

Taking ETFs to the next level

Jon Howie, Head of iShares Australia

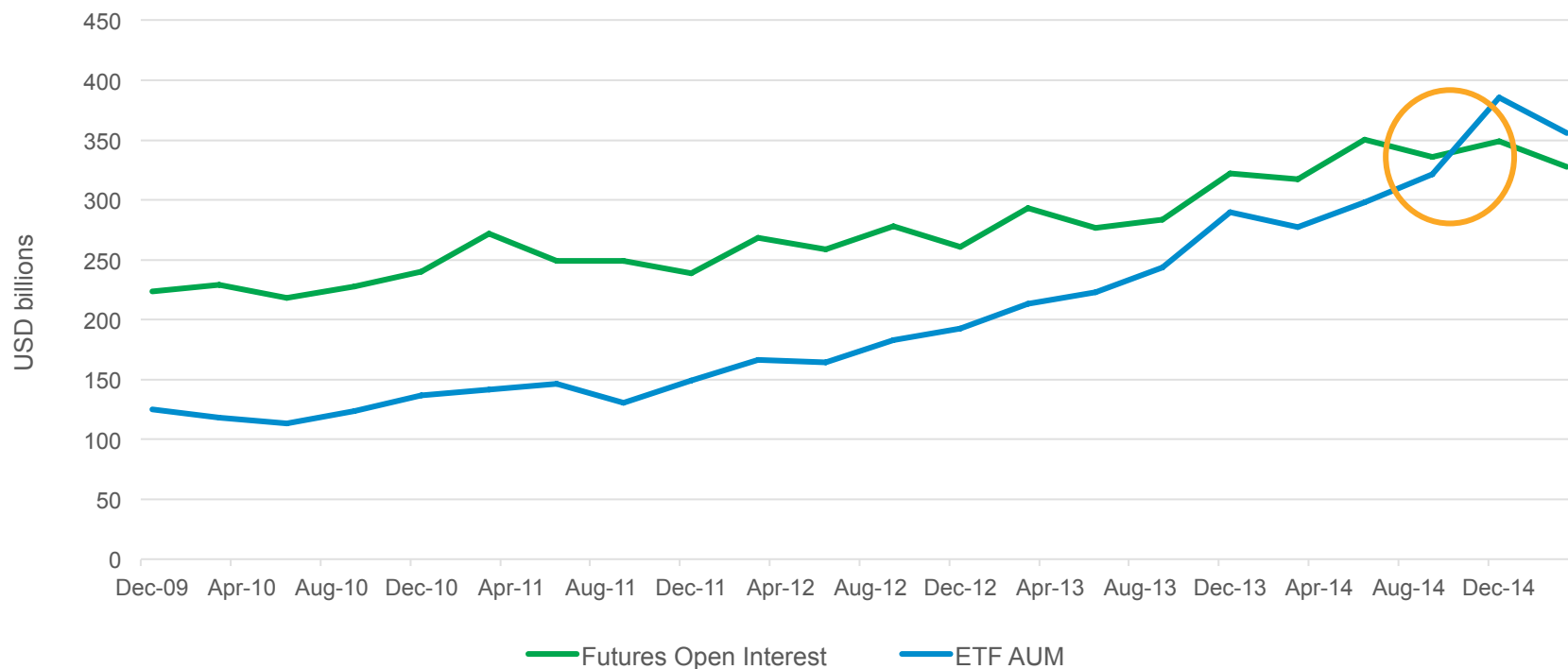
June 2015

A fundamental shift is occurring

ETFs are changing the face of global capital markets

Assets in S&P 500 ETFs now exceed open interest in S&P 500 futures contracts

S&P 500 Futures Open Interest vs ETF AUM



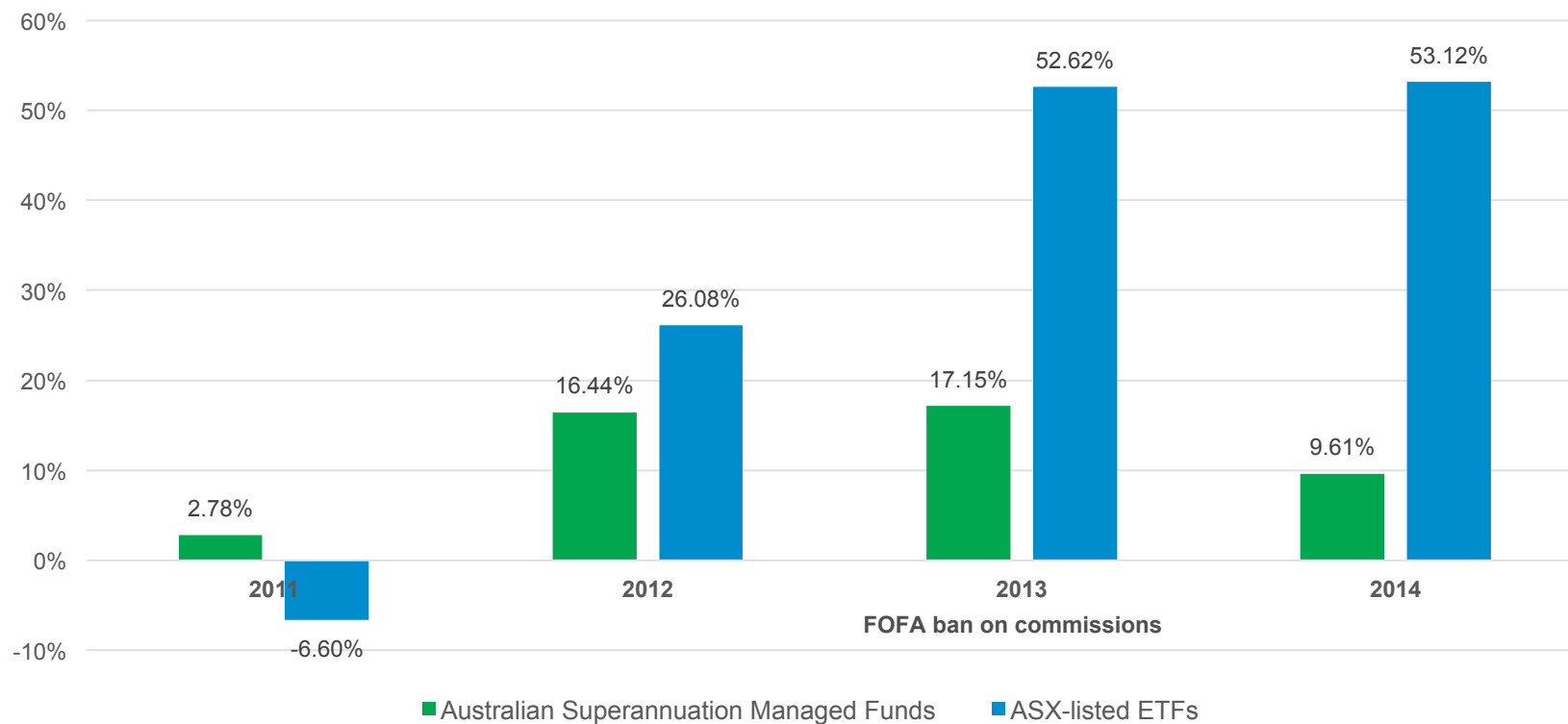
Source: BlackRock, ETP Landscape, Bloomberg, as at 31 March 2015. The Futures open interest was computed as the combined near month E mini and SP1 contract open interests multiplied by their respective contract values, referencing the relevant historic S&P 500 index values.

*Source: BlackRock, based on brokers' estimates. TRS is Total Return Swap. Data as at 31 March 2015.

ETFs are changing the face of investment management in Australia

The Australian ETF industry is growing at an extraordinary pace

Annual growth rate of assets under management



Source: Bloomberg, ASX. Data as at 31 December 2014.

Why do Investors Use ETFs?



Seek to outperform other investments

Performance vs. active funds

Express a view

Manage risk

Diversification

Tradability and flexibility

Transparency

Spend less, save more

Cost effectiveness

Tax efficiency

Past performance does not guarantee future results. Diversification may not protect against market risk. Transactions in shares of iShares funds may result in brokerage commissions.

Agenda

Taking ETFs to the next level

1. **Know what you own: the ETF due diligence check list**
2. **Know how to use it: using ETFs to your client's advantage (and yours)**
3. **Knowledge applied: Q & A**

1. Know what you own: the ETF due diligence check list

The ETF due diligence check list

1. Manager

How well do you know your ETF provider?

2. Exposure

What's inside your fund?

3. Structure

What are the implications of structure?

4. Liquidity

Can you trade when you need to?

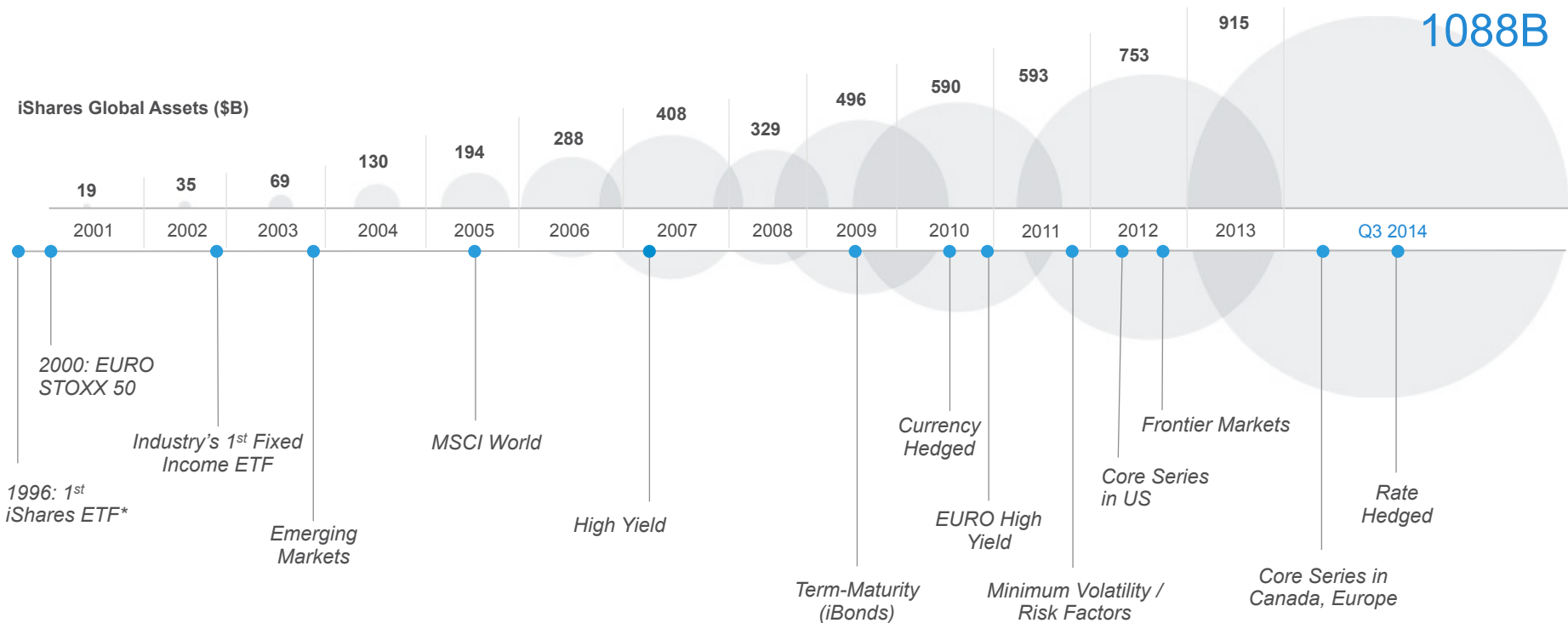
5. Costs

What is the true total cost of ownership?

1. Manager How well do you know your ETF provider?

It takes size, skill and expertise to realise the benefits of ETFs for investors

- ▶ It requires scale, experience and a business model aligned to your needs
- ▶ When choosing your provider, pay close attention to their track record, expertise and history of ETF innovation
- ▶ A global model can benefit investors through indexing excellence, breadth of choice, and deep liquidity

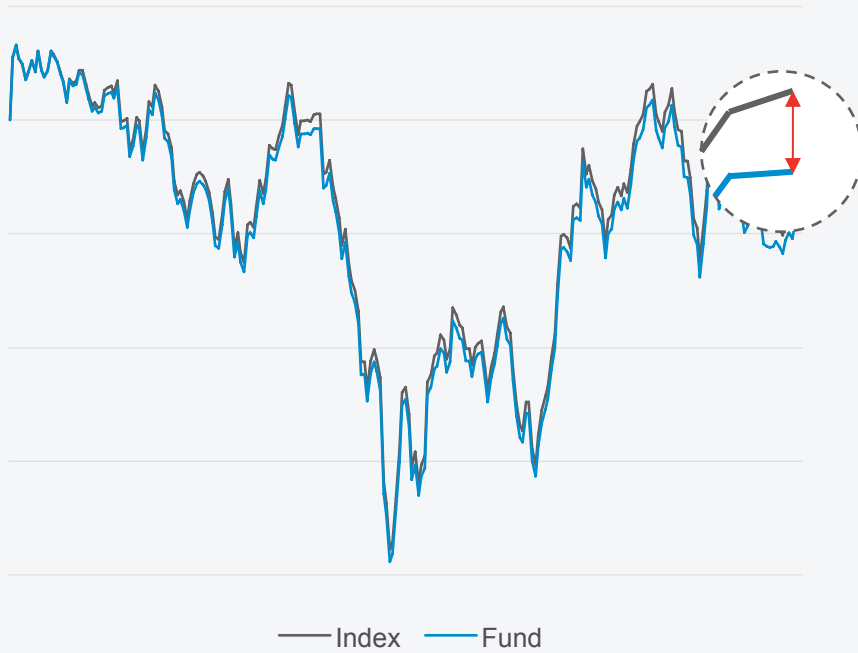


As of 31 March 2015. Source: BlackRock and Bloomberg. *Originally branded WEBS

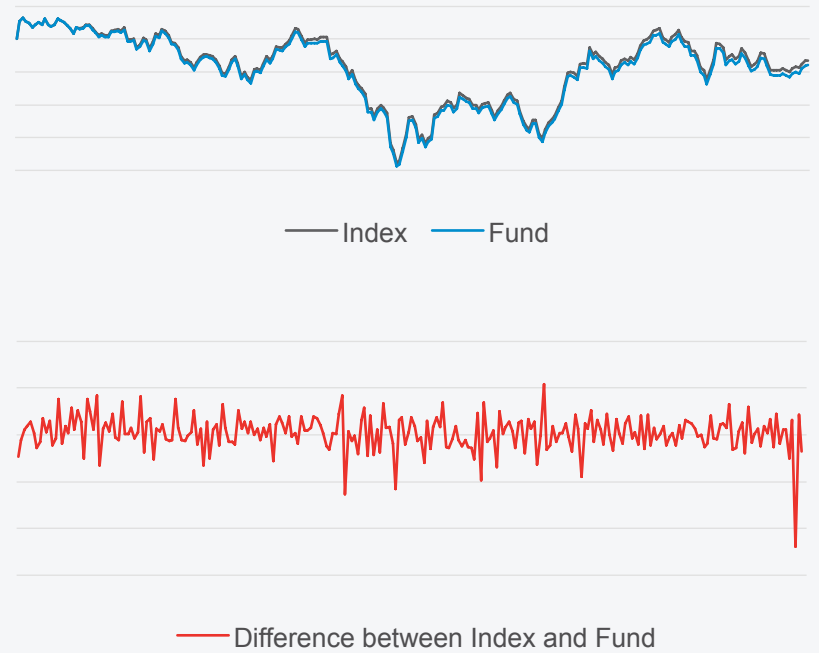
1. Manager Evaluate the ETF manager's ability to deliver the index performance

A well-managed ETF minimizes both tracking error and tracking difference to deliver accurate index performance

Tracking difference is simply the return difference between the ETF and its underlying index over a given time period.



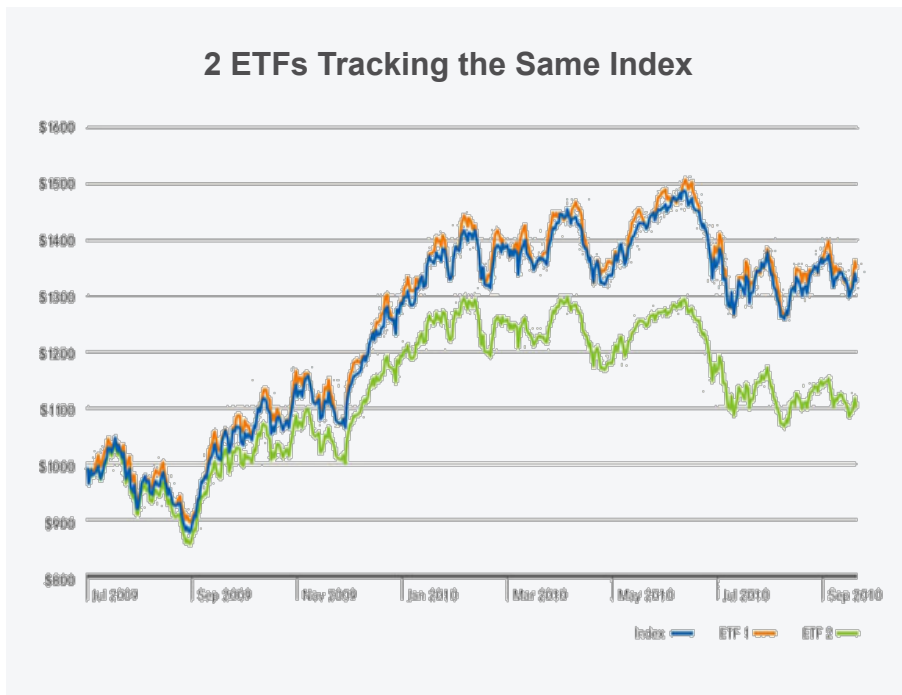
Tracking error is the volatility (as measured by standard deviation) of that return difference.



Diagrams are for illustrative purposes only.

1. Manager Evaluate the ETF manager's ability to deliver the index performance

Example: Looking at both tracking difference and tracking error together will give a fuller picture of how well an ETF tracks its index over time



	Tracking Difference	Tracking Error
Index	--	--
ETF 1	Zero	High
ETF 2	High	Low

An ETF can have high tracking error and still produce accurate index returns

Diagrams are for illustrative purposes only.

2. Exposure What's inside your ETF?

Index definition methodology impacts upon economic exposure and outcomes



Index Exposure

What exposure does the index provide?

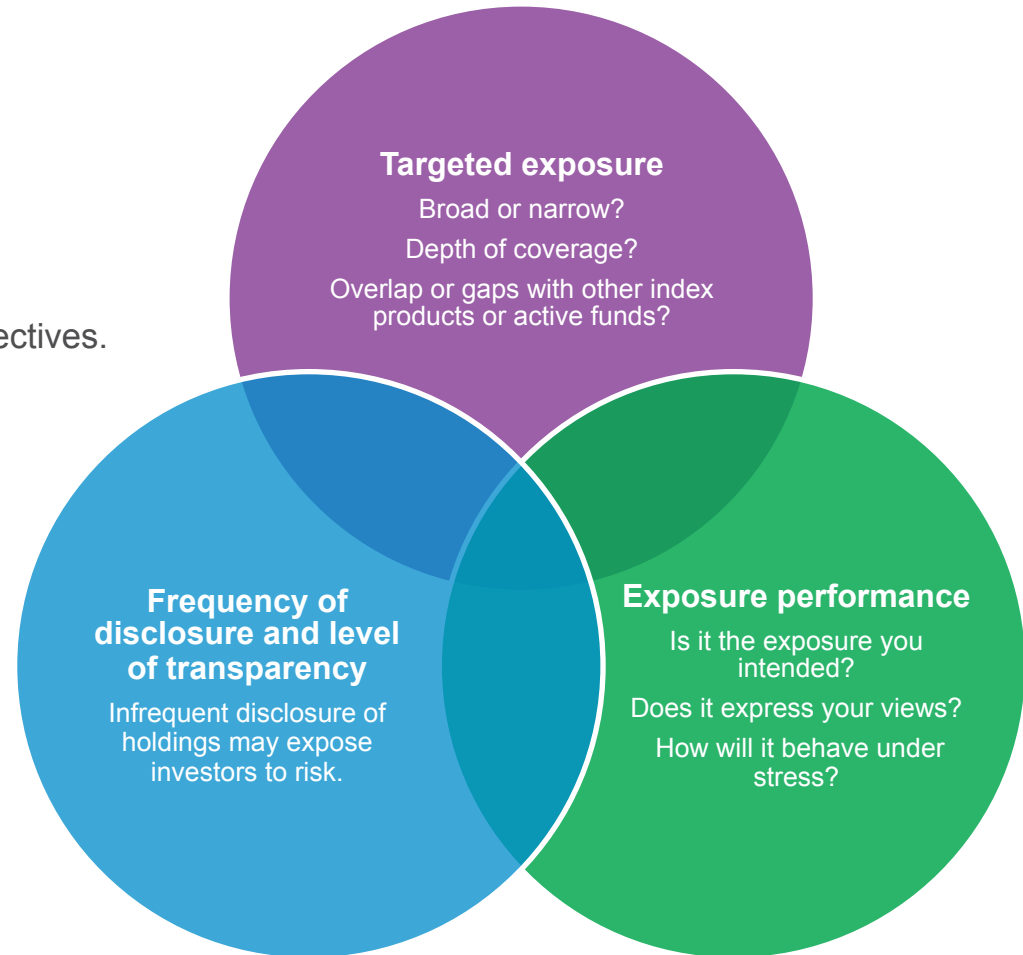
Consider the weightings in countries, sectors, and companies and its relevance in your investment objectives.



Index Methodology

How is the index constructed?

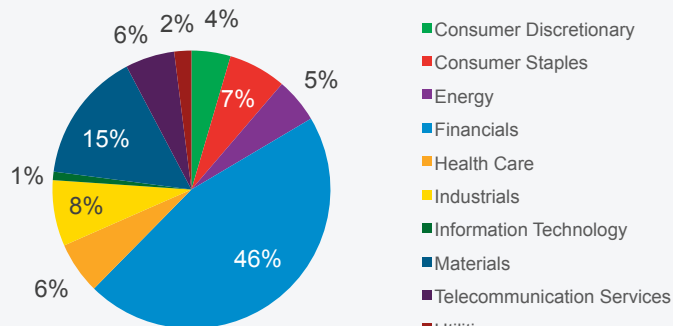
Understand the methods that the index provider uses to screen companies to include in the index.



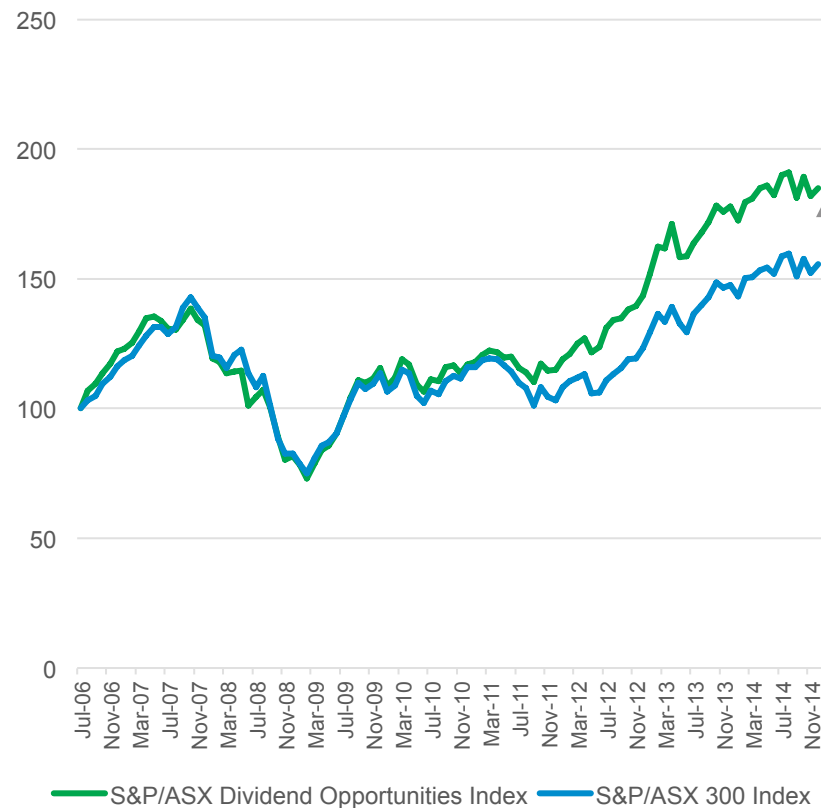
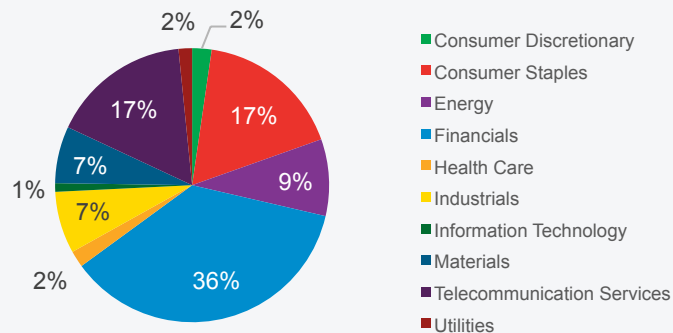
2. Exposure What's inside your ETF?

Understanding the difference between indices is key to selecting the most appropriate ETF for your client's investment objectives

S&P/ASX 300 Index



S&P/ASX Dividend Opportunities Index



Source: Bloomberg, S&P Dow Jones Indices. Growth figures based to 100 for illustrative purposes.

3. Structure Sophisticated portfolio construction

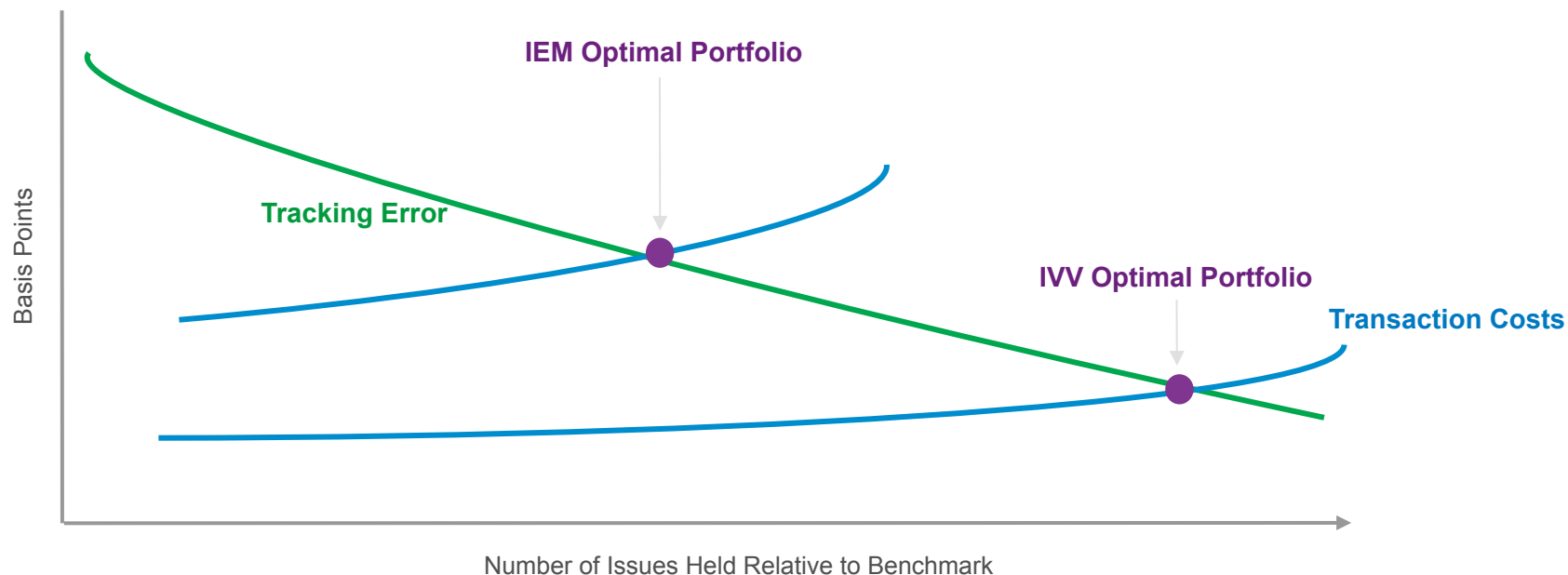
The portfolio construction approach is a fundamental aspect of ETF performance

Full Replication

- ▶ Highly liquid, developed markets that have a wide breadth and depth of trading.
- ▶ Typically leads to tight tracking of benchmarks.

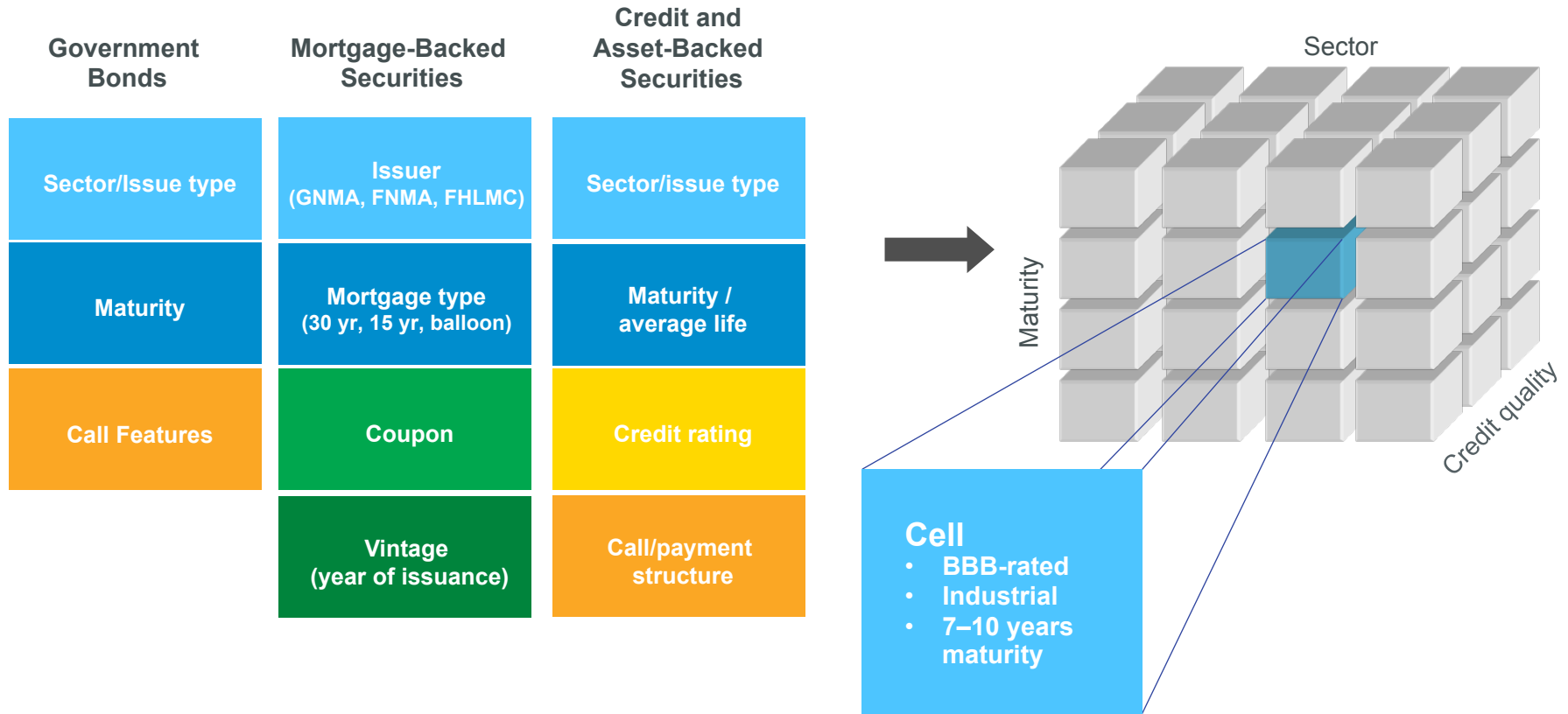
Optimization

- ▶ Concentration issues, diversification rules.
- ▶ Less liquid, lack of breadth in developed, less developed markets.
- ▶ Less accessible, illiquid benchmarks.



3. Structure Sophisticated portfolio construction: stratified sampling

Benchmark is divided into subsets (cells) based upon relative risk factor parameters

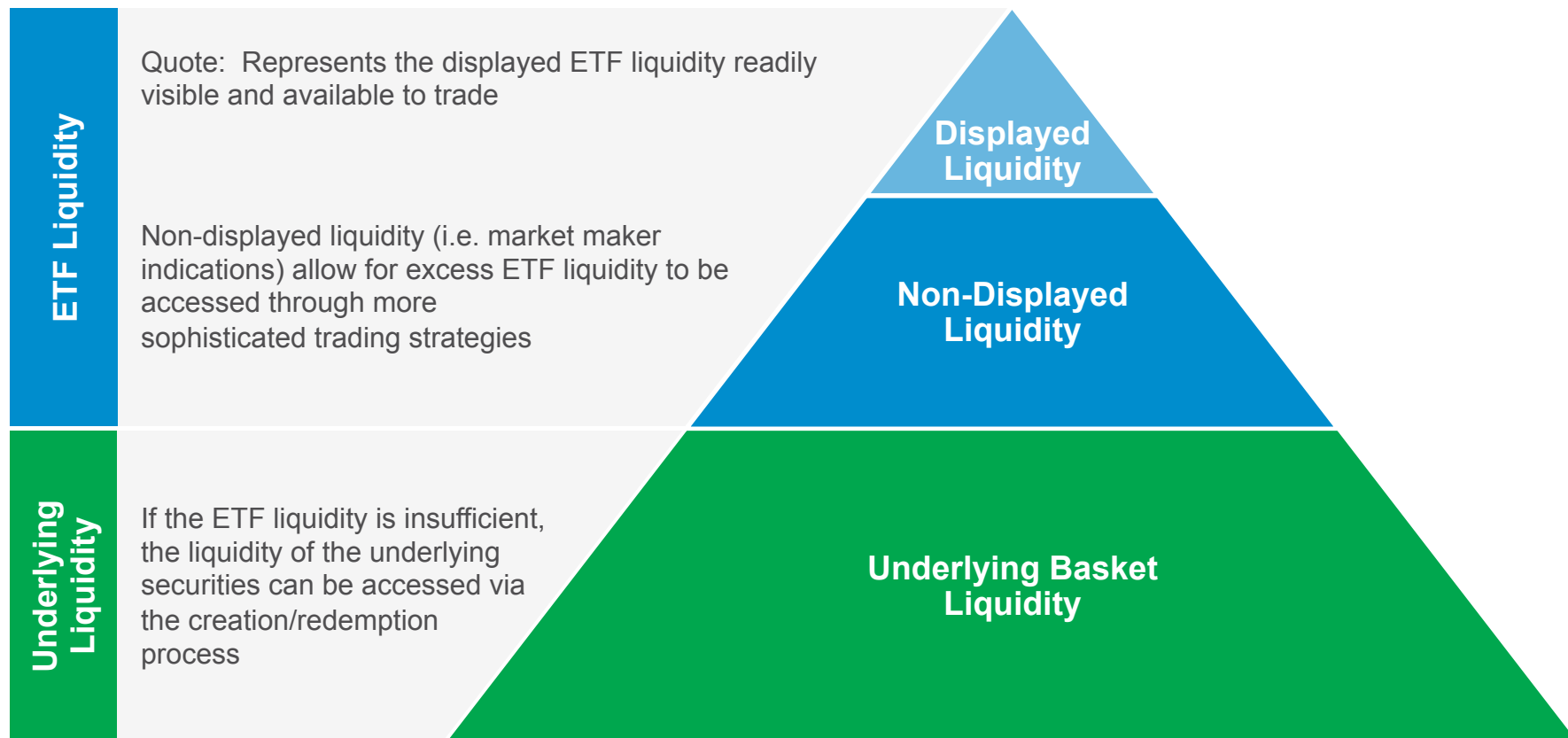


Portfolios are constructed by sampling bonds from each index cell

For illustrative purposes only.

4. Liquidity Trading Costs - “Liquidity Beyond the Quote”

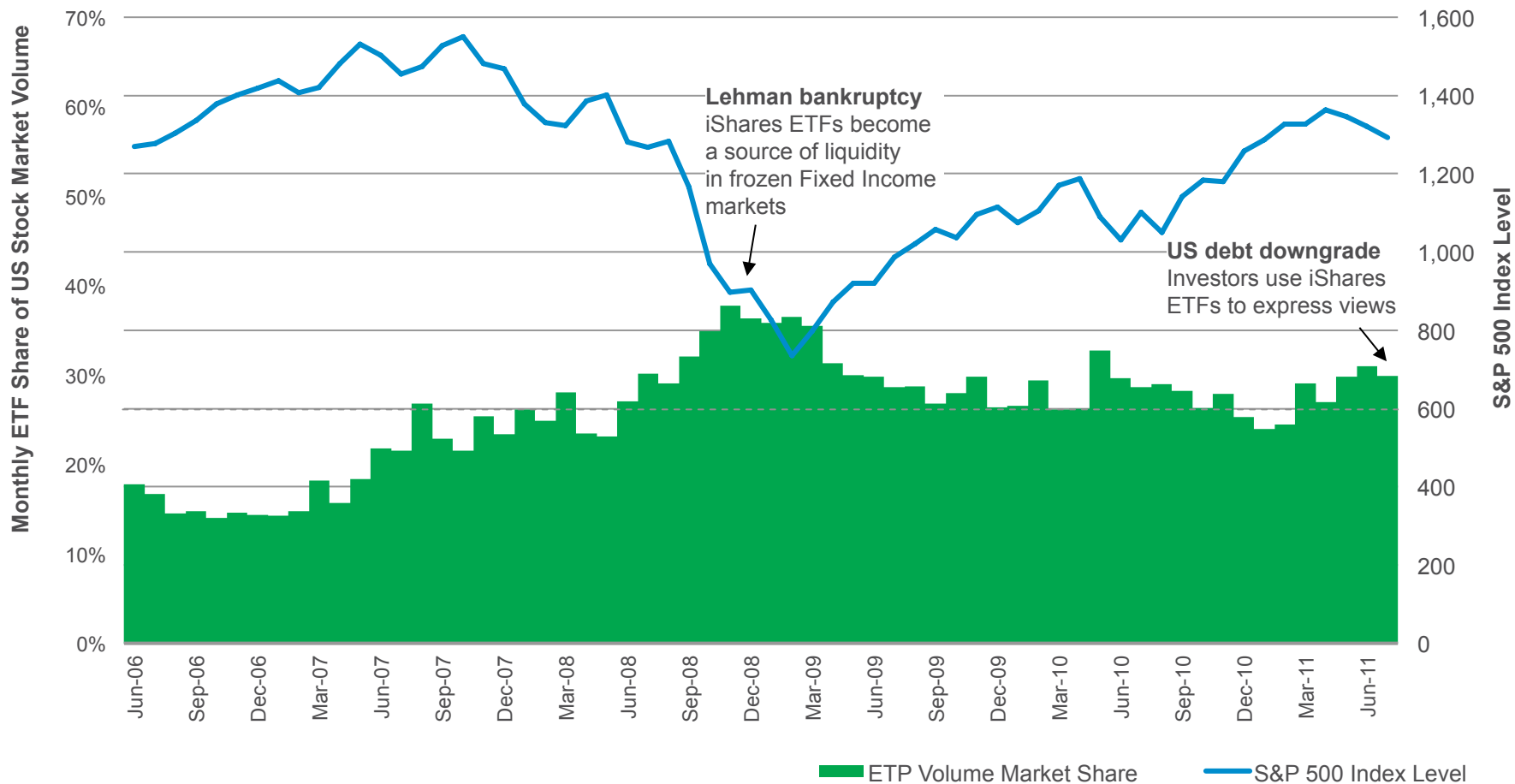
To gauge an ETF’s liquidity, you must look deeper to its underlying market



There can be no assurance that an active trading market for shares of an ETF will develop or be maintained.

4. Liquidity Case study: liquidity during volatile markets

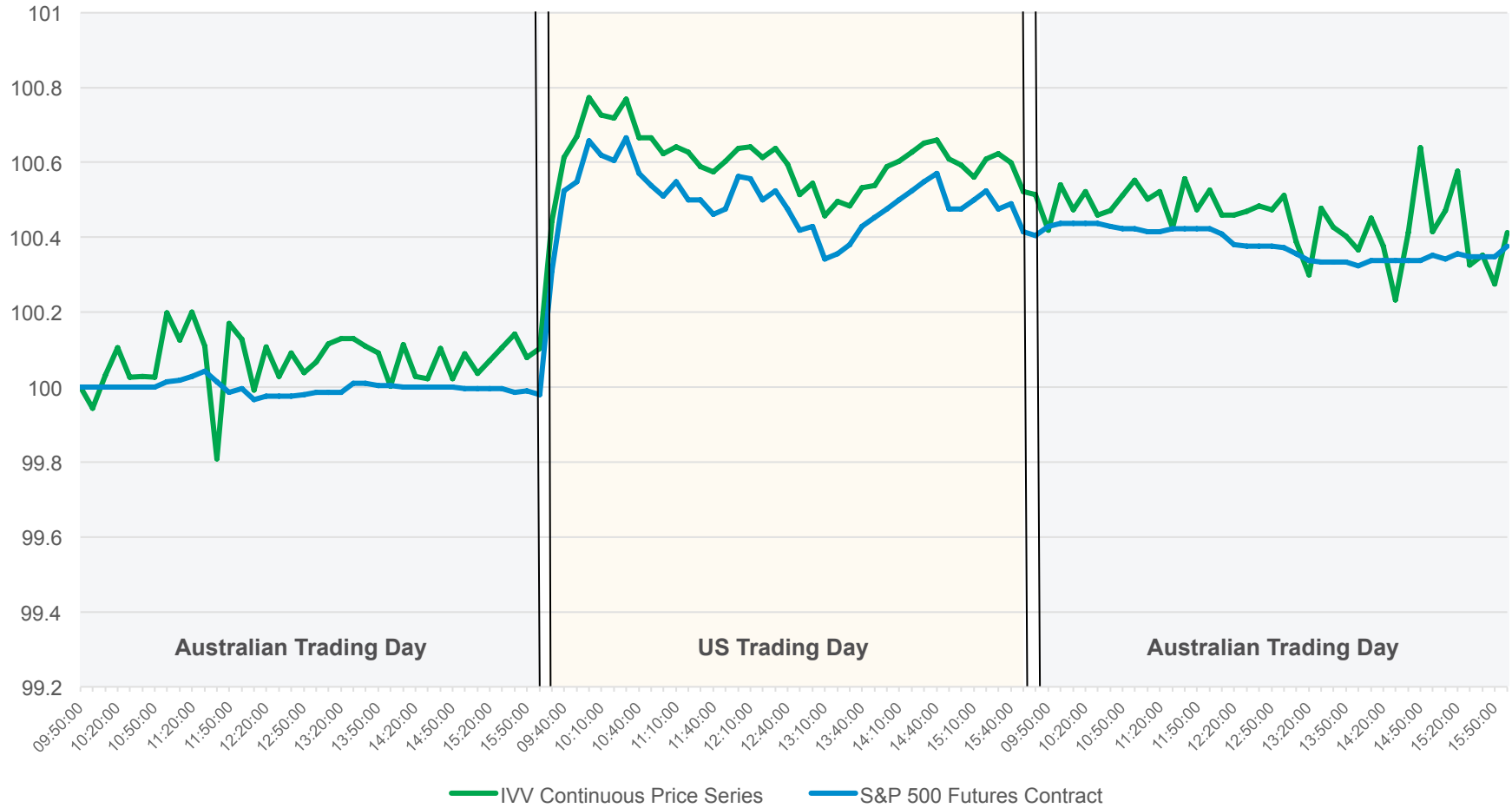
Investors have turned to iShares ETFs to take action



Sources: Bloomberg, NYSE Arcvision, S&P (June 2006–August 2011).

4. Liquidity Trading internationally during the Australian trading day

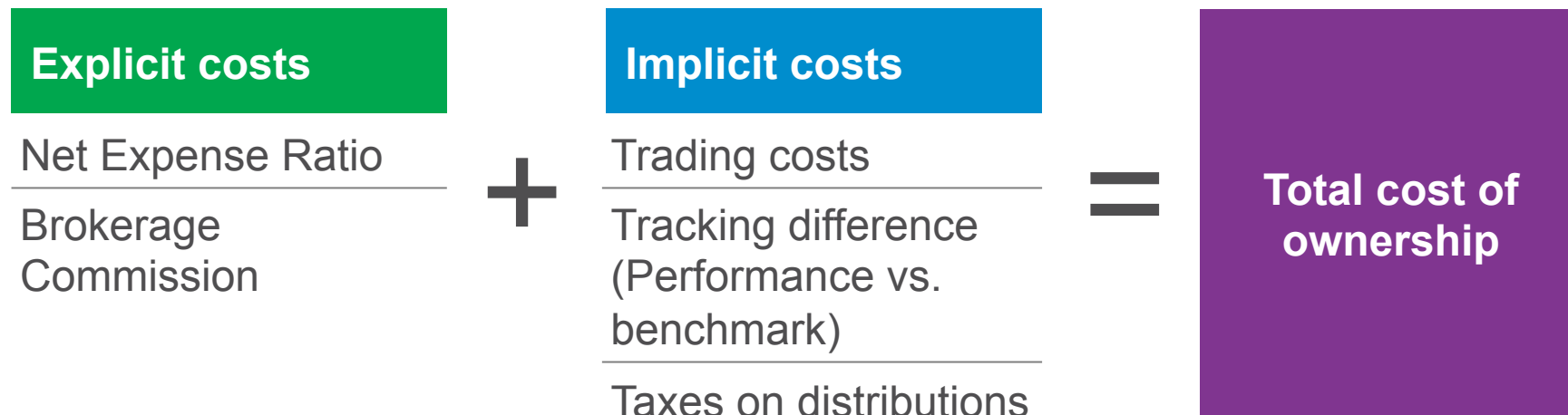
How are international exposures priced?



Source: Bloomberg. Prices based to 100 for illustrative purposes.

5. Costs Expense ratio is just one part of the total cost of ownership

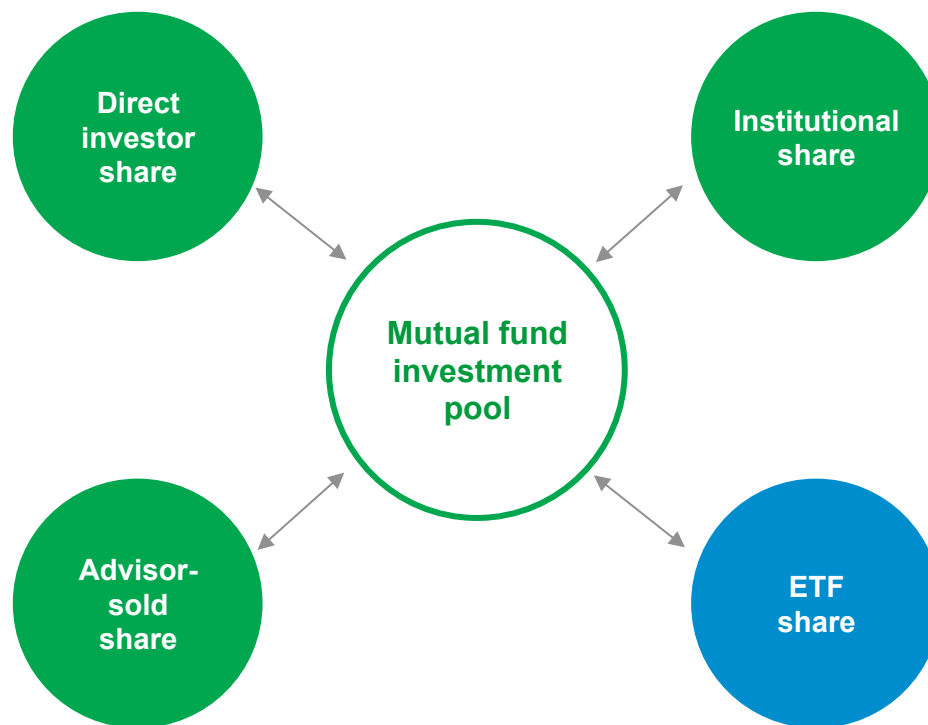
Look beyond the management expense ratio when considering costs



Explicit costs are predetermined based on the ETF's fees and brokerage firm's commission schedule. Implicit costs may vary based on market events and trading volume. Implicit costs may change continuously based on current market conditions.

5. Costs Fund structure can have a significant impact on tax outcomes

Mutual fund shareholders interact with the same investment pool underlying the ETF share class



Actions of Mutual Fund Shareholders may Create Capital Gains Distributions for ETF Shareholders. Additionally, ETF Shareholders may Pay for Potential Costs Incurred by Other Share Classes

Recap: the ETF due diligence check list

1. Manager

It takes size, skill and expertise to realise the benefits of ETFs for investors

2. Exposure

Index methodology impacts upon economic exposure and outcomes

3. Structure

The portfolio construction approach is a fundamental aspect of ETF performance

4. Liquidity

To gauge an ETF's liquidity, you must look deeper to its underlying market

5. Costs

Minimising costs means more than just a low management fee

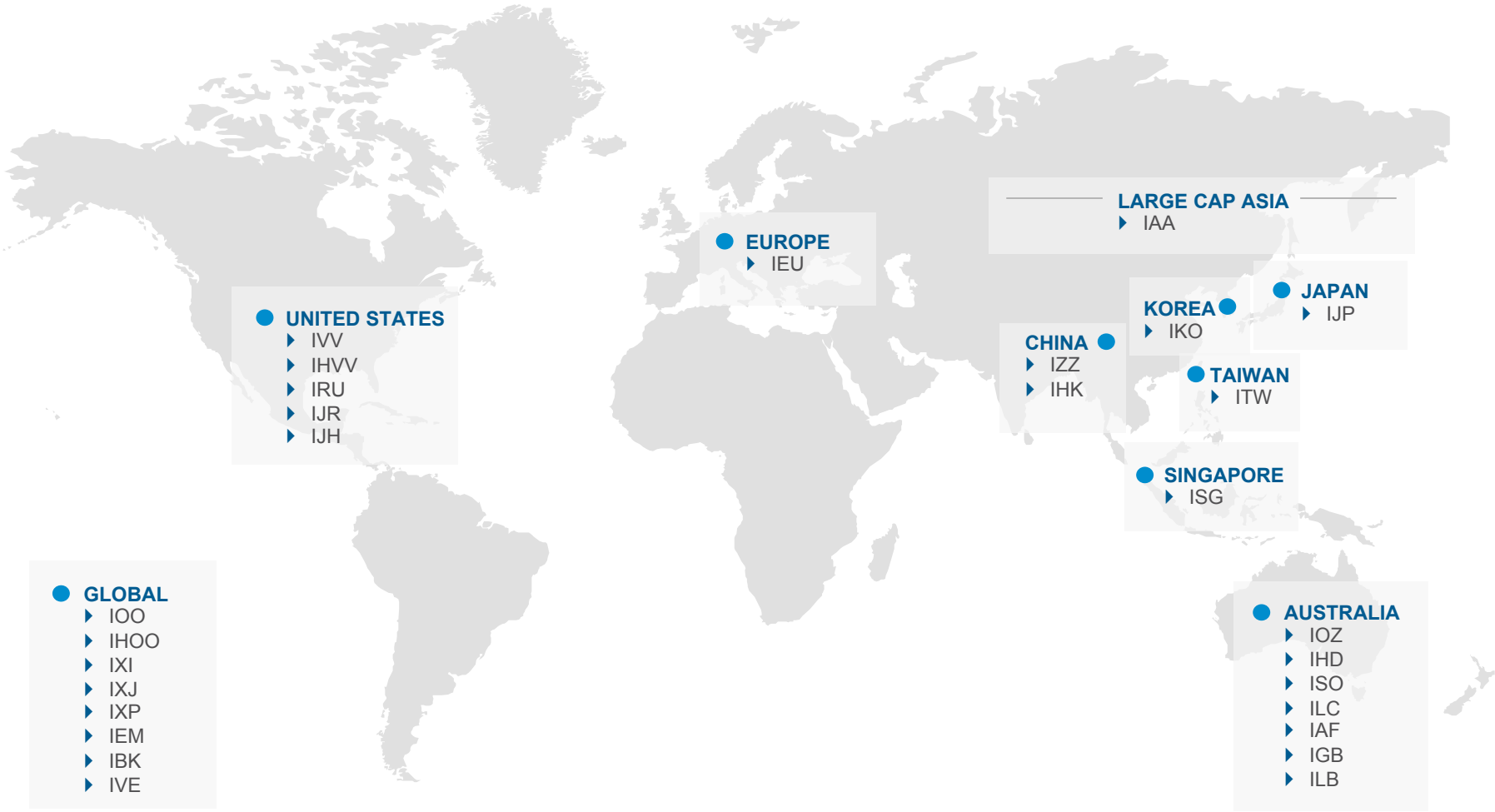
2. Know how to use it:

using ETFs to your client's advantage (and yours)

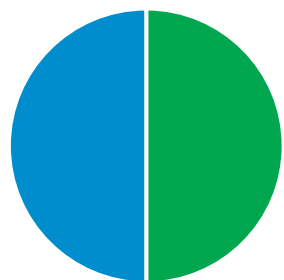
- A. Single asset class exposure
- B. Entire portfolios built with ETFs
- C. Blending ETFs and active funds

A. **Single asset class** exposure

Global reach: access securities in 49 different markets



Case study: building a world exposure



- 50% iShares Core S&P 500 ETF (IVV)
- 50% iShares MSCI EAFE ETF (IVE)

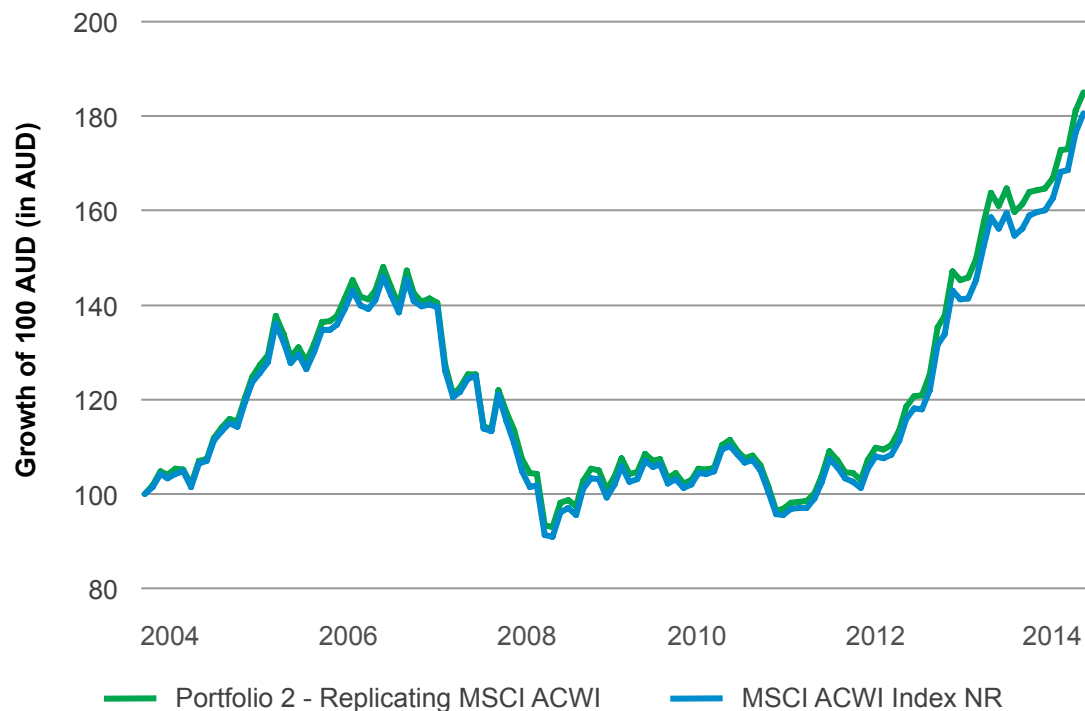


Key stats

Composite Management Costs	0.20%
Performance Currency	AUD
Benchmark	MSCI World Index
Inception Date	31/10/2004
Std Dev Since Inception	11.36%
Tracking Error Since Inception	0.65%

Created with MPI Stylus Analytics.

Case study: adding emerging markets to your world exposure



Key stats

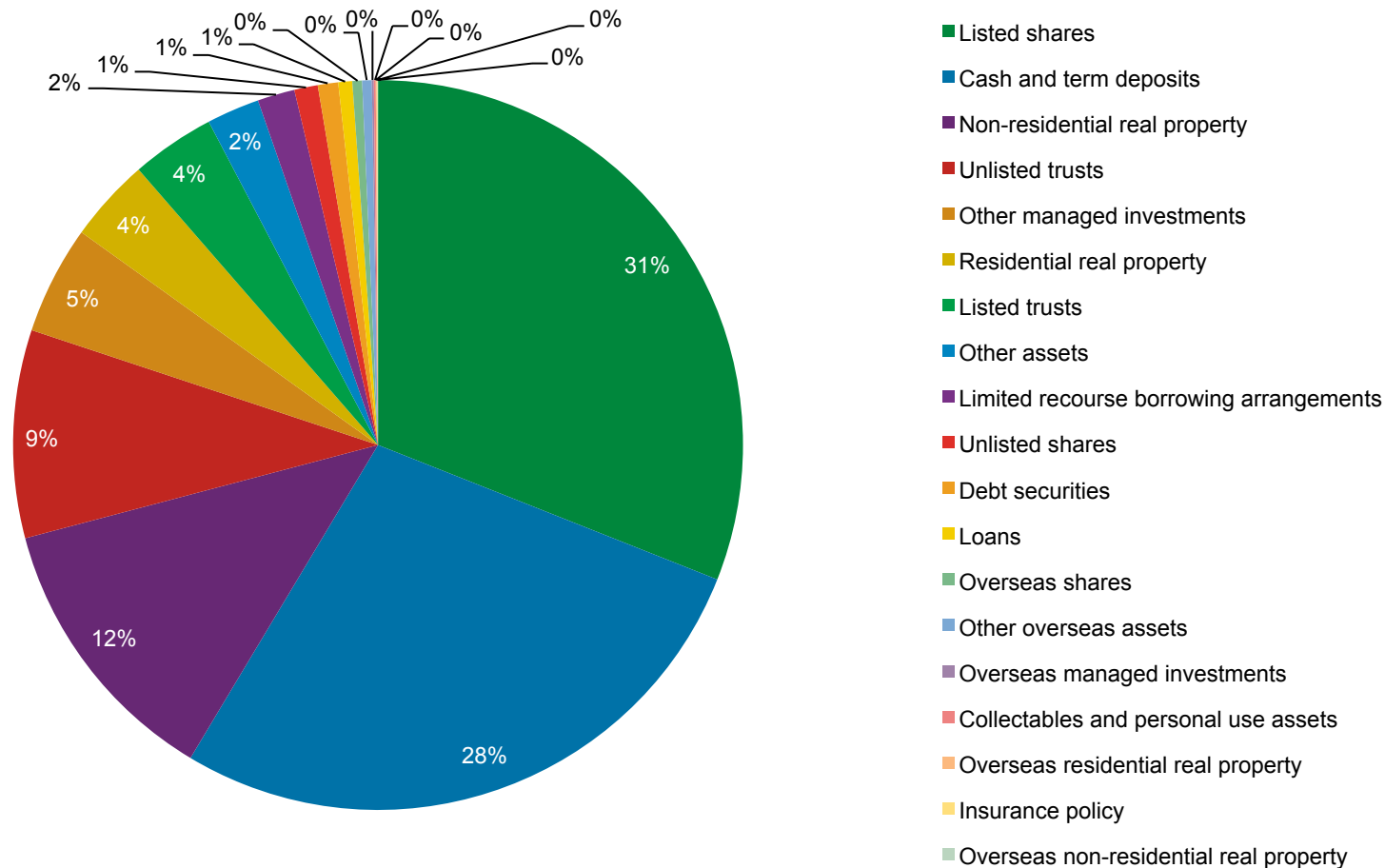
Composite Management Costs	0.25%
Performance Currency	AUD
Benchmark	MSCI ACWI Index
Inception Date	31/10/2004
Std Dev Since Inception	11.16%
Tracking Error Since Inception	0.79

Created with MPI Stylus Analytics.

B. Building **entire portfolios** with ETFs

Asset allocation: getting the basics right

What makes up the majority of Australian SMSF assets?

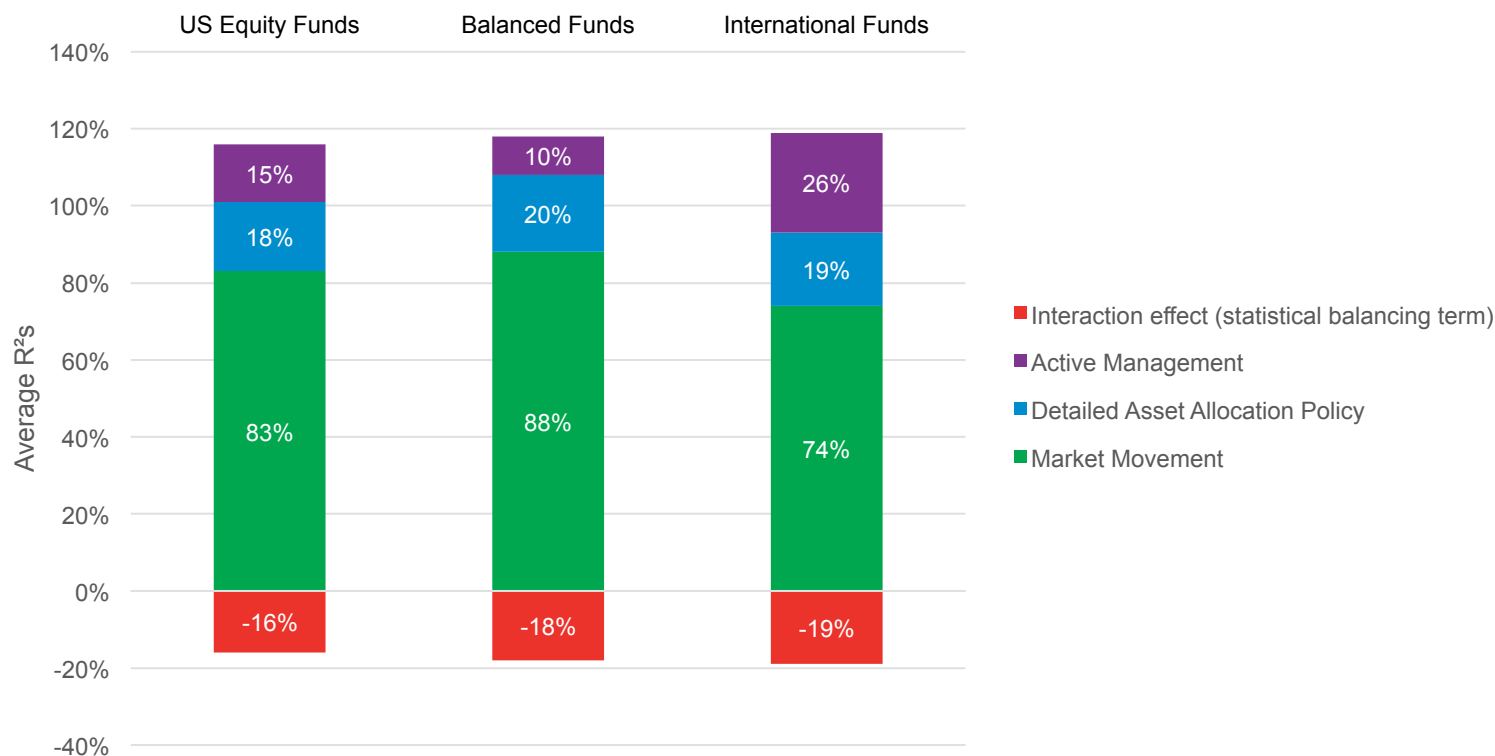


Source: Australian Taxation Office.

Asset allocation: getting the basics right

Broad market allocation decisions explain the majority of total return variation

Decomposition of Time-Series Total Return Variations in Terms of Average R²s, May 1999 - April 2009



Source: Xiong, Ibbotson, Idzorek and Chen, Financial Analysts Journal, March/April, 2010

Why build a portfolio with ETFs: the business case

Free up time to focus on value-adding services:

- ▶ grow your business
- ▶ service more clients
- ▶ insurance
- ▶ structuring
- ▶ estate planning
- ▶ retirement planning
- ▶ tax planning

Low cost

- ▶ lower investment costs without impacting margin
- ▶ portfolio cost not dependent on size
- ▶ spend fee budget on compelling alpha opportunities

Simple

- ▶ easy to explain investment methodology
- ▶ scalable access to thousands of underlying securities

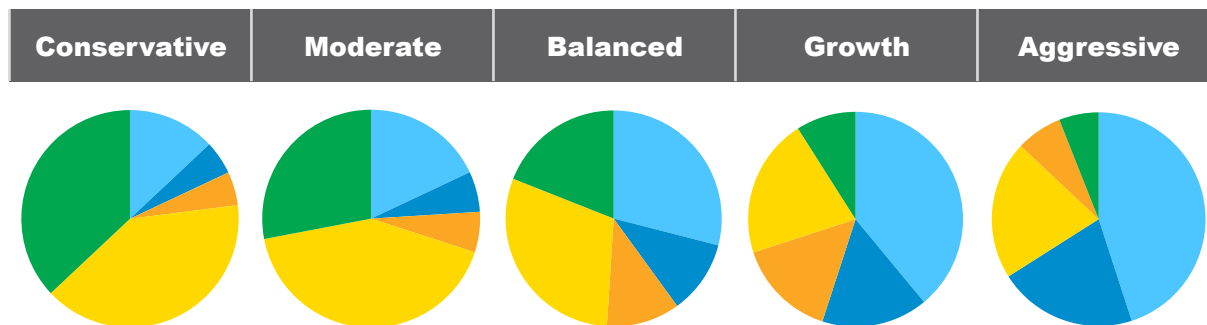
Choose what you control

- ▶ asset allocation
- ▶ rebalance frequency
- ▶ client portfolio risk
- ▶ greater control over tax outcomes



1. The efficient core: iShares Diversified Model Portfolios

- ▶ Low cost, simple solutions for controlling the core of your portfolio
- ▶ Demonstrate a range of investment possibilities with various risk preferences
- ▶ iShares ETFs provide efficient and low-cost building blocks across asset classes



		Conservative	Moderate	Balanced	Growth	Aggressive
	Weighted Average Management Cost*	0.14%	0.16%	0.17%	0.19%	0.19%
IOZ	iShares MSCI Australia 200 ETF	13%	18%	29%	39%	45%
IVV	iShares S&P 500 ETF	5%	6%	11%	16%	21%
IVE	iShares MSCI EAFE ETF	5%	6%	11%	15%	21%
IAF	iShares Composite Bond ETF	40%	42%	30%	21%	7%
-	Australian Cash**	37%	28%	19%	9%	6%

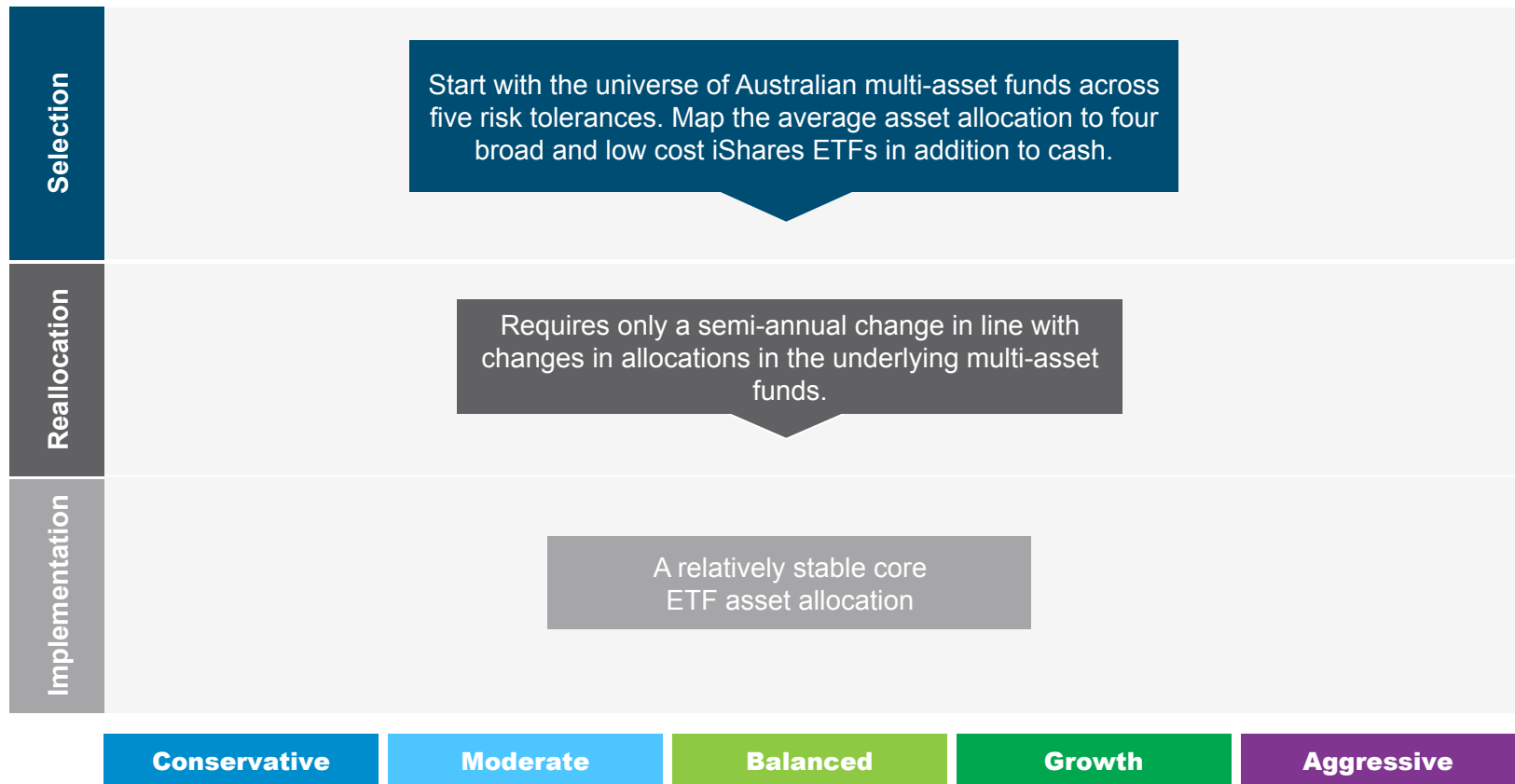
* Weighted average management cost ignores entry and exit costs (spread and brokerage), semi-annual rebalancing cost and taxes.

** Australian Cash is represented by Bloomberg AusBond Bank Bill Index.

For illustrative purposes only. This information should not be relied upon as investment advice, research, or a recommendation by BlackRock regarding the iShares Funds (ii) the use or suitability of the model portfolios or (iii) any security or financial product in particular.

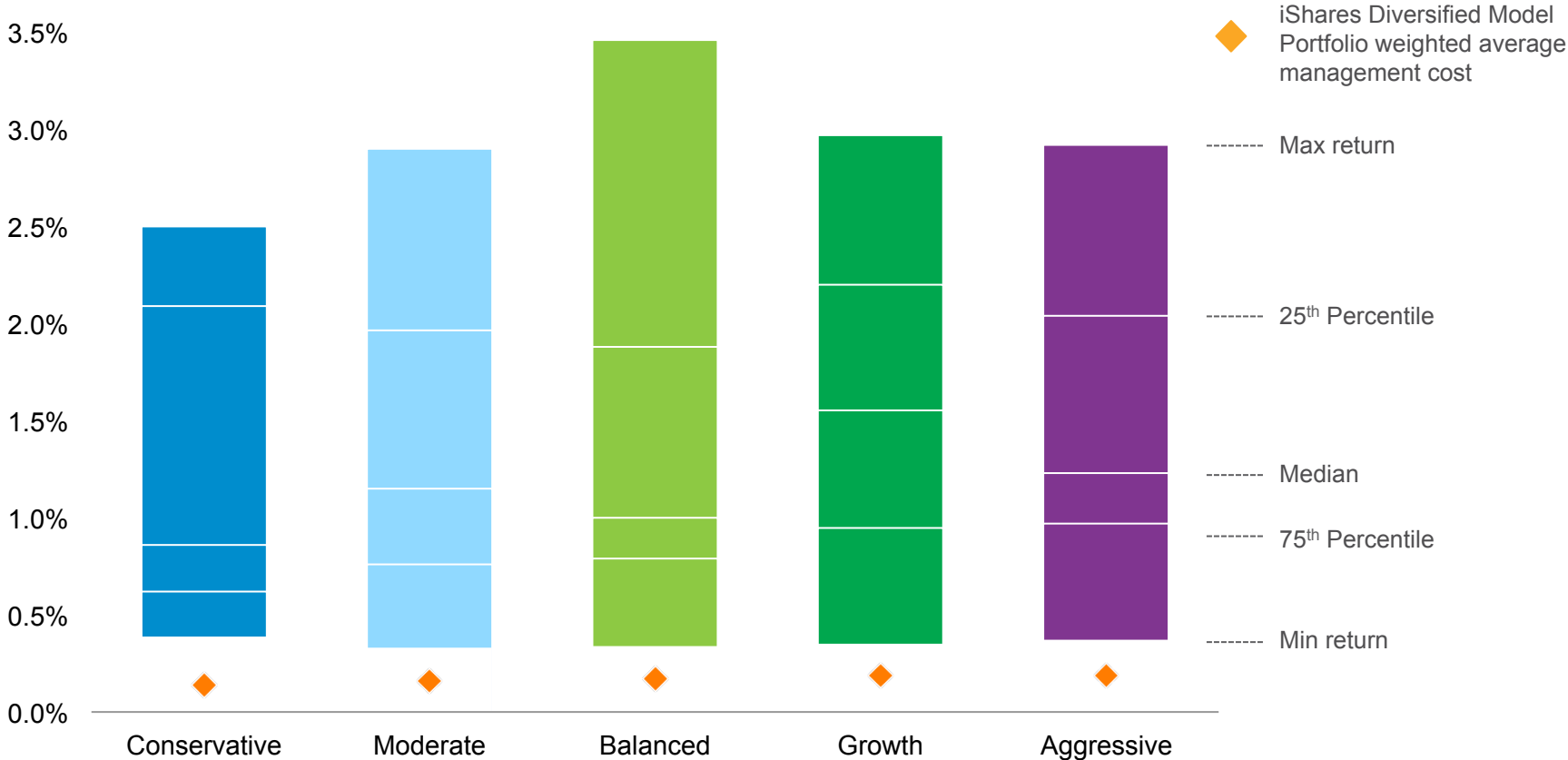
1. The efficient core: building iShares Diversified Model Portfolios

- ▶ **Simple** portfolios based on average asset class allocations by Australian managed funds in these categories
- ▶ **Low-cost** way to access the 'better than' average
- ▶ **Control** the investment outcome



1. The efficient core: low cost

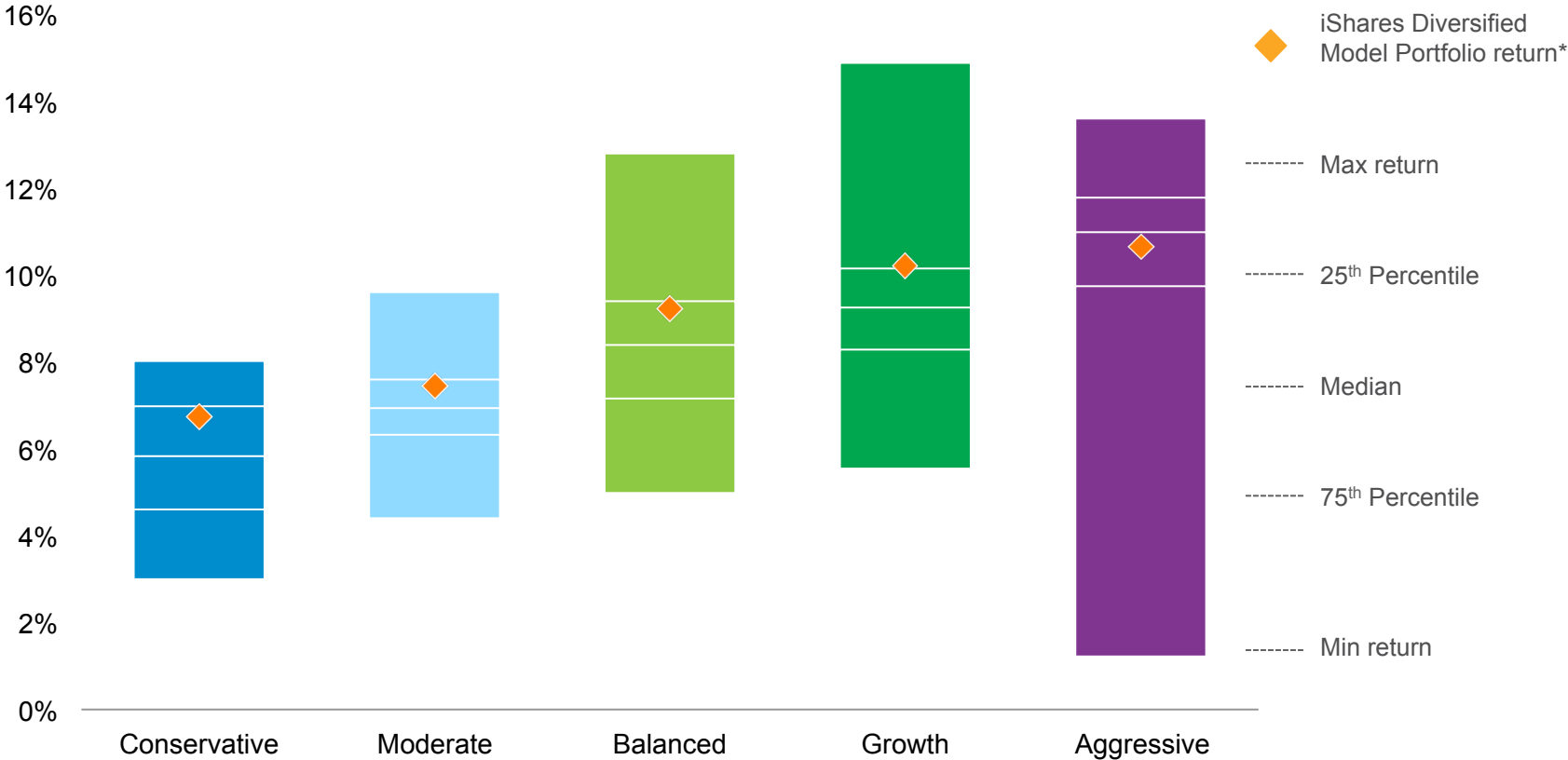
iShares Diversified Model Portfolios ongoing costs are well below the lowest multi-sector managed fund



Source: Morningstar and BlackRock as at 17 April 2014. Indirect Cost Ratio (ICR) as reported by Morningstar has been used to construct the max/min/average for each category. iShares Diversified Model Portfolios cost calculated as the weighted average ETF Management Costs.

1. The efficient core: 5 year annualised total return






iShares Diversified Model Portfolios outperform the average in all categories



*Due to limited ETF performance history, the performance of each iShares Diversified Model Portfolio relates to the underlying indices, less portfolio weighted average management cost, not the iShares ETFs, and do not take into account transaction costs, rebalancing costs, taxation and tracking error.

Source: Morningstar and BlackRock as at 31 December 2013. Past performance does not guarantee future results.

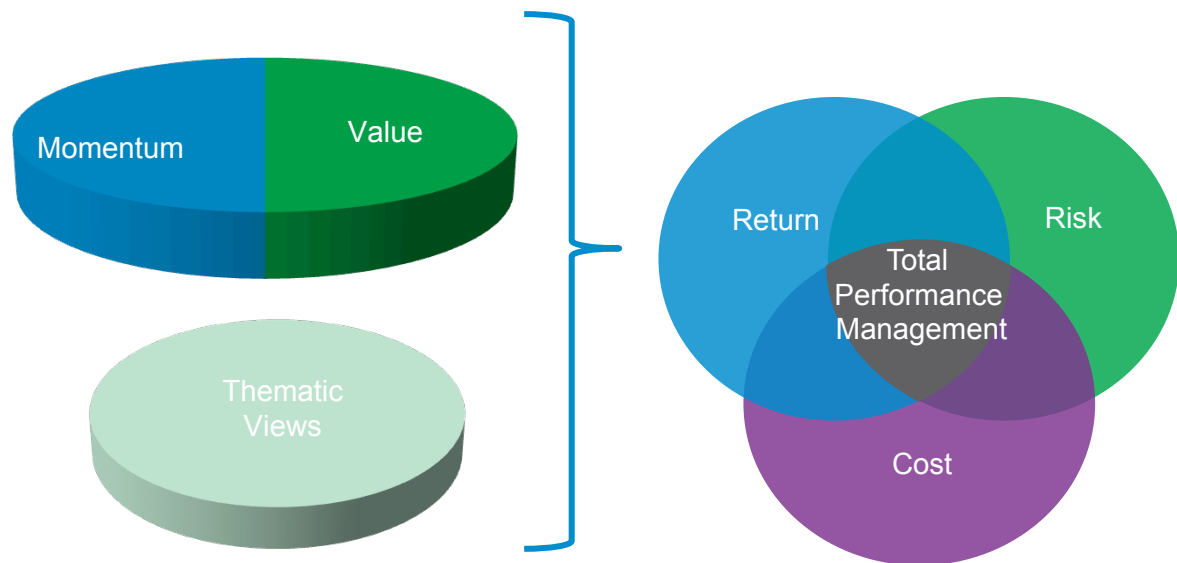
2. The tactical asset allocation: BlackRock Enhanced Strategic Models

		Conservative	Moderate	Balanced	Growth	Aggressive
						
Asset Allocation (% Growth / Defensive)		15.9/84.1	31.2/68.8	51.5/48.5	71.6/28.4	86.7/13.3
Weighted Average Expense Ratio		0.15%	0.19%	0.24%	0.26%	0.28%
Standard Deviation ¹		2.14%	3.51%	5.56%	7.67%	9.22%
Australian Equity		10.3%	18.5%	27.7%	37.8%	42.8%
IOZ	iShares MSCI Australia 200 ETF	8.1%	15.2%	23.4%	32.4%	36.4%
ISO	iShares S&P/ASX Small Ordinaries ETF	2.2%	3.3%	4.3%	5.4%	6.4%
International Equity		3.5%	8.2%	17.4%	26.2%	35.0%
IVV	iShares Core S&P 500 ETF	2.1%	4.9%	10.9%	15.8%	21.7%
IVE	iShares MSCI EAFE ETF	1.4%	3.3%	-	-	-
IEU	iShares Europe ETF	-	-	6.0%	9.0%	11.0%
IJP	iShares MSCI Japan ETF	-	-	0.5%	1.4%	2.3%
Emerging Equity		2.1%	4.5%	6.4%	7.6%	8.9%
IEM	iShares MSCI Emerging Markets ETF	0.8%	3.0%	4.4%	5.5%	6.6%
IZZ	iShares China Large-Cap ETF	1.3%	1.5%	2.0%	2.1%	2.3%
Fixed Income		40.1%	37.8%	32.5%	19.4%	9.3%
IAF	iShares Composite Bond ETF	32.2%	29.5%	24.8%	13.5%	4.2%
ILB	iShares Government Inflation ETF	7.9%	8.3%	7.7%	5.9%	5.1%
Cash		44.0%	31.0%	16.0%	9.0%	4.0%
-	Bloomberg AusBond Bank Bill Index	44.0%	31.0%	16.0%	9.0%	4.0%

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2. The tactical asset allocation: what drives the tactical allocation?

Position portfolios tactically across countries, sectors and themes using iShares ETFs



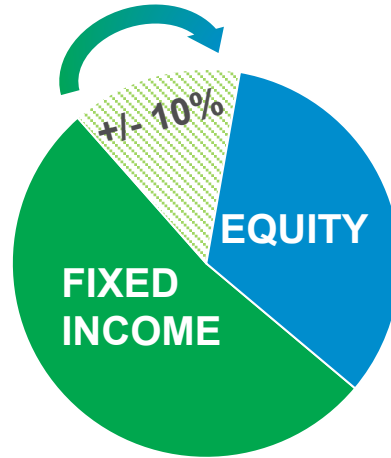
Key insights:

- **Valuation**: Mean-reversion of under or overvaluation based on market fundamentals.
- **Momentum**: Empirical research shows markets underreact to news for behavioral and market structure reasons in mid-term horizon.
- **Thematic Views**: Capture long term trends and short term Policy surprises.

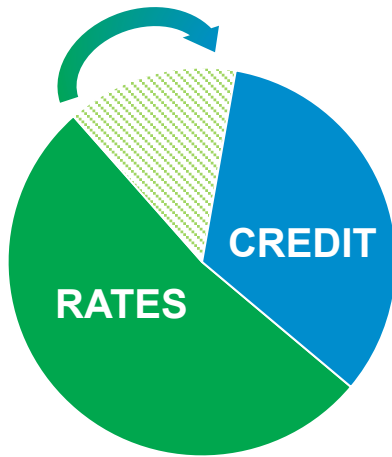
Leverage BlackRock global research resource and systematic approach to identifying tactical market opportunities globally

2. The tactical asset allocation: how does it aim to deliver outperformance?

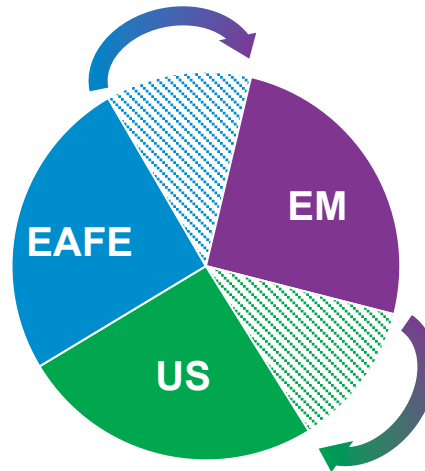
1) Broad Asset Class Tilts



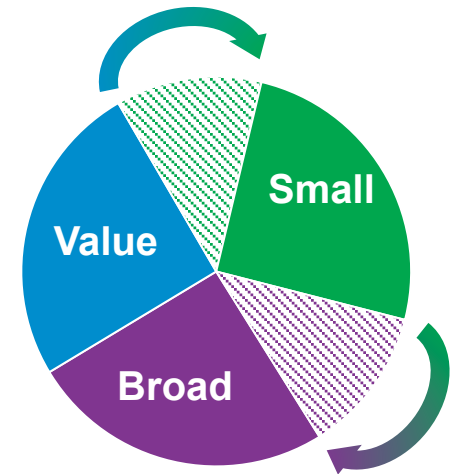
2) Within Asset Class Selection



Fixed Income



Global Equity



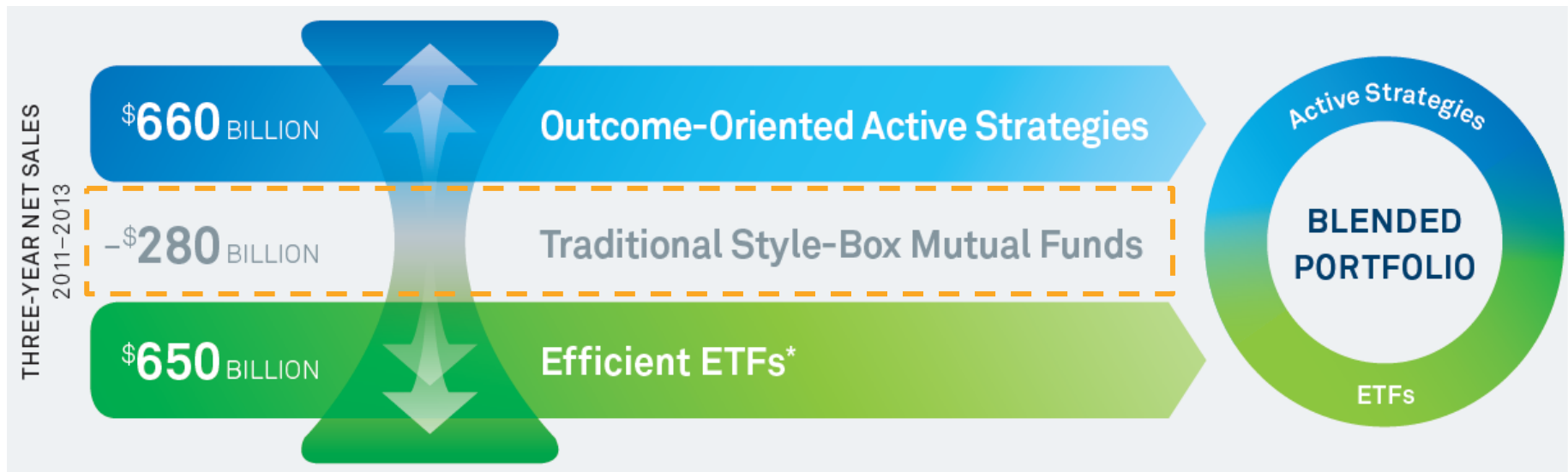
Australian Equity

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C. **Blending** ETFs and active funds

A new industry landscape is taking shape

Investors Continue Moving Toward a Blended Approach



Why are investors abandoning traditional style-box mutual funds?

Data represented above in respect of US-domiciled funds. Source: Simfund, as of 12/31/13. AUM and net flows include ETFs and open end mutual funds. Categories based on Lipper categories.

Finding value in active management

- Investors are best served by active when they provide outcomes and growth that indexes cannot
- A basic framework can help investors in judging for themselves which active managers are best incorporated in a portfolio

Outcome-Oriented

- ▶ Designed to achieve a specific client objective with equity growth; e.g.:
 - Income
 - Protection
 - Diversification
- ▶ Clear mandate and measure of success



INCOME



GROWTH

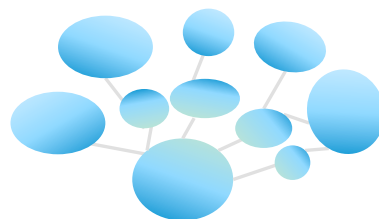


PROTECTION

Offering clients solutions for their individual needs

Flexible

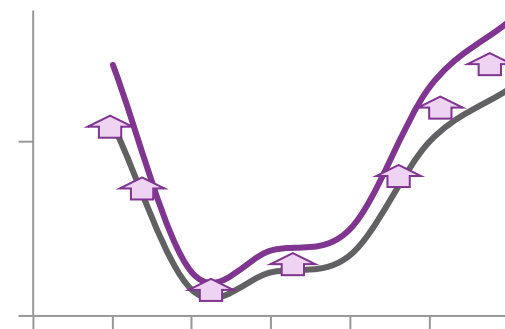
- ▶ “Go-anywhere” to take advantage of opportunities
- ▶ Maximize potential for manager skill to produce higher returns or lower risk



Clearly differentiated products with higher tracking error

Benchmark Plus

- ▶ **High conviction managers** with a proven and repeatable process for delivering excess returns

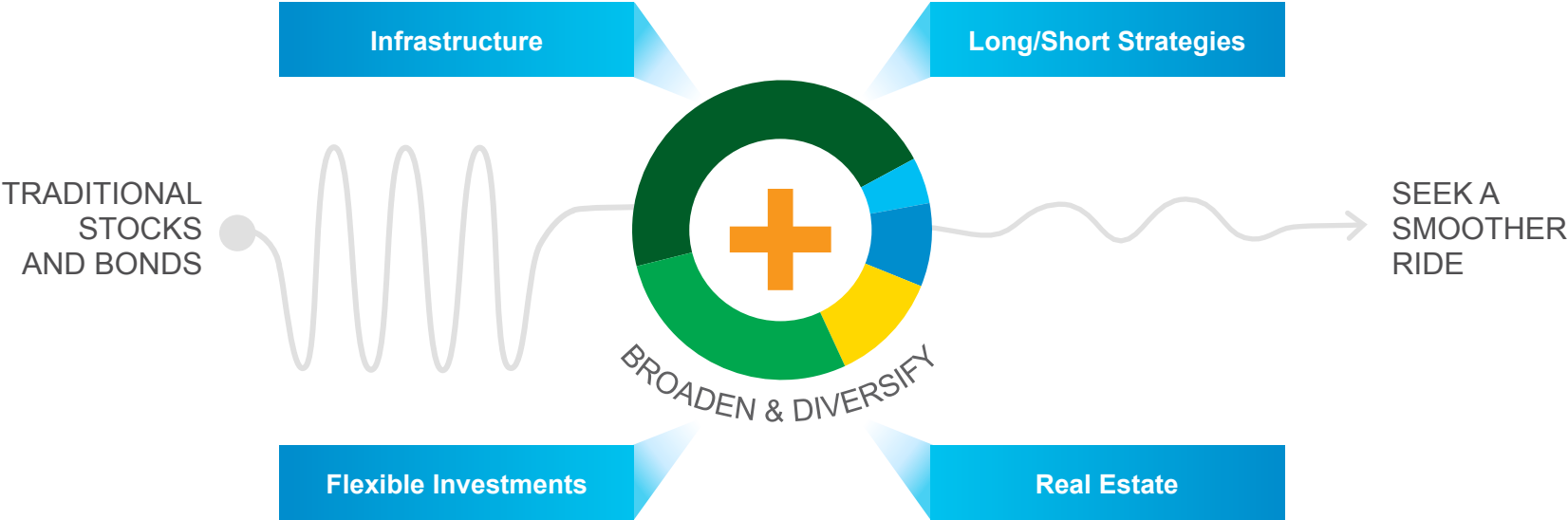


Traditional actively managed, benchmark plus products

Going beyond traditional stocks and bonds

Investors Continue Moving Toward a Blended Approach

Use **non-traditional tools** to diversify and seek a smoother ride

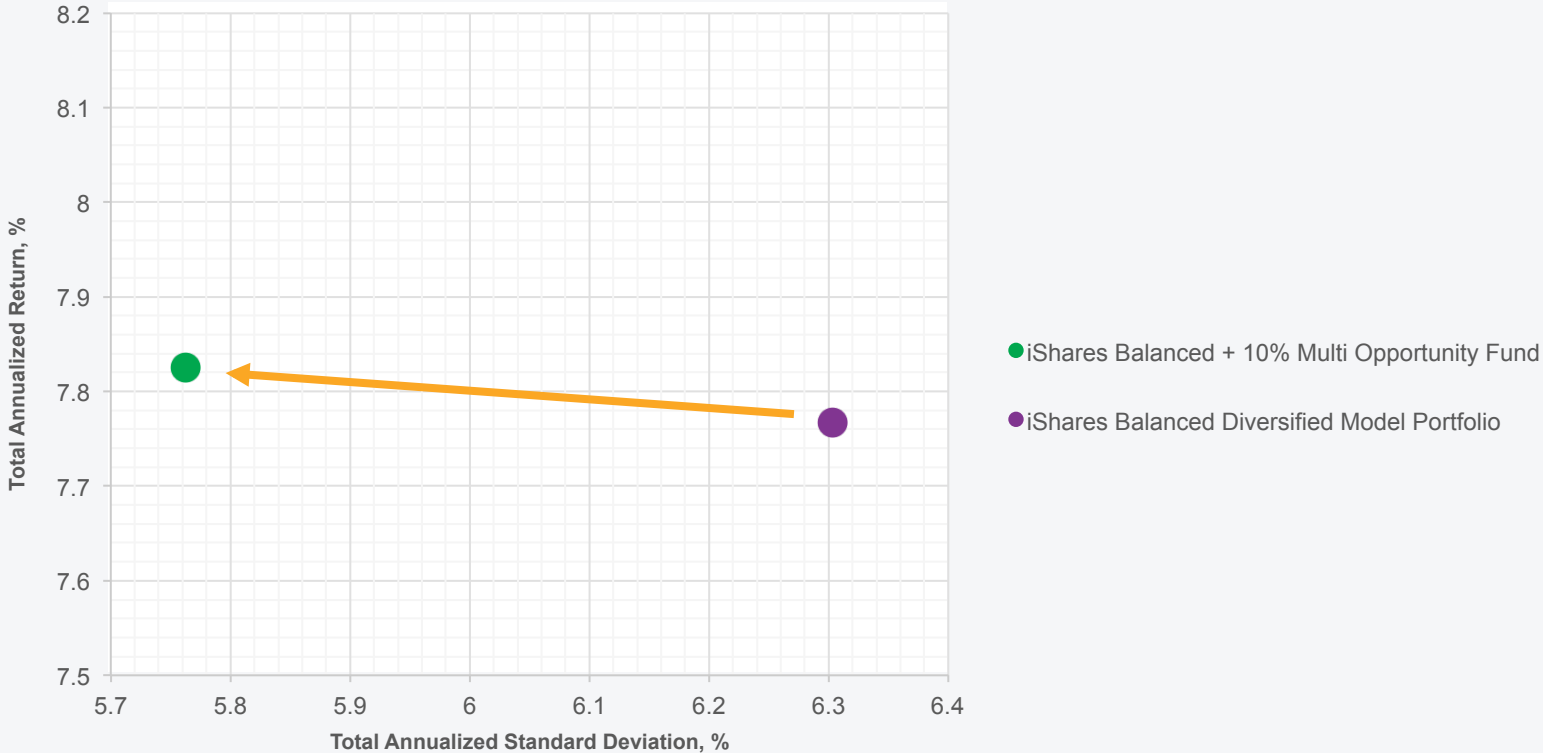


Consider **long/short strategies, infrastructure, real estate, and flexible investments**

Charting our journey

10 year risk/return of a balanced portfolio and a blended portfolio with a simple 10% allocation to the BlackRock Multi Opportunity Absolute Return Fund

Performance vs Risk, April 2005 – March 2015



Source: BlackRock, MPI Stylus Analytics. For illustrative purposes only. Past performance is not a reliable indicator of future performance. Net returns are used for the BlackRock Multi Opportunity Absolute Return Fund applying fee of 1.4% base plus 20% performance fee. Assumes reinvestment of distributions. Typical Balanced Portfolio Asset Allocation based on the following indices: Bloomberg AusBond Composite Index, Barclays Global Aggregate Bond Index Hedged to \$A, Bloomberg AusBond Bank Bill Index, MSCI World Ex Australia, MSCI World Ex Australia Hedged to \$A, S&P/ ASX All Ordinaries and S&P/ASX300 REIT.

Recap: using ETFs to build portfolios



Getting asset allocation right is the primary driver of returns

The process you choose to build portfolios must be robust and scalable

Depending on your clients and value proposition, you may also be able to deliver additional value with a tactical asset allocation

Once you have the basics right, it may be possible to further improve risk adjusted returns by blending index and active

Manager skill is essential

3. Knowledge applied: Q & A

Taking ETFs to the next level

1. **Know what you own: the ETF due diligence check list**
2. **Know how to use it: using ETFs to your client's advantage (and yours)**
3. **Knowledge applied: Q & A**

iShares make investing simpler, easier, and more efficient for investors of all sizes

TRUSTED ETF LEADER

- ▶ Serves investors of all sizes—wealth managers, banks, asset managers, pensions, insurers, advisors, and personal investors
- ▶ Brings you more than a decade of ETF innovation and expertise
- ▶ The scale of iShares benefits you through indexing excellence, breadth of choice, and global liquidity

SUSTAINED RECORD OF PERFORMANCE

- ▶ iShares have delivered strong performance through tight tracking, deep liquidity, and institutional-quality indices¹
- ▶ 700+ funds globally—the most comprehensive range of choices for your portfolios, 28 listed on ASX
- ▶ iShares give you versatility to build the core of your portfolio, help meet specific goals, and implement your market views

POWERED BY BLACKROCK

- ▶ Expert portfolio management actively seeks to optimize returns, risk, and cost
- ▶ Risk-managed by Aladdin, BlackRock's industry-leading technology platform
- ▶ Specialized client teams who help you choose the right iShares ETFs, trade efficiently, and build better portfolios

For assistance with trading please call iShares' Capital Markets team: +61 2 9272 2345

¹ See appendix. There can be no assurance that an active trading market for shares of an ETF will develop or be maintained.

IMPORTANT INFORMATION

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