



Invesco Fixed Income Multi-sector asset allocation outlook

Q1 2020



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IFI multi-sector asset allocation overview

- **Macro factor summary:** We expect positive growth surprises in 2020 led by reduced trade tensions and easier global monetary policy. We expect US growth to stabilize at around 1.8%, European growth at around 1% and Chinese growth at just below 6%. Global inflation remains low with a sharp rise unlikely in the near term, enabling global central banks to maintain easy monetary policies for the foreseeable future.
- **Asset allocation summary:** Our macro factor framework implies an underweight position in global rates and the US dollar and a neutral position in credit. Recovering global growth, reduced trade tensions and expanding central bank balance sheets are overall positive for credit assets, but tight valuations in many sectors limit potential upside, in our view.
- **Risk position:** We have upgraded our risk positioning to slightly positive from neutral. Although valuations are tight, we believe the macro environment is favorable for the performance of risky assets. Geopolitical events are likely to continue, but unless they impact growth or monetary policy, are unlikely to change our view. Instead, they may create entry points for risk takers.

Factors vs. market expectations



IFI macro factor outlook (3-month outlook)

Global growth: Above market expectations

We believe stabilizing global growth, reduced trade tensions and easier monetary policy will lead to positive global growth surprises in 2020. Growth in Europe and China appear to be troughing, and, while it is too early to call a bottom in the US manufacturing sector, the US Federal Reserve (Fed) has been supportive and the consumer remains healthy in terms of jobs, confidence and household balance sheets. The signing of a Phase-1 US-China trade deal in January and waning Brexit risk remove some previous headwinds to global growth.

Global inflation: At market expectations

US and European inflation remain low, especially excluding the temporary impact of tariffs. Chinese inflation is higher than preferred by Chinese policy makers due to idiosyncratic and exogenous factors, but we believe a sharp increase in global inflation is unlikely in the near term.

Global policy and financial conditions: Easier than expectations

Global policymakers have eased significantly in recent months. Although the Fed has completed its cutting cycle, it has indicated a high bar for raising rates in the future. It has also begun increasing the size of its balance sheet for technical reasons to support the short-term funding market. The European Central Bank (ECB) is also loosening and has resumed its quantitative easing (QE) program. China has eased fiscal policy in the past year and recently implemented monetary easing measures.

IFI 2020 macro outlook

	Growth (%)		Inflation (%)		Policy (next move)	
	IFI Forecast	Consensus	IFI Forecast	Consensus	IFI Forecast	Consensus
US	1.8	1.9	2.2	2.1	No change until 2021	2020
Europe	1.0	1.0	1.3	1.3	2021	2021
China	5.9	5.9	3.0	3.1	Mid 2020	N/A
Japan	0.5	0.5	0.7	0.7	No change in 2020	No change in 2020

Source: Invesco Fixed Income, Bloomberg L.P., Jan. 13, 2020. IFI forecasts are 6-month trends. There is no guarantee these forecasts will be realized.

IFI broad asset allocation (3-month outlook)

		Macro factor vs. market expectations			Asset allocation
		Growth: Above expectations	Inflation: At expectations	Policy: Easier than expectations	
Market impact	Global duration	Negative	Neutral	Neutral	Underweight
	US dollar	Neutral	Neutral	Negative	Underweight
	Global credit	Positive	Neutral	Positive	Neutral

Asset allocation (3-month outlook)

Global duration: Underweight

We expect global core interest rates to increase toward fair value levels. We are positioning for a moderate back-up in rates either by adjusting core duration positions or allocating to less duration-sensitive assets. We do not expect interest rates to sell off beyond fair value unless there is a significant increase in inflation, which we believe is unlikely. Certain markets like the US enjoy strong demand technicals and might outperform relative to their typical betas in such a scenario.

US dollar: Underweight

We expect the US dollar to weaken as global growth bottoms and monetary policy eases in the US. Expansion of the Fed's balance sheet and the resolution of trade tensions may also add to downward pressure on the dollar. We expect the dollar to depreciate versus developed and emerging markets currencies.

Global credit: Neutral

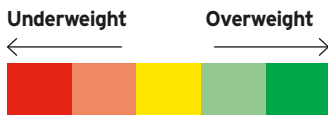
The macro environment of steady growth, easy financial conditions and benign inflation is supportive of credit assets overall, in our view. Valuations are tight in many credit sectors, however, limiting the potential upside. We expect positive credit returns in 2020 with limited spread tightening in IG and HY. We favor sector rotations away from longer duration sectors, which have been the strongest performers, into more credit-sensitive, less duration-sensitive, sectors that have lagged. For example, we favor bank loans versus BB high yield.

IFI risk position (3-month outlook)



We have upgraded our risk positioning to positive. Although valuations are tight, we believe the macro environment is favorable for the performance of risky assets. Easy monetary policy, both through low interest rates and now increasing central bank balance sheets, will likely be supportive of risky assets. Solid growth at close to potential across major global economies is supportive of financial markets. Low and benign inflation will not likely threaten financial market performance in the near term. Geopolitical events are likely to continue, but unless they impact growth or monetary policy, are unlikely to change our view. Instead, they may create entry points for risk takers.

IFI multi-sector asset allocation (3-month outlook)



Long-term government interest rates

US	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

US interest rates currently offer a poor risk-reward trade-off, in our view. Factors that have driven risk aversion over the past several months have shown signs of improving: global trade tensions seem to be heading toward resolution and the chances of a hard Brexit have been significantly reduced. Most importantly, global growth is improving. Improved global growth conditions combined with easier US financial conditions will likely pave the way for higher longer-term interest rates in the next several months. However, we do not expect sharp increases in interest rates until inflation conditions improve, which we believe is unlikely in the medium term.

Europe	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

We are seeing a stabilization in eurozone data, with manufacturing showing tentative signs of bottoming out. At the December European Central Bank (ECB) meeting, President Lagarde acknowledged some initial signs of stabilization in the growth slowdown and announced a strategic review of ECB policy over the course of 2020. We expect a supportive ECB to remain on hold in 2020, with a high hurdle to either hike or cut rates amid its policy review.

Japan	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

We expect the yield curve to steepen from current levels. In contrast to the front end of the yield curve, the long end has been very stable over the last month, due to persistent local pension demand. However, the Bank of Japan's (BoJ) determination to steepen the yield curve will likely limit the potential outperformance of longer-term Japanese government bonds, especially if international yields move higher.

China	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

We are neutral Chinese government bonds but cautious on duration through the first quarter of 2020. Chinese onshore government bonds continue to provide a notable yield pick-up versus major developed market bonds, such as US German and Japanese bonds. However, we are cognizant of efforts by Chinese policy makers to bolster economic growth with fiscal measures, a potential recovery in risk sentiment and seasonal investment patterns. The spike in headline inflation may limit central bank easing moves in the near term and potentially larger local government special project bond quotas in 2020 could increase supply pressure early next year. We anticipate better opportunities after the first quarter, when inflation may peak and the central bank has more flexibility to conduct monetary easing.

Currencies

USD	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

Three main factors have caused us to downgrade the US dollar to underweight: global growth is improving and good global growth has historically been negative for the US dollar; the Fed has telegraphed that it is on hold despite better growth data; and other factors that have caused global risk aversion, such as trade tensions and Brexit uncertainty, have improved. We expect these conditions to lead to US dollar depreciation against most currencies in the near term.

EUR	Red	Orange	Yellow	Light Green	Dark Green
Fundamentals	Red	Orange	Yellow	Light Green	Dark Green
Valuations	Red	Orange	Yellow	Light Green	Dark Green
Technicals	Red	Orange	Yellow	Light Green	Dark Green

We expect eurozone growth to stabilize around current below-trend levels of around 1% and the ECB to remain accommodative in the near term. Political uncertainty and weak economic data, as well as the negative cost of carry, should keep the euro range-bound against the US dollar in the near term.

JPY	
Fundamentals	
Valuations	
Technicals	

The long-run return profile for the yen appears skewed to the upside, given attractive valuations. However, reduced downside risks to global growth and yields and relatively persistent Japanese capital outflows probably limit the yen's short-term upside. Nevertheless, we believe the yen remains an attractive hedge to risk assets, especially if positions can be structured to take advantage of the historically low level of implied options volatility.

RMB	
Fundamentals	
Valuations	
Technicals	

The market has become more optimistic about US-China trade negotiations and the renminbi has appreciated against the US dollar in recent weeks. In the short term, markets will likely focus on details of the "Phase One" deal and progress of the "Phase Two" negotiations. In the medium term, geopolitical headlines have complicated the renminbi's outlook. We expect the currency's performance to be largely event-driven, presenting binary risks. Markets are closely watching trade-related headlines and investors who are preparing to increase allocations to Chinese assets could view renminbi depreciation as a buying opportunity. We believe further progress in US-China trade talks could send the renminbi/US dollar exchange rate further below 7.0.

Credit

Investment grade (IG)

US	
Fundamentals	
Valuations	
Technicals	

The technical environment for investment grade corporate credit remains strong as central banks continue to provide liquidity. Moderate growth and inflation should be a positive for credit markets going forward. Earnings growth is also expected to support fundamentals in the coming quarters while low interest rates also benefit borrowers. Investment grade credit spreads begin the year at low levels and we remain cautious on valuations. As a result, we expect security selection to be a significant factor in performance during the year.

Canada	
Fundamentals	
Valuations	
Technicals	

The Canadian economy is showing some signs of strain under the weight of high levels of household debt. Inflation is being led by the rise in overall housing costs which is likely to dampen consumer spending. We are anticipating a rate cut by the Bank of Canada, which provides a supportive backdrop for high quality Canadian corporate debt. Valuations are less compelling given the persistence of spread tightening, but selective opportunities are still present, in our view. We favour the telecom, infrastructure and utilities sectors. The technical backdrop is expected to remain extremely strong as demand appears to outstrip expected supply.

Europe	
Fundamentals	
Valuations	
Technicals	

Our base case remains that the macro backdrop of low growth, low inflation and easy monetary policy will likely be positive for high quality European corporate bonds going forward and that, combined with a hunt for yield, should support the asset class during 2020. We still see the potential for credit spreads at an index level to widen further from here based on the technical (open-ended ECB bond buying) and economic backdrop, but believe this will be secondary to carry.

UK	
Fundamentals	
Valuations	
Technicals	

We remain neutral at current valuations given the still uncertain trade backdrop as the conservative government begins the process of negotiating a trade agreement with Europe, the UK's largest export market. However, we are selectively involved in large multinational UK credits with diversified international revenue that could potentially benefit from potential weakness in sterling and that we believe are well-placed to navigate possible Brexit outcomes. We favor well capitalized banks, while avoiding higher beta sectors, such as retail.

Asia	
Fundamentals	
Valuations	
Technicals	

Asian investment grade bonds still offer value, in our view, compared to similar bonds in other regions. We expect low tail risk in Asian credit as financial conditions remain easy. Asian investment grade corporates have continued to deleverage in the past year and are relatively well prepared for potential shocks, in our view. We expect supply to moderate after a record year in 2019.

High yield (HY)

US					
Fundamentals					
Valuations					
Technicals					
Europe					
Fundamentals					
Valuations					
Technicals					
Asia					
Fundamentals					
Valuations					
Technicals					

We expect supportive global growth in 2020 (although below 2019 growth) to keep HY fundamentals stable. We think 2% growth in the US represents a sweet spot for debt investors, as companies can grow revenue and free cash flow, but aren't quite ready to re-leverage their balance sheets. From a macro standpoint, we acknowledge the extended age of the current economic cycle, but also recognize the supportive actions by the Fed and ECB. At the sector level, we expect positive catalysts in the wireless sector as the industry continues to consolidate but see poor relative value in the technology sector, a sluggish revenue outlook for auto-related companies, and secular challenges for the wireline industry.

The ECB's policies remain supportive of the European high yield market, in our view. At the company level, fundamentals are generally stable, with companies demonstrating low-to-moderate revenue growth, coupled with some debt repayment. In lower-rated and cyclical credits, weakening macro fundamentals and trade tensions are creating volatility, warranting a more prudent risk positioning in those names, in our view.

We expect positive technicals to support Asian high yield as the rising volume of negative-yielding global debt incentivizes investors to hunt for higher yields in Asia. Additionally, new Chinese government rules will likely limit the net supply of Chinese real estate dollar bonds. Fundamentals of privately-owned entities in the Chinese industrial sector have deteriorated due to the economic downturn but the Chinese real estate industry has been resilient. We expect volatility to gradually pick up.

Emerging markets (USD)

Sovereign					
Fundamentals					
Valuations					
Technicals					

While valuations seem relatively rich, in our view, with spreads near the lows of the last ten years, the overall backdrop is supportive given reasonable valuations versus developed markets, a decent emerging markets growth backdrop and benign financial conditions. Taking all of this into consideration, we think spreads can continue to grind tighter absent a negative shock. However, as valuations seem to be pricing in a fairly positive scenario, we believe a degree of caution is warranted.

Municipals

IG					
Fundamentals					
Valuations					
Technicals					
HY					
Fundamentals					
Valuations					
Technicals					

Last year saw record flows into the muni market, resulting in a supportive technical environment that we believe will continue into the first quarter of 2020.¹ We expect around USD400-450 billion of municipal issuance in 2020, with a significant amount of new issuance coming in the form of taxable deals as the market continues to advance refund tax-exempt debt using taxable deals. Given the strong appetite for municipal debt among retail, institutional and overseas investors, we believe the market is well positioned to absorb new deals, even in a heightened issuance environment.

High yield municipal spreads tightened in 2019, driven by a scarcity of tax-exempt HY paper during a time of strong demand. We estimate that demand exceeded supply by more than USD28 billion in 2019.² We expect this pattern to continue in 2020. As a result, we believe HY asset managers will find it challenging to put the steady inflows of cash to work.

1 Source: Lipper US Fund Flows, Dec. 31, 2019.

2 Source: Invesco, Citigroup, data as of Jan. 13, 2020.

Structured

Agency MBS	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green

Some of our concerns about Agency MBS were recently realized: volatility spiked due to trade friction with China and concerns arose over future Fed policy and higher interest rate volatility which typically leads to wider MBS spreads. The only thing that has gotten notably more attractive in the Agency MBS market is valuations. Nominal spreads are cheap to their three-year averages and Agency MBS valuations have become more attractive relative to IG corporate debt. However, fundamentals and technicals will likely challenge Agency MBS performance in the 2020 with heavy supply expected. With refinancing risk also high, we remain neutral on the asset class.

Non-QM Senior MBS	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green

We believe Non-QM valuations are attractive relative to corporate bonds. The low supply of moderately priced homes will likely continue to support price appreciation, although at a slower pace than in recent years. Mortgage rates have declined, borrower balance sheets are strong and delinquencies remain low. Technical conditions are less positive than fundamentals due to a higher issuance of Non-QM product recently, but we expect conditions to improve as originators turn to conventional mortgage products amid lower rate levels.

Non-Agency MBS GSE CRT (BBB)	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green

We believe IG CRT residential mortgage credit valuations are currently attractive, particularly relative to corporate debt. Housing market fundamentals are still a positive tailwind for HY CRT residential mortgage credit. Single family homes continue to record price gains in most major metropolitan areas, although at a slower rate than recent years. Technical conditions in CRT bond markets in recent months have been more challenging due to the shifting rate posture of the Fed and market; lower short-term rates reduce coupon income on floating rate bonds, which comprise all CRT issuance. We believe these technical factors have caused IG CRT spreads to lag other sectors.

Non-Agency GSE CRT (Below IG)	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green

We believe HY CRT valuations are currently attractive. Housing market fundamentals are still a positive tailwind for HY CRT residential mortgage credit. Single family homes continue to record price gains in most major metropolitan areas, but at a slower rate than in recent years. Bond rating upgrades from HY to IG continue to create a positive environment for HY CRT paper, despite the more challenged demand for floating rate bonds.

ABS	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green









































The case for benchmark ABS continues to be strong, bolstered by stable consumer fundamentals, rational underwriting and stable demand. Increased market volatility and uncertainty (due partly to ongoing trade tensions) tends to favor high quality, domestically focused ABS. ABS valuations currently appear attractive, in our view, as they generally underperformed corporate bonds in the fourth quarter of 2019, while esoteric ABS appear more differentiated and challenged, requiring selective investment and substantial monitoring.

CMBS*	Red	Orange	Yellow	Green	Green
Fundamentals	Red	Orange	Yellow	Green	Green
Valuations	Red	Orange	Yellow	Green	Green
Technical	Red	Orange	Yellow	Green	Green

Fundamental improvement continues but the pace is slowing. We expect property price appreciation to vary significantly across property types and markets, with retail property sectors remaining challenged. Valuations relative to corporate bonds have recently improved. Market technical conditions are now neutral as conduit issuance has increased and dealer balance sheets have grown somewhat. We prefer senior bonds from new issue securitizations and seasoned subordinate credit.

*MBS is mortgage-backed securities. Non-QM Senior MBS is Non-Qualified Mortgage Senior MBS. GSE is government-sponsored enterprises. CRT is Credit Risk Transfer securities. ABS is asset-backed securities. CMBS is commercial mortgage-backed securities. RMBS is residential mortgage-backed securities.

Bank loans

US					
Fundamentals					
Valuations					
Technicals					
Europe					
Fundamentals					
Valuations					
Technicals					

The fundamental and technical outlooks for US loans are as constructive as they have been in several months, and collectively inform our positive total return expectation for 2020. Better-than-expected economic and earnings data to close 2019, along with the recent trade war de-escalation, have set the stage for a stable price environment in Q1 and point to a continued low default environment, in our view. Market technicals will likely continue to be driven by collateralized loan obligation demand, for which the outlook is strong in Q1. The new issue supply pipeline remains relatively light, reflecting the delayed impact of weaker risk sentiment in previous months, which had weighed on capital market activity.

The European bank loans new issuance pipeline looks healthy moving into 2020. We expect loan supply to kick-off strongly in Q1 and then follow 2019 trends, reaching around €70 billion in total. While the credit cycle is aging, default rates in Europe are still significantly below historic averages and are forecast to increase only modestly in 2020.

Investment risks

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. Past performance is not a guide to future returns.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating. The values of junk bonds fluctuate more than those of high quality bonds and can decline significantly over short time periods.

Junk bonds involve a greater risk of default or price changes due to changes in the issuer's credit quality.

The values of junk bonds fluctuate more than those of high quality bonds and can decline significantly over short time periods.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

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Mortgage- and asset-backed securities, which are subject to call (prepayment) risk, reinvestment risk and extension risk. These securities are also susceptible to an unexpectedly high rate of defaults on the mortgages held by a mortgage pool, which may adversely affect their value. The risk of such defaults depends on the quality of the mortgages underlying such security, the credit quality of its issuer or guarantor, and the nature and structure of its credit support.

Asset-backed securities are subject to prepayment or call risk, which is the risk that the borrower's payments may be received earlier or later than expected. Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

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