BlackRock Global Funds (BGF) Hedged Share Classes Explained

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BlackRock offers currency hedged share classes on a selection of funds within its flagship BlackRock Global Funds (BGF) range. The hedged share classes aim to provide investors with a return correlated to the base currency performance of the fund, by reducing the effect of exchange rate fluctuations between the base and hedged currency.

During times of market volatility, fluctuations in the short term exchange rate and the underlying security market can be more marked. It is important to note that the hedge is not perfect - it aims to reduce, not eliminate, currency risk and mismatches between the currency and invested positions of the fund and the hedged share class may result.

Hedged share classes offer a number of advantages to investors:

- Offer the convenience of dealing in currencies other than a fund's base currency
- Lessen the exposure to movements between the dealing currency and the base currency of the fund throughout the life of the investment
- Typically deliver returns more closely correlated with those of the equivalent base currency share class, adjusted for the relevant interest rate differential
- Create a broader investor universe, leading to increased shareholder diversification

Hedged share classes do not offer:

- Hedging of underlying currency positions within a fund
- Added value through active currency selection
- Exactly the same returns as the equivalent base currency share class

Key considerations:

- Before investing in a hedged share class where it is available, investors should bear in mind that they are electing to gain exposure to the currency of the hedge. This currency may strengthen or weaken against other major world currencies in the future
- All gains/losses or expenses arising from the hedging transactions are borne separately by the shareholders of the respective hedge share class

How does the hedge operate?

The hedging strategy employs a currency overlay to hedge the Net Asset Value (NAV) of the relevant share class. This strategy is applied to funds with underlying assets in one or multiple currencies and is designed to reduce, but not eliminate, currency exposure between the base currency and the hedging currency.

- Purchases of a hedged share class are converted into the base currency of the fund at the spot rate
- As part of the same contract, the resultant base currency exposure is hedged at the forward foreign exchange (FX) rate
- The hedging transaction is rolled at least on a monthly basis, crystallising any gain or loss on the hedge
- The gain or loss on the currency protection always forms part of the related hedged share class daily NAV calculation. However, it remains effectively uninvested in underlying fund assets until the profit or loss is realised, which occurs when the hedge is rolled over
- During the period of the hedge, the volatility in exchange rates and in underlying fund assets are monitored. In periods of high volatility, the forward FX transaction maybe rolled earlier, hence crystallising any gain or loss and reinvesting it into the underlying fund more rapidly than would otherwise have been the case. This process seeks to mitigate but will not eliminate deviation in returns between the hedged share class and the base currency share class

What is the impact on portfolio management?

The investment management of the funds offering hedged share classes is not affected. This is because it is the NAV of the relevant share class which is hedged, not the underlying assets. This process is cheaper and simpler than implementing a "line-by-line" hedge on the underlying instruments, and less distracting for the portfolio manager.

Expected returns

Broadly, the expected returns of the currency hedged share class reflect the interest rate differential between the base currency and the hedged share class. This may result in a positive or negative effect, depending on prevailing rates. This is illustrated with the following examples:

Example 1: EUR Hedged Shares on USD Base Currency	
USD Total Return	**10.00%**
USD Interest Rate	0.25%
EUR Interest Rate	2.00%
Interest Rate Differential	**+1.75%**
EUR Total Return	11.75%

Example 2: SGD Hedged Shares on USD Base Currency	
USD Total Return	**10.00%**
USD Interest Rate	0.25%
SGD Interest Rate	0.15%
Interest Rate Differential	**-0.10%**
SGD Total Return	9.90%

These examples are for illustrative purposes only. Interest rates are likely to change.

Other factors which may impact returns

There are other factors which may impact returns, and result in the hedge not being perfect. These include:

- any unrealised profit/loss on the currency forward remains uninvested until the hedge is rolled over any profit or loss is crystallised
- transaction costs which will erode a small portion the overall return
- short term interest rate changes
- the timing of the market value hedge adjustments relative to the fund's valuation point
- intra-day volatility of the value of the base currency assets in relation to the existing hedge
- the hedge may not always be at 100%, to avoid transaction costs of minor adjustments

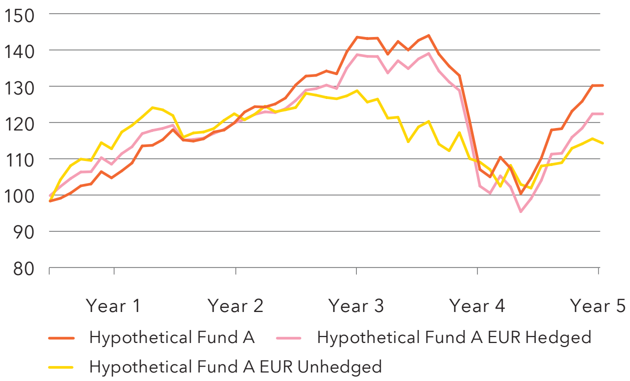
While the fund or its authorised agent may attempt to hedge currency risks, there can be no guarantee that it will be successful in doing so and it may result in mismatches between the currency position of the fund and the hedged share class. The hedging strategies may be entered into whether the base currency is declining or increasing in value relative to the relevant currency of the hedged share class and so, where such hedging is undertaken, it may substantially protect investors in the relevant class against a decrease in the value of the base currency relative to the hedged share class currency, but it may also preclude investors from benefiting from an increase in the value of the base currency.

All gains/losses or expenses arising from hedging transactions are borne separately by the shareholders of the respective hedged share class. Given that there is no segregation of liabilities between share classes, there is a remote risk that, under certain circumstances, currency hedging transactions in relation to one share class could result in liabilities which might affect the NAV of the other share classes of the same fund.

How will the hedged share class behave relative to the base currency?

As an example only, here is the performance of Hypothetical Fund A share class in base currency (USD) versus the unhedged EUR share price and the hedged EUR share price:

Hypothetical Fund Hedged Share versus Base Currency Share



The above is a hypothetical example and does not represent the return of any specific investment.

This illustration shows that even during periods of high market volatility, hedged share class investors can receive a return more closely correlated to the base currency return. However, there can be no guarantee that it will be successful.

During periods of extreme volatility, there can be a greater mismatch between the invested position of the fund and that of the hedged share class as a result of any unrealised profits or losses in the hedged shareclass. As indicated above, the process of rolling and re-setting the hedge crystallises any unrealised profits or losses but, if intra-period volatility is sufficiently high, the difference in invested position can have a noticeable impact on relative returns of the two share classes.

It should also be noted that hedged share classes in non-major currencies may be affected by the fact that capacity of the relevant currency market may be limited, which, together with other related factors, could further affect the volatility of the hedged share class.

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For more information

www.blackrock.com/sg | clientservice.asiapac@blackrock.com | +65 6411 3000

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