Tactical Asset Allocation

Invesco Investment Solutions

July 2020 Update

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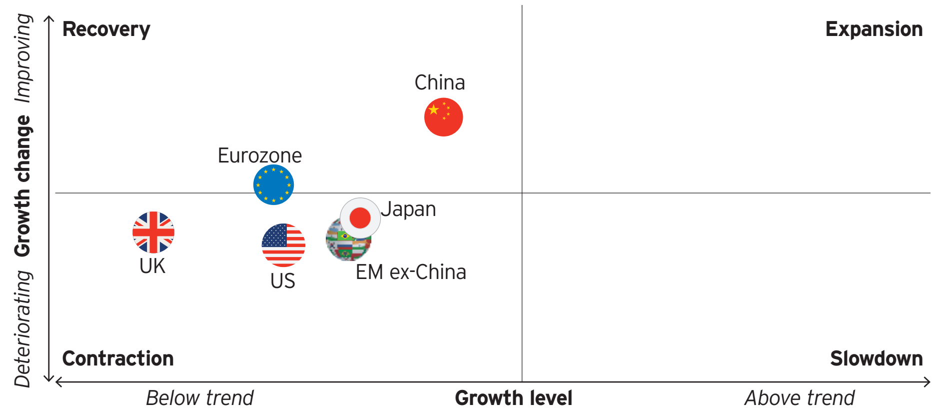
Synopsis:

- By and large, recent global economic data releases have shown signs of stabilization as most economies have begun the reopening process, confirming our **Recovery** regime initiated in June.
- Sentiment in global capital markets and outperformance of risky assets continues to signal improving global growth expectations despite recent rising contagion concerns in parts of the US.
- Our investment risk posture is higher than our Global 60/40 benchmark, sourced through an overweight exposure to credit, emerging market equities and cyclical equity factors.

Our macro regime framework continues to indicate the global economy is moving into a **recovery** regime, confirming our expectation of an inflection in the business cycle. By and large, recent global economic data releases have shown signs of stabilization as most economies have begun the reopening process. Over the past two months, indicators from consumer confidence to retail sales, business surveys and industrial orders suggest modest improvements off the bottom readings registered in April when the most stringent lockdown measures were in effect. As we discussed in our June update, the improvement in economic data is most apparent in Asia, particularly in China, where evidence of an economic recovery is emerging across several parts of the economy, such as housing, industrial orders and production, money and credit growth. Emerging markets outside of Asia are still lagging, reflecting the most recent contagion waves in Latin America and Russia (**Figure 1**).

While the developed world is still contracting, the rate of deterioration is slowly improving, particularly in Europe where economic data may soon confirm the transition to a recovery phase likely ahead of the United States. Furthermore, sentiment in global capital markets continue to improve with additional broad-based outperformance in risky assets, indicative of improving global growth expectations despite recent concerns of rising COVID-19 cases in several parts of the United States (**Figure 2**). Overall, a combination of below-trend growth (as indicated by our leading economic indicators) and improving growth expectations leads us to believe all regions are in a recovery (as Asia today) or will move into a recovery phase soon (i.e. the developed world).

Figure 1: Leading economic indicators suggesting Emerging Asia is already in recovery. Improving growth expectations, implied by rising risk appetite, suggest the rest of the world is entering a recovery regime soon.
Current Leading Economic Indicators (LEIs) – June 30, 2020

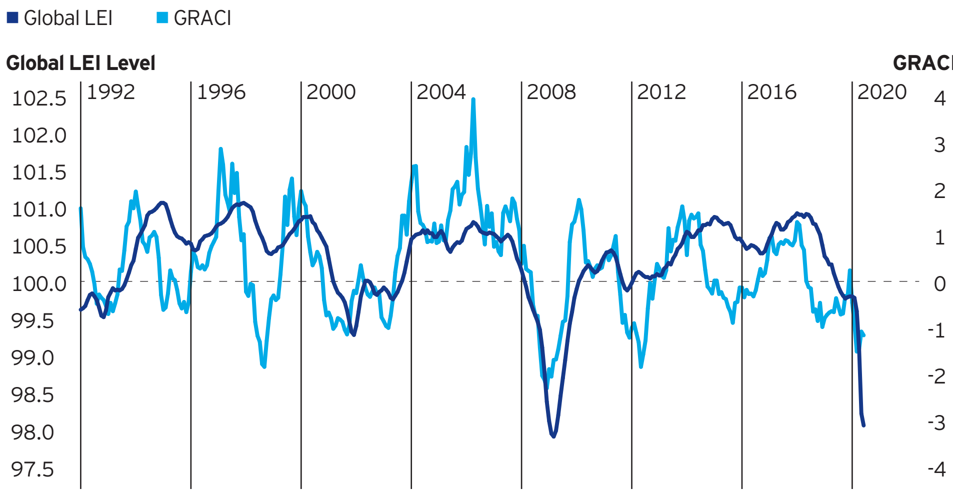


Source: Invesco Investment Solutions team proprietary research, June 30, 2020.

<table>
<tr><th>Region</th><th>(a)
Current level of growth (LEIs)</th><th></th><th>(b)
Change in global growth expectations (GRACI)</th><th></th><th>(c)
Expected macro regimes</th></tr>
<tr><td>Global</td><td>Below Trend</td><td rowspan="9">&</td><td rowspan="9">Growth Expectation Improving</td><td rowspan="9">=</td><td>Recovery</td></tr>
<tr><td>United States</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>Developed Markets ex-USA</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>Europe</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>United Kingdom</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>Japan</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>Emerging Markets</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>China</td><td>Below Trend</td><td>Recovery</td></tr>
<tr><td>Emerging Markets ex-China</td><td>Below Trend</td><td>Recovery</td></tr>
</table>

Source: Invesco Investment Solutions. Macro regime data as of June 30, 2020. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the macroeconomic trend level. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment. For illustrative purposes only.

Figure 2: Market sentiment signaling improving growth expectations and the potential for a bottom in the global economic contraction



Sources: Bloomberg L.P., MSCI, Citi, Barclays, JPMorgan, Invesco Investment Solutions research and calculations, from January 1992 to June 2020. The Global Leading Economic Indicator (LEI) is a proprietary, forward-looking measure of the macroeconomic trend level. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.

As we discussed in our latest update, the duration and strength of the recovery will likely depend on whether reopening the economy will affect the spread of the disease and how countries will contain the potential increase in new contagions. We believe these developments are in line with the base case scenario we outlined last month, centered on the hypothesis that the world economy would start the reopening process at the beginning of the summer, but that such process would be gradual, uneven across industries and countries, and subject to much uncertainty given the lack of meaningful developments of medical treatments.

Investment positioning

We maintain a **higher risk posture** than our benchmark[1] in our Global Tactical Asset Allocation model, sourced through an overweight exposure to credit, emerging market equities and cyclical equity factors. In particular:

- We maintain a neutral total **equity exposure** tilted towards cyclical markets and sectors with an overweight to emerging market equities, and cyclical factors such as size and value. In addition, we have increased our exposure to developed markets outside the US, at the expense of US equities, given favorable currency valuations and relative growth momentum.
- In **fixed income**, we maintain an overweight exposure to US high yield credit, emerging markets sovereign dollar debt, and event-linked bonds at the expense of government bonds, particularly in developed markets outside the US. Our total duration stance is neutral.
- In **currency markets,** we maintain an overweight exposure to foreign currencies, positioning for US dollar depreciation. We remain underweight perceived safe havens such as the Japanese yen and the Swiss franc in favor of cheaply valued, growth sensitive currencies like the Euro, Canadian dollar and Scandinavian currencies.

1 Global 60/40 benchmark (60% MSCI ACWI / 40% Bloomberg Barclays Global Agg USD Hedged).

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.

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