



Applied philosophy

The déjà vu tantrum

With another “taper tantrum” on investors’ minds, we feel like we have been here before. Back in 2013, Emerging Market assets underperformed once the Federal Reserve announced plans to start reducing the pace of its asset purchases. We believe that point is unlikely to occur before 2022 and prefer to watch commodity prices, the US dollar and valuations to determine our stance on EM.

The past year has been marked by a constant feeling of déjà vu and not just because every day has felt the same as the one before (that is more *Groundhog Day*). We have witnessed: a crisis that has triggered extraordinary monetary and fiscal stimulus; the global economy going into a tailspin; financial assets recovering long before there is light at the end of the tunnel; rising yields driven by inflation fears and positioning for higher interest rates. We feel like we have seen this movie before.

Risk assets have reacted to these concerns in a similar fashion to what we have experienced in the past three decades. Since the 1987 market crash – when the expression “Greenspan put” was coined –, market sentiment has become increasingly reliant on the implicit and explicit support provided by central banks, most prominently by the US Federal Reserve.

Markets have become increasingly reliant on central banks and parents will be familiar with the reaction to real or imagined threat to the supply of treats. This is

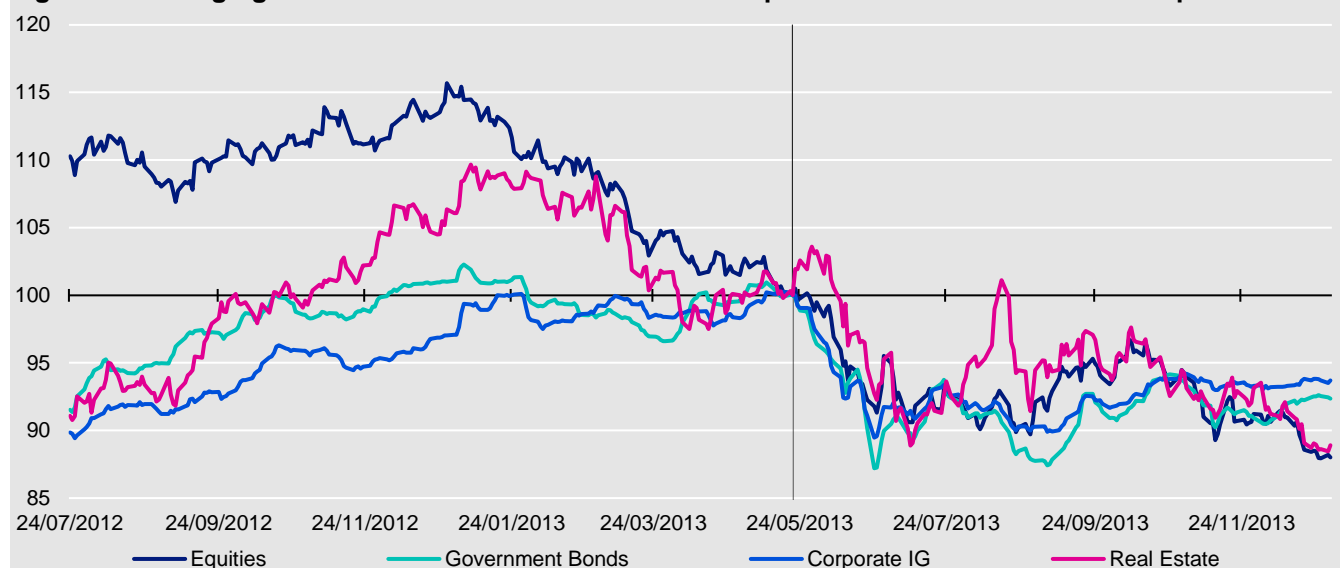
the analogy that was used to describe the so-called “taper tantrum” of 2013.

In that episode, yields rose in anticipation of the Fed scaling back the pace of its asset purchases and then surged when that was confirmed by then-Fed Chairman Ben Bernanke during an appearance before the Congressional Joint Economic Committee on 22nd May 2013. Yields stopped rising by the end of 2013 and reversed course when the tapering actually began.

We believe that the Fed is unlikely to start slowing its asset purchases before their target in 2022. Nevertheless, in our view, the move in Treasury yields is logical if the recovery remains on track. We suspect the way the recovery progresses and accompanying expectations of monetary policy tightening will remain the main drivers of movements in Treasury yields. Even if we think further upside to yields is limited (we currently expect the 10-year Treasury yield to reach 2% in the next 12 months), it may be worth considering how Emerging Market assets could react to tapering concerns.

It sounds sensible to expect EM assets to underperform in periods when yields on supposedly safer assets rise. Indeed, as **Figure 1** shows, both equity-like and fixed income EM assets underperformed during the 2013 “taper tantrum” compared to developed markets and global benchmarks (usually dominated by issuers from the US, Europe and Japan).

Figure 1 – Emerging Market asset returns relative to Developed Markets around the 2013 “taper tantrum”



Notes: Daily data from 24/07/2012 to 31/12/2013. We use the MSCI Emerging Markets index relative to MSCI World for equities, the Bloomberg Barclays Emerging Markets Sovereign index relative to the ICE BofA Developed Market Sovereign index for government bonds, the Bloomberg Barclays Emerging Markets Corporate index relative to the ICE BofA Global Corporate index for corporate IG and the FTSE EPRA/NAREIT Emerging Market index relative to the FTSE EPRA/NAREIT Developed Markets index for real estate. All indices in US dollars and rebased to 100 on 21st May 2013. Past performance is no guarantee of future results. Source: Refinitiv Datastream and Invesco



The worst underperformers were equities, which lagged their developed market equivalents by 12% between 21 May to 31 December 2013 (based on MSCI USD indices), while real estate did better, underperforming by only 11.1% (using FTSE EPRA/NAREIT USD indices). Relative returns for fixed income indices in US dollar terms were close to equities at 7.6% underperformance for government bonds and 6.3% for corporate debt. (we compared Bloomberg Barclays EM index returns to the ICE BofA Developed Market sovereign index for the former and the ICE BofA Global corporate bond index for the latter).

Even with the caveat that these returns are in US dollars, the trend seems to be clear (as shown in **Figure 2**, EM currencies were broadly stable during this period, so the problem was the underlying assets). We understand why investors may be concerned about something similar happening this year. If the US economy grows faster than currently expected and there are signs of persistent inflation pressures, the Fed may decide to bring forward the starting point of tapering from 2022.

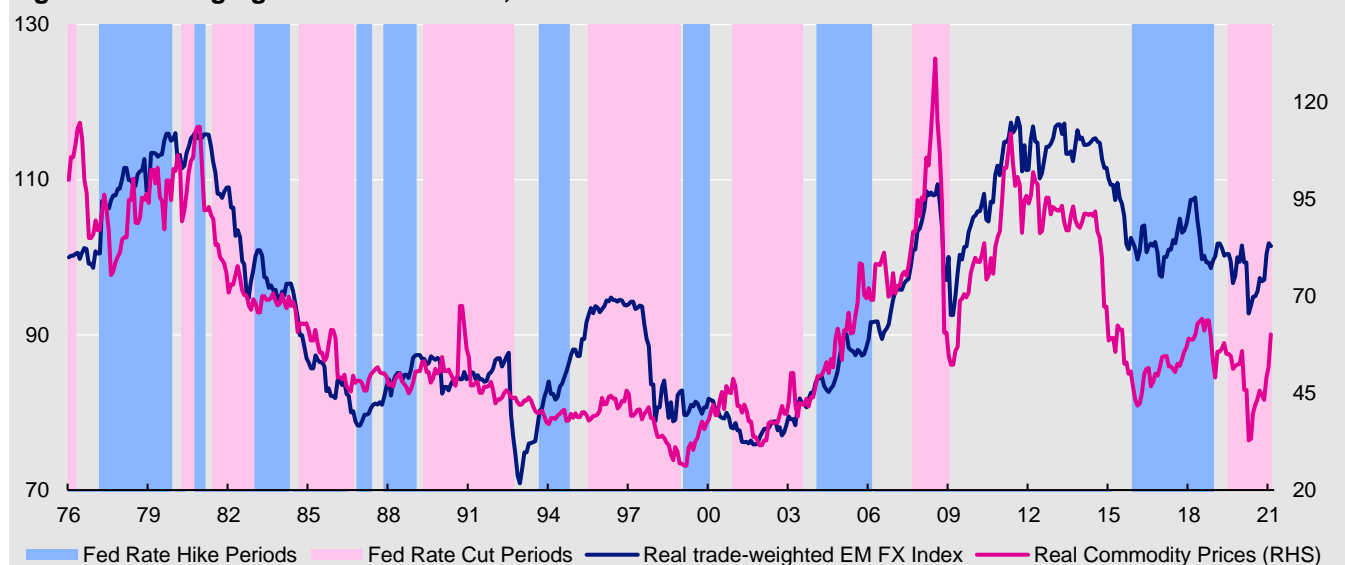
Nevertheless, we detect little sign of stress in EM returns since global yields troughed on 4th August 2020. Using the same indices, only EM real estate has underperformed its developed market equivalent (by 10% as of 24th March 2021), but in contrast to 2013, both indices have risen in this period. EM equities and

government bonds have been broadly in line so far, while corporate bonds have outperformed their global benchmark by 6% (again as of 24th March 2021).

We believe it may be too early to determine when monetary policy tightening will start in the US. More importantly, we think it may not matter as much for EM assets as current concerns suggest. Looking back further in **Figure 2**, we have found little tendency for EM currencies to fall during Fed rate hike periods (which is not an immediate threat, in our view). We have found a closer connection with commodity prices, which we expect to rise in the next 12 months.

We tend to consider three things when determining our general stance towards EM assets. First, commodity prices, which we expect to rise from current levels in the next 12 months. Second, the US dollar, which we expect to strengthen somewhat, but do not think significant moves are likely (EM asset returns have a slight negative correlation to the trade-weighted dollar price). Third, valuations, which look less attractive than in the autumn, suggesting to us that much of the recovery may have been priced in. We are most concerned about further appreciation of the dollar, as that could have a direct effect on EM assets and an indirect effect via commodity prices. Though we think the cycle still favours commodities and EM assets, we have recently reduced our exposure to both within our Model Asset Allocation (**Figure 6**).

Figure 2 – Emerging market currencies, commodities and the Fed



Note: monthly data from January 1976 to February 2021. Real trade-weighted EM FX index is a trade weighted average of national currencies versus US dollar (trade weights are based on total trade flows for each country). There are 18 currencies in the EM basket – those of China, Brazil, South Korea, Mexico, Singapore, India, Russia, Poland, Thailand, Turkey, Czech Republic, Malaysia, Indonesia, Hungary, Philippines, South Africa, Chile and Nigeria (ordered by size of trade flows). Real adjustments use national CPI indices versus that of the US. Real commodity price index is based on the S&P GSCI Commodity Spot Price Index, adjusted by the US CPI index. All indices rebased to 100 as of January 1976. As of 26 February 2021. Past performance is no guarantee of future returns. Source: IMF, OECD, Oxford Economics, S&P GSCI, Bloomberg L.P., Refinitiv Datastream and Invesco.

Figure 3 – Asset class total returns (% annualised)

Data as at 25/03/2021	Index	Current Level/Ry	Total Return (USD, %)					Total Return (Local Currency, %)				
			1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Equities												
World	MSCI	664	-1.4	-0.3	3.1	3.1	58.5	-1.0	0.8	4.3	4.3	53.7
Emerging Markets	MSCI	1288	-4.3	-6.7	0.1	0.1	57.9	-3.7	-5.5	1.8	1.8	52.3
China	MSCI	105	-6.8	-11.2	-2.6	-2.6	42.2	-6.7	-10.9	-2.4	-2.4	40.9
US	MSCI	3792	-0.2	1.7	3.7	3.7	63.6	-0.2	1.7	3.7	3.7	63.6
Europe	MSCI	1880	-2.0	-0.6	2.8	2.8	48.6	-0.7	3.1	6.2	6.2	34.7
Europe ex-UK	MSCI	2360	-1.8	-0.2	2.2	2.2	51.6	-0.5	3.7	6.7	6.7	39.7
UK	MSCI	1070	-2.9	-2.1	5.0	5.0	38.9	-1.3	0.9	4.6	4.6	19.0
Japan	MSCI	3925	-3.0	-2.3	1.9	1.9	43.6	-2.9	0.3	7.7	7.7	40.7
Government Bonds												
World	BofA-ML	0.44	0.2	-1.4	-4.9	-4.9	3.3	0.8	0.6	-2.6	-2.6	-1.0
Emerging Markets	BBloom	4.54	0.1	-1.3	-6.7	-6.7	19.9	0.1	-1.3	-6.7	-6.7	19.9
China	BofA-ML	3.12	-0.2	-0.6	0.9	0.9	8.7	0.3	0.7	0.8	0.8	0.0
US (10y)	Datastream	1.61	1.1	-0.9	-5.6	-5.6	-4.8	1.1	-0.9	-5.6	-5.6	-4.8
Europe	Bofa-ML	-0.09	-0.4	-2.6	-5.5	-5.5	13.0	0.9	1.1	-1.8	-1.8	4.0
Europe ex-UK (EMU, 10y)	Datastream	-0.43	-0.1	-2.2	-5.2	-5.2	10.1	1.1	1.5	-1.5	-1.5	1.3
UK (10y)	Datastream	0.77	-0.2	-2.4	-4.5	-4.5	13.3	1.3	0.5	-4.8	-4.8	-2.9
Japan (10y)	Datastream	0.08	0.1	-2.0	-5.8	-5.8	2.1	0.2	0.6	-0.5	-0.5	0.0
IG Corporate Bonds												
Global	BofA-ML	1.76	0.3	-1.4	-4.1	-4.1	16.0	0.7	-0.2	-3.0	-3.0	12.4
Emerging Markets	BBloom	3.89	0.2	-0.8	-1.5	-1.5	34.4	0.2	-0.8	-1.5	-1.5	34.4
China	BofA-ML	4.02	-0.3	-0.8	1.0	1.0	10.5	0.2	0.5	0.9	0.9	1.7
US	BofA-ML	2.30	0.9	-0.6	-4.3	-4.3	13.8	0.9	-0.6	-4.3	-4.3	13.8
Europe	BofA-ML	0.41	-0.9	-3.3	-4.2	-4.2	19.5	0.4	0.4	-0.5	-0.5	9.9
UK	BofA-ML	1.86	-0.3	-2.4	-3.3	-3.3	30.7	1.3	0.5	-3.7	-3.7	12.0
Japan	BofA-ML	0.40	-0.1	-2.3	-5.3	-5.3	2.7	0.1	0.3	0.1	0.1	0.6
HY Corporate Bonds												
Global	BofA-ML	4.80	0.0	-1.1	-0.2	-0.2	32.3	0.3	-0.3	0.5	0.5	30.0
US	BofA-ML	4.91	0.6	-0.3	0.6	0.6	30.7	0.6	-0.3	0.6	0.6	30.7
Europe	BofA-ML	2.98	-1.2	-3.6	-2.4	-2.4	36.6	0.1	0.1	1.4	1.4	25.6
Cash (Overnight LIBOR)												
US		0.08	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1
Euro Area		-0.58	-1.3	-3.4	-3.8	-3.8	7.5	0.0	0.0	-0.1	-0.1	-0.6
UK		0.04	-1.4	-2.0	0.4	0.4	15.6	0.0	0.0	0.0	0.0	0.0
Japan		-0.08	-0.3	-2.7	-5.4	-5.4	1.8	0.0	0.0	0.0	0.0	-0.1
Real Estate (REITs)												
Global	FTSE	1860	-1.4	0.1	5.2	5.2	38.9	-0.2	3.9	9.3	9.3	27.8
Emerging Markets	FTSE	2015	-3.2	-2.0	2.5	2.5	21.9	-2.0	1.7	6.5	6.5	12.2
US	FTSE	3058	-1.0	2.5	9.3	9.3	47.4	-1.0	2.5	9.3	9.3	47.4
Europe ex-UK	FTSE	3459	-1.5	-2.1	-7.6	-7.6	32.1	-0.3	1.6	-4.0	-4.0	21.5
UK	FTSE	1372	-1.8	-3.3	2.6	2.6	38.5	-0.3	-0.4	2.2	2.2	18.7
Japan	FTSE	2796	-1.8	-2.6	7.3	7.3	28.2	-1.7	0.0	13.4	13.4	25.6
Commodities												
All	GSCI	2220	-1.5	-5.5	12.3	12.3	38.9	-	-	-	-	-
Energy	GSCI	320	-2.1	-6.9	19.8	19.8	46.2	-	-	-	-	-
Industrial Metals	GSCI	1531	-1.1	-5.4	9.4	9.4	54.4	-	-	-	-	-
Precious Metals	GSCI	2006	-0.9	-3.7	-8.8	-8.8	7.1	-	-	-	-	-
Agricultural Goods	GSCI	417	-1.5	-4.9	4.4	4.4	29.1	-	-	-	-	-
Currencies (vs USD)*												
EUR		1.18	-1.3	-3.4	-3.7	-3.7	8.1	-	-	-	-	-
JPY		109.19	-0.3	-2.7	-5.4	-5.4	1.9	-	-	-	-	-
GBP		1.37	-1.5	-2.9	0.4	0.4	16.7	-	-	-	-	-
CHF		1.06	-1.4	-3.8	-5.8	-5.8	3.9	-	-	-	-	-
CNY		6.55	-0.6	-1.4	-0.3	-0.3	8.7	-	-	-	-	-

Notes: *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). Past performance is no guarantee of future results. Please see appendix for definitions, methodology and disclaimers.

Source: Refinitiv Datastream and Invesco


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

Data as at 25/03/2021	Global				
	1w	1m	QTD	YTD	12m
Energy	0.1	-0.2	4.2	4.2	-5.1
Basic Materials	-1.8	-2.7	1.3	1.3	17.0
Basic Resources	-3.4	-6.1	0.7	0.7	23.2
Chemicals	0.3	1.9	2.0	2.0	10.2
Industrials	-0.2	1.7	1.7	1.7	5.9
Construction & Materials	0.1	2.3	3.2	3.2	6.6
Industrial Goods & Services	-0.2	1.6	1.5	1.5	5.8
Consumer Discretionary	-0.9	0.0	-1.6	-1.6	10.0
Automobiles & Parts	-2.6	0.1	0.1	0.1	49.7
Media	-2.6	-1.3	0.6	0.6	9.3
Retailers	1.0	0.8	-4.4	-4.4	-1.3
Travel & Leisure	-2.1	0.4	4.1	4.1	10.2
Consumer Products & Services	-1.4	-1.0	-2.2	-2.2	10.3
Consumer Staples	1.3	2.5	-4.0	-4.0	-17.6
Food, Beverage & Tobacco	0.8	2.4	-3.5	-3.5	-16.7
Personal Care, Drug & Grocery Stores	2.4	2.6	-4.7	-4.7	-19.3
Healthcare	0.9	-0.9	-4.4	-4.4	-13.8
Financials	-0.7	1.2	6.5	6.5	1.0
Banks	-1.3	1.2	8.9	8.9	0.1
Financial Services	-0.1	0.4	4.2	4.2	7.1
Insurance	0.0	2.0	4.1	4.1	-4.8
Real Estate	0.9	0.6	0.6	0.6	-13.8
Technology	0.2	-2.8	-1.9	-1.9	12.7
Telecommunications	0.3	1.9	0.6	0.6	-12.5
Utilities	3.3	3.9	-3.5	-3.5	-15.7

Notes: Returns shown are for Datastream sector indices versus the total market index. Past performance is no guarantee of future results.
Source: Refinitiv Datastream and Invesco



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

Data as at 25/03/2021	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	0.2	1.6	6.0	6.0	81.9	0.3	-0.6	1.4	1.4	13.2
Low volatility	1.7	6.1	2.9	2.9	50.9	1.8	3.8	-1.5	-1.5	-6.1
Price momentum	-2.3	0.2	3.7	3.7	57.8	-2.2	-2.0	-0.7	-0.7	-1.8
Quality	0.5	5.9	10.7	10.7	72.7	0.7	3.6	6.0	6.0	7.5
Size	-2.0	6.1	21.0	21.0	114.1	-1.8	3.8	15.8	15.8	33.3
Value	-1.5	5.8	24.0	24.0	119.8	-1.4	3.5	18.7	18.7	36.8
Market	-0.1	2.2	4.5	4.5	60.7					
Market - Equal-Weighted	-0.4	3.8	9.9	9.9	74.9					

Notes: 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. Past performance is no guarantee of future results.

Source: Refinitiv Datastream and Invesco

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

Data as at 25/03/2021	Absolute					Relative to Market				
	1w	1m	QTD	YTD	12m	1w	1m	QTD	YTD	12m
Growth	-0.4	4.9	6.1	6.1	69.4	0.3	1.8	-0.4	-0.4	22.3
Low volatility	0.8	4.4	4.5	4.5	34.0	1.5	1.3	-2.0	-2.0	-3.3
Price momentum	-1.4	0.5	3.2	3.2	50.1	-0.6	-2.5	-3.2	-3.2	8.4
Quality	-0.7	2.8	6.5	6.5	63.0	0.0	-0.3	-0.1	-0.1	17.7
Size	-1.1	2.2	8.2	8.2	70.7	-0.4	-0.9	1.5	1.5	23.3
Value	-2.1	4.1	15.9	15.9	67.5	-1.3	0.9	8.7	8.7	21.0
Market	-0.8	3.1	6.6	6.6	38.5					
Market - Equal-Weighted	-1.0	2.3	6.5	6.5	50.3					

Notes: 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. Past performance is no guarantee of future results.

Source: Refinitiv Datastream and Invesco



Figure 6 – Model asset allocation

	Neutral	Policy Range		Allocation	Position vs Neutral
Cash Equivalents	5%	0-10%		10%	
Cash	2.5%			10%	
Gold	2.5%			0%	
Bonds	40%	10-70%	↑	22%	
Government	25%	10-40%	↑	17%	
US	8%		↑	5%	
Europe ex-UK (Eurozone)	7%			4%	
UK	1%		↓	1%	
Japan	7%		↑	4%	
Emerging Markets	2%		↓	3%	
China**	0.2%		↓	0%	
Corporate IG	10%	0-20%		0%	
US Dollar	5%			0%	
Euro	2%			0%	
Sterling	1%			0%	
Japanese Yen	1%			0%	
Emerging Markets	1%			0%	
China**	0.1%			0%	
Corporate HY	5%	0-10%		5%	
US Dollar	4%		↑	5%	
Euro	1%		↓	0%	
Equities	45%	25-65%		50%	
US	25%			18%	
Europe ex-UK	7%			12%	
UK	4%		↑	7%	
Japan	4%		↓	5%	
Emerging Markets	5%			8%	
China**	2%		↓	2%	
Real Estate	8%	0-16%		16%	
US	2%		↑	4%	
Europe ex-UK	2%			4%	
UK	1%		↓	1%	
Japan	2%		↑	4%	
Emerging Markets	1%			3%	
Commodities	2%	0-4%		2%	
Energy	1%		↓	1%	
Industrial Metals	0.3%		↓	0%	
Precious Metals	0.3%			0%	
Agriculture	0.3%			1%	
Total	100%			100%	
Currency Exposure (including effect of hedging)					
USD	48%		↑	40%	
EUR	20%		↓	22%	
GBP	7%		↓	10%	
JPY	15%		↑	14%	
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



Figure 7 – Model allocations for Global sectors

	Neutral	Invesco	Preferred Region
Energy	5.8%	Neutral	US
Basic Materials	4.3%	Underweight	Europe
Basic Resources	2.4%	Underweight	Europe
Chemicals	1.9%	Neutral	US
Industrials	12.8%	Neutral	US
Construction & Materials	1.6%	Neutral	Europe
Industrial Goods & Services	11.3%	Neutral	US
Consumer Discretionary	16.5%	Overweight	Japan
Automobiles & Parts	2.7%	Underweight	Japan
Media	1.4%	Overweight	US
Retailers	6.1%	Underweight	EM
Travel & Leisure	2.1%	Overweight	US
Consumer Products & Services	4.2%	Overweight	Japan
Consumer Staples	6.6%	Overweight	Europe
Food, Beverage & Tobacco	4.3%	Overweight	Europe
Personal Care, Drug & Grocery Stores	2.3%	Underweight	Europe
Healthcare	10.3%	Underweight	Europe
Financials	13.7%	Neutral	EM
Banks	6.3%	Neutral	EM
Financial Services	4.1%	Overweight	US
Insurance	3.2%	Neutral	Europe
Real Estate	3.4%	Overweight	EM
Technology	19.0%	Overweight	US
Telecommunications	4.2%	Neutral	Europe
Utilities	3.4%	Neutral	Europe

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: Refinitiv Datastream and Invesco



Appendix

Definitions of data and benchmarks for Figure 3

Sources: we source data from 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). The global rate is the average of the euro, British pound, US dollar and Japanese yen rates. The series started on 1st 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 Bank of America Merrill Lynch government bond total return index for the World and Europe. The emerging markets yields and returns are based on the Bloomberg Barclays emerging markets aggregate government bond index.

Corporate investment grade (IG) bonds: Bank of America Merrill Lynch investment grade corporate bond total return indices. The emerging markets yields and returns are based on the Bloomberg Barclays emerging markets aggregate corporate bond index.

Corporate high yield (HY) bonds: Bank of America Merrill Lynch 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

Factor index definitions

We focus on relatively large-cap stocks, as we suspect that most investors will be conscious of liquidity constraints when implementing such strategies. We have chosen six factors, that we think cover the classic definitions used by most investors. We aim to capture roughly a fifth of the market in each of our factor indices using the historical constituents of the STOXX 600 since August 1999 and the S&P 500 since September 1989, with monthly rebalancing. All our rankings are based on data in euros for Europe and in US dollars for the US. All factor indices are equal-weighted. We use the following definitions:

Growth: stocks in both the top third based on their 5-year sales per share trend and the top-third based on their internal growth rate (the product of the 5-year average return on equity and the retention ratio).

Low volatility: stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months.

Price momentum: stocks in the top quintile based on their performance in the previous 12 months.

Quality: stocks in both the top third based on their return on invested capital and the top third based on their EBIT to EV ratio (earnings before interest and taxes to enterprise value). This follows Joel Greenblatt's "magic formula" from his 2005 book: The little book that beats the market.

Size: stocks in the bottom quintile based on their market value.

Value: stocks in the bottom quintile based on their price to book value ratios.



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