Invesco

Tactical Asset Allocation

Maintain defensive portfolio positioning. Overweight fixed income versus equities, favoring US equities over developed ex-US and emerging markets, defensive equity factors, higher duration and credit quality.

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Head of Investments,
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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.

Synopsis

- The December FOMC meeting delivered a significant shift in strategy by the Fed compared to the communication at Jackson Hole in August, with renewed focus and concern on inflation. Equity and bond market sensitivity to economic data is likely to increase in 2025.
- Our framework remains in a contraction regime. We maintain a cautious asset allocation versus benchmark, overweighting fixed income relative to equities, favoring US equities over developed ex-US and emerging markets, overweighting defensive sectors with quality and low volatility characteristics. In fixed income, we remain overweight duration and underweight credit risk. Maintain overweight to the US dollar.

Macro update

Market trades associated with the US election have begun to lose momentum and unwind earlier gains. US small and mid caps have given back all the outperformance over US large caps since election day, and over the past month, emerging market equities have outperformed US equities despite unremarkable economic performance and concerns around global trade policy. As we highlighted last month, these developments are reminiscent of the same pattern that followed the 2016 election, with markets focusing on newer and potentially more consequential developments.

The December FOMC meeting provided a noticeable break in the prevailing expectation for a long and gradual easing cycle. After delivering 100 basis points (bps) in rate cuts over the last three meetings, the FOMC effectively delivered a U-turn on its economic forecasts and expected policy path compared to Powell's Jackson Hole speech in August and the September FOMC meeting. Headline and core inflation statistics are no longer decelerating at the rapid pace experienced in 2023 and the first half of 2024. This, coupled with higher inflation uncertainty due to increased ambiguity regarding tariffs, global trade and immigration policies, has caused the Federal Reserve's inflation projections to "kind of fall apart," as described by Chair Powell. The FOMC made clear that any adjustments to policy rates will hinge on further progress in cooling price increases, expecting to deliver only two additional rate cuts in 2025 compared to earlier projections for four rate cuts. Equity and bond markets reacted negatively. This heightened inflation data dependence is a significant shift in strategy compared to the communication at Jackson Hole in August, where Powell stressed the increased confidence of the FOMC that inflation was on a sustainable path back to 2% while highlighting the urgency to focus on a weakening labor market. Following this backdrop, the sensitivity of equity and bond markets to economic data, both growth and inflation, is likely to increase meaningfully in 2025, potentially seeing the return of cyclical macro indicators as primary drivers of market performance.

Our barometer of global risk appetite has modestly improved over the past month but is yet to flag a sufficient rebound and inflection point in the cycle. However, global growth remains broadly stable around the world. Our macro framework remains in a contraction regime, signaling growth below-trend and decelerating growth expectations (**Figures 1**&**2**).

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Our macro framework continues to remain in a contraction regime, which is below trend growth and expectations for further deterioration in growth.

Figure 1a: Global macro framework remains in a contraction 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 deteriorating		**Contraction**
United States	**Below Trend**				**Contraction**
Developed markets ex-US	**Below Trend**				**Contraction**
Europe	Below Trend				Contraction
United Kingdom	Below Trend				Contraction
Japan	Above Trend				Slowdown
Emerging markets	**Below Trend**				**Contraction**
China	Below Trend				Contraction
Emerging markets ex-China	Above Trend				Slowdown

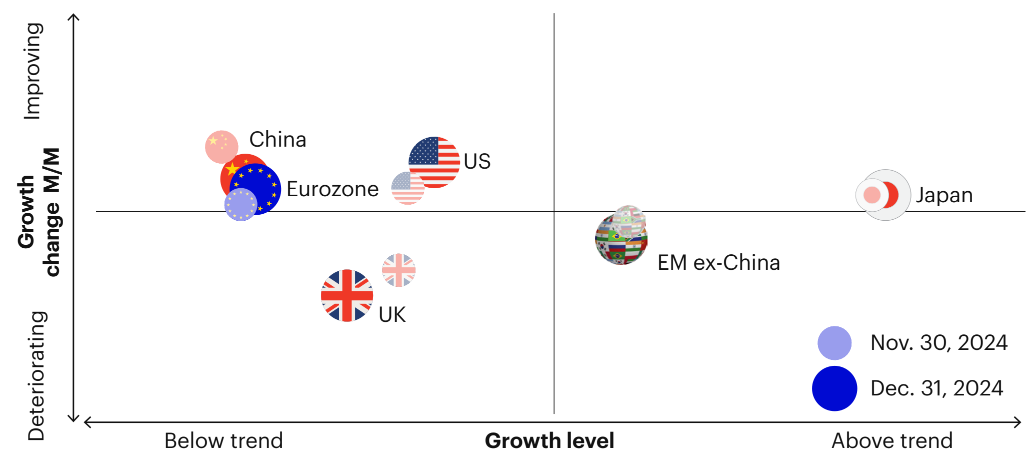
Sources: Bloomberg L.P., Macrobond. Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of Dec. 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global 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 contraction phase, with LEIs below their long-term trend and growth expectations deteriorating

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

Growth stabilization has been led by the US, though other significant economies have also seen improvement, specifically the Eurozone and China.

Figure 1c: Global growth is stabilizing, and recent laggards such as China and the eurozone are improving, alongside the US

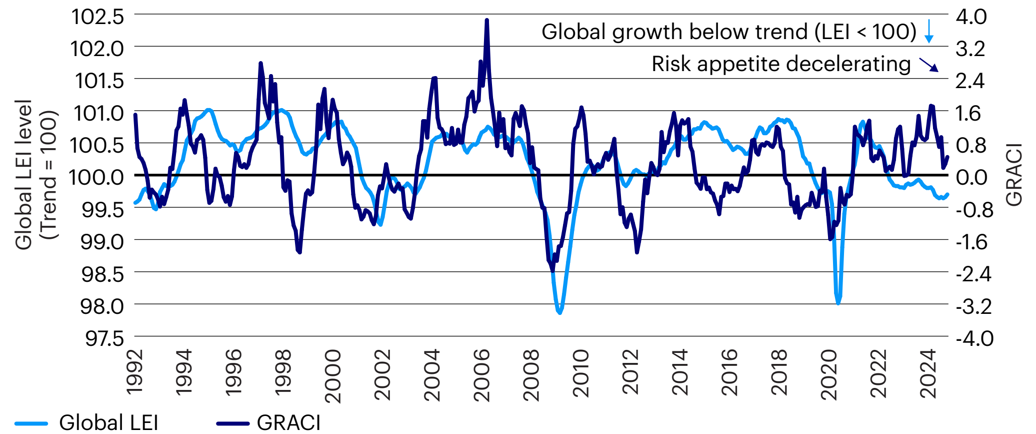


Sources: Bloomberg L.P., Macrobond. Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data, as of Dec. 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The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

Global growth has remained stable below trend as global risk appetite has yet to meaningfully break out of deceleration.

Figure 2: Global risk appetite is decelerating, and leading economic indicators remain stable and below the long-term trend

GRACI and Global LEI



Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Invesco Solutions research and calculations, from Jan. 1, 1992 to Dec. 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.**

There are no changes in portfolio positioning this month.

Investment positioning

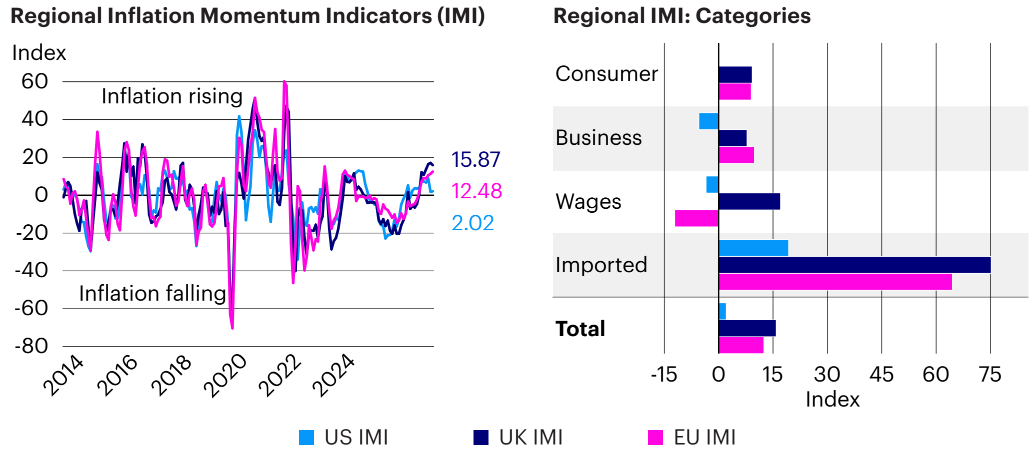
There are no changes in portfolio positioning this month. We underweight risk relative to benchmark in the Global Tactical Allocation Model,[1] underweighting equities relative to fixed income, favoring US equities and defensive sectors with quality and low volatility characteristics. In fixed income, we underweight credit risk[2] relative to benchmark and overweight duration via investment grade credit and sovereign fixed income at the expense of lower quality credit sectors. (**Figures 4** to **7**). In particular:

- In **equities**, we overweight defensive sectors with quality and low volatility characteristics, tilting towards larger capitalizations at the expense of value, mid and small caps. Despite the extended positioning in mega-cap quality names, we expect a combination of quality and low volatility characteristics to outperform and provide downside risk mitigation in a scenario of falling growth expectations, falling bond yields, and weaker equity markets. Hence, we favor exposures to defensive sectors such as health care, staples, utilities, and technology at the expense of cyclical sectors such as financials, industrials, materials, and energy. From a regional perspective, we maintain an overweight position in US equities relative to other developed markets and emerging markets, driven by declining global risk appetite, stronger US earnings revisions vs. the rest of the world, and a still favorable outlook for the US dollar.
- In **fixed income**, we underweight credit risk and overweight duration, favoring investment grade and sovereign fixed income relative to high yield. Credit spreads tightened further over the past month, clearly signaling resilience in credit markets. While the current backdrop does not suggest a major risk for credit spreads, downward revisions to growth expectations are likely to be accompanied by marginally wider spreads from cycle lows and lower bond yields, favoring higher quality and higher duration assets. In sovereigns, we maintain a modest overweight in inflation-protected securities versus nominal bonds **(Figure 3**).
- In **currency markets**, we maintain a moderate overweight in the US dollar, as yield differentials with major foreign currencies are narrowing. However, overall higher yields and negative surprises in global growth still inform our position in favor of the greenback. Within developed markets, we favor the euro, the British pound, Norwegian kroner, Swedish krona, and Singapore dollar relative to the Swiss Franc, Japanese yen, Australian and Canadian dollars. In EM, we favor high yielders with attractive valuations, such as the Colombian peso, Brazilian real, Indian rupee, Indonesian rupiah, and Mexican peso, relative to low yielding and more expensive currencies, such as the Korean won, Taiwan dollar, Philippine peso, and Chinese renminbi.

1. Reference benchmark 60% MSCI ACWI, 40% Bloomberg Global Aggregate Hedged Index.
2. Credit risk defined as duration times spread (DTS).

The modest overweight in inflation-protected sovereigns relative to nominal sovereigns is maintained, given the trend in inflation.

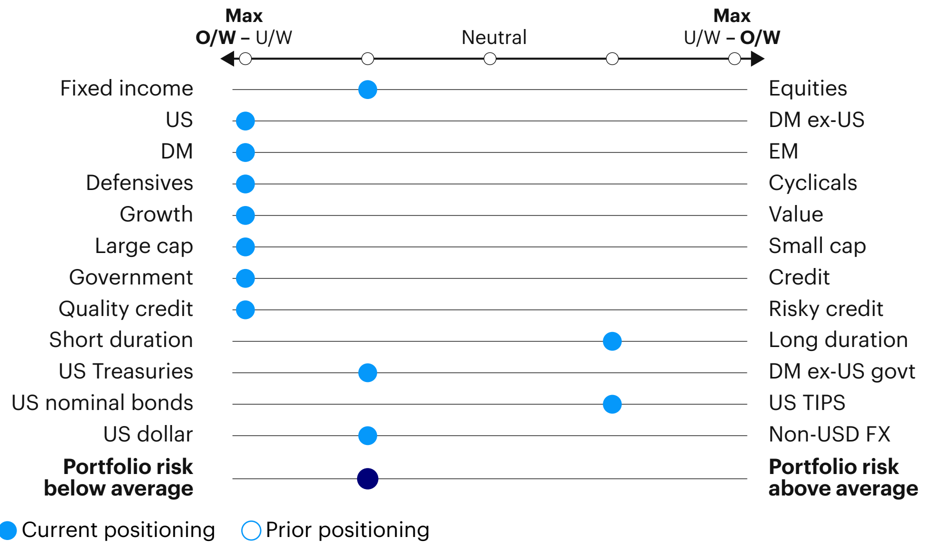
Figure 3: Inflation is no longer declining, complicating the easing cycle of the Federal Reserve and other central banks



Source: Bloomberg L.P. data as of Dec. 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.

Figure 4: Relative tactical asset allocation positioning

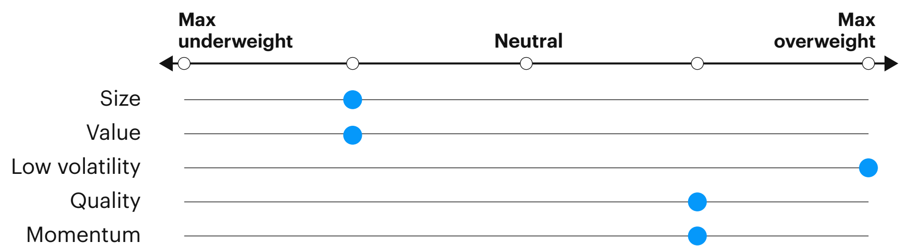
Underweight portfolio risk vs. benchmark, favoring US equities, defensive sectors, and quality credit



Source: Invesco Solutions, Jan. 1, 2025. 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.

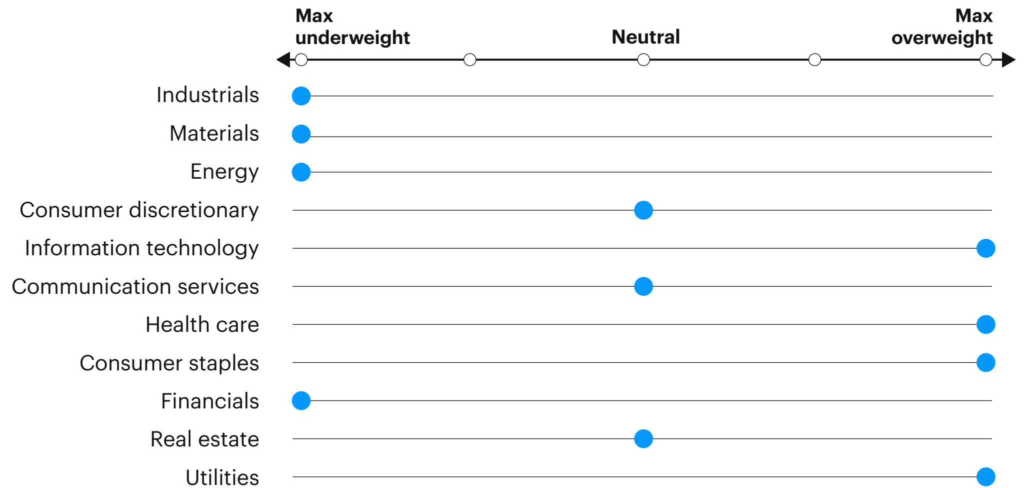
Figure 5: Tactical factor positioning

Overweight quality, low volatility, and momentum



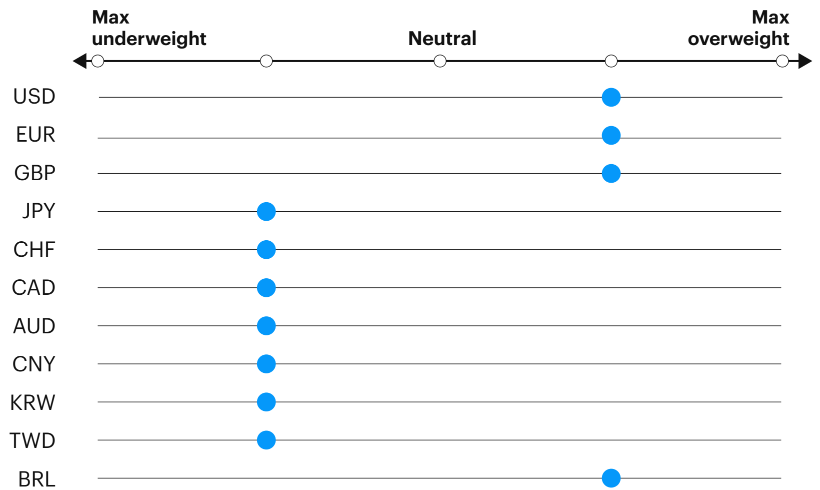
Source: Invesco Solutions, Jan. 1, 2025. For illustrative purposes only. Neutral refers to an equally weighted factor portfolio.

Figure 6: Tactical sector positioning
Sector exposures favoring defensives



Source: Invesco Solutions, Jan. 1, 2025. For illustrative purposes only. Sector allocations derived from factor and style allocations based on proprietary sector classification methodology. As of December 2023, Cyclicals: energy, financials, industrials, materials; Defensives: consumer staples, health care, information technology, real estate, utilities; Neutral: consumer discretionary and communication services.

Figure 8: Tactical currency positioning
Overweighting US dollar, favoring euro and sterling vs. other developed currencies



Source: Invesco Solutions, Jan. 1, 2025. 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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