

Tactical Asset Allocation

Overweight risk assets, with a preference for non-US equities on early signs of cyclical divergence in favor of Europe and emerging markets

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.



Alessio de Longis, CFA®
Senior Portfolio Manager,
Head of Investments,
Invesco Solutions

Synopsis

- We remain positioned for a recovery in the global cycle, while the United States has moved back from an expansion to a recovery phase due to decline in leading indicators back to below-trend levels. Growth outside the US continues to improve while inflation declines.
- We remain overweight portfolio risk in the Global Tactical Asset Allocation model,¹ favoring equities relative to fixed income, non-US equity markets, value, and smaller capitalizations. In fixed income, we are overweight risky credit, neutral on duration, and underweight the US dollar.

Macro update

Growth

Our leading indicators suggest global growth in aggregate remains stable, while confirming the emergence of cyclical divergence in favor of developed markets outside the US and emerging markets; the United States continues to decelerate and has now returned to below-trend growth. In the US, consumer sentiment and business survey results stabilized but remain below their long-term trend. Manufacturing activity improved and remains above its long-term trend, while housing indicators deteriorated marginally and remain around their historical average. On the other hand, manufacturing business survey results demonstrate improving momentum in Europe, where the inventory cycle is pointing to rising production expectations and improving demand. Similarly, incoming data from China and the rest of Asia is showing positive cyclical momentum, with improvements in business survey data and industrial production, while property markets have stabilized, albeit at weak levels (**Figures 1a, 1b, and 1c**).

From a medium-term perspective, based on our modeling research of the business cycle, we expect lagged effects from past monetary tightening to contribute negatively over the next few quarters on a global basis, given the extent and duration of global yield curve inversion in the past two years. In other words, we attribute a high probability to a scenario where our leading indicators remain below their long-term trend for the foreseeable future.

The last quarter of 2023 ended with a powerful recovery in asset prices, driven by a goldilocks backdrop of weak-but-stable growth, rapidly falling inflation, and central banks not only signaling the end of the tightening cycle but, importantly, acknowledging the potential for rate cuts over the course of 2024. The decline in global bond yields by approximately 100 basis points (bps) in Q4 2023 led to positive repricing across asset classes via lower discount rates. It also ignited expectations for improving growth and risk appetite, as indicated by the meaningful compression in credit spreads across all sectors, both corporate and sovereign, now hovering well below their historical long-term averages.

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

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

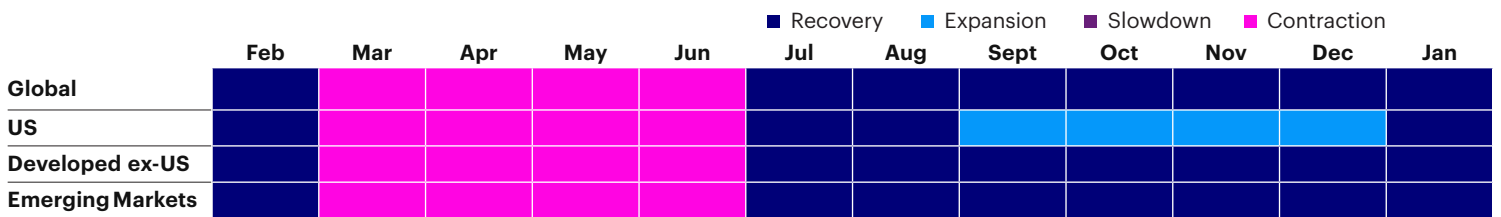
Regional regime signals and components

LEIs		Global risk appetite	Expected macro regimes
Region	Current level of growth		
Global	Below Trend	Change in global growth expectations 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 December 31, 2023. 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

US moves back to a recovery phase as LEIs decline below the long-term trend

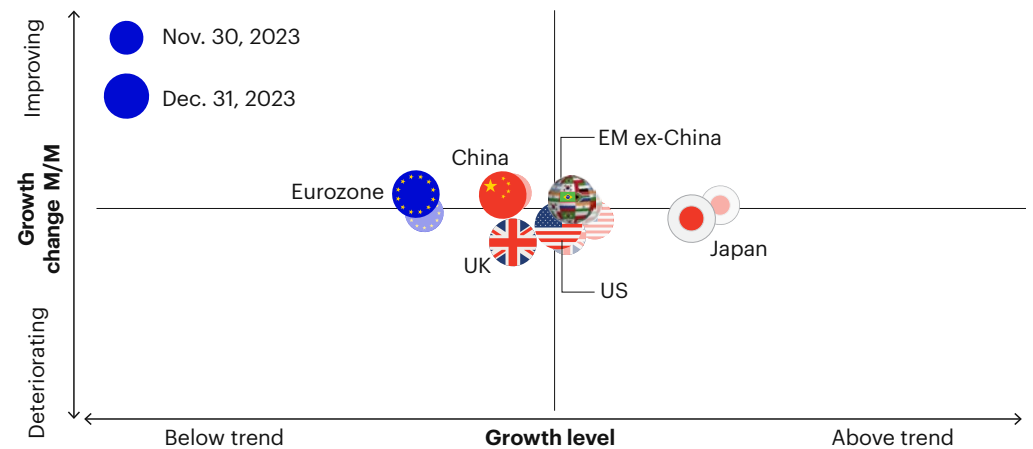


Source: Invesco Solutions as of December 31, 2023.



Our leading indicators suggest global growth in aggregate remains stable while confirming the emergence of cyclical divergence in favor of developed markets outside the US and emerging markets; the United States continues to decelerate and has now returned to below-trend growth.

Figure 1c: Cyclical divergence between the US and the rest of the world, with improving momentum in Europe and China



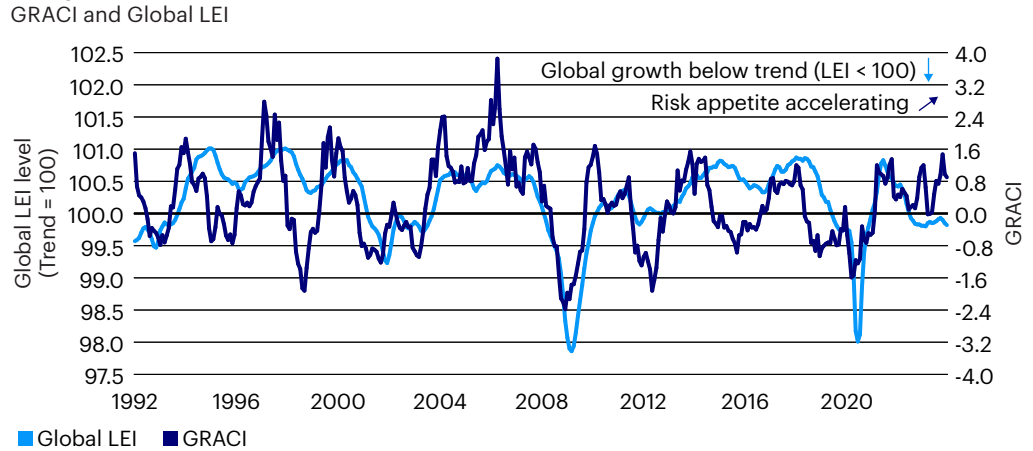
Sources: Bloomberg L.P., Macrobond. Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of December 31, 2023. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.

Our barometer of global risk appetite has stabilized over the past two months after peaking at levels consistent with similar peaks in the post-GFC period. Unless global growth begins to accelerate meaningfully in the near term, validating market expectations and fueling additional momentum in risky assets, we believe markets have otherwise largely priced in a normalized inflation environment and more accommodating policy backdrop, with some risk of profit taking in case of negative surprises. Overall, our framework suggests the global economy remains in a recovery regime, while the United States has moved from an expansion back to a recovery phase due to a decline in leading economic indicators back to below-trend levels (Figure 2).



Our barometer of global risk appetite has stabilized over the past two months after peaking at levels consistent with similar peaks in the post-GFC period.

Figure 2: Global risk appetite stabilizing at levels consistent with prior peaks in the post-GFC period



Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Invesco Solutions research and calculations, from January 1, 1992 to December 31, 2023. 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.**

Inflation

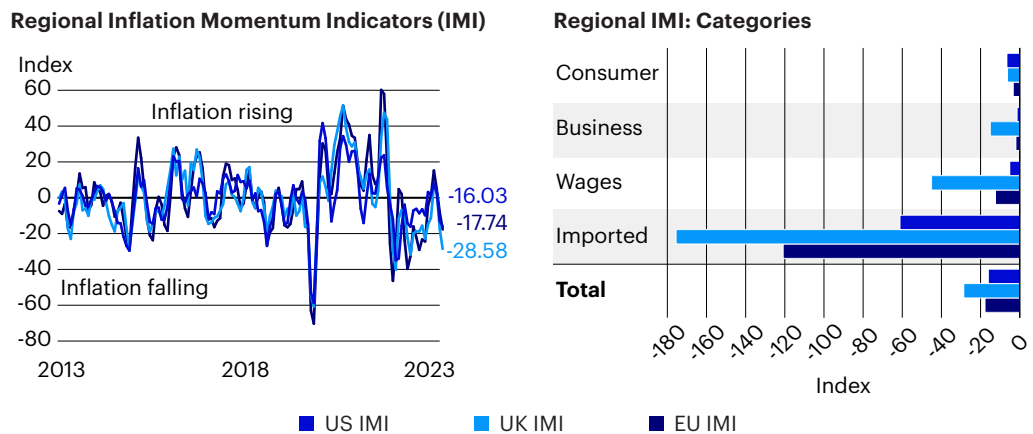
Inflation continues to decline across regions and economic sectors, led by falling commodity prices resulting in lower production costs and consumer prices. Incoming data across sectors suggest this trend is likely to continue over the next few months (Figure 3).

Overall, the evolution of growth, inflation, and monetary policy expectations continues to support our positioning for a favorable backdrop in risk assets in the near term while we remain ready to adjust exposures in case of changes in economic and market conditions.



Inflation continues to decline across regions and economic sectors, led by falling commodity prices resulting in lower production costs and consumer prices.

Figure 3: Inflation continues to decline across Europe, UK, and US



Sources: Bloomberg L.P. data as of December 31, 2023, 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.



Within equities, we overweight cyclical factors with high operating leverage and a higher sensitivity to a rebound in growth expectations, such as value and smaller capitalizations, while we underweight defensive factors such as low volatility, quality, and larger capitalizations.

In currency markets, we underweight the US dollar, as regimes of cyclical recoveries are typically accompanied by strong reflationary flows into non-US assets.

Investment positioning

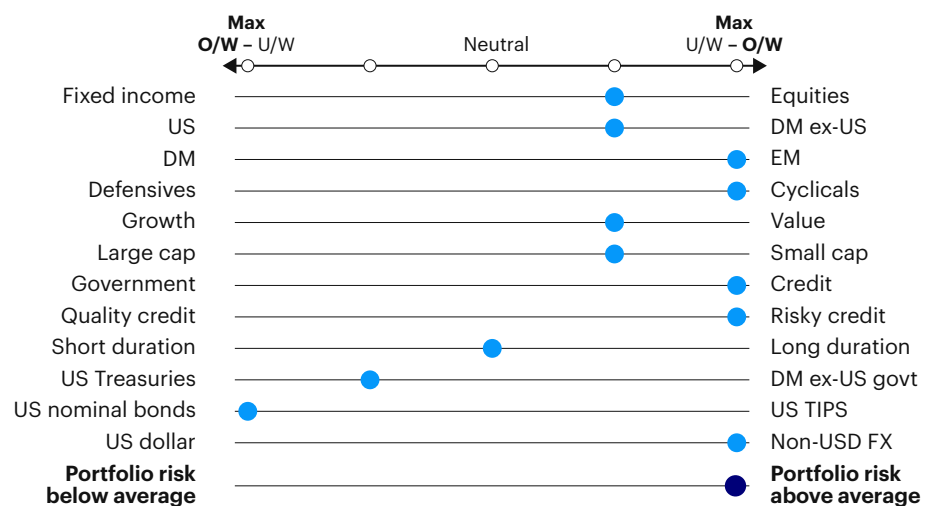
We remain overweight risk relative to the benchmark in the Global Tactical Allocation Model, overweight equities over fixed income, favoring developed ex-US equities and emerging markets at the expense of US equities, and remain underweight the US dollar. We overweight cyclical sectors, value, and smaller capitalizations. In fixed income, we remain overweight credit risk via lower quality sectors, maintaining a neutral duration posture (Figures 4-7). In particular:

- Within **equities**, we overweight cyclical factors with high operating leverage and a higher sensitivity to a rebound in growth expectations, such as value and smaller capitalizations, while we underweight defensive factors such as low volatility, quality, and larger 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, as well as developed ex-US equities, driven by cyclical divergence in leading economic indicators between the US and other developed markets.
- In **fixed income**, we remain overweight in risky credit² via high yield, bank loans and emerging markets hard currency debt. Credit spreads have tightened further, now hovering around historical lows in most sectors. However, 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 favor duration in nominal bonds across developed markets, driven by negative inflation momentum (**Figure 3**).
- 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, the Australian and Canadian dollars. In EM, we favor higher yielding currencies with attractive valuations, such as the Colombian peso, the Brazilian real, the South African rand, and the Indonesian rupiah, relative to lower yielding and more expensive currencies, such as the Korean won, the Chilean peso, the Thai baht, and the Chinese renminbi, although we still expect these currencies to do well in a US dollar depreciation scenario.

Figure 4: Relative tactical asset allocation positioning

Overweight portfolio risk vs. benchmark via emerging markets, non-US equities, credit, and cyclicals

● Current positioning ○ Prior positioning

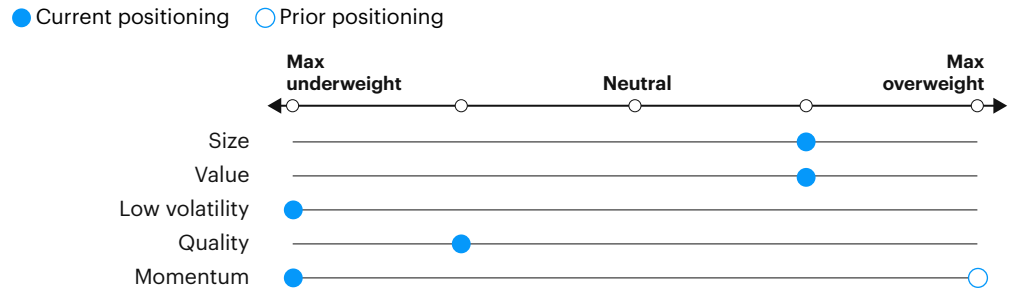


Source: Invesco Solutions, January 1, 2024. DM = developed markets. EM = emerging markets. Non-USD FX refers to foreign exchange exposure as represented by the currency composition of the MSCI ACWI Index. For illustrative purposes only.

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

Figure 5: Tactical factor positioning

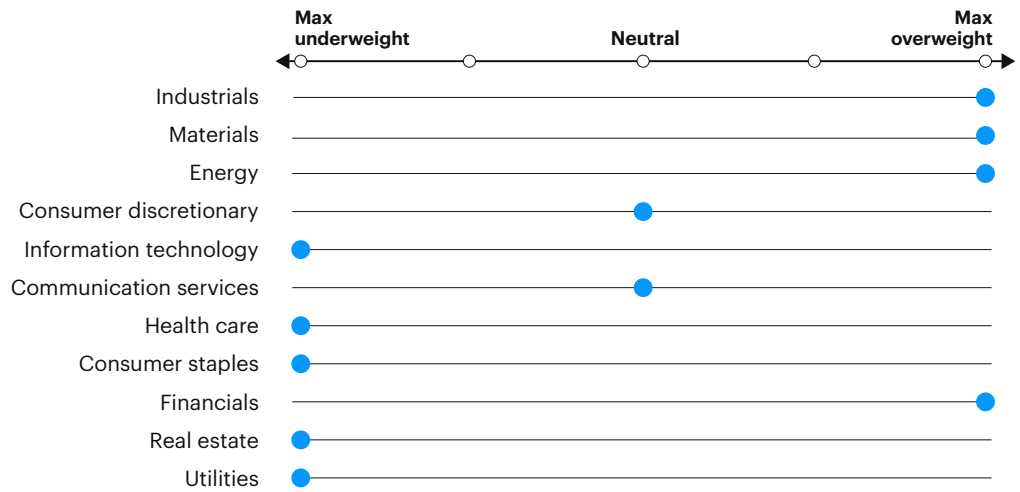
Overweight value and small size; underweight quality, low volatility, and momentum



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

Figure 6: Tactical sector positioning

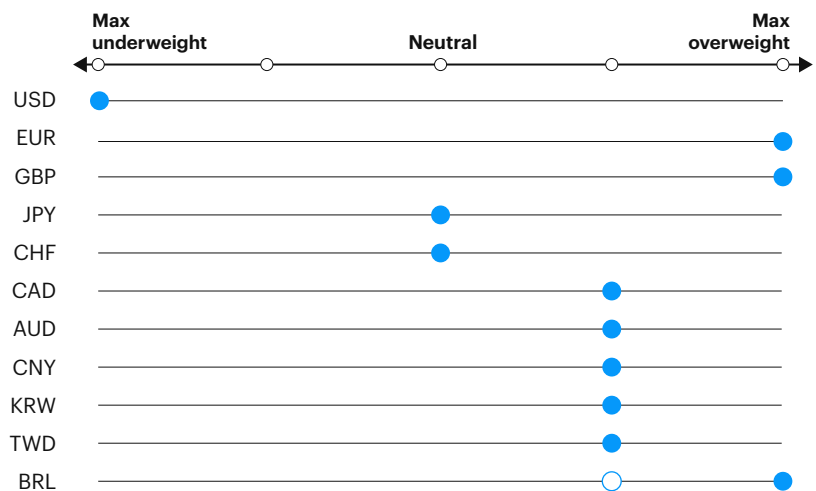
Sector exposures favoring cyclicals



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

Figure 7: Tactical currency positioning

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



Source: Invesco Solutions, January 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.

Important information

This document is intended only for professional investors in Hong Kong, for Institutional Investors and/or Accredited Investors in Singapore, for certain specific sovereign wealth funds and/or Qualified Domestic Institutional Investors approved by local regulators only in the People's Republic of China, for certain specific Qualified Institutions and/or Sophisticated Investors only in Taiwan, for Qualified Professional Investors in Korea, for certain specific institutional investors in Brunei, for Qualified Institutional Investors and/or certain specific institutional investors in Thailand, for certain specific institutional investors in Malaysia upon request, for certain specific institutional investors in Indonesia and for qualified buyers in Philippines for informational purposes only. This document is not an offering of a financial product and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful. Circulation, disclosure, or dissemination of all or any part of this document to any unauthorized person is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements," which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.

This document is issued in the following countries:

- in Hong Kong by Invesco Hong Kong Limited 景順投資管理有限公司, 45/F, Jardine House, 1 Connaught Place, Central, Hong Kong. This document has not been reviewed by the Securities and Futures Commission.
- in Singapore by Invesco Asset Management Singapore Ltd, 9 Raffles Place, #18-01 Republic Plaza, Singapore 048619.
- in Taiwan by Invesco Taiwan Limited, 22F, No.1, Songzhi Road, Taipei 11047, Taiwan (0800-045-066). **Invesco Taiwan Limited is operated and managed independently.**