Invesco

Tactical Asset Allocation

Maintaining defensive portfolio positioning, favoring fixed income over equities. Upgrading developed ex-US equities to neutral relative to US equities. Favoring defensive equities with low volatility and quality characteristics.

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

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

- Shifting market dynamics leading to downward revisions in US earnings expectations, while Europe sees upward revisions in response to an expansionary fiscal impulse and defense spending plans. Downgrades in US earnings expectations could have important implications for global equities.
- Our framework remains in a contraction regime. We maintain a cautious asset allocation versus benchmark, overweighting fixed income relative to equities. We upgrade developed ex-US equities to neutral versus US equities but remain underweight in emerging markets. Overweight duration via inflation-linked bonds and underweight credit risk.

Macro update

Leading economic indicators continue to register steady improvements across regions, led by the US and Eurozone. Weakness in consumer sentiment has been offset by a rebound in manufacturing business surveys, improving inventory cycle, and a steepening in global yield curves following cuts in policy rates. China remains stable, with modest but steady improvements in housing indicators, manufacturing orders and credit growth. However, after increasing for three consecutive months, our barometer of global market sentiment has resumed its decline, driven by uncertainty surrounding global trade policy and the announcement of new tariffs imposed by the US on major trading partners. We highlighted this theme as one of the key drivers of markets through 2025, with potential repercussions on inflation, earnings, and market volatility. The deterioration in diplomatic negotiations surrounding the Russia-Ukraine conflict could further complicate future trade policy in a series of retaliatory actions. Over the past month, global equities underperformed fixed income, global bond yields rallied, and credit spreads widened modestly across sectors, highlighting the moderate but consistent risk-off adjustment in markets. Our framework remains in a contraction regime of below-trend and decelerating growth for the ninth consecutive month (**Figures 1** and **2**).

US equities have led the decline, underperforming European equities and emerging markets. Earnings forecasts in the United States are reflecting increasing downward revisions, now at aggregate levels last seen during the bear market of 2022 (**Figure 3**). Three themes are likely driving this downward adjustment in US earnings revisions, namely trade policy uncertainty, increased global competition in the AI race, and concerns around federal budget cuts. Conversely, earnings outside the United States have stabilized after years of downward revisions, likely reflecting expectations for increased defense spending and an expansionary fiscal impulse in Europe. Following these developments, our framework for relative positioning between US and developed ex-US equities moves from moderately overweight US equities to neutral, the second consecutive monthly improvement towards non-US markets. From here, an overweight stance in Europe and Japan will require a more bearish outlook for the US dollar or a rebound in global risk appetite, beneficial to these cyclical and value-oriented markets. Conversely, earnings expectations in emerging markets continue to lag developed markets, leading to a moderate underweight exposure in our asset allocation.

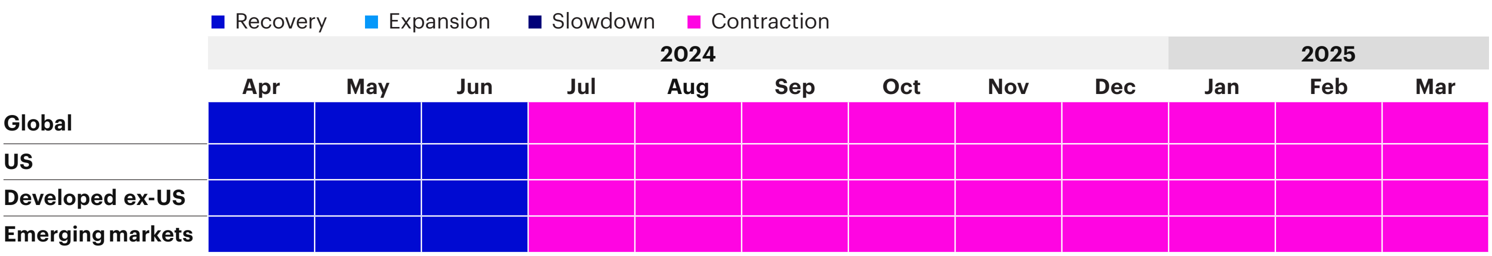
> Our macro framework continues to remain in a contraction regime, which is below trend growth and expectations for further deterioration in growth.

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. Asset Allocation research and calculations. Proprietary leading economic indicators of Asset Allocation. Macro regime data as of Feb. 28, 2025. 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.

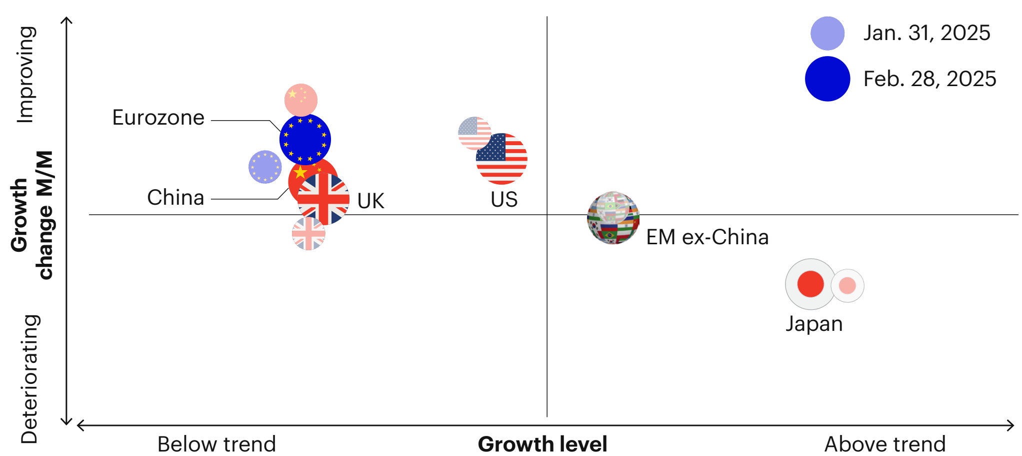
Figure 1b: Trailing 12-month regime history by region
Global economy in a contraction phase, with LEIs below their long-term trend and growth expectations deteriorating



Source: Asset Allocation as of Feb. 28, 2025.

> Steady improvements across regions, led by the US and eurozone.

Figure 1c: Global growth is improving, led by the US and eurozone.

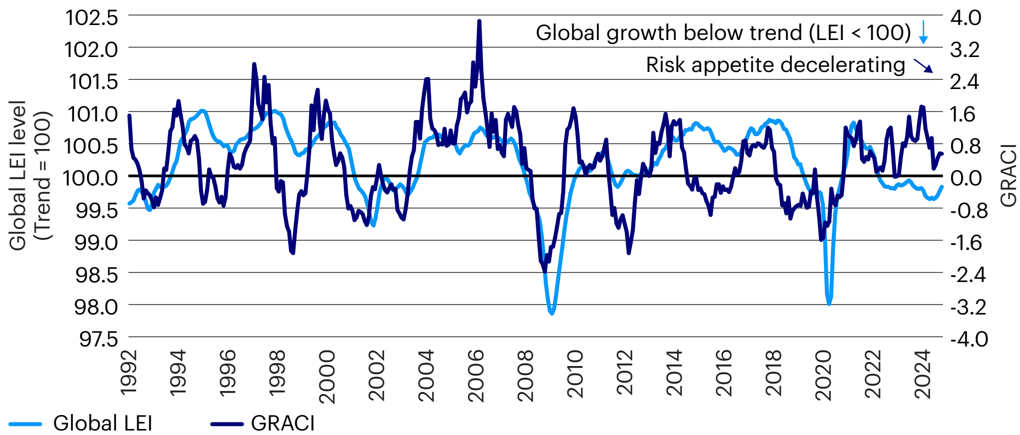


Sources: Bloomberg L.P., Macrobond. Asset Allocation research and calculations. Proprietary leading economic indicators of Asset Allocation. Macro regime data as of Feb. 28, 2025. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.

After three months of modest increases, global risk appetite has stalled on global trade policy uncertainty.

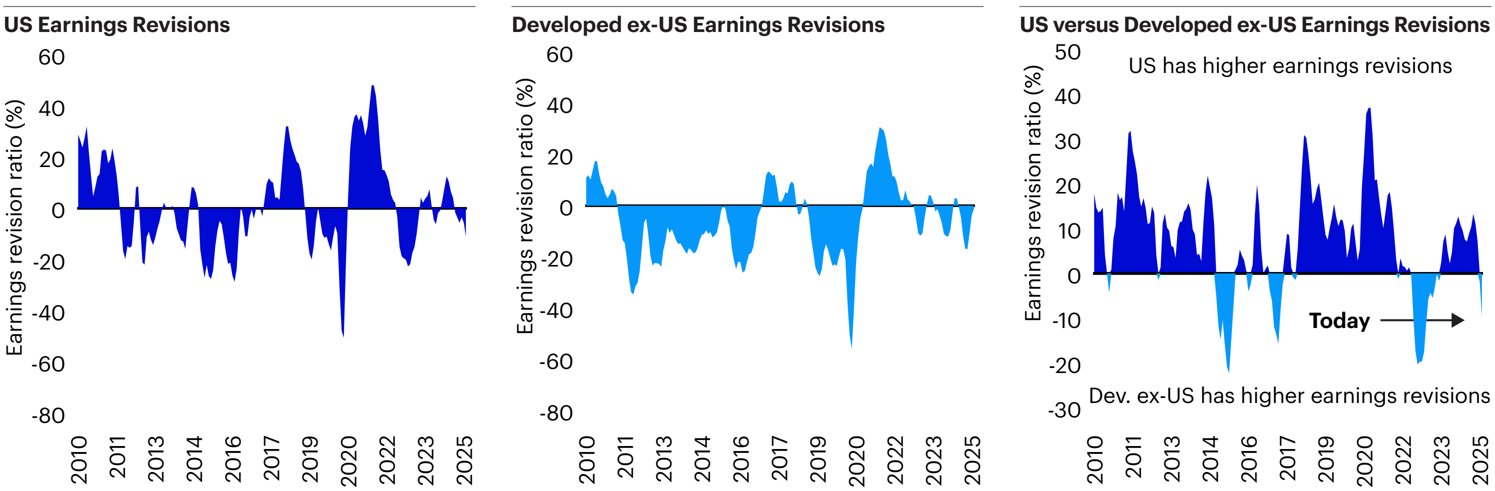
Figure 2: Global risk appetite has stalled after three months of modest increases as markets digest global trade policy uncertainty

GRACI and Global LEI



Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Asset Allocation research and calculations, from Jan. 1, 1992 to Feb. 28, 2025. 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.**

Figure 3: Downward revisions in US earnings, while non-US equities revisions have stabilized, led by improvements in Europe



Source: JPMorgan. Asset Allocation calculations. As of Feb. 25, 2025.
US equities represented by the MSCI USA Index. Developed ex-U.S. equities represented by the MSCI World ex-U.S. Index.
Earnings Revisions Ratio defined as 3-month average of (# Upward Revisions - # Downward Revisions) / (# Total Revisions), using 12-month forward earnings.

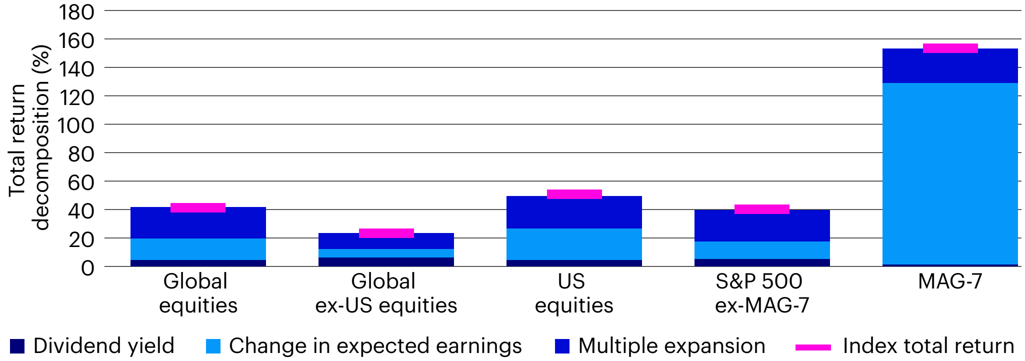
Aside from relative value considerations, the prospect of downward earnings revisions and the de-rating of US equity multiples could have negative implications for global equities overall. Following the market correction of 2022, the bull market of the past two years has been disproportionately driven by rising forward earnings expectations and multiple expansion in US equities, mainly the Magnificent 7, with the rest of the world seeing consistent but more modest contributions (**Figure 4**). Furthermore, rising inflation momentum in the US and Europe reduces the possibility of preemptive dovish central banks' actions ahead of more pronounced weakness in economic data (**Figure 5**). Through our systematic macro frameworks, we continue to monitor the evolution of these themes and the resulting impact on global market sentiment, inflation expectations, and growth expectations across regions, repositioning our asset allocation accordingly.

Over the past 2 years, rising earnings estimates and multiple expansion predominately in the US Magnificent 7 have driven the global equity bull market.

Rising inflation momentum keeps inflation-linked bonds at a maximum overweight relative to nominal Treasuries.

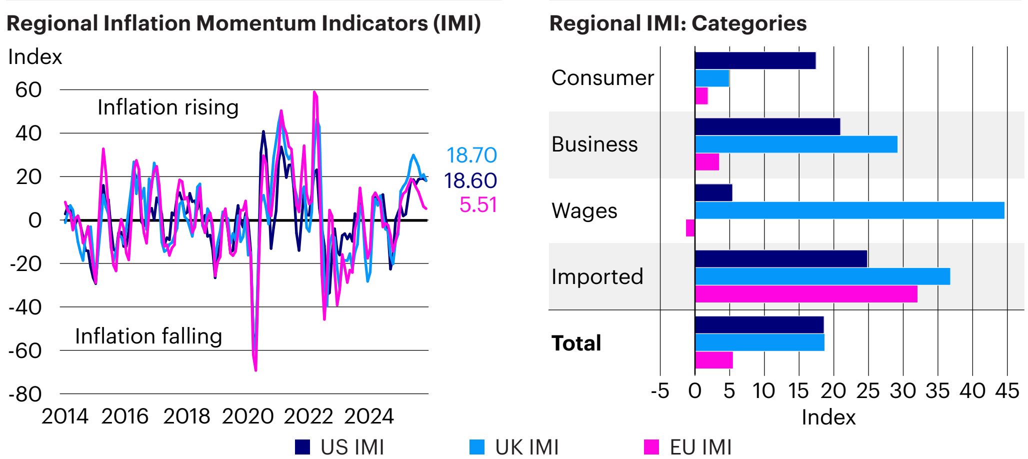
Developed ex-US equities have been brought to neutral relative to US equities.

Figure 4: Global equity bull market of the past 2-years driven predominantly by rising earnings estimates and multiple expansion in the US Magnificent 7



Source: Bloomberg L.P. Asset Allocation calculations, as of February 28, 2025. Consensus Bloomberg estimates using the mean of sell-side analyst estimates.
Global equities = MSCI ACWI Index. Global ex-US Equities = MSCI World ex-US Index. US equities = S&P 500 Index. Equity total return decomposition over the past 2-years, from February 2023 to February 2025.

Figure 5: Inflation trending higher across developed markets



Sources: Bloomberg L.P. data as of Feb. 28, 2025, Asset Allocation calculations. The US Inflation Momentum Indicator (IMI) measures the change in inflation statistics on a trailing three-month basis, covering indicators across consumer and producer prices, inflation expectation surveys, import prices, wages, and energy prices. A positive (negative) reading indicates inflation has been rising (falling) on average over the past three months.

Investment positioning

We implemented minor changes to our asset allocation this month in the Global Tactical Allocation Model,[1] bringing the developed ex-US equities allocation to neutral relative to US equities. We remain underweight risk relative to benchmark, underweighting equities relative to fixed income, primarily via an underweight to emerging markets versus developed markets. We maintain an overweight in defensive sectors with quality and low volatility characteristics. In fixed income, we underweight credit risk[2] relative to benchmark and overweight duration via inflation-linked bonds at the expense of nominal Treasuries (**Figures 6** to **9**). In particular:

- In **equities**, we have neutralized the relative allocation between US and developed ex-US equities following downward earnings revisions in the former and improving revisions in the latter. Our neutral stance on the US dollar also supports this position. Going forward, a bearish outlook for the US dollar or a rebound in global risk appetite would be necessary for our framework to trigger an overweight to developed markets outside the US. We maintain a moderate underweight in emerging market equities relative to developed markets and still favor defensive sectors with quality and low volatility characteristics, tilting towards larger capitalizations at the expense of value, mid and small caps. As expected, low volatility equities have delivered favorable downside protection in the recent round of equity volatility. 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.

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

- In **fixed income**, we underweight credit risk and overweight duration, favoring investment grade and sovereign fixed income relative to high yield. Given the decelerating growth environment and credit spreads at cycle lows, we believe the risk-reward in this position is attractive. In sovereigns, we maintain a maximum overweight exposure to inflation-linked bonds relative to nominal Treasuries, given rising inflation momentum across regions (**Figure 5**).
- In **currency markets**, we move back to a neutral stance on the US dollar after the brief underweight exposure over the past month. While economic data outside the US are still surprising to the upside, wider yield differentials towards the greenback lead our models to a neutral position in aggregate. 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, Philippines peso, and Chinese renminbi.

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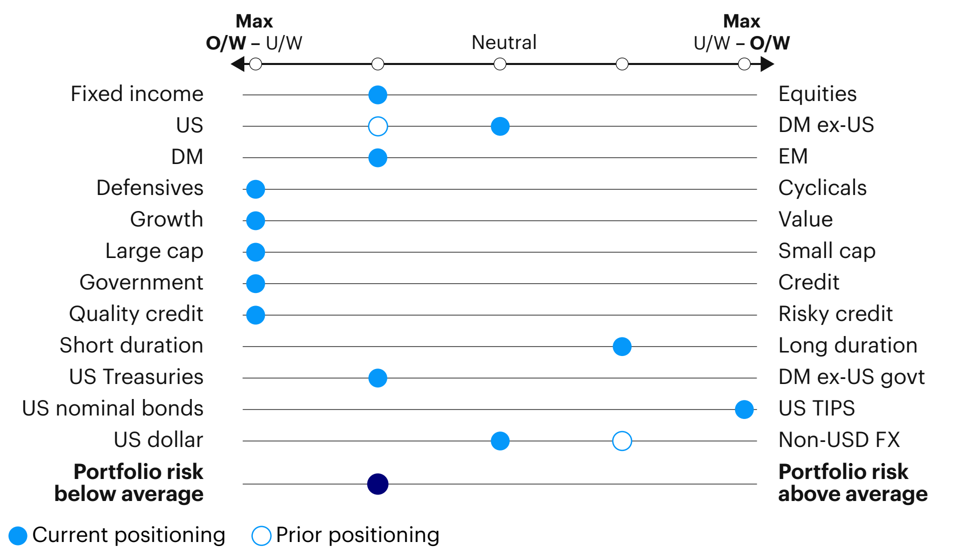
Wider yield differentials have moved the US dollar back to a neutral stance.

Figure 6: Relative tactical asset allocation positioning

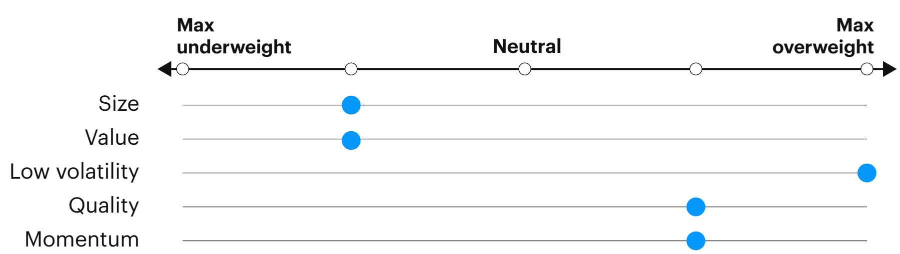
Moving to a neutral stance between Developed ex-US equities and US equities



Source: Asset Allocation, Mar. 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.

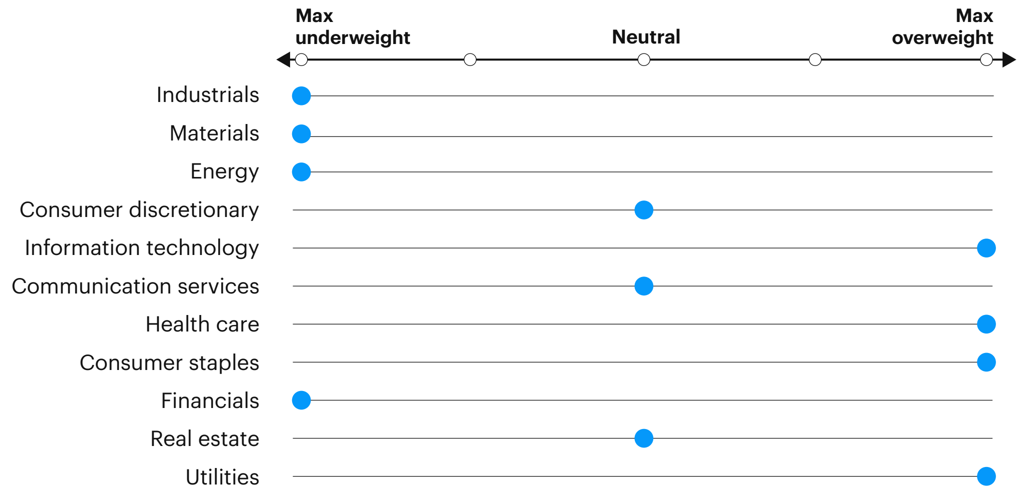
Figure 7: Tactical factor positioning

Overweight quality, low volatility, and momentum



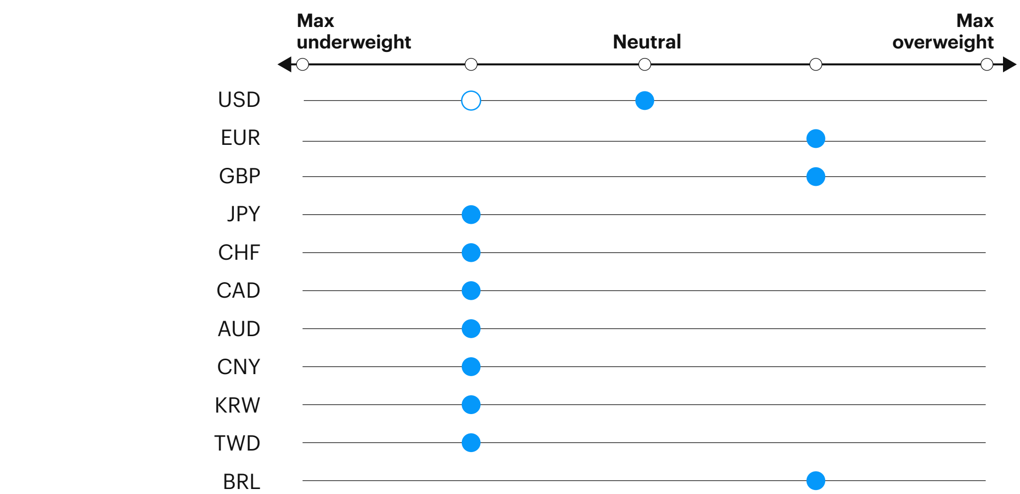
Source: Asset Allocation, Mar. 1, 2025. For illustrative purposes only. Neutral refers to an equally weighted factor portfolio.

Figure 8: Tactical sector positioning
Sector exposures favoring defensives



Source: Asset Allocation, Mar. 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.

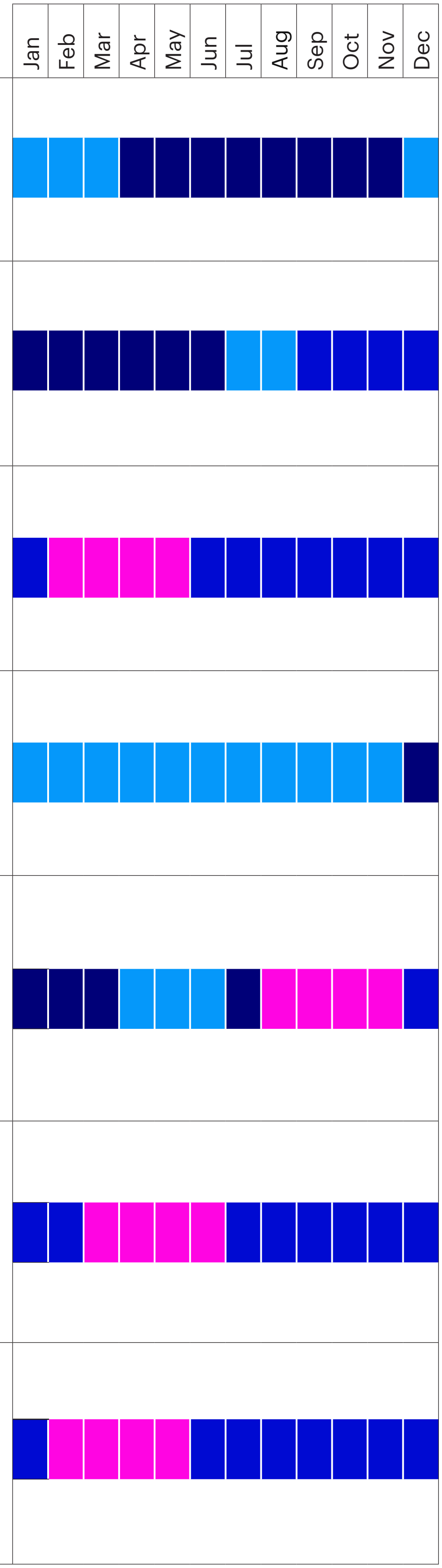
Figure 9: Tactical currency positioning
Neutral US dollar, favoring euro and sterling vs. other developed currencies



Source: Asset Allocation, Mar. 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.

Regime signal history

■ Recovery ■ Expansion ■ Slowdown ■ Contraction



2018

- **Market sentiment:** Decelerated following Q1 as equity markets had two significant corrections, the Federal Reserve hiked rates four times, privacy and regulatory concerns took hold of the technology sector, and trade tensions between the US and China escalated.
- **Economic data:** Was supported by a tight labor market and strong services sector, despite gradual weakening in manufacturing.
- **Our regime framework (2 shifts):** Risk-on in Q1 and rotated to a defensive stance throughout the year. Defensive asset classes outperformed led by global fixed income.

2019

- **Market sentiment:** Bottomed early and made a significant turnaround mid-year as the Fed switched to a dovish stance, eventually leading to rate cuts in H2. US-China trade tensions eased amidst a "Phase One" deal.
- **Economic data:** Deteriorated due to weaker manufacturing and services data. Yield curve inversion raised recessionary concerns.
- **Our regime framework (3 shifts):** Defensive in H1, then shifted into a recovery with the combination of below-trend growth but improving market sentiment. Equities posted strong returns led by the US, credit spreads tightened, and duration was supported by interest rate cuts.

2020

- **Market sentiment:** Deteriorated quickly as emerging market equities underperformed in response to COVID-19. Sentiment reversed in the summer as large monetary and fiscal stimulus supported the economy. Reopening post-lockdown and vaccine news fueled positive sentiment in Q4.
- **Economic data:** Weakened to historic levels before the eventual economic reopening and resulting rebound. Overall economic data remained below-trend throughout the year.
- **Our regime framework (2 shifts):** Rotated into a contraction in February, ahead of the depths of market volatility, and shifted into recovery in June as the global economy reopened, benefiting from cyclical assets outperforming in H2 2020.

2021

- **Market sentiment:** Moved higher following the economic reopening in H2 2020. Market volatility fell significantly. Historic levels of fiscal stimulus were enacted in the US and COVID-19 vaccines were slowly deployed.
- **Economic data:** Continued to normalize and moved to above-trend despite supply chain bottlenecks and supply-demand disruptions. Inflationary pressures emerged and Fed rhetoric became more hawkish in December.
- **Our regime framework (2 shifts):** Was in an expansionary regime throughout the year. This was validated as equities, led by the US, outperformed, credit spreads tightened, and bond yields rose.

2022

- **Market sentiment:** Peaked early in the year and deteriorated following Russia's invasion of Ukraine, the surge in energy prices, and inflationary pressures. Aggressive monetary policy tightening led to negative growth implications.
- **Economic data:** Weakened from 2021 peaks but remained above-trend for roughly half the year. Consumers benefitted from a tight labor market, fueling strong retail sales, which helped buoy a supply-chain-constrained manufacturing sector.
- **Our regime framework (4 shifts):** Changed multiple times but spent the bulk of the year positioned defensively. This was beneficial as equities underperformed and duration also sold off meaningfully due to higher rates.

2023

- **Market sentiment:** Declined in Q1 following US regional banking failures. Turned positive again in H2 as inflation showed signs of moderating, leading to the end of the Fed hiking cycle. Markets became optimistic on themes including AI advancements and China's post-COVID reopening.
- **Economic data:** Remained below-trend although supported by consumer spending, business investment, and government spending.
- **Our regime framework (2 shifts):** Significantly pivoted from defensive to cyclical in H2, consistent with tightening credit spreads, equity outperformance, and rising bond yields. But cyclical equities underperformed due to a relentless bid for AI-related, quality, and growth equities.

2024

- **Market sentiment:** Rose in H1 as inflation decelerated, markets rewarded AI adoption, and consumer spending remained resilient. Deteriorated in H2 with US election uncertainty, fears over a weakening labor market, and corporate earnings growth concentrated in expensive mega-cap names.
- **Economic data:** Below-trend as the unemployment rate rose despite resilient consumer spending. The Fed began easing and the yield curve began to steepen.
- **Our regime framework (2 shifts):** Risk-on until midyear when below-trend and decelerating growth triggered a contraction. Cross-asset class performance in H1 was consistent with this stance, while equity returns were led by the Magnificent 7 and AI-theme, rather than cyclical fundamental drivers.

Source: Invesco Solutions as of Feb. 28, 2025.

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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