TRANSCRIPT

Fund your future with income ETFs

Sean Murphy: Thank you. Thank you. And thank you all for joining us. My name is Sean Murphy, I'm a vice president with the iShares product consulting team, and we're a team that helps our salespeople as well as helping financial advisors find the right funds that solve investor challenges. I've been with BlackRock now a little over five years. Prior to that I spent 12 years at Citi, where I was in equity and ETF trading. And I'd like to share a little bit of a fun fact about me. On Sunday of this weekend I'm going to be running a Halloween half marathon. My costume will be an out of shape guy who regrets signing up for a half marathon. (laughter) It's a very cheap costume. I just have to basically be myself.

Bill Purvin: I think I have that costume too.

Sean Murphy: So I digress. Enough about me, let's talk about what you're all here to hear about and that is about income, specifically how iShares ETFs can help fund your future. This is a very hot topic right now for people in my shoes for financial advisors and clients like yourselves. The baby boomer generation is at or nearing retirement and that money they've worked so hard for, well, it's time for that money to work for them. But a lot of investors are sweating

because the challenges in income right now are pretty steep. I'll explore this space a little bit. We have a lot of investors sitting in cash for any one of a number of reasons. Like I said, they could be near retirement, they could be just trying to de-risk. The problem, though, is that available options for cash are -- and this is a technical term -- they're yielding bupkis right now. So, as evidence of this we did a survey of savings rates at banks and the average savings rate was 0.1 percent. Not much better in money markets or in CDs. Locking your money for a year, still not getting you to that one percent figure. The number that's really important, though, on this screen is that last bar, that 1.6 percent. You might put your money under your mattress, and sure that money will be there the next day. You won't lose it but that money is losing value if you're not getting at least 1.6 percent.

So, let's say you are an investor who recognizes this challenging environment and you decide, I'm going to take money out of my CDs, out of my money markets, and I want to put that money to work in the marketplace. Your first look is often the fixed income market. Well, things are pretty challenging there as well. In 2007, if let's say you wanted to yield about four percent on your investment, you could just spin the fixed income wheel because 100 percent of the fixed income market was yielding north of four percent. The risk-free rate three-month U.S. treasury bills in 2007 were yielding north of four

percent. Now you fast forward to today, 2019, that last bar, not so promising is it? Less than 20 percent of the fixed income market is now yielding north of four percent. And in order to get that you're taking on quite a bit of risk. You're looking at emerging market or high-yield debt. Think about that. Twelve years ago, you could invest with the risk-free investor, the U.S. Treasury, and get north of four, and now you have to look at high-yield and emerging market bonds.

This is the dichotomy that income investors are facing these days. You can sit in cash or sit in your savings account and not cover inflation, or if you need higher levels of income, you're taking on more risk. Traditional sources of income are just not cutting it. So, investors are starting to take on more risk to generate that income they need, some alternative sources like REITs, like emerging market debt, like preferred stock. The problem is, if you're generating higher levels of income, well then the likelihood, the possibility of you losing some of your money, increases. The key is recognizing -- and I'm probably going to say this about a dozen times today -- the key is recognizing the benefits of diversification and knowing what risks you're exposed to.

And that's where ETFs come in. ETFs give you instant diversification and invest in a way that's transparent. For those who need a little bit of a refresher

on ETFs, or haven't dealt with ETFs before, ETFs stand for Exchange-Traded Fund. And they're trying to give you the same benefits as mutual funds. And mutual funds offer a lot of benefits. For starters, you get instant diversification with one purchase, access to hundreds, potentially thousands of securities. You get access to a professional portfolio manager and team. They have tools at their disposal that most investors, myself included, don't have. Bloomberg terminals. Ivy League-educated analysts. Algorithms. You name it. But mutual funds do have a couple of shortcomings. For starters, you can't buy it like a stock whenever you want during the market hours. You'd have to buy it essentially at the end of the day. And second, you don't get the transparency. If you own a mutual fund, go to their -- a mutual fund website, type in that fund, and look at their holdings. And more than likely you're looking at a list of holdings that's a couple of months old.

So, ETFs try to incorporate some of the benefits while missing some of those shortcomings. ETFs do have portfolio managers. You get access to hundreds if not thousands of securities with one purchase. A couple of funds we'll be talking about have six, 7,000 holdings, individual line items that you can see as of this morning. You can go to ishares.com, type in a ticker, and see all of the holdings of that fund. And that's what's key for income investors: knowing what risks you're taking.

When we talk to the ETF investors and ask what are the reasons that they are purchasing ETFs we get one of three responses. Typically, first is they provide competitive performance in relation to mutual funds. So, as evidence of this we have some stats here on our U.S. equity funds. We have nine U.S. equity ETFs that track S&P indexes. And the average one of those nine funds has beaten 73 percent of the competing mutual funds over the past five years. 73 percent. They've done this at a significantly lower cost. The typical ETF costs about a third of a mutual fund -- and I should say a typical iShares ETF costs about a third of a mutual fund. And for income investors the cost of a fund is much more important because whatever income you receive from a mutual fund or an ETF is after the fund takes out its expenses, after it takes out its expense ratio. So, if you have two of the same portfolios but one has a higher expense ratio, well, it's going to distribute less in income to you. And lastly, ETFs are more tax efficient. What do I mean by that? Well, taxes for mutual fund or ETF investors come from really two things: capital gain distributions and from the income that they receive. ETFs, because of their structure, are less likely to distribute capital gains, which is something that if you're invested in mutual funds and taxable accounts, now's the time start looking out for those capital gain distributions. But because of the strategy, most of our ETFs are index funds. The income they distribute tends to be more qualified

dividend income. And qualified dividend income is taxed not at your income rate but at long-term capital gains rates.

So, we've talked about the challenges income investors face, we've talked a little bit about the benefits of ETFs. Now let's take a look at the iShares ETF income toolkit. Before I get into this a couple of things. I'm going to go a little bit off script here. I love my job. This is the happiest I've been in my career and I'm not saying that because there's cameras, I'm not saying that because my annual review is coming up, (laughter) my boss -- great guy by the way -- but I love my job because iShares has 350-plus products, so no matter what end client I talk to, no matter what financial advisor I talk to, more than likely, whatever they're worried about, whatever exposure they're after, I probably have something that they can use. But it's also a challenge because not every income investor is the same. Some fund companies, if they hear income, they have their one fund and they go with it. But for people at BlackRock and iShares, we have to really get to know what it is you're after. And we put income investors in really three buckets. Let's say you have your money in your CDs and your money markets, and you want to take a little bit more risk but don't want to risk losing too much while getting yield in excess of inflation. Well, typically those types of investors who are looking to put cash to work should consider high quality investment-grade bonds that have a short time to

maturity. But the second group might want income, but they also are looking at this income investment in a total portfolio lens, meaning they don't just want the income, they want to diversify risks in other portions of their portfolio, particularly equity risk. And lastly you have groups of investors who need to set -- to hit certain targets of income and they're willing to take on more risk as a result. And so they're going to be looking at some of those alternative sources of income, whether it's emerging market bonds, high yield bonds, heck, even equities itself.

The key is recognizing what type of investor you are, and then once you've figured out what bucket you are in, what's the right fund for you. And I think there's three real key considerations. For starters, how much income do you actually need? Because if you don't need four percent then don't reach for it. Because as I mentioned in the beginning the more income you're getting, the more yield a particular investment is kicking off in relation to ones that are distributing less, well there's an element of risk there. So, don't take on unnecessary risk if you don't have to. Not all income is the same either. You want to look for quality income as well. So, what does that mean? Companies, based on their business model, based on certain strengths and characteristics they have, might be more likely to continue to make their income -- their interest payments or distribute income because of certain

characteristics they have. So maybe seek out some investment options that take that into consideration.

A couple of our slides here at the bottom -- you'll obviously not be able to see it but maybe some of the people watching at home can -- we have -- on pretty much every disclosure, you'll see from an asset manager it'll say "past performance is not indicative of future returns." Right? But what do we do? We're talking about future income and we're examining historical numbers, right? We have no better option. None of us have a crystal ball at our disposal. But there are things we can look at to see if that income might be able to be sustained in the future.

And lastly there's risk. If you need higher levels of income, if you need that four or five percent, make sure you understand the risks you are exposed to because there might be ways to diversify some of those risks by casting a wider net and not giving up too much in return.

So, for starters we mentioned putting cash to work. And we have four funds listed here. Our lowest-risk fund is SHV. SHV is buying short dated U.S. treasuries, treasury bonds with less than one year to maturity. And right now, it's yielding -- I looked yesterday -- it's yielding about one point... SEC yield of

about 1.7 percent. So, you're picking up yield in excess of inflation and a couple of basis points extra. The other three funds you'll see here, ICSH and EAR and MEAR are pretty unique in our offering. We have 350-plus funds and we have about five actively managed funds and those are three of them. And by "actively managed" I mean we have a portfolio manager picking investments. The way we see it, if you're looking at short duration bonds from high quality issuers, what's paramount to you is capital preservation. So, we put an extra layer of risk management by having human beings watching the investments that they're making.

And let's take a closer look at one of those investments. So ICSH is our iShares ultra-short-term bond ETF. What the team tries to do is seek income by investing in short term bonds and money market instruments. But to be clear, this is not a money market fund, all right? There is the possibility of some price fluctuation here. What I really like about ICSH on this slide in particular is we at BlackRock are constantly talking about the benefits of diversification and we eat our own cooking. If you look at the right side on that pie chart and you see that we're not concentrated in one particular area but instead we're casting a wide net to generate income, offset some risks, and stay diversified, while all the investments in ICSH are of the highest of quality investment-grade money market instruments, some CDs as well. This fund as of yesterday SEC yield of

about 2.2 percent. So, 2.2 percent, again, inflation about 1.6, so you're picking up some basis points there.

But we do have a couple of other options that I mentioned, NEAR and MEAR, but you'll see here is that NEAR is pretty close from a yield perspective with ICSH. They're both actively managed but NEAR takes on a little bit more risk. You're not going to see as much in money market instruments, in CDs, taking a little bit more risk but buying investments that have short maturity, short duration. And because it's taking a little bit more risk you get a little bit more yield, about 10 basis points, so 2.3 percent let's say.

The last of the options was MEAR, M-E-A-R, and very similar to NEAR, not just in the fact that they rhyme, but in the fact that they have a similar strategy, capital preservation, high quality investments, but instead of taxable investments they're buying tax free munis. So, you might be asking, well why would I buy MEAR if its yield is below the other option shown? Well, this is their -- you have to incorporate essentially taxes, right? MEAR and ICSH are investing investments that you're going to be taxed on the income, MEAR, investing in munis you're not. So, the tax equivalent yield of MEAR is actually a little bit above NEAR. So, for those tax-aware investors that could be a great option for you.

To give all of these funds a little bit perspective, what we did here was we plotted out the U.S. Treasury curve. Now, SHV, the most conservative option we showed, provides exposure to let's say those left three x's, treasuries with less than a year to maturity. What you'll notice is as you head to the right, bonds with 10 years to maturity aren't yielding much more. So why would a fixed-income investor buy a bond with 10 years to maturity over one with one year to maturity if you're not picking up much yield? And the reason is because for some investors it's more than just about income. They need something to help diversify other risks in their portfolio, particularly equity risk. And longer dated U.S. treasuries and investment-grade bonds do a better job of diversifying equity risk.

As evidence of this, what we did here is we went back to 1989 and we looked at those years where S&P returns were negative. And then we compared those returns that year to an index of high-quality investment-grade bonds. The index is the Bloomberg Barclays U.S. Aggregate Bond Index, and it's about 40 percent U.S. treasuries, the rest is in some securitized assets as well as corporate bonds. But what's interesting here is on those years when the equity market zigged, the aggregate bond index zagged, right? You look at 2001, for example, the dotcom bubble when toys.com and everything .com started going belly up. U.S. equity market down about 12 percent but the

investment-grade Barclays Aggregate was up 8.4 percent. More recently, 2008, U.S. equity market's down about 37 percent, and what did the Barclays Aggregate do? It was up five percent -- over five percent. So, when the equity market sells off, for some investors they want their fixed income, not just to generate income, but to help soften the blow.

The other great thing about having so many ETFs available to you is you can tweak whatever it is you're after. So AGG is our ETF that tracks that Bloomberg Barclays index. And like I said, it's about 40 percent U.S. treasuries. What you see on that first line, where it says S&P 500 correlation, what that really means, that negative number, it means that when the equity market goes up or goes down, the aggregate tends to buffer you a little bit, serving as ballast to that equity risk. So, if you're, let's say, a 60/40 -- you have 60 percent equities, 40 percent bonds -- but that return that you're seeing in the Aggregate just isn't cutting it. Well, maybe you could think about cutting some of that treasury exposure, adding some higher yielding asset classes like high yield and emerging market bonds, and that's what IUSB provides. What you'll see is that negative correlation that diversifying characteristic of fixed income becomes a little less strong, but you get higher return as a result.

And lastly, what if you wanted to get rid of all the treasury exposure but still be invested in high quality fixed income? LQD invests in investment-grade corporate bonds, which still have a relatively low correlation to the S&P 500, and you're going to pick up higher levels of yield. But you don't have to pick one of these in that last column you can essentially tweak your fixed income allocation to essentially your liking. If you're willing to give up some of the diversification benefits and pick up some yield you can do that.

So, the last group is those seeking higher levels of income. We have 350 products. I have a great product idea. It's a product that capital preservation is key, it diversifies equity risk, so when the equities go down it goes up, and it kicks out a ton of income. And I want to call it the iShares Unicorn Fund and the reason is because it doesn't exist. (laughter) I know, I know. If you need higher levels of income what you have to recognize is that you're giving up one of the top two things: you're giving up capital preservation or you're giving up some of the diversification benefits. But as long as you recognize the risks you're taking and cast a wide net, diversify some of those risks, then you can still generate fair amounts of income. So, what we show here is what a combination of three of our more popular alternative or fixed income products would look like. HYG, which invests in high yield bonds, tends to be the default option for investors who need to get yield in excess of what most

of fixed income is yielding. But you can actually combine with HYG with emerging market bonds and with preferred securities, EMB and PFF, and what you'll see is that you'll increase yield, you'll get a little bit more of the diversification benefits, you'll lower that correlation to equities, and you'll also reduce risk as measured by standard deviation. So again, diversification is paramount for income investing.

I've talked about casting a wide net, I think that's the fourth time I've said it now, so let's look beyond traditional fixed income. For some investors, equities provide a compelling income source as well. Obviously the equity market the last 10 years or so has had a pretty good run, and equity investors who took dividends and reinvested those dividends actually did even dramatically better than those who just sat on the dividends in cash, and that's what you're seeing in that green line, the compounding the reinvestment of dividends in an up market, what's that led to in terms of cumulative growth.

As further evidence of this, and this chart really does a great job of summing up some of the challenges we saw in the first few slides and what we're going to get into now. If you have a 60/40 allocation, a 60 percent allocation to equity and a 40 percent allocation to bonds, the percentage of income that's coming from equities has been on the rise since 2000. And that's because

fixed income, again not yielding what it used to, and the equity market, especially the U.S. equity market, dividends have actually grown. Over the last five years, the dividend yield of the S&P 500 has been ticking up. So, equity income also gives you a great option to help fund your future.

To capture the growth of dividends within U.S. equities, we have a fund DGRO, standing our iShares core dividend growth ETF. This is a highly diversified fund, over 400 holdings, tracks an index, and all the securities that are eligible for inclusion into that index have to meet certain criteria. For one, the stocks within it have to grow their dividends year over year for five years. And second, as I mentioned before, past performance is not indicative of future returns, so we want to incorporate some metrics that look at what we think the companies will do going forward, so one of the metrics we use incorporates forecasted earnings. What is the forecasted earnings of these companies in the next year? And the result? A highly diversified portfolio, both from a number of stocks perspective as well as a sector perspective, and the yield on DGRO is about 2.2. So not huge but again these are dividend growers, not high dividend payers. As a point of reference, the dividend yield on the S&P 500 is right around 2. So, you're picking up some yield over the broad market.

But if you want higher levels of income from your dividends -- for your equity funds -- we have HDV, our high dividend ETF. And so, what this fund is trying to capture are those funds that have high degrees of income. Here is Coca-Cola. Fun fact: right before every presentation I drink a Diet Coke so if you're wondering why I'm pacing a little bit up here it's that artificial sweetener. But Coca-Cola has a four percent dividend yield. And what is its strength? What is its competitive advantage? Why is it that when we go to the grocery store and we see Coca-Cola and a store brand option that's 10 cents cheaper, why do we still go with Coca-Cola? It's because of that brand. It's an intangible asset that helps insulate Coca-Cola from its competition, and it's why Coca-Cola has persisted as a high dividend paying stock. The yield on HDV I believe is about 3.2 percent over the trailing 12-month period.

But I've talked about casting a wide net -- I think that's the sixth time -- so think internationally as well. Historically, international equities have paid higher dividends than U.S. equities. This is going back to 1995 and that pink line signifying non-U.S. stocks, historically the difference between that pink line and the green line about one percent. So, for those who are looking for international equities for their income sources we have IDV. And IDV, our international select dividend fund, combines some of the things you see in DGRO as well as some of the things in HDV. For starters, we're looking for

stocks that have grown their dividends -- only three years, not five -- but also have a high dividend yield. And as evidence of that, dividend yield on IDV over the trailing twelve months is north of five percent. The index this portfolio tracks is investing in developed markets, so mostly U.K., Australia, and other European markets equities but again, screened for dividend growth and high yield.

So, to recap: income is tough right now, really difficult, and it's at the worst possible time. So many investors are in need of income, and we think we at iShares have some great options for you to use in your income toolkit. ETFs offer competitive performance at a low cost and are more tax efficient than their mutual funds. And for income investors they provide two of the key attributes, diversification and transparency, because knowing what risks you're taking as an income investor is paramount. So that's it for me. With that, thank you all for your time. I believe I'm going to be turning it back over to Bill.

Bill Purvin: Thank you, Sean. (applause) We're going to do a short demonstration of our tools on our website. Sean, I think you said there are about 350. How do I navigate 350 when there's over 2,000 out there? So, this is our website. If you go on here, in the middle tab, there's "News and Research." If you slide down ETFs are right smack dab in the middle. Brings you to this page. If your page

at home doesn't look like it, it looks like this, you can update the view. So, I was on the updated view here -- we have to sign back in. So, there is a classic view of the website and a new view of the website. So, we know more and more people are logging onto our website on smaller and smaller devices, so you'll see we'll be changing the website over time to make sure it's easier to navigate this on any device you access our website.

So, if I look over here, I can search by ETF if I have a stock symbol. So maybe I have an idea, I want to look for stocks that have Coca-Cola -- ETFs that have Coca-Cola in it, I could type that there, I could compare ETFs. I could look at ETFs that are similar. Maybe I want to look at what's considered -- what's similar to AGG, but these are all the iShares, ETFs, these are the Fidelity ETFs. Towards the bottom of the page -- we talked about cash moving into the marketplace -- you can actually see where funds are flowing in ETFs. So you can see gainers, losers, so we talked a little bit about some fixed income ETFs, so I can get a list of the gainers there, where the flows might have been over the prior day, HYG, SHV, so some names that we heard before. But if I go over here, there's a couple of ways to look at ETFs, so if you go to the bottom of the page, I think there's a -- look, it's a big wide universe. I want to narrow the universe and find the ideas a little bit easier. I think a lot of clients don't look at the heat map view. So, if I click on that, that's a visual image of the space. So,

we're looking at just fixed income. AGG, we talked about that just a short while ago, show me that ETF and what's in that. If I click on here and I'll come to that ETF. So, the box size is based on the amount of assets in it, so that was the bigger ETF there in that space. But maybe I'm looking for income and I want to do that with equity. So, on the top here, you can see here I'm looking at just fixed income. I could look at all markets, all ETFs, so this actually is an iShare ETF right over here, IVV, the S&P 500.

I want to go back one page. I want to show you another way to look for ETFs. So, on here there is a screener, and you can save screens. If you've built one and you've found that it's effective at finding the ideas, you can build and save it. So, they'd be over here under "My Screens." But I'm going to launch the screener from scratch. So, I want to highlight a couple things that I think clients don't know with a screener that makes it easier to use and more effective in how you find the ideas. So, one of the criteria I can choose -- there are all these little things I could click here. If you click "View All" you can see everything you can choose from. There is a lot of choices and you can choose them from here. So, if you can't find the metric, you're looking for maybe it's easier to find it this way because I want the 30-day yield. I'm going to apply that criteria.

I'm going to show you another way to look at this differently than others. So, you can see you can type the number in here and you can type the number here from high to low, you check off on the bottom over here which ones you want. I like to look this way, show the chart. So we see rates come lower. I remember my first mortgage, when my wife and I bought a mortgage it was a three-year adjustable 10 and a half percent. I couldn't get that if I tried right now. Have reasonable expectations of where the market is and what the landscape looks like. This is the landscape. So, if you haven't looked at rates for a while you can see where we fall within the rate environment. So, this is the median. So maybe I don't want something that has a crazy high yield because there might be more risk with that, but I want to slide this over here and give me some results based on that. And when I come over to the right, I've got that field there, 30-day yield, I can sort it by that. So, if I'm looking for the highest where do I end up looking? Maybe I look at a lot of emerging markets. I see here energy, maybe I don't want to be in that space, but if you understand where you want to look, what you might end up gravitating towards, you might gravitate towards the assets that are probably riskier than you might want to look at.

If you find some ideas you like, you can do a comparison. So, if I click on here I can do a comparison and I could pull it down right over here and compare. I

can add to my watch list. Maybe I found some ideas here. So, I'm just going to bounce out of here and show you one other way to do this. So, if I look on here -- let's look at IVV. So, I look at IVV, there's the S&P 500, so that's how a lot of people gauge their performance. It might be in the S&P 500. What's in this ETF? What's the yield? So, if you're looking at the broader market the broader market is 1.88 on the yield here. If I'm looking above that I'm probably taking a little bit more risk than the market is at on average, and if I scroll down here, I can get reports on that particular ETF. I get a chart on it as well. But there's a page on here I can compare them side by side. So SPYs in ETF there, expense ratio for SPYs compared to IVV, IVV is half that expense ratio, and that's a way to see what opportunities are out there in the marketplace.

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