

A SIMPLE DEFENSIVE SECTOR STRATEGY

- **Defensive sectors are often added to *tilt* the overall risk characteristics of a portfolio. We test the potential for outperformance of an equally-weighted basket of three defensive sectors (“DSS”).**
- **We find scope for significant *average* outperformance of the DSS during market downturns, across geographies, and with a high *rate of success* in reducing losses...**
- **...while still participating in market upside prior to downturns, providing some leeway in terms of timing the implementation of DSS.**
- **Finally we address questions of sizing of the DSS in portfolios based on investors’ active risk budget.**

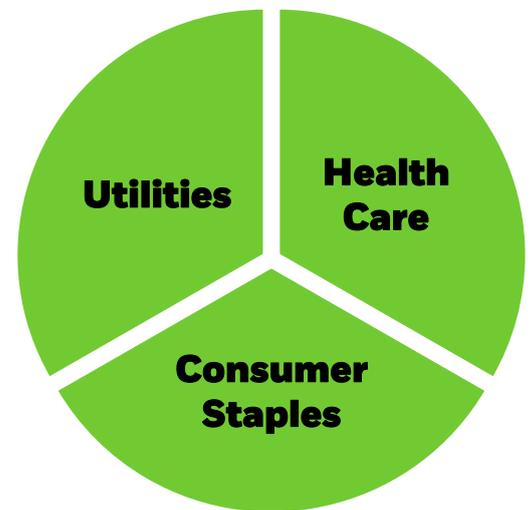
1. Defensive Sectors Strategy

Sectors are often categorised as either cyclical or defensive: Cyclical sectors tend to outperform the broad index in periods of economic expansion while Defensive sectors may outperform the broad index in periods of market correction. Consumer Staples, Healthcare, and Utilities are generally considered to be defensive sectors given the inelastic demand for the output from these sectors.

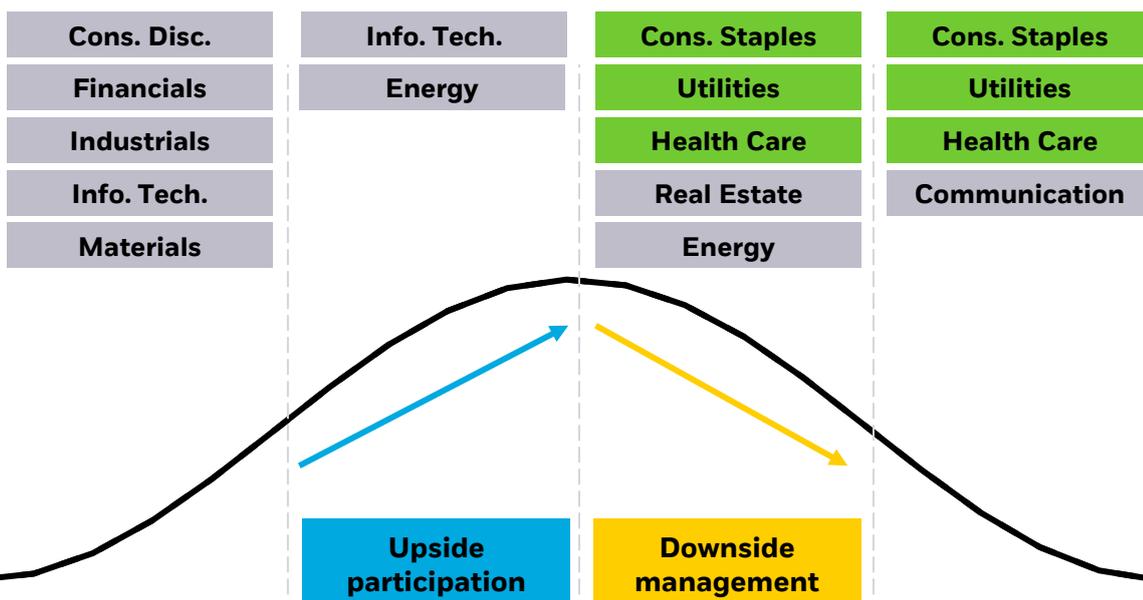
We set out to assess if these three sectors combined, which we name **Defensive Sector Strategy (“DSS”)**, have indeed shown greater resilience in periods of economic downturn or market stress. We test the effectiveness of this strategy against both:

- 1 **Downside protection** during contraction periods
- 2 **Upside participation** during periods before contraction periods

Defensive Sector Strategy (DSS) Basket
An equally-weighted basket of three sectors



Mapping sectors through the cycle



2. Downside management

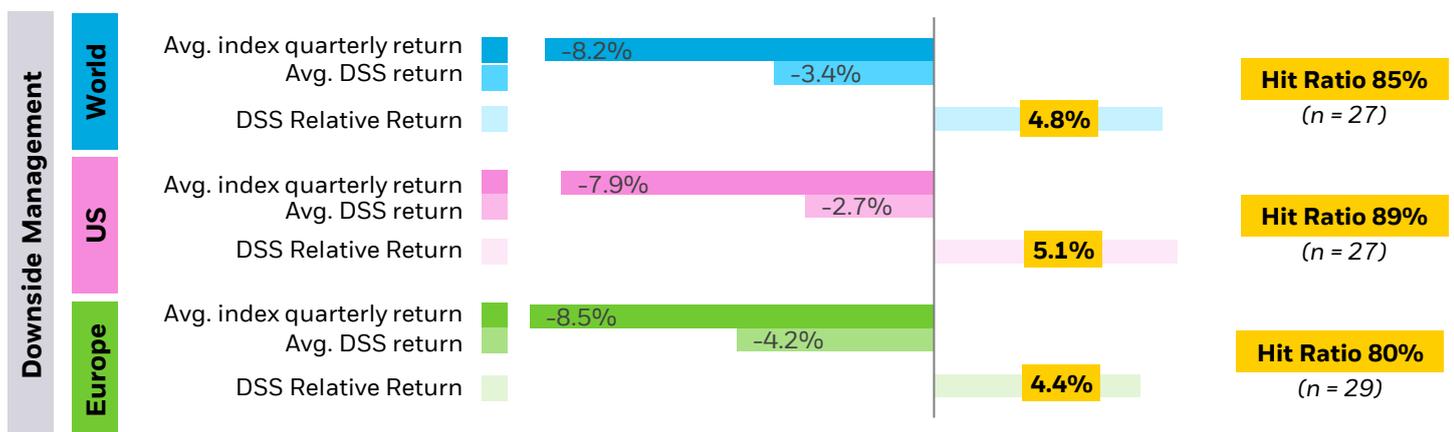
We analysed the performance of an equally-weighted basket of the Consumer Staples, Healthcare, and Utilities sectors during all periods in which their parent indices registered negative quarterly returns since the year 2000.

The results are telling. The Defensive Sector Strategy (DSS) delivered an average outperformance against its parent index to the tune of 4.4%-5.1% depending on the region. Moreover, this significant average outperformance against the benchmark occurred with a high rate of success as measured by the relative hit ratio. We define the relative hit ratio as the number of observation in which the DSS basket outperforms the index compared to the total number of observations.

The Defensive Sector Strategy (DSS) delivered significant outperformance against the broad indices, on average and across geographies, and with a high rate of success, above 80%.

Downside management

Defensive Sector Strategy (DSS) vs. broad index during periods of negative return



Note: “Hit ratio” refers to the number of observations where DSS outperforms the parent index divided by total number of observations. Total number of observations shown as (n = X).

Index	30 Aug 16 30 Aug 17	30 Aug 17 30 Aug 18	30 Aug 18 30 Aug 19	30 Aug 19 30 Aug 20	30 Aug 20 30 Aug 21
SPTR500N	12.1%	19.1%	10.4%	6.5%	31.1%
SPSVHCN	9.3%	19.7%	2.2%	11.1%	23.5%
SPSVULN	5.4%	3.5%	34.0%	-12.5%	11.4%
SPSVCSN	-1.5%	3.7%	23.4%	-0.6%	11.9%
MSDEE15N	16.3%	1.5%	5.7%	-7.8%	28.8%
NE731679	2.1%	0.1%	17.5%	-5.8%	10.7%
NE731680	6.8%	2.4%	14.9%	7.4%	12.9%
NE731683	8.0%	-1.8%	27.5%	3.8%	6.8%
NDDUWI	12.4%	13.0%	8.5%	2.7%	30.5%
M1W00HC	6.9%	16.0%	4.6%	12.4%	20.2%
M1W00UT	5.2%	2.7%	28.5%	-9.0%	9.3%
M1W00CS	-0.5%	3.5%	18.9%	-3.3%	11.3%

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. Source: BlackRock, Bloomberg, as at 30 Sep 2021. Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

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3. Upside participation

Having shown that the DSS consistently outperformed the parent index in historical periods of equity market decline, a natural question arises: How does the strategy perform in the run-up to such events?

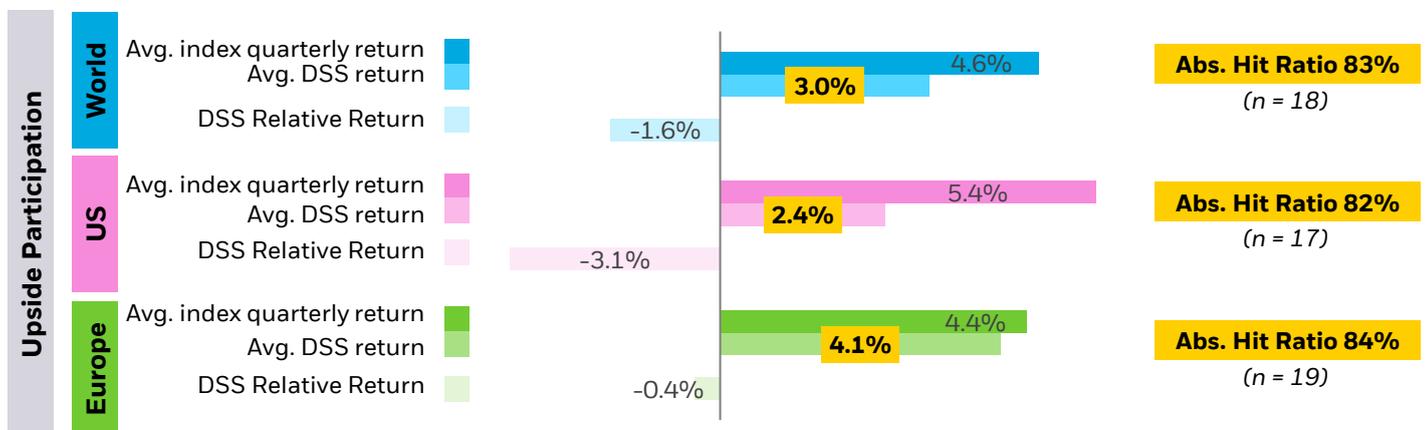
Across regions, the DSS has underperformed in the last positive quarter before a negative quarter for the wider market. However, it is noteworthy that the DSS still delivered favourable outcomes in two aspects:

1. The DSS has realised on average positive *absolute* returns in the last quarter of market gains. In other words, DSS can deliver upside market participation should the market rise. Further, the DSS's positive returns occurred with a high rate of success, or absolute hit ratio.
2. The DSS's underperformance in these pre-decline periods, between -0.4% and -3.1%, is *lower* than its average outperformance in the event of market decline. This implies using defensive sectors to build-in resilience can still be beneficial even if the allocation is added too early and in the period prior to the slowdown.

The DSS still participates in the market upside prior to a decline. And though it underperforms the market, that underperformance is lower than its subsequent outperformance. This provides some leeway in terms of timing the implementation of DSS.

Upside participation

Defensive Sector Strategy DSS vs. broad index during quarters preceding a negative quarter



Note: "Abs. Hit ratio" refers to the Absolute Hit Ratio, reflecting the number of observations where DSS delivers positive absolute returns, divided by the total number of observations. Total number of observations shown as (n = X).

Index	30 Aug 16 30 Aug 17	30 Aug 17 30 Aug 18	30 Aug 18 30 Aug 19	30 Aug 19 30 Aug 20	30 Aug 20 30 Aug 21
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NE731680	6.8%	2.4%	14.9%	7.4%	12.9%
NE731683	8.0%	-1.8%	27.5%	3.8%	6.8%
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M1W00UT	5.2%	2.7%	28.5%	-9.0%	9.3%
M1W00CS	-0.5%	3.5%	18.9%	-3.3%	11.3%

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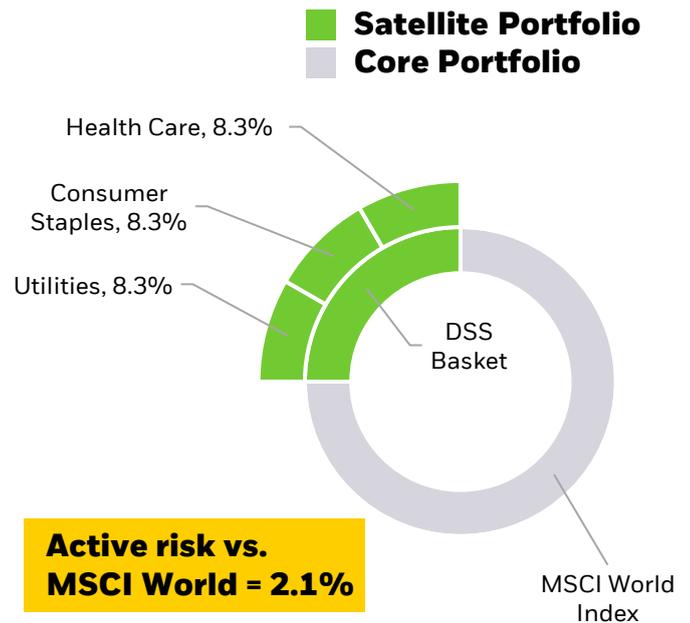
Source: BlackRock, Bloomberg, as at 30 Sep 2021. Index performance is for illustrative purposes only. Index performance does not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

4. The portfolio context

Deviations from benchmark, such as sector overweights or underweights, will lead to active risk vs. the benchmark. Investors can size their allocation to the DSS depending on their risk tolerance and/or their market conviction.

For example, for a \$100mn portfolio benchmarked to the MSCI World Index, a \$25mn allocation (25%) to a basket of DSS coupled with \$75mn (75%) in the benchmark index, would result in an overall portfolio with 2.05% active risk. A higher (lower) risk tolerance would call for a higher (lower) allocation to the DSS.

Portfolio sizing example



Budgeting for active risk

Table below illustrates various weightings for Defensive Sector Strategy and the resulting active risk

Index Weight (%)	DSS Weight (%)	Active Risk (%)		
		World	US	Europe
100	0	0%	0%	0%
90	10	0.8%	1.0%	0.9%
80	20	1.6%	1.9%	1.7%
70	30	2.5%	2.9%	2.6%
60	40	3.3%	3.8%	3.4%
50	50	4.1%	4.7%	4.3%
40	60	4.9%	5.7%	5.2%

Source: Aladdin, As of: 13 Sept 2021.

Note: DSS basket made of equal weighted Consumer Staples, Health Care and Utilities sectors. Index tickers are M1WO Index, SPTR500N Index, and M7EU Index.

5. Conclusion

A simple strategy of equally-weighting three defensive sectors, namely Consumer Staples, Healthcare and Utilities, may be able to help build portfolio resilience for investors expecting market declines, while still enabling their participation in potential market gains should the event occur later than anticipated. The historical outperformance of this defensive sector strategy outweighs the historical underperformance in the periods of positive return ahead of the slowdown. This implies using defensive sectors to build-in resilience can be beneficial even if the allocation is added earlier and in the period prior to the slowdown.

Sector investing with iShares

Sector ETFs allow investors to customise their portfolios, providing them with the tools to express targeted views on the markets. This top-down approach has been increasingly used by investors looking to benefit from the large performance dispersion across the different sectors observed over the last years. iShares offers the largest and broadest UCITS sector range¹, which can provide investors with access to sectors across different geographic regions at low cost.

43%
Average annual performance differential between the best and worst performing world sector over the last 10 years²

\$11.7B
Net inflows into UCITS Sector ETFs year to date in 2021¹ after \$10B of net flows in 2020

49
iShares Sector ETFs, 23 GICS L1 ETFs

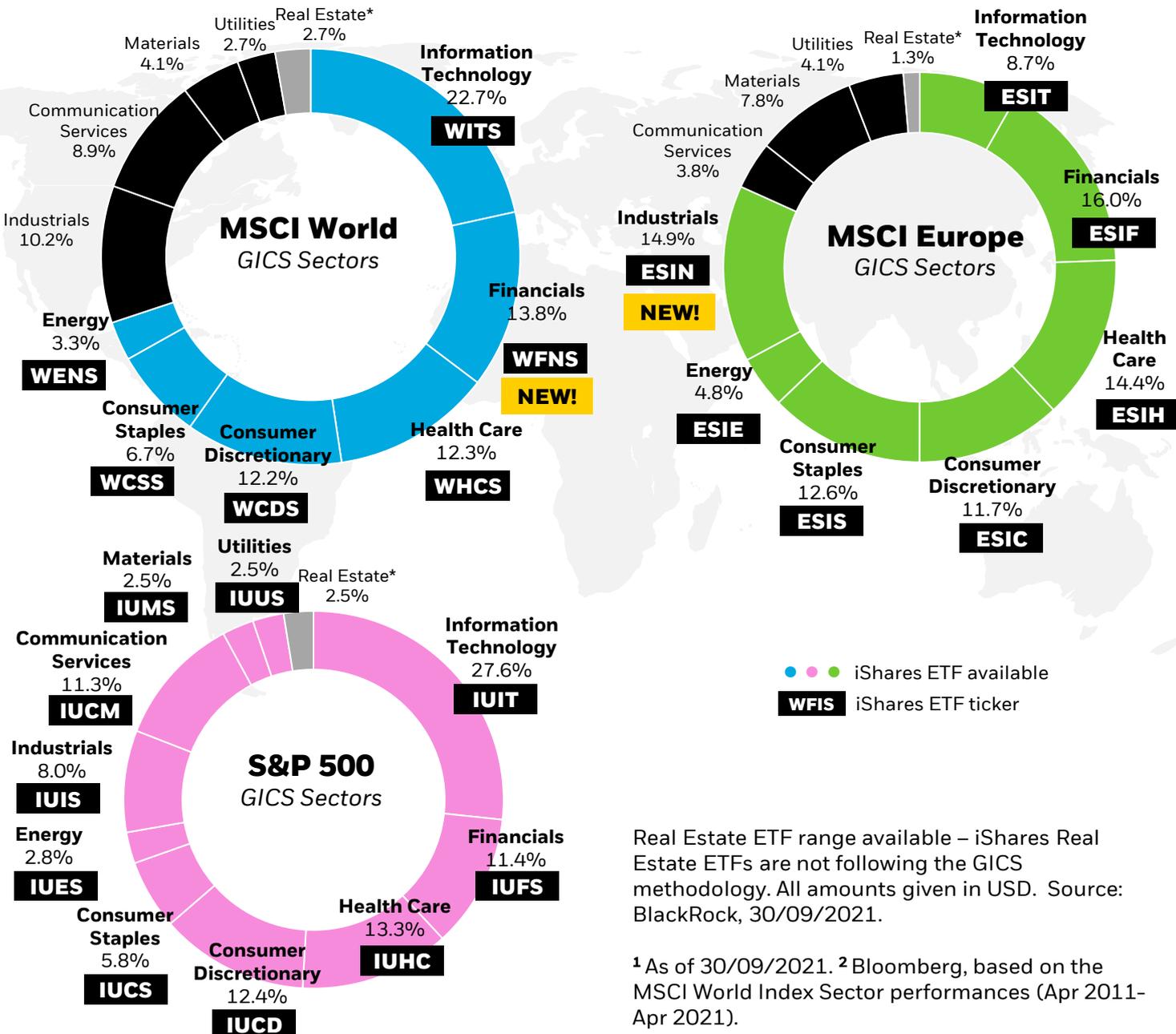
0.15%
iShares S&P 500 Sector ETFs TER

0.25%
iShares MSCI World Sector ETFs TER

0.18%
iShares MSCI Europe Sector ETFs TER

Developed Market Sectors

GICS Sector and MSCI regional breakdown



Real Estate ETF range available – iShares Real Estate ETFs are not following the GICS methodology. All amounts given in USD. Source: BlackRock, 30/09/2021.

¹ As of 30/09/2021. ² Bloomberg, based on the MSCI World Index Sector performances (Apr 2011-Apr 2021).

iShares & BlackRock index and alpha-seeking product verticals

	Info Tech	Industrial	Utilities	Financials	HealthCare	Cons. Disc.	Cons. Staples	Com. Services	Energy	Materials
	Recovery / Expansion	Recovery	Slowdown / Contraction	Recovery	Slowdown / Contraction	Recovery	Slowdown / Contraction	Contraction	Expansion / Slowdown	Recovery
Size	+++	+++		+++		+++				+++
Value	+++	+++		+++		+++				+++
Momentum									+++	
Quality			+++		+++		+++	+++	+++	
Min. Vol.			+++		+++		+++	+++	+++	

Global Sector ETFs

MSCI World GICS L1	Info Tech			NEW Financials	Health Care	Cons. Disc.	Cons. Staples		Energy	
Other	NEW Semi-Conductor	DM Infra EM Infra		Listed Private Equity					Oil & Gas Exploration	Gold Producers

US Sector ETFs

S&P 500 GICS Level 1	Info Tech	Industrials	Utilities	Financials	Health Care	Cons. Disc.	Cons. Staples	Com. Serv.	Energy	Materials
Other GICS				US Banks	Biotech Medical Devices					

European Sector ETFs

MSCI Europe GICS L1	Info Tech	NEW Industrials		Financials	Health Care	Cons. Disc.	Cons. Staples		Energy	
STOXX Europe 600 ICB Level 2	Tech	Industrial Good & Serv.	Utilities	Banks Financial Serv. Insurance	Health Care	Auto & Parts Travel & Leisure Retail	Food & Beverages Personal & House. goods	Telecom. Media	Oil & Gas	Basic Resources Constr. & Materials Chemicals
Other	TecDax			Stoxx Banks				Stoxx Telecom.		

Active sectors

Active Funds	Tech			Financials	Health Care				Energy	Gold Mining Natural Resources
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Thematics

Index Exposure	Autom. & Robotics Digital Security Digitalisation	Smart City Infra	Clean Energy Global Water DM & EM Infra	Inclusion & Diversity	Ageing population Health care innovation	Electric Vehicle EM Consumer	Agri-business			Global Timber & Forestry
Active Exposure	Next Gen Tech	Future of Transport		Fintech	Next Gen Health Care	Future Consumer	Nutrition		Sustainable Energy	Circular Economy

Source: BlackRock, 12 Oct 2021. Reference to individual investments mentioned in this communication is for illustrative purposes only and should not be construed as investment advice or investment recommendation.

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Product Risks

iShares MSCI Europe Consumer Discretionary Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI Europe Consumer Staples Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI Europe Energy Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk, Investments in Energy Securities Risk

iShares MSCI Europe Financials Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI Europe Health Care Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI Europe Industrials Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI Europe Information Technology Sector UCITS ETF EUR (Acc)

Concentration Risk, Counterparty Risk, Equity Risk, Investment in Technology Securities Risk

iShares MSCI World Consumer Discretionary Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI World Consumer Staples Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI World Energy Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Equity Risk, Investments in Energy Securities Risk

iShares MSCI World Financials Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Credit Risk, Equity Risk

iShares MSCI World Health Care Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Equity Risk

iShares MSCI World Information Technology Sector UCITS ETF USD (Dist)

Concentration Risk, Counterparty Risk, Equity Risk, Investment in Technology Securities Risk

iShares S&P 500 Communication Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Consumer Discretionary Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Consumer Staples Sector UCITS ETF

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Energy Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk, Investments in Energy Securities Risk

iShares S&P 500 Financials Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Health Care Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Industrials Sector UCITS ETF

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Information Technology Sector UCITS ETF USD (Acc)

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Materials Sector UCITS ETF

Concentration Risk, Counterparty Risk, Equity Risk

iShares S&P 500 Utilities Sector UCITS ETF

Concentration Risk, Counterparty Risk, Equity Risk, Investments in Energy Securities Risk

Description of Product Risks

Concentration Risk

Investment risk is concentrated in specific sectors, countries, currencies or companies. This means the Fund is more sensitive to any localised economic, market, political or regulatory events.

Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Share Class to financial loss.

Equity Risk

The value of equities and equity-related securities can be affected by daily stock market movements. Other influential factors include political, economic news, company earnings and significant corporate events.

Investments in Energy Securities Risk

Investments in energy securities are subject to environmental concerns, taxes, government regulation, price and supply changes.

Investment in Technology Securities Risk

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