



Investment Philosophy and Process: Separately Managed Accounts **Invesco Growth and Income SMA**

Objective

Seeks total return through growth of capital and current income.

Universe

Large-cap stocks with a market cap greater than \$5 billion.

Team

- Management team has an average of almost 20 years of industry experience
- Sector specialists
- Fundamental, bottom-up stock pickers

Philosophy

We call our investment philosophy “value with a catalyst.” We believe that longer-term investors can take advantage of pricing anomalies in financial markets by purchasing stocks of companies that are currently under-priced. We believe that large, well-established, undervalued companies that are experiencing a positive change – or catalyst–may have the potential to provide long-term growth of capital and income.

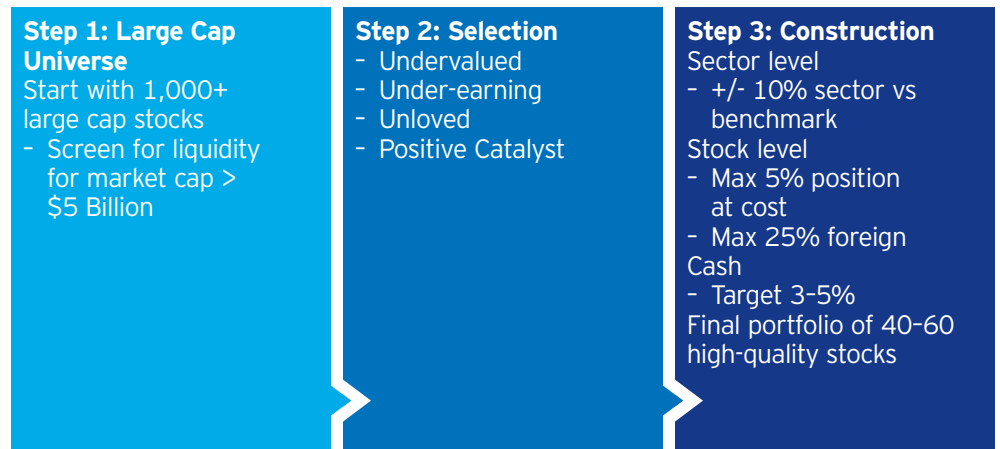
In short, we seek companies that are:

- Undervalued
- Under-earning relative to their potential
- Out of favor with investors
- Experiencing a positive catalyst

Process

Our disciplined investment process identifies attractive securities through multifactor screening and thorough, hands-on fundamental analysis.

Investment process overview: Value with a catalyst



Selected stocks

Attractive based on:

- Fundamentals
- Valuation
- Outlook
- Risks

Stock characteristics:

- Undervalued
- Under-earning
- Unloved
- Positive catalyst

Diversified, yet concentrated, portfolio of typically 40-60 high quality stocks

Step 1

Universe

The managers begin the investment process by screening the universe for liquidity constraints. The remaining securities are then screened on value criteria including various measures such as price to earnings, price to sales, price to cash flow, and CFROI (Cash Flow Return on Investment). Yet, the two most important factors for inclusion in the portfolio are favorable relative return on capital and enterprise value to sales. The managers are looking at these measures because they want to see that the business is investing their money back in the business and looking to improve results going forward.

To retain purity to the style box, the stocks are then quickly filtered for market capitalization i.e. mostly large cap companies; ensuring that the holdings are all \$5 billion in market cap or greater. Additionally, the portfolio managers will compare the remaining securities with the benchmark weights. These screens reduce the number of candidates to approximately 150-200 where the intensive research begins.

Step 2

Selection

We place heavy emphasis on financial analysis when assessing an investment opportunity.

We look for businesses that are :

1. Undervalued
2. Under-earning
3. Unloved
4. Positive catalyst

Undervalued. The portfolio managers target the price range based on growth potential and a valuation multiple common to the sector. We look for attractive business franchises at a discount to their "fair" value.

Underearning. We look for companies with conservative accounting practices. We pay close attention to balance sheet, cash flow, and income statements. Our analysis is often supplemented by meeting a company's senior management, suppliers and competitors.

Unloved. We believe the in-depth fundamental analysis is the key to the early identification of a catalyst that may lead to improved business fundamentals or share price appreciation. The managers will only initiate a purchase of a security if they believe the potential for stock price appreciation outweighs potential downside risk.

The conclusion of our focused security analysis is the development of an investment thesis for each potential holding. This investment thesis clearly articulates the outlook for the company and the stock, the critical drivers of growth, the macro, industry and stock-specific risk, upside potential and an attractive purchase price. To be added to the portfolio, stocks must exhibit a catalyst.

Positive catalyst. The Growth and Income team would call their investment philosophy "large-cap value with a catalyst." We believe that large, well-established, undervalued companies that are experiencing a positive change – or catalyst–may have the potential to provide long-term growth of capital and income. The Growth and Income team identifies companies with strong fundamentals that are experiencing:

- A change in management
- Positive industry dynamics
- Or, operational efficiency

To be added to the portfolio, stocks must exhibit a catalyst.

Step 3

Construction

All members of the team have specific sector responsibilities, so they spend the majority of their time evaluating stocks for inclusion in the portfolio and/or monitoring existing holdings within their respective sectors.

Because our target portfolio attempts to limit volatility and downside risk, portfolio construction plays an important role in risk management at both the sector and security levels:

- **Sector level:** We seek to limit non-stock-specific risk by using a disciplined portfolio construction process that aligns the portfolio with the benchmark Russell 1000 Value Index. We diversify the portfolio based on the industry group diversification of the benchmark and maintain a maximum deviation from index industry groups of ± 10 percentage points of the index.
- **Stock level:** We seek to limit stock-specific risk by building a diversified portfolio of typically 40-60 high quality stocks. We set price targets for each stock and increase or decrease our average positions based on a stock's price relative to our price targets. Our position weights are a maximum of 5% (at cost). Our historic turnover range is typically 20%-60%.

Portfolio managers take position sizes that are weighted by conviction. We avoid timing the market by staying fully invested, with a target of 3% to 5% in cash.

The portfolio is well diversified across sectors, and we avoid focusing the holdings in any one sector or company. The final portfolio typically holds 40-60 high-quality stocks.

At a glance

Construction

- The target portfolio attempts to limit volatility and downside risk:
 - Sector level: diversified based on industry group diversification
 - Stock level: limited to 40-60 high quality stocks

Stay fully invested, with target of 3% to 5% in cash.

Sell

Our sell discipline is just as important as the buy decision. Maintaining the discipline to sell has been a key component of our strategy. Here are the most common instances for selling a stock:

- We generally set a price horizon on our normalized earnings projections, based on the impact of the catalyst, relative to an industry-wide multiple. If we believe the price of that stock has reached our fair value target we will gradually sell.
- We also may sell if we determine that a better value can be found elsewhere. The opportunity cost of holding an undervalued security without a catalyst is much greater than the contrary.
- In general, we try to sell a stock when we believe that the premise for purchase (i.e. effect of a catalyst) will remain unrealized.
- When favorable investor sentiment surrounds the security, we are also more inclined to sell.
- When the value of a position appreciates to over 5% of the portfolio the position will be trimmed or sold.

Generally, a more concentrated stock position is funded with a corresponding sale.

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