

BlackRock

Time to tilt

Harnessing factor cyclicalality to seek alpha



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Summary

- Delivering alpha in equity markets has been notoriously difficult and has continued to challenge active managers in the post-pandemic environment. Some managers rely on static factor exposures to drive returns, making them vulnerable when market conditions shift, and factors move in and out of favour.
- We harness factor cyclicalities with the aim of generating returns throughout different phases of the economic cycle and in varying market conditions.
- Portfolio managers combine several timing indicators to create a forward-looking outlook for each factor and then evaluate stocks based on their unique factor exposures. We believe that a holistic timing approach can be additive in the portfolio.
- As a low cost global active equity strategy, BlackRock Systematic's iShares World Equity Factor Rotation Active UCITS ETF (FACT) can be used as core or complementary exposure, seeking to enhance passive and active portfolio outcomes.
- BlackRock Systematic has 40 years of experience managing factor-based and alpha-seeking strategies, constantly innovating to deliver on behalf of our clients.

There is no guarantee that a positive investment outcome will be achieved.

Adapting to changing markets

iShares World Equity Factor Rotation Active UCITS ETF (FACT) is an actively managed stock selection strategy that seeks long-term capital growth by tactically allocating to well-known factors such as momentum, quality, value, minimum volatility and size. The strategy seeks to benefit from two sources of return:

- 1 Long-run premiums associated with these factors.
- 2 Tactical returns adjusting allocations to these factors over time.

Figure 1 uses simulated data to show how the strategy would have been positioned during volatile periods by adeptly navigating changing market conditions (the ETF launched in January 2025):

2021 Robust economic growth driven by vaccination rollouts, easing of COVID-19 restrictions, and improved consumer spending and business activity. Continued fiscal stimulus and loose monetary policy from the Federal Reserve supported market growth. The strategy would have pivoted from an underweight to value during the pandemic to an overweight during the recovery.

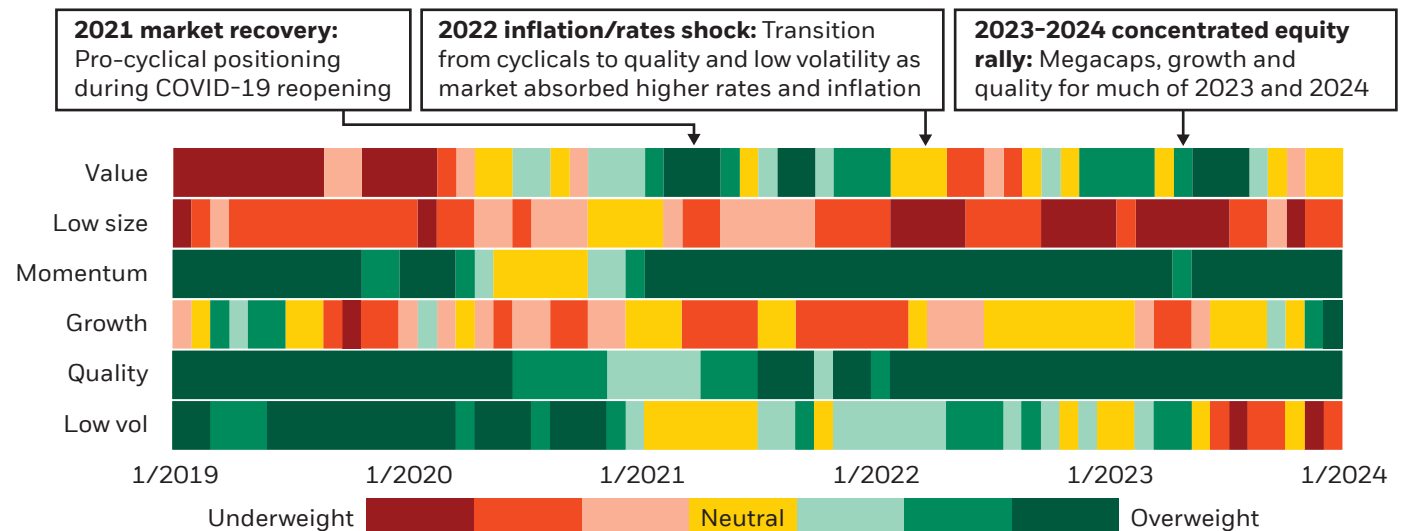
2022 Persistent inflation, driven by supply chain issues, energy prices, and labour shortages, hurt consumer spending and corporate margins. FACT would have shifted to a more defensive posture, favouring low volatility and quality stocks. Central banks raised rates in response to inflationary pressures, increasing market volatility and putting pressure on stock prices.

2023 The US Federal Reserve moderated its rate hikes as inflation showed signs of cooling, stabilising market sentiment and encouraging some risk-on behaviour. The strategy would have positioned long in megacaps – overweighting momentum and quality – thus, would have benefitted from a narrow market rally led by the “magnificent seven.”

2024 AI optimism fuelled a market rally, extending the technology sector’s leadership. The strategy’s continued bullish outlook on growth, quality and megacaps would have boosted outperformance.

As factor performance is cyclical, tactical allocations to factors may increase the return potential of the portfolio and help deliver more consistent returns throughout varying market conditions.

Figure 1: Simulated factor weightings over time



Source: BlackRock as of 30/6/24. Chart illustrates simulated monthly factor exposures of FACT over 60 months. Factor exposures are measured using the BlackRock Fundamental Risk for Equities Model (BFRE Global). Factor exposures are shown as Z-scores, which are statistical measurements of the number of standard deviations the portfolio’s style exposure is away from the estimated total universe. From red to green, z-scores are categorized according to the following 7 ranges: <-0.2, <-0.1, <-0.05, <+0.05, <+0.1, <+0.2, >+0.2. Factors are represented by the style factors of the same name, with the exceptions of quality (profitability style factor), min vol (volatility style factor, inverted), and size (size style factor, inverted). This information should not be relied upon as research, investment advice or a recommendation regarding the Funds or any security in particular. This information is strictly for illustrative and educational purposes and is subject to change. BlackRock makes no representations or warranties as to the accuracy or completeness of any simulated data contained herein, and further nothing contained herein shall be relied upon as a promise by, or representation by BlackRock whether as to past or future results. Multifactor funds employ a management approach using style factors whose impact they have on the fund’s performance can be difficult to predict. Investors should consider this Fund as part of a broader investment strategy.

Subduing ebbs and flows with diversified exposure

Style factors are well-known and intuitive sources of risk and return within asset classes. While several individual factors have historically delivered positive long-term returns, they are inherently cyclical. Each factor is driven by different phenomena, causing them to outperform at different times as market conditions evolve.

Figure 2 illustrates the long-term performance and cyclicity of six global style factors relative to the MSCI World Index on a calendar basis. Over the past 20 years, momentum and quality have outperformed the market over the long run, while low volatility has had a similar return, with meaningfully less risk, resulting in a higher Sharpe ratio.³ Value and growth have alternated in leadership during changing regimes.

A common way to address cyclicity is to diversify exposures across multiple factors, thereby reducing the potential impact of any single factor on the overall portfolio. Maintaining a diversified allocation across factors can smooth the highs and lows, in an attempt to create a more consistent return stream, shown in purple.

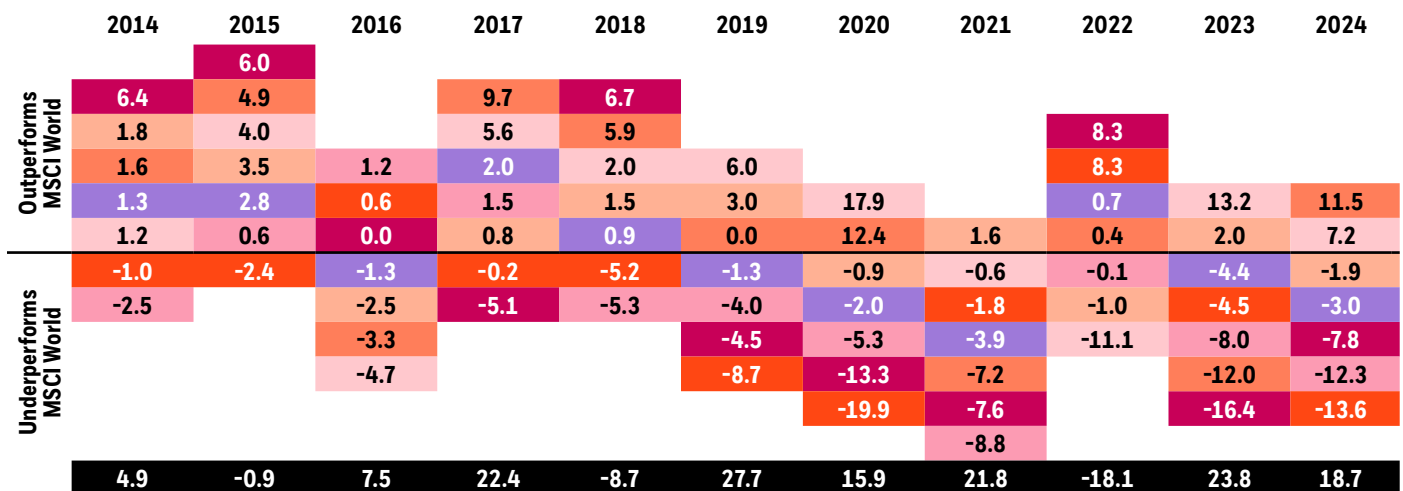
Factor cyclicity raises an intriguing question:

Can we adjust allocations to different factors over time, anticipating their over or underperformance to achieve incremental returns above long-term factor premiums?

Some investors have argued that only trending factors make attractive investments and have based their investment views upon momentum-based measures. Others believe that factor timing is too complex to execute successfully and advise against trying to time altogether.

Our research suggests that both these views have merit but fail to capture the full picture. While factor timing is challenging and involves taking on additional active risk, we believe that a form of timing can be additive, provided the methodology is sufficiently diversified and robust. Combining several indicators may yield enhanced results compared to using any one in isolation. We diversify our timing insights just as we prefer diversifying portfolios. Our approach integrates both fundamental and technical measures to evaluate each factor relative to its historical performance and relative to other factors.

Figure 2: Factor returns over time (%)



MSCI World Index annual total return: ● Value ● Momentum ● Quality ● Size ● Growth ● Min volatility ● Multifactor

The figures shown relate to (simulated) past performance. Past performance is not a reliable indicator of current or future results. There can be no guarantee that the investment strategy can be successful and the value of investments may go down as well as up. Diversification and asset allocation may not fully protect you from market risk. Source: MSCI, Bloomberg as of 31/12/2024. Index returns are NTR USD for the period 31/12/2004–31/12/2024. Index returns are for illustrative purposes only. MSCI World Momentum Index denoted as Momentum; MSCI World Mid-Cap Equal Weighted denoted as Size; MSCI World Enhanced Value Index denoted as Value; MSCI World Quality Sector Neutral Index denoted as Quality; MSCI World Minimum Volatility denoted as Min Vol; MSCI World Growth Index denoted as Growth. The Equal-Weighted portfolio, which is calculated monthly using the average of the six aforementioned indices, is denoted as Multifactor. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. The value of an investment can fall as well as rise and you may not get back the original amount invested. There is a risk that the entire amount invested may be lost. BlackRock makes no representations or warranties as to the accuracy or completeness of any past, estimated or simulated performance results contained herein, and further nothing contained herein shall be relied upon as a promise by, or representation by BlackRock whether as to past or future performance results. This analysis contains back-tested index data. Data for time periods prior to the index inception date is hypothetical and is provided for informational purposes only to indicate historical performance had the index been available over the relevant time period.

About style factors

Style factors are intuitive drivers of equity market risk and return. Future returns from style premia may be lower than past returns and could even be negative. We focus on six equity style factors that are grounded in economic intuition and are well-supported by academic research. Each factor has a risk premium, structural impediment, or behavioural anomaly that justifies its return premium.

- Value** strategies target securities that are inexpensive relative to fundamentals.
- Momentum** strategies invest in securities with improving prices or market sentiment.
- Quality** strategies favour securities with stable and high-quality earnings.
- Minimum volatility** strategies target securities with lower volatility.
- Size** strategies favour smaller, more nimble companies over larger ones.
- Growth** strategies target companies with future earnings growth potential.

Our approach is best described as factor timing. Over the long run, the portfolio maintains diversified exposure to multiple factors. In the near-term, however, the portfolio tilts into factors with tailwinds and away from factors with headwinds.

A dynamic approach

Our dynamic factor timing strategy starts by assessing the current economic regime to identify which factors are likely to have a long-term tailwind or a headwind based on the macroeconomic and market backdrop. We then examine the valuation and sentiment of all factors, which influence short-term price behaviour, along with factor-specific indicators to create a comprehensive forward-looking outlook for each factor. This outlook is translated into a portfolio of global stocks, overweighting stocks which have higher exposure to factors which are in favour. The resulting portfolio adapts to changing market conditions and seeks long-term capital growth across a variety of market environments.

Factor-timing indicators:

Economic regime – What is the current economic and market regime, and does the factor tend to do well in the identified environment?

Fundamentals – Is the factor over- or under-valued compared to its own history and other factors?

Sentiment – Is the market sentiment on this factor currently positive or negative?

Factor specific insights – Is future growth priced in? Is there elevated risk of a momentum reversal?



There can be no guarantee that the investment strategy can be successful and the value of investments may go down as well as up. Investment process is subject to change and provided here for illustrative purposes only.

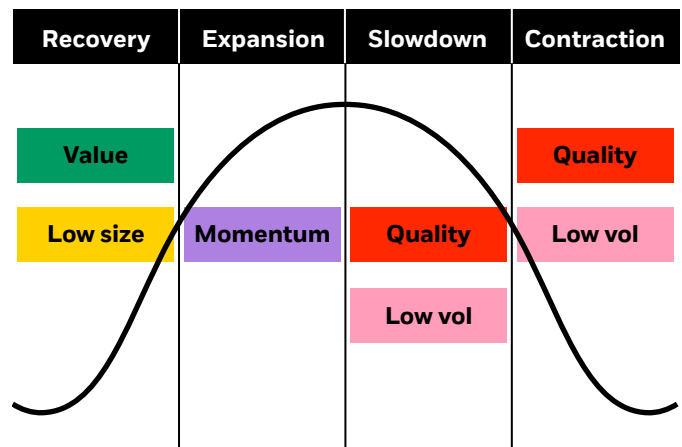
Gauging the economic and market regime

The prevailing economic regime has a strong and intuitive link to market behaviour and individual factors. For example, increases in productivity and employment tend to fuel equity markets, while recession fears often drive investors to the safety of bonds.⁴ Similarly, the behaviour of individual style factors is linked to the economic regime, with each factor being rewarded at different times in the economic cycle. We determine the phase of the economic cycle based on our assessment of the level of economic growth, probability of recession, market sentiment, interest rates, and volatility. We then allocate to the factors that perform best in the current economic environment. Our assessment of the economic cycle includes:

- Economic growth and recession probability:** Economic growth is a key driver of asset prices, but it is difficult to measure accurately. Official GDP is released quarterly – and is often revised. To address this, BlackRock has developed a nowcasting model that forecasts the 12-month forward consensus GDP using leading and coincident economic indicators, including realised activity, employment, sentiment and survey data. This model helps us determine the level of economic growth and the probability of recession, informing whether the current economic regime is in expansion, slowdown, contraction or recovery.
- Market sentiment:** Market sentiment measures, such as equity returns and investor risk tolerance, provides real-time information that compliments the economic data described above. Equity returns and GDP are closely related, but equity returns are more forward-looking and reflect a wider range of information than GDP. High equity returns may indicate optimism about the economy, suggesting an expansion phase. Investor risk tolerance reflects market risk aversion; high risk tolerance indicates positive investor sentiment, common during expansion, while low risk tolerance indicates bearish sentiment typical of slowdown or contraction phases. The Risk Tolerance Index (RTI) measures correlation between the volatility and returns of major asset classes, helping us map economic phases.
- Interest rates and volatility:** We consider broad macro-financial conditions, specifically interest rates and volatility, to complete our understanding of the current economic regime, we analyse how these macro-economic variables have impacted style factor returns in the past and forecast future returns. For instance, rising rates increase borrowing costs, negatively impacting highly leveraged companies

and leading to underperformance in factors like value and size. Conversely, factors like quality, which focuses on financially healthy firms with strong balance sheets, tend to perform better in rising interest rate environments. Market volatility, often measured by indices like the VIX, can also affect style factor performance. During periods of high volatility, investors tend to seek safer investments, leading to outperformance in factors like minimum volatility and quality. These factors are associated with lower risk and more stable returns. On the other hand, factors like momentum and size, which are more sensitive to market swings, may underperform during volatile periods. The combined effects of interest rates and volatility can create complex dynamics. For example, during periods of rising interest rates and high volatility, investors might favour minimum volatility and quality factors for their defensive characteristics. Conversely, in a low-interest-rate and low-volatility environment, factors like momentum and value might perform better as investors seek higher returns and are more willing to take on risk.

Our holistic view of the economic regime combines these macroeconomic and market insights. We find that factor performance varies significantly depending upon the regime. During expansion, momentum strategies tended to perform well. In slowdown or contractionary phases, quality companies with healthier balance sheets and lower leverage outperformed due to their risk-mitigation properties. During recessions, quality and the low volatility factors performed best, owing to their defensive characteristics. As the economy recovered, smaller companies and value companies benefited from the renewed economic growth.



Source: BlackRock Systematic as of 31/12/24. For illustrative purposes only.

There is no guarantee that research capabilities will contribute to a positive investment outcome. Source: BlackRock Systematic as of 31/12/24. For illustrative purposes only. Not intended to depict actual results. ⁴ McKenna, Kristin. "Are Bonds Safe During a Recession or Market Crash?" Barron's, 26 February 2025.

Evaluating fundamentals

Factors, like individual stocks, can become over- or under-valued. Our research indicates that undervalued factors have historically outperformed their expensive counterparts. Valuation ratios commonly applied to securities can also assess the cheapness or expensiveness of a given factor. Rather than rely on a single valuation metric, we combine multiple valuation metrics, including both trailing and forward-looking insights into a composite valuation indicator. We consider a factor relatively cheap when it has a low valuation relative to its own history and to other factors. This time-series comparison adjusts for the perennial richness or cheapness of specific factors.

Assessing sentiment

Just as we see trend following behaviour in individual securities, we also see evidence of momentum across groups of securities, including factors. Investors tend to pile into, and thus, bid up the prices of assets that have exhibited strong recent performance. As a result, factors that performed well recently tend to continue to perform well. Historically, we have relied on price momentum measures as the sole gauge for factor sentiment. Over the years we have expanded the methodology to include earnings momentum as well as indicators of strong bearish sentiment.

Going for growth and minding momentum

The alternating dominance of value and growth factors has driven risk and returns in equity markets for decades. Although growth is not unconditionally rewarded in the long run, it has periodically been an important positive and negative driver of returns. By expanding the opportunity set to tactically position across value and growth stocks during periods of cyclical strength, investors can incorporate a more flexible approach in the hunt for enhancing risk-

adjusted returns. Given the goal of growth investing is to identify firms with the potential for future profitability, understanding whether growth firms are currently profitable and are investing their resources in innovation is critical to identifying periods when growth investing is relatively attractive. Additionally, investors who eschew growth investing often argue that future growth is already priced into current valuations. Because investors tend to extrapolate past earnings into the future, they may drive up the current prices of growth firms to unattractive levels. Thus, our approach to growth timing is based on assessing whether growth firms are profitable, investing in innovation, and whether future growth is fully “priced-in.”

Our cohort of factor-specific insights also includes momentum-specific indicators. Trend-following strategies can be profitable, momentum-based strategies can experience sharp reversals when trends change. To mitigate against these periods, we evaluate the stability and crowdedness of the momentum trade as part of our holistic timing methodology.

Stronger together

While each of the preceding indicators is individually useful, they are more powerful when combined. **Figure 3** shows the information ratio and max drawdown of each cohort of timing insights, as well as the aggregate model. While the IR for the economic regime and sentiment-based insights are the highest individually, attenuating these views with growth timing and fundamental timing insights creates a more robust framework. The aggregate model has a significantly higher information ratio than any of the individual indicators, and the lowest drawdown, presenting the optimal solution.

How do these insights come together to create a portfolio? First, we determine our holistic factor-based outlook by combining all indicators: The economic and market regime, factor fundamentals, sentiment and factor-specific indicators. We then translate our desired factor

Figure 3: Information ratios and maximum drawdowns of individual indicators and aggregate indicator

Signal	Information ratio	Max drawdown	Max drawdown date
Economic regime	1.01	-3.08%	27/05/2003
Fundamentals	0.19	-6.63%	03/09/2021
Sentiment	0.92	-3.65%	15/05/2015
Growth timing	0.48	-3.73%	19/04/2006
Aggregate signal	1.53	-2.10%	30/04/2015

The figures shown relate to (simulated) past performance. Past performance is not a reliable indicator of current or future results. Source: BlackRock Systematic, 31/12/2024. Multi-factor funds employ a management approach using style factors whose impact they have on the fund’s performance can be difficult to predict. Investors should consider this Fund as part of a broader investment strategy.

positioning into a robust, stock-level representation of our desired factor exposures. This involves analysing each stock's inherent factor exposures, favouring those that align with our current factor outlook, and leveraging mean variance optimisation. This optimization allows us to balance our factor-informed return expectations for each stock with its associated risk and transaction costs, while incorporating constraints to ensure the portfolio remains diversified.⁵

Portfolio implementation

How does FACT, or other factor timing strategies fit into a broader equity allocation? FACT can serve as a core or complementary exposure within the portfolio, sitting alongside other actively managed strategies or other broad equity market ETFs.

Investors can utilise FACT as a potentially a diversifying source of alpha within their active equity manager allocation. While equity portfolio managers often have style tilts or biases (e.g., value or growth investors), they typically do not change their investment style depending on the prevailing macroeconomic conditions.

As a result, the alpha stream produced by FACT, which dynamically allocates to global stocks based on their exposure to historically rewarded factors and our forward-looking outlook for those factors, is differentiated from other active managers.

On the other end of the spectrum, investors can use FACT as a cost and capital efficient way to introduce active returns into a predominantly passively managed portfolio. While the strategy is actively managed by BlackRock Systematic, creating the potential for generating alpha, it is systematic, transparent, and risk controlled. The higher transparency associated with factor-based strategies and with ETFs may appeal to investors who are most familiar with passive strategies.

Generating alpha with dynamic factor tilts

BlackRock Systematic has over four decades of experience innovating new ways to deliver better outcomes for clients.⁵ Through a rigorous research process, we continuously build and improve upon our platform capabilities. FACT is the latest iteration of our factor rotation strategies that are designed to assess the near-term alpha potential of historically rewarded factors. By carefully considering both fundamental and technical indicators, we can construct a robust forward-looking view for each factor, providing a new source of potential return and diversification. FACT dynamically allocates to MSCI World Index stocks based on their exposure to historically rewarded factors and our forward-looking outlook. This dynamic approach allows us to seek to identify which factors are best positioned for current returns and adapt flexibility to changing economic and market conditions.



Source: BlackRock Systematic, 31/8/2025. FACT inception: 16/1/25. For illustrative purposes only. Multifactor funds employ a management approach using style factors whose impact they have on the fund's performance can be difficult to predict. Investors should consider this Fund as part of a broader investment strategy. There can be no guarantee that the investment strategy can be successful and the value of investments may go down as well as up. While the investment approach described herein seeks to control risk, risk cannot be eliminated. ⁵ Years of experience for systematic investing strategies at BlackRock includes predecessor firms.

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iShares World Equity Factor Rotation Active UCITS ETF (Acc)

Counterparty Risk, Equity securities, ESG risk (fund screening), Multi-factor fund risk, Quantitative Models Risk, Smaller Companies.

Description of product risks

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B.V., Rembrandt Toren, 17th floor, Amstelplein 1, 1096 HA Amsterdam, Netherlands or by calling the Dutch representative's information request line on 0800 0233 466 and the iShares website www.ishares.nl in Dutch and English. Any decision to invest should be based on the information contained in the Prospectus and the key investor Information Document and the latest half-yearly report and unaudited accounts and/or annual report and audited accounts. Investors should read the fund specific risks in the Packaged Retail and Insurance-based Investment Products Key Information Document (PRIIPs KID) and the Company's Prospectus. The risk indicator shown on this document refers to the relevant share class of the Fund. Higher or lower risk may apply to the other share classes of the Fund. For information on investor rights and how to raise complaints please go to <https://www.blackrock.com/corporate/compliance/investor-right> available in English and Dutch.

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