Commentary as of 09/30/23

- The fund posted returns of -2.31% (Institutional shares) and -2.38% (Investor A shares, without sales charge) for the third quarter of 2023.
- The fund outperformed its benchmark during the quarter. Overall rates rose significantly and longer duration (higher sensitivity to interest rate movements), longer maturity issues were the worst performers. Investment grade credit outperformed high yield, especially discounted high yield securities that fell below the “de minimis” tax threshold. The fund’s shorter duration positioning and hedging helped cushion the decline in prices.
- The fund had a quality bias during the quarter. The cash reserve was reduced to 7.1%, duration of 7.04 years was below the benchmark’s 7.31 years, and 12.3% of securities were exposed to alternative minimum tax bonds. The fund maintained 2.4% leverage (borrowed capital) from tender option bonds and had an overweight exposure to the utilities sector.

Contributors
The cash reserve position was reduced from about 10% at the start of the quarter to about 7%. Zero duration helped returns as prices remained stable. Lower duration “cushion bonds” aided performance, as did higher coupon short call options, which muted price volatility as rates rose. Hedging, through short U.S. Treasury futures positioning, was also beneficial amid the rise in rates.

Detractors
Long duration, long maturity bonds were the biggest detractors as the dramatic rise in rates caused the longest duration exposures to decline the most. Securities that were more defensively structured fared better. Lower coupon investment grade securities that declined past the de minimis tax threshold weighed on performance as they became less attractive to institutional buyers. An overweight exposure to the utilities sector detracted, while leverage, though only 2% of the fund, was a minor negative.

Further insight
The California municipal market was not immune to the significant rise in yields during the quarter. The fund has continued to experience outflows as investors have not yet returned to realize higher yields. California credit is still a concern due to lost tax revenue as people have moved out of the state. Yields have risen to a level where investor demand starts to materialize. However, the market still needs to overcome the following concerns. Firstly, how far will the Federal Reserve (Fed) raise short-term interest rates? Secondly, mutual fund outflows. Thirdly, as the Fed raises rates, will leveraged products need to reduce leverage? For the time being, funds such as ours need to maintain a degree of liquidity in cash reserves. A more aggressive stance requires a more reliably stable market.
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. Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities. The fund may invest up to 50% in non-investment-grade/high-yield bonds. 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. There may be less information on the financial condition of municipal issuers than public corporations. The market for municipal bonds may be less liquid than taxable bonds. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions are taxable. Concentrating in a single state is subject to greater risk of adverse economic conditions and regulatory changes.

The opinions expressed are those of the fund’s portfolio management team as of September 30, 2023, 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.

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1 The BBG Municipal Bond Index measures the U.S. municipal market performance of bonds issued by states or municipalities and are exempt from federal income and alternative minimum tax. The state level municipal bond indices consist of bonds that have been issued by municipalities or municipal authorities within the 50 states, the District of Columbia, Puerto Rico and the US Virgin Islands.
2 The BBG Custom California Municipal Bond Index measures the performance of municipal bonds issued in California. All bonds in the index are exempt from U.S. federal income taxes or subject to the alternative minimum tax.
3 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 Muni California Intermediate funds over the following time periods: 61 in the last 3 years, 59 in the last 5 years and 48 in the last 10 years. With respect to these Muni California Intermediate funds, the fund received a Morningstar Rating of 5, 3, and 5 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.

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