2021 Investment Outlook

A macroeconomic and asset allocation framework

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Introduction

The year 2020 saw the global economy plunged into economic turmoil. Unlike many past crises, this one was unique in that it was not economic in origin but started as a health crisis. The COVID-19 pandemic rapidly impacted the economy through lockdowns across the globe, which stymied economic activity and caused an unprecedented destruction of demand. Given these circumstances, we recognize that the shape of economic growth in the coming year is dependent on a wide variety of factors, including: infection rates, fiscal policy, monetary policy, public health policy including the severity – or "stringency" – of lockdowns, progress towards the development of therapies and a vaccine, and consumer and business confidence.

To address the breadth of possibilities that lie ahead in this environment, we at Invesco brought some of our experienced investment professionals and thought leaders together to create an outlook for 2021 – a base case, an upside scenario and a downside scenario. Our goal is to provide you with a range of possibilities, enabling you to select the scenario that aligns most closely with your expectations for the coming year. To provide a broader perspective we have addressed these scenarios on both a global basis and with respect to specific economies – the United States, the eurozone and China. We begin first with an assessment of the macro outlook, followed by the investment implications we see tied to see these conditions.

What we have learned thus far

An economy's ability to manage the spread of the virus is critical to its economic recovery in the absence of a vaccine. East Asia – in particular, China, Japan and South Korea – has managed the virus well as a result of targeted lockdowns and coordinated social efforts. Much of the developed world and many emerging markets, on the other hand, have struggled to contain the pandemic. This difference is reflected in economic activity: those countries that have effectively curtailed the virus have been less impacted economically. We must also recognize that even in the absence of lockdowns, economic activity can be impacted by a rise in infections, which can impact confidence and result in behavioral shifts in consumption.

We have also learned that the pandemic has disproportionately impacted the services industry versus the manufacturing industry due to social distancing measures and changes in behavior. We expect this pattern is likely to continue until a vaccine is developed and distributed.

This recovery has also demonstrated the importance of policy support throughout this crisis for both economies and markets. Across the globe, countries have enacted significant fiscal spending programs; as a result, the economic recovery has been relatively strong in a number of economies. Some economies have run the risk of not providing adequate fiscal stimulus, especially some emerging markets economies.

Major central banks around the world have provided even greater monetary policy support, undertaking a range of policies to support economies including a massive expansion of their balance sheets through large-scale asset purchases. In addition to impacting the economy, this has had a substantial impact on capital markets.

Our Base Case

Our base case scenario projects that the global economy continues to recover albeit unevenly and at a slower pace. COVID-19 had an extremely negative impact on the Chinese economy, but its recovery is well underway. We expect China to outperform given its better control of the virus, while the US and Eurozone are likely to experience pauses in their respective re-openings given our expectation of partial lockdowns – although some fiscal stimulus will continue to support activity. Our assumption in this scenario is that an effective vaccine will be developed and rolled out in the back half of 2021. In this environment, we expect the goods economy will continue to outpace services earlier in the year until the rollout of a vaccine in the second half of 2021, when services rebounds more robustly.

Our Upside Case: "V" for Accelerated Vaccine

In this scenario, the global economic recovery is more robust, led by China but with other economies participating more quickly due to the development and distribution of a vaccine in the first half of 2021. We also assume greater fiscal stimulus in this scenario affords a faster recovery.

Our Downside Case: Double-Dip

In this scenario, we assume multiple waves of the virus which are difficult to control, requiring renewed national lockdowns in many countries and weighing down the global economy. In this scenario, we assume fiscal and monetary stimulus is too slow and inadequate as the political will and fiscal space for these policy actions prove to be less than in 2020.

Asset Allocation Recommendations

These three scenarios in turn dictate our asset allocation views:

In our base case scenario, we expect equities to outperform fixed income as growth moves above trend, the global earnings cycle recovers, and risky assets are supported by ample money supply growth. Gradual re-opening of face-to-face sectors to favor cyclicals, value and small/mid cap stocks, also supported by attractive valuations and rising bond yields. Improving risk appetite and a depreciating US dollar drives outperformance in emerging market (EM) equities over developed markets (DM). Currency and local market valuations favor DM ex-US over US equities, supported also by cyclical outperformance in 2021 and a rotation away from growth into value sectors and regions. In fixed income, we believe credit markets have room for additional spread compression and may offer attractive risk-adjusted returns. Global yield curves may steepen with gradually rising bond yields but remain well-anchored by asset purchase programs and low inflation expectations. Real assets are expected to do well with low and stable inflation.

In our upside scenario, we would take a more 'risk on' approach, expecting equities to more dramatically outperform fixed income. Given our assumption that a vaccine will be developed more quickly, we would expect cyclicals, value and small/mid cap stocks to begin to perform well earlier in 2021.

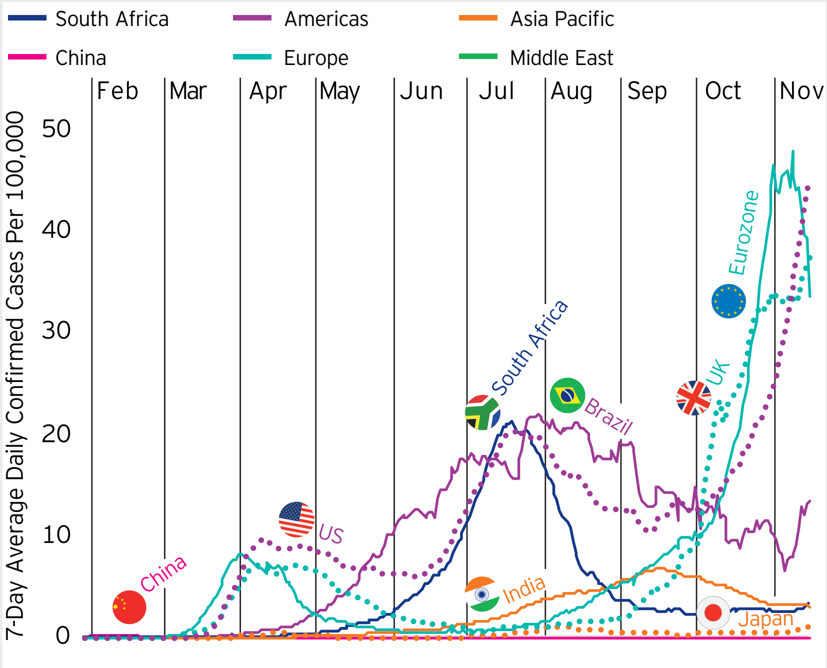
In our downside scenario, we would take a more 'risk off' approach, expecting fixed income to outperform equities. Within equities, we would favor defensives, given our expectation that it will take longer for the development of a vaccine. Within fixed income, we would favor US Treasuries, credit and longer duration bonds. In this environment, we would favor the US dollar versus other currencies.

An Overview of the Pandemic: The Totals
Population-adjusted sums reveal the extent of the spread of virus

This crisis, unlike most others that have occurred in the past, is not economic in origin. Lockdowns and the behavioral shifts in consumption – both from households and businesses – will stunt any recovery, and the main factor that defines these effects is the degree of the spread of the virus.

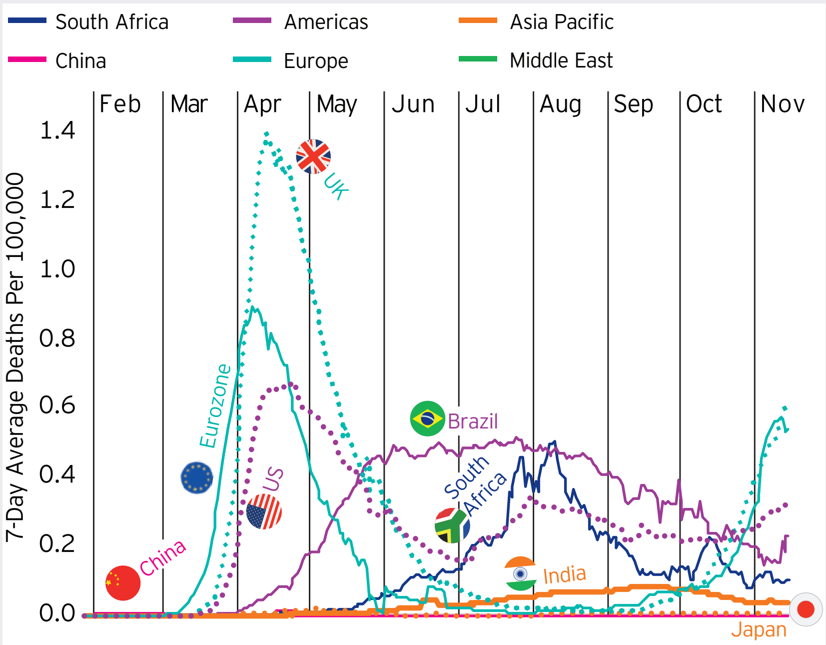
Until the virus abates, we expect the economic recovery from the COVID-19 pandemic to progress in fits and starts.

Figure 1A
The Developed World Lags in Virus Control; 2nd Wave in Full Force



Sources: Invesco, JHU CSSE COVID-19 Data, as of 15 November 2020. Population data is from OurWorldinData.

Figure 1B
Second Wave Death Toll Lower, but Still a Threat



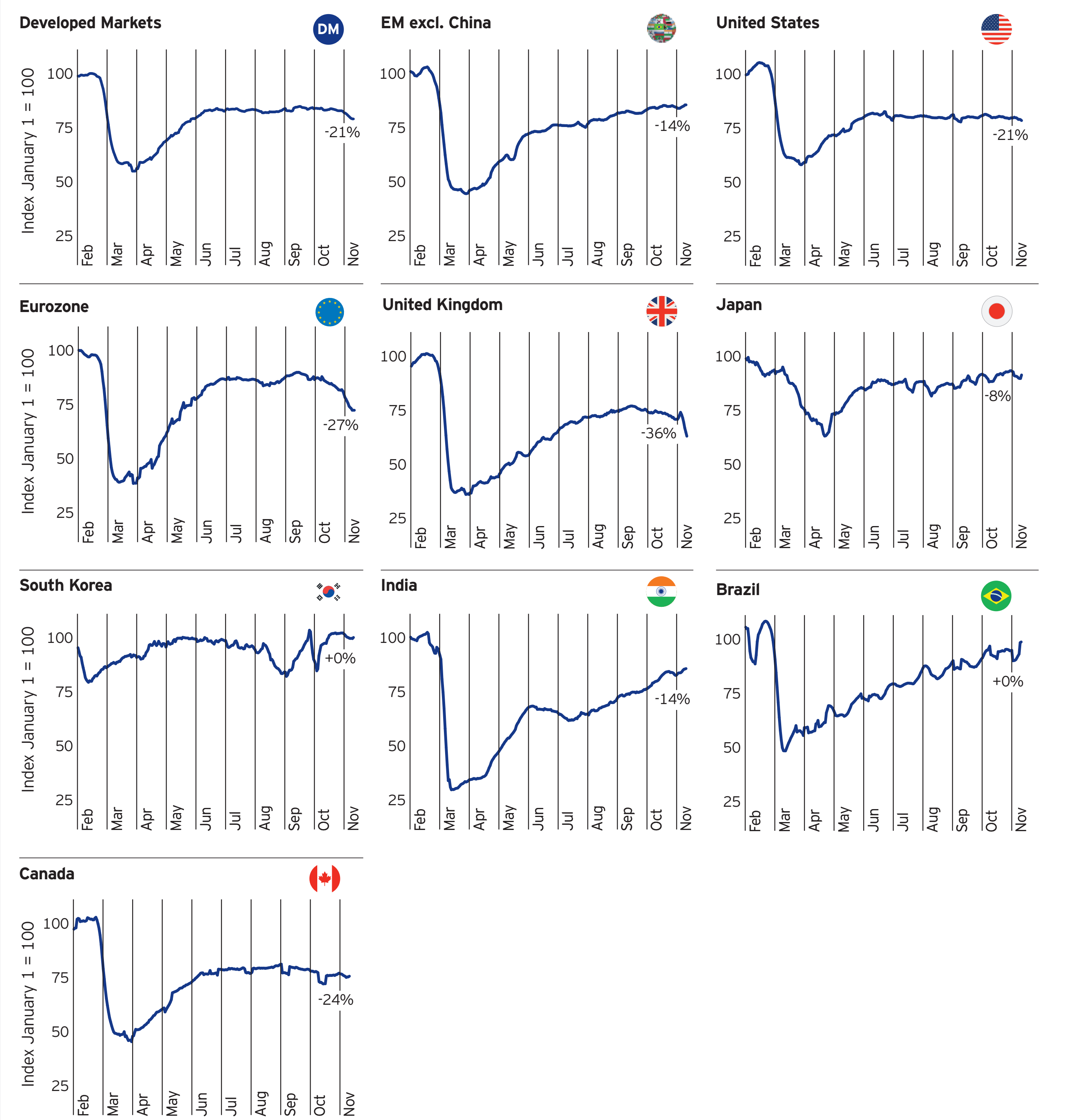
Sources: Invesco, JHU CSSE COVID-19 Data, as of 15 November 2020. Population data is from OurWorldinData.

Until COVID-19 Abates, "Normal" Activity Likely to be Depressed

Using measures of the movement of people as a demand proxy indicates a large gap from normal

We look to high frequency indicators of demand to gauge the progression of the recovery. Here, we highlight mobility as an approximation of the gap between current and "normal" activity, especially in industries requiring face-to-face interactions.

Figure 2



The 7-Day Average Mobility is the Google mobility trends indices. These show how visits and length of stay at different places vary compared to a 100 basis, measured as the median value for the corresponding day of the week, during the 5-week period 3 Jan to 6 Feb 2020. The "average" above is the simple average of retail & recreation, workplace, transit stations, and grocery & pharmacy series. "Eurozone", "Developed Markets" and "EM excl. China" are the mobility indices for each country, weighted according to their 2019 GDP. Sources: Google, MSCI, Macrobond and Invesco. As of 15 November 2020. Mobility data published with a one-week lag.

Reimposition of Lockdowns Impacts Services More Than Manufacturing

Purchasing managers indices signal that services suffer first and most

The recovery to date has largely played out in the goods economy much more than in services, as consumers can carry on with purchases from home while other activities requiring face-to-face interactions, such as leisure and travel, are more challenging to resume.

Figure 3

Sources: Invesco, JHU CSSE COVID-19 Data, as of 15 November 2020. Population data is from OurWorldinData.

2020 Fiscal Easing Far Outstrips 2009, Supporting Recovery

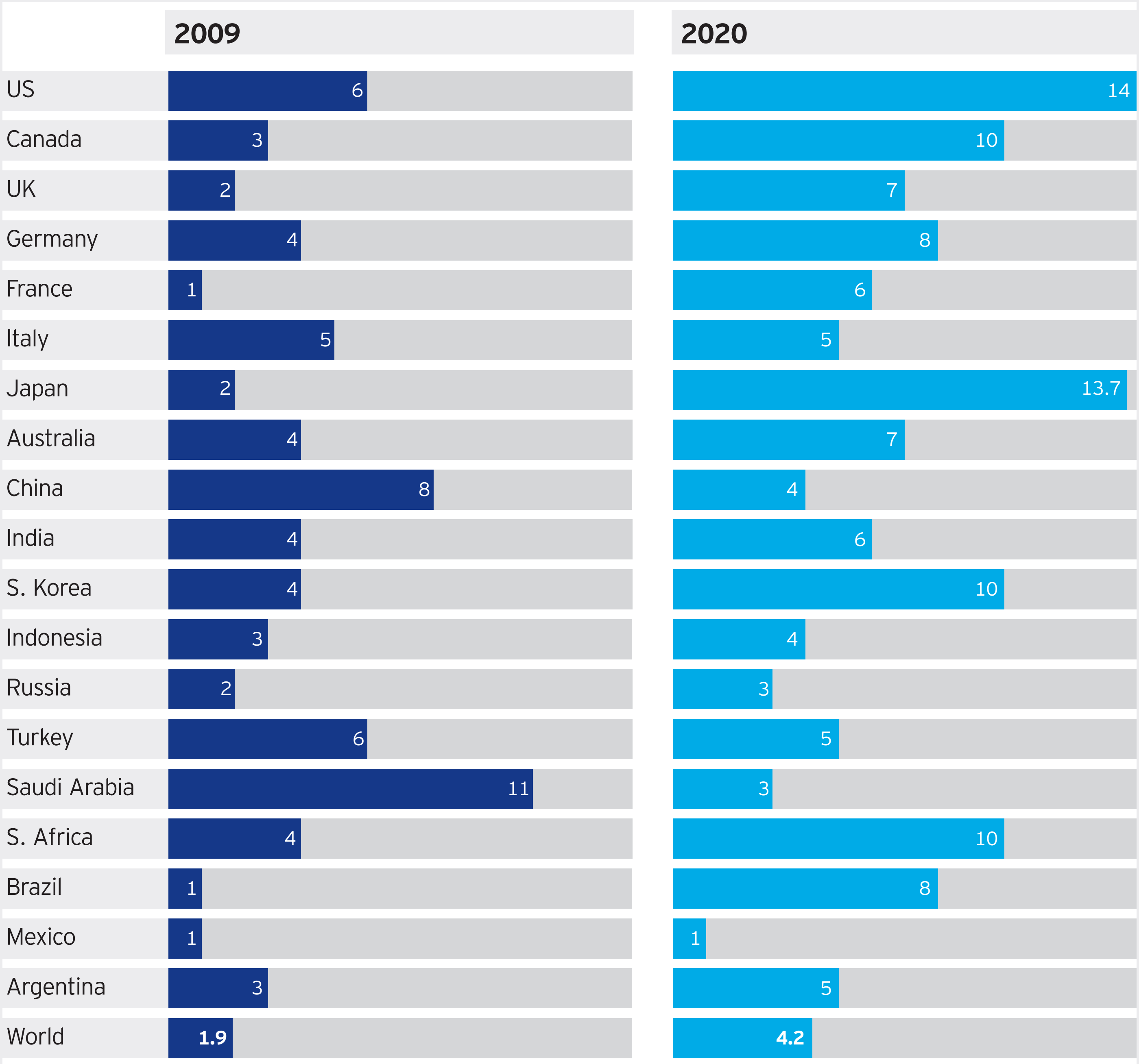
However, amount varies across regions, pointing to divergent growth

Investors fearful of the current macro environment would do well to look to policy as a guide to the rapid bounceback in markets.

Countries across the globe have enacted outsize fiscal spending programs to carry economies through the virus, far surpassing the actions undertaken in the Global Financial Crisis.

Figure 4

Fiscal Support by G20 Members as % of National GDP



Sources: IMF Policy Tracker, IMF GDP Data, Atlantic Council, DE Data Wrapper, Invesco. Calculations based on data at various national release and announcement dates, and Atlantic Council as of 26 July 2020. 2009 based on IMF, Eurostat and G20 data. NB: Calculations exclude deferrals and guarantees; include discretionary fiscal support programs (aside from "automatic stabilizers"); announced and implemented programs -- all scaled against 2008 and 2019 GDP, respectively. The "World" aggregate represents G20 nations - G20 comprises 19 major economies plus the EU.

Monetary Policy in the Driver's Seat

Emergency monetary programs are pumping cash into banks

In addition to the large fiscal policy support that governments have put forward, major central banks are also undertaking a range of policies to support economies.

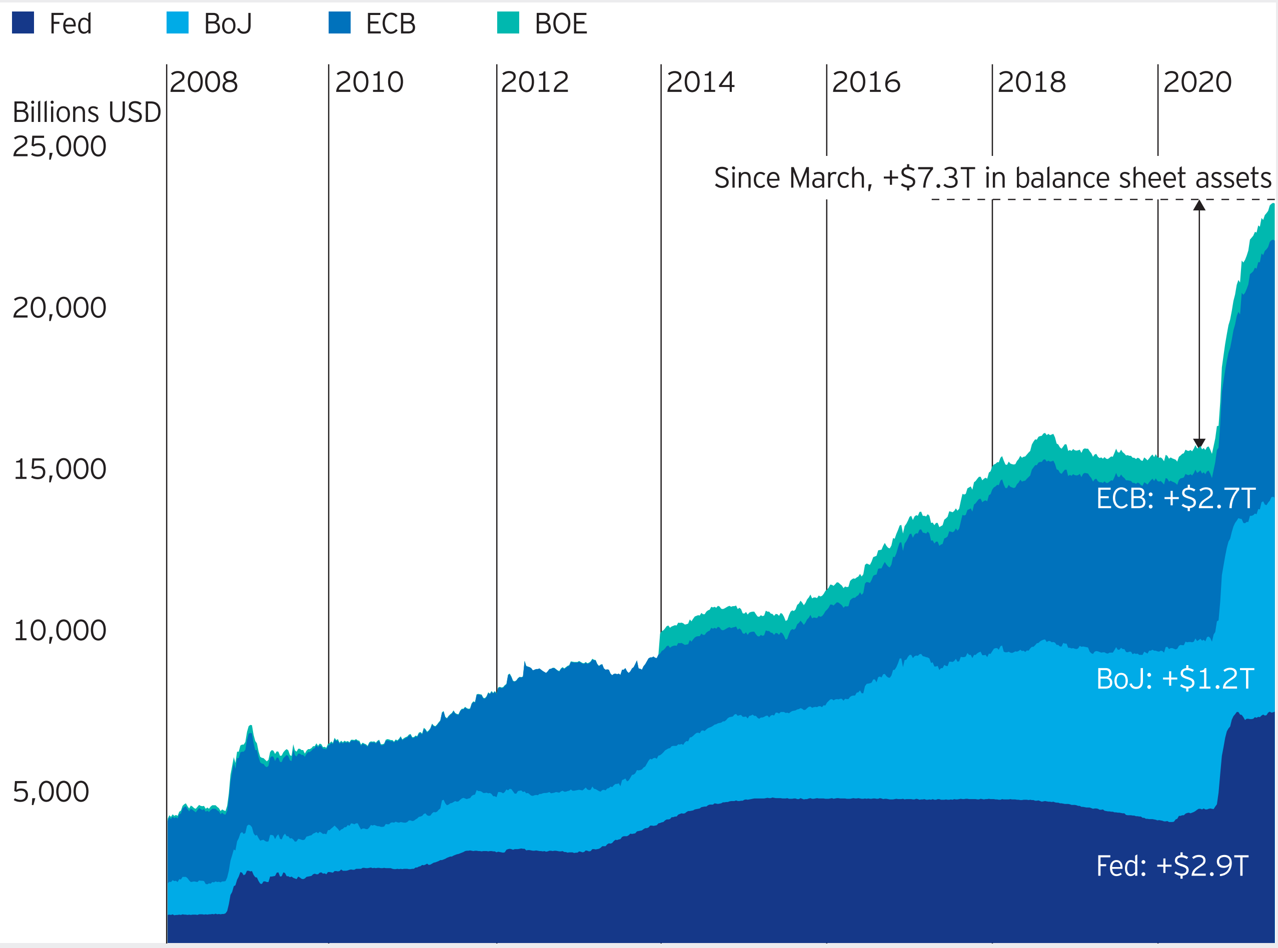
As part of this, central banks have resumed their balance sheet expansions via large-scale asset purchases.

This additional cash in banks has helped ease financial conditions to support economic activity.

Figure 5

Substantial Large-Scale Asset Purchases Will Likely Support Recovery

Major Central Bank Balance Sheets, Total Assets



Sources: Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), as of 9 November 2020.

Broad Money Growth Has Surged Across the Developed World

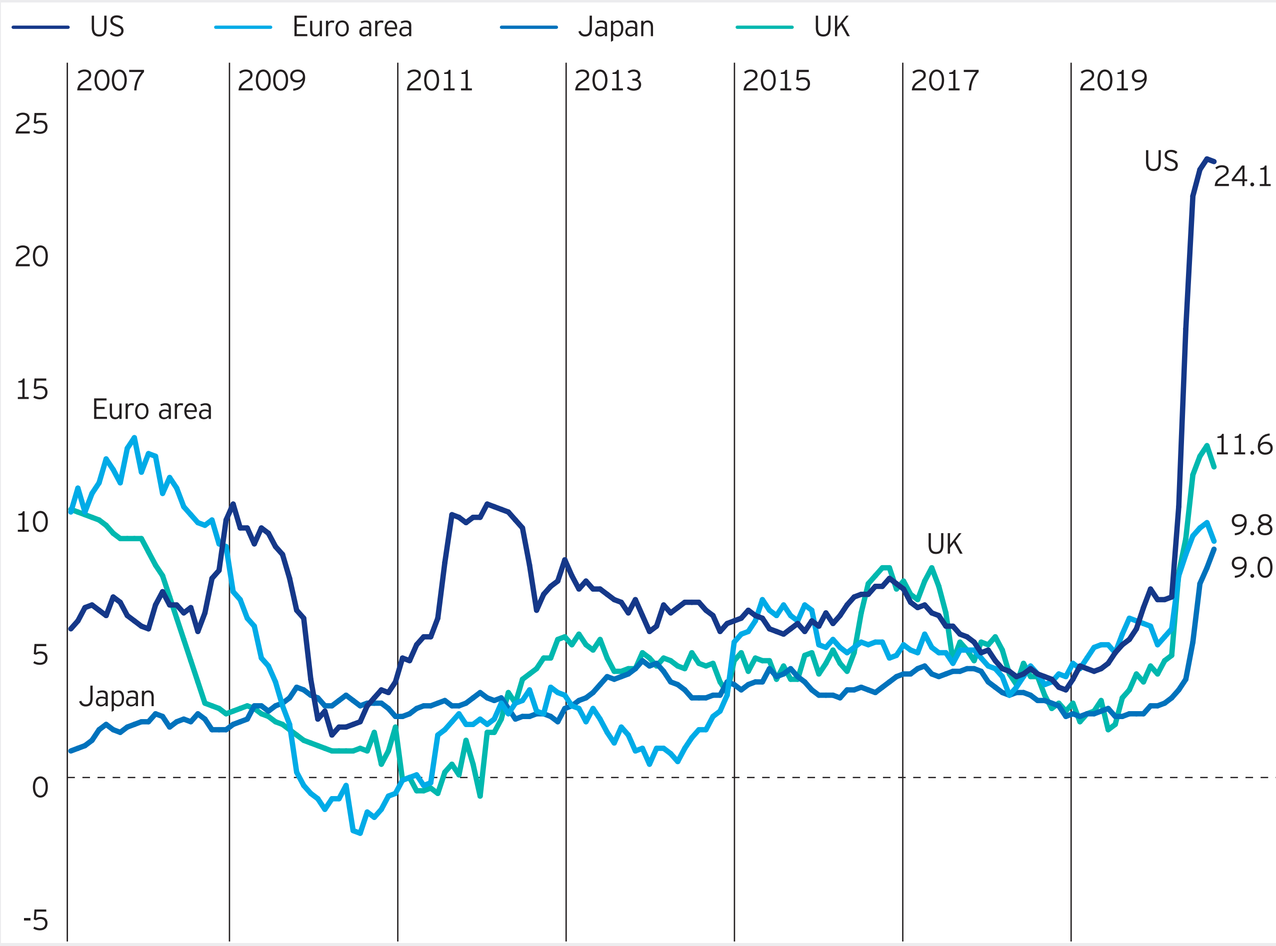
If not curtailed, this will raise spending and later inflation

A recent dramatic uptick in money supply has stoked inflation fears.

The US outpaces developed market peers – but all are up substantially.

Figure 6

Money Supply Growth across Major Developed Economies, % yoy

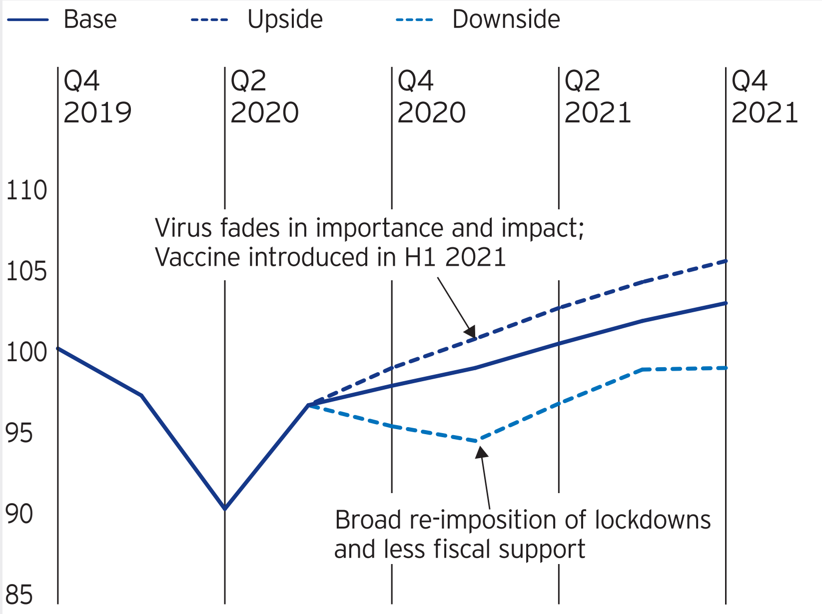


Sources: Refinitiv, US Federal Reserve (M2), European Central Bank (M3), Bank of Japan (M2), Bank of England (M4x), as of 28 October 2020.

Implications for World GDP

Our base, upside and downside scenarios for 2021 call for a policy-fueled recovery, led by China

Figure 7



Source: Invesco assumptions, with historical data provided by national governments.

Base Case...

- China outperforms. US and Eurozone pause their reopening with partial lockdowns, while fiscal and monetary policy continue to support activity.
- Manufacturing continues to lead, while a recovery in service sectors transpires, assuming a vaccine is rolled out broadly in H2 2021.

"V" for Accelerated Vaccine...

- In our assessment of upside risks, we assume a vaccine is approved early and broadly in use in H1 2021, driving a faster recovery.
- We also incorporate further expansionary fiscal policy actions.

Double-Dip...

- Downside risks include severe secondary waves, requiring renewed national lockdowns in many countries.
- Concurrently, the benefits of fiscal and monetary support are delayed as in during the first wave.
- Political will and fiscal space for these policy actions proves to be less than in 2020.

The Upside and Downside Risks for Major Economies

We anticipate that the US and Europe will recover in fits and starts, while China begins the year on strong footing

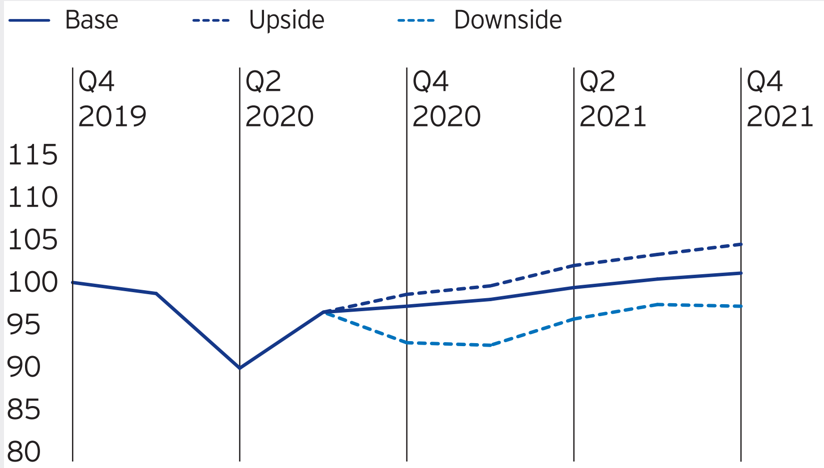
US

Base Case – The current resurgence of the virus slows reopening and dampens spending but proves to be short-lived. Reopening resumes in Q2/Q3 aided by further fiscal support. Confidence is aided by the rollout of a vaccine in H2 2021.

"V" for Vaccine – Renewed fiscal support and a vaccine rollout in H1 2021 enable comprehensive reopening and rapid recovery.

Double-Dip – Multiple waves require extensive lockdowns amid insufficient fiscal support. A vaccine is not available through the entirety of the forecast period.

Figure 8A



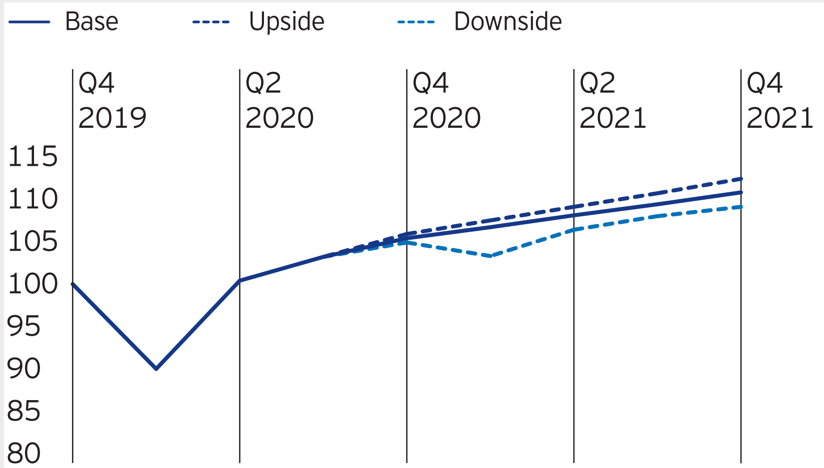
China

Base Case - China continues to exert strong control over the pandemic. The growth recovery becomes self-sustaining enabling policy support to fade. Global trade lags the domestic demand recovery.

"V" for Vaccine - China's vaccination strategy proves effective strengthening the consumption and services rebound. International relations and geopolitical tensions – and with it, trade frictions – improve meaningfully.

Double-Dip - Geopolitical tensions escalate. The pandemic continues to be well-controlled but remains a threat. Net trade takes a substantial hit; foreign investment also suffers.

Figure 8B



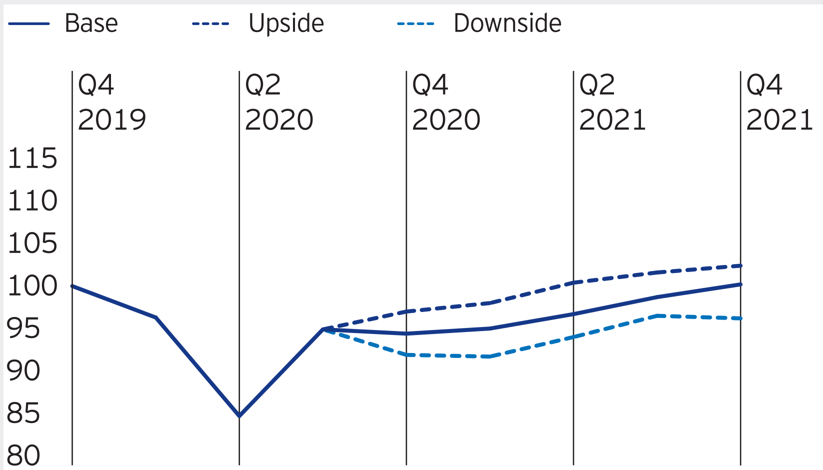
Eurozone

Base Case - Resurgence of virus, proliferating targeted lockdowns halt the recovery over the winter. Growth resumes with re-openings from Q2 and a vaccine in H2.

"V" for Vaccine - The second wave is brought under control in Q4 2020, allowing easing of lockdowns through Q1 2021. Strong fiscal policy response and an early vaccine available in H1 2021.

Double-Dip - Multiple waves of the virus return with renewed, extensive lockdowns. Risks of financial stress in the Eurozone rise. A vaccine is not available through the entirety of the forecast period.

Figure 8C



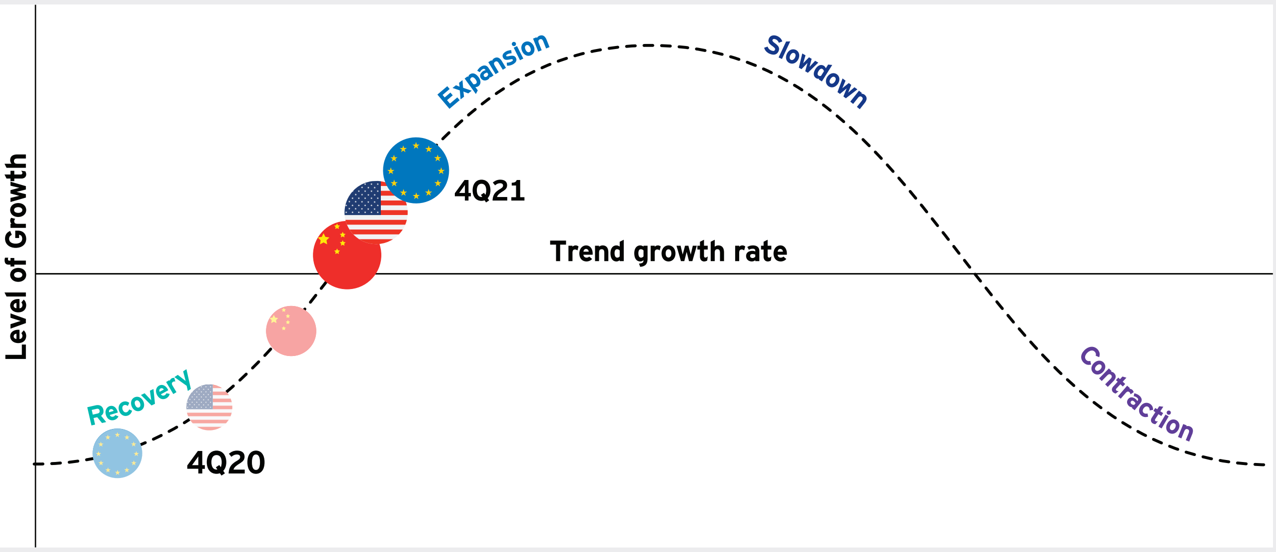
Source: Invesco assumptions, with historical data provided by national governments.

Asset allocation perspective

Invesco Investment Solutions – Tactical Asset Allocation: Macro Framework

- As of Q4 2020, the world economy and all its major regions are in a **recovery regime.** However, a strong second wave of Covid-19 infections increases the likelihood that Europe, and potentially the US, may experience a double-dip contraction given selective lockdowns in parts of the economy. China has led the recovery in 2020.
- In our base case scenario we expect the world economy and all its major regions to move into an **expansion regime** by the end of 2021. Europe should experience a stronger rebound, especially versus its trend growth rate, as a result of slower growth in Q4 2020. China expected to converge to its trend growth rate.

Figure 9



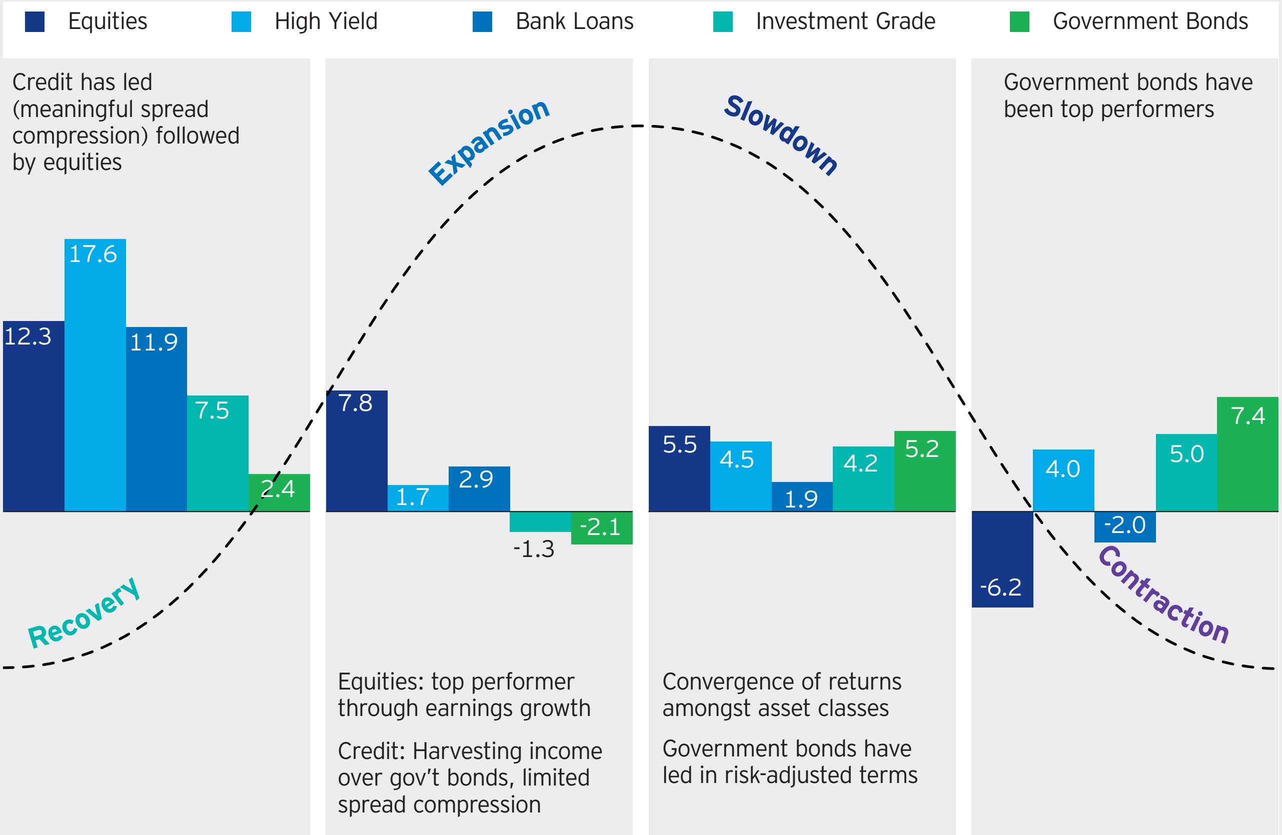
Source: Invesco Investment Solutions' proprietary global business cycle framework mapping GMS and IFI scenario projections. For illustrative purposes only.

Invesco Investment Solutions – Tactical Asset Allocation: Macro Framework

- In the medium term, asset prices are strongly influenced by the prevailing macro regime. Asset classes, and their risk premia, perform differently in different stages of the business cycle.
- Mapping our three macro scenarios into a macro regime framework can help guide tactical asset allocation decisions and support the analysis of current developments with an historical perspective.

Figure 10
Global Cycle: historical excess returns across asset classes

- Risky credit has led in **recoveries**, while equities have led in **expansions**.
- Returns across asset classes have experienced convergence in **slowdown** regimes.
- Government bonds and safe assets have outperformed in **contractions**.



Source: Invesco Investment Solutions' proprietary global business cycle framework and Bloomberg L.P. Index return information includes back-tested data. Returns, whether actual or back-tested, are no guarantee of future performance. Annualized monthly returns of the defined risk premia from January 1973 – October 2020, or since asset class inception if at later date. Asset classes excess returns defined as follows: Equities = MSCI ACWI - US T-bills 3-Month, High Yield = Bloomberg Barclays HY - US T-bills 3-Month, Bank loans = Credit Suisse Leveraged Loan Index - US T-bills 3-Month, Investment Grade = Bloomberg Barclays US Corporate - US T-bills 3-Month, Government bonds = US Treasuries 7-10y - US T-bills 3-Month. For illustrative purposes only. Past performance is not a guarantee of future results. An investment cannot be made in an index.

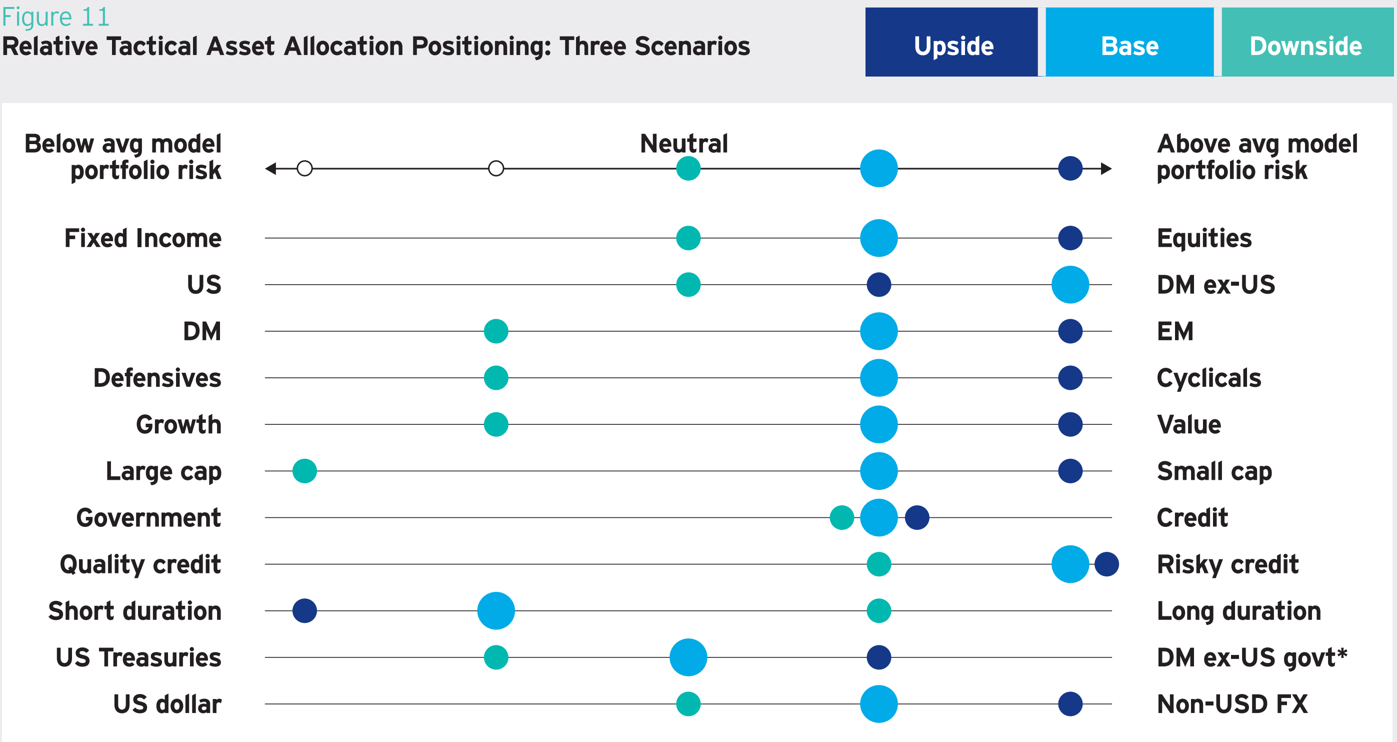
Investing within the business cycle

Base case:

- Equities expected to outperform fixed income as growth moves above trend, the global earnings cycle recovers, and risky assets are supported by ample money supply growth. Gradual re-opening of face-to-face sectors to favor cyclicals, value and small/mid cap stocks, also supported by attractive valuations and rising bond yields. Improving risk appetite and a depreciating US dollar to drive outperformance in EM equities over developed markets. Currency and local market valuations favoring DM ex-US over US equities, also supported by cyclical outperformance in 2021, and a rotation away from growth into value sectors and regions.

- In fixed income, credit markets have room for additional spread compression and may offer attractive risk-adjusted returns. Global yield curves may steepen with gradually rising bond yields but remain well-anchored by asset purchase programs and low inflation expectations. Real assets are expected to do well with low and stable inflation.

Figure 11
Relative Tactical Asset Allocation Positioning: Three Scenarios



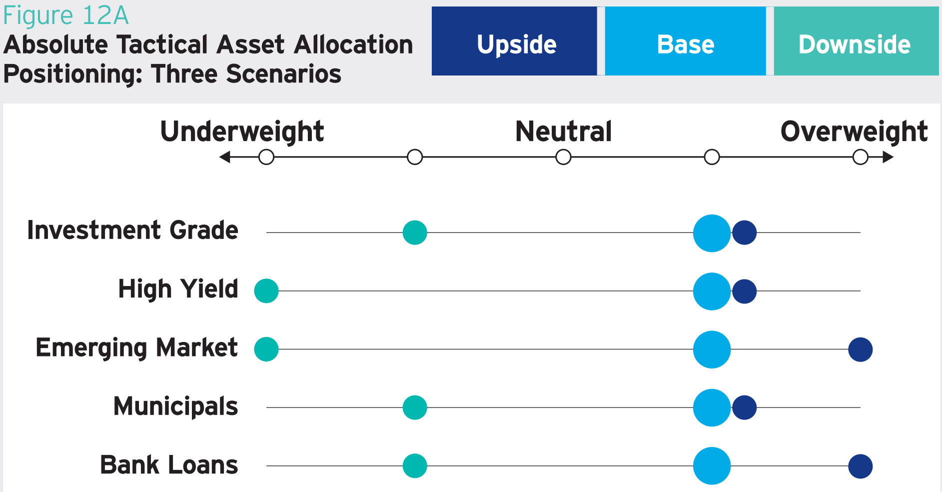
*Hedged
Source: Invesco Investment Solutions, September 2020. For illustrative purposes only.

Invesco Investment Solutions – Tactical Asset Allocation

Investing in Fixed Income*

- For our base and upside scenarios, we anticipate that continued economic expansion, positive fundamentals and accommodative policies will continue to generate positive credit conditions over the next year, though returns may be limited by continued tight spreads.
- In the downside double-dip economic scenario, tight valuations would contribute to negative outcomes, particularly for lower quality credit and EM due to a related uptick in default losses.

Figure 12A
Absolute Tactical Asset Allocation Positioning: Three Scenarios

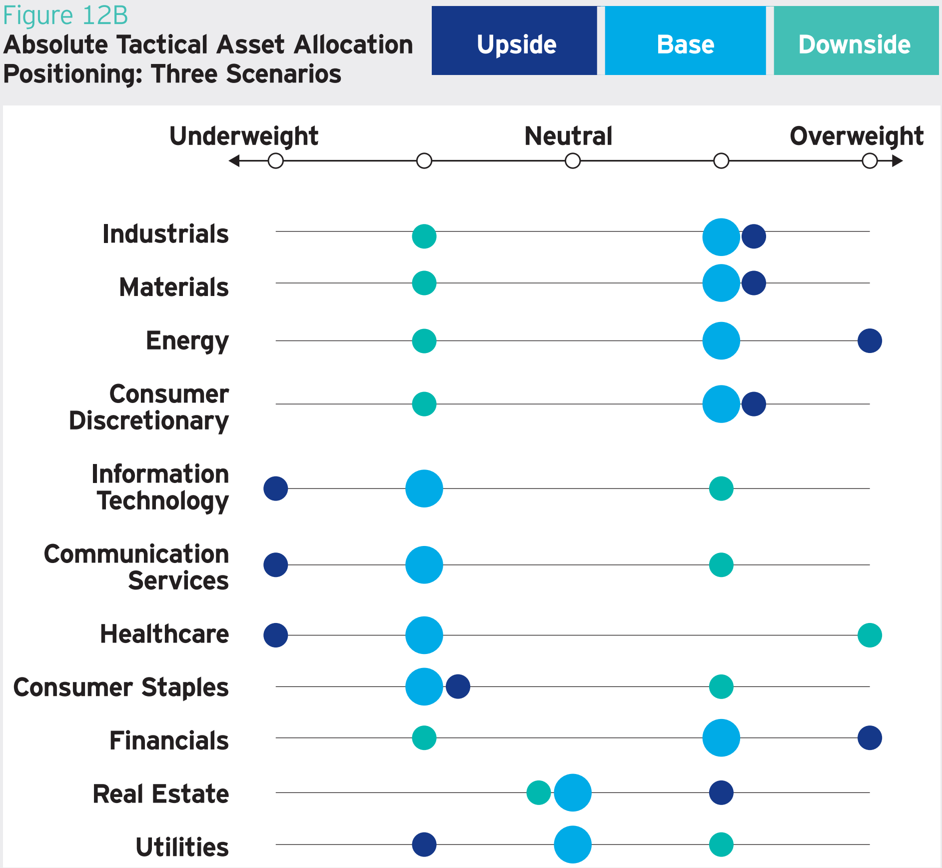


*Source: Invesco Fixed Income

Investing in Equities**

- Across scenarios, our sector allocations are a by-product of our factor/style allocations.
- In our base case scenario, we expect a rotation in favor of traditional cyclical sectors, which should benefit from a gradual re-opening of face-to-face sectors, attractive valuations and rising bond yields.
- In the upside scenario, the cyclical theme would be further boosted by additional infrastructure spending. In the downside scenario, a return to technology, healthcare and communication services is likely to prevail.

Figure 12B
Absolute Tactical Asset Allocation Positioning: Three Scenarios



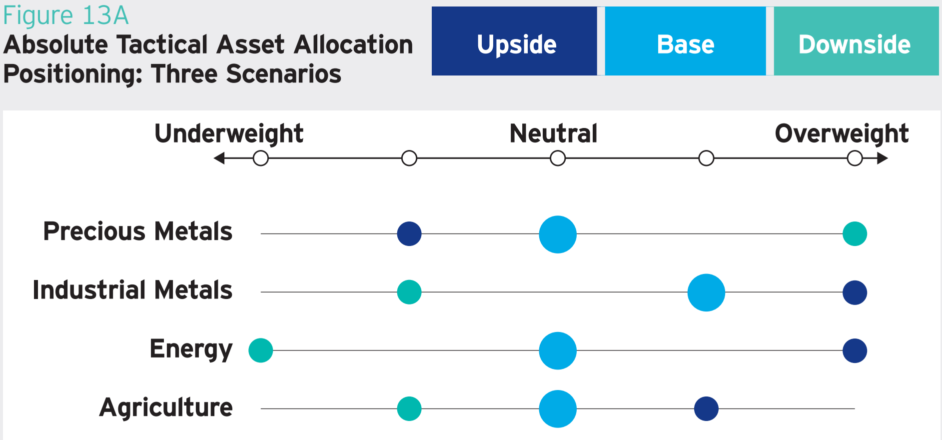
**Source: Invesco Investment Solutions

Invesco Investment Solutions - Tactical Asset Allocation

Investing in Commodities*

- **Precious metals** should benefit from anticipated continued low real yields and the potential for inflation and dollar weakness. The tightening supply/demand balance for **Industrial metals** should continue into 2021.
- **Energy** markets still face substantial excess inventory but suppliers have already reduced capex substantially. **Agricultural** markets should benefit from likely increases in Chinese demand and potential weather challenges.

Figure 13A
Absolute Tactical Asset Allocation Positioning: Three Scenarios

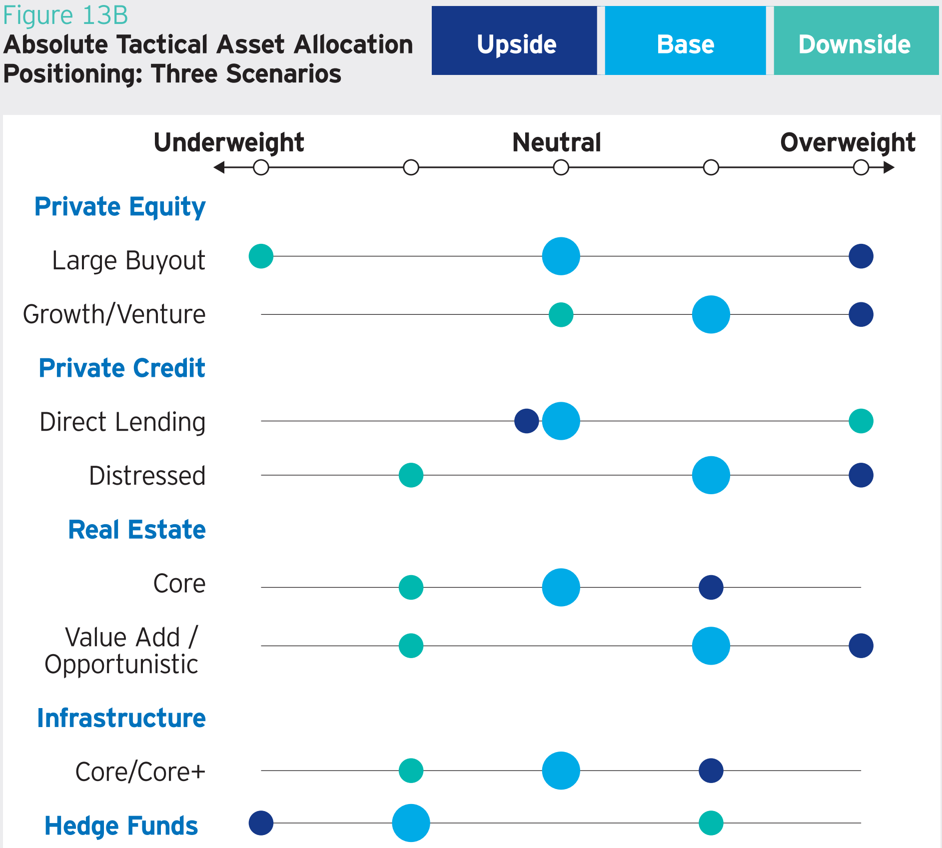


*Source: Invesco Systemic & Factor Investing team

Investing in Alternatives**

- In our base and upside scenarios we are constructive on opportunistic strategies poised to take advantage of recent dislocations, including distressed credit and value add real estate.
- In our downside scenario, we favor credit strategies that are more senior in the capital structure as well as hedge fund strategies with low correlations to the overall market.
- Growth and venture categories are expected to continue to outperform across a range of macroeconomic scenarios.

Figure 13B
Absolute Tactical Asset Allocation Positioning: Three Scenarios



**Source: Invesco Investment Solutions. Alternatives tactical asset valuations represent our view of which asset classes are likely poised to outperform over an approximate 3-5-year timeframe.

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