Tactical Asset Allocation

Invesco Investment Solutions

June 2020 Update

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Synopsis:

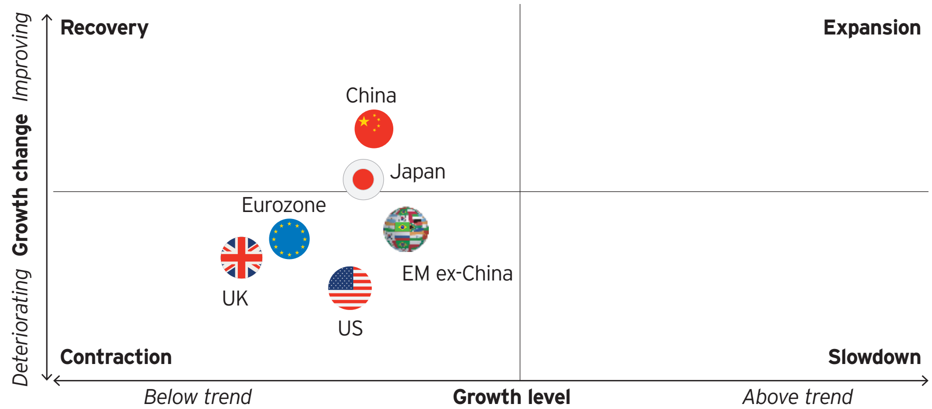
- Extraordinary monetary and fiscal policy announcements have helped markets find a bottom in late March, and the steady decline in new Covid-19 infections in the developed world has increased the likelihood of a gradual reopening across major economies in Europe and North America over the next month.
- As a result, markets have quickly repriced improving growth expectations, which lead our macro framework to move to a **recovery** regime after spending four months in contraction. Based on our leading indicators we are already seeing this recovery materialize in major economies across Asia, which led the way during the downturn and now lead the way in a recovery.
- We have implemented several changes in the hypothetical **Global Tactical Asset Allocation** strategy over the past couple of weeks given the transition from a contraction to a recovery regime, **increasing the total risk posture of the portfolio from below average to above average and adjusting exposures across asset classes (to more credit and equities), regions (emerging markets) and style/factors (small size and value).**

Our macro regime framework is signaling that the global economy is moving into a **recovery** regime. While economic data have deteriorated further over the past month, particularly in the developed world, sentiment in global capital markets continues to improve, as broad-based outperformance in risky assets indicates improving global growth expectations. Extraordinary monetary and fiscal policy announcements have helped markets find a bottom in late March, and the steady decline in new Covid-19 infections in the developed world has increased the likelihood of a gradual reopening across major economies in Europe and North America over the next month.

As a result, markets have quickly repriced improving growth expectations, which lead our macro framework to move to a recovery regime after spending four months in contraction. Based on our leading indicators we are already seeing this recovery materialize in major economies across Asia, which led the way during the downturn and now lead the way in a recovery (**Figure 1**). Chinese business surveys and industrial production data are early evidence of improving economic momentum[1].

1. Source: Macrobond, 2020

Figure 1: Market sentiment signaling improving growth expectations and a recovery regime. Asian leading indicators already improving.
Current Leading Economic Indicators (LEIs) – May 31, 2020



Source: Invesco Investment Solutions team proprietary research, May 31, 2020.

Region	(a) Current level of growth (LEIs)		(b) Change in global growth expectations (GRACI)		(c) Expected macro regimes
Global	**Below Trend**				**Recovery**
United States	**Below Trend**				**Recovery**
Developed Markets ex-USA	**Below Trend**				**Recovery**
Europe	**Below Trend**				**Recovery**
United Kingdom	**Below Trend**	**&**	**Growth Expectation Improving**	**=**	**Recovery**
Japan	**Below Trend**				**Recovery**
Emerging Markets	**Below Trend**				**Recovery**
China	**Below Trend**				**Recovery**
Emerging Markets ex-China	**Below Trend**				**Recovery**

Source: Invesco Investment Solutions. Macro regime data as of May 31, 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.

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 have implemented several changes in our hypothetical Global Tactical Asset Allocation strategy over the past couple of weeks given the transition from a contraction to a recovery regime, increasing the total **risk posture** of the portfolio from below average to above average[2] and adjusting exposures across asset classes, regions and style/factors. In particular:

- We have moved our total **equity exposure** from underweight to neutral and increased the cyclicality of its composition, moving from underweight to overweight emerging market equities vs. developed markets. In addition, we have moved from defensive towards cyclical factors, tilting in favor of (small) size and value in US equities.
- In **fixed income**, we have increased our credit risk by moving from US investment grade to US high yield credit, while maintaining previous exposure to emerging markets sovereign dollar debt. We maintain a moderate overweight to duration risk with a bias towards yield curve steepeners and maintain our exposure to alternatives such as event-linked bonds.
- In **currency markets**, we have increased our total foreign currency exposure, positioning for US dollar depreciation. Furthermore, given the currency moves over the past few months, a rebalancing towards undervalued currencies has led to a reduction in perceived safe havens such as the Japanese yen and the Swiss franc in favor of more growth sensitive exposures like the Euro, Canadian dollar and Scandinavian currencies.

2. Source: Average risk posture refers to the Global 60/40 benchmark volatility (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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