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MARCH 2011

NEWCITS

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% returns, as at 31 January 2011	1 year	2 years	3 years	Since Launch
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FTSE All-Share*	18.1	57.4	13.7	18.1
UK savings	0.1	0.3	1.6	4.8

*The Fund is not managed to any benchmark. The above figures are shown for illustrative purposes only.

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NEWCITS: TIME TO TAKE STOCK

Newcits funds continue to grow in popularity as investors seek returns less correlated with the oscillations of stock markets.

But with further changes expected as the industry prepares for Ucits IV and the Alternative Investments Fund Managers Directive, now is an opportune time to take stock of these products.

With that in mind, Citywire has joined forces with BlackRock to investigate how wealth managers view the Newcits sector and use these funds in client portfolios.

Findings reveal the majority of wealth managers and advisers allocate up to 40% to these strategies, with funds from BlackRock itself, Standard Life Investments, Gartmore and GAM also popular. More than 60% of respondents also said they plan to increase their Newcits exposure over the next 12 months, with risk diversification the overriding reason for this.

When considering Newcits vehicles, fund manager skill and strong risk management came out as the key considerations, relegating past performance to third place. Elsewhere, the question on whether investors feel they receive enough support from the industry in presenting the case for Newcits received a 60/40 response in the affirmative, suggesting groups still have plenty of education work to do.

As ever, we hope this research gives you a useful insight into this key part of the fund world and helps inform your allocation to Newcits as the product continues to evolve over the coming years.

James Phillipps

Assistant editor

In today's volatile environment, intermediaries are under considerable pressure to choose products that can deliver consistent positive returns in all market cycles. At BlackRock, we believe Newcits funds have an important role to play in delivering these outcome orientated solutions and are

committed to providing intermediaries with the support and knowledge they need to be able to maximise the use of these types of investment strategies.

Tony Stening

Managing Director, Head of UK Retail Business at BlackRock

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Overview

AN ANTIDOTE TO VOLATILITY

After a three-year period of such extreme volatility across all major asset classes, it is little surprise that investors are increasingly looking at alternative investment strategies.

During the height of the credit crunch, traditional safe havens from the vagaries of the stock market, such as bonds and property, failed to protect investors and left even cash savers nervous. Although equities have rebounded sharply over the past two years, volatility remains high as the markets grapple with the macro concerns of massive levels of overhanging sovereign debt and rising inflation.

Against this backdrop, absolute return funds have really come to the fore as investors have looked further afield for products that can deliver steady returns across the market cycle.

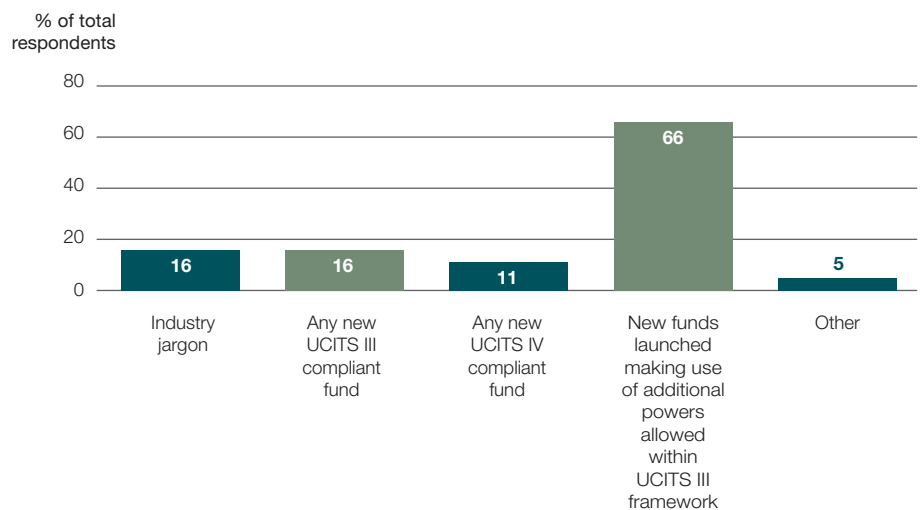
But amid the hype around these funds, it can be forgotten that these products are actually just bringing investment strategies that have been proven over several decades to the wider retail market.

Many investors would probably be very surprised to learn that the world's first absolute return fund, AW Jones & Co, was launched way back in 1949 and more than 60 years on, it is still running today.

It may have been a different era, but the eponymous Alfred W Jones, an accomplished statistician, recognised then, as now, that by simultaneously buying certain stocks and selling others short, he could manage market risk and reduce the overall volatility of the portfolio.

Jones and his fund pretty much went under the radar until 1966 when an article in

WHAT IS YOUR UNDERSTANDING OF THE TERM 'NEWCITS'? (number of respondents answering for each category)



SOURCE: Citywire in association with BlackRock



Many investors would probably be surprised to learn that the world's first absolute return fund, AW Jones & Co, was launched way back in 1949 and more than 60 years on, it is still running today

Forbes magazine highlighted the fact he had outperformed the best mutual fund by 87% over the past decade. Perhaps unsurprisingly this led to a rash of launches from other asset managers and opened the door for such modern-day investment gurus as George Soros and Michael Steinhardt.

Hitting the mainstream

It was not until 1990, though, that absolute return strategies really lurched towards the mainstream. This was when Yale University became the first institutional investor to recognise

hedge funds as an individual asset class.

The Ivy Leaguer had long been a trailblazer in the field of multi-asset investing, being the first pension fund to back private equity and venture capital back in the 1970s.

Take-up by UK institutions was much slower and the bull run of the markets in the 1990s resulted in many overlooking the benefits of diversification.

The bursting of the technology bubble in 2000 and the three-year bear market that ensued convinced many institutions of the benefits of moving away from the conventional

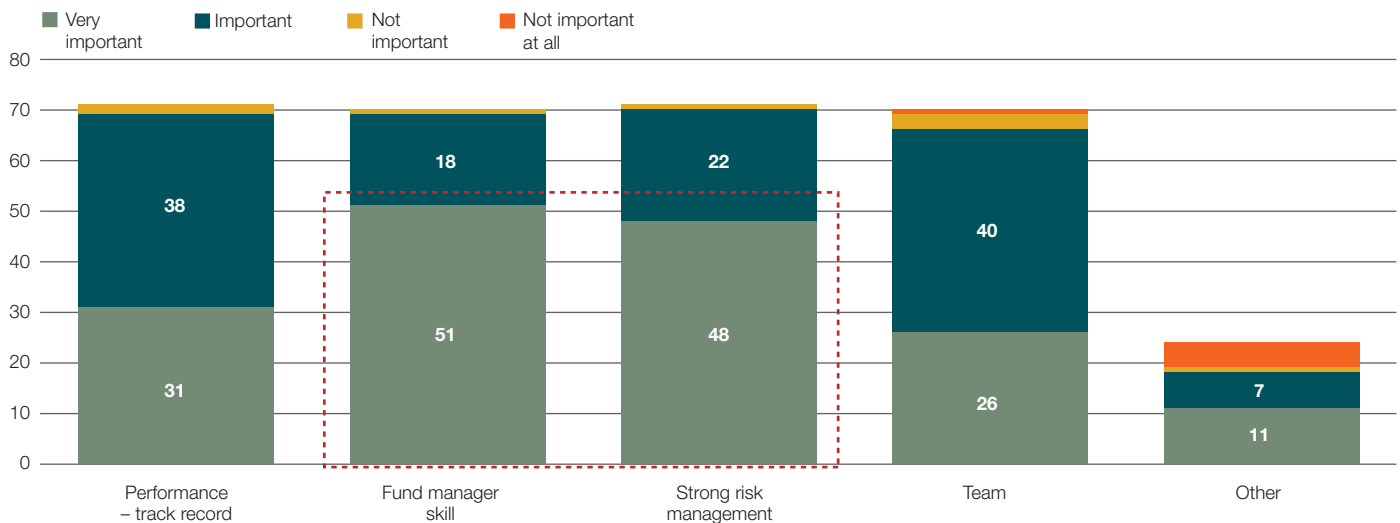
approach to running managed mandates, leading them to increasingly incorporate alternatives into their asset mix.

The impact of the credit crunch has only served to reinforce this message.

Until the last few years, though, it has been all but impossible for retail investors to access alternatives. The introduction of the Ucits III legislation in 2005 was a major breakthrough, enabling asset managers to roll out absolute return funds to the wider market.

Due partly to the strong market conditions at the time, the launch of the first wave of

**WHAT DO YOU LOOK FOR IN A NEWCITS FUND?
Please rate each criteria in terms of importance**



SOURCE: Citywire in association with BlackRock

funds, such as the BlackRock UK Absolute Alpha fund, was initially met with a lukewarm response from investors. But by the time the financial crisis started to bite, the early adopters had already established track records and proven their low correlation to the stock market.

The massive inflows into BlackRock UK Absolute Alpha underlines this. It took in more than £1 billion between June 2007 and June 2008, swelling in size from £200 million to £1.2 billion.

In April 2008, the Investment Management Association (IMA) launched a dedicated sector for absolute return funds and there are now 53 in the peer group.

Such has been its growth, the IMA is now considering breaking this down into sub-sectors in recognition of the sheer variety of underlying strategies employed by absolute return managers.

Diverse plays

With a lump sum of just £1,000 or so, investors can access funds as diverse as long/short equity, market neutral and volatility plays.

Although the addition of absolute return funds has enabled advisers to add another dimension to clients' portfolios, in some ways they have also introduced a whole new range of strategies to be learned and understood. Added to this is the need to carry out more in-depth due diligence, given the counterparty risk often involved.

There is also the important issue of managing clients' expectations. As the past few years have shown, absolute return funds



are not a panacea for investors in falling markets and the Financial Services Authority has voiced concerns that too many retail clients believe they are guaranteed products. Certainly some funds have disappointed while others have excelled.

Absolute return funds are clearly a useful addition to an adviser's toolkit, but there is still a knowledge gap that needs to be closed if advisers are to understand how best to use them within their clients' portfolios.

Mark Lyttleton's
BlackRock UK Absolute
Alpha fund took in
£1 billion between June
2007 and June 2008

How advisers use Newcits funds

REVEALED: HOW ADVISERS ASSESS NEWCITS FUNDS

Newcits funds have made significant inroads into wealth advisers' asset allocation strategies over the past three years, but past performance is not the key driver behind fund selection.

Citywire's survey of leading wealth managers found the vast majority view manager skill and strong risk management as the most important factors when choosing a fund.

Some 72.86% of wealth advisers rated fund manager skill as very important and a further 25.71% said it was an important criteria. Strong risk management proved the second highest-rated input, with 68.57% viewing it as very important and 31.43% ranking it as important.

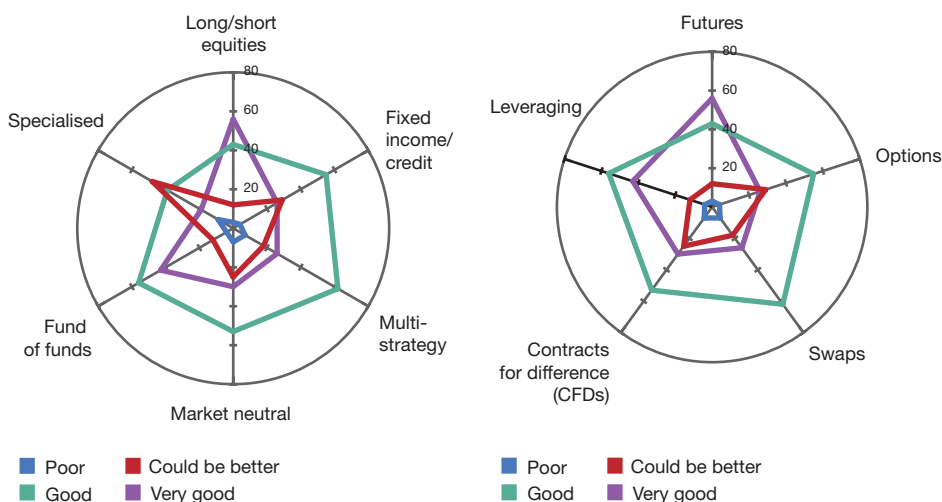
Past performance is unsurprisingly viewed as the next most eminent factor, given the competitiveness within the absolute return space. Although only 44.28% rated a fund's track record as very important, a further 54.29% said it was important, underlining just how crucial demonstrable outperformance is.

On the flipside, none of the wealth advisers surveyed dismissed fund manager skill, strong risk management or past performance as not important at all, while only 1.43% of respondents regarded manager skill and strong risk management as not important.

Team ethic adds depth

Reflecting the collegiate approach many investment managers take to running money, the strength of a group's team was also rated highly as a crucial consideration, with 37.14% of wealth advisers rating it as very important and an additional 57.14% saying it is important. Indeed, only 4.29% viewed it as not important

NEWCITS USE A VARIETY OF FINANCIAL INSTRUMENTS. HOW WOULD YOU RATE YOUR UNDERSTANDING OF THE FOLLOWING?



SOURCE: Citywire in association with BlackRock

and just 1.43% ranked it as not important at all.

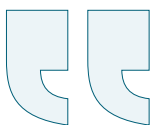
A look at how wealth advisers use Newcits funds within their clients' portfolios provides an interesting insight into their perceptions of the products.

Some 14.28% of respondents regard them as an essential part of their asset allocation. The survey found a significant number of wealth advisers view them as alternative investments, with a further 11.43% believing they should be deemed an altogether new and distinct category by themselves. Perhaps most tellingly,

almost half – 44.29% – of wealth advisers simply view absolute return funds as a natural extension of the traditional long-only funds that they buy.

This belief that Newcits funds should be ranked alongside their long-only peers is certainly justified. Indeed, many wealth advisers prefer to compare the two directly, viewing them simply as part of their allocation to regional equities, bonds or whatever the underlying asset class is.

The fact that Newcits funds are lumped



Citywire’s survey of leading wealth managers found the vast majority view fund manager skill and strong risk management as the most important factors when choosing a fund

together in the Investment Management Association’s absolute return sector certainly does not make wealth advisers’ lives any easier. The sector has developed into a mish-mash collection of funds that use absolute return strategies as diverse as investing in long/short equities, currencies and long/short bonds.

Consensus benchmark

Many intermediaries and asset managers alike would prefer absolute return funds to be benchmarked against their long-only peers. A move to break down the sector into a number of sub-sectors is being mooted, albeit that some of these may end up far too small to be of any real value to investors.

Of course, not all wealth advisers have embraced Newcits funds. Some have preferred to stick with traditional investments, while other wealth managers favour pursuing their own strategies using options and derivatives overlays.

Looking at how those respondents that do not invest in Newcits funds view the products, 70.45% see them as being the preserve of fund of fund or other sophisticated investors. Some 29.54% also believe they are suitable for sophisticated retail investors, while 22.72% see them as funds for institutional investors.

Perhaps surprisingly, only 15.9% said they think they are suitable for financial advisers. More than half – 54.54% – said it really depends on the underlying strategy. This is perhaps unsurprising given the myriad of asset classes and strategies that absolute return fund managers use – some of which are clearly far easier to understand than others.

Readers' understanding

WHY THE DOUBTERS STILL NEED CONVINCING

Newcits funds may have attracted several billion pounds over the past few years, but there remain clear gaps in wealth advisers' knowledge and understanding of them.

Close to 60% of wealth advisers and managers are allocating just over 20% of their clients' portfolios to absolute return strategies and a similar number seem to fully understand just what comprises a Newcits fund.

Some 57.39% of respondents identified Newcits funds as new launches that make use of the additional powers allowed within the Ucits III framework.

A further 13.91% similarly view them as any Ucits III-compliant portfolio – regardless of whether they use these additional powers or not – with the same number dismissing the moniker as 'industry jargon'.

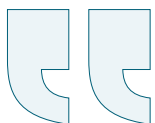
One area where there appears to be some confusion is around the upcoming Ucits IV legislation, with 9.56% of wealth advisers thinking that Newcits funds fall under this category.

Those who do invest in absolute return funds clearly need support from product providers to enable them to fully understand the underlying investment strategy and accordingly know how to best use them in their clients' portfolios.

The research shows that although 59.2% of wealth advisers and managers feel they get sufficient support from the asset management industry, this still leaves a large rump – of some 40.8% – who feel they do not.

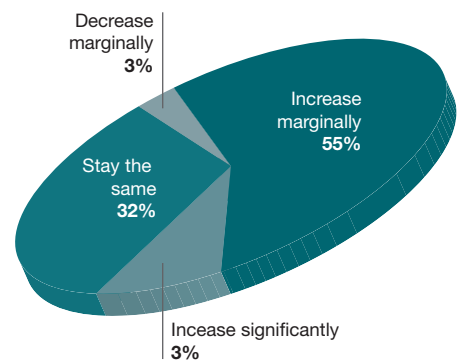
The opportunity is ripe for asset managers to broaden the range of investors in their absolute return funds through a programme of education.

Both wealth managers and advisers believe support from fund groups could be improved



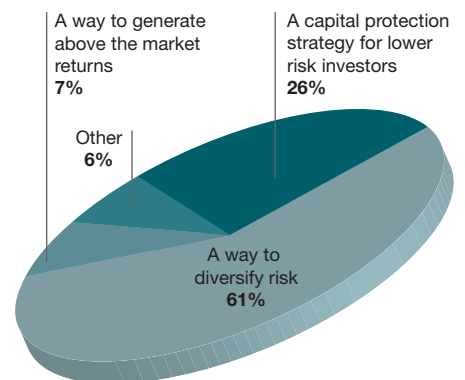
The opportunity is ripe for asset managers to broaden the range of investors in their absolute return funds through a programme of education

HOW WILL YOUR ALLOCATION TO NEWCITS CHANGE IN THE NEXT 12 MONTHS?



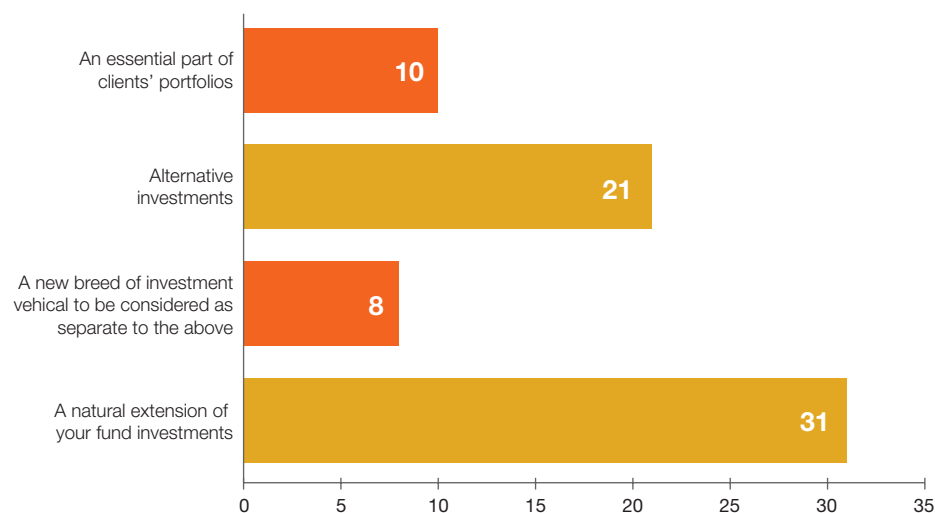
SOURCE: Citywire in association with BlackRock

WHAT ROLE DO YOU FEEL NEWCITS PLAYS NOW OR COULD PLAY IN THE FUTURE IN A CLIENT PORTFOLIO?



SOURCE: Citywire in association with BlackRock

WHAT DO YOU CONSIDER NEWCITS ARE?



SOURCE: Citywire in association with BlackRock

in several areas. Some 30.4% want to be able to access better and more readily available educational material, with 22.4% favouring online learning modules they can tap into at any time.

Moreover, 26.4% would value training sessions that contribute to their continuing professional development qualification requirements, which suggests a fantastic opportunity for fund groups to help wealth advisers with their understanding and ongoing training needs, while at the same time forging stronger relationships with intermediaries.

Indeed, one wealth adviser said: 'I need to get my understanding right before considering using [Newcits funds] with clients.'

The best-rated asset management groups in terms of the support they provide advisers around absolute returns are, perhaps unsurprisingly, some of the biggest players in this space.

Standard Life Investment, which runs the biggest fund in the sector – the £6.85 billion Global Absolute Returns Strategies – was the best-rated by wealth advisers, with 12% naming it as providing the best support.

Gartmore, which runs four absolute return funds, was the next most highly rated on 8%, with BlackRock – which has high-profile UK and European Newcits funds – coming in at third on 6.4%. Schroders, on 4.8%, and GLG with 4% were the other most-cited groups.

The wide spread of votes indicates that few asset managers are really standing out in terms of the work they do on providing educational resources. Although this could be because wealth advisers have different favourite groups, a number of the respondents did say that training and education is lacking.

One told Citywire: 'At this moment, I have not had any Newcits [fund] presented to me and until such time and my confidence in any fund [builds], I would not use it.'

Even some of those wealth advisers that do invest in Newcits funds pointed out that clients can have reservations owing to the negative press they have read about certain hedge funds along with the Madoff scandal.

Fund strategies

Looking at the different underlying absolute return strategies, long/short equities is the best understood, with 48% saying that they have a very good understanding of it and a further 37% professing to have a good understanding. Indeed, only 2.6% admitted to having a poor understanding of equity long/short investing.

In terms of the underlying financial instruments used by absolute return fund managers, futures are the best understood, with 48.7% of respondents having a very good knowledge of how they are used and 37.29% having a good working knowledge – again with just 2.3% saying their knowledge is poor.

This suggests that while a significant proportion of wealth advisers needs more support and education, there is also a very knowledgeable base of professional investors out there with an appetite for absolute return funds.

Funds they use

THE NEWCITS FUNDS MANAGERS ARE BUYING

Absolute return – where most Newcits products sit – has proved an extremely popular sector since launch in 2008, ranking second and third in terms of net sales for the two subsequent years.

Inflows have been consistent, with funds in the peer group enjoying retail sales of £2.3 billion last year and a slightly higher £2.5 billion in 2009.

Only bond sectors have outsold absolute return, suggesting it has quickly started to assume default status in many portfolios.

Restrictions

Looking at the differences between Newcits and offshore hedge funds, most important is the restriction on naked or physical shorting in the former, which means managers have to mirror such positions using contracts for difference.

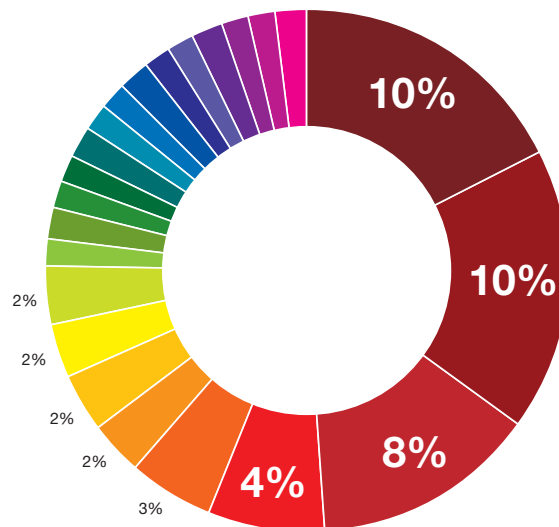
Meanwhile, the Ucits regime offers superior liquidity – typically daily rather than monthly, with no scope for gating – transparency and risk controls to the hedge fund world.

According to our research, BlackRock UK Absolute Alpha and Standard Life Investments’ Global Absolute Return Strategies (Gars) are the most popular Newcits vehicles among advisers, with one in 10 using each of the products.

Gartmore UK Absolute Return is the third most popular, followed by Jupiter Absolute Return and Newton Real Return. A raft of funds follow close behind, with offerings from fund houses such as Investec, Artemis, Schroder and Threadneedle.

LEADING NEWCITS FUNDS THAT RESPONDENTS ARE USING

- BlackRock UK Absolute Alpha
- Standard Life GARS
- Gartmore Absolute Return
- Jupiter Absolute Return
- Newton Real Return
- Gartmore European Absolute Return
- GLG UK Alpha Select
- Artemis Strategic Assets
- GAM Star Emerging Market Rates Fund
- Investec Enhanced Natural Resources
- Absolute Insight UK Equity Market Neutral
- BlackRock European Absolute
- CF Ruffer Total Return
- FAST – Europe I EUR
- Insight Absolute Emerging Market Debt
- Insight Asolute Insight
- JPM Income Opportunities
- M&G Optimal Income
- Ruffer Absolute Return
- RWC Europe
- Schroder GAIA Sloane Robinson Absolute Return
- Schroder ISF Asian Tot Ret
- Threadneedle Absolute Return
- Other



SOURCE: Citywire in association with BlackRock

Funds wealth managers use



A further differentiating factor from peers is that Newman (left) and Wallace are prepared to take individual stock positions on the short book rather than just shorting the index

BLACKROCK UK ABSOLUTE ALPHA

This was among the first retail absolute return offerings launched into the UK market back in 2005, taking first-mover advantage, with substantial inflows and recently breaching the £2 billion mark.

UK Absolute Alpha is designed to cut out the beta element of returns, with managers Mark Lyttleton and Nick Osborne seeking positive absolute performance in rising and falling markets.

To achieve this, they employ four basic strategies – traditional long-only investment, synthetic short positions, pair trades and tactical use of cash.

Over the past year, the managers said their long portfolio performed well and relative strategies generated robust returns, although shorts were modestly disappointing.

Within the long portfolio, they had particular success from positions in the resources and financial sectors, while media, retail and technology holdings also made important contributions.

Overall, the fund has retained high levels of gross and net exposure, given strong corporate balance sheets, the likelihood of continued earnings growth and compelling equity valuations.

GARTMORE UK ABSOLUTE RETURN

Gartmore launched its UK Absolute Return fund for Ben Wallace in April 2009 based on his Octanis hedge fund, with Luke Newman joining later that year to co-run the vehicle.

Key to the transition into a retail offering was the fact Octanis has always kept leverage relatively low and used contracts for difference when shorting.

The funds are straightforward equity long/short with a large-cap bias and that flexibility helped maintain performance when liquidity fell out of the market in 2008.

Exposure range is -30% to 75% and being net short throughout most of 2008 helped produce positive returns.

A further differentiating factor from peers is that Newman and Wallace are prepared to take individual stock positions on the short book rather than just shorting the index.

Looking at recent portfolio activity, the managers were relatively cautious in the past year and their long exposure looked like an equity income fund, finding value in unleveraged pharmaceuticals and utilities with strong balance sheets.

On the short side, they identified opportunities in the opposite kind of company, those with too much leverage that have been forced into risky rights issues.

SLI GLOBAL ABSOLUTE RETURN STRATEGIES

Launched in 2008, this Global Absolute Return Strategies (Gars) fund seeks to provide investors with the returns historically achieved by conventional long-term equity investment but with considerably less uncertainty.

The product is run by SLI's multi-asset investing team, which looks to hit its performance targets via a range of investment strategies – key areas in the past year included global and European equities, plus a long US dollar versus euro position.

Overall, the strategies are split into four areas of potential performance: market returns, directional, relative value and stock selection.

On market returns, for example, the team is simply looking to invest in assets expected to provide a long-term return superior to cash, such as equities, corporate bonds and property.

From inception, Gars benefited from a significant investment in equity markets until late 2007, when the team significantly cut this exposure.

During the volatile markets of 2008, the fund's exposure to equity holdings fell in line with market movements to a low of 18% before the managers topped these up to 25% in October 2008 and again in February 2009.

Looking forward

MOST MANAGERS PLAN TO INCREASE THEIR NEWCITS WEIGHTING IN 2011

Broad swathes of the wealth management community have already embraced Newcits funds as core holdings within their client portfolios and Citywire research reveals that almost two thirds of advisers expect to increase their exposure within the next 12 months.

The popularity of the Investment Management Association’s absolute return sector has been readily apparent with the Standard Life Investments Global Absolute Return Strategies, BlackRock UK Absolute

Alpha and Newton Real Return funds now running more than £10 billion of retail money between them.

But the findings show that some 55% of wealth advisers are planning to marginally increase their clients’ exposure to absolute return funds over the next 12 months, with a further 10% saying they will raise it significantly.

Strong take-up

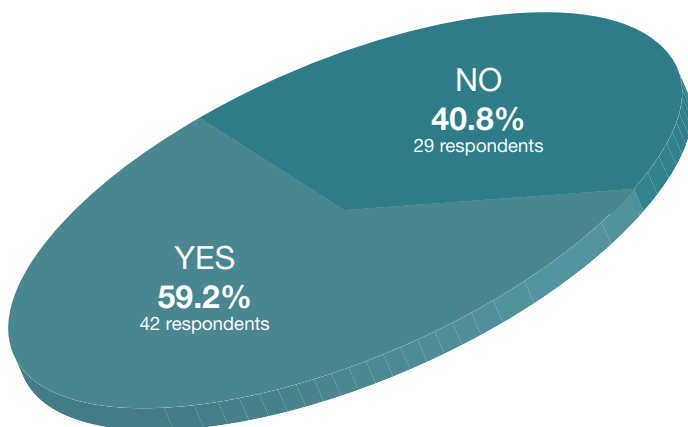
Perhaps reflecting the strong take-up of alternative investment strategies among

professional investors, 32% expect to maintain their current levels of exposure, with only 3% saying they will reduce their weightings.

In terms of how wealth advisers see the usage of Newcits funds in their clients’ portfolios, a large majority – some 61% – view them as means of diversifications.

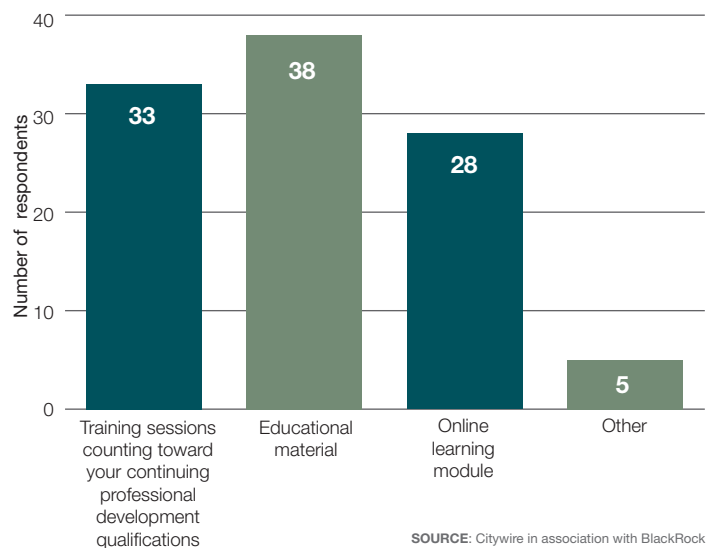
A significant number – 26% – favour them as a means of building capital protection into lower risk clients’ portfolios, with an additional 7% holding with the aim of receiving index-beating returns.

DO YOU FEEL YOU RECEIVE SUFFICIENT SUPPORT FROM THE ASSET MANAGEMENT INDUSTRY IN PRESENTING THE CASE FOR NEWCITS PRODUCTS TO END INVESTORS?



SOURCE: Citywire in association with BlackRock

HOW CAN SUPPORT FROM THE ASSET MANAGEMENT INDUSTRY BE IMPROVED?

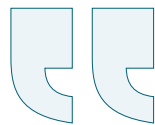


SOURCE: Citywire in association with BlackRock

Looking forward

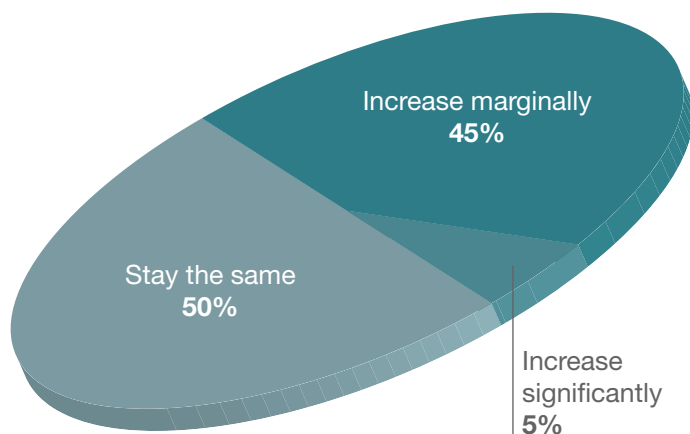
The fact that the majority of wealth advisers buy absolute return funds for their ability to both provide diversification and downside protection again suggests that the majority have a good understanding of how the funds work, with only a handful investing on a relative return basis.

Overall, although take-up is strong among wealth advisers, there is little doubt some of those who have yet to start allocating at least part of their clients' portfolios to absolute return strategies will do so as their understanding of the products grows and funds build up longer-term track records.

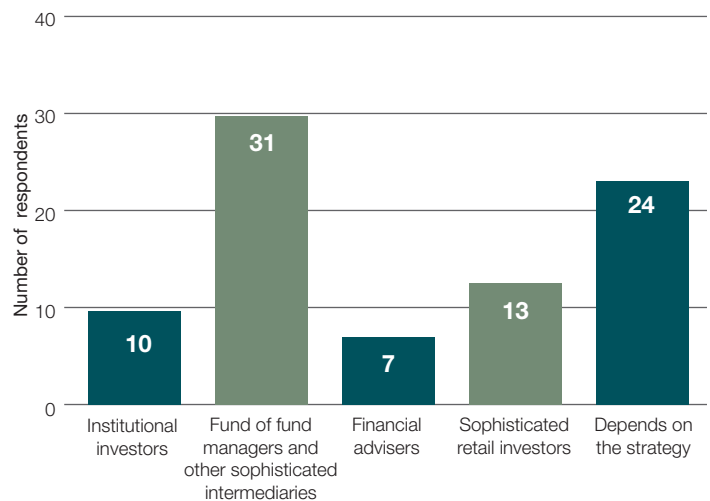


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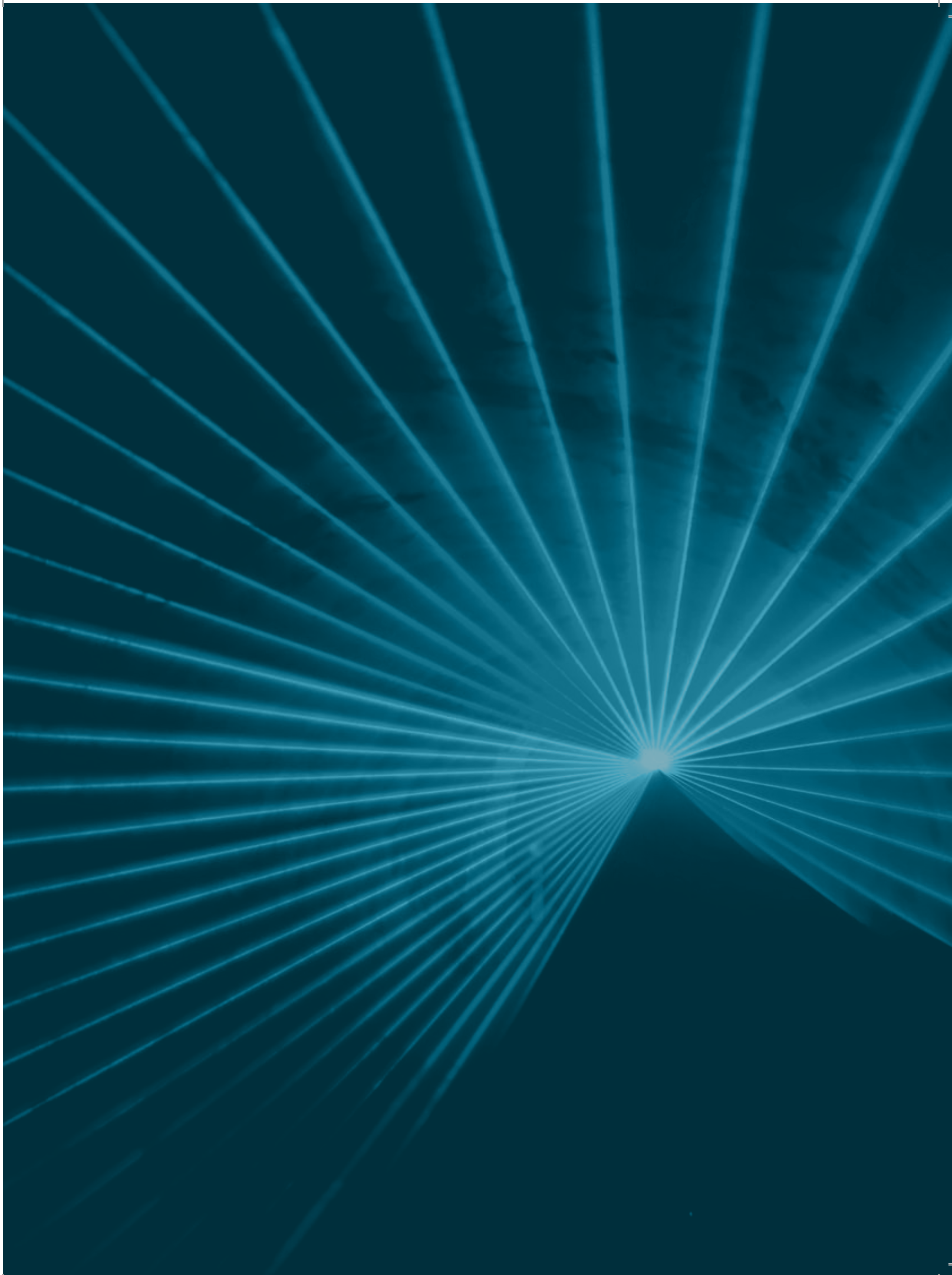
HOW DO YOU ANTICIPATE YOUR ALLOCATION TO NEWCITS-TYPE STRATEGIES CHANGING IN THE NEXT 12 MONTHS?



WHAT TYPE OF INVESTORS DO YOU BELIEVE NEWCITS PRODUCTS ARE SUITABLE FOR?



SOURCE: Citywire in association with BlackRock





TALK

WALK

BETWEEN THE TALK AND THE WALK, OPPORTUNITY IS FOUND.

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