Cash market commentary

BlackRock

Q4 2023

Global macroeconomic outlook

In Q4 2023, the economic environment in Europe, the UK, and the US displayed resilience amidst evolving monetary strategies and diverse regional economic scenarios.

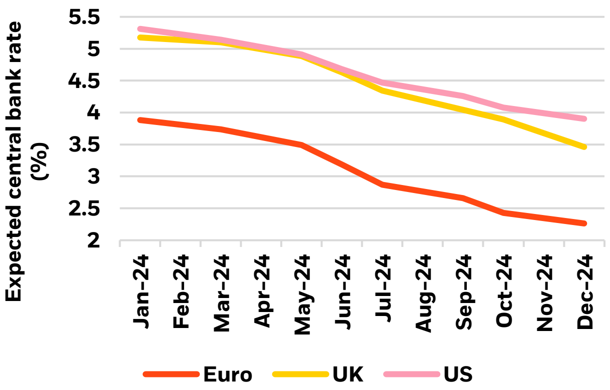
The global economy demonstrated overall strength, although some regions were impacted by the aggressive policies of central banks. While inflation rates were decreasing, a return to normal levels was expected to be a gradual process.

The US Federal Reserve (Fed), the Bank of England (BoE), and the European Central Bank (ECB), among other key central banks, were nearing the end of their strict policy phases. It was expected that they would maintain interest rates for several periods before starting a slow reduction phase. Europe's growth was comparatively lower than that of the US, partly because European households had less savings to offset the impact of high inflation.

The expected change in monetary policy, moving from prolonged high-interest rates to potential rate reductions, significantly influenced the end of 2023. As a result, there was a noticeable decrease in government bond yields in major economies such as the US, UK, and Europe.

The Fed has signalled its intention to lower its key rate to around 3.75% by the end of 2024, with a further decrease to around 3% by the end of 2026 before rising again.

Chart 1: Global central bank expectations



Economists forecast that the ECB will begin reducing interest rates from March 2024. This is due to the expected decrease in borrowing costs caused by a decline in inflation rates (refer to Chart 1).

Both the ECB and the BoE are adjusting their monetary policies in response to the changing economic conditions, particularly in relation to inflation rates and economic growth. The exact timing and extent of the rate cuts will depend on the evolution of economic indicators throughout the year.

Resilient economic landscape in late 2023

Europe, UK, and US show cautious optimism amidst monetary transitions

Inflation and monetary policies

Gradual transition anticipated as central banks maintain rates

Global economic robustness amidst shifting monetary policies

Expected monetary policy changes for 2024, including rate cuts

Source: BlackRock's opinion using Bloomberg data as of 29 December 2023. The opinions expressed are as of 29 December 2023 and are subject to change at any time due to changes in market or economic conditions. For illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

Dollar Market Overview

The focus has shifted in the US market as the Fed has reached terminal rates and investors await a potential easing.

In Q4, there was a gradual and interconnected shift in the U.S. financial landscape regarding monetary policy, market dynamics and Treasury activities.

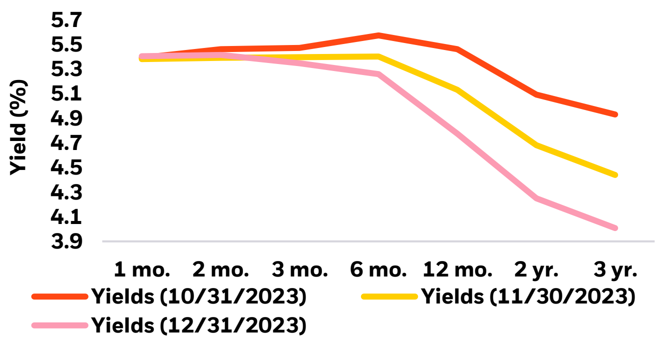
In October, there was a growing inclination among policymakers to pause interest rate hikes, as indicated by the minutes from the September Federal Open Market Committee (FOMC) meeting. This sentiment suggested a possible break in the tightening cycle in November, signalling the first consecutive pause. During this period, there were increased geopolitical tensions and a decline in market expectations for a year-end rate hike from 50% to 25%. At the same time, the U.S. Treasury escalated the issuance of Treasury securities, with a significant rise in both bill and coupon issuance, marked by a spike in the Secured Overnight Financing Rate (SOFR).

In November, the FOMC meeting maintained the federal funds rate at 5.25%-5.50%, reflecting a dovish shift in the committee's stance. This was in line with slowing U.S. manufacturing and employment data, leading to a substantial bond market rally under the belief that the steady rate might signify the end of the aggressive tightening cycle. Despite another $200 billion increase in Treasury bill issuance, strong demand in the money fund complex absorbed this supply without significantly impacting yield levels.

In December, the FOMC held the rate steady for the third consecutive meeting. The updated economic projections suggested a more pronounced pace of rate cuts by the end of 2024, influencing a rally in longer-term fixed-rate securities and further inversion of the yield curve. The Treasury's rate of bill issuance slowed down compared to previous months, signalling a shift in pace.

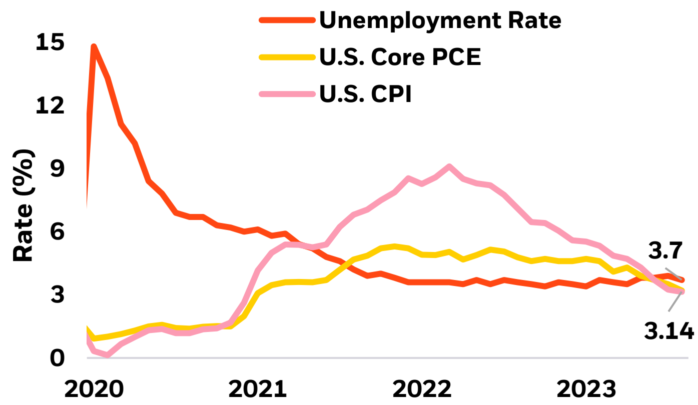
Market expectations of a more accommodative monetary policy in 2024 have led to a decrease in Treasury yields.

Chart 2: Treasury yields



Although the overall inflation rate is decreasing, the core inflation rate, which excludes items that are prone to fluctuation such as food and energy, continues to remain high and surpasses the Fed's target levels. This persistent core inflation is partly due to the continuous growth in wages within the service sector. In terms of headline inflation, as demonstrated by the CPI, there has been a small rise of 0.1% on a seasonally adjusted basis, following a stable rate in October. Over the past year, the all-items index has increased by 3.1% before seasonal adjustment, which is consistent with the predictions made by economists.

Chart 3: Inflation and unemployment rate



The US jobs report for December has shown impressive results, exceeding expectations. Non-farm payroll additions amounted to 216,000, which was higher than the predicted 175,000. The private sector also saw a significant increase of 164,000 jobs, surpassing the forecasted 130,000.

Despite expectations of the unemployment rate rising to 3.8%, it remained steady at 3.7%. Moreover, wage growth was stronger than anticipated, with a month-on-month increase of 0.4% and a year-on-year rise of 4.1%, surpassing the predicted figures of 0.3% and 3.9%, respectively. (Chart 3)

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Probability of rate hike implied in the OIS curve

Meeting date	Implied rate change priced in bps	Implied rate in %
Jan-24	-1.5	5.313
Mar-24	-18.5	5.143
May-24	-41.5	4.913
Jun-24	-64.9	4.679
Jul-24	-86	4.468
Sep-24	-107.1	4.257
Nov-24	-125	4.078
Dec-24	-142.7	3.901

Rates	29 December 2023	29 September 2023
Overnight repo rates	5.30% - 5.33%	5.26% - 5.33%
Overnight deposit rates	5.26% - 5.30%	5.26% - 5.33%
3-month core treasury bills	5.36%	5.31%
1-year indicative ECP level	5.00% - 5.20%	5.75% - 6.05%

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Strategy for the Institutional Cash Series (ICS)

BlackRock ICS US Treasury Fund

Short-Term Public Debt Constant NAV (CNAV) Fund

In Q4, we adjusted our investment strategy in response to the changing conditions in the market. In October, we increased our exposure to repurchase agreements (repo) to improve yield and liquidity. In November, we extended the duration of our portfolio due to sustained demand for money funds. In December, we shifted to a barbell strategy, anticipating a more relaxed monetary policy. This involved reducing our repo exposure and favouring longer-term fixed-rate securities. These changes were aimed at adapting to the evolving economic dynamics and maintaining a favourable composition of our portfolio.

BlackRock ICS US Dollar Liquidity Fund

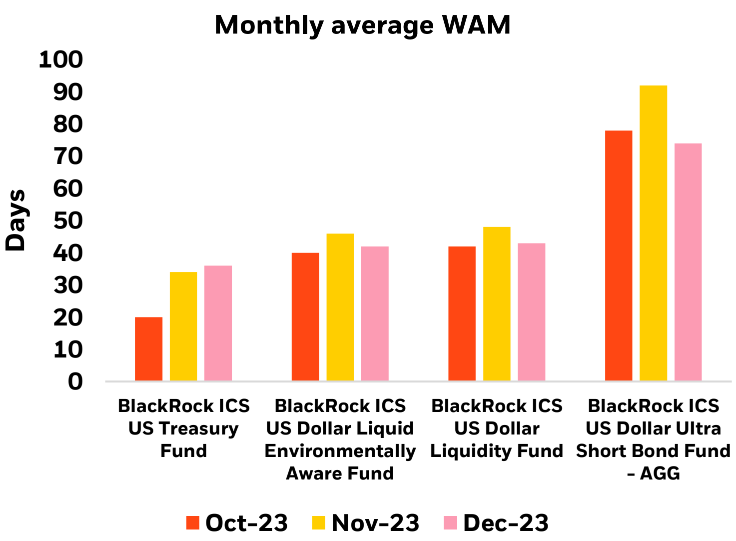
Short-Term Low Volatility NAV (LVNAV) Fund

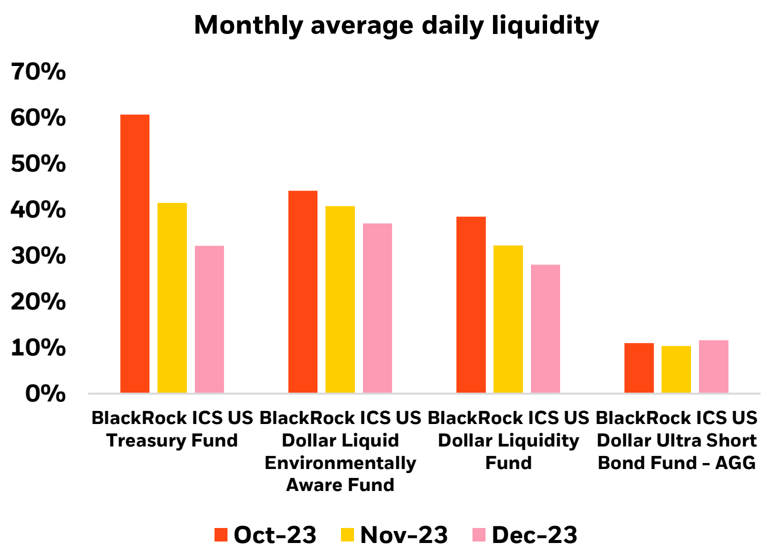
In Q4, we focused on opportunities for investing in longer-dated fixed-rate securities. We noticed signs that the Federal Funds rate has peaked in this cycle, at around 5.25-5.50%. As a result, we invested largely in tenors of six months or longer. However, we also looked at investments extending into early 2024, to position ourselves for year-end. As a result, our exposure to floating rate securities decreased. Nonetheless, we continued to see opportunities in some variable rate securities out to six months, given the market's optimism regarding the timing of any rate cuts in early 2024. From a credit perspective, we increased our focus on higher quality securities, including sovereign and agency investments. These appeared attractive from a relative value and liquidity perspective. Overall, we maintained a weighted average maturity (WAM) close to 45 days, with strong levels of liquidity to accommodate any market uncertainty.

BlackRock ICS US Dollar Ultra Short Bond Fund

Standard Variable NAV (VNAV) Fund

In Q4, most of the investments were made for periods of six months or longer. However, we found shorter-term tier two investments with maturities up to three months to be attractive from a carry perspective. As a result, we reduced our exposure to floating-rate securities. Nevertheless, since the market appeared optimistic about the timing of any rate cuts in early 2024, we still saw opportunities in some variable-rate securities. In terms of credit, we increased our bias towards higher quality securities, especially those that could help us extend the duration of our investments. Overall, the fund's duration remained close to 0.25 year, along with appropriate levels of liquidity to accommodate market flows in this uncertain environment.





Source: BlackRock as of 29 December 2023.
A Money Market Fund (MMF) is not a guaranteed investment vehicle. An investment in MMFs is different from an investment in deposits, the principal invested in an MMF is capable of fluctuation and the risk of loss of the principal is to be borne by the investor. The MMF does not rely on external support for guaranteeing the liquidity of the MMF or stabilising the Net Asset Value (NAV) per share.

Investors should refer to the prospectus or offering documentation for the fund's full list of risks.

Risks

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

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

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

Specific Fund Risks

BlackRock ICS US Dollar Ultra Short Bond Fund

Accumulating share class risk: On any day where the net return (i.e., return less costs and expenses) of the Fund is negative an Accumulating Share Class of the Fund will see a decrease in the NAV per Share.

The Fund seeks to exclude companies engaging in certain activities inconsistent with ESG criteria. Investors should therefore make a personal ethical assessment of the Fund's ESG screening prior to investing in the Fund. Such ESG screening may adversely affect the value of the Fund's investments compared to a fund without such screening.

Credit Risk: The issuer of a financial asset held within the Fund may not pay income or repay capital to the Fund when due.

Counterparty Risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Money Market Funds: Money Market Funds do not generally experience extreme price variations. Changes in interest rates will impact the Fund. Levels of credit risk are affected by longer weighted average maturity and weighted average life of the Fund.

Applicable to BlackRock ICS US Treasury Fund

Accumulating share class risk: On any day where the net return (i.e., return less costs and expenses) of the Fund is negative an Accumulating Share Class of the Fund will see a decrease in the NAV per Share.

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Concentration Risk: Investment risk is concentrated in specific sectors, countries, currencies or companies or because the Fund has only a small number of investments. This means the Fund is more sensitive to any localized economic, market, political or regulatory events. Concentrated investment exposure by the Fund could magnify the other risks to which the Fund is exposed.

Money Market Funds: Money Market Funds do not generally experience extreme price variations. Changes in interest rates will impact the Fund. Levels of credit risk are affected by longer weighted average maturity and weighted average life of the Fund.

Risks

Applicable to BlackRock ICS US Dollar Liquidity Fund

Accumulating share class risk: On any day where the net return (i.e., return less costs and expenses) of the Fund is negative an Accumulating Share Class of the fund will see a decrease in the NAV per Share.

The Fund seeks to exclude companies engaging in certain activities inconsistent with ESG criteria. Investors should therefore make a personal ethical assessment of the Fund's ESG screening prior to investing in the Fund. Such ESG screening may adversely affect the value of the Fund's investments compared to a fund without such screening.

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