Global Product Solutions | Investment & Portfolio Solutions

BlackRock

Revisiting the role of bonds: Resilience in a volatile environment

May 2026

Quick read

We look to an expanded fixed income toolkit to solve some of today's key challenges by:

1. Optimising a **cash allocation**
2. Building resilience against energy shocks with **inflation-linked bonds**
3. Diversifying fixed income sleeves for uncorrelated upside

- Japanese government bonds
- Brazilian government bonds
- Selectivity in broad EM debt

Leaning into opportunities in...

...Cash-like instruments

ONSW	**iShares € Overnight Rate Swap UCITS ETF**
ERNE	**iShares € Ultrashort Bond UCITS ETF**

...Inflation-linked bonds

TIP5	**iShares $ TIPS 0-5 UCITS ETF**
IBCI	**iShares € Inflation Linked Govt Bond UCITS ETF**

...Fixed income diversification

JGB1X	**iShares Japan Govt Bond UCITS ETF**
BLTN	**iShares Brazil LTN BRL Govt Bond UCITS ETF**
	BGF Emerging Markets Local Currency Bond Fund
ISOV	**iShares $ EM Bond Active UCITS ETF**

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Investors today face three interconnected challenges: persistent inflation uncertainty, the weakening reliability of traditional portfolio hedges, and the need for broader fixed income diversification. Energy disruption in the Middle East is pushing up near- and medium-term inflation expectations, driving rapid repricing of central bank policy paths with knock-on effects for rates markets. In this environment, both short-end rates instruments and long-duration government bonds have become less effective hedges, while elevated intraday volatility has made stable directional positioning more difficult.

At the same time, rising deficits across developed markets (DM) and unreliable stock-bond correlations reinforce our cautious stance on duration in the US and Europe. Yet this doesn't diminish the role of fixed income altogether. We see value in attractively-yielding cash-like instruments and inflation-linked bonds to navigate price uncertainty, while diversifying with less traditional exposures including Japanese government bonds (JGBs) and select areas of emerging market debt (EMD) to reduce portfolio risk while enhancing return potential.

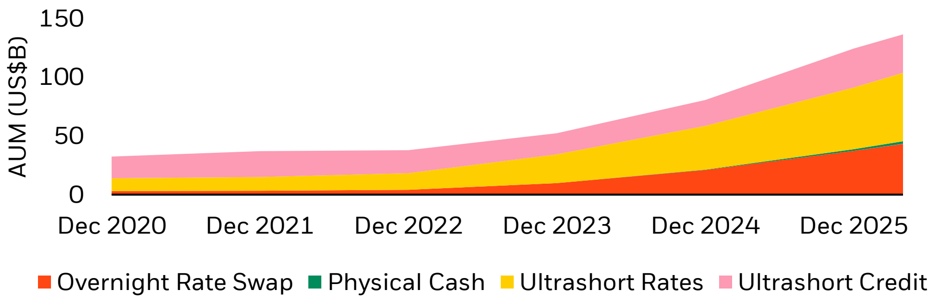
1. Optimising a cash allocation

While we don't see a case for a broad 'flight to cash', the asset class is re-emerging as a more deliberate part of portfolio construction in Europe – cash is no longer a passive allocation, in our view, serving increasingly as a source of return alongside liquidity and capital preservation. EUR short-term rates currently sit in the 1.9%–2.3% range,[1] in contrast to the pre-2022 period of near-zero or negative yields. At the same time, cash balances across Europe have grown significantly over the past two decades,[2] increasing the performance drag from unoptimised holdings. In practical terms, leaving large cash balances idle today can mean forgoing close to 200bps of annual income.[3]

The macro backdrop complicates the case for simply sitting in cash. While elevated policy rates support cash yields in the near term, markets continue to price eventual easing, particularly from the US Federal Reserve (Fed). Because money market and overnight instruments reprice rapidly as policy rates shift, today's elevated cash yields are inherently transient and expose investors to reinvestment risk.

This shifts the question from whether to hold cash to how to hold it. Moving modestly along the curve into ultrashort (typically sub-1Y) duration strategies can help lock in elevated yields for longer while retaining daily liquidity and capital stability. Beyond physical cash and money market funds, swap-based overnight rate ETFs like our iShares € Overnight Rate Swap UCITS ETF now offer a complementary route to enhanced yield. Money market funds, swap-based ETFs and ultra-short bond strategies provide a broader toolkit to deploy liquidity efficiently, capturing elevated income while mitigating reinvestment risk.

AUM Growth in UCITS ETFs used as Cash Management Tools



Source: BlackRock, Bloomberg as of 30 April 2026.

1, 2, 3 Source: Bloomberg, as of 10 May 2026.

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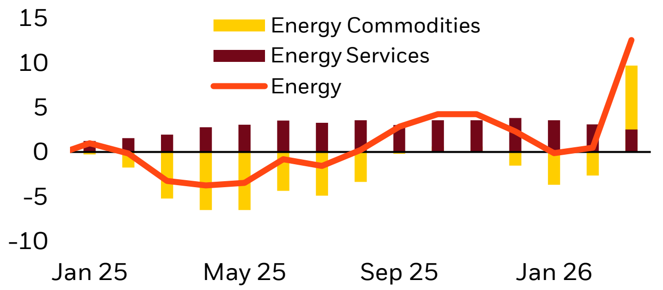
2. Building resilience against energy-driven inflation

Inflation-linked bonds are reasserting their role as a core portfolio hedge, but the case extends beyond a response to price pressures. Eurozone headline CPI has risen to 2.5% YoY from 1.9%,[4] driven largely by the recent energy price surge, with oil and gas pressures starting to feed through the economy. Markets have reacted primarily through front-end inflation pricing – up c.100–120bps across major regions – while longer-dated inflation expectations have remained relatively anchored.[5]

This divergence is central to the opportunity. Current pricing implies limited inflation risk premium across the curve, effectively assuming that the shock will prove transitory and contained. Yet persistent energy disruptions and potential broader pass-through effects create a more uncertain (and inherently lagged) outlook. Firms are just starting to pass on higher input costs: indirect and second-order impacts on wages, margins or broader pricing remain unclear. Previous inflation episodes, particularly in 2022, suggest that inflation can run above market expectations well after the initial shock has peaked, as pressures broaden gradually through the economy. Early estimates already point to input shortages – particularly in petrochemicals – potentially lifting cost bases by c.10% or more across sectors.[6]

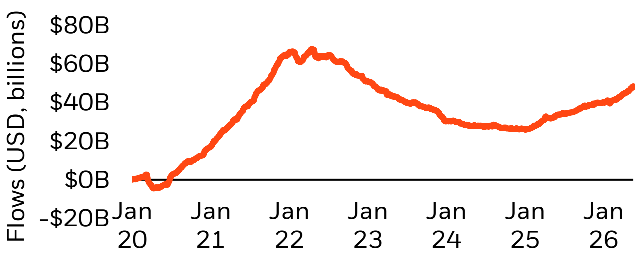
Energy contributions to US CPI YoY (%)



Source: Bloomberg, as of 22 May 2026.

From a market perspective, this leaves scope for further repricing if inflation proves more persistent than expected. Inflation-linked bonds have historically held up well during the build-up phase of energy-driven shocks. As oil prices rise, nominal bonds tend to incorporate higher inflation risk premia, while linkers benefit from widening breakevens and the mechanical accrual of realised inflation. Importantly, inflation risk premia do not appear to be fully embedded in nominal yields. The fact that longer-dated inflation forwards remain anchored suggests that markets are still looking through the shock, rather than pricing a sustained shift in inflation dynamics. Investor sentiment has also been robust: inflows into inflation-linked ETPs globally have been positive for 16 out of the last 17 months, with $8.3B added YTD – including $1.1B into eurozone linkers.[7]

Cumulative flows to linker ETPs, Jan 2020-May 2026



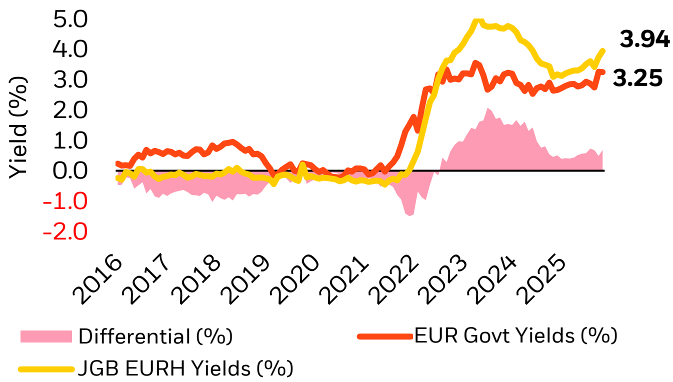
Source: BlackRock and Markit, as of 19 May 2026.

Taken together, rising near-term price pressures, limited pricing of medium-term risks and a still-compressed inflation risk premium support a constructive view on inflation-linked bonds. In an environment where the inflation path is uncertain and difficult to model, they offer both a direct hedge and potential diversification against scenarios where inflation proves more durable than currently expected.

3. Diversifying for uncorrelated upside

Alongside cash and inflation-linked bonds, we see selective opportunities across global government bond markets, particularly where macro regimes are shifting more materially. In Japan and Brazil, higher yields and changing policy dynamics are creating a more differentiated opportunity set for investors seeking income, diversification and potential portfolio ballast. Our analysis also shows that the average EMEA multiasset portfolio has a sizeable (15.7pp) underweight to EMD versus Global Agg.[8]

JGB EUR-Hedged Yields vs EUR Government Bonds



Source: BlackRock, Bloomberg, as of 30/04/2026. Indices used for yields are Bloomberg Japan Treasury and Bloomberg Euro Treasury Bond Index. Hedging costs based on 3m annualised FX forwards.

Our Fixed Income strategists believe JGBs now present a more attractive and differentiated opportunity set than at any point in the past decade. As the world's second-largest government bond market, Japan offers deep liquidity, efficient execution and strong ETF tradability. The return of yield has improved JGBs' appeal, especially for foreign investors accessing the market on a currency-hedged basis. USD-hedged JGB yields are now c.5.4%, versus c.4.2% for US Treasuries, while EUR-hedged yields are closer to 5.6% versus c.3.3% for euro area sovereigns.[9]

The improvement in valuations reflects Japan's broader macro regime shift from decades of deflation towards a more sustained inflation backdrop – supported by stronger wage growth, tighter labour markets and ongoing pass-through from higher energy costs. Yet the Bank of Japan has maintained a gradual approach to policy normalisation, in contrast to the more aggressive tightening cycles seen recently in other DMs.

These dynamics are also reshaping the yield curve. Dislocations are most visible in the 5-10Y segment, which is increasingly acting as the market's adjustment mechanism, reflecting evolving expectations for the medium-term inflation and policy path.

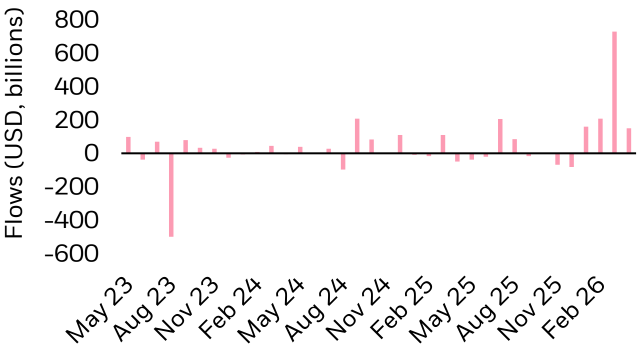
Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

4, 5, 9 Source: Bloomberg, as of 10 May 2026. **6** Source: Goldman Sachs, as of 7 May 2026. **7** Source: BlackRock and Markit, as of 21 May 2026 **8** Source: BlackRock Investment and Portfolio Solutions EMEA, BlackRock Aladdin, Morningstar, as of 19 May 2026. Portfolio average allocation based on 166 EMEA moderate risk multi-asset portfolios.

While supply-demand dynamics at the long end remain relevant episodically, the dominant driver of yields YTD has been macro: higher domestic inflation, rising fiscal concerns and spillover from elevated global yields. Over time, moderation in realised inflation could compress some premia currently embedded in longer-dated bonds, but without a more decisive policy response, markets are likely to continue pricing higher uncertainty.

Combined with historically lower volatility than other major developed bond markets, this backdrop is increasingly attracting global investors seeking higher carry alongside diversification and relative stability. Reflecting this shift, our Japan Government Bond UCITS ETF has grown from $83m at the start of the year to more than $1B in assets today, supported by a series of sizeable allocations.[10] Taken together, improved carry, rebuilding risk premia and stronger inflows suggest JGBs are evolving from a yield-starved market into one offering increasingly compelling opportunities for hedged global investors.

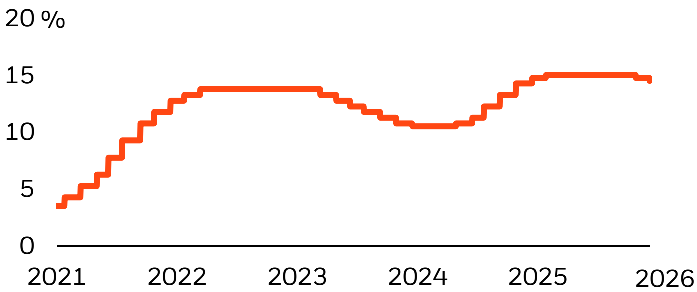
Monthly flows into EMEA-listed JGB ETPs, May 2023-Apr 2026



Source: BlackRock and Markit, as of 30 April 2026.

Brazilian local bonds remain one of the more compelling opportunities across emerging markets (EM), although the drivers have evolved in recent months. The earlier selloff in local rates, driven by fading expectations for aggressive easing, has reset valuations to more attractive levels. At the same time, Brazil offers one of the highest real yield profiles in the investable universe, with double-digit ex-ante real rates providing a substantial buffer against inflation uncertainty and external volatility.

Brazilian Selic Rate, 2021-2026 YTD



Source: Bloomberg, as of 21 May 2026.

This elevated carry backdrop has become increasingly relevant with the timing and extent of global easing cycles now delayed, effectively extending the window over which investors can earn high real yields.

Unlike many EM peers, Brazil sits on the favourable side of the current terms-of-trade shock as a major commodity and energy exporter, supporting both the BRL and local rates markets. High-carry currencies like the BRL have continued to perform well, with terms-of-trade improvements a key driver of returns alongside traditional carry dynamics.[11]

At the same time, the Central Bank of Brazil has taken a cautious approach to easing, acknowledging rising inflation forecasts and the risk of second-round effects from higher energy prices. With the Selic rate still at restrictive levels and potential for both slower and shallower cuts than previously expected, real yields are set to remain elevated for longer.

From a market structure perspective, local curves have already adjusted materially to this new reality: the opportunity has shifted from anticipating policy easing to harvesting carry in a higher-for-longer environment. Political considerations – particularly the upcoming presidential election – are beginning to enter the narrative, although historical market outcomes across cycles have varied considerably, with domestic cyclicals and rate-sensitive assets often supported in the run-up period. Our Global Fixed Income team, moreover, sees the election cycle presenting important alpha opportunities in Brazilian rates.

In an environment of uncertain rate paths and elevated volatility, our iShares Brazil LTN BRL Govt Bond UCITS ETF (BLTN) offers a differentiated exposure, exclusively holding zero-coupon bonds (Letras do Tesouro Nacional) that eliminate reinvestment risk from coupon payments. The fund tracks an index with a duration of just 2.2 years, allowing investors to take materially less interest rate risk than broader EM local currency bond allocations while still capturing attractive carry, with yields at c.13.6%.[12] This combination of high yield and limited duration sensitivity provides a compelling risk-adjusted entry point into Brazilian local rates.

Taken together, high real yields, supportive external dynamics and a more measured easing cycle leave Brazilian local bonds well positioned to deliver attractive carry and relative resilience within EM.

Zooming out to a more holistic view on EMD, our Global Fixed Income team notes that the global economy has absorbed the energy shock better than expected – and EM fundamentals and structural reforms continue to improve. IMF Spring meetings reinforced this view, with most participants highlighting a cautiously constructive tone on EMD. Light investor positioning, returning flows, and contained net issuance are also reinforcing a healthy technical base for EMD, the team notes.

GFI also notes that EMD can be a fertile ground for alpha generation, with a $4T investable universe spanning 70+ countries and 200+ sovereign and quasi sovereign issuers[13] – opening ample idiosyncratic opportunities amid dispersion.

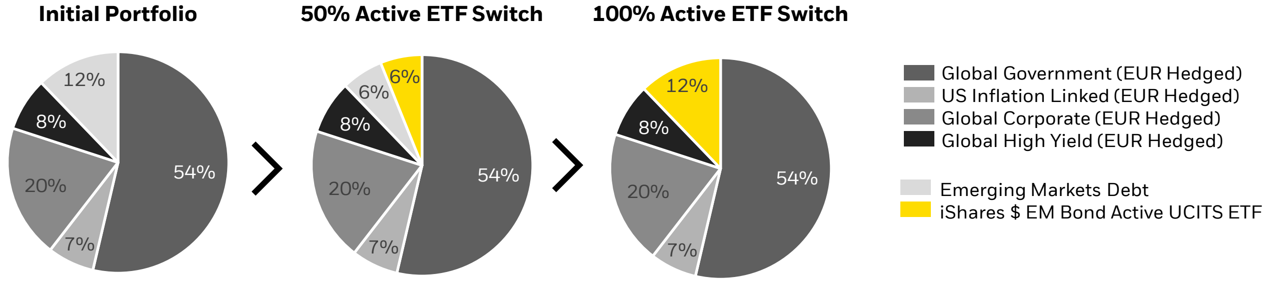
Our portfolio analysis shows that enhancing fixed income allocations with active EMD bond ETFs results in minimal risk changes and improved historical returns – see case study on the following page.

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.

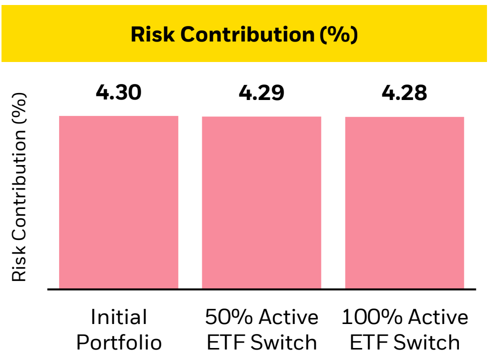
10, 11 Source: BlackRock, as of 30 April 2026. **12** Source: iShares.com, as of 10 May 2026. **13** Source: BlackRock Fundamental Fixed Income, as of April 2026.

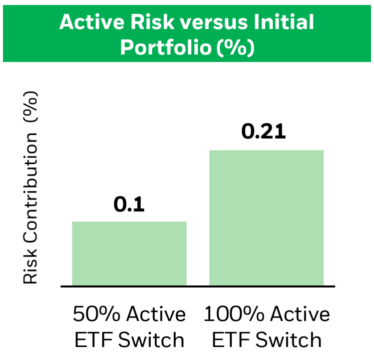
Enhancing Fixed Income Allocations with Active EMD Bond ETFs

We begin with the fixed income allocation of the Moderate Strategic EUR model and assess the impact of replacing either half or all of the EMD exposure with the iShares $ EM Bond Active UCITS ETF (ISOV).



Forward Looking Risk Metrics (%)





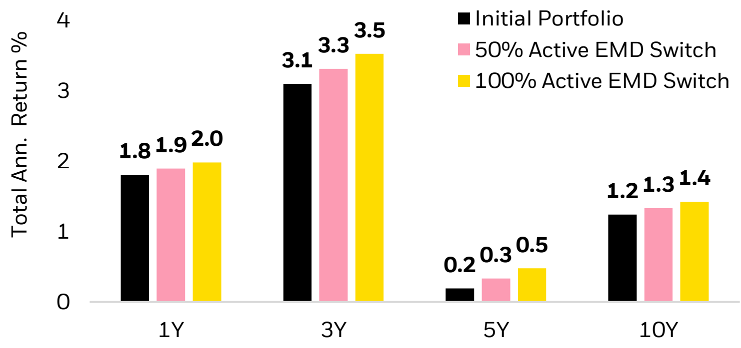
Source: BlackRock Aladdin as of 31/03/2026. Currency: EUR. Note that the risk metrics for the iShares $ EM Bond Active UCITS ETF is the representative portfolio - BGF Emerging Markets Bond Fund. Asset Class Indies, Global Government (EUR Hedged) is BBG Global Aggregate Treasury Index, 100% EUR Hedged; US Inflation Linked (EUR Hedged) is BBG US Government Inflation-Linked Bond Index 100% EUR Hedged; Global Corporate (EUR Hedged) is BBG Global Aggregate Corporate Index 100% EUR Hedged Index; Global High Yield (EUR Hedged) is BBG Global High Yield Corporate 100% EUR Hedged Index and Emerging Markets Debt is JP Morgan EMBI Global Diversified Index.

We observe that switches in exposure to the iShares $ EM Bond Active UCITS ETF result in minimal risk changes and improved historical returns.

12-Month Returns in EUR Starting 1st April Each Year (%)

	'16-'17	'17-'18	'18-'19	'19-'20	20'-'21	21'-'22	22'-'23	23'-'24	24'-'25	25'-'26
Starting Portfolio	2.2	-0.2	3.8	3.4	2.4	-3.0	-5.0	3.7	3.8	1.8
50% IG Switch	2.5	-0.3	3.8	3.0	2.8	-2.8	-5.1	4.2	3.9	1.9
100% IG Switch	2.7	-0.4	3.7	2.6	3.3	-2.6	-5.2	4.6	4.0	2.0

Performance to Date (%)



Risk-Return Metrics (%)

	Starting Portfolio	50% Active ETF Switch	100% Active ETF Switch
Annualised Return, %	1.36	1.47	1.59
Annualised StdDev, %	4.35	4.35	4.35
Return/Risk	**0.31**	**0.34**	**0.37**
Max Drawdown Return, %	-12.66	-12.67	-12.67

The figures shown relate to past performance. 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. Source: BlackRock, MPI, Morningstar. Time Period: 01/04/16 – 31/03/26. Data Frequency: month. Currency: EUR. All historical fund performance is net. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. This information demonstrates, in part, the firm's Risk/Return analysis. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. Note that the risk metrics for the iShares $ EM Bond Active UCITS ETF is the representative portfolio – BGF Emerging Markets Bond Fund – X2 share class (Dealing Net), shown in EUR on a NAV price basis, with income reinvested, net of expenses and gross of management fees, where applicable. The fee structure of the Institutional (I2) USD share class includes Ongoing Charges of 0.72%..

BlackRock Emerging Markets Equity Strategies Fund

The Fund is actively managed and the IA has discretion to select the Fund's investments. In doing so, the IA will refer to the MSCI Emerging Markets Index (the "Index") when constructing the Fund's portfolio, and also for risk management purposes to ensure that the active risk (i.e. degree of deviation from the index) taken by the Fund remains appropriate given the Fund's investment objective and policy. The IA is not bound by the components or weighting of the Index when selecting investments. The IA may also use its discretion to invest in securities not included in the Index in order to take advantage of specific investment opportunities. However, the geographical scope of the investment objective may have the effect of limiting the extent to which the portfolio holdings will deviate from the Index. The Index should be used by shareholders to compare the performance of the Fund.

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Risk Warnings

Investors should refer to the prospectus or offering documentation for the funds full list of 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.

Product Risks

iShares $ TIPS UCITS ETF USD (Acc)
Concentration Risk, Counterparty Risk, Credit risk, Liquidity Risk

iShares $ Ultrashort Bond UCITS ETF USD (Acc)
Counterparty Risk, Credit Risk (Non SRRI), Liquidity Risk

iShares € Inflation Linked Govt Bond UCITS ETF EUR (Acc)
Concentration Risk, Counterparty Risk, Credit risk, Liquidity Risk

iShares € Overnight Rate Swap UCITS ETF
Counterparty Risk, Derivative Risk, Equity securities, Swap Agreements (Non SRRI)

iShares Brazil LTN BRL Govt Bond UCITS ETF (DE)
Counterparty Risk, Credit risk, Credit Risk (Non SRRI), Currency Risk, Emerging Market Government Fixed Income Securities Risk, Emerging Markets Risk, Interest Rate Risk, Liquidity Risk

iShares Japan Govt Bond UCITS ETF EUR Hedged (Acc)
Concentration Risk, Counterparty Risk, Credit risk, Credit Risk (Non SRRI), Liquidity Risk

iShares $ EM Bond Active UCITS ETF USD (Acc)
Combined Credit and non-investment Grade Risk, Credit risk, Emerging Market Government Fixed Income Securities Risk, Emerging Markets Risk, ESG risk (fund screening), Liquidity Risk

BGF Emerging Markets Local Currency Bond Fund
Counterparty Risk, Credit Risk, Currency Risk, Derivative Risk, Emerging Market Government Fixed Income Securities, Emerging Markets, Liquidity Risk

Description of Product Risks

Combined Credit and non-investment Grade Risk
Changes to interest rates, credit risk and/or issuer defaults will have a significant impact on the performance of fixed income securities. Non-investment grade fixed income securities can be more sensitive to changes in these risks than higher rated fixed income securities. Potential or actual credit rating downgrades may increase the level of perceived risk.

Concentration Risk
Investment risk is concentrated in specific sectors, countries, currencies or companies. This means the Fund is more sensitive to any localised economic, market, political or regulatory events.

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 Share Class to financial loss.

Credit risk
Credit risk, changes to interest rates and/or issuer defaults will have a significant impact on the performance of fixed income securities. Potential or actual credit rating downgrades may increase the level of risk.

Credit Risk (Non SRRI)
The issuer of a financial asset held within the Fund may not pay income or repay capital to the Fund when due. If a financial institution is unable to meet its financial obligations, its financial assets may be subject to a write down in value or converted (i.e. "bail-in") by relevant authorities to rescue the institution.

Currency Risk
The Fund invests in other currencies. Changes in exchange rates will therefore affect the value of the investment.

Derivative Risk
Derivatives may be highly sensitive to changes in the value of the asset on which they are based and can increase the size of losses and gains, resulting in greater fluctuations in the value of the Fund. The impact to the Fund can be greater where derivatives are used in an extensive or complex way.

Emerging Market Government Fixed Income Securities Risk
Fixed income securities issued or guaranteed by government entities in emerging markets generally experience higher 'Credit Risk' than developed economies.

Emerging Markets Risk
Emerging markets are generally more sensitive to economic and political conditions than developed markets. Other factors include greater 'Liquidity Risk', restrictions on investment or transfer of assets, failed/delayed delivery of securities or payments to the Fund and sustainability-related risks.

Equity securities
The value of equities and equity-related securities can be affected by daily stock market movements, political factors, economic news, company earnings and significant corporate events.

ESG risk (fund screening)
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.

Interest Rate Risk
Fixed income asset prices can decline significantly when interest rates rise. Long-term bonds are more sensitive to interest rate changes given the amount of payments accumulating in the future, making them more volatile compared to short-term bonds.

Liquidity Risk
The Fund's investments may have low liquidity which often causes the value of these investments to be less predictable. In extreme cases, the Fund may not be able to realise the investment at the latest market price or at a price considered fair.

Swap Agreements (Non SRRI)
The Fund's ability to track the benchmark's performance is reliant on the counterparties to continuously deliver the performance of the benchmark in line with the swap agreements (i.e. counterparty risk) and would also be affected by any spread between the pricing of the swaps and the pricing of the benchmark. If any swap counterparty fails to provide sufficient assets as security for amounts owed to the Fund, there might be an increased counterparty risk exposure at a given time.

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