BlackRock

The Global Allocation Fund:

Managing through the present while investing for the future

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The investment team at the BlackRock Global Allocation Fund recently hit their one-year anniversary of working under the leadership of Rick Rieder, so we got the group together to discuss how the team's investment process has evolved over an extraordinarily challenging period.

Rick, what are the two or three things stand out from your experience in managing the Global Allocation team over the last year?

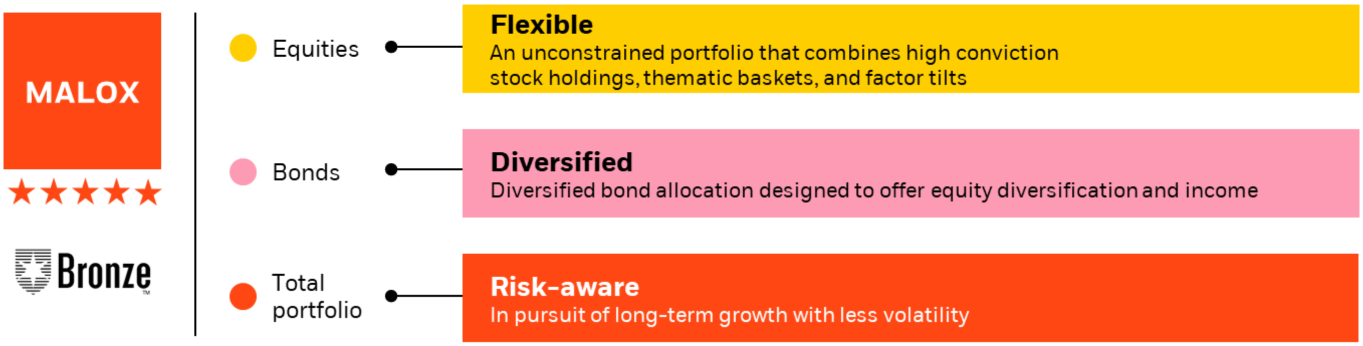
The first thing I'd like to say is that it's a privilege to work with the talented team at Global Allocation, and we've found many ways to share ideas between this team and the Global Fixed Income group (where Rick has been Chief Investment Officer for nearly a decade). I'd also point out that the past year has been an extraordinary period in which to manage client capital, as we saw the tail-end of an 11-year bull market in equities give way to a pandemic and health crisis in early-2020 that may well take much of the world into economic recession and will likely take time to resolve. Still, it's during periods like this when the idea-sharing between these teams becomes most valuable.

It's also times like this when the flexibility, diversification and resilience built into the Global Allocation (GA) portfolio can truly shine. To expand on that a bit; at GA we manage a globally diversified, unconstrained, multi-asset-class strategy that can invest across the capital stack and can own securities/implement strategies that are not in our benchmark and that are often extremely difficult (if not impossible) to execute in a timely manner as an individual (see Figure 1). That's particularly the case if you have things going on in your life other than studying the capital markets and how they can be most effectively navigated.

Figure 1

INST: MALOX • A: MDLOX • C: MCLOX

BlackRock Global Allocation Fund Portfolio Philosophy



A focus on growth combined with lower risk to help people stay invested across markets.

Source: Morningstar as of 6/30/2020. Morningstar category is represented by the World Allocation Fund category. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its 3-, 5-, and 10-year Morningstar Rating metrics. Ratings are based on risk-adjusted total returns, are determined monthly and are subject to change. The Global Allocation Fund received a Morningstar Rating of 5 stars for the 3-year period, 4 stars for the 5-year period and 4 stars for the 10-year period, rated against 399, 342 and 207 World Allocation Funds, respectively. Morningstar Rating is for the Institutional share class only; other classes may have different performance characteristics. **Past performance is no guarantee of future results**. More information available in "Important Notes" section.

The opinions expressed throughout this paper are as of June 30, 2020 and are subject to change at any time due to changes in market or economic conditions.

As a case in point, the past few decades have witnessed some tremendous changes to the structure of the U.S., and indeed the global, economy, and it's absolutely critical that investors position themselves on the right side of these evolutions. For example, the demographic trend of population aging in developed markets holds important implications that point to slower economic growth in these regions in the decade to come, shifting consumption patterns, as well as an enormous need for income-producing assets. There are implicit industry and corporate winners and losers in meaningful changes like this.

As another example, the technological innovation of the past decade, or so, has delivered extraordinary efficiencies in product pricing, has begun to disrupt the business models of long-established industries, and at the level of the macroeconomy, has moderated inflation from the rates previously perceived as normal. In the midst of these changes, we think it's critical to position portfolios in the industries and companies that comprise what might be called "the fast rivers of cash flow," and at the same time allocate that capital in the most efficient manner possible across the capital stack.

Rick, can you expand on what you mean by "fast rivers of cash flow?"

Absolutely, generally speaking, the industries and corporations that comprise the fast rivers of cash flow are those that benefit most from technological innovation, either because they're driving the development of new technologies, or they're at the forefront of implementing them in novel ways to disrupt established business methods. One of the most commonly cited examples of this is the sea change we've witnessed over the past decade in how goods/services are sold/distributed, with online purchasing taking an ever-greater share of consumer spending and brick-and-mortar stores suffering greatly. The advent of the coronavirus health crisis, and the practice of "social distancing" may even end up accelerating the increasing trend toward online consumption that was already firmly entrenched prior to the crisis.

There are many other examples we can look to, involving artificial intelligence, advanced robotics in manufacturing, and the rise of smartphones and the "app economy." In 2020, none of this seems particularly new anymore, but we're continually astounded by the many investors that aren't adequately implementing changes to their portfolios, by directing capital toward those locations that are winning the war for cash flow on the technological front. Another key point to understand here is that these "fast river" companies are able to reinvest huge amounts of their profits into research and development to help create the opportunities of the next 20 years- certain firm's advances in the area of quantum computing is a great example. The success many of these companies have seen may well bring heightened regulatory scrutiny in the years to come, so pricing the political risk properly is critical too.

Finally, a related point that's important to make is that with the flexibility we have in GA, to invest across the capital stack, and globally, it's also critical that we deploy client capital in the most efficient manner possible. Functionally, what does that mean? One example we can look to involves the fact that as interest rates have come down over the past year, there was a great deal of interest in investing in the so-called "bond proxies" in the equity world, such as firms in the utilities and consumer staples spaces, but we think there's a real question as to why you'd choose to fund these kinds of companies at the equity segment of the capital stack. We think a more efficient use of capital would fund equity risk in faster growing areas of the economy, such as the technology or healthcare sectors, saving exposure to utilities and staples for the debt side of asset allocation. Furthermore, utilities tend to be highly regulated companies with fairly stable and predictable cash flows, so there are good reasons why it makes more sense to engage these firms in bond form. On the tech side of the equation, the reason to own their equity is to capture the high growth potential in one of the areas of the economy that actually displays excellent growth fundamentals, even as overall economic growth remains muted. In the end, you can create real portfolio efficiencies, build income in the places that are stable and capture upside potential in those places that represent the fast rivers of cash flow.

Russ, talk about the philosophy behind Global Allocation's systematic tilts and explain how you implement them?

What we're aiming to do in the GA portfolio is institutionalize a process whereby we can manage, and when necessary neutralize, the various factor exposures in the portfolio. The basic goal is to use modern portfolio construction and risk management tools to truly allow the fund to perform as an "all weather" investment vehicle. What does that mean in practice? It means that we want the portfolio to see gains in both periods in which growth, or value, segments are leading the markets. Further, we'll use duration as a hedge to our equity risk, but we'll also take tactical positions in gold and select currencies, which can also provide hedging capabilities. In the end, the portfolio's overall exposure to growth versus value factors is more balanced today than it has been historically, which as mentioned should help the portfolio perform under various market conditions.

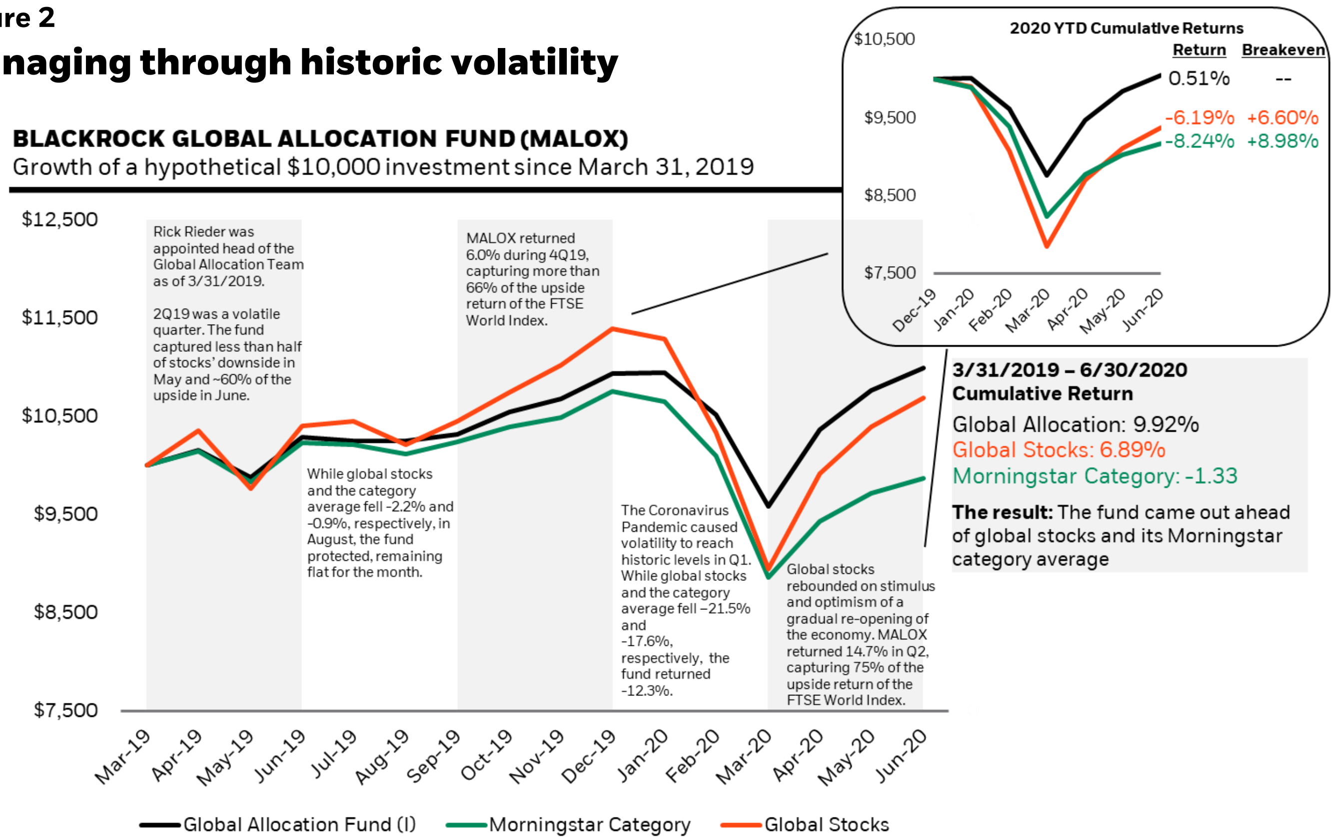
Overall, the systematic strategies typically account for between 6% and 8% of total portfolio exposure, and they allow the team to view the portfolio through a different prism; to more fully understand the style factors that the portfolio is exposed to. As an example, a 60% equity/40% fixed income portfolio that is made up of defensive, and high quality, equities and government bonds is going to perform very differently from one that is made up of cyclical equities and high-yield bonds.

While both are technically classified as a classic "60/40 portfolio," they have very different factor exposures and risk profiles due to the underlying characteristics of the segments of each asset class that you're exposed to. Looking at the portfolio through a factor lens allows you to understand predominant style exposures and provides a more granular way to both express deliberate views and minimize unintended exposures.

Another way that we like to analogize our adoption of systematic tilts is to liken them to "vitamins." In other words, people consume vitamins to supplement their regular diets and achieve more optimal levels of personal health. We employ systematic tilts in the GA portfolio in order to either partially off-set certain factor exposures that can inadvertently develop as a result of our core/fundamental portfolio construction process, or to supplement those exposures where the portfolio managers have concluded that the portfolio may be deficient. Typically speaking, our systematic baskets will be implemented in a manner so as not to disrupt the portfolio's primary exposures (be they equity beta, region, country, sector, currency, or other risk exposure). Finally, we also use a customized minimum-volatility basket, which we've put in place as a partial off-set to unwanted volatility that can inadvertently arise from some of the value-oriented positions within our core/fundamental holdings. That has helped hold down the portfolios' overall volatility level, relative to equity market volatility, and in turn has helped performance during periods of heightened volatility (see Figure 2).

Figure 2

Managing through historic volatility



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Kate, as Head of Thematic Strategy, how do you think about the thematic investment baskets within Global Allocation and the role that they play?

As Rick indicated at the beginning of our conversation, at GA we look to identify trends across global industries that are economically disruptive, and we explore how best to take advantage of the eventual market dispersion that results between the disruptors and those disrupted. In this way, we seek to add incremental, and durable, alpha to the portfolio overall. Generally speaking, the thematic strategies we employ are focused on opportunities within industries that we believe will drive growth for years to come, further refining both the bottom-up fundamental analysts' research and the team's top-down views. In a sense, then, these themes represent the portfolio's longer-term orientation, they're not based on short-term views.

The thematic positions seek to capitalize on macro trends identified in the marketplace, and often developed through the regular conversations that we're having with the team's fundamental analysts. These opportunities (particularly in mid/small/emerging market stocks), however, can often be difficult to incorporate into the strategy on a security-by-security basis, due to liquidity and/or market capitalization limitations. As a result, the team has the ability to access these investment opportunities by employing a "basket approach" that often comprises dozens of securities at very small individual percentages. Overall, the team thinks that incorporating thematic baskets to gain access to these desired exposures is often preferable to trying to allocate to a select few equity holdings that possesses the characteristics the team is seeking to exploit.

Some of the current thematic baskets being applied within the portfolio include an emerging market dividend yield strategy, a basket focused on the build-out relating to the digital transformation toward 5G, a basket focused on the rising Chinese consumer, companies positioned to benefit for increased cyber security demand and exposure to healthcare opportunities in Brazil, to take a few examples.

Another point that I think is critical to emphasize is the dynamism with which the team can manage the portfolio. What I mean by this is that it's very important to understand the economic and market regimes one is operating in, as the changes to regime can influence true asset class correlations and diversification potential. In fact, as we've seen during periods of quantitative easing (QE) in the wake of the Global Financial Crisis, and more recently with the coronavirus health crisis, asset classes can have a tendency to move together, and various measures of market volatility are also suppressed. That's because central banks are dropping interest rates and buying assets, which simultaneously reduces the discount rate on all assets; producing this market dynamic. But even within these periods of QE, regimes shift and evolve, which speaks to the need to employ a process that is constantly evaluating asset class correlations and making required adjustments to the portfolio. This is the kind of thing we're very effective at doing here at the GA team.

As Russ was describing, volatility is a critical portfolio characteristic that we strive to optimize, so as to efficiently manage through the regime we are operating within, and by using instruments across the entire spectrum of assets dynamically, we can sometimes save or make hundreds of basis points of return for clients using these tools. As an example, we've recently been selling a significant amount of rate volatility against our longer duration position, as rate volatility is likely to plummet as rates all move lower across the curve. And, interestingly, if rates do move higher, on the back of the economic recovery we expect later this year, rate volatility could actually come down anyway, as it would be a sign of economic stabilization. Thus, being long duration and short volatility works as an effective convexity position in the portfolio.

David, you manage a world-class team of equity analysts, so talk about the process that's led to superior security selection.

Though it's not as discussed by some investment managers these days, we've doubled down on fundamental analysis. That's a definite differentiator. Roughly half of the book is now represented by about 120 equity names derived by careful fundamental analysis, with an additional 10% to 15% invested in the thematic and systematic baskets that Kate and Russ have described. Of course, when constructing these baskets, the process includes close collaboration with and input from our fundamental analyst team too. Still, what needs to be understood here is that fundamental analysis doesn't preclude the use of more quantitative tools and analysis. In fact, both fundamental and quantitative analysis are integral to the research process and help the team seek to identify potential opportunities and monitor each security held in the portfolio. Indeed, while the team examines a wide array of macro and micro factors, as well as company- and industry-specific considerations when evaluating a potential purchase, some of the specific metrics we look particularly closely at include a combination of expected free cash flow generation along with various relative valuation metrics, such as P/E, P/CF, P/B and EV/EBITDA.

As discussed a bit previously, we find cash flow analysis to be particularly useful when evaluating security desirability across a single company's entire capital structure. As might be expected from our discussion today, longer-term structural themes are often key components to an analysts' projections of a company's future cash flow potential, particularly when they're attempting to identify those regions of the market that Rick referred to as the "fast rivers of cash flow."

Analysts are required to provide a detailed investment thesis – including a quantified degree of conviction and estimated price target – for each equity security offered to the portfolio managers for potential inclusion to the portfolio. We include both the conviction levels and price targets as matters of record in the team's proprietary research tool, Mosaic, and they are available for all team members to view. And further, the team utilizes other quantitative investment tools and BlackRock resources, such as the Global Allocation Risk Dashboard and BlackRock's Aladdin, to augment its fundamental research and further evaluate portfolio positioning.

Finally, and perhaps uniquely, we have a number of experienced analysts that- while focused primarily on equities now- have very strong credit analysis backgrounds, and at times of severe market stress like this, those credit skills and perspectives are incredibly important to security selection, including in the equities space. Added to that; having an even greater connection to the Global Fixed Income team and credit analyst groups also provides for expanded opportunities to drive forward the efficient allocation of capital between the equity and debt segments of the corporate capital structure. GA has an immense toolbox for investing virtually anywhere in the world, across a huge range of securities, so working on a collaborative team with this flexibility is very rewarding.

Rick, based on what the team is doing and the landscape ahead, how should investors think about Global Allocation as a way to help achieve their desired outcomes?

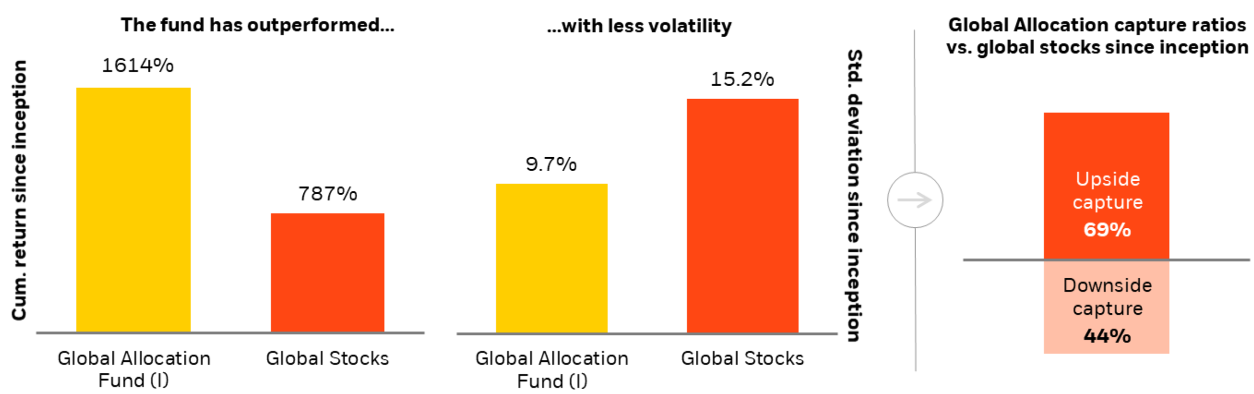
In terms of the economic and market landscape ahead of us, even before the coronavirus health crisis hit, we thought it was likely that we'd witness increased asset class and sector return dispersion, which underscores the importance of employing an unconstrained strategy in your portfolio, to both enable the team to take defensive measures when required and capitalize on investment opportunities. As we've mentioned, the fund has a vast investment universe and seeks growth from high-cash flow equities, equity diversification and income from bonds and uses hedging instruments to reduce portfolio volatility.

Two of the most common ways we see clients employing GA in their overall portfolios are either as a core diversifier within the portfolio, or as a defensive equity allocation, which gets to the fund's longtime objective of providing equity-like returns over a fully market cycle, with lower levels of volatility than equity markets. Obviously, I'm a big believer in the process and

BLACKROCK GLOBAL ALLOCATION FUND (MALOX)

Designed to seek a better outcome

Seeking returns competitive with global stocks, but at a lower level of volatility over a full market cycle.



Average annual total returns (%) as of June 30, 2020	1 year	5 years	10 years	Since Inception
Global Allocation Fund (Inst.)	6.85	4.49	6.34	9.49
FTSE World Index	2.74	7.17	9.99	7.21
Morningstar World Allocation Category	-3.32	2.70	5.44	
Morningstar World Allocation Percentile Rating	5	16	31	

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portfolio here, so I'd also suggest that the fund can serve as the central core holding of a portfolio that investors can then build other desired exposures around. To that end, I'll also say that those of us that manage the fund hold significant investments in it, so we're clients too, and we believe deeply that this process holds a great potential to improve returns with reduced levels of risk and can help people and institutions achieve their goals and objectives.

Finally, I think the beauty of our platform is our ability to look out across the asset class landscape and find value quickly. In these tumultuous times, a good deal of return can be had in finding those assets that are experiencing anomalous capital flows, or disruptive price-action for some technical reason not related to underlying fundamentals. Nobody individually, even if you have spent 40 years as a market professional, can identify regime, manage correlations/diversification/volatility dynamically without world-class risk systems, analytics, access to information and flow, and try to put it all together across the globe with deep fundamental research across all of the asset classes. The era of just buying dull market beta expressions is over, I think, and the times we're facing, when volatility explodes (and the return differentials are epic), are precisely when the flexibility and opportunistic character of a fund like GA is needed most. Much of the real money to be gained for clients is in being able to pan across the universe to find where the opportunity is and to exploit it as quickly as possible with a myriad of efficient tools and the risk systems to manage them well.

Want to know more?

Read more market insights from Rick Rieder on the BlackRock Blog and @RickRieder

You should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus and summary prospectus contain this and other information about the fund and are available, along with information on other BlackRock funds, by calling 800-882-0052 or at blackrock.com. The prospectus and, if available, the summary prospectus should be read carefully before investing.

Important Notes:

The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods.

The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected. Morningstar has awarded the Fund a Bronze Medal (effective 4/12/19). Fewer than 10% of US open-end funds hold medalist ratings. The Morningstar Analyst Rating is not a credit or risk rating. It is a subjective evaluation performed by the manager research analysts of Morningstar. Morningstar evaluates funds based on five key pillars, which are process, performance, people, parent, and price. Analysts use this five pillar evaluation to determine how they believe funds are likely to perform over the long term on a risk-adjusted basis. They consider quantitative and qualitative factors in their research, and the weighting of each pillar may vary. The Analyst Rating scale is Gold, Silver, Bronze, Neutral, Negative. A Morningstar Analyst Rating of Gold, Silver, or Bronze reflect an Analyst's conviction in a fund's prospects for outperformance. Analyst Ratings are continuously monitored and reevaluated at least every 14 months. The Morningstar Analyst Rating should not be used as the sole basis in evaluating a mutual fund. Morningstar Analyst Ratings involve unknown risks and uncertainties which may cause Morningstar's expectations not to occur or to differ significantly from what we expected. For more detailed information about Morningstar's Analyst Rating, including its methodology, please go to http://corporate.morningstar.com/us/documents/MethodologyDocuments/AnalystRatingforFundsMethodology.pdf

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