

# Strategic Municipal Opportunities Fund

A flexible strategy to complement your traditional muni bond allocation

**Performance:** The fund's strong performance in February was driven by duration management, interest rate hedges and security selection. An underweight to the belly of the curve (maturities of 8-15 years) slightly hindered results.

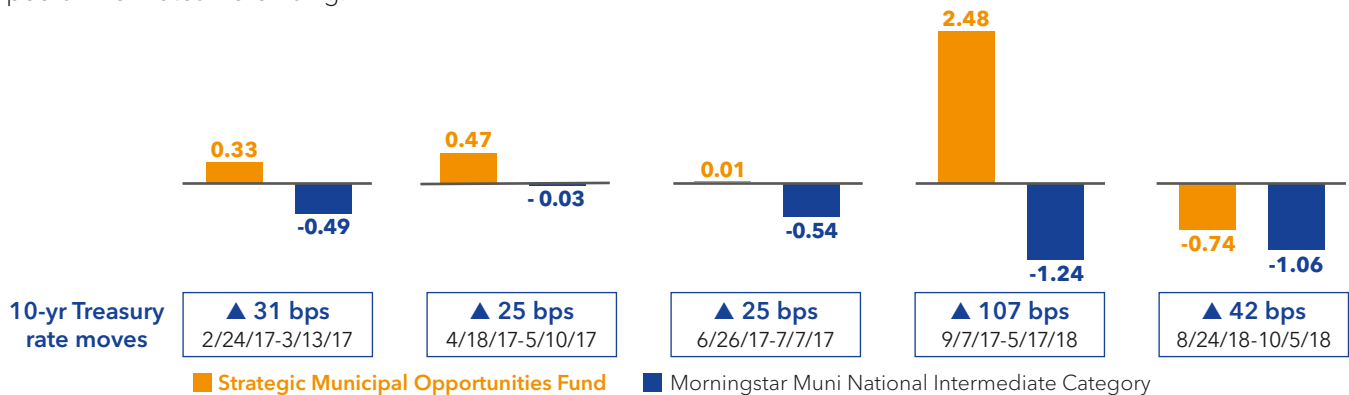
**Positioning:** Throughout the month of February, our trading activity was focused on swapping longer-dated bonds for exposures on the front end of the yield curve. We continue to employ a high quality bias in the fund.

▲ **Increased:** Maturities of 0-6 years, state tax-backed, pre-refunded/escrow, AAA and non-rated paper

▼ **Decreased:** Maturities of 20+ years, utilities and education, credits rated AA

## Outperformance in rising rate environments

The fund's flexible strategy and ability to quickly adapt to changing markets resulted in outperformance versus its peers when rates were rising.



Source: Bloomberg, Morningstar Direct, BlackRock. Rate moves are basis point increases in the 10-year Treasury yield. One basis point is equal to 0.01%.

## Strong outperformance

The fund has generated higher returns and higher yields than its category average.

	BlackRock Strategic Municipal Opportunities Fund	Morningstar Muni National Interm Category Average
Higher return (3-year)	3.70%	1.77%
Higher 30-day SEC yield (sub/unsub)	2.88% / 2.83%	2.02%
Higher tax equivalent yield (sub/unsub)	4.86% / 4.78%	3.38%
Higher Sharpe ratio (3-year)	0.70	0.18

Source: Morningstar. Data as of 2/28/19. 30-day SEC yield reflects the income earned by an investor in the fund during a 30-day period after deducting the fund's expenses. Unsubsidized SEC yield represents what a fund's 30-day SEC yield would have been had no fee waiver or expense reimbursement been in place over the period. Tax equivalent yield represents the yield a taxable bond would have to earn in order to match, after taxes, the yield available on a tax-exempt municipal bond. Assumes a federal tax rate of 40.8% and does not account for any other taxes. Individuals' tax burden will vary. Sharpe ratio uses a fund's monthly standard deviation and excess return (difference between the fund's return and the risk-free return of 90-day Treasury Bills) to determine reward per unit of risk.

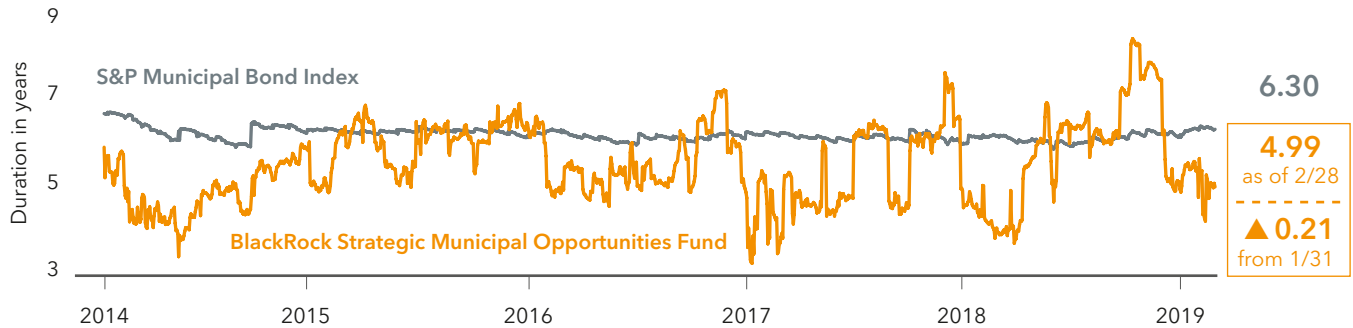
**Fund data based on Institutional shares, which may not be available to all investors. Other share classes may vary.**

Performance data quoted 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 all dividend and capital gain distributions. Current performance may be lower or higher than that shown. Refer to blackrock.com for recent performance.

The Overall Morningstar Rating of 5 stars pertains to the fund's Institutional shares, rated against 259 Municipal National Intermediate Bond funds as of 2/28/19. Ratings are based on risk-adjusted total return and a weighted average of performance figures associated with 3-, 5- and 10-year Morningstar rating metrics. Ratings are determined monthly and subject to change.<sup>1</sup>

## Active duration management

We had a neutral duration stance during the month of February as we expected favorable supply-and-demand dynamics in the municipal market would buffer interest rate risk.

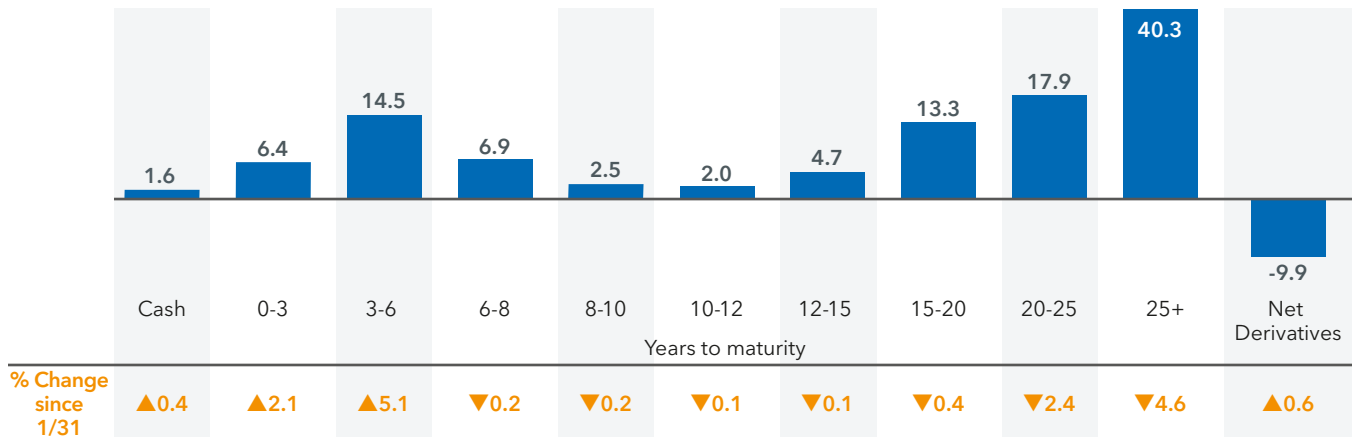


Monthly data since inception of the fund's strategy (1/27/14). Duration is a measure of sensitivity to interest rate movements. As a general rule, for every 1% change in interest rates, a bond's price will change approximately 1% in the opposite direction for every year of duration. Therefore, when interest rates rise, bonds with shorter duration fare better. When interest rates fall, bonds with longer duration tend to outperform.

## Tactical yield curve positioning

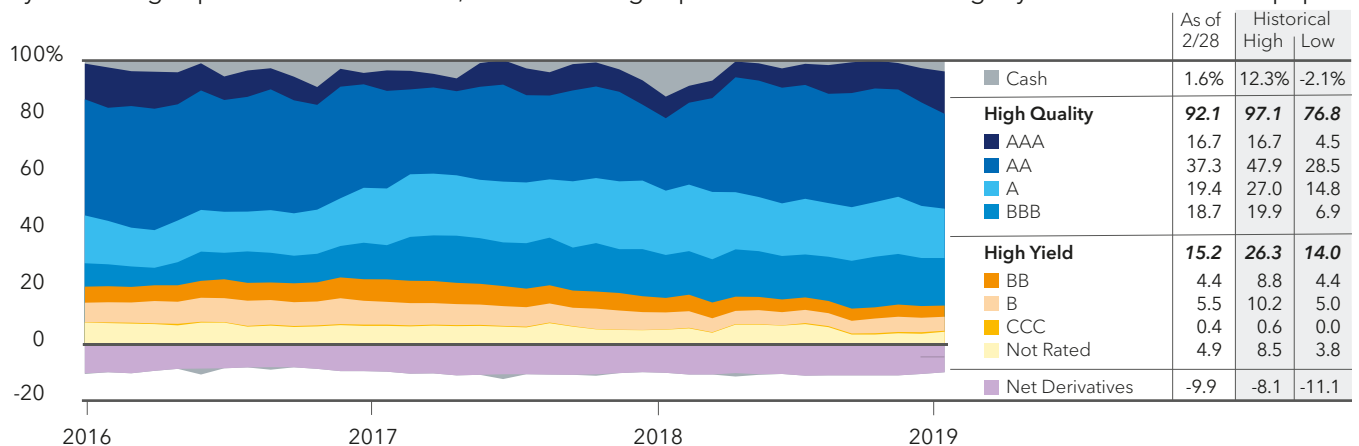
In February, we focused our trading activity on moving toward the front end of the yield curve. We reduced exposure to maturities of 20+ years in favor of the 0-6 year part of the curve.

% of notional value<sup>2</sup> as of 2/28/19



## Dynamic credit quality allocation

We seek attractive opportunities across the credit quality spectrum. In February, we employed a high quality bias by increasing exposure to AAA credits, while reducing exposure to AA. We also slightly added to non-rated paper.



The fund itself has not been rated by an independent rating agency. Credit quality ratings on underlying securities of the fund are received from S&P, Moody's and Fitch and converted to the equivalent S&P major rating category. This breakdown is provided by BlackRock and takes the median rating of the three agencies when all three agencies rate a security; the lower of the two ratings if only two agencies rate a security and one rating if that is all that is provided. Unrated securities do not necessarily indicate low quality. Below investment-grade is represented by a rating of BB and below. Ratings and portfolio credit quality may change over time.



### Peter Hayes

Head of BlackRock's  
Municipal Bond Group

## Market overview

Municipal bonds forged ahead with a fourth consecutive month of strong performance in February amid favorable supply-and-demand dynamics and range-bound interest rates. The S&P Municipal Bond Index gained 0.53% over the month, bringing the year-to-date return to 1.26%. Particularly strong returns came from the long end of the yield curve, lower-rated investment grade credits, Puerto Rico bonds, issues in higher yielding states, and the utility and healthcare sectors.

## Outlook

Although continued strong performance has resulted in fairly stretched relative valuations, especially in the front and intermediate parts of the yield curve, we remain constructive on the asset class. We anticipate that issuance will remain manageable and retail demand may strengthen further as investors are likely to place a higher value on the tax advantages of municipal bonds after realizing the disappointing impact of reform during tax season.

## Positioning

Since the end of February, we have moved the fund from a neutral to a shorter duration stance given low rates and our belief that seasonal trends will resume

## Diversification benefits of the fund

	Correlation to fund	Annualized volatility
BlackRock Strategic Municipal Opportunities	-	3.01
S&P 500 Index	0.07	11.20
S&P Muni Bond Index	0.87	2.77
S&P Muni Bond High Yield Index	0.80	3.52

Source: Morningstar, as of 2/28/19. Monthly data since strategy inception (1/27/14). Fund data based on Institutional shares. Past correlations are no guarantee of future correlations. Annualized volatility is the standard deviation of returns. S&P 500 Index comprises large-capitalization U.S. equities. S&P Municipal Bond Index measures the performance of bonds issued by U.S. states or municipalities that are exempt from federal income tax and alternative minimum tax.

their course, which typically brings weakness ahead of tax season. We tactically use hedges to adjust overall duration and capitalize on interest rate volatility. We maintain a barbell yield curve strategy with more concentrated exposures in maturities of 0-6 and 20+ years. The fund's underweight in the 10-15 year space detracted from performance in February.

We have been reducing risk and increasing liquidity in the fund. We increased exposure to higher quality credits rated AAA while decreasing exposure to AA. As of month end, approximately 15% of the fund's net assets were high yield municipal bonds, which primarily include tobacco, corporate-backed, health care and education bonds. We currently hold an underweight to high yield credits given recent spread compression and richer valuations. We recently added Puerto Rico COFINA bonds at attractive valuations, which positively contributed to performance.

On a sector basis, security selection within tax-backed states, utilities and tobacco credits proved beneficial, while tax-backed local credits hindered performance in February. We increased exposure to high-quality prerefunded bonds, while decreasing exposure to utilities and education credits. We continue to prefer revenue bonds over general obligation bonds as the latter can be vulnerable to political risk stemming from state and local budget negotiations.

## Selective sector allocation

% of notional value<sup>2</sup>

Sector	As of 2/28	Change since last month
State Tax-Backed	20.0	▲ 1.9
Transportation	15.4	▼ 0.8
Health	13.0	▼ 0.8
Utilities	12.0	▼ 1.0
Housing	10.3	▼ 0.4
Local Tax-Backed	9.2	▼ 0.9
Education	6.5	▼ 1.0
Corporate Muni	6.0	▼ 0.1
Tobacco	4.6	▼ 0.2
School Districts	3.9	▲ 0.2
Other Industries	3.8	▼ 0.2
PreRefunded/Escrow	2.6	▲ 2.3
Cash	1.6	▲ 0.4
Other	1.1	▲ 0.1
Derivatives	-9.9	▲ 0.6

## Average annual total returns (%) as of 2/28/19

	1 Month (not annualized)	YTD (not annualized)	1 Year	3 Years	5 Years	10 Years	Inception <sup>3</sup>
Institutional	1.32	1.67	3.01	3.70	4.19	5.40	5.29
Investor A (Without Sales Charge) <sup>4</sup>	1.21	1.63	2.78	3.45	3.94	5.15	5.03
Investor A (With Sales Charge) <sup>4</sup>	-3.09	-2.69	-1.59	1.96	3.04	4.69	4.88
Morningstar Municipal National Intermediate Funds Avg.	0.56	1.38	3.47	1.77	2.72	3.96	-
S&P Municipal Bond Index <sup>5</sup>	0.53	1.26	4.03	2.36	3.45	4.77	-

**Annualized total returns as of 12/31/18 for Institutional shares: 1 year, 1.26%; 5 years, 4.59%; 10 years, 5.62%; since inception, 5.26%; and for Investor A shares without/with maximum sales charge: 1 year, 0.95%/-3.34%; 5 years, 4.36%/3.46%; 10 years, 5.38%/4.92%; since inception, 5.00%/4.85%.**

Investment returns reflect total fund operating expenses, net of all fees, waivers and/or expense reimbursements. Expenses as stated in the fund's most recent prospectus for Institutional shares/Investor A shares: Total **0.82%/0.96%**; Net, Including Investment Related Expenses (dividend expense, interest expense, acquired fund fees and expenses and certain other fund expenses): **0.77%/0.91%**. Institutional and Investor A shares have contractual waivers with an end date of 9/30/19, terminable upon 90 days' notice. The fund's annual total returns prior to January 27, 2014 reflect a different investment strategy. Performance data quoted 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 dividend and capital gain distributions. Current performance may be lower or higher than that shown. Refer to [blackrock.com](http://blackrock.com) for current month-end performance. 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 the deduction of current maximum initial sales charge of 4.25% for Investor A shares. **Institutional shares have no front- or back-end load, have limited availability and may be purchased at various minimums. See prospectus for details.**

Net, excluding investment-related expenses for Institutional/Investor A shares: 0.58%/0.78%.

**Important Risks:** The fund is actively managed and its characteristics will vary. 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. There may be less information on the financial condition of municipal issuers than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable. 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. 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. 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. 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 February 28, 2019, 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.

**1** 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. With respect to U.S.-domiciled funds in the Municipal National Intermediate Bond fund category, the fund received a Morningstar Rating of 5 stars for the 3-year period, rated against 259 funds; 5 stars for the 5-year period, rated against 227 funds; and 5 stars for the 10-year period, rated against 147 funds. Ratings are for Institutional share class. Other classes may have different performance characteristics. **2** Notional value accounts for a fund's use of derivatives, including but not limited to futures, options, and swaps. This value captures the fund exposures as if the derivative was replaced with the underlying asset and the corresponding financing or lending, such that all exposures sum to the net asset value. For non-derivatives, the market value and the notional value are identical. **3** Fund inception: 11/26/86. **4** The performance information for periods prior to the inception date of the Investor A share class (10/2/06) is based on the fund's Institutional shares, adjusted to reflect the fees and expenses applicable to the Investor A share class. See the fund's prospectus for more details. **5** The Standard & Poor's Municipal Bond Index measures U.S. municipal market performance of bonds issued by states or municipalities and exempt from federal income and alternative minimum tax.

*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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