Press Release
For immediate release

Sovereign investors turn to emerging markets as geopolitical tensions rise

- **Geopolitical tension becomes sovereign investors' primary concern - compounded by upcoming elections in key markets - prompting moves towards greater geographic diversification and 'safe haven' assets**
- **Competition between major powers is seen to create opportunities for emerging markets to attract investment and benefit from trends such as 'near-shoring'**
- **'Higher for longer' outlook boosts appeal of listed equities and private credit**
- **Energy transition becomes a high-priority theme for long-term investment**

London, 22 July 2024 – Geopolitical tension has surpassed inflation as the primary concern of sovereign investors and is prompting greater interest in allocating to emerging markets, according to the twelfth annual **Invesco Global Sovereign Asset Management Study** (link here).

Geopolitical tensions were cited by **83%** of respondents as a major risk to global growth over the next year, up from **72%** in 2023, reflecting concerns over competition between the major powers and the potential for trade disruption. Sovereign wealth funds (SWFs) regard emerging markets as potential beneficiaries, pointing to the opportunities presented by trends such as near-shoring. As a result, **67%** of SWFs expect emerging markets to match or beat the performance of developed markets over the next three years.

SWFs also saw an average return of **7.2%** a significant improvement from the **-3.5%** reported last year. Which was the first time, since the survey started in 2013, that SWFs had experienced negative returns.

Invesco's study, which has become the leading bellwether for sovereign investor activity, is based on the views of 140 chief investment officers, heads of asset classes and senior portfolio strategists at 83 SWFs and 57 central banks, who together manage $22 trillion in assets*.

Emerging markets primed to benefit from multipolar world

SWFs view strategic competition between the US and China as likely to create opportunities for emerging markets to attract investment, forge new partnerships, and assert their economic and political influence on the global stage.

The majority (**54%**) expect this competitive dynamic to work to the advantage of emerging markets - versus just **12%** that disagree – as they benefit from trends such as 'near-shoring' whereby major economies strengthen their global supply chains and manufacturing and procurement strategies across multiple locations. SWFs expressed interest in exposure to these opportunities, either through direct investment in companies based in these markets or via multinational companies expanding their presences within them.

However, SWFs are increasingly adopting a nuanced approach to investing in these markets, considering their unique risks and opportunities and reflective of each country's positioning in an increasingly complex and interconnected geopolitical landscape. Within emerging markets, Asia (ex-China) is seen as the most attractive region overall, with a particular interest in India, with its large domestic market, growing middle class and increasing global competitiveness. Latin America is also in the spotlight, particularly for Middle Eastern and Asian Funds with Mexico and Brazil seen as well placed for US near-shoring **(Figure 2)**. China remains a large and important market for SWFs, whilst they navigate regulatory shifts and geopolitical tensions.

Within Emerging markets, EM debt is viewed as an attractive asset class for SWFs to diversify their portfolios. It is seen as offering attractive spreads over developed market bonds, providing a potential boost to portfolio income. Meanwhile, the improving economic fundamentals and policy reforms in many important emerging markets have enhanced their creditworthiness, reducing the perceived risks associated with investing in these markets. SWFs identified India as the most attractive destination for investing in emerging market debt. **88%** are interested in increasing their exposure to Indian debt, up from **66%** in 2022, reflecting improved confidence in the country's economic prospects.

"Cautious optimism about the global economic outlook has been tempered by growing concern over competition between global powers", said **Rod Ringrow, Head of Official Institutions at Invesco**. "The long-standing rivalries between the major powers have escalated, and the picture is complicated further by the sequence of important elections taking place this year, particularly in the US, which could have profound implications for markets."

The allure of gold in an uncertain world

The impact of geopolitics has also been felt by central banks, which are increasingly turning to gold to diversify their reserves and hedge against various risks.

The majority **(56%)** of central banks agree that the potential weaponisation of central bank reserves makes gold more attractive, while **48% believe** that rising US debt levels have increased its appeal. "Gold's status as a tangible, apolitical asset gives confidence to central banks", continued **Ringrow**. "Especially given the challenge of finding viable alternatives to the US dollar as a reserve currency."

Central banks are also looking to bolster their reserves over the next two years, motivated not only by long-standing geopolitical tensions but by upcoming elections in key markets. Central banks are mindful of the potential for election outcomes to trigger market volatility, currency fluctuations and changes in investor sentiment, leading **53%** to indicate their intention to increase the size of their reserves over the next two years, with only **6%** looking to reduce them.

'Higher for longer' outlook prompts caution on leveraged asset classes

Invesco's study also revealed a widespread view that inflation and interest rates are set to stay higher than previously expected **(43%)** of SWFs and central banks expect inflation to settle above central bank targets, with just over half **(55%)** expecting targets to be met.

In total, **71%** of SWFs and central banks anticipate interest rates and bond yields to remain in the mid-single digits in the long term, which is having a significant impact on SWFs' long-term asset allocation plans by prompting greater caution on highly leveraged and growth-oriented investments due to uncertain borrowing costs.

Infrastructure leads the way as the most popular asset class over the next 12 months, with a net asset allocation intention of **21%**, followed by listed equities (**19%**) and absolute return funds/hedge funds (**12%**). By contrast, SWFs' sentiment towards cash **(-11%**), real estate (**-6%**) and private equity (**-3%**) has diminished (**Figure 3**).

This outlook has also boosted the appeal of private credit, which has emerged as a compelling alternative to traditional fixed income, offering attractive yields and access to opportunities that do not exist in public markets. More than one-third (**36%**) of SWFs have reported better than expected returns from their private credit investments, with just **5%** indicating that the asset class had performed worse than expected.

Private credit is also seen as offering attractive diversification from traditional fixed income, highlighted by **63%** of investors, and good value when compared to conventional debt (**53%**).

Energy transition a priority theme for long-term investors

The energy transition continues to present challenges and opportunities for SWFs and central banks.

This year's study revealed that the energy transition is viewed as an increasingly attractive investment opportunity, with **30%** of SWFs and central banks considering it a high priority allocation theme and a further **27%** holding some form of renewable and cleantech investments. "Development sovereigns and liability sovereigns in particular often have strong mandates for societal good alongside long-term steady returns that make these investments appealing", said **Ringrow**. "The stable, predictable cash flows over extended time horizons are attractive to sovereign wealth funds, which are among the longest-term investors of all."

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Press contact:

Michelle Ballington
Invesco
michelle.ballington@invesco.com
+44(0)1491 416353

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Views and opinions are based on current market conditions and are subject to change.

This is Invesco's twelfth sovereign asset management study. In 2024 we conducted interviews with 140 funds: 83 sovereign wealth funds and 57 central banks. The 2024 sovereign sample is split into three core segmentation parameters (sovereign investor segment, region, and size of assets under management). The 2024 central bank sample is broken down by region. The fieldwork for this study was conducted by NMG between January and March 2024.

* Sourced by NMG Consulting: total assets of those sampled stands at $22 trillion as of March 2024.

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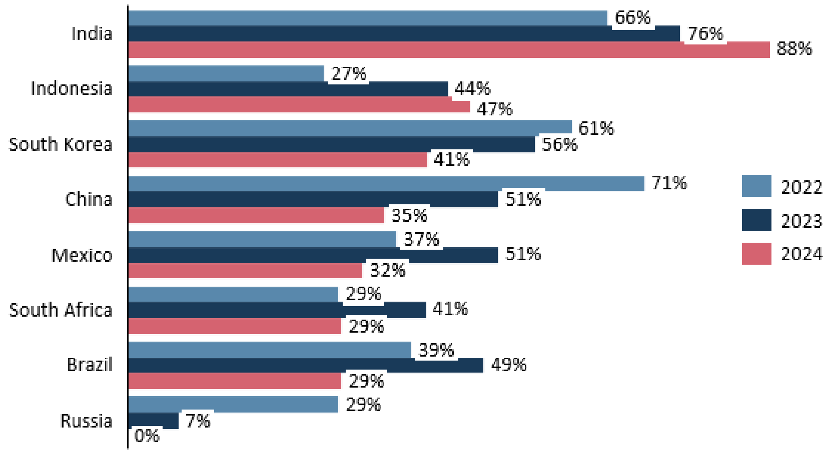
<u>Appendix</u>

Figure 1. Attractive markets for increasing EM debt exposure (% citations, SWFs only)



Which of the following markets do you see as attractive for increasing your EM debt exposure?

Figure 2. Priority EM regions (% citations, SWFs only)

	Region based				
	Total	Asia	Emerging Markets	Middle East	West
Asia (ex-China)	83%	100%	58%	100%	83%
China	43%	75%	25%	43%	42%
Latin America	53%	75%	42%	71%	46%
Central & Eastern Europe	48%	88%	17%	57%	48%
Africa	43%	13%	77%	57%	32%
Middle East	51%	50%	50%	100%	36%

What are your top EM investment priorities?

Figure 3. Net allocation intentions by year (intentions to increase – intentions to decrease) (% citations, SWFs only)

For each asset class, how do you expect your allocation to change over the next 12 months?