Tactical Asset Allocation

Overweight risk assets, value, small-/mid-caps, credit, and reestablish an overweight to developed ex-US equities vs. US equities.

Our macro process drives tactical asset allocation decisions over a time horizon between six months and three years, on average, seeking to harvest relative value and return opportunities between asset classes (e.g., equity, credit, government bonds, and alternatives), regions, factors, and risk premia.

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Synopsis

- Market sentiment and growth expectations continue to improve. Broadening equity market performance towards value, cyclicals, and smaller capitalizations further validates the recovery trade.
- We remain overweight portfolio risk in our Global Tactical Asset Allocation model,[1] favoring equities relative to fixed income, non-US equities, value, and smaller capitalizations. We're overweight risky credit, neutral duration and are increasing exposure to inflation-linked bonds. We're underweight the US dollar.

Macro update

Stable economic conditions around the world continue to dampen macro and financial market volatility. Economic data releases are delivering modest but steady outperformance relative to consensus across regions, leading to upward revisions in growth expectations and rising investor risk appetite.

Against this backdrop, bullish market trends were reinforced over the past month. Global equity markets outperformed fixed income. Credit spreads tightened across corporate investment grade, high yield, and sovereign emerging markets debt, reaching levels last seen in mid-2021 before the start of global hiking cycles. As a result, our barometer of global risk appetite registered a noticeable increase over the past month, rising above recent highs and signaling potential tailwinds for risk assets in the medium term (**Figures 1 and 2**). Most notably, March delivered a long-waited broadening in equity markets performance to more cyclical sectors and factors such as value and mid- and smaller-capitalization equities relative to more defensive characteristics such as quality and low volatility (**Figure 3**). We expect this broader cyclical participation to continue, as discussed in recent updates, and see it as a confirmation of the improving growth outlook, which credit markets have indicated since mid-2023.

1 Global 60/40 benchmark (60% MSCI ACWI, 40% Bloomberg Global Aggregate USD Hedged).

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Figure 1a: Global macro framework remains in a recovery regime

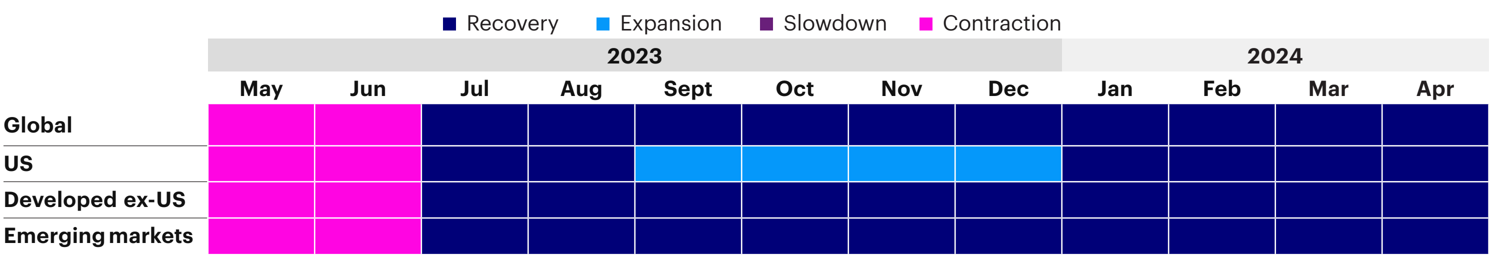
Regional regime signals and components

Region	LEIs: Current level of growth		Global risk appetite: Change in global growth expectations		Expected macro regimes
Global	**Below Trend**	&	Growth expectation improving	=	**Recovery**
United States	**Below Trend**				**Recovery**
Developed markets ex-USA	**Below Trend**				**Recovery**
Europe	Below Trend				Recovery
United Kingdom	Below Trend				Recovery
Japan	Above Trend				Expansion
Emerging markets	**Below Trend**				**Recovery**
China	Below Trend				Recovery
Emerging markets ex-China	Above Trend				Expansion

Sources: Bloomberg L.P., Macrobond. Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of March 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment. Developed markets ex-USA include the eurozone, UK, Japan, Switzerland, Canada, Sweden, Australia. Emerging markets include Brazil, Mexico, Russia, South Africa, Taiwan, China, South Korea, India.

Figure 1b: Trailing 12-month regime history by region

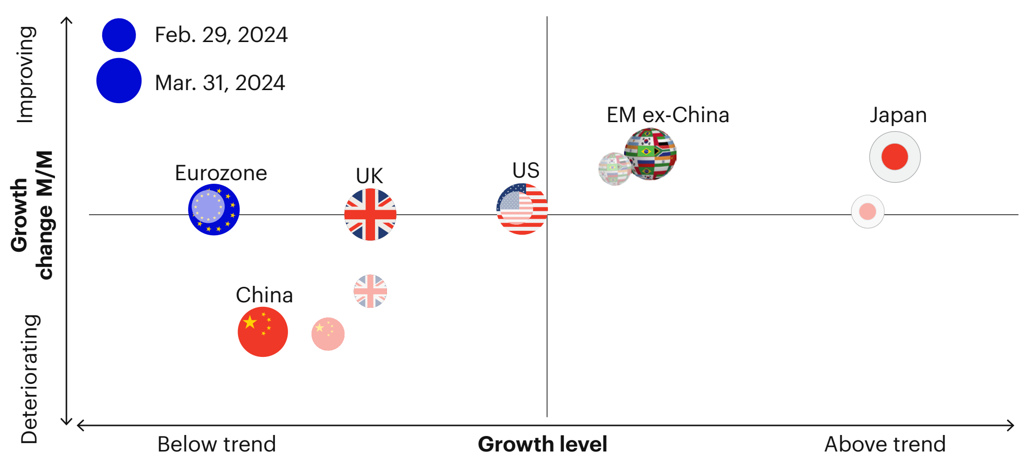
Global economy in a recovery phase with LEIs below the long-term trend and improving growth expectations



Source: Invesco Solutions as of March 31, 2024.

> Stable economic conditions around the world continue to dampen macro and financial market volatility.

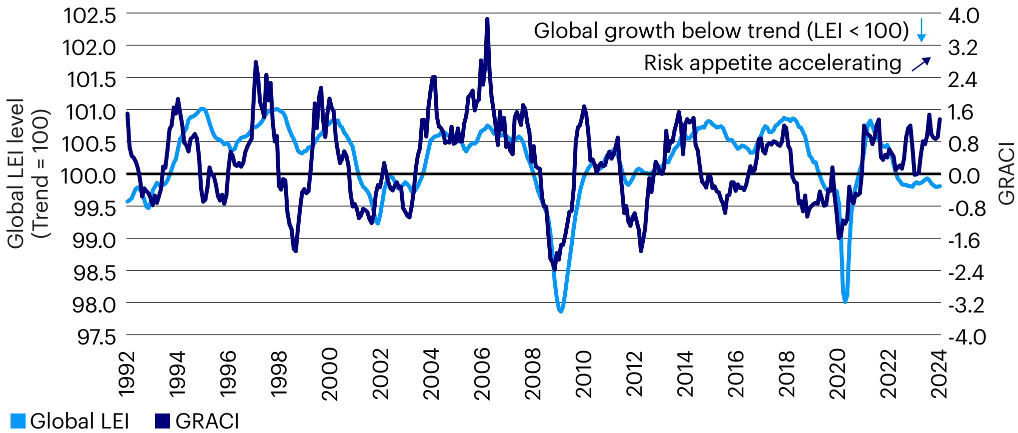
Figure 1c: Developed markets and EM-ex China gradually improving



Sources: Bloomberg L.P., Macrobond. Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of March 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.

> Our barometer of global risk appetite registered a noticeable increase over the past month, rising above recent highs and signaling potential tailwinds for risk assets in the medium term.

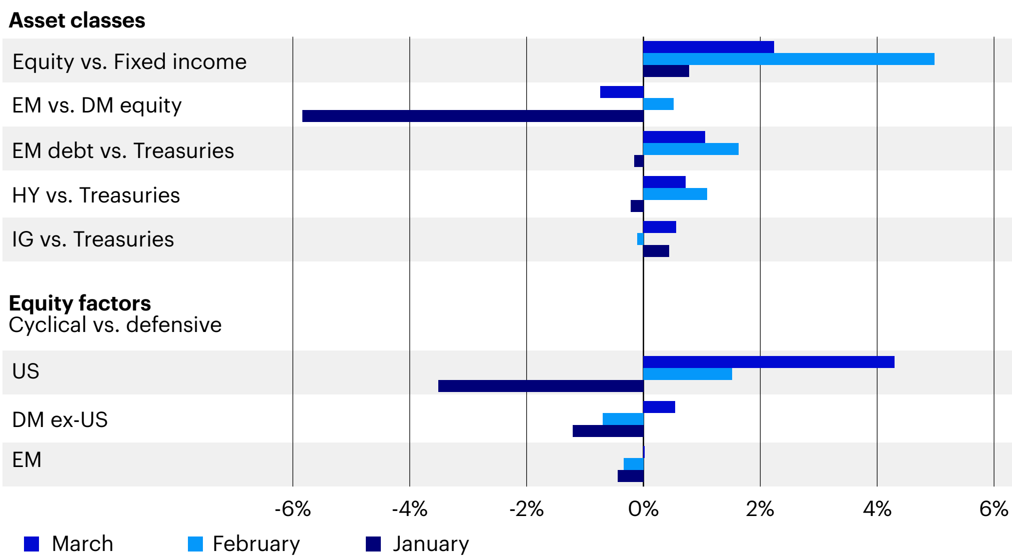
Figure 2: Risk appetite remains strong, pushing above recent highs, with equities outperforming fixed income markets, and credit spreads tightening.
GRACI and Global LEI



Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Invesco Solutions research and calculations, from January 1, 1992 to March 31, 2024. The Global Leading Economic Indicator (LEI) is a proprietary, forward-looking measure of the growth level in the economy. A reading above (below) 100 on the Global LEI signals growth above (below) a long-term average. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment. A reading above (below) zero signals a positive (negative) compensation for risk-taking in global capital markets in the recent past. **Past performance does not guarantee future results.**

> We expect this broader cyclical participation to continue, as discussed in recent updates, and see it as a confirmation of the improving growth outlook, which credit markets have indicated since mid-2023.

Figure 3: Broadening equity market performance to value and smaller capitalizations confirming a cyclical repricing across assets.
Relative performance (YTD)



Source: Bloomberg, Invesco, March 31, 2024. Equity = MSCI ACWI Net Return USD Index, Fixed Income = Bloomberg Global Aggregate USD Hedged. Emerging Equity = MSCI Emerging Markets TR Index , Developed Equity = MSCI World TR Index. Investment Grade vs. Treasury = Bloomberg US Corporate Excess Return Index. High Yield vs. Treasury = Bloomberg US High Yield Excess Return Index. Size & value = Russell 2XSize/2XValue 5% capped total return index, Quality & Low Vol = Russell 1000 2XQuality/2XLow Volatility 5% capped total return index, and equivalent indices for FTSE Developed ex USA and FTSE Emerging Indices.

Inflation continues to show resilience across the developed world, mainly fueled by rising commodity prices (**Figure 4**). While this doesn't pose a threat of renewed tightening, it's likely to postpone the start of or reduce the extent of the easing cycles already signaled by the US Federal Reserve and European Central Bank.

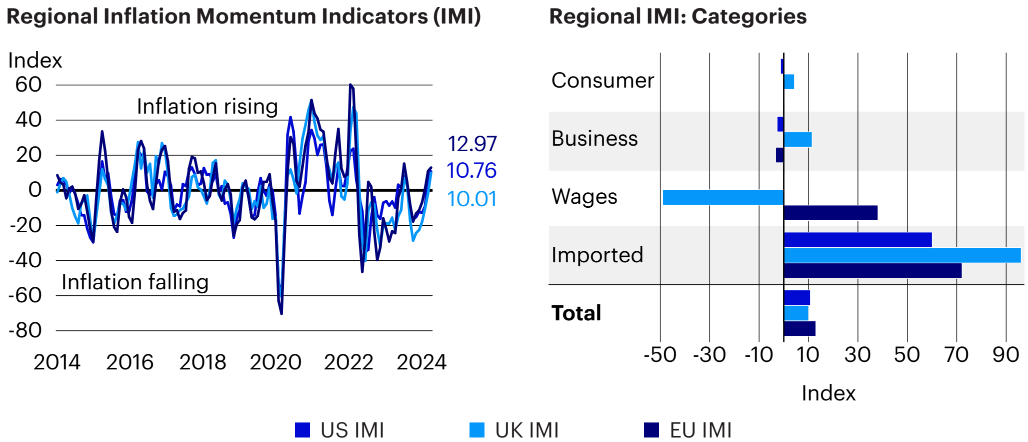
Overall, macro conditions, and thus our framework, are broadly unchanged, suggesting a recovery regime for the global economy and its major regional blocks, with growth below trend and improving. We expect this backdrop to continue for the next few months. Our rules-based process maintains portfolio positioning in favor of risk assets with cyclical characteristics.

Inflation continues to show resilience across the developed world, mainly fueled by rising commodity prices.

We reestablish the overweight exposure in developed ex-US equities versus US equities, driven by improvements in manufacturing business surveys in Europe and Japan.

We have further increased exposure to TIPS at the expense of nominal Treasury bonds in the US and Europe, given resilient inflation and upward pressure from commodity prices.

Figure 4: Inflation moderately increasing across regions



Sources: Bloomberg L.P. data as of March 31, 2024, Invesco Solutions calculations. The US Inflation Momentum Indicator (IMI) measures the change in inflation statistics on a trailing three-month basis, covering indicators across consumer and producer prices, inflation expectation surveys, import prices, wages, and energy prices. A positive (negative) reading indicates inflation has been rising (falling) on average over the past three months.

Investment positioning

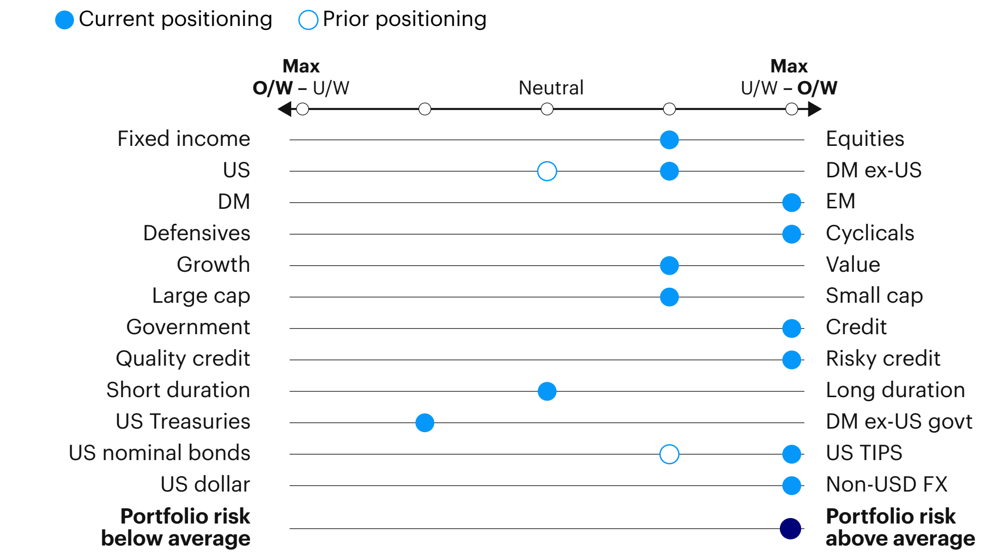
We remain overweight risk relative to the benchmark in our Global Tactical Allocation model — overweight equities over fixed income, favoring emerging markets, cyclical sectors, value, and smaller capitalizations. We return to an overweight in developed ex-US equities versus US equities. In fixed income, we continue to overweight credit risk[2] via lower quality sectors, maintaining a neutral duration posture and further increasing exposure to Treasury inflation-protected securities (TIPS) versus nominal bonds. (Figures 5 to 8). We remain underweight the US dollar. In particular:

- In **equities**, we continue to overweight value and mid and small caps at the expense of quality, low volatility, and momentum factors. Resilient economic data and broader cross-asset performance in favor of risk assets confirm a backdrop that has historically favored cyclical factors with high operating leverage and a higher sensitivity to a rebound in growth expectations, such as value and smaller capitalizations. Similarly, we favor exposures to cyclical sectors such as financials, industrials, materials, and energy at the expense of health care, staples, utilities, and technology. From a regional perspective, we remain overweight emerging markets, supported by improving risk appetite and expectations for US dollar depreciation. We reestablish the overweight exposure in developed ex-US equities versus US equities, driven by improvements in manufacturing business surveys in Europe and Japan. Orders-to-inventory ratios are pointing to a near-term cyclical upside.
- In **fixed income,** we overweight credit risk via high yield, bank loans, and emerging markets hard currency debt. Despite spreads near historic lows, we expect volatility to remain subdued and credit markets to offer stable yields in a stable macro backdrop. The case for credit assets remains limited to their income advantage over government bonds rather than capital appreciation. In sovereigns, we have further increased exposure to TIPS at the expense of nominal Treasury bonds in the US and Europe, given resilient inflation and upward pressure from commodity prices.
- In **currency markets,** we underweight the US dollar, as regimes of cyclical recoveries are typically accompanied by strong reflationary flows into non-US assets. Within developed markets, we favor the euro, the British pound, the Norwegian kroner, the Swedish krona, and the Singapore dollar relative to the Swiss franc, the Japanese yen, and the Australian and Canadian dollars. In emerging markets (EM), we favor high yielders with attractive valuations, such as the Colombian peso, the Brazilian real, the South African rand, and the Indonesian rupiah relative to low yielding and more expensive currencies, such as the Korean won, the Chilean peso, the Thai baht, and the Chinese renminbi. We still expect these currencies to do well in a US dollar depreciation scenario.

2 Credit risk defined as duration times spread (DTS).

Figure 5: Relative tactical asset allocation positioning

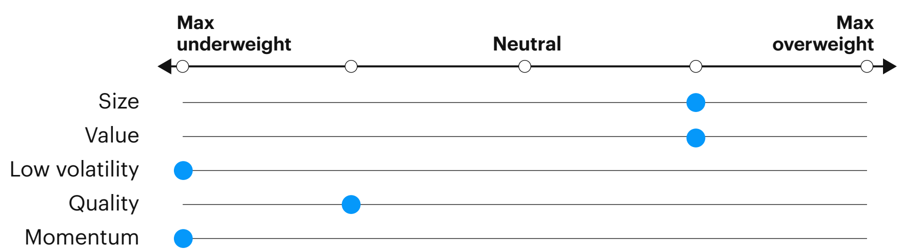
Overweight portfolio risk vs. benchmark, favoring non-US equities, value and smaller capitalizations.



Source: Invesco Solutions, April 1, 2024. DM = developed markets. EM = emerging markets. Non-USD FX refers to foreign exchange exposure as represented by the currency composition of the MSCI ACWI Index. For illustrative purposes only.

Figure 6: Tactical factor positioning

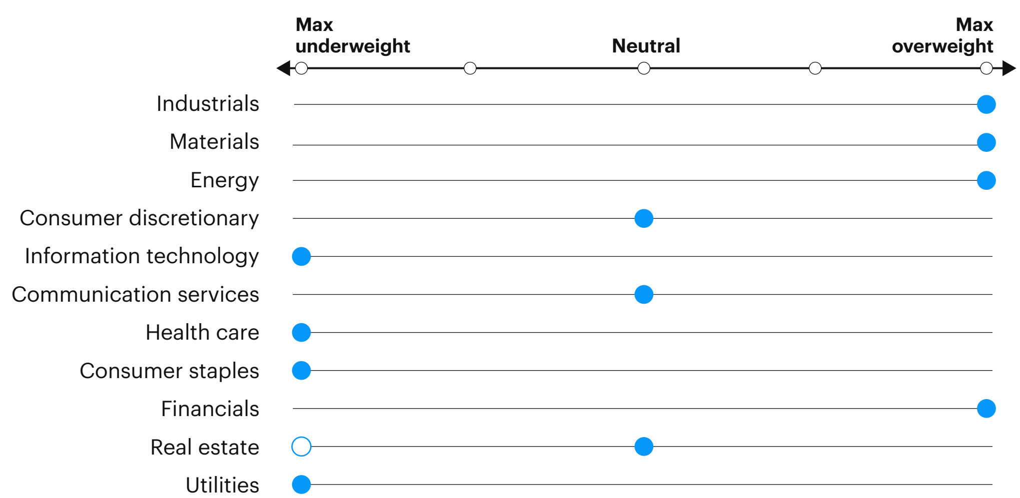
Overweight value and small size; underweight quality, low volatility and momentum



Source: Invesco Solutions, April 1, 2024. For illustrative purposes only. Neutral refers to an equally weighted factor portfolio.

Figure 7: Tactical sector positioning

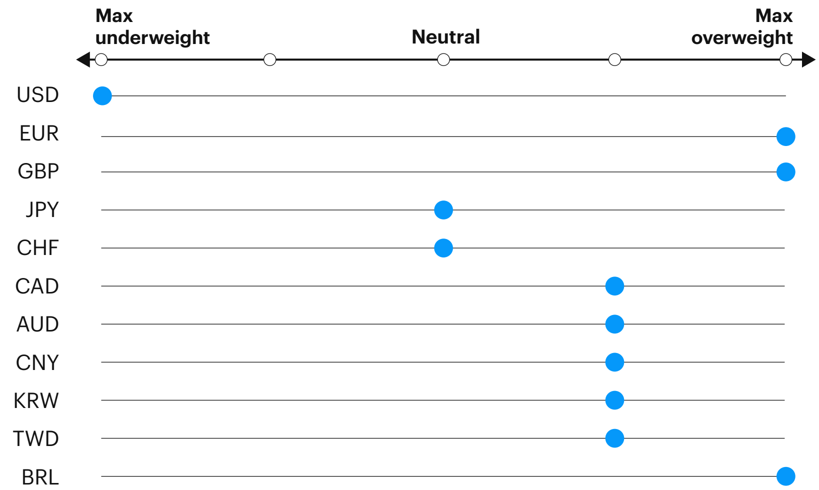
Sector exposures favoring cyclicals



Source: Invesco Solutions, April 1, 2024. For illustrative purposes only. Sector allocations derived from factor and style allocations based on proprietary sector classification methodology. As of March 2024, Cyclicals: energy, financials, industrials, materials; Defensives: consumer staples, health care, information technology, utilities; Neutral: consumer discretionary, communication services and real estate.

Figure 8: Tactical currency positioning

Underweight the US dollar, favoring the euro and British pound within developed markets



Source: Invesco Solutions, April 1, 2024. For illustrative purposes only. Currency allocation process considers four drivers of foreign exchange markets: 1) US monetary policy relative to the rest of the world, 2) global growth relative to consensus expectations, 3) currency yields (i.e., carry), 4) currency long-term valuations.

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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