



Investment Philosophy and Process

Invesco Large Cap Core Portfolio

Investment philosophy

We believe a portfolio of attractively valued companies managed by good stewards of capital may outperform the market over the long term. We seek to invest in good businesses with high or increasing returns on capital that have strong future growth prospects and are temporarily mispriced.

Universe definition

We begin with the universe of domestic stocks generally defined by the Russell 1000 Index. We then identify companies trading at favorable valuations on both a current and historical basis relative to several measures, including return on invested capital (ROIC), free cash flow, growth potential and operating margins. This defines our universe of potentially undervalued businesses and helps focus our fundamental research efforts.

Stock selection

Through fundamental research, we attempt to gain a thorough understanding of the prospects for each business, its appreciation potential and the degree to which it may sustain or grow ROIC. The overall investment process can be separated into two phases: The deconstructive phase involves forensic analysis of the company and industry, and the constructive phase helps to create the overall investment thesis. Both phases of the investment process include the following types of analysis:

- Financial
- Business
- Valuation

Financial analysis provides vital insight into historical and potential ROIC, which we believe is an indicator of the quality of the business and the responsibility of its management. We also consider the sources of capital and the capital intensity of the firm to determine its financial flexibility. The business analysis allows us to understand the key drivers of the company, appreciate the industry challenges and evaluate the sustainability of competitive advantages. The financial and business analyses serve as a basis to construct the valuation models.

We triangulate an estimate of a company's value using a combination of methods. The three primary techniques are:

- Discounted cash flow
- Traditional valuation multiples (price-earnings ratio (P/E), enterprise value/ROIC, etc.)
- Net asset value (sum of the parts)

The combination of these efforts results in the fundamental aspects of our risk management framework. In addition, we diversify across industry and thematic exposures, initiate positions based on conviction tiers and generally limit positions to less than 5% of the portfolio.

Investment Process

Universe Definition

Companies generally in the market-cap range of the Russell 1000 Index

Financial Analysis

- ROIC
- Management action
- Capital allocation
- Free cash flow

Business Analysis

- Competitive advantages
- Industry challenges
- Business risks
- Scenario analysis

Valuation

- Discounted cash flow
- Traditional multiples
- Net asset value

Growth/Value Candidate

Portfolio Construction/Risk Management

- Target 50-55 stocks
- Consider downside
- Implement tier weights
- Balance risk and reward
- Diversify fully

Portfolio construction

Our portfolio construction process is designed to manage volatility and preserve and grow capital. We analyze the risk-reward profile of all investment candidates and rank each stock in absolute and industry terms. We also incorporate sector-relative considerations to help ensure the majority of portfolio returns come from stock selection.

We generally invest in stocks that require 18 to 24 months to reach our price target and determine their position in the portfolio based on their probability of reaching our price target. This is reflected in a four-tiered approach to position weightings. The most attractive stocks have an initial maximum weight of 3.25%. The remaining three tiers include stocks with decreasing weightings down to a minimum initial position of 1.35%. Smaller weightings imply lower anticipated upside potential and higher downside risks.

We may also maintain a cash position to help limit volatility in narrow markets. The final portfolio is a well-diversified, style-pure, large-cap core portfolio of 50 to 55 stocks.

Sell discipline

We will consider a stock for sale for any of the following reasons:

- Price target is exceeded.
- Eighteen- to 24-month time horizon is surpassed without demonstrable improvements in fundamentals.
- Fundamentals deteriorate.
- More compelling investment opportunities exist.

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Diversification does not guarantee a profit or eliminate the risk of loss.