2023 Midyear Investment Outlook

Kristina Hooper
Chief Global Market Strategist

The high degree of synchronicity brought about by pandemic-era policies is over. We are far from a globally synchronized cycle.

Executive Summary

In an effort to curtail the worst inflation in decades, Western developed central banks have moved aggressively to tighten monetary policy. This has helped exert downward pressure on inflation but has also brought about a meaningful slowdown in global growth and some financial accidents, including several US regional bank failures. However, against this backdrop, we see resilient domestic demand in many economies, especially in services.

Our base case anticipates a relatively brief and shallow economic slowdown as inflation continues to moderate and monetary policy tightening nears an end, followed by a recovery. We call this a bumpy landing because there will continue to be some economic damage in this scenario. We believe there is the possibility of a downside scenario – a "hard landing" – in which global growth is hit harder, with a recession first in the US, which then cascades into other economies. We also believe there is the possibility of an upside scenario – a "smooth landing" – in which monetary policy impacts growth less than expected and the global economy is relatively unscathed.

In the US, we believe rate hikes are ending, and US inflation will continue to fall significantly, albeit imperfectly. While discussion of a recession in the US is now commonplace, we continue to believe the US is likely to avoid a substantial broad-based recession. Instead, we expect some weakness in the second half of this year as policymakers accomplish a bumpy landing, but we anticipate activity will nevertheless remain relatively resilient. As we enter 2024, we expect a more positive growth outlook to unfold as the economy recovers.

In our view, the eurozone and UK are likely to follow a pattern similar to the US, but with a lag. A variety of forces have helped sustain European economic momentum so far in 2023, but we expect tightening financial conditions to weigh on credit growth over time, helping to reduce inflationary pressures but also causing a significant economic slowdown.

In contrast with many major developed market economies, China is in a markedly different place in its cycle. The relaxation of COVID-19 restrictions has driven a meaningful though uneven recovery. The reopening is largely benefiting the services component of the economy while slowing growth momentum globally has meant weaker-than-hoped manufacturing activity. Nevertheless, China remains a bright spot with subdued inflation and a robust growth outlook. We expect continued accommodation from the People's Bank of China (PBoC) through the rest of 2023.

In short, we believe we are at a policy peak, that disinflation is underway, and that a relatively brief global economic slowdown is occurring, but markets are likely to soon look past this episode and begin to discount a future economic recovery.

Contributors

Alessio de Longis, CFA®
Senior Portfolio Manager
Head of Investments
Invesco Investment Solutions

Mo Haghbin CFA®, CAIA®
Head of Solutions
Invesco Investment Solutions

Kristina Hooper
Chief Global Market Strategist

Rob Waldner, CFA®
Chief Strategist, IFI
Head of Macro Research

Jeffrey Bennett, CFA®
Senior Portfolio Manager
Head of Manager Selection

Adam Burton
Senior Macro Strategy Analyst

David Chao
Global Market Strategist

Arnab Das
Global Macro Strategist

David Gluch, CFA®
Client Portfolio Manager, GAA

Paul Jackson
Global Head of Asset Allocation Research

Benjamin Jones, CFA®
Director, Macro Research

Tomo Kinoshita
Global Market Strategist

Turgut Kisinbey
Chief US Economist, IFI Research

Brian Levitt
Global Market Strategist

Ashley Oerth, CFA®
Senior Investment Strategy Analyst

Drew Thornton, CFA®
Head of Thought Leadership Solutions

András Vig
Multi-asset Strategist

Macro Views

1

Stage of the economic cycle

- Major developed markets (DMs) are in late-cycle, in our view
- China, in contrast, is in early cycle
- Other emerging markets (EMs) mixed

2

Direction of economy

- "Bumpy landing" in major developed markets and recovery to follow thereafter
- A "bumpy takeoff" in China with post-COVID-19 reopening against a challenged global backdrop

3

Policy implications

- US rates are at or near policy peak as inflation keeps falling
- European policy tightening set to continue
- Chinese policy likely to remain supportive

4

Key risks and themes

- Financial accidents likely in wake of tightening
- Commercial real estate weakness may spillover
- Geopolitics remains an ever-present risk

Market Views

Fixed Income

All-in yields are attractive, and the macro backdrop is increasingly supportive. Easier financial conditions, as the Federal Reserve (Fed) pauses, should support corporate credit.

Equities

Bearish sentiment is overdone, and valuations are more attractive. With manufacturing likely to bottom soon, history suggests upside for equities.

US Dollar / Currencies

USD to weaken as other major central banks hike/when Fed eases. JPY extremely weak and could benefit if Bank of Japan (BoJ) normalizes. An early economic rebound would favor AUD/ CAD.

Commodities & Alternatives

We prefer to access private markets as a creditor, given attractive spreads over higher base rates. Presently underweight commodities due to negative price trends and slowing demand.

Emerging Markets

EM valuations are attractive; currencies and assets should benefit as USD weakens and as China recovers.

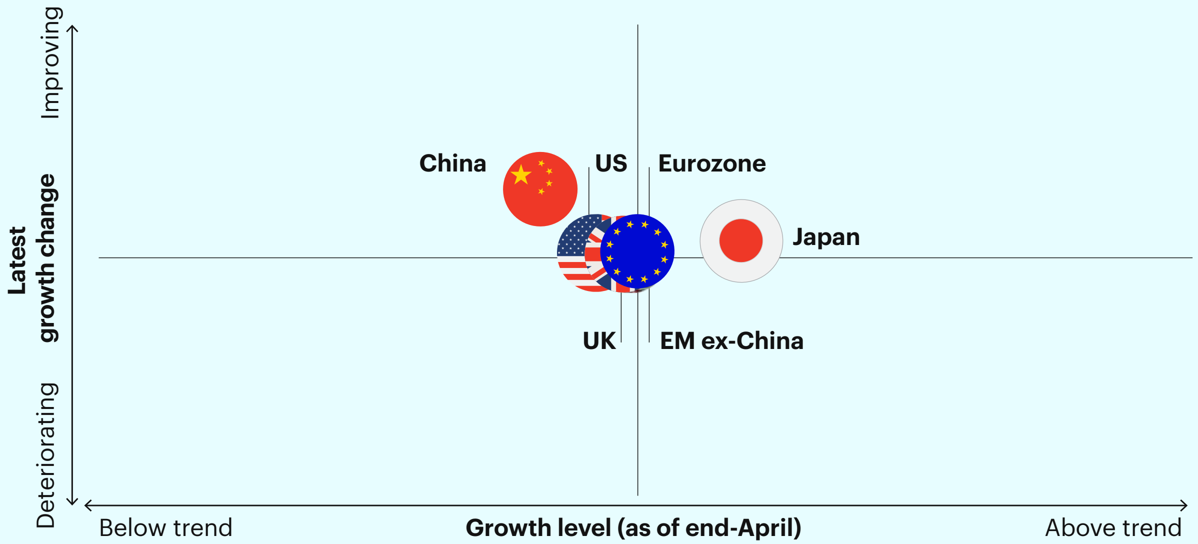
1 Major developed markets are in late cycle, while China is in early cycle

We believe global growth is below trend and slowing. A broad-based recession is a risk, but not our base case.

After the pandemic boom and a sharp increase in interest rates, major Western economies are slowing. Goods consumption, which boomed in the post-pandemic period, is slowing while services consumption continues to expand.

The easing of supply chain pressures has facilitated the easing of goods' price pressures, and we expect price pressure in services to ease going forward. A disinflationary trend should provide a more positive overall backdrop for economies and markets.

Leading economic indicators



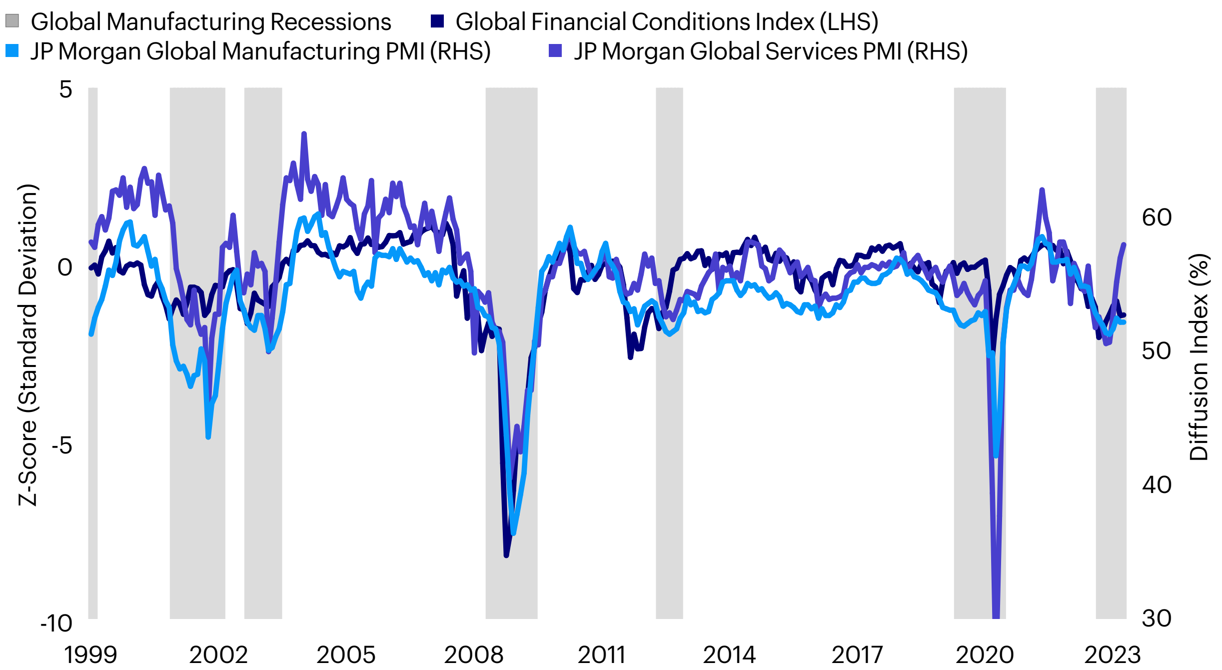
Source: Invesco Investment Solutions, latest available data, as of April 30, 2023.

Manufacturing, which has been relatively weak after the post-pandemic boom in goods consumption, is expected to remain weak until monetary policy begins to ease.

Services demand remains strong, reflecting the post–pandemic ongoing recovery in services as well as the underlying strength of the labor markets in Western economies. Easing energy prices have also been supportive.

Chinese reopening has boosted consumption in the services sector, less so in goods. This has limited the global impact of the Chinese recovery.

Services activity is solid despite slowing in goods consumption



Source: Bloomberg L.P., as of April 30, 2023. See p.21 for index definitions. An investment cannot be made into an index.

2 A "bumpy landing" in the West

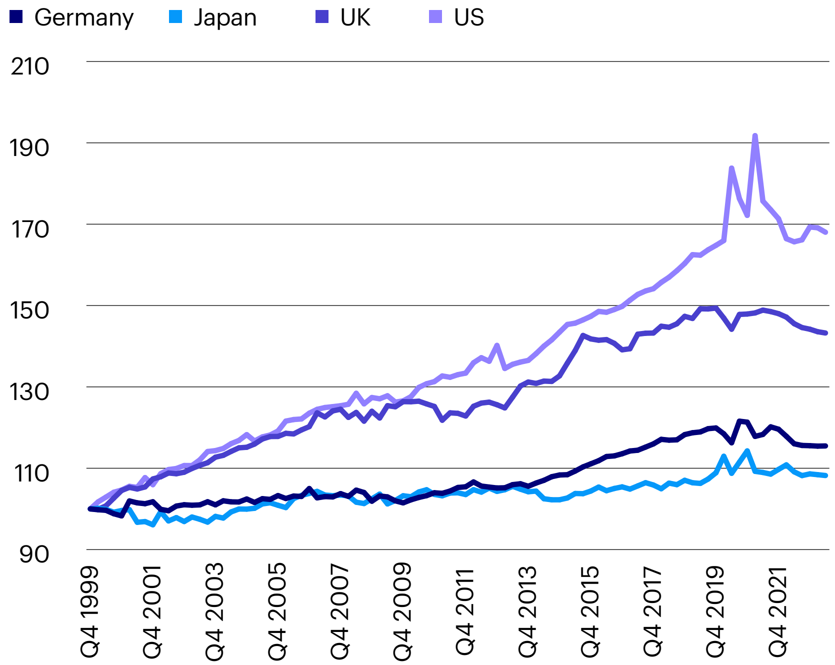
Forward-looking indicators suggest that inflation is likely to moderate, as is already underway in the US.

Demand is already slowing in many major economies, credit conditions are tightening, and in some economies — notably the US — inflation is already on a downward trajectory. The disinflationary process is underway.

While inflation momentum is weakening, so, too, is growth. We expect some weakness in the second half of this year as policymakers accomplish a bumpy landing, which may or may not precipitate a mild recession in the back half of 2023. While credit standards have tightened and the yield curve has been inverted for some time, activity has remained resilient, and labor markets have remained tight.

Real incomes have been hit by high inflation, helping to curtail demand

Real household disposable income (Q4 1999 = 100)

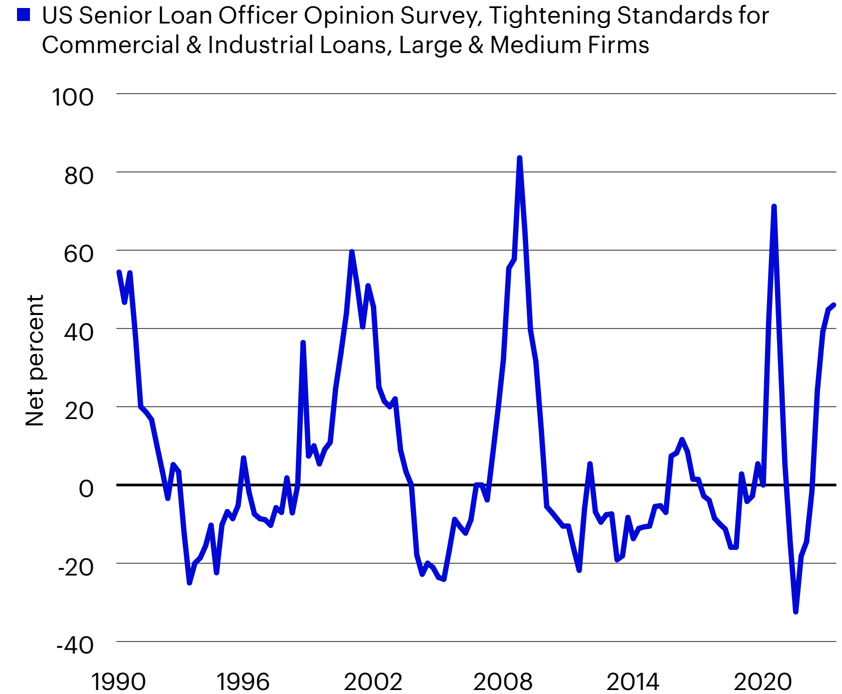


Consumers in major developed markets have been stretched as inflation outpaced wages, which should help reduce demand-side inflation. Now that inflation is falling, consumers are set to feel some relief, reducing growth downside risk.

Quarterly data from Q4 1999 to Q2 2023 (as of May 15, 2023). Data (including forecasts for 2023) provided by OECD. Data is net for all countries except UK, which is gross.
Sources: OECD, Refinitiv Datastream and Invesco Global Market Strategy Office.

Meanwhile, credit conditions are tightening in recent bank surveys

Tightening standards for commercial & industrial loans

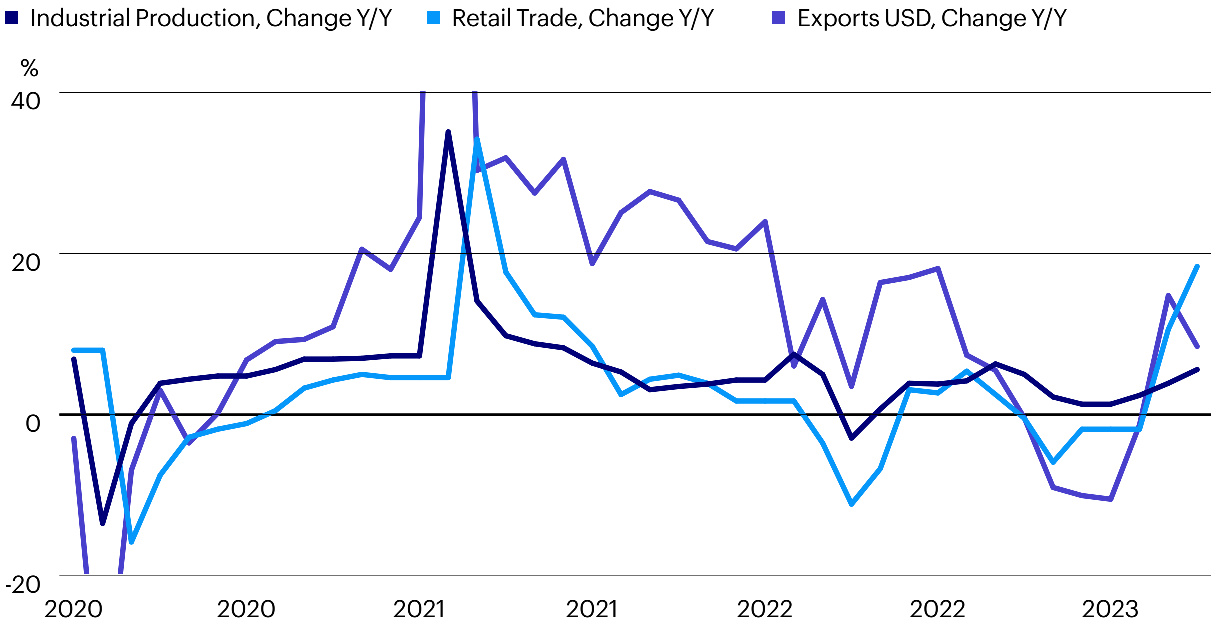


Recent bank lending surveys point to tightening credit standards, which will likely sap demand to some extent through reduced commercial real estate activity.

Quarterly data from Q1 1990 to Q1 2023 (as of May 31, 2023).
Sources: Federal Reserve and Macrobond.

2 A “bumpy takeoff” in China, a mixed picture for other emerging markets

China Economic Activity Indicators: Strong but uneven recovery

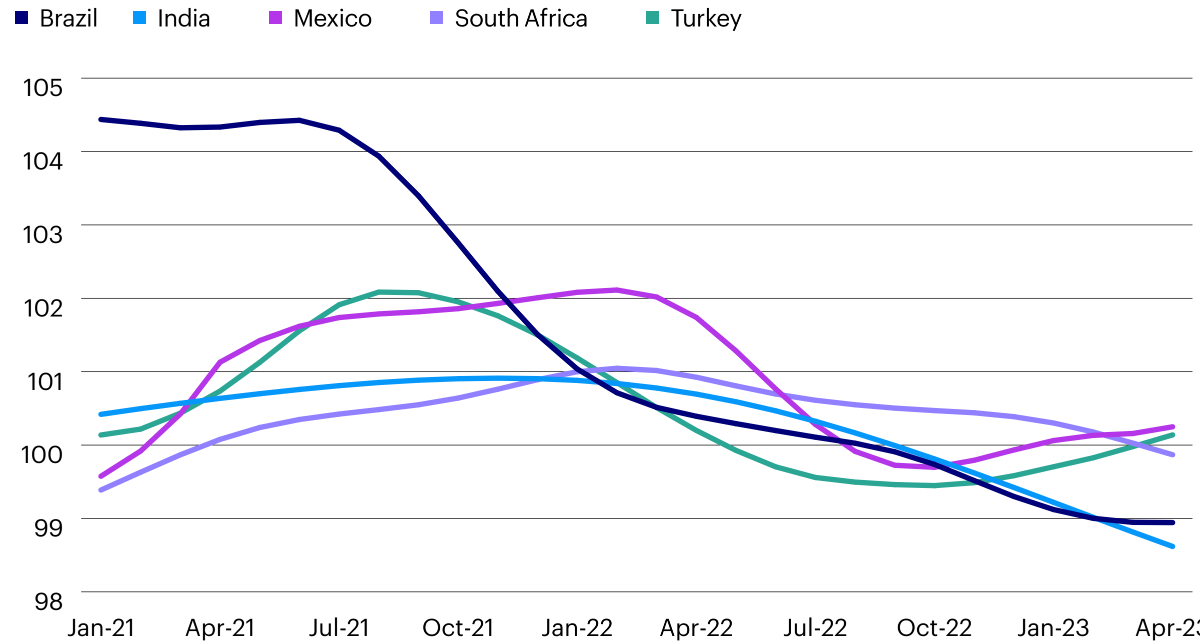


The relaxation of COVID-19 restrictions has driven a meaningful but less rapid than expected recovery in Chinese growth. Services activity has seen the most pronounced pick-up while slowing global growth has meant softer industrial production and exports.

Still, China’s near-term outlook remains favorable — growth should accelerate in the H2, inflation is well-anchored and monetary policies remain accommodative. After 2023, the growth outlook for China appears less certain. Policymakers will need to set policies to reinvigorate the property market and counter demographic headwinds.

Source: National Bureau of Statistics (NBS). Data as of April 2023. Note that Exports data for February 2020 and February 2021 figures are not shown in the graph due to irregular values. February 2020 was -40.6% Y/Y; February 2021 was +154.3% Y/Y.

Other Emerging Markets: OECD Leading Indicators (Amplitude Adjusted)



Leading indicators suggest a mixed near-term outlook for other emerging market economies.

As with China, the outlook appears to be improving in Mexico and Turkey while stabilizing in Brazil.

Deterioration may continue in South Africa and begin in India, the latter perhaps cooling after a period of strong performance.

Note: Monthly data from January 2021 to April 2023.

Sources: OECD, Refinitiv Datastream and Invesco Global Market Strategy office.

3 US rates are at their peak; more hikes in Europe

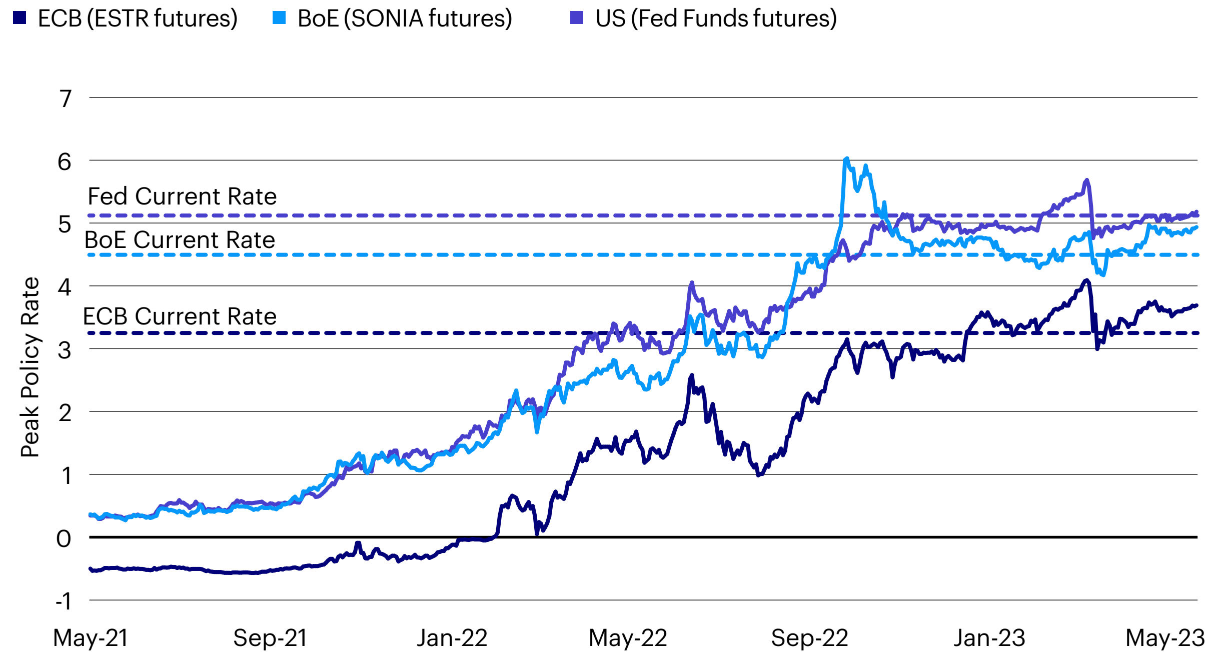
Policy rates are peaking across developed markets, in our view, with the US leading and Europe lagging. In contrast, China's policy remains supportive.

After a rapid tightening cycle, we believe the Fed is at or near its terminal rate, with inflation ending the year at a level above the Fed's 2% target, likely closer to the 3% mark. Looking forward, we expect some marginal rate cuts, possibly starting as soon as the end of this year but far more likely in 2024; policy rates are nevertheless likely to remain elevated.

The eurozone and the UK are likely to follow a pattern similar to the US but with a lag. We view European growth positively in the near term but with region-specific challenges re-emerging later in the year. Tightening financial conditions will likely weigh on credit growth over time, helping to reduce inflationary pressures. The BOE and ECB are likely to continue hiking, but the ECB terminal rate is likely to be lower than in the US.

China is in a markedly different place in its cycle, and overall we expect monetary policies to remain accommodative to support credit growth. More proactive measures from the PBoC could be expected, such as a cut to the reserve requirement ratio (RRR) to boost household and business sentiment.

Market expectations for peak policy rate over 24 months ahead



After recent banking stress, policy rates in the US repriced lower, now at a rate that matches the terminal rate.

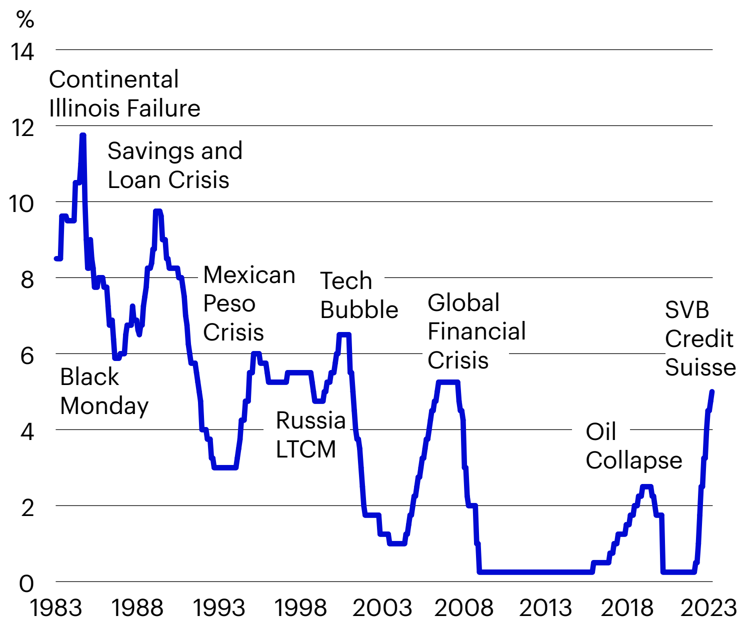
In the eurozone and the UK, rates expectations have moved higher as inflation data has emerged as more persistent than initially anticipated.

Futures data are not available for China's policy rate expectations. Our expectations are for only marginal changes, if any, from the PBoC.

Sources: Bloomberg L.P. and Macrobond, as of May 22, 2023. The peak policy rate in this chart is the highest rate across 30-day futures over all maturities 24 months out.

4 Potential risks

1. Financial accidents
Federal funds rate, upper bound

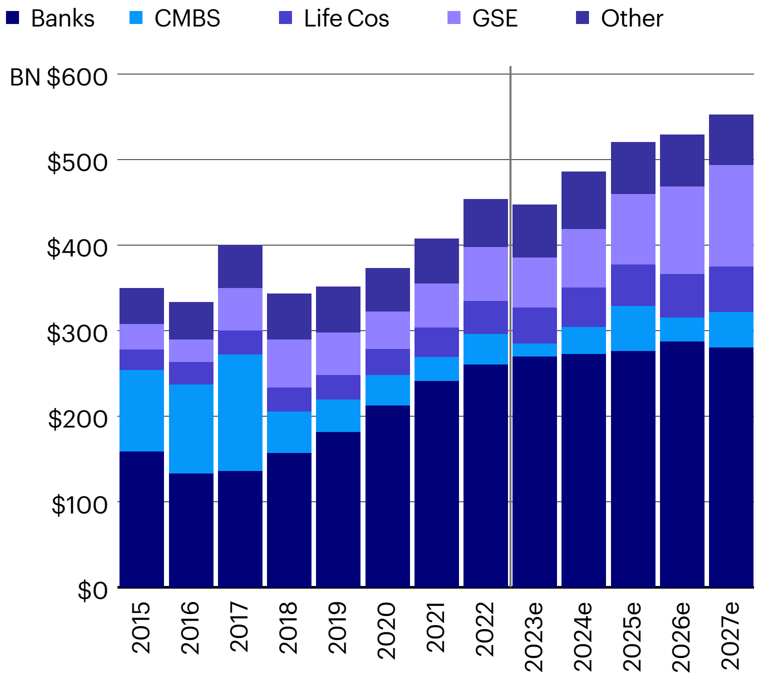


As central banks tighten, the risk of a financial crisis is elevated. Indeed, this tightening cycle has already resulted in the failures of SVB, Signature Bank, Credit Suisse, and First Republic Bank.

Such financial crisis risks raise the probability that central banks will likely have to pivot to an easing regime more quickly, perhaps leading to an eventual transition to a recovery regime.

Sources: Bloomberg L.P. and Macrobond, as of April 30, 2023.

2. US Commercial Real Estate Risks
Estimated commercial mortgage maturities (USD)

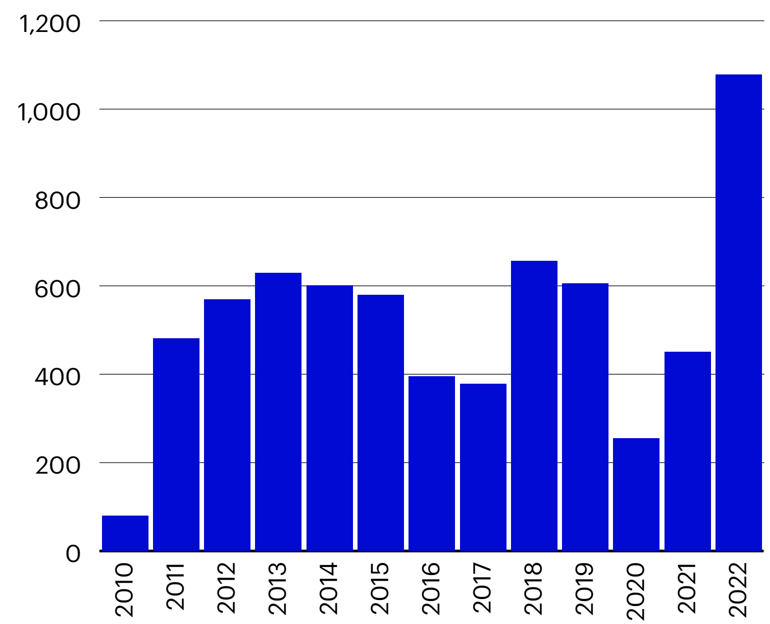


Aggressive Fed rate hikes caused a rapid rise in mortgage rates, which exerted downward pressure on commercial real estate prices. This has been exacerbated by the US regional bank mini-crisis and a further tightening of credit conditions. This has raised concerns about the risks facing US commercial real estate going forward.

We anticipate continued downward pressure on real estate prices in the near term. However, commercial mortgage rates may actually be lower, and credit conditions may have improved by later in 2024 — by the time a significant portion of commercial real estate loans mature and need to be refinanced. We will remain vigilant about financial stresses that could emerge from continued bank stress.

Includes multifamily and non-residential loans; estimate as of Q3 2022.
LTCM = Long-Term Capital Management.
Source: Invesco Real Estate using data from Trepp as of March 2023.

3. Geopolitics
Central bank net purchases of gold (tonnes)



Geopolitical risks remain a key concern. One indicator of recent tensions may have been the jump in central bank purchases of gold during 2022 (which may explain the resilience of gold in the face of a rising bond yields and a stronger dollar).

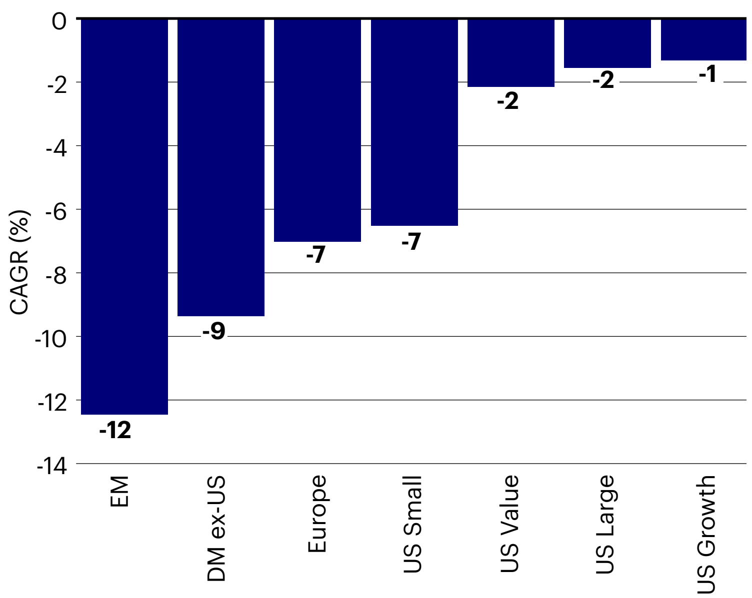
Inflation may have encouraged those central bank purchases. However, we suspect the desire to diversify away from USD holdings was deepened by the sanctions imposed upon Russia after its invasion of Ukraine.

Annual data from 2010 to 2022.
Sources: World Gold Council and Invesco Global Market Strategy.

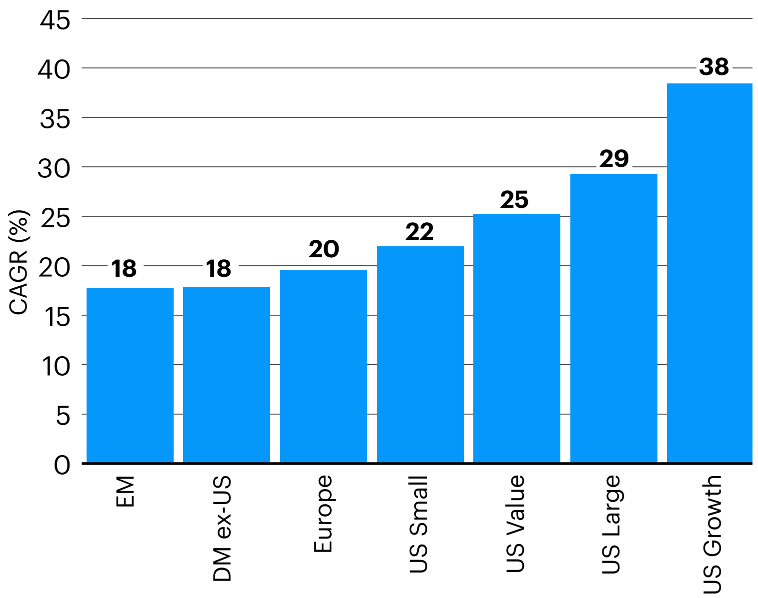
EQUITIES
Contraction now, recovery later

Global equity performance in periods of falling and rising global manufacturing activity since 1998

Periods of falling manufacturing activity



Periods of rising manufacturing activity



In turbulent times, investors typically flee for the safety of US high quality, large-cap growth stocks, which has been the case in recent months (left chart).

By contrast, persistent global value stock outperformance depends on the end of Fed interest rate hikes, a falling US dollar, and rising worldwide output (right chart).

Looking past near-term volatility, the good news is that global manufacturing activity has improved, the US dollar has fallen, and broader financial conditions have eased – all since the end of last year.

While the Fed delivered an interest rate hike at its last meeting, we think policymakers are nearing the end of policy tightening.

Eventually, we expect the global value trade to regain investor interest amidst an improving operating climate.

Sources: Bloomberg L.P., Invesco, April 30, 2023. Notes: EM = MSCI Emerging Markets Index. DM ex-USA = MSCI ACWI ex USA Index. Europe = MSCI Europe Index. US small = Russell 2000. US value = Russell 1000 Value. US large = S&P 500. US growth = Russell 1000 Growth. Price returns in US dollars. See page 21 for index definitions. An investment cannot be made into an index. **Past performance does not guarantee future results.**

The Opportunity

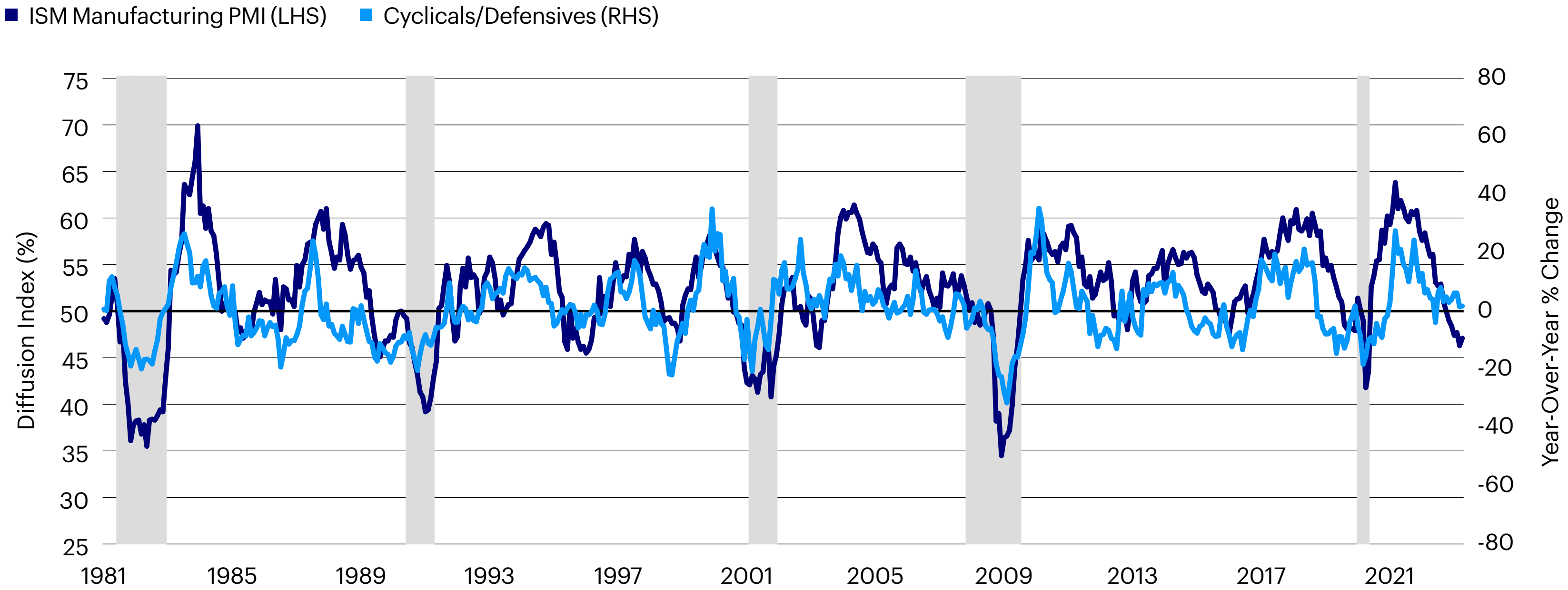
- **Valuations are more attractive** – In recent years, the underperformance of global value stocks, including emerging markets, Europe, and small caps – has produced compelling opportunities.

The Catalysts

- **End of Fed tightening** – Policymakers appear to be nearing the end of policy tightening.
- **Weaker US dollar** – The US dollar index (DXY) peaked in September 2022.
- **Global recovery** – An improving pace of turnover has favored international stocks over their US counterparts, a trend that may be developing.

EQUITIES
Tactical defense, strategic offense

US manufacturing activity and cyclicals relative to defensives since 1981



How can investors tell where we are in the cycle?

Manufacturing activity is one helpful gauge. Industrial output peaked in March 2021, meaning we have been in a gradual risk-shedding stage of the market cycle for over two years. While turnover has weakened to the point where it may be approaching a bottom, it hasn't inflected convincingly yet.

From a market perspective, it may also be too soon to announce that a broad-based recovery has taken hold. After all, we've seen another risk-off rotation from the cyclical to the defensive sectors of the stock market since March.

Which sector should lead the way out? If we're right about an inflection point in consumer prices, declining bond yields, and a calmer Fed reaction function, those dynamics could support rate-sensitive, early-cycle consumer discretionary stocks.

Sources: Bloomberg L.P., Standard & Poor's, Invesco, April 30, 2023. Notes: The Institute for Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI) is a direct measure of expectations captured by business surveys of production and the general economic climate. Diffusion indices have the properties of leading indicators and are convenient summary measures showing the prevailing direction and scope of change. Cyclicals = Consumer Discretionary, Energy, Financials, Industrials, Information Technology, and Materials.
Defensives = Consumer Staples, Health Care, Telecommunication Services, and Utilities. NBER = National Bureau of Economic Research. Shaded areas denote NBER-defined US recessions.
See page 21 for index definitions. An investment cannot be made in an index. **Past performance does not guarantee future results.**

The Opportunity

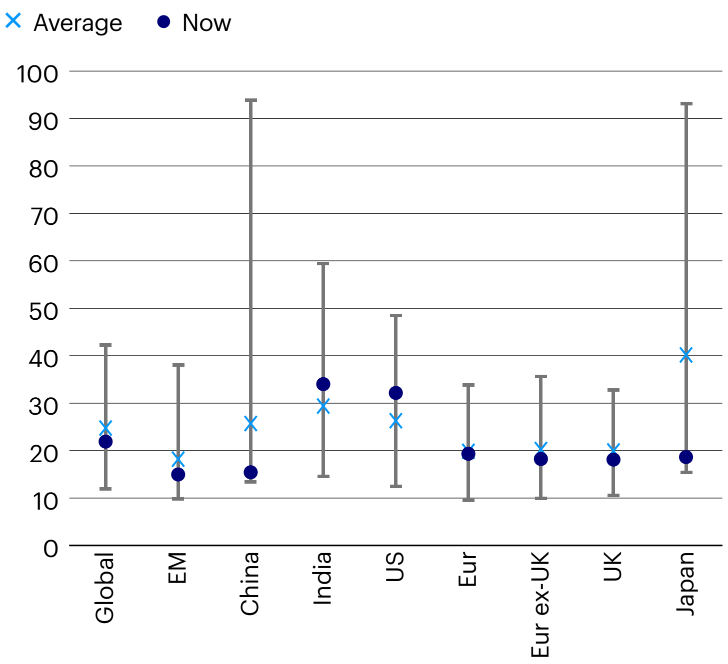
- **Defensives now, cyclicals later** – Investors have shed risk for over two years. However, bearish sentiment is extreme and could turn on a dime.

The Catalysts

- **Manufacturing activity** – Industrial output is contracting, but may be approaching a bottom.
- **Sentiment and positioning** – In the near term, investors have favored the defensive sectors of the stock market. Longer term, aging risk aversion and lopsided positioning could spark a shift back to the economically-sensitive market segments.

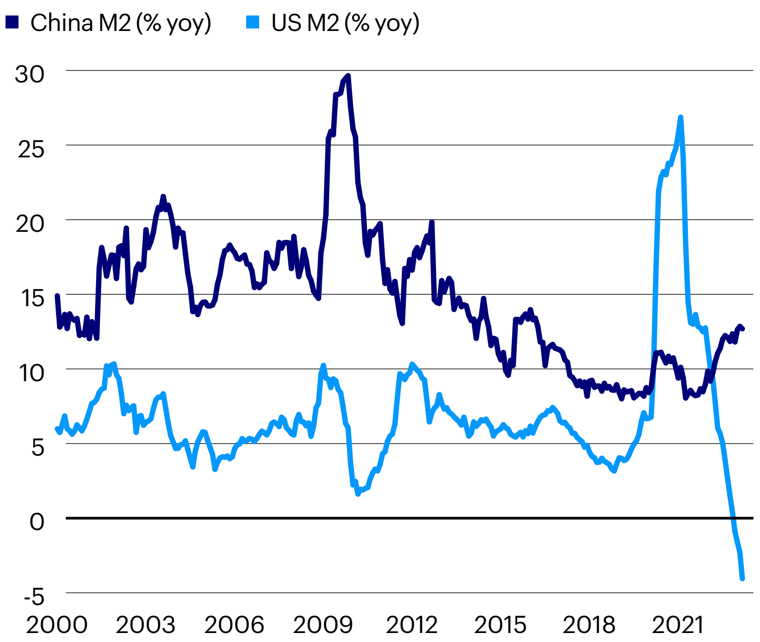
EMERGING MARKETS
Chinese equities

Equity CAPEs within historical ranges



We believe valuations are an important determinant of long-term returns, which we think shines a favorable light on Chinese stocks, especially compared to India and the US.

Monetary growth favorable in China



However, in the shorter term, economic momentum may be more important. The Chinese central bank (PBoC) has been easing over recent years, while the Fed has been tightening aggressively. One outcome has been the divergent paths of money supply growth in both countries. We believe this points to better economic (and profit) momentum in China.

The Opportunity

- Based on our cyclically adjusted price to earnings ratios, Chinese equities are nearly as cheap as they have ever been, a big contrast to the US market.

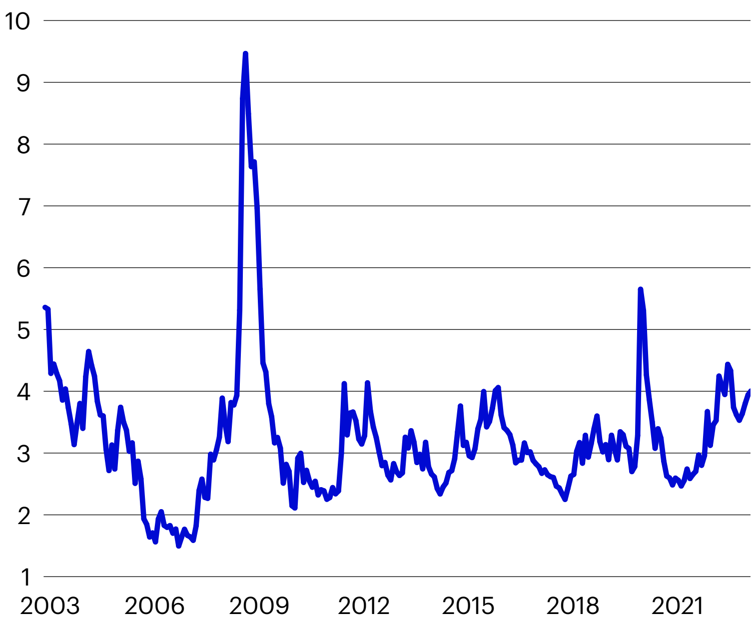
The Catalyst

- The Chinese economy is recovering from poor performance in 2022, aided by the removal of COVID-19 restrictions. If monetary conditions are any guide to future economic performance, China would appear to be well placed. This could favor Chinese equities over the next 12 months.

Note: CAPE = Cyclically Adjusted Price/Earnings and uses a 10-year moving average of earnings. Based on daily data from January 3, 1983 (except for China from April 1, 2004, India from December 31, 1999, and EM from January 3, 2005), using Datastream indices. As of April 10, 2023. Sources: Refinitiv Datastream and Invesco.

EMERGING MARKETS
Relatively good value

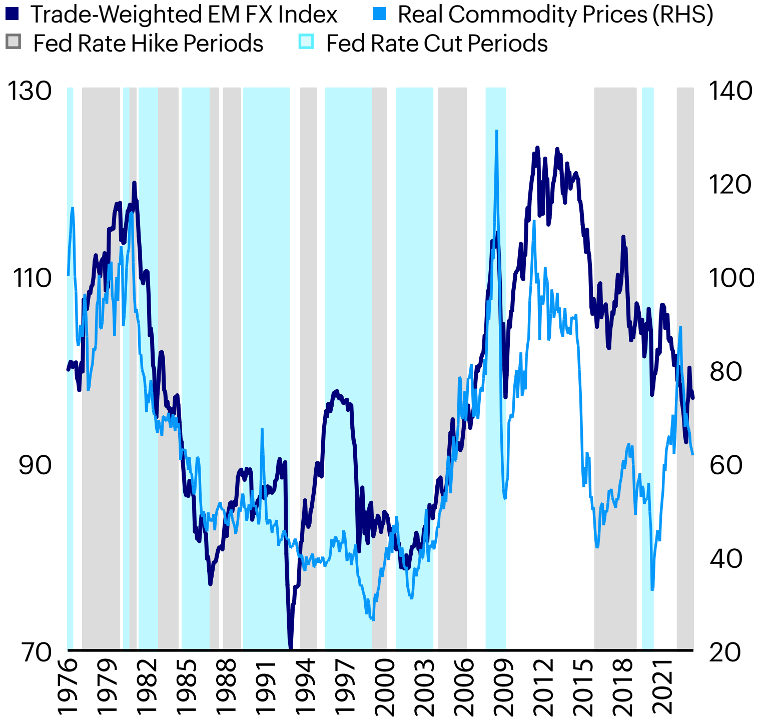
EM USD government bond yield spread versus US



We find that emerging market assets are attractively valued compared to developed world counterparts. As an example, the spread on USD-denominated EM government debt versus US Treasury yields is wider than normal.

Monthly data from February 2003 to May 2023 (as of May 17, 2023). The chart shows the difference between the yield-to-worst on the Bloomberg EM USD 7-10 Year Index and the yield to maturity on the US 10-year Treasury yield. See p.21 for index definitions. An investment cannot be made into an index. See p.21 for index definitions. An investment cannot be made into an index.
Sources: Bloomberg L.P., Refinitiv Datastream and Invesco.

EM currencies, commodities, and the Fed



EM currencies have weakened since the peaking of the commodity bubble around 2011. Commodity prices may weaken further in the short term, in our opinion, which could penalize EM currencies (on average) but as the Fed starts to ease and markets look ahead to economic recovery, we think this could benefit EM currencies and EM assets in general.

Note: **Past performance is no guarantee of future returns.** Monthly data from January 1976 to April 2023. Real trade-weighted EM FX index is a trade weighted average of national currencies versus US dollar (trade weights are based on total trade flows for each country). There are 18 currencies in the EM basket – those of China, Brazil, South Korea, Mexico, Singapore, India, Russia, Poland, Thailand, Turkey, Czech Republic, Malaysia, Indonesia, Hungary, Philippines, South Africa, Chile and Nigeria. Real adjustments use national CPI indices versus that of the US. Real commodity price index is based on the S&P GSCI Commodity Spot Price Index, adjusted by the US CPI index. All indices rebased to 100 as of January 1976. As of April 28, 2023.
Sources: IMF, OECD, Oxford Economics, S&P GSCI, Bloomberg L.P., Refinitiv Datastream, Invesco.

The Opportunity

- Emerging market assets are attractively valued, in our opinion, whether equities, fixed income, or real estate. We believe this offers the possibility of high returns over the medium return.

The Catalysts

- Fed easing has in the past been associated with poor EM asset performance (because it coincides with a weak global economy and falling commodity prices, in our opinion).
- However, emerging market assets have suffered over the last 18 months in response to the sharp rise in US bond yields and the appreciating US dollar (we think). We suspect that this cycle will continue to be atypical and expect Fed easing and weakening of the US dollar to help riskier assets, including emerging markets.

FIXED INCOME
Best of times or worst of times?

Global duration

- The significant reset higher in real yields in the last year provides an opportunity for fixed income investors to put money to work at attractive all-in yield levels.
- We favor duration in the medium term, but in the near term, bond yields are at the lower end of their expected ranges. Yield curves are very inverted, and the Fed is not expected to cut rates in the near future.
- This setup will likely cause bonds to remain stuck in a range: While growth and inflation fundamentals are favorable for bonds, central banks are pursuing high interest rates to ensure that the inflation battle is won.

Credit views

- Credit valuations are close to their longer-term medians, but credit fundamentals are positive in corporate credit. Easier financial conditions, as the Fed pauses, should be supportive of corporate credit.
- Fundamentals in certain securitized sectors, such as CMBS, are mixed.
- We favor high quality credit in investment grade corporate, municipal and some securitized asset classes. Agency MBS should do well when policy uncertainty drops, and interest rate volatility eases.

Views from Invesco Fixed Income

Rob Waldner, CFA®
Chief Strategist

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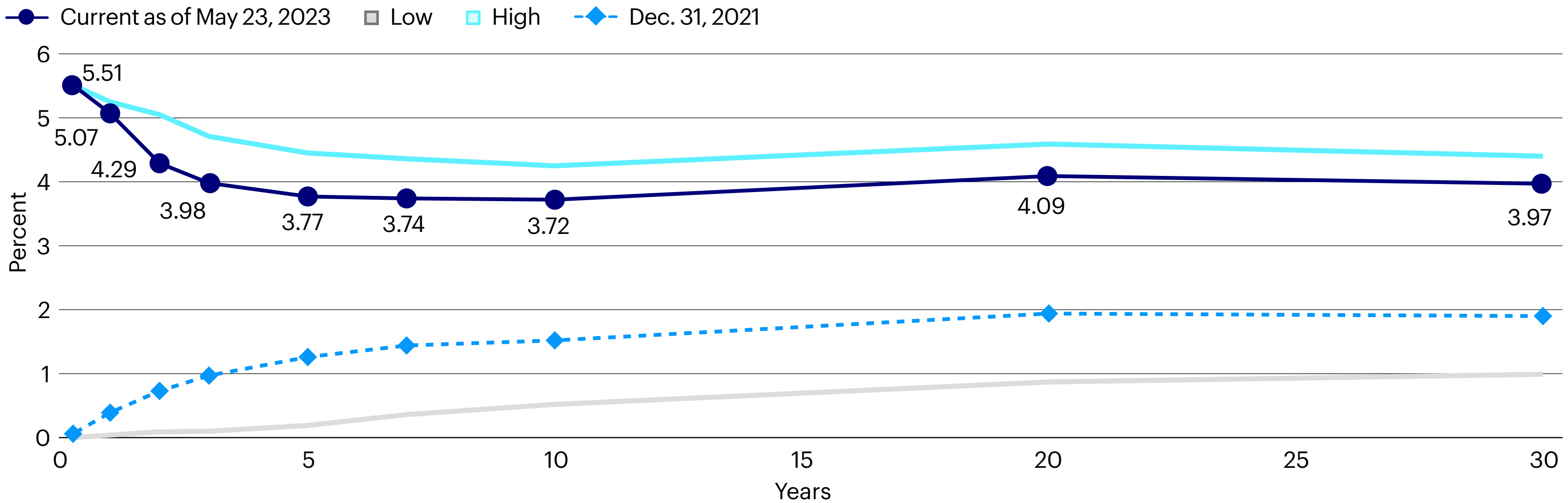
The macro backdrop is increasingly supportive of global markets, but bond yields are likely stuck in a range. Typically, a disinflationary, slow growth environment should be good for asset markets, but in the current situation, global central banks are aggressively tightening monetary policy, which is keeping financial conditions tight and volatility elevated. This tightening of financial conditions is keeping rates and spreads higher than where they would otherwise be. A pause by global central banks should facilitate market performance.

FIXED INCOME
A compelling opportunity

Bonds currently offer a compelling investment opportunity
US Treasury yields over the last 10 years



The current environment is uncertain for investors. Growth has been stronger than expected, and the US labor market has been more resilient to rising rates. Worries about energy availability have eased, allowing better economic performance in Europe and across the global economy. While not booming, global economic momentum has remained solidly in positive territory, and so far, the major economies have skirted a recession. The outlook for US inflation is steadily improving as we see housing price weakness work its way into price indices and as wage pressure shows signs of easing.

Despite rosy macro data, many forecasters see clouds on the horizon that could precipitate negative market outcomes. These two clouds are recession and inflation. Market observers can point to recent banking stress and declining deposits as signs of tightening credit growth – the early signs of recessionary activity. Whether we get a recession in the coming quarters remains a forecast for now.

Current data show remarkable stability, and there are no obvious imbalances in the US economy. So, while a recession remains a possibility, it is far from certain and less than a 50% probability, in our view. The fact that inflation has begun to come down should ease some of this concern, but many market observers are concerned that labor markets will exert renewed upward pressure on inflation going forward. If inflation renews an upward push in the coming months while growth remains anemic, we may move to a stagflation environment, which is quite negative for financial assets across the board.

While negative scenarios of recession or higher inflation would likely be negative for markets, these remain forecasts that are not consistent with current data. Acknowledging the good news of the current data while keeping an eye out for signs of negative scenarios would seem to be the way to go for now.

Source: Macrobond, May 22, 2023.

The Opportunity

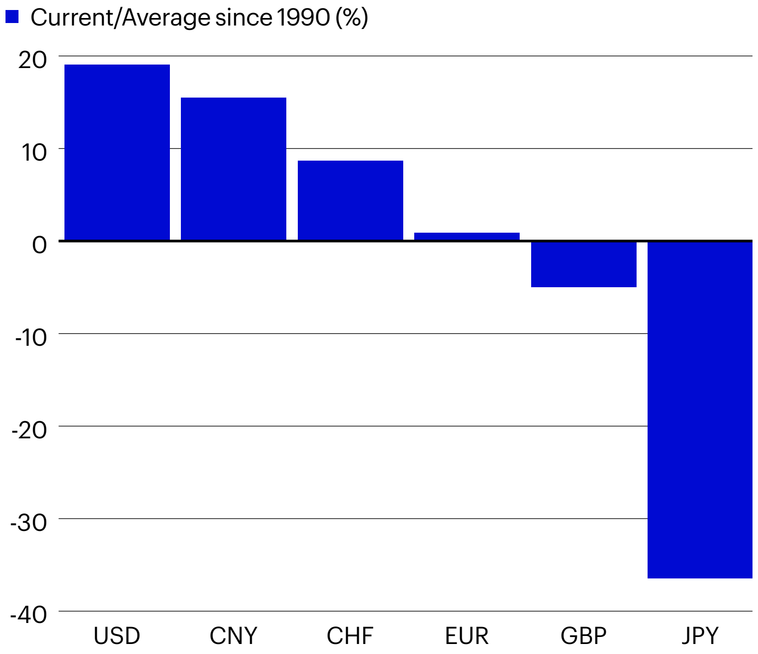
- We believe high quality credit offers a compelling investment opportunity.

The Catalysts

- **Inflation on the decline** – Inflation has likely peaked. We expect inflation to decline through the balance of 2023 in the US and Europe.
- **End of Fed tightening** – Central banks increased rates aggressively to fight inflation pressure. With that fight largely won, central banks will be able to pause. Higher yields resulting from those rate hikes are a buying opportunity.
- **Soft landing** – We believe the US economy will slow but expect the job market to hold up. We would expect investment grade companies to perform well, even if we experience a recession. Corporate fundamentals are generally on a solid footing.

THE DOLLAR
USD looks expensive, and yield gaps are moving against it

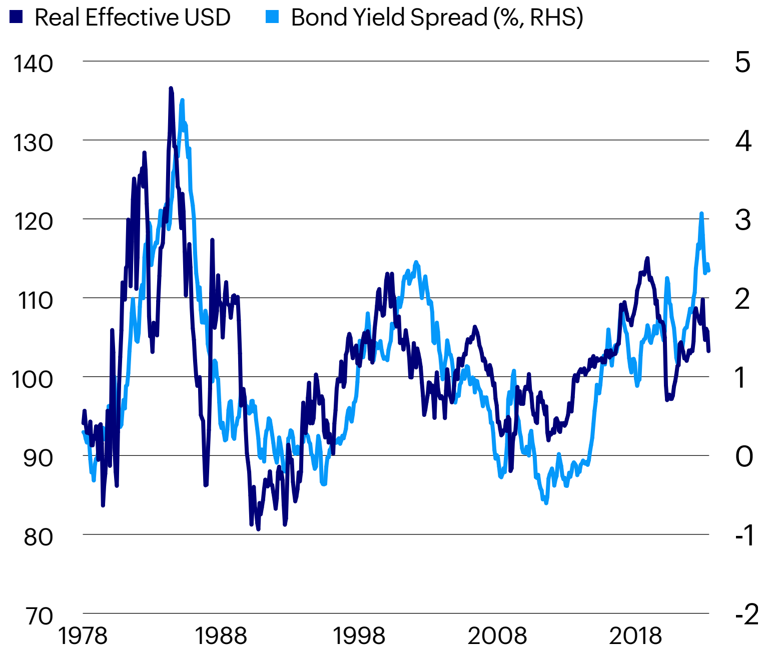
Real effective exchange rates*



Real effective exchange rates suggest that the US dollar is more expensive than usual, with the Japanese yen at the other extreme (because the BOJ is one of the few central banks that did not tighten over the last 18 months). This doesn't seem sustainable, given that the US is running a sizeable current account deficit.

*Currency indices measured against a trade-weighted basket of currencies and adjusted for inflation differentials. As of April 28, 2023.
Sources: OECD, Datastream and Invesco.

Real effective USD and yield spreads



Currencies are often thought to overshoot what is considered to be long-term fair value and to remain away from fair value for some time. Those over shootings are often explained by the fact that financial flows adapt to new circumstances more rapidly than flows of goods and services. Financial flows are often driven by interest rate differentials, which are now moving against the dollar.

Monthly data from January 1978 to April 2023. Real effective US dollar is an index calculated by the OECD as the trade-weighted value of the US dollar versus a basket of currencies and adjusted for CPI inflation differentials. Bond yield spread is the US 10-year Treasury yield minus the average of the 10-year government yields of: Germany, Japan and the UK. As of April 28, 2023.
Sources: OECD, Refinitiv Datastream and Invesco.

The Opportunity

- The US dollar continues to be well above historical norms when measured in real trade-weighted terms. Such valuations can persist but not over the long term, in our opinion. Therefore, we expect the US dollar to weaken.

The Catalyst

- Yield differentials often drive short-term currency movements. USD was supported during 2022 by aggressive Fed tightening that increased the yield spread on US government bonds versus those elsewhere. However, as markets look ahead to Fed easing, that yield spread is now moving against the dollar.

ALTERNATIVES: Private market outlook

Jeff Bennett, CFA®
Head of Manager Selection
Invesco Investment Solutions

Private credit

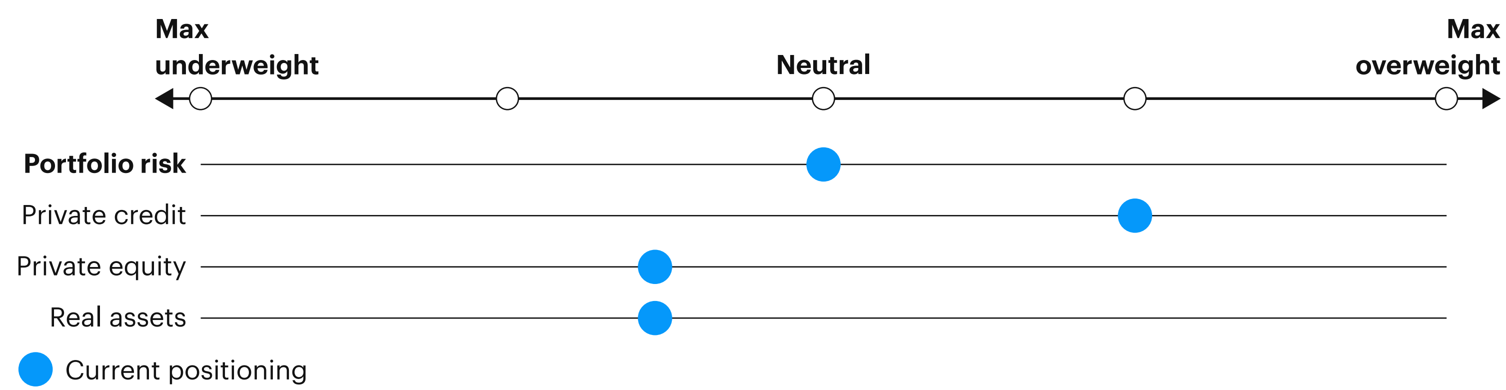
As we consider direct lending going forward, we expect the opportunity set to remain robust and attractive due to higher yields, record levels of PE dry powder, and strong balance sheets. While we do expect default activity to increase modestly, we believe investors are more than compensated for the risks given the senior protections from the asset class. As dislocations arise, distressed and special situations are beginning to appear more attractive. Finally, real asset credit remains our preferred way of gaining exposure to the asset class, as pressure on the regional banking sector should create avenues for alternative lending.

Private equity

We downgrade our rating on private equity to a slight underweight as valuations are moderating amid higher borrowing costs. Pockets of opportunity appear in private-to-private transactions. At a high level, this is an environment that favors dry powder and new investments relative to investments made over the last several years, which in general, have yet to be marked down. There are opportunities for growth equity firms to provide capital for private companies that would have looked to access the IPO market.

Real assets

Expect cap rates to stabilize in the second half of the year after the current correction. The impact of the repricing will vary by region, market, and real estate sector. Given valuation concerns, we have slightly reduced our positioning on real estate. Infrastructure remains an area of interest due to attractive fundamentals as projects are expected to be well funded from recent legislation.



Source: Invesco Investment Solutions, views as of April 30, 2023.

COMMODITIES

David Gluch, CFA®
Client Portfolio Manager
Invesco Global Asset Allocation

Overall underweight a broad basket of commodities based on fundamentals and secular trend

Asset class	Overall	Valuations	Fundamentals	Secular trend
Agriculture	Underweight	Unattractive	Attractive	Unattractive
Energy	Underweight	Attractive	Unattractive	Unattractive
Industrial metals	Underweight	Attractive	Unattractive	Unattractive
Precious metals	Underweight	Unattractive	Unattractive	Attractive

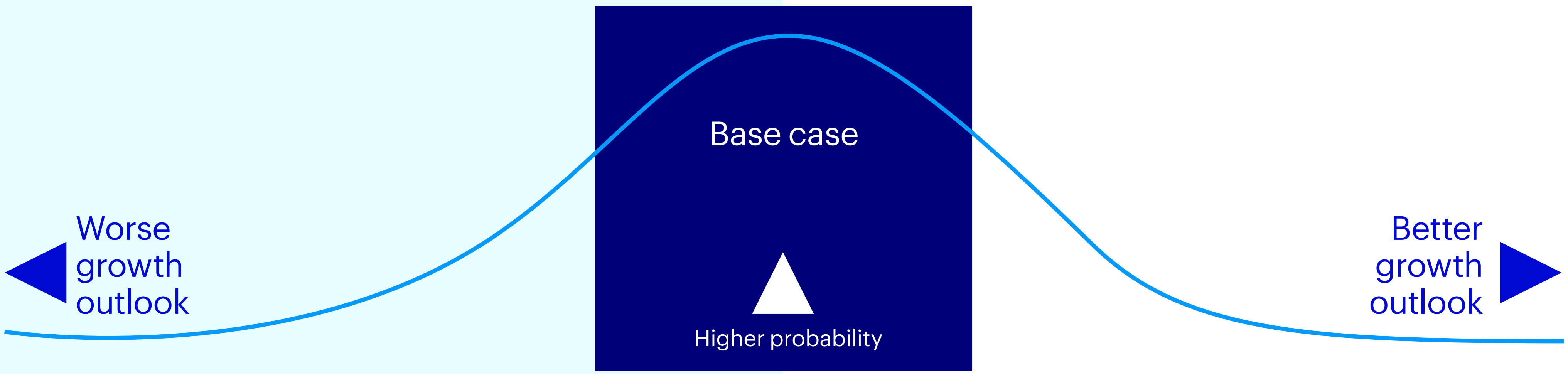
Commodities have declined six consecutive months from December 2022 to May 2023, as measured by the Bloomberg Commodity Index. The asset class is under pressure over fears of a global recession, including a tepid post-COVID-19 industrial recovery in China and concerns over the impact of tight monetary policy. Since the Russian invasion of Ukraine in February 2022, the Bloomberg Commodity Index has been down 9% and 29% since peaking in early June of last year. While positive long-term catalysts remain in place, including demand for clean energy, supply impediments resulting from underinvestment, ESG restrictions and maturing geology, the near-term outlook for commodities remains dependent on the likelihood and magnitude of a potential global recession. As a result, the trend is unattractive, except in precious metals, as gold began to rally last November in anticipation of a peak in yields and a softer dollar.

However, the broad decline in prices is helping to improve valuations, mostly in energy and, to a lesser extent, in industrial metals. For valuation, a comparison of spot prices to exponentially weighted five-year average prices is utilized. The index's large weight to declining raw petroleum (oil and natural gas) is driving most of the improved valuation. As an example, since mid-2020, natural gas has gone from sub $2 to almost $10 in August 2022 and then back to $2 in 2023, while Brent is trading at 2019 levels in the $70s after plummeting to the $20s during COVID-19 and reaching $120 last year. Precious metals and agriculture are slightly overvalued.

Fundamentals, as measured by annual carry, are net unattractive mainly due to the Bloomberg Index's large weight to natural gas. In contrast, refined products are demonstrating a much tighter supply profile, but they have a lower allocation in the index. Moreover, the index's largest holding is gold, and gold's carry follows interest rates, making it currently unattractive due to the inverted yield curve.

Source: Invesco Investment Solutions, views as of May 31, 2023. Views reflect the Bloomberg Commodity Index and do not translate directly to any Invesco commodity strategy. See p.21 for index definitions. An investment cannot be made into an index.

Alternative scenarios



1. "Hard Landing"

Lagged effects of policy tightening and/or credit pullback due to bank crises curtail economic activity, resulting in a stronger hit to growth than in our base case. In this scenario, we expect a recession to emerge first in the US, with likely spill-over effects on European growth as policy effects also begin to take their toll on growth there. Inflation falls meaningfully towards the 2% level as price pressures continue to fade while activity also recedes. China and EMs would likely see lower growth through trade effects but avoid recession, all else being equal.

2. "Smooth Landing"

Policy tightening impacts growth less than expected in our base case while still achieving a better alignment of aggregate demand with supply. The resolution of these imbalances enables inflation to fall towards but above 2% in the US, with inflation in the eurozone falling but less quickly than in the US. The resolution of the inflation question allows the cycle to continue, though at a below-trend pace of growth. China and EMs would likely benefit marginally, all else being equal.

GLOBAL MARKET STRATEGY OFFICE
Favored assets in the period ahead

Hard Landing

A stronger hit to growth, with recession first in the US, with likely spillover effects on Europe. Inflation falls further; China and EMs suffer via trade effects but avoid recession, all else being equal. We look to more defensive plays to outperform.

Our favorite picks...

- Cash
- Fixed income: Long-duration sovereigns
- Equities: Defensive equities, such as consumer staples, health care
- Currencies: Non-USD, non-commodity currencies such as CHF, JPY
- Commodities: Gold

Bumpy Landing

- Growth is below trend and slowing over the near term, but recovery to unfold late in the second half of this year. Fed to pause tightening shortly, potentially cutting rates as soon as the end of this year. Eurozone and UK to follow similar outlooks but with a lag, and ECB and BoE to continue rate hikes. China to continue reopening, with services leading the recovery and manufacturing faring worse due to weaker global backdrop. We anticipate that defensive plays will perform better in the near term but that as markets start to discount an economic recovery, cyclical plays will start to perform better.

Our favorite picks...

- Fixed Income: High quality corporate and structured credit
- Equities:
  - Asia (especially China)
  - Growth and quality
  - Technology, consumer products & services
- Currencies: EUR, CHF and JPY

Smooth Landing

Tightening impacts growth less than expected, with inflation following a pattern similar to our base case. Inflation in the eurozone falls but less quickly than in the US. The cycle continues, though at a below-trend pace of growth. China and EMs benefit marginally, all else being equal. We look to more mid-cycle plays to outperform.

Our favorite picks...

- Fixed Income: High yield credit
- Equities
  - Europe and emerging markets
  - Value and small caps
  - Basic resources, industrials
- Currencies: AUD, CAD
- Commodities: Industrial commodities, especially metals

Source: Invesco, as of May 22, 2023.

Tactical asset allocation: Macro framework

	Recovery	Expansion	Slowdown	Contraction
Economic regime	Growth ▼ **below** trend & ▲ **accelerating**	Growth ▲ **above** trend & ▲ **accelerating**	Growth ▲ **above** trend & ▼ **decelerating**	Growth ▼ **below** trend & ▼ **decelerating**
Monetary policy direction	**Still easy** **~ 15% of the business cycle**	**Tightening** **~ 35% of the business cycle**	**Tight** **~ 35% of the business cycle**	**Easing** **~ 15% of the business cycle**
Market leadership (Ranked by expected outperformance)	**Risky credit** • High yield, bank loans • EM hard currency	**Equity** • Value, size, momentum • Emerging markets	**Equity** • Quality, low volatility • Defensives, developed markets	**Government bonds** • Long duration • Nominal bonds
	Equity • Size, value, cyclicals • Emerging markets	**Risky credit** • High yield, bank loans • EM hard currency	**Government bonds** • Long duration • Nominal bonds	**High-quality credit** • IG corporate • IG securitized
	High-quality credit • IG corporate • IG securitized	**High-quality credit** • IG corporate • IG securitized	**High-quality credit** • IG corporate • IG securitized	**Risky credit** • High yield, bank loans • EM hard currency
	Government bonds • Intermediate duration • Nominal bonds	**Government bonds** • Short duration • Inflation-linked bonds	**Risky credit** • High yield, bank loans • EM hard currency	**Equity** • Quality, low volatility, momentum • Defensives, developed markets

Note: Economies can move backward and forward in this framework.

For illustrative purposes only. We define policy easing as the US Federal Reserve lowering interest rates and/or expanding its balance sheet. Still easing suggests that the US Federal Reserve is maintaining the lower interest rate policy and/or continuing its bond-buying program. Tightening suggests that the US Federal Reserve is tapering asset purchases and/or beginning to raise interest rates. Tight policy suggests that the US Federal Reserve is raising rates in an effort to ease inflation concerns. There is no guarantee that these trends will continue in the future.

Important information

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Definitions

The Bloomberg 5-7 Year US Treasury Bond Index measures the performance of the US Government bond market and includes public obligations of the US Treasury with a maturity of between five and up to (but not including) seven years. Certain special issues, such as state and local government series bonds (SLGs), TIPS and STRIPS are excluded. Securities must be fixed rate and rated investment grade, as defined by the Index methodology.

The **Bloomberg Commodity Index** is a broadly diversified commodity price index.

The Bloomberg Global Financial Conditions Index tracks the overall level of financial stress in US, Europe, UK and Asia ex-Japan money, bond, and equity markets to help assess the availability and cost of credit.

The Institute for Supply Management (ISM) **Manufacturing Purchasing Managers Index (PMI)** is a diffusion index that measures US manufacturing output.

The **MSCI Emerging Market Index** measures the equity market performance of emerging markets.

The **MSCI All-Country World Index (ACWI)** measures the equity market performance of developed and emerging markets.

The **MSCI ACWI ex USA Index** measures the equity market performance of developed and emerging markets, except the US.

The **MSCI Europe Index** measures the equity market performance of Europe.

The **Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the US equity universe.

The **S&P 500 Index** measures the performance of 500 of the largest companies in the US.

The **Russell 2000 Index** measures the performance of the small-cap segment of the US equity universe.

The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the US equity universe.

US cyclical sectors include the S&P 500 consumer discretionary, energy, financials, industrials, information technology, and materials indices.

US defensive sectors include the S&P 500 consumer staples, health care, telecommunication services, and utilities indices.

The AAII Bull-Bear Spread is the net percentage of positive (bull) minus negative (bear) survey respondents, where a difference of roughly -30% signals extremely negative investor sentiment.

The **US Dollar Index** measures the value of the US dollar relative to majority of its most significant trading partners.

The VIX or so-called “investor fear gauge” is a weighted, constant, 30-day measure of the expected volatility of the S&P 500, calculated from out-of-the-money SPX options.

The CBOE Equity Put/Call Ratio is a measure of seller (put) relative to buyer (call) positioning derived from the options market, where a ratio greater than 1 signals extremely negative investor sentiment.

The % of NYSE stocks above their respective 200-day moving averages, when it is extremely low, signals weak internal breadth and can reflect an approaching seller climax.

The S&P 500’s deviation from its 200-day moving average – calculated as the S&P 500 minus its 200-day moving average as a percentage of its 200-day moving average – when it is extremely low, measures technical damage at the index level.

The daily US News-Based Economic Policy Uncertainty Index utilizes newspaper archives from Access World News’ NewsBank service. When extreme uncertainty eases, it helps stocks further along in their bottoming process.

The **JPMorgan Global Manufacturing Purchasing Managers Index (PMI)** is considered an indicator of economic health for the global manufacturing sector. It is based on survey responses from senior purchasing executives.

The **JPMorgan Global Services PMI** is based on data compiled from questionnaires sent to purchasing executives in around 350 private service sector companies. The index tracks variables such as sales, employment, inventories, and prices.

The Bloomberg US Corporate High Yield Average OAS measures the spread of US dollar-denominated, below investment-grade, fixed-rate corporate bonds above their Treasury counterparts. When the spread is wide, investors demand high compensation for taking risk.

The NYSE Composite Advance/Decline Ratio is a breadth indicator that compares the number of advancing stocks to the number of declining stocks within the index. Divergences between the A/D ratio and the index may warn of a coming reversal.

Important information

All data as of May 31, 2023, unless otherwise stated. All data is USD, unless otherwise stated.

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