.02
ANNUAL FEES AND COSTS (PDS)	0.17

WHERE MANAGEMENT FEES & COSTS IS NULL "-" NO DATA HAS BEEN PROVIDED AND THE ANNUAL FEES & COSTS (PDS) CANNOT BE CALCULATED. REFER TO THE PDS FOR THE FEE INFORMATION.

Daily trading information

TICKER	IUSG
52 WEEK LOW	\$97.74
52 WEEK HIGH	\$100.83
LAST PRICE	\$100.80
LAST NET ASSET VALUE (NAV)	\$103.24
PREMIUM / DISCOUNT TO NAV (DAILY)	-0.024%
AVERAGE DAILY TRADED VOLUME	852
AVERAGE DAILY TRADED VALUE	\$84,813.78

What this Rating means

The 'Recommended Index' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

Strengths

- The Fund represents a cost effective and efficient means of accessing a portfolio of US government treasury bonds from across the yield curve.
- The Fund's Annual Fees and Cost ('AFC') is priced favourably against its peer group.
- BlackRock is a leading global manager of passive strategies, allowing investors to enjoy the benefits of their scale, experience, and resources.

Weaknesses

- Both the Fund and the Underlying Index are still building a track record over an investment cycle.

Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK	●		
CAPITAL VOLATILITY		●	
SECURITY CONCENTRATION RISK			●
SECURITY LIQUIDITY RISK	●		
CREDIT RISK		●	
INTEREST RATE RISK		●	
FOREIGN CURRENCY RISK		●	

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIometrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE				●			

A Standard Risk Measure score of 4 equates to a Risk Label of 'Medium' and an estimated number of negative annual returns over any 20 year period of 2 to less than 3. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

	LOW	MODERATE	HIGH
RISK TO INCOME		●	

Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY		●	
ESG		●	

We strongly recommend that potential investors read the product disclosure statement Lonsec Research Pty Ltd ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

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Fee profile

	LOW	MODERATE	HIGH
FEES VS. UNIVERSE	●		
FEES VS. ASSET CLASS	●		
FEES VS. SUB-SECTOR	●		

Fee BIOmetrics are a function of expected total fee as a percentage of expected total return.

What is this Fund?

- iShares U.S. Treasury Bond (AUD Hedged) ETF ('IUSG' or 'The Fund') provides investors exposure to a portfolio of U.S. dollar denominated, fixed rate Treasury securities with maturity between 1-30 years. The Fund is designed to track the performance of the ICE U.S. Treasury Core AUD Hedged Index ('the Underlying Index'), before fees and expenses.
- The Fund is passively managed by BlackRock ('the Manager') and the Underlying Index is defined by ICE Data Indices, LLC ('ICE' or 'the Index Provider').
- Lonsec notes that the Fund is an Australian-domiciled fund that invests in the iShares \$ Treasury Bond UCITS ETF ('the Underlying Fund'), an Irish-domiciled fund listed in the UK. The Underlying Fund constituents are denominated in USD, however, Fund invests into a unit class that is priced and hedged to AUD.
- The Fund has not made a hedging election under the Taxation of Financial Arrangements ('TOFA') rules. BlackRock has noted that the Fund's structure (gaining indirect investment exposure through an AUD hedged UCITS share class) removes the need for operationally complex hedge accounting at the Australian product.
- The Fund's PDS, dated 25 October 2023 and subsequent continuous disclosure notice, disclosed Annual Fees and Costs ('AFC') totaling 0.17% p.a. This value comprises (1) management fees and costs of 0.15% p.a., and; (2) net transaction costs estimate of 0.02% p.a. In line with RG97, some fees, and costs have been estimated by the issuers on a reasonable basis.

Using this Fund

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Lonsec notes that the Manager has produced a Target Market Determination ('TMD') which forms part of the Responsible Entity's Design and Distribution Obligations for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of the Target Market, and Review Triggers.
- The Fund is a 'long only', fixed income product and as such, will generally sit within the defensive component of a balanced portfolio.
- Fixed income funds are useful for investors seeking yields greater than cash or cash equivalents and those prepared to accept a low to moderate level of asset price volatility.

- Global and Australian fixed income funds typically perform better during periods of declining or stable interest rates and contracting or stable credit spreads.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
	●	●	●	●	

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- Lonsec notes there have been no significant changes to the investment team, investment process, or risk management process since the last review.

Lonsec Opinion of this Fund

People and resources

- BlackRock is a global leader in ETFs with over 1,100 iShares ETFs listed globally. Further, BlackRock also had US\$5.95 trillion of FUM invested across its suite of ETF and Index strategies as at September 2023. These funds are managed and brought to market by BlackRock, one of the largest asset management firms globally. BlackRock has significant scale and resources for effectively managing and structuring ETFs both in Australia and abroad and has a proven track record of successfully running index strategies.
- Lonsec notes that the Fund invests through a fund-of-fund structure, whereby it gains exposure to the Underlying Index via an underlying Irish domiciled iShares ETF ('iShares \$ Treasury Bond UCITS ETF AUD Hedged' or 'GADUX'). As the Fund is an Australian-domiciled ETF, it is officially managed by the APAC EII Portfolio Engineering Team that is led by Jane Kim, Head of APAC ex Japan Index Equity Portfolio Management. However, the Underlying UK-listed ETF is managed by the EMEA Fixed Income Core Portfolio Management Team.
- The EMEA Fixed Income Core Portfolio Management Team is based in the UK and is led by John Hutson. Furthermore, the Fund's portfolio is managed by Francis Rayner. These teams are further supported by the wider operational staff across BlackRock as well as in-house analysts and traders. There is also a Global Sector Specialist Team responsible for sector oversight, research, and analysis. The team continues to collaborate globally and utilise BlackRock's global presence which Lonsec believes adds to efficiency and scalability.
- Due to the quantitative approach to the construction of the index/portfolio and the breadth of resources available within BlackRock globally for the management of index funds, key person risk is considered to be lower than for active style funds.
- ICE, the Underlying Index provider, is a global index provider with over 6,000 indices covering major asset classes and backed by a 50-year track record in index provisioning.

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Investment approach

- At the Underlying Fund level, the manager has adopted a full replication approach by holding all the securities included in the index where practical, otherwise a representative sample of the securities in the index. The manager will at times adopt the latter approach particularly for when large creations/redemptions occur, where it would not be feasible to hold all the securities in the index. Lonsec finds this investment approach appropriate and useful in managing the portfolio while helping to keep the Underlying Fund's tracking error low.
- Lonsec notes that the Fund is a feeder-fund for the UK-listed Underlying Fund. Historically, Lonsec found that the tracking error performance associated with this fund-of-fund structure has generally been exacerbated due to time time-zone differences with the underlying holdings and the listing market of the Underlying Fund. However, Lonsec notes that BlackRock will be referencing the Underlying Fund's NAV rather than the more common closing price methodology used across the industry in Australia with the aim of reducing this risk. The valuation approach is based on the NAV price of the Fund and limits the timing difference between the underlying share class valued at the closing price and the index. Lonsec takes comfort from BlackRock confirming it followed an internal governance process to evaluate the appropriateness of this novel approach in Australia. Lonsec, however, will continue to monitor this valuation structure in future reviews to assess its effectiveness in meeting expectations.
- Lonsec considers BlackRock's Aladdin risk management system and trade execution systems to be impressive and notes that it allows stress testing for funds to be conducted in addition to the daily monitoring of standard risk metrics for the Fund. Lonsec considers technology to be an important factor in establishing a scalable index and/or ETF business. Lonsec also considers the overall quality of its investment personnel and research effort to be high for this somewhat specialised style of management.

ESG Integration

- Lonsec's ESG integration assessment considers the rigour and structure of the ESG process for the Fund and how well it integrates into the investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Fund's portfolio or the Manager's adherence to any form of impact, green/sustainable, or ethical standards.
- ESG integration for index tracking portfolios is largely limited to stewardship and engagement activities unless ESG considerations are clearly incorporated within the index. As such, for non-ESG driven indices, the ESG score provided by Lonsec is primarily an assessment of the overall ESG adoption, commitment, and policy framework implemented at the Manager level. Further, Lonsec notes that simple sector exclusions do not constitute the incorporation of ESG.
- At the corporate level Lonsec views the Manager's overall ESG policy framework and disclosure as ahead of peers. The Manager has an articulated commitment to the integration of ESG within their

investment process with clear public positioning and evidence of a strong policy framework. The updated ESG policy and stewardship principles are freely available on the firm's website. The proxy voting policy and reporting on voting outcomes is stronger than peers with particular credit paid to the disclosure of voting rationale for controversial votes. The level of disclosure with respect to the Manager's engagement policies and outcomes is considered ahead of peers, particularly the firm's stewardship policies. Reporting on engagement outcomes is publicly available and the Manager is transparent about the engagement priorities, which focus on disclosure and climate change related issues.

- The Underlying Index used for this Fund has no basic filters applied and there is no integration of ESG factors in its construction.

Overall

- Lonsec has maintained the Fund's 'Recommended^{Index}' rating. In Lonsec's opinion, the Fund represents an effective and efficient means of gaining ASX-listed exposure to US Treasury securities. The Fund's fees are viewed as being very competitive in the international government fixed income ETF peer group. BlackRock's use of referencing the Underlying Fund's NAV rather than closing price is innovative and designed to overcome the elevated tracking error commonly seen in fund-of-fund investment structures.
- However, Lonsec notes that the Fund has a limited track record having launched in September 2023.

People and Resources

BlackRock, Inc. is a global asset management business and provider of global investment management, risk management and advisory services to institutional and retail clients around the world. As at September 2023, BlackRock Inc. managed approximately US\$9.1 trillion with products that span active, enhanced and index strategies across various markets and asset classes. BlackRock, Inc. is publicly listed on the New York Stock Exchange (NYSE) and the company has a majority of independent directors. BlackRock Investment Management (Australia) Limited ('BlackRock') is a wholly-owned subsidiary of BlackRock Inc. BlackRock is the Investment Manager and Responsible Entity of the Fund. BlackRock Australia managed approximately A\$207.48 billion as at September 2023.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
JOHN HUTSON	HEAD OF EMEA SYSTEMATIC AND INDEX FIXED INCOME CORE PORTFOLIO MANAGEMENT	22 / 11
FRANCIS RAYNER	PORTFOLIO MANAGER	21 / 15
JANE KIM	HEAD OF ASIA PACIFIC EX JAPAN PORTFOLIO ENGINEERING	15 / 7

ANALYST: NATHAN UMAPATHY | APPROVED BY: MICHAEL ELSWORTH

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The APAC EII Portfolio Engineering Team which is led by Jane Kim, Head of Asia Pacific ex Japan Portfolio Engineering has formal responsibility for the Fund. The investment team responsible for managing the Underlying Fund, that the Fund is invested in, is the London-based, EMEA Fixed Income Core Portfolio Management Team, which is managed by Francis Rayner. However, the portfolio management resources are structured along asset class lines, rather than a more traditional active/passive demarcation, meaning several more portfolio managers are abreast of the portfolio characteristics.

Investment Approach

Overview

For the Underlying Fund, BlackRock employs a passive investment strategy to track the performance of the Underlying Index, before fees and expenses.

Additionally, currency hedging is conducted at the Underlying Fund.

Underlying index

The ICE U.S. Treasury Core Bond Index is provided by ICE and aims to measure the performance of the U.S. Treasury bond market hedged to Australian dollars. The Index is market value weighted, and is designed to include U.S. dollar denominated, fixed rate securities with minimum term to maturity greater than one year. The securities included in the Underlying Index are selected based on the the following eligibility criteria:

- USD-denominated bonds issued by the US government.
- Minimum par amount outstanding of US\$300 million excluding amounts held by the Federal Reserve System Open Market Account or bought at issuance by the Fed;
- Minimum time to maturity greater than one year at the rebalancing date;
- Both on-the-run and off-the-run securities are included.

Securities are weighted by market capitalisation and are rebalanced each month.

INDEX METRIC	DATA
INDEX PROVIDER	ICE DATA INDICES, LLC
NUMBER OF ISSUERS	1
NUMBER OF HOLDINGS	278
MODIFIED DURATION	5.62 YEARS (NOVEMBER 2023)
YIELD TO MATURITY	4.59% (NOVEMBER 2023)
AVERAGE MATURITY	7.26 YEARS (NOVEMBER 2023)
AVERAGE COUPON	4.29% (NOVEMBER 2023)
REBALANCING	MONTHLY

Transparency

iShares' ETF [website](#) is both detailed and user-friendly. It is designed as a self-service website with information relating to performance, current holdings, and key risk characteristics for all iShares ETFs.

Liquidity

As at September 2023, the Fund managed \$1m in FUM which is very low compared to its peer group although this feeds into a greater pool of FUM via the fund-of-fund structure. Lonsec notes that the Fund has a recent inception date, and expects the FUM to grow over the medium term. Lonsec will continue to monitor how demand for the Fund impacts its liquidity and bid / ask spreads.

The Fund offers investors liquidity via the ASX which is supported by dedicated market makers that are obligated to provide continuous liquidity to the market by maintaining pre-agreed spreads and volumes on the ASX.

The Fund's underlying holdings are income-generating treasury securities issued by the US government. Investors should be aware that during normal market conditions, liquidity for these securities will not be a concern; however in times of market distress, some securities may experience more challenging liquidity conditions.

Fees and Indirect Costs

The Fund's AFC of 0.17% p.a. is very competitive in comparison to its peer group.

The Fund is newly launched and bid / ask spread cannot yet be readily estimated. The bid / ask spread for an ETF represents the average daily spread over a one-year period but may not reflect the actual spread incurred.

Fee comparison

FUND NAME	AFC (% P.A.)	AVERAGE BID/ASK SPREAD (%) P.A.)
ISHARES U.S. TREASURY BOND (AUD HEDGED) ETF	0.17	0.12 [^]
GLOBAL X US TREASURY BOND ETF [CURRENCY HEDGED] (USTB)	0.27	0.22

Source: ASX daily average bid / ask spread over 12 months to September 2023

[^]Fund has less than one month's track record.

Performance

The Fund commenced in 25 September 2023 and is still establishing a track record. Lonsec prefers to observe a Fund's performance over an investment cycle before drawing any meaningful observations on fund performance.

Risks

An investment in the Fund carries a number of standard investment risks associated with domestic investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the relevant PDS and should be read in full and understood by investors. Lonsec considers the major risks to be:

Tracking error risk

The Manager seeks to minimise the tracking error against the index the Fund aims to track. There is no guarantee that this objective will be met. Additionally, the use of a feeder-fund structure has the potential

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to result in higher observed tracking error relative to holding investments directly. BlackRock has sought to minimise the potential for higher tracking error associated with the fund-of-fund structure by referencing the Underlying Fund's NAV rather than its closing price in the Australian fund's valuation process.

Performance risk

The value of, and returns (if any) from an investment in the Fund will depend upon the performance of the index. There is no guarantee the value of an investment in the Fund will increase.

Interest rate risk

The movement in interest rates and bond yields directly impacts the net asset value of the Fund. Market prices of fixed-rate securities are typically inversely related to the movement of interest rates or bond yields. Duration is a measure of the interest rate risk in a fund.

Credit risk

Investing in sovereign debt securities carries credit risk, albeit typically lower than corporate credit risk. Credit risk refers to the capacity or willingness of a borrower to repay its obligations as they fall due. Higher credit risk generally infers a greater risk of capital loss.

Market-making risk

The Fund takes on counterparty risk with regard to its market-making activities. Counterparties may default on their contractual obligations, potentially exposing investors to some financial losses.

Currency risk

The Fund invests through an AUD hedged vehicle. The Underlying Fund predominantly invests in assets that are denominated in non-A\$ currencies. A rise in the relative value of the AUD vis-à-vis the currencies in which the assets are denominated will negatively impact the market value of the assets (and vice versa) from an Australian investor's perspective. The Underlying Fund is managed on a 'currency hedged' basis to reduce the impact of currency movements. While the Fund is managed on a fully hedged basis to reduce the impact of currency movements on overall performance, market movements and cash flows may move the Fund away from a fully hedged position.

Further information

Further information can be obtained by calling BlackRock on 1300 474 273 or visiting: www.blackrock.com/au.

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Glossary

[Click here for the glossary of terms.](#)

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Analyst Disclosure and Certification

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