Uncommon truths

Elections and Fed rate cuts: the perfect recipe?

We are witnessing a rarity: the Fed initiating an easing cycle within two months of an election. Could this be the perfect recipe for risk assets? Elections have tended to be followed by strong credit and equity performance but the evidence on Fed easing is mixed. If the mid-1990s were a good template, the portents would be good but I worry about slow growth, valuations and politics.

At the halfway point of a tour of Asia, US elections remain a topic of keen interest. At meetings so far, it is my impression that a small majority of investors think Donald Trump will be the next president. Broader media commentaries seem to suggest that US stock markets and the dollar are rallying in that belief. So, what does history tell us about the effect of elections on US asset performance and how does this compare to what usually happens when the Fed eases?

First, it is worth noting that we are witnessing something that is almost unique in the last 100 years: a Fed easing cycle starting within two months of a presidential election (which traditionally take place on the first Tuesday of November). Other examples were the election of 2000, with the Fed starting to ease on 2 January 2001 (not a great precedent for stock investors), 1984, with the Fed starting to ease on 30 August (almost within two months of the 6 November election) and, if we really stretch things, 1968, when, in the middle of a tightening cycle, there was a single rate cut on 30 August that was reversed by year-end.

As far as elections go, history is encouraging for credit and stock investors. **Figure 1a** shows average US asset performance around US presidential elections since 1988 (a start date chosen because the high yield (HY) index only started in 1986). It appears that most assets have on average done better in the year after elections than in year before (year-ends are defined as 31 October to better match the election cycle). Performance in the year after elections has also tended to be better than the average across all years since 1988. Government bonds appear to be the exception, with little difference between pre-election, post-election and average annual performance.

Turning to Fed easing cycles, **Figure 1b** is less promising, with returns on all assets tending to be worse after the first rate cut (a lot may already be priced in). Also, defensive assets (government bonds and investment grade (IG)) have tended to outperform the riskier assets after the first cut (the latter perhaps hit by recession). Those defensive assets have also tended to perform better than average ("All calendar years") in the year after the first rate cut, while riskier assets have not. Again, given the limited history of the HY index, the analysis cannot start earlier than 1986, with the first easing cycle included in this analysis starting in June 1989 (see the appendix for the dates of the first rate cuts). This limits the analysis to five rate cutting cycles prior to this year (the focus is on rate cuts, rather than quantitative easing), which is not an enormous sample (nine elections are covered).

Figure 1a: US asset performance at elections (%)

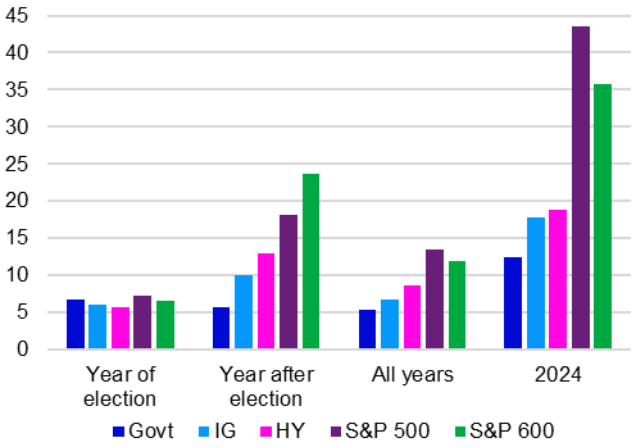
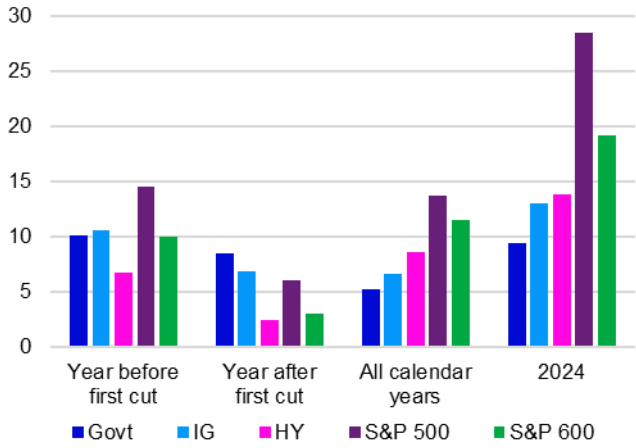


Figure 1b: US asset performance & Fed easing (%)



Notes: **Past performance is no guarantee of future results**. The charts show total returns in US dollars. "Govt" is based on the ICE BofA US Treasury Index; "IG" is based on the ICE BofA US Corporate Index and "HY" is based on the ICE BofA US High Yield Index. Figure 1a is based on monthly data from 31 October 1987 to 30 September 2024 and shows average returns in presidential election years since 1988 (with years defined as running from 31 October in the preceding year to 31 October of the election year), compared to the returns in the year after the election (defined as being from 31 October in the election year to 31 October in the following year). "All years" shows the average return across all years since 1988 (with years running from 31 October, starting on 31 October 1987). "2024" shows the annualised return from 31 October 2023 to 30 September 2024. Figure 1b is based on daily data from 1 June 1988 to 18 September 2024 and shows average returns in the years before and the years after the day before the first interest rate cut in Fed easing cycles (the focus is on interest rates and not quantitative easing). "All calendar years" shows the average return across all calendar years from 1988 to 2024 (the latter is the annualised return up to 30 September 2024). "2024" shows the returns in the year before the 18 September 2024 Fed rate cut. See appendices for charts that exclude the global financial crisis and pandemic episodes and for dates of the first interest rate cut in Fed easing cycles.
Source: ICE BofA, S&P Dow Jones Indices, LSEG Datastream and Invesco Global Market Strategy Office

Of course, the circumstances of each election and easing cycle are different and those averages may hide more than they reveal, especially when it is considered that they include the global financial crisis (GFC) and the Covid pandemic. The appendix contains charts that show what happens if we exclude those two extreme episodes. A comparison of **Figures 1** and **8**, suggests that the GFC and pandemic episodes had a number of effects on the data in **Figure 1**: first, all pre-election asset returns (except government bonds) were depressed due to large losses in 2008; second, post-election credit (IG and HY) and equity returns were boosted by the large rebounds in 2009 and 2021; third, pre-rate cut small-cap equity returns were reduced by the poor performance prior to the July 2019 easing and, finally, post-rate cut credit and equity performance was depressed by large negative returns in the year after September 2007 rate cut (as the GFC was unfolding).

Hopefully, neither the GFC nor pandemic episodes will serve as guides for the coming year. A more encouraging template may be the mid-1990s, a period during which the Fed eased from rates similar to those of this cycle (starting on 5 July 1995), an election occurred (5 November 1996) and there was no recession (according to the National Bureau of Economic Research, there was no recession between March 1991 and March 2001).

All asset returns were impressive in 1995, with further strong gains in 1996 and 1997 (especially for HY and equities). Hence, there were strong returns for all assets in the year to the first rate cut in July 1995 and equities delivered similar high returns in the following 12 months. Likewise, strong returns across all assets in the year to the November 1996 election became even stronger in the year after.

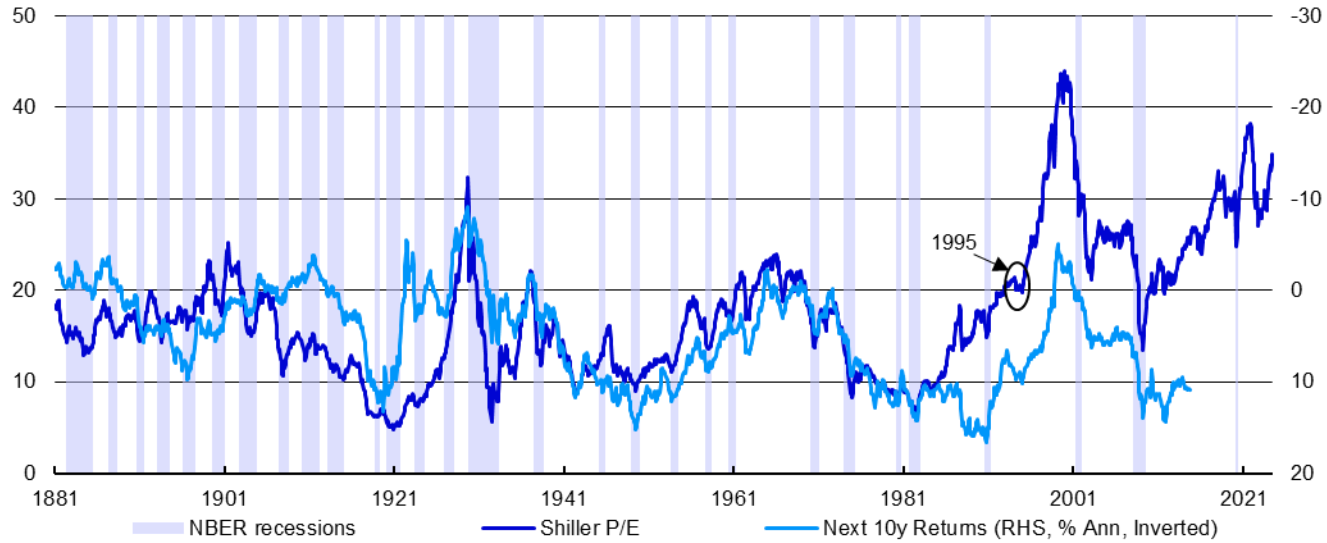
So, what could go wrong and prevent mid-1990s like HY and stock returns? The obvious answer is disappointing growth or even recession. It is worth noting that average quarterly annualised GDP growth was 3.8% in the 1994-97 period, versus only 2.3% since the start of 2022.

Also, **Figures 1a** and **1b** show that all assets (especially equities) have performed extremely well in the last year. This is now reflected in HY spreads that are close to cyclical tights and elevated broad equity index valuations. **Figure 2** shows that equity market valuations (as judged by the Shiller PE) bear no relation to those in 1995 (the Shiller PE started that year at around 20 and is now around 35). It can always go higher (it peaked around 43 during the dot.com bubble) but the starting point seems to have priced in a lot of good news. Also, US market concentration is much higher than during that previous tech bubble.

Finally, the election itself could bring bad news. Though markets seem to be embracing the idea of a Trump presidency, I am not convinced that he will win, nor that, if he does, an economy weakening boost to tariffs, a tax cut fuelled deepening of fiscal imbalances and an undermining of the Fed's independence will bring a strong dollar or a record breaking stock market. I am currently underweighted in the US equity market within my Model Asset Allocation (see **Figure 6**) and suspect the dollar will weaken. I favour an equally-weighted approach to US stocks.

Unless stated otherwise, all data as of 18 October 2024.

Figure 2 – Shiller PE, US recessions and future market returns



Note: **Past performance is no guarantee of future results**. Monthly data from January 1881 to September 2024 (as of 30 September 2024). "NBER recessions" are periods of US recession, as defined by the National Bureau of Economic Research. See appendices for definitions and disclaimers. Source: Robert Shiller, LSEG Datastream and Invesco Global Market Strategy Office

Figure 3 – Asset class total returns (%)

Data as at 18/10/2024		Current	Total Return (USD, %)					Total Return (Local Currency, %)				
	Index	Level/RY	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Equities												
World	MSCI	857	0.5	3.8	0.6	19.8	33.3	0.6	4.6	1.5	21.0	32.3
Emerging Markets	MSCI	1155	-0.4	6.3	-1.3	15.7	26.1	-0.2	7.0	0.0	18.7	26.2
China	MSCI	68	-2.8	21.9	-3.0	25.7	23.0	-2.7	21.7	-2.7	25.2	21.7
US	MSCI	5587	0.9	4.6	2.0	24.1	38.1	0.9	4.6	2.0	24.1	38.1
Europe	MSCI	2174	-0.2	-0.1	-2.2	10.9	25.0	0.5	2.0	0.5	12.2	20.0
Europe ex-UK	MSCI	2689	-0.6	-0.2	-2.5	10.0	25.8	0.3	2.2	0.2	12.3	21.8
UK	MSCI	1297	1.0	0.2	-1.2	14.0	22.5	1.3	1.5	1.6	11.5	14.2
Japan	MSCI	3980	-1.0	1.0	-2.5	9.9	20.3	-0.8	6.4	1.9	16.6	20.1
Government Bonds												
World	BofA-ML	3.10	0.1	-2.7	-2.6	-0.5	9.0	0.4	-1.0	-0.8	1.3	7.7
Emerging Markets	BBloom	6.88	0.4	-0.9	-1.0	10.7	30.7	0.4	-0.9	-1.0	10.7	30.7
China	BofA-ML	1.87	0.0	-0.7	-0.8	5.9	10.9	0.5	-0.5	0.5	6.0	7.7
US (10y)	Datastream	4.08	0.1	-2.5	-2.1	1.5	11.0	0.1	-2.5	-2.1	1.5	11.0
Europe	Bofa-ML	2.61	0.2	-1.6	-2.4	0.5	13.8	1.0	0.7	0.3	2.3	10.4
Europe ex-UK (EMU, 10y)	Datastream	2.18	0.0	-2.1	-3.0	-0.8	12.3	0.8	0.3	-0.3	1.0	9.0
UK (10y)	Datastream	4.06	1.0	-2.6	-3.0	2.1	18.5	1.3	-1.3	-0.2	-0.2	10.4
Japan (10y)	Datastream	0.94	-0.4	-5.9	-5.0	-7.2	0.4	-0.2	-0.8	-0.6	-1.5	0.3
IG Corporate Bonds												
Global	BofA-ML	4.49	0.1	-1.2	-1.5	3.9	14.7	0.3	-0.5	-0.6	4.5	13.5
Emerging Markets	BBloom	6.16	0.3	0.1	-0.8	12.4	25.8	0.3	0.1	-0.8	12.4	25.8
China	BofA-ML	2.56	-0.2	-0.5	-1.1	3.9	8.4	0.3	-0.3	0.2	4.1	5.3
US	BofA-ML	5.00	0.1	-1.2	-1.1	4.6	15.0	0.1	-1.2	-1.1	4.6	15.0
Europe	BofA-ML	3.23	-0.1	-1.2	-2.2	2.6	14.0	0.7	1.1	0.5	4.3	10.7
UK	BofA-ML	5.24	1.0	-1.2	-2.1	5.3	21.3	1.3	0.1	0.7	3.0	13.0
Japan	BofA-ML	1.11	-0.3	-5.4	-4.8	-6.0	0.7	-0.1	-0.3	-0.4	-0.2	0.6
HY Corporate Bonds												
Global	BofA-ML	7.11	0.2	0.1	-0.5	8.1	18.0	0.4	0.6	0.1	8.5	17.1
US	BofA-ML	7.28	0.3	0.3	-0.1	7.9	17.3	0.3	0.3	-0.1	7.9	17.3
Europe	BofA-ML	5.93	-0.3	-1.2	-2.2	5.5	17.5	0.5	1.2	0.6	7.3	14.1
Cash (Overnight LIBOR)												
US		4.82	0.1	0.4	0.2	4.2	5.5	0.1	0.4	0.2	4.2	5.5
Euro Area		3.41	-0.3	-0.4	-1.6	2.1	7.0	0.1	0.3	0.1	3.0	3.9
UK		4.95	-0.3	0.6	-2.1	6.9	11.8	0.1	0.4	0.2	4.1	5.3
Japan		0.23	-0.3	-4.5	-3.7	-5.4	0.1	0.0	0.0	0.0	0.1	0.1
Real Estate (REITs)												
Global	FTSE	1753	1.7	-0.1	-1.5	10.8	29.7	2.5	2.3	1.3	12.7	25.9
Emerging Markets	FTSE	1298	0.0	6.9	-3.7	5.7	16.5	0.8	9.5	-1.0	7.5	13.0
US	FTSE	3439	3.0	0.5	0.4	15.5	35.4	3.0	0.5	0.4	15.5	35.4
Europe ex-UK	FTSE	2646	-1.7	-2.8	-4.9	6.7	43.7	-0.9	-0.4	-2.3	8.6	39.4
UK	FTSE	902	0.2	-4.1	-4.9	3.6	32.2	0.4	-2.8	-2.1	1.3	23.2
Japan	FTSE	2084	-0.4	-5.8	-4.9	-1.2	6.1	-0.2	-0.8	-0.5	4.8	6.0
Commodities												
All	GSCI	3517	-4.9	0.8	-0.1	5.1	-5.5	-	-	-	-	-
Energy	GSCI	595	-7.9	-0.3	0.5	2.7	-13.2	-	-	-	-	-
Industrial Metals	GSCI	1755	-1.6	3.0	-1.3	9.6	16.4	-	-	-	-	-
Precious Metals	GSCI	3046	2.3	5.7	3.2	31.5	38.3	-	-	-	-	-
Agricultural Goods	GSCI	486	-2.5	-1.2	-4.0	-5.2	-9.3	-	-	-	-	-
Currencies (vs USD)*												
EUR		1.09	-0.7	-2.3	-2.4	-1.5	3.1	-	-	-	-	-
JPY		149.54	-0.3	-4.9	-4.0	-5.7	0.3	-	-	-	-	-
GBP		1.30	-0.3	-1.3	-2.8	2.3	7.3	-	-	-	-	-
CHF		1.16	-0.9	-2.2	-2.2	-2.7	3.9	-	-	-	-	-
CNY		7.10	-0.5	-0.3	-1.2	0.0	3.0	-	-	-	-	-

Notes: **Past performance is no guarantee of future results.** *The currency section is organised so that in all cases the numbers show the movement in the mentioned currency versus USD (+ve indicates appreciation, -ve indicates depreciation). Please see appendix for definitions, methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 4 – Global equity sector total returns relative to market (%)

Data as at 18/10/2024	Global				
	1w	1m	QTD	YTD	12m
Energy	**-2.2**	**-2.1**	**-0.1**	**-13.7**	**-23.6**
Basic Materials	**-0.1**	**1.3**	**-2.0**	**-9.6**	**-8.9**
Basic Resources	0.2	3.1	-1.9	-8.3	-6.3
Chemicals	-0.5	-1.3	-2.2	-11.3	-12.5
Industrials	**0.3**	**0.2**	**0.1**	**-0.8**	**3.1**
Construction & Materials	0.4	-1.6	-1.2	-0.4	7.2
Industrial Goods & Services	0.3	0.4	0.3	-0.8	2.5
Consumer Discretionary	**-0.7**	**-0.4**	**-2.1**	**-5.0**	**-3.7**
Automobiles & Parts	-0.9	-4.6	-7.6	-18.8	-23.5
Media	2.4	2.1	2.5	5.9	10.5
Retailers	-0.4	0.2	0.4	7.0	9.2
Travel & Leisure	0.4	3.0	1.1	-5.9	-2.3
Consumer Products & Services	-2.7	-1.2	-5.4	-13.4	-10.0
Consumer Staples	**-0.3**	**-4.1**	**-2.6**	**-8.7**	**-11.9**
Food, Beverage & Tobacco	0.1	-3.8	-2.2	-9.7	-12.5
Personal Care, Drug & Grocery Stores	-0.9	-4.6	-3.3	-6.8	-10.8
Healthcare	**-0.6**	**-4.1**	**-0.8**	**-2.1**	**-5.8**
Financials	**1.3**	**0.6**	**1.6**	**4.6**	**5.9**
Banks	1.2	-0.2	1.3	3.0	4.8
Financial Services	1.8	1.8	2.7	4.3	8.4
Insurance	0.5	0.2	0.5	9.0	4.2
Real Estate	**1.0**	**-2.5**	**-1.7**	**-5.7**	**-1.0**
Technology	**-0.2**	**3.6**	**1.7**	**11.7**	**14.5**
Telecommunications	**1.1**	**-0.9**	**0.3**	**-3.4**	**-5.4**
Utilities	**1.4**	**-1.8**	**-1.1**	**1.2**	**2.2**

Notes: **Past performance is no guarantee of future results.** Returns shown are for Datastream sector indices versus the total market index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5a – US factor index total returns (%)

Data as at 18/10/2024	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	-0.4	2.3	3.8	13.9	31.4	-1.3	-2.0	-3.8	-8.4	-4.8
Low volatility	2.3	2.6	13.8	22.4	32.8	1.4	-1.8	5.5	-1.5	-3.7
Price momentum	1.0	5.9	10.5	22.9	38.8	0.2	1.3	2.4	-1.1	0.6
Quality	0.3	4.0	10.4	15.2	25.3	-0.6	-0.5	2.4	-7.4	-9.2
Size	1.5	2.8	13.1	11.8	31.4	0.6	-1.6	4.8	-10.0	-4.7
Value	1.7	3.6	13.6	19.5	38.4	0.8	-0.8	5.4	-3.9	0.4
Market	0.9	4.5	7.8	24.3	37.9					
Market - Equal-Weighted	1.1	3.7	11.2	16.9	31.8					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the S&P 500 index, they are rebalanced monthly, use data in US dollars and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in US dollars. Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the S&P 500 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 5b – European factor index total returns relative to market (%)

Data as at 18/10/2024	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	0.9	2.1	1.5	4.9	24.2	0.3	-0.1	-1.6	-7.1	1.9
Low volatility	1.8	3.0	9.5	16.6	23.1	1.2	0.8	6.1	3.3	1.0
Price momentum	1.3	2.1	6.4	20.1	33.2	0.7	0.0	3.1	6.4	9.3
Quality	1.1	2.5	1.4	10.4	21.3	0.5	0.3	-1.7	-2.2	-0.5
Size	0.9	1.2	3.2	7.1	25.4	0.3	-1.0	0.1	-5.1	2.9
Value	0.8	1.7	6.0	11.5	26.9	0.2	-0.4	2.7	-1.2	4.1
Market	0.6	2.2	3.2	12.9	21.9					
Market - Equal-Weighted	0.9	1.9	5.4	11.0	24.7					

Notes: **Past performance is no guarantee of future results.** All indices are subsets of the STOXX 600 index, they are rebalanced monthly, use data in euros and are equal-weighted. Growth includes stocks in the top third based on both their 5-year sales per share trend and their internal growth rate (the product of the 5-year average return on equity and the retention ratio); Low volatility includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months; Price momentum includes stocks in the top quintile based on their performance in the previous 12 months; Quality includes stocks in the top third based on both their return on invested capital and their EBIT to EV ratio (earnings before interest and taxes to enterprise value); Size includes stocks in the bottom quintile based on their market value in euros; Value includes stocks in the bottom quintile based on their price to book value ratios. The market represents the STOXX 600 index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 6 – Model asset allocation

	Neutral	Policy Range		Allocation	Position vs Neutral	Hedged	Currency
Cash Equivalents	**5%**	**0-10%**		**6%**			
Cash	2.5%			6%			
Gold	2.5%			0%			
Bonds	**40%**	**10-70%**	↑	**45%**			
Government	25%	10-40%	↑	30%			
US	8%			16%		25%	JPY
Europe ex-UK (Eurozone)	7%			3%			
UK	1%			2%			
Japan	7%		↑	5%			
Emerging Markets	2%			4%			
China**	0.2%			0%			
Corporate IG	10%	0-20%	↑	15%			
US Dollar	5%		↑	9%		50%	JPY
Euro	2%			1%			
Sterling	1%			2%			
Japanese Yen	1%		↑	1%			
Emerging Markets	1%			2%			
China**	0.1%			0%			
Corporate HY	5%	0-10%		0%			
US Dollar	4%			0%			
Euro	1%			0%			
Bank Loans	**4%**	**0-8%**		**8%**			
US	3%			6%			
Europe	1%			2%			
Equities	**45%**	**25-65%**		**35%**			
US	25%			10%			
Europe ex-UK	7%		↓	9%			
UK	4%		↑	5%			
Japan	4%			3%			
Emerging Markets	5%			8%			
China**	2%			4%			
Real Estate	**4%**	**0-8%**	↓	**4%**			
US	1%		↓	0%			
Europe ex-UK	1%			1%			
UK	1%			2%			
Japan	1%			1%			
Emerging Markets	1%		↓	0%			
Commodities	**2%**	**0-4%**	↓	**2%**			
Energy	1%		↓	0%			
Industrial Metals	0.3%			1%			
Precious Metals	0.3%			0%			
Agriculture	0.3%			1%			
Total	**100%**			**100%**			

Currency Exposure (including effect of hedging)							
USD	52%		↓	36%			
EUR	19%		↓	18%			
GBP	7%		↑	13%			
JPY	13%		↑	20%			
EM	9%		↓	14%			
Total	**100%**			**100%**			

Notes: **China is included in Emerging Markets allocations. This is a theoretical portfolio and is for illustrative purposes only. See the latest The Big Picture document for more details. It does not represent an actual portfolio and is not a recommendation of any investment or trading strategy. Arrows indicate the direction of the most recent changes.
Source: Invesco Global Market Strategy Office

Figure 7 – Model allocations for global sectors

	Neutral	Invesco	Preferred Region
Energy	**6.1%**	**Neutral**	**EM**
Basic Materials	**3.8%**	**Underweight ↓**	**Japan**
Basic Resources	2.3%	Underweight ↓	Japan
Chemicals	1.5%	Neutral	US
Industrials	**13.2%**	**Underweight**	**US**
Construction & Materials	1.7%	Underweight	US
Industrial Goods & Services	11.4%	Underweight	US
Consumer Discretionary	**14.0%**	**Underweight**	**US**
Automobiles & Parts	2.4%	Underweight	Europe
Media	1.1%	Neutral	Japan
Retailers	5.3%	Overweight	US
Travel & Leisure	1.9%	Underweight	EM
Consumer Products & Services	3.4%	Underweight	Japan
Consumer Staples	**5.4%**	**Overweight**	**US**
Food, Beverage & Tobacco	3.4%	Overweight	US
Personal Care, Drug & Grocery Stores	2.0%	Overweight	Europe
Healthcare	**9.3%**	**Overweight**	**US**
Financials	**15.7%**	**Overweight**	**US**
Banks	7.4%	Overweight	Europe
Financial Services	5.3%	Overweight	US
Insurance	3.1%	Overweight ↑	US
Real Estate	**2.8%**	**Neutral**	**Japan**
Technology	**23.0%**	**Neutral**	**EM**
Telecommunications	**3.4%**	**Underweight**	**US**
Utilities	**3.4%**	**Neutral**	**US**

Notes: These are theoretical allocations which are for illustrative purposes only. They do not represent an actual portfolio and are not a recommendation of any investment or trading strategy. See the latest Strategic Sector Selector for more details.

Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix

Methodology for asset allocation, expected returns and optimal portfolios

Portfolio construction process

The optimal portfolios are theoretical and not real. We use optimisation processes to guide our allocations around "neutral" and within prescribed policy ranges based on our estimations of expected returns and using historical covariance information. This guides the allocation to global asset groups (equities, government bonds etc.), which is the most important level of decision. For the purposes of this document the optimal portfolios are constructed with a one-year horizon.

Which asset classes?

We look for investibility, size and liquidity. We have chosen to include equities, bonds (government, corporate investment grade and corporate high yield), bank loans, REITs to represent real estate, commodities and cash (all across a range of geographies). We use cross-asset correlations to determine which decisions are the most important.

Neutral allocations and policy ranges

We use market capitalisation in USD for major benchmark indices to calculate neutral allocations. For commodities, we use industry estimates for total ETP market cap + assets under management in hedge funds + direct investments. We use an arbitrary 5% for the combination of cash and gold. We impose diversification by using policy ranges for each asset category (the range is usually symmetric around neutral).

Expected/projected returns

The process for estimating expected returns is based upon yield (except commodities, of course). After analysing how yields vary with the economic cycle, and where they are situated within historical ranges, we forecast the direction and amplitude of moves over the next year. Cash returns are calculated assuming a straight-line move in short term rates towards our targets (with, of course, no capital gain or loss). Bond returns assume a straight-line progression in yields, with capital gains/losses predicated upon constant maturity (effectively supposing constant turnover to achieve that). Forecasts of corporate investment-grade, high-yield and bank loan spreads are based upon our view of the economic cycle (as are forecasts of credit losses). Coupon/interest payments are added to give total returns. Equity and REIT returns are based on dividend growth assumptions. We calculate total returns by applying those growth assumptions and adding the forecast dividend yield. No such metrics exist for commodities; therefore, we base our projections on US CPI-adjusted real prices relative to their long-term averages and views on the economic cycle. All expected returns are calculated in local currency and then, where necessary, converted into other currency bases using our exchange rate forecasts.

Optimising the portfolio

Using a covariance matrix based on monthly local currency total returns for the last 5 years and we run an optimisation process that maximises the Sharpe Ratio. Another version maximises Return subject to volatility not exceeding that of our Neutral Portfolio. The optimiser is based on the Markowitz model.

Currency hedging

We adopt a cautious approach when it comes to currency hedging as currency movements are notoriously difficult to accurately predict and sometimes hedging can be costly. Also, some of our asset allocation choices are based on currency forecasts. We use an amalgam of central bank rate forecasts, policy expectations and real exchange rates relative to their historical averages to predict the direction and amplitude of currency moves.

Definitions of data and benchmarks for Figure 3

Sources: we source data from LSEG Datastream unless otherwise indicated.

Cash: returns are based on a proprietary index calculated using the Intercontinental Exchange Benchmark Administration overnight LIBOR (London Interbank Offer Rate). From 1st January 2022, we use the Refinitiv overnight deposit rate for the euro, the British pound and the Japanese yen. The global rate is the average of the euro, British pound, US dollar and Japanese yen rates. The series started on 1 January 2001 with a value of 100.

Gold: London bullion market spot price in USD/troy ounce.

Government bonds: Current levels, yields and total returns use Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK, and the ICE BofA government bond total return index for the World and Europe. The emerging markets yields and returns are based on the Barclays Bloomberg emerging markets sovereign US dollar bond index.

Corporate investment grade (IG) bonds: ICE BofA investment grade corporate bond total return indices, except for in emerging markets where we use the Barclays Bloomberg emerging markets corporate US dollar bond index.

Corporate high yield (HY) bonds: ICE BofA high yield total return indices

Equities: We use MSCI benchmark gross total return indices for all regions.

Commodities: Goldman Sachs Commodity total return indices

Real estate: FTSE EPRA/NAREIT total return indices

Currencies: Global Trade Information Services spot rates

Dates of Fed easing in Figure 1b and Figure 8b
For the purposes of this analysis, the dates of the first rate cuts in US Federal Reserve rate easing cycles were:

5 June 1989
5 July 1995
2 January 2001
17 September 2007
31 July 2019
18 September 2024

Definition of US equity benchmark used to generate long-term returns
To generate US equity returns we have calculated a total return index for broad US stocks based on index and dividend data from US academic Robert Shiller and LSEG Datastream. The index prior to 1926 is Robert Shiller's recalculation of data from Common Stock Indexes by Cowles & Associates (see here). From 1926 to 1957, the Shiller data is based on the S&P Composite Index and thereafter is based on the S&P 500 as we know it today.

Supplementary charts

Asset performance around elections and first Fed rate cuts when the global financial crisis and pandemic episodes are excluded.

Figure 8a: US asset performance at elections (%)

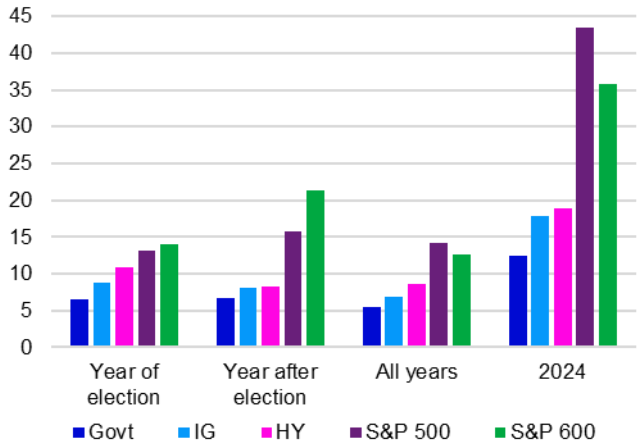
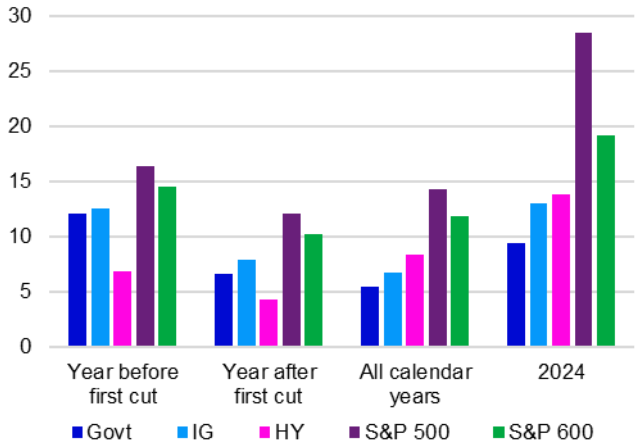


Figure 8b: US asset performance & Fed easing (%)



Notes: **Past performance is no guarantee of future results**. The charts show total returns in US dollars. "Govt" is based on the ICE BofA US Treasury Index; "IG" is based on the ICE BofA US Corporate Index and "HY" is based on the ICE BofA US High Yield Index. Figure 1a is based on monthly data from 31 October 1987 to 30 September 2024 and shows average returns in presidential election years since 1988 (with years defined as running from 31 October in the preceding year to 31 October of the election year), compared to the returns in the year after the election (defined as being from 31 October in the election year to 31 October in the following year). "All years" shows the average return across all years since 1988 (with years running from 31 October, starting on 31 October 1987). "2024" shows the annualised return from 31 October 2023 to 30 September 2024. Figure 1b is based on daily data from 1 June 1988 to 18 September 2024 and shows average returns in the years before and the years after the day before the first interest rate cut in Fed easing cycles (the focus is on interest rates and not quantitative easing). "All calendar years" shows the average return across all calendar years from 1988 to 2024 (the latter is the annualised return up to 30 September 2024). "2024" shows the returns in the year before the 18 September 2024 Fed rate cut. See appendices for dates of the first interest rate cut in Fed easing cycles. **These charts exclude the elections and rate cutting cycles that occurred during the global financial crisis and the Covid Pandemic (the "All years" and "All calendar years" data also exclude those periods).**
Source: ICE BofA, S&P Dow Jones Indices, LSEG Datastream and Invesco Global Market Strategy Office

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

Your capital is at risk. You may not get back the amount you invested.

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Authors

Paul Jackson
Global Head of Asset Allocation Research
paul.jackson@invesco.com
London, EMEA

Global Market Strategy Office

Kristina Hooper
Chief Global Market Strategist
kristina.hooper@invesco.com
New York, Americas

Ashley Oerth
Associate Global Market Strategist
ashley.oerth@invesco.com
London, EMEA

Brian Levitt
Global Market Strategist, Americas
brian.levitt@invesco.com
New York, Americas

James Anania
Investment Strategy Analyst, Americas
james.anania@invesco.com
New York, Americas

David Chao
Global Market Strategist, Asia Pacific
david.chao@invesco.com
Hong Kong, Asia Pacific

Thomas Wu
Market Strategy Analyst, Asia Pacific
thomas.wu@invesco.com
Hong Kong, Asia Pacific

Tomo Kinoshita
Global Market Strategist, Japan
tomo.kinoshita@invesco.com
Tokyo, Asia Pacific

Arnab Das
Global Macro Strategist
arnab.das@invesco.com
London, EMEA

Paul Jackson
Global Head of Aset Allocation Research
paul.jackson@invesco.com
London, EMEA

András Vig
Multi-Asset Strategist
andras.vig@invesco.com
London, EMEA