

Alternative opportunities

2025 outlook and methodology | USD | Q1 update

Invesco Solutions



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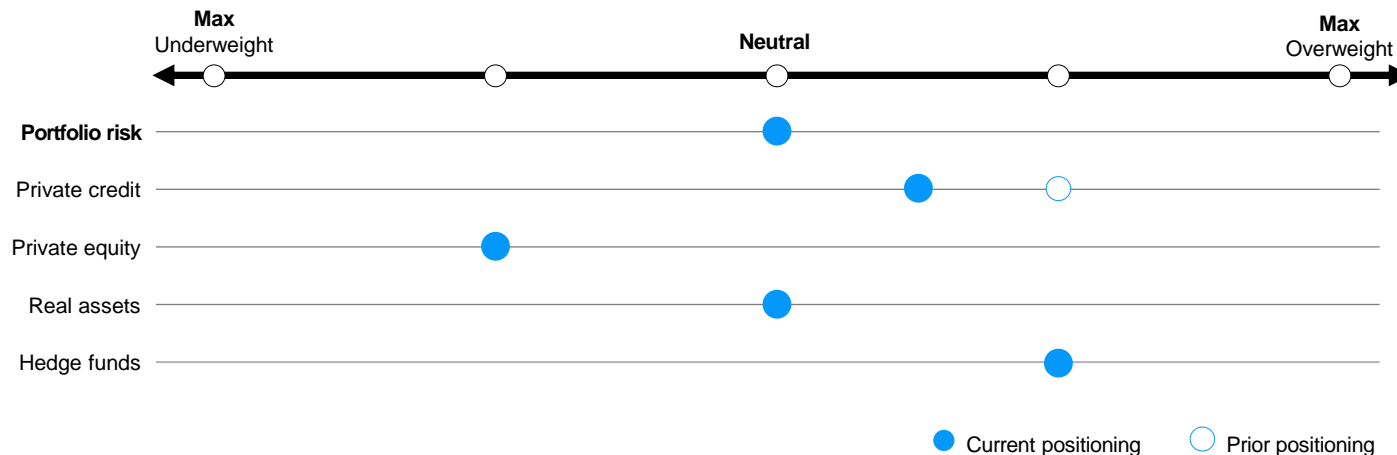
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2025 alternative opportunities – Q1 outlook: Alternatives

Executive summary



Jeff Bennett, CFA
Head of Manager Selection
Invesco Solutions



Portfolio risk

We remain neutral on how we're allocating risk within our alternatives portfolio due to elevated downside growth risks, high equity valuations, and benign capital markets activity. In general, we're more defensive, favoring private debt and hedged strategies versus private equity.

Private credit

We remain constructive on the backdrop for direct lending in 2025, given macroeconomic and anticipated deployment tailwinds.

Real estate credit remains our preferred way of accessing real estate markets, with the anticipation of a bottoming of valuations coming in 2025.

Private equity

PE exit activity appears to be improving this year from cycle lows on the backdrop of an improved financing environment with lower interest rates and less regulatory uncertainty. Deal activity is also anticipated to improve, given lower funding rates and a more robust lending environment. Growth strategies are still favored.

Real assets

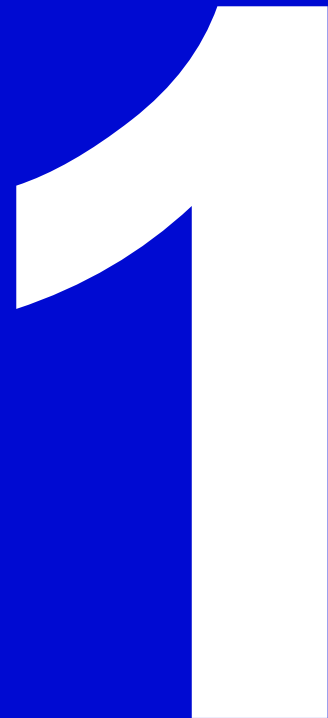
Key to our outlook for 2025 is the fact that global interest rates have started to decline, increasing confidence in real estate markets and enabling a recovery in transaction volumes. Private market values have continued to fall while public market prices have started to recover, leading us to anticipate a recovery of private property values.

Hedge funds

Spreads within event-driven strategies remain high despite limited capital market activity from mergers and acquisitions as private equity remains sidelined. Trend-following strategies have historically benefited from a tailwind during periods of high and declining rates.

Private credit

Direct lending
and real asset debt



2025 alternative opportunities – Q1 outlook: Private credit



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Ron Kantowitz
Head of Direct Lending
Invesco Private Debt



Charlie Rose
Global Head of Commercial
Real Estate Credit

Presently overweight private credit however spreads continue to compress across public and private credit markets

Asset class	Overall	Valuations	Fundamentals	Secular trend
Direct lending	Overweight	Neutral	Neutral	Attractive
Real asset credit	Overweight	Attractive	Neutral	Attractive
Alternative credit	Overweight	Neutral	Neutral	Attractive

Market overview

The Federal Reserve (Fed) has embarked on its first rate cut cycle since 2020, and we have entered a new macroeconomic environment with lower base rates starting to reduce the all-in yields of floating rate assets. Spreads have continued to tighten due to the high demand for credit and benign levels of defaults under the assumption of a soft landing. We anticipate this increased certainty will improve pricing discovery and aid in stimulating M&A transactions.

Direct lending

We remain constructive on the backdrop for direct lending in 2025, given meaningful macroeconomic and anticipated deployment tailwinds. We expect all-in yields in direct lending to remain well above historical levels and offer a compelling risk and return value proposition. Core middle market direct lending continues to prioritize asset selection, strong documentation and moderate leverage.

Distressed debt and special situations

We believe 2025 is setting up favorably for the small-capitalization distressed credit and special situations opportunity set. Almost half of these firms are burdened with greater cash interest expense than free cash flow generated by their operations. Interestingly, many of these businesses are strategically and operationally sound, managed by excellent teams, with backing from highly respected sponsors, making them great candidates for attractive capital solutions with materially less risk than prior vintages.

Commercial real estate debt

We believe, given the macroeconomic backdrop, that we have seen the bottom of transaction pricing across all real estate sectors, as evidenced by the significant bounce in pricing over the past quarter, even in office. A continuation of cuts would help lenders and borrowers alike with debt service coverage and drive demand into the oversupplied life science sector. While rate cuts will lower dividend yields, the strategic use

of interest rate floors has minimized the impact on the asset class historically.

Infrastructure debt

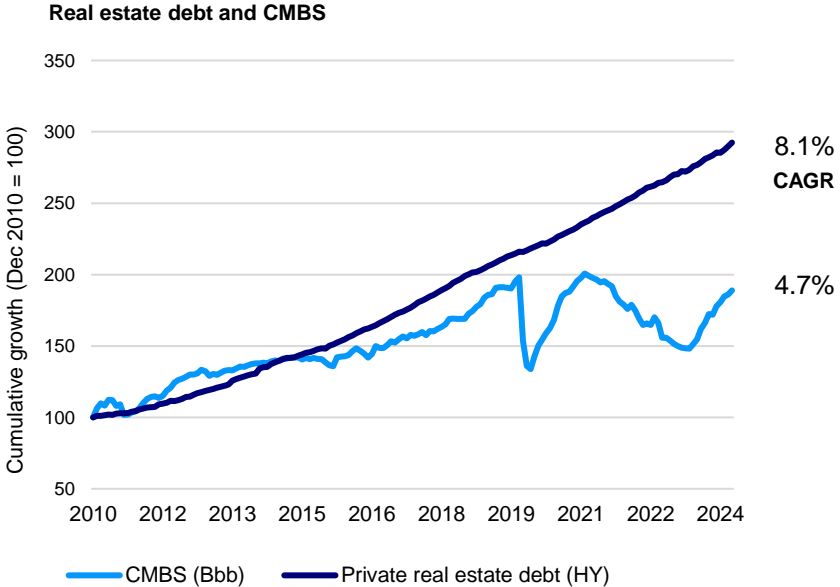
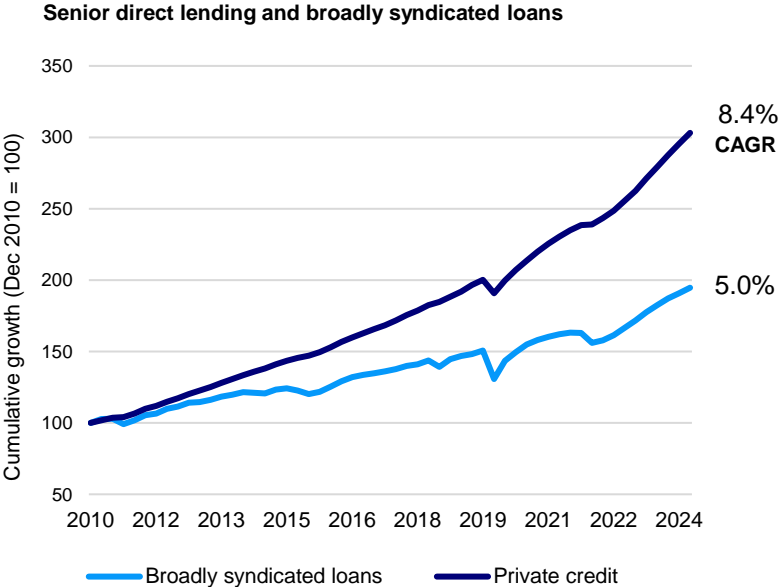
Spreads remain attractive, driven in part by secular infrastructure tailwinds* resulting largely from the convergence of two powerful themes in digitation and energy transition; we have seen some return compression along public market credit spreads. We believe the space offers diversification, exposure to contracted revenues, and an ability to access several long-term secular growth themes.

Alternative credit

While absolute yields remain attractive relative to longer-term averages, and pockets of outsized return opportunities exist in areas such as venture lending, the space is becoming more competitive, resulting in modest spread compression. Despite this trend, the diversification benefit provided via exposure to amortizing debt strategies is still attractive as part of a broader portfolio.

Sources: Invesco Solutions, Invesco Private Credit, Invesco Real Estate Credit, views as of Dec. 31, 2024. *See real assets section for more detail on the secular trends in infrastructure.

Cumulative growth of private credit vs. public credit



Sources: Investment growth of 100; Private credit represented by the Cliffwater Senior Direct Lending Index and broadly syndicated loans represented by the Credit Suisse Leveraged Loan Index, quarterly from Dec. 2010 to Sept. 2024; CMBS (BBB) represented by Bloomberg Non-Agency Investment Grade CMBS: Bbb Total Return Unhedged Index and private real estate debt (HY) represented by the Giliberto-Levy High Yield Commercial Real Estate Debt Index (G-L 2), monthly, from Dec. 2010 to Sept. 2024. Private credit is net of normative fees, while loans are gross of fees. An investment cannot be made directly into an index. **Past performance does not guarantee future results.**

Views on private assets: Private credit

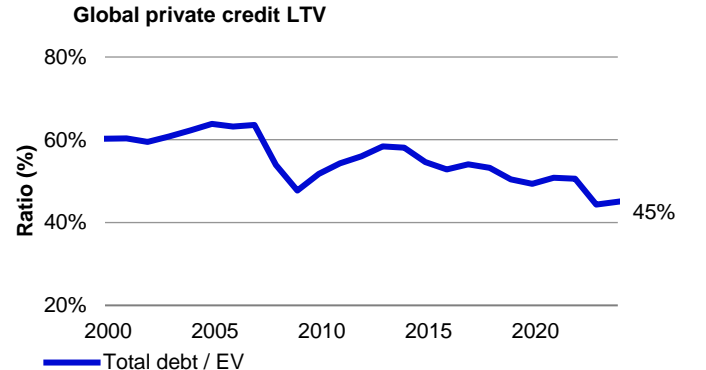
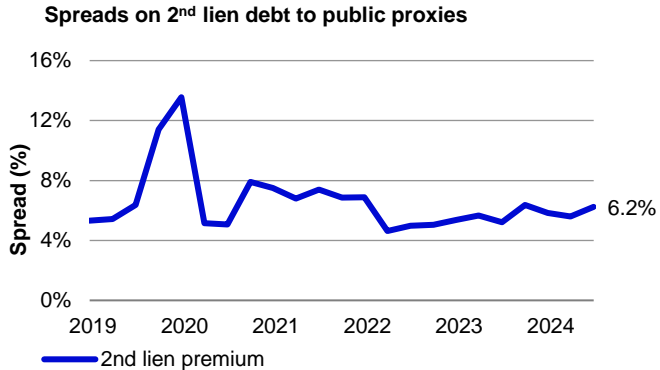
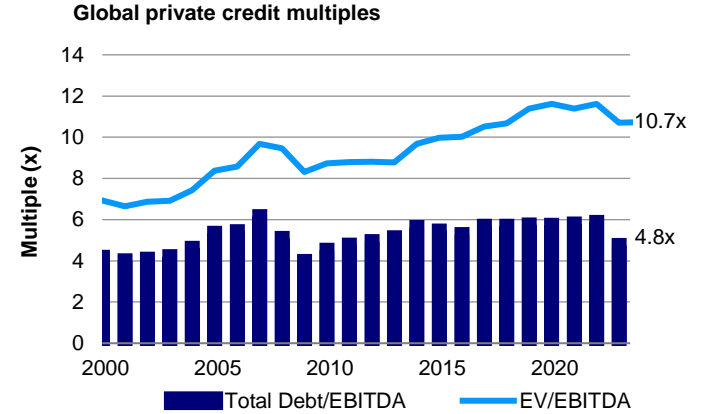
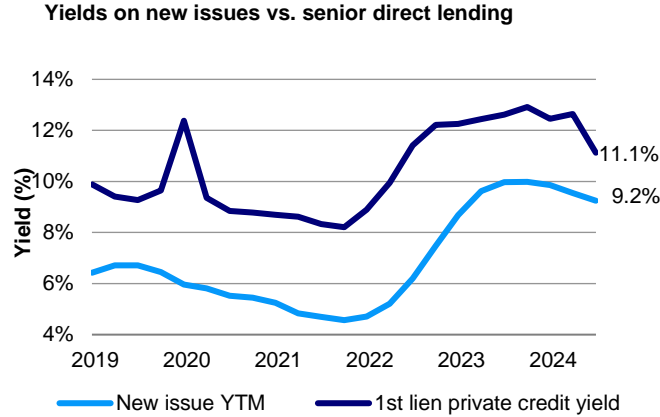
Investment type	Spread (SOFR+, bps*)	Allocation range			Comments
		Underweight	Neutral	Overweight	
Direct lending senior (1st lien)	550-650				<ul style="list-style-type: none"> Anchor for diversified private debt portfolios. Favorable environment for creditors, with strong covenants and call protections.
Direct lending junior (2nd lien/mezz)	800-1000				<ul style="list-style-type: none"> Borrowing that occurs behind senior/1st lien private corporate debt. Potential for opportunistic financing with attractive risk/reward.
Real estate debt (Whole loan/mezz)	350-500 / 600-800				<ul style="list-style-type: none"> Mortgage secured by a lien on a commercial property. High single-digit, low double-digit returns with conservative terms and modest LTVs. Low CMBS issuance and pullback from US regional banks have improved opportunity.
US infrastructure debt (HY)	550-650				<ul style="list-style-type: none"> Current environment allows for 1st lien secured Opco loans. Long-term contractual cash flows, CPI linkages, and lower defaults/higher recoveries. Secular trends driving growth in digital and renewables sectors and limited competition from regional banks drive favorable supply-demand dynamics.
Alternative credit	600-1000				<ul style="list-style-type: none"> Non-traditional markets such as loans, leases and other receivables. Asset-backed nature of collateral and amortization schedules enhances protection. Provides diversification and relies on current income.
Venture debt (1st lien)	1000+				<ul style="list-style-type: none"> Loans to well-capitalized venture-backed borrowers with LTVs typically below 20%. Limited access to IPO markets and increased cost of capital for venture equity drive favorable pricing and higher creditor protections.
Distressed debt/special situations	1000+				<ul style="list-style-type: none"> Focus on capital solutions and special situations opportunities. We see many small companies pressured by higher rates and inflation looking for capital solutions.

● Current positioning ○ Prior positioning

Valuations and fundamentals:

1st lien private credit – new issue YTM and leverage ratios

Spreads on offer to 1st lien lenders are attractive on an absolute, relative, and risk-adjusted basis.

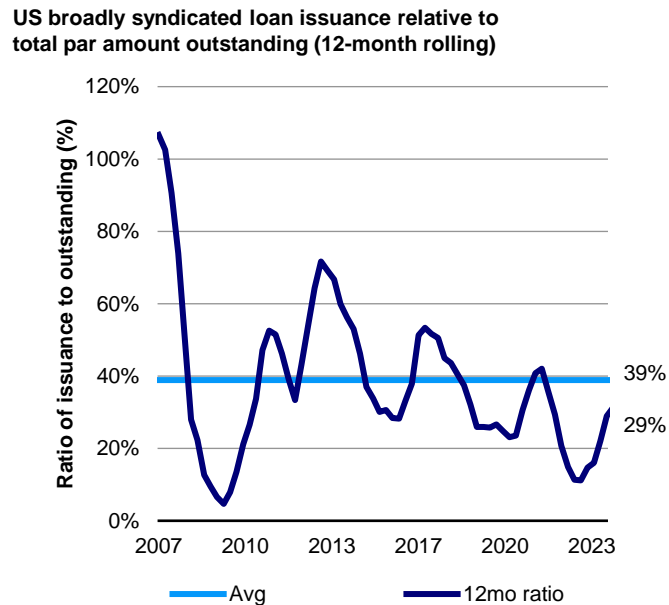
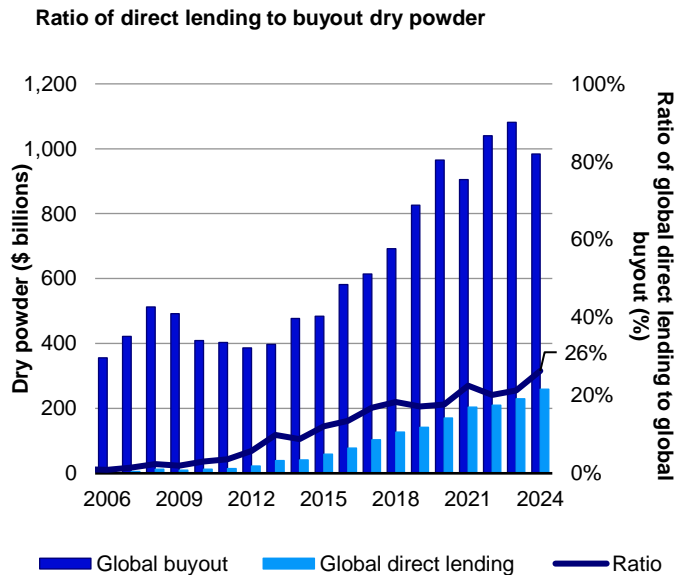


Sources: Pitchbook, LCD Leveraged Loan, SEC EDGAR, JPMorgan, Bloomberg L.P., as of Sept. 30, 2024. Most recent global multiples and LTV data presented as a YTD figure as of Aug. 31, 2024. New issues refer to broadly syndicated loans over \$200M issued within the quarter and presented as a 4Q moving average. 2nd lien spread over LIBOR estimates based on SEC filings by a representative sample of BDCs and is calculated by subtracting an HY corporate bond yield based on Option-Adjusted Spread on BBG US Corp HY Index.

Supply-demand dynamics

Direct lending and buyout dry powder and loan issuance

Supply-demand dynamics support a robust environment for lenders with available dry powder. While still not at average levels, 2024 has shown a notable uptick in broadly syndicated loan volume as markets reopened.

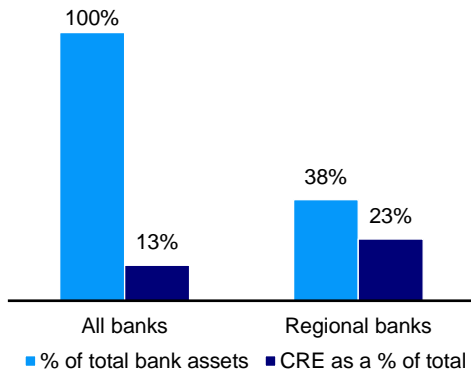


Sources: Invesco Solutions, Preqin, Pitchbook LCD, data as of Sept. 30, 2024.

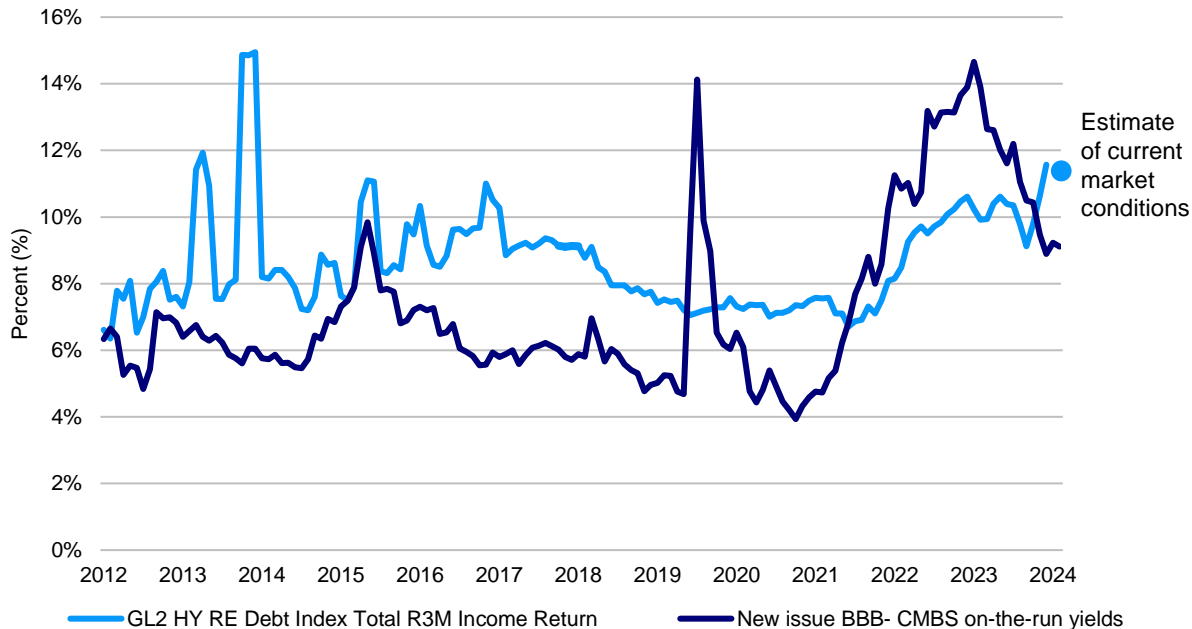
Real estate credit

High absolute yields and “illiquidity premium” supported by a reduced supply of loans from regional banks.

Regional banks as a percentage of CRE loans



Real estate credit yields compared to proxy new issue BBB- CMBS new issue on-the-run yields

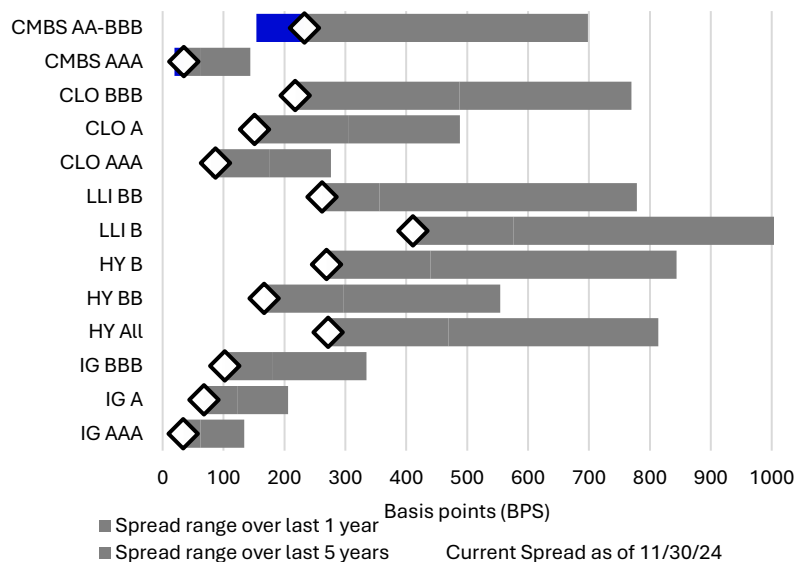


Sources: Invesco Solutions, Gilberto-Levy, FDIC, Bloomberg L.P., as of Sept. 30, 2024. Regional bank data as of June 30, 2024. Regional banks defined as “Assets \$1B - \$250B.”

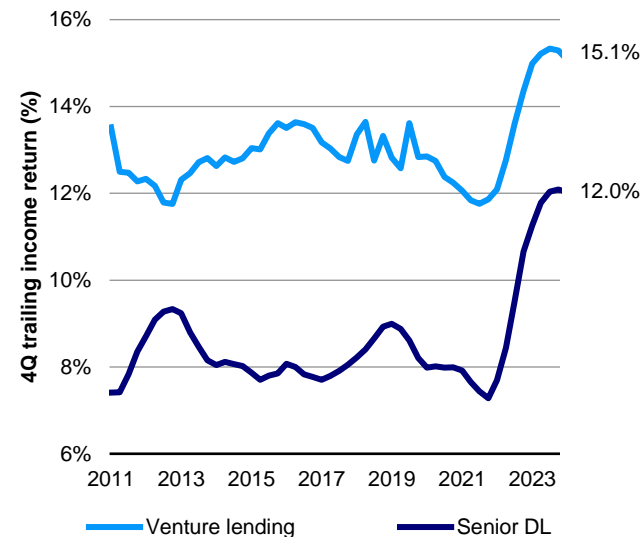
Alternative credit

While spreads across most liquid markets have tightened significantly relative to recent history, spreads on alternative credit strategies remain wide compared to traditional corporate credit. The more illiquid parts of the alternative credit market, such as venture lending, are still offering a spread premium.

Liquid alternative spreads (current, 1-year and 5-year ranges)



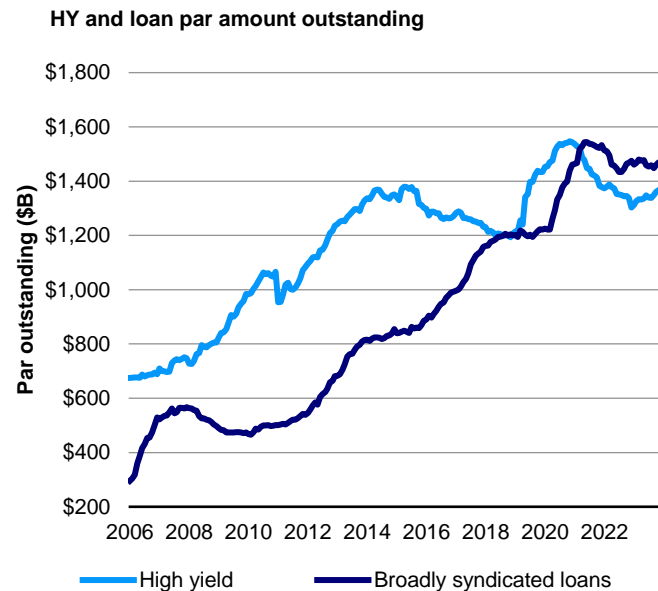
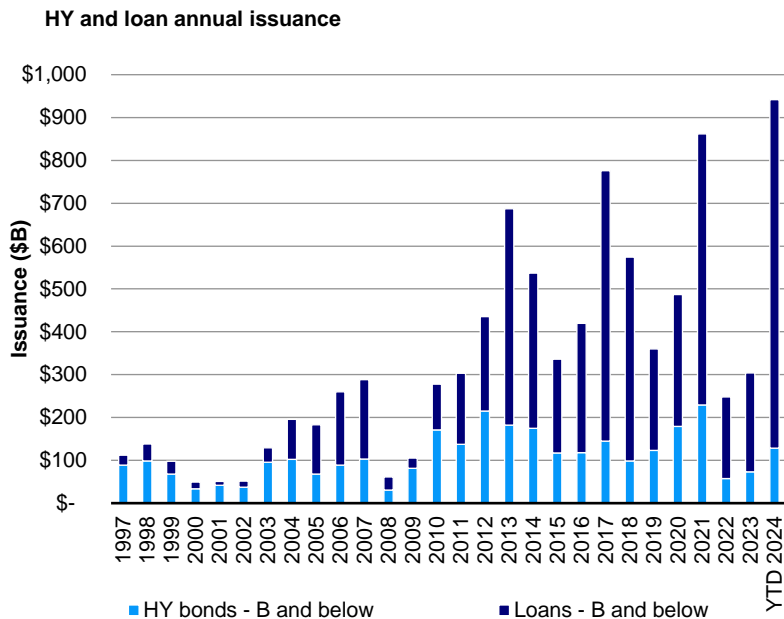
Venture lending vs., senior direct lending income return



Sources: Invesco Solutions, Bloomberg L.P., FRED, ICE, Morningstar, JPM, as of Nov. 29, 2024. Cliffwater, as of Sept. 30, 2024. IG, HY, CMBS, and ABS spreads are OAS to spot Treasury, LL is spread to maturity over SOFR, and CLO is discount margin to SOFR.

Distressed

Significant issuance in the loan market rated single B and below, showcasing the opportunity set relative to history.



Sources: Invesco Solutions, ICE BofA, JP Morgan, as of Nov. 30, 2024.

Private equity
Large buyout

2

2025 alternative opportunities – Q1 outlook: Private equity



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Head of Manager Selection
Invesco Solutions

Underweight private equity (PE) as valuations are moderating, with pockets of opportunity in private-to-private transactions

Asset class	Overall	Valuations	Fundamentals	Secular trend
Private equity	Underweight	Unattractive	Neutral	Neutral

Doors begin to open for exit opportunities

The median holding period for private equity-backed portfolio companies in 2024 has reduced to 5.8 years from 7 years in 2023, closer to the average we have seen post-COVID-19, giving some hope for a more normal exit environment and improvement in dealmaking. Exit activity has remained at cycle lows for the past three years, plagued by high interest rates and limited transaction options for PE managers. IPO volume is still near record lows as public valuations have remained high; however, we are witnessing some improvement in announced IPOs, showing signs of healing towards pre-pandemic levels of exit count and value. For now, sponsor-to-sponsor exits are the preferred path versus public listings or

corporate acquisitions. Tightening in credit spreads within the direct lending market and improvement in leveraged loan volume should aid in price discovery and allow for improvements in transactions. With election uncertainty in the rearview and the anticipation of a less burdensome regulatory environment from the new administration in the US, we may see the appetite for dealmaking increase into the new year.

Take private valuations have risen

A higher conviction for a soft landing has proliferated through markets with high growth and falling base rates, leading to higher public market valuations. We have seen a collapse in take-private volumes in the past few quarters, which are now near the long-term average.

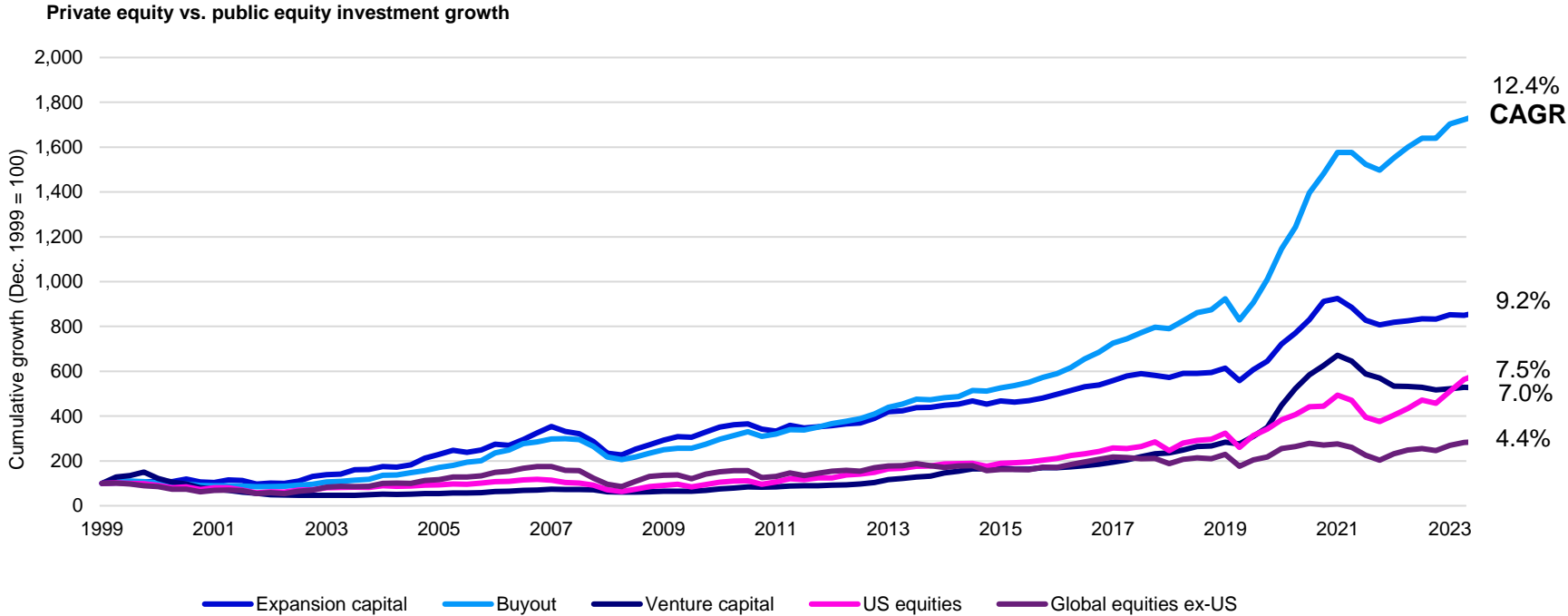
Beyond some large take-private deals, PE valuations are recovering as sellers are bringing their most attractive opportunities to market. This trend may be unsustainable as deal activity broadens to inevitably include less attractive inventory.

Continued focus on growth

Returns for large buyouts have performed well despite the challenges facing the asset class. We anticipate growth equity and expansion capital to outperform, given significant investor demand for equity-financed deals versus those that are backed by expensive debt. Venture capital has begun to recover as valuations outside of AI have begun to expand.

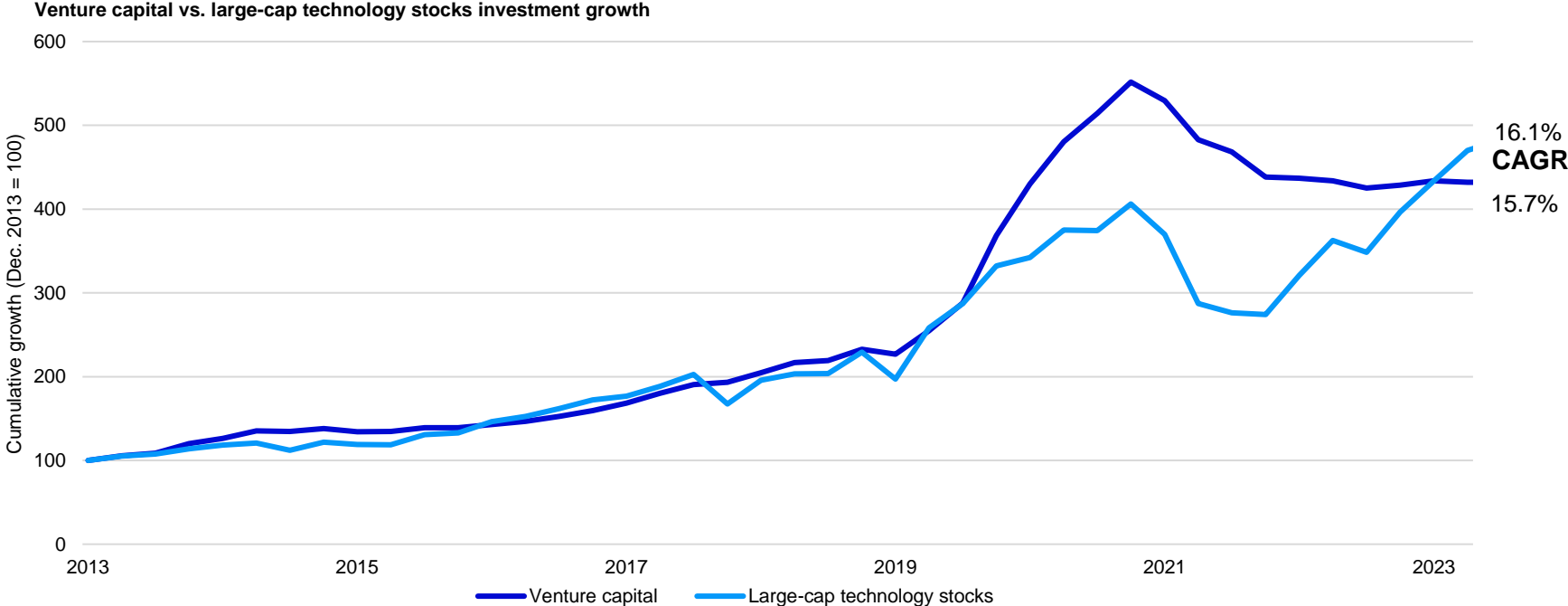
Sources: Invesco Solutions, Pitchbook, views as of Dec. 31, 2024. For reference Invesco Vision uses a proxy for private equity large buyouts, combining US Private equity large buyout private factor and public exposure from MSCI USA IMI index with beta set by Barra.

Cumulative growth of private equity vs. public equity



Sources: Investment growth of 100; Private asset index return data (large buyout, expansion capital, and VC / growth equity) from Burgiss and are net of fees; US equity returns represented by Russell 3000 TR index; Global ex-US equity returns represented by MSCI ACWI ex USA net TR index are gross of fees, quarterly from Dec. 1999 to June 2024, most current data available. **Past performance does not guarantee future results.**

Cumulative growth of venture capital vs. large-cap technology stocks



Sources: Investment growth of 100; Private asset index return data (VC) from Burgiss and are net of fees; Technology stocks represented by Nasdaq Composite TR Index are gross of fees, quarterly from Dec. 2013 to June 2024, most current data available. **Past performance does not guarantee future results.**

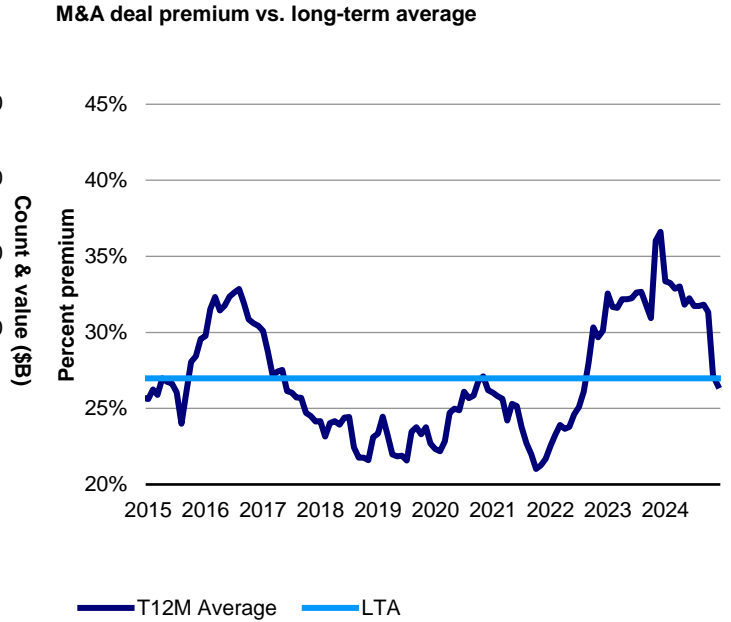
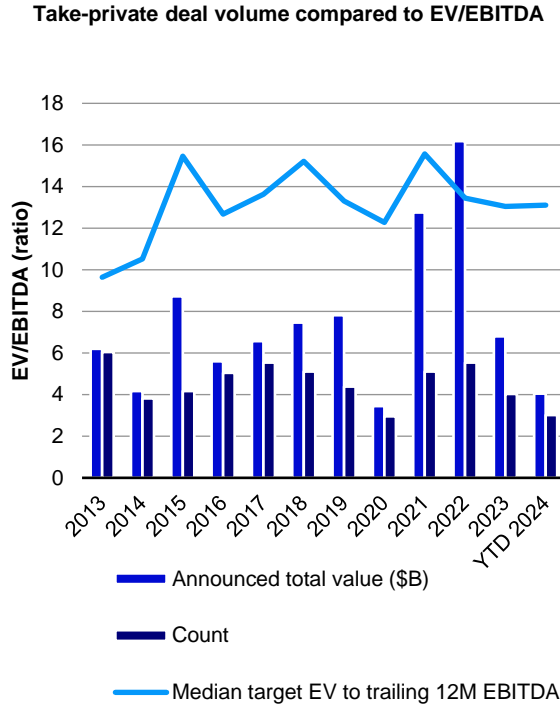
Views on private assets: Private equity

Investment type	Allocation range			Comments
	Underweight	Neutral	Overweight	
Large buyout				<ul style="list-style-type: none"> • Exposure to high quality companies backed by strong management teams. • Renewed opportunity for take-private transactions and private-to-private exits at favorable valuations balanced by headwinds from high cost of debt.
Growth/expansion equity				<ul style="list-style-type: none"> • Profitable franchises exposed to secular growth themes. • Less competition for deals from the IPO or SPAC markets. • Heightened focus on platforms.
Venture capital				<ul style="list-style-type: none"> • Exposure to a wide variety of disruptive technologies and secular growth themes at an early stage. • Challenging exit environment with the potential for a sustained period of “down rounds.” • Valuations have corrected meaningfully in recent quarters.
Secondaries				<ul style="list-style-type: none"> • Robust volumes. • Attractive discounts, particularly in venture and real estate. • Secular tailwinds in GP-led space.

Source: Invesco Solutions, views as of Dec. 31, 2024. For illustrative purposes only.

US large buyout take-private volume and EV/EBITDA valuations

Transaction volume has plummeted while premiums are reverting to their long-term averages from recent peaks.

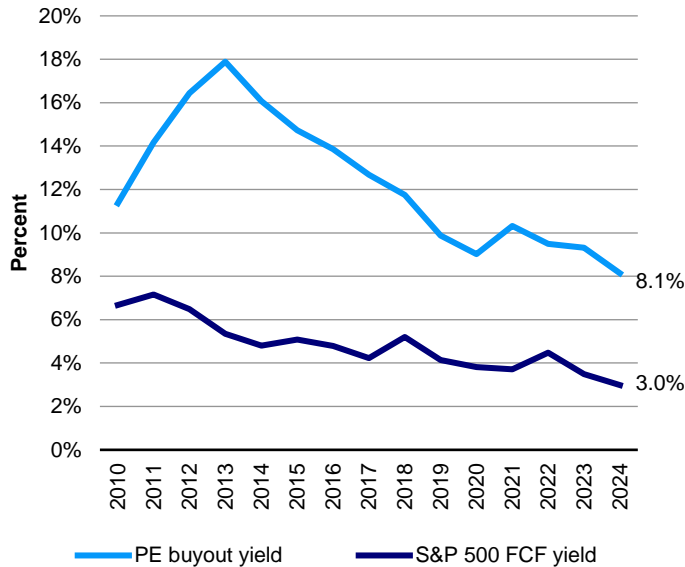


Sources: Invesco Solutions, Pitchbook, Bloomberg L.P., as of Nov. 30, 2024.

US large buyout vs. equity market yield

While purchase prices have moderated slightly, this is more than offset by elevated financing costs. We anticipate this pressure will ease as base rates are lowered.

Buyout yield vs. US equity market yield



Financing rates (SOFR)

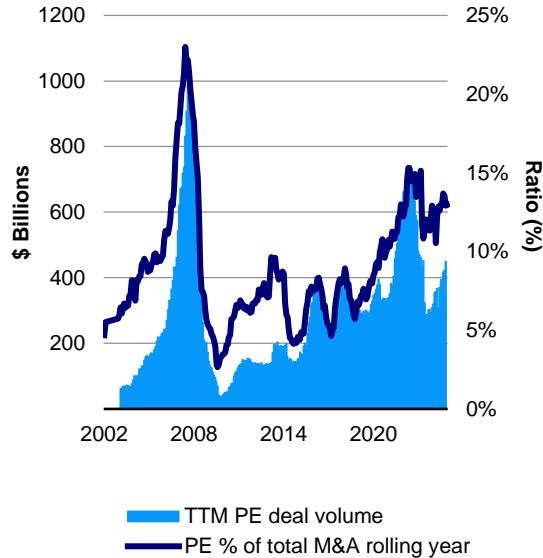


Sources: Invesco Solutions, Pitchbook LCD, Bloomberg L.P., as of Nov. 30, 2024.

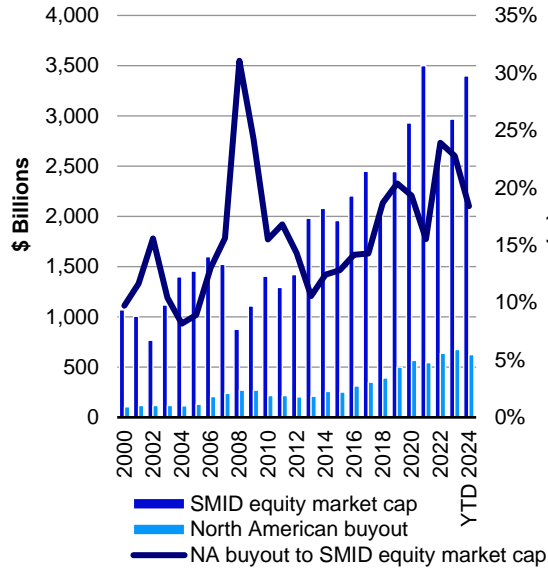
Buyout and IPO deal volume

Limited exit opportunities favor those with dry powder and should drive an increase in private-to-private deal activity

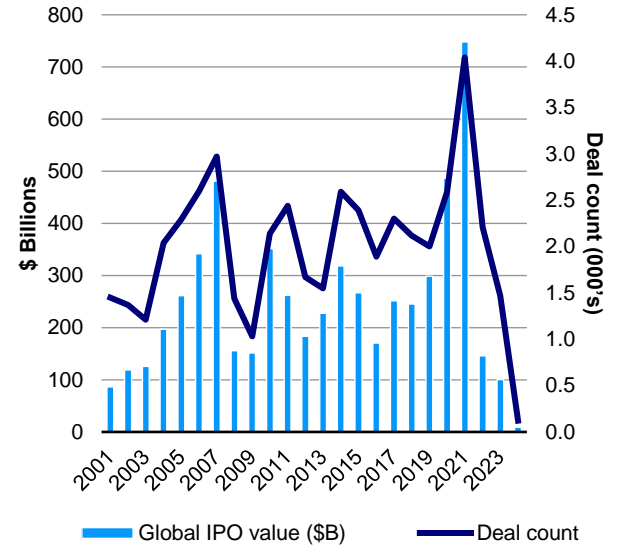
PE deal volume



PE dry powder to target's market cap



Trailing year IPO activity

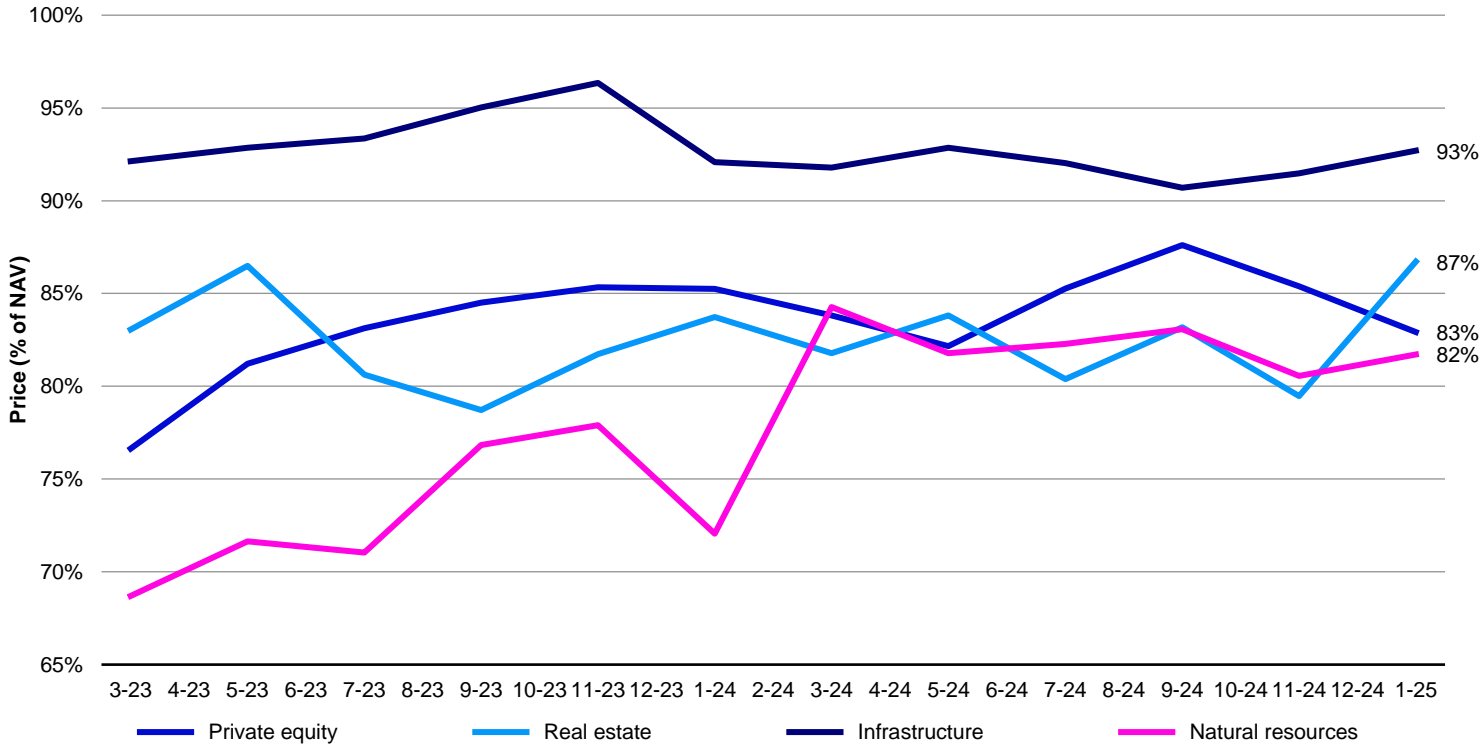


Sources: Invesco Solutions, Pitchbook, Preqin, Bloomberg L.P., latest data available, as of Nov. 30, 2024.

Secondaries pricing of private assets

While purchase prices have broadly stabilized, discounts remain elevated to long-term (pre-COVID-19) histories, particularly in real estate.

Price of secondaries as a percent of NAV



Source: SecondaryLink, as of Nov. 30, 2024.

Real assets

Real estate and
infrastructure

3

2025 alternative opportunities – Q1 outlook: Real assets



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Mike Bessell, CFA
MD, Investment Strategist
Invesco Global Real Estate

Neutral real assets, as valuations approach trough, starting to appear attractive in real estate

Asset class	Overall	Valuations	Fundamentals	Secular trend
Real estate	Neutral	Attractive	Neutral	Neutral
Infrastructure	Neutral	Unattractive	Attractive	Attractive

Real estate

The public REIT market can serve as a leading indicator for the private property market, especially during market peaks and troughs. Over the past year, private market values have continued to fall while public market prices have started to recover, leading us to anticipate a recovery of private property values. Key to our outlook for 2025 is the fact that global interest rates have started to decline, resulting in increasing confidence in real estate markets and pricing, enabling a recovery in transaction volumes.

In the current environment, investors must focus on the interplay of rental growth versus cap rate pressures and how these may differ across sectors and markets. Meanwhile, most global real estate markets continue to see robust income fundamentals. The key

exceptions are areas that are seeing a period of excess supply, either due to elevated deliveries, such as apartment markets in certain US metros, or a contraction in demand, such as we currently see in many office markets.

We believe that there will be ongoing opportunities to invest through 2025-26, driven by a combination of the roll-off of debt facilities signed at lower interest rates, existing owners needing to address regulatory changes around the efficiency of assets, and also funds seeking liquidity or closed-ended funds coming to the end-of-life and therefore needing to sell.

Infrastructure

Despite above-average valuations (which are lagging public markets), record levels of dry powder, and limited fundraising in private

infrastructure, an easing of policy and regulatory clarity post-election may provide a runway for investors to start deploying capital.

Secular tailwinds within infrastructure include:

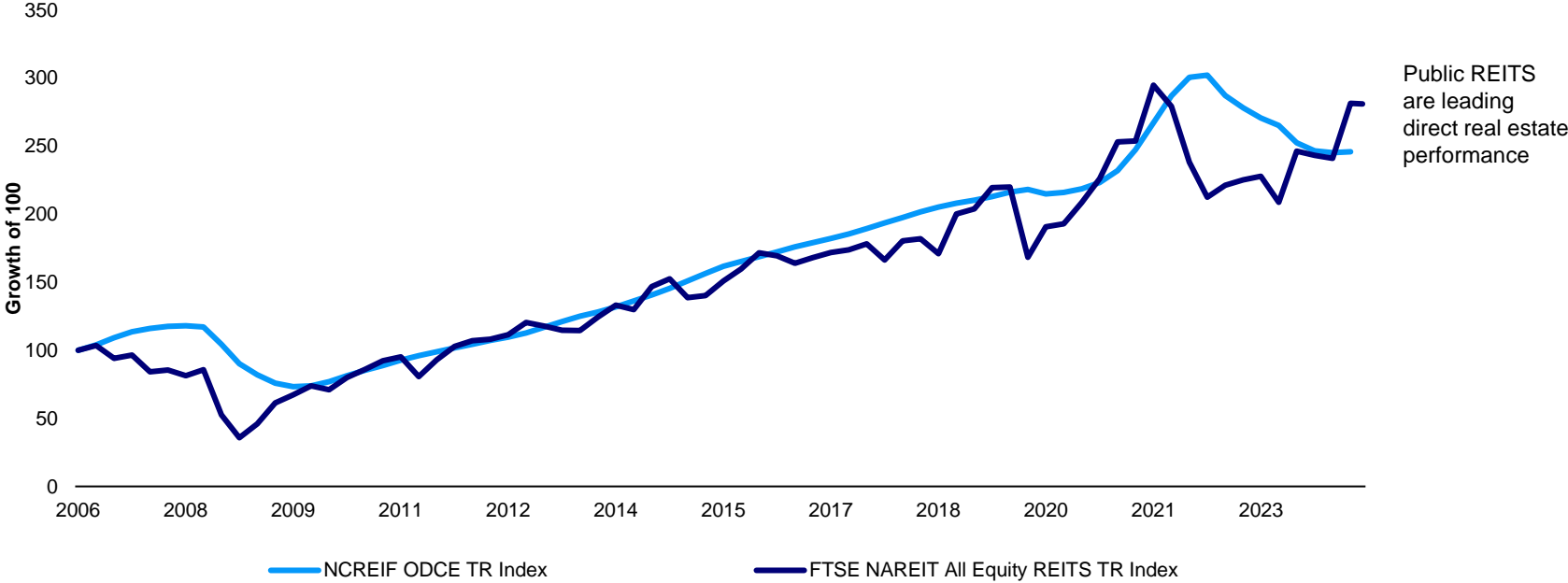
- Convergence of two primary secular themes in digital infrastructure and energy transition. Driven in part by the artificial intelligence, there is increasing demand for data centers, which also includes fiber, towers, and satellites.

- The data center buildout also requires power investments, which will accelerate the energy transition and require enhanced transmission infrastructure and additional traditional power generation investment.

- Continued strong fundamentals within the traditional sectors such as transportation and mid-stream.

Cumulative growth of listed vs. unlisted real estate

Listed and unlisted real estate performance 2006-2024, Dec. 2006=100



Source: Invesco Solutions based on data from NCREIF ODCE TR Index representing unlisted real estate performance, as of Sept 30, 2024, and FTSE NAREIT All Equity REITS TR Index representing listed real estate performance as of Nov. 30, 2024. Listed real estate is gross of fees while unlisted is net of fees. **Past performance does not guarantee future results**

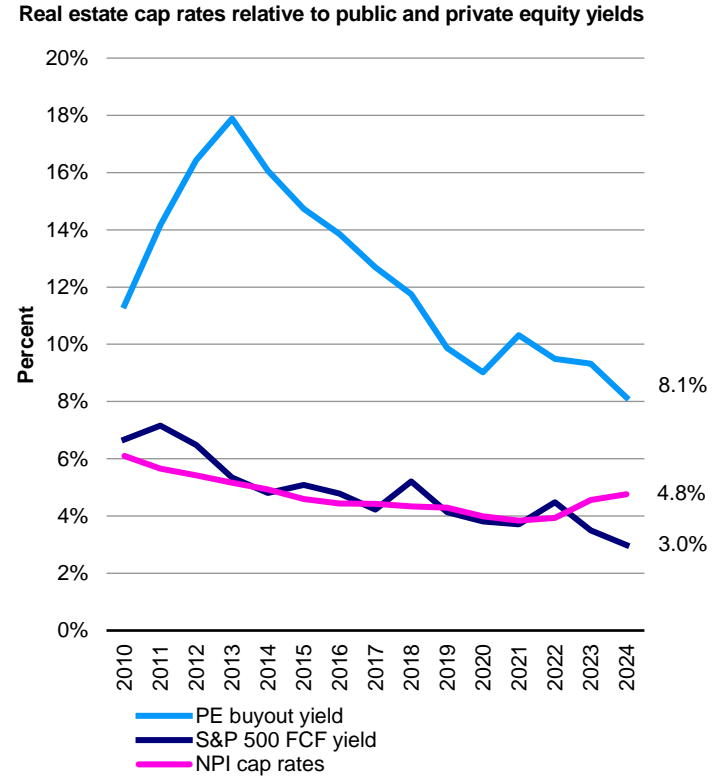
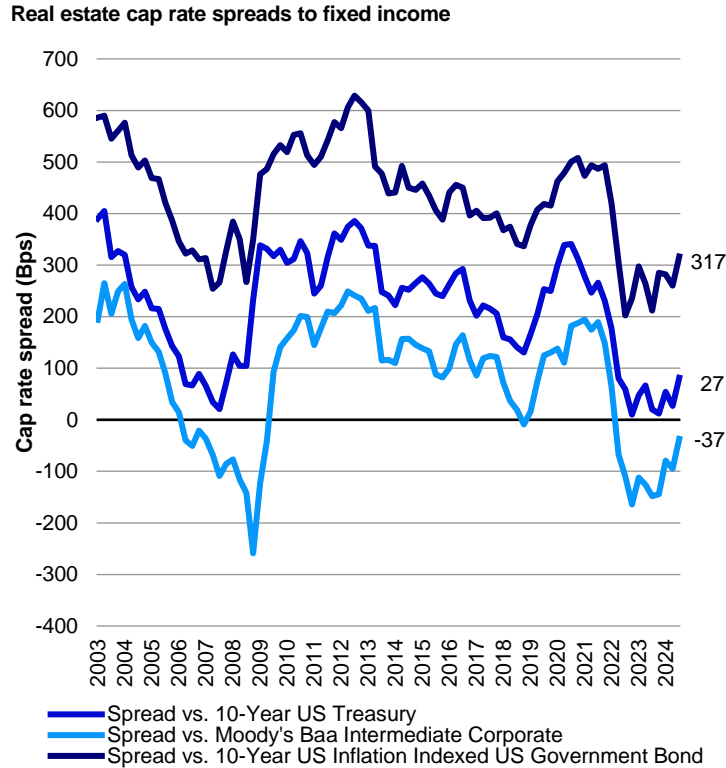
Views on private assets: Real assets

Investment type	Allocation range			Comments
	Underweight	Neutral	Overweight	
Real estate core				<ul style="list-style-type: none"> Public and private valuations have converged, and we expect the trough in valuations is imminent. Exposure to high quality real estate assets with stable current income. Potential headwinds to existing cap rates resulting from rapid rise in interest rates. Mixed outlook varies by sub-sector.
Real estate value add/opportunistic				<ul style="list-style-type: none"> Focus on dislocations in credit markets. High levels of economic and market volatility may create attractive opportunities.
Infrastructure core				<ul style="list-style-type: none"> Exposure to current inflation-linked income backed by long-term contracts and/or concessions. Broad-based fundamental tailwinds across sub-sectors balanced by high valuations.
Infrastructure value add/opportunistic				<ul style="list-style-type: none"> Includes exposure to brownfield and greenfield projects. Tailwind from secular growth themes (renewables, digital) and increased government support (IIJA).

Source: Invesco Solutions, views as of Dec. 31, 2024. For illustrative purposes only.

Real estate cap rate spreads

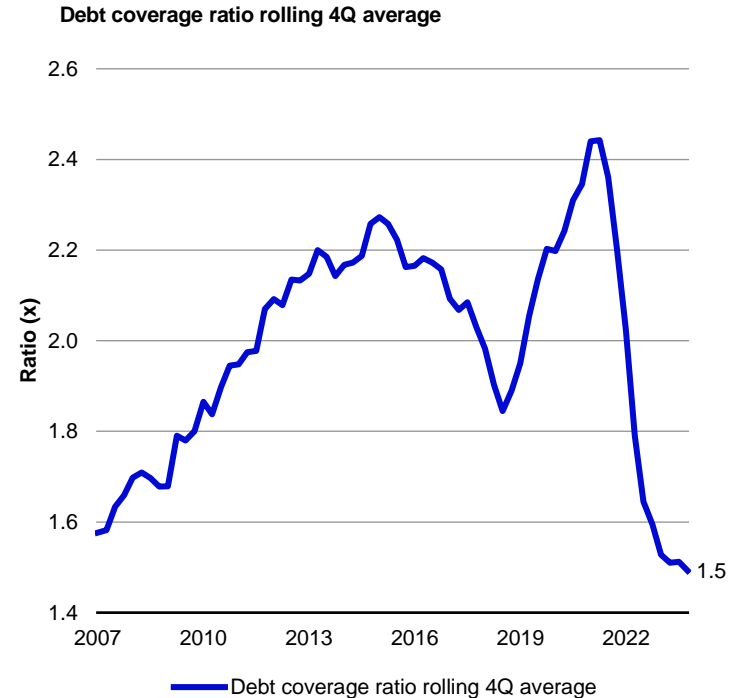
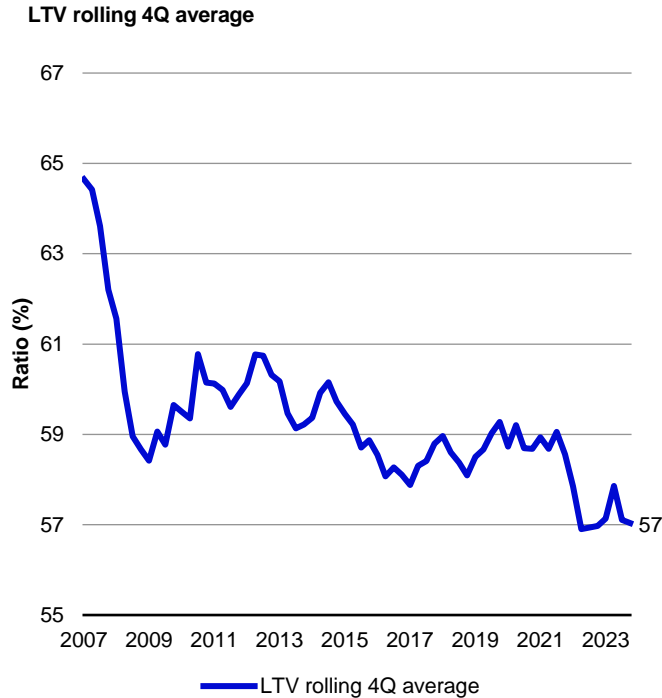
Direct real estate valuations remain elevated relative to other income-generating alternatives; however, they appear to have bounced from recent lows and stabilized. Cap rates relative to public equity yields are the most attractive they've been post-GFC.



Sources: Invesco Solutions, NCREIF, Moody's Analytics, S&P, Pitchbook LCD, as of Sept. 30, 2024.

Real estate leverage (loan-to-value, LTV) and debt coverage ratio

Modest levels of leverage in the system post-GFC should moderate systemic risk. We are currently monitoring interest coverage ratios.

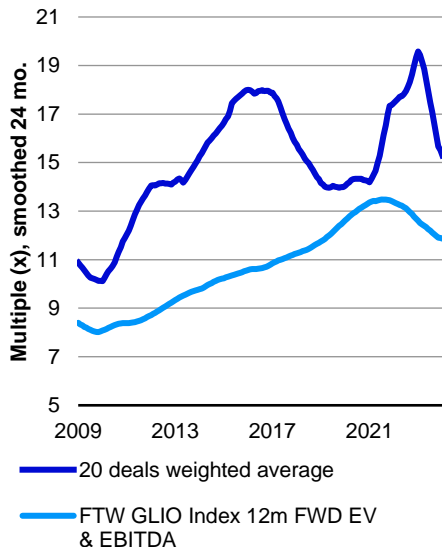


Sources: Invesco Solutions, NCREIF, Moody's Analytics, as of Sept 30, 2024.

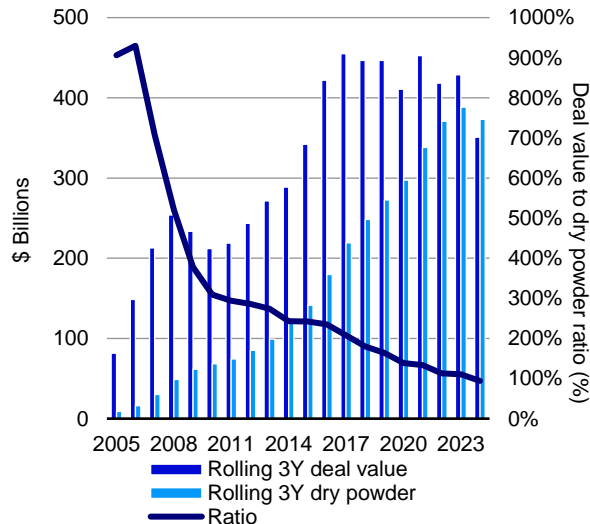
Infrastructure

Elevated valuations combined with robust dry powder are offset by an expanding opportunity set with long-term secular tailwinds

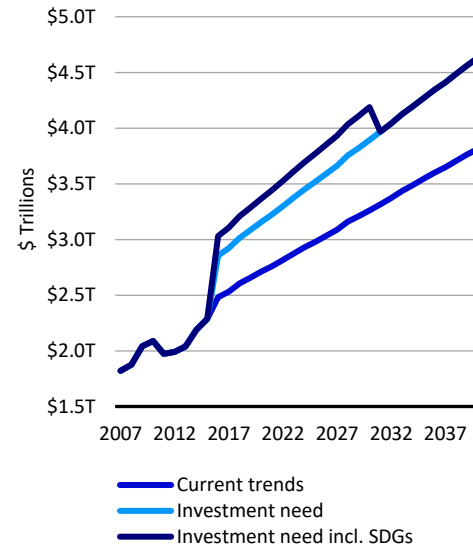
Infrastructure EV/EBITDA



Deal value to dry powder ratio



Investment need in infrastructure



Sources: Invesco Solutions, Pitchbook, Preqin, Global Infrastructure Hub, as of Nov. 30, 2024.

Hedge funds

Event-driven and
systematic trend

4

2025 alternative opportunities – Q1 outlook: Hedge funds



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Overweight hedge funds, given current levels of arbitrage spreads and a central bank easing cycle

Asset class	Overall	Valuations	Fundamentals	Secular trend
Event-driven and arbitrage	Overweight	Neutral	Neutral	Attractive
Systematic trend	Overweight	Neutral	Neutral	Attractive

Hedge funds

With low correlations to traditional assets and the possibility for higher-for-longer interest rates, we believe hedge funds are particularly attractive. Since hedge funds operate off a spread, elevated base rates provide a generous tailwind. While not our base case, a market correction due to a recession or inflation resurgence may prove hedge funds to be a valuable alternative within a portfolio.

Event-driven and arbitrage

Spreads within event-driven strategies remain high despite limited capital market activity from mergers and acquisitions as private equity remains sidelined. With the possibility of an improved corporate action environment due to aging private equity capital, lower interest rates and a clearer regulatory environment post-election, these strategies may have tailwinds into 2025.

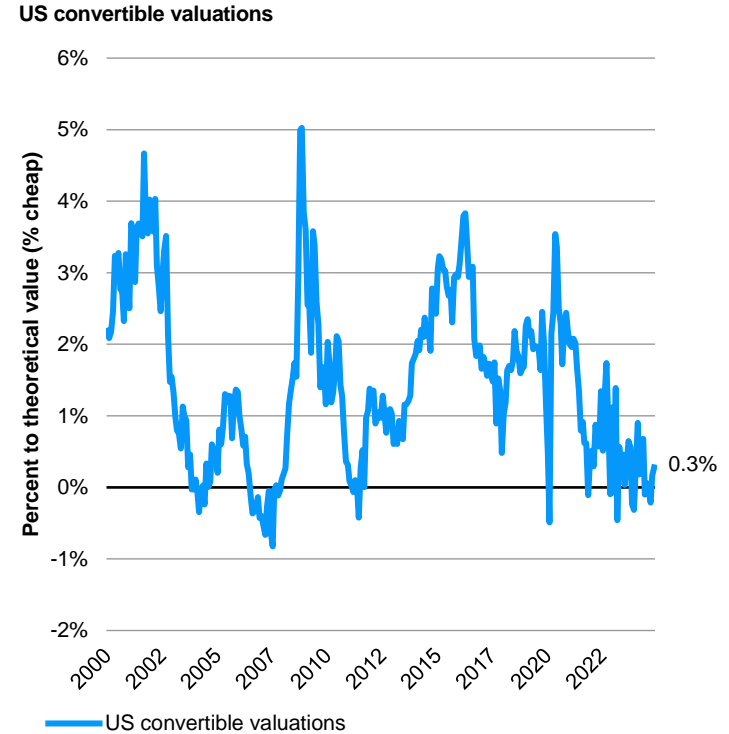
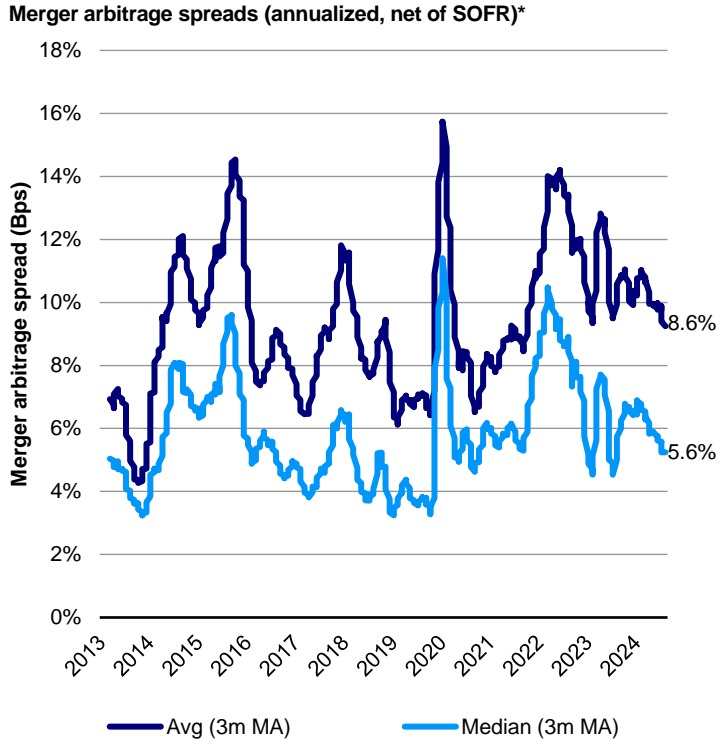
Systematic trend

With the Federal Reserve (Fed) beginning to cut interest rates from elevated levels, we analyzed how systematic trend strategies perform in this market environment. Our first finding is that trend strategies outperform when base rates are above average and falling. Additionally, the correlation of systematic trend funds to US equities is significantly negative as the fed funds rate is lowered, allowing for diversification benefits within asset allocations.

Source: Invesco Solutions, views as of Dec. 31, 2024.

Merger arbitrage and convertible arbitrage

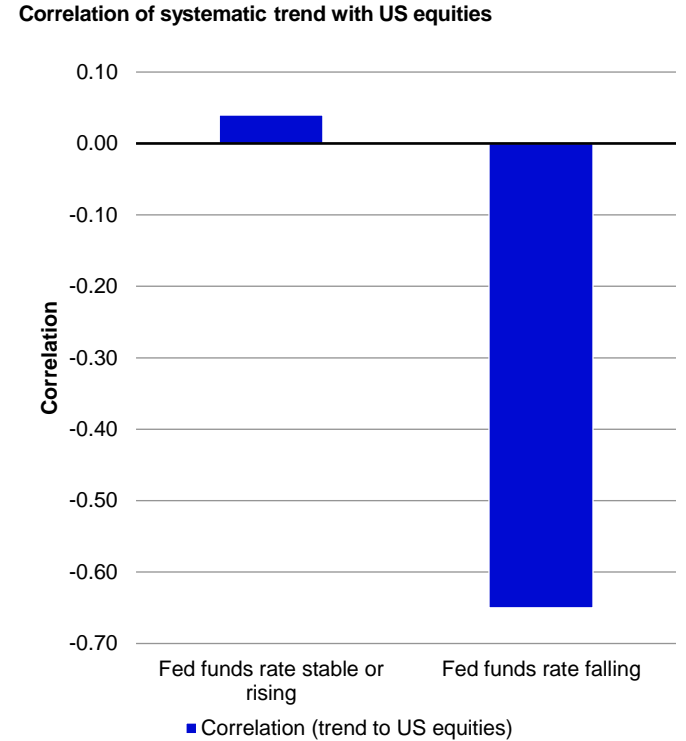
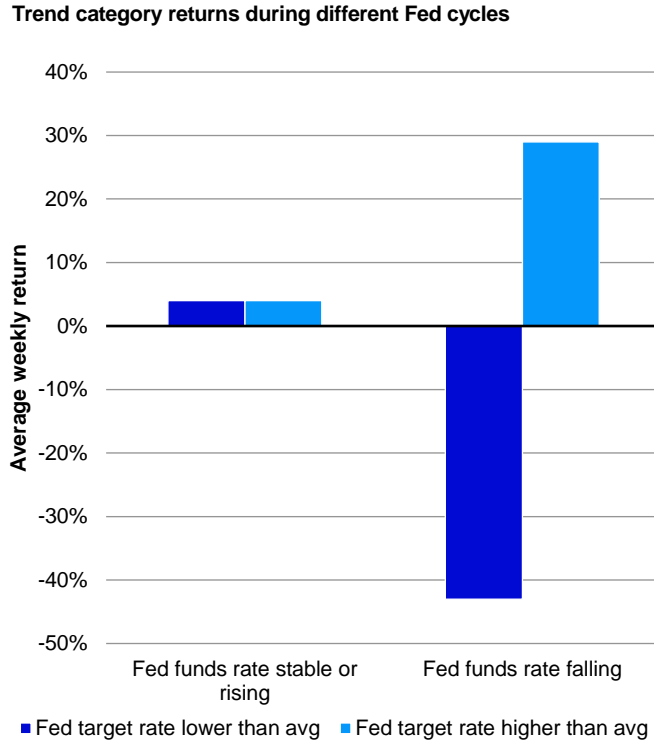
Spreads are wide on a variety of measures within merger arbitrage. Convertible valuations relative to theoretical value are slightly below average.



Sources: Invesco Solutions, UBS Special Situations, Moody's Analytics, S&P, Pitchbook LCD, latest data available as of Nov. 30, 2024. *Merger arbitrage averages and medians are only for definitive deals with more than 5 days to expected closing and impose a 0% floor and 50% cap.

Systematic trend

Trend strategies tend to outperform when base rates are above average and falling. Further, their correlations to US equities are significantly negative as the fed funds rate is lowered.



Sources: Invesco Solutions, Morningstar, Bloomberg LP., as of Nov. 30, 2024.

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