

U.S. MORTGAGE FUND

BLACKROCK®

4Q 2018 COMMENTARY

Inst: MSUMX • A: BMPAX • C: BMPCX

- ▶ The fund posted returns of 1.45% (Institutional shares) and 1.39% (Investor A shares, without sales charge) for the fourth quarter of 2018.
- ▶ The main drivers of performance were active trades within the agency mortgage market; active benchmark strategies; out-of-benchmark allocations; and macro overlay strategies.
- ▶ The fund remained overweight in agency mortgage-backed securities (MBS) relative to the benchmark. However, it was positioned more defensively, favoring sectors such as 15-year MBS and Government National Mortgage Association securities. The fund continued to hold a core allocation to collateralized mortgage-backed securities (CMBS) and agency collateralized mortgage obligations (CMOs), which benefit the fund's carry profile. Finally, the fund was underweight duration (sensitivity to interest rates) relative to the benchmark.

Contributors	Detractors
The fund's allocation to well-structured agency CMOs contributed to performance, as did its allocations to asset-backed securities.	Active trades within the agency mortgage market detracted – in particular, an overweight exposure to higher-coupon MBS relative to lower-coupon MBS was detrimental. Macro overlay strategies underperformed, driven by the fund's tactical duration positioning. Allocations to CMBS detracted from performance too, along with active benchmark strategies that sought to optimize the blend of to-be-announced contracts and specified pools relative to the benchmark.

Further Insight

Although the fund remains overweight in agency MBS, we reduced its overweight owing to valuations that were less compelling relative to comparable high-quality fixed income spread sectors, which have seen widening. The fund continues to favor higher coupons relative to lower coupons, as valuations appear attractive relative to the underlying fundamentals. The fund holds a core allocation to CMBS and agency CMOs for carry, and has been pursuing an increased allocation to agency CMBS, owing to valuations that have reached attractive levels versus low-coupon MBS. In terms of rates risk, the fund covered its duration overweight, and ended the quarter with a modest underweight relative to the benchmark.

Overall Morningstar Rating®: Institutional



Rated against 876 Intermediate-Term Bond Funds, as of 12/31/18, based on risk-adjusted total return. Ratings are determined monthly and subject to change. 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 (if applicable) Morningstar Rating metrics.††

Portfolio Management

Matthew Kraeger, Siddharth Mehta

TOP 10 HOLDINGS

(% of Net Assets as of 12/31/18)

1. Gnma2 30yr 2016 Production	14.9
2. Fnma 15yr Tba(reg B) 3 01/17/2019	13.0
3. Gnma2 30yr Tba(reg C) 4 01/23/2019	9.4
4. Fnma 30yr Tba(reg A) 5 01/14/2019	9.2
5. Fnma 30yr Tba(reg A) 4.5 02/13/2019	5.7
6. Fnma 30yr 2011 Production	4.8
7. Gnma2 30yr Tba(reg C) 4.5 01/23/2019	4.0
8. Fnma 30yr 4.5% Mlb 125k 2018	3.8
9. Fgold 30yr Tba(reg A) 4 01/14/2019	3.4
10. Fgold 30yr Tba(reg A) 3 01/14/2019	3.3

Invests primarily in mortgage-related securities of any maturity, including U.S. government and agency securities, securities issued by U.S. government instrumentalities and U.S. government-sponsored enterprises and other MBS or mortgage-related securities issued by the U.S. government or by private issuers.

% AVERAGE ANNUAL TOTAL RETURNS AS OF 12/31/18

	4Q18 (not annualized)	YTD (not annualized)	1 Year	3 Year	5 Years	10 Years	Since Inception ¹
Institutional	1.45	0.66	0.66	2.06	3.07	5.37	4.97
Investor A (Without Sales Charge) ²	1.39	0.40	0.40	1.79	2.80	5.06	4.68
Investor A (With Sales Charge) ²	-2.66	-3.61	-3.61	0.42	1.97	4.63	4.36
Morningstar Intermediate-Term Bond Category Avg.	0.87	-0.50	-0.50	2.15	2.27	4.31	—
Barclays U.S. Mortgage-Backed Securities ³	2.08	0.99	0.99	1.71	2.53	3.11	—

Expenses for Institutional shares: Total 1.08%; Net, Including Investment Related Expenses (dividend expense, interest expense, acquired fund fees and expenses and certain other fund expenses) 0.91%. For Investor A shares: Total 1.37%; Net, Including Investment Related Expenses 1.16%. Institutional and Investor A shares have contractual waivers with an end date of 8/31/20 terminable upon 90 days' notice. For certain share classes, BlackRock may voluntarily agree to waive certain fees and expenses in which the adviser may discontinue at any time without notice. Expenses stated as of the fund's most recent prospectus. Data represents past performance and is no guarantee of future results. Investment returns and principal values may fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. All returns assume reinvestment of dividends and capital gains. Current performance may be lower or higher than that shown. Refer to blackrock.com for most recent month-end performance. Investment returns reflect total fund operating expenses, net of all fees, waivers and/or expense reimbursements. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an unmanaged index. Share classes have different sales charges, fees and other features. Returns with sales charge reflect deduction of current maximum initial sales charge of 4% for Investor A shares. Institutional shares have no front- or back-end load. Institutional shares have limited availability and may be purchased at various minimums. See prospectus for details. Net Expenses Excluding Investment Related Expenses for Institutional shares: 0.45%; for Investor A shares: 0.70%.

Important Risks: The fund is actively managed and its characteristics will vary. Holdings shown should not be deemed as a recommendation to buy or sell securities. Bond values fluctuate in price so the value of your investment can go down depending on market conditions. Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. Principal of mortgage- or asset-backed securities normally may be prepaid at any time, reducing the yield and market value of those securities. Obligations of U.S. gov't agencies are supported by varying degrees of credit but generally are not backed by the full faith and credit of the U.S. gov't. The fund may use derivatives to hedge its investments or to seek to enhance returns. Derivatives entail risks relating to liquidity, leverage and credit that may reduce returns and increase volatility. Short-selling entails special risks. If the fund makes short sales in securities that increase in value, the fund will lose value. Any loss on short positions may or may not be offset by investing short-sale proceeds in other investments.

The opinions expressed are those of the fund's portfolio management team as of December 31, 2018, and may change as subsequent conditions vary. Information and opinions are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. Past performance is no guarantee of future results. There is no guarantee that any forecasts made will come to pass. This material does not constitute investment advice and is not intended as an endorsement of any specific investment. Investment involves risk. Reliance upon information in this material is at the sole discretion of the reader.

¹ Fund inception: 7/29/05. ² The performance information for periods prior to the inception date (12/6/10) of Investor A shares is based on the fund's Institutional shares, adjusted to reflect the fees and expenses applicable to such share class. See the fund prospectus for more details. ³ The Barclays U.S. Mortgage-Backed Securities Index consists of fixed-rate securities, such as mortgage pools created by GNMA, FHLMC and FNMA. It is a performance benchmark for many mortgage-backed securities funds. †† 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 Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. 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 fund was rated against the following numbers of U.S.-domiciled Intermediate-Term Bond funds over the following time periods: 876 in the last 3 years, 767 in the last 5 years and 560 in the last 10 years. With respect to these Intermediate-Term Bond funds, the fund received a Morningstar Rating of 3, 5 and 4 stars for the 3-, 5- and 10-year periods, respectively. Other classes may have different performance characteristics.

You should consider the investment objectives, risks, charges and expenses of the fund carefully before investing. The prospectus and, if available, the 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 from your financial professional. The prospectus should be read carefully before investing.

FOR MORE INFORMATION OR TO RECEIVE UPDATES, VISIT: blackrock.com

©2019 BlackRock, Inc. All Rights Reserved. BLACKROCK is a registered trademark of BlackRock, Inc. or its subsidiaries in the United States and elsewhere. All other trademarks are those of their respective owners.

Prepared by BlackRock Investments, LLC, member FINRA.

Not FDIC Insured • May Lose Value • No Bank Guarantee

01/19 — U.S. Mortgage Fund

BLACKROCK®