# **Market Pulse:** Portfolio Manager Perspectives

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COVID-19 raises new questions in emerging markets, fixed income and ESG

## Invesco's investment experts discuss the pandemic's ripple effects in these markets

By **Kristina Hooper**

The ripple effects of COVID-19 are impacting a wide variety of markets, and investors have lots of questions. Among them: Will production facilities leave China for other markets? What fixed income opportunities have been created by central bank intervention? And what has the pandemic meant for environmental, social and governance (ESG) investing?

In this piece, I get answers to these questions from three Invesco investment experts:

- **Jeff Feng,** Senior Portfolio Manager, Emerging Markets
- **Todd Schomberg,** Senior Portfolio Manager, Invesco Fixed Income
- **Cathrine De Coninck-Lopez,** Global Head of ESG

### China: Some production facilities may leave, but others rely on the country's strengths

**Jeff Feng:** China's success in flattening the COVID-19 transmission curve and its early signs of economic recovery have sparked a great deal of investor interest. We are encouraged by the stimulus efforts enacted by the government thus far and believe it has additional resources that it can utilize to further boost economic growth. At the same time, however, investors are concerned about a potential backlash against China and whether the rest of the world may seek alternative supply chains.

There is merit to those concerns. Regardless of a global backlash or a continued trade war with the US, we believe many production facilities will likely migrate away from China to countries with lower labor costs. In our view, the virus and trade war are catalysts to accelerate this shift — and this is incredibly important to consider when investing in Chinese stocks. For example, our team is not interested in companies that are reliant on cheap labor to compete.

On the other hand, it is also important to remember that unlike many other countries, China has a large and growing domestic market with a large percentage of future growth coming from internal demand. For many industries, unwinding the complex supply chain network that has been built over the past 30 years would be extremely challenging, very costly, and would take years — if it is even possible in my view.

Given all of these factors, we believe the most likely outcome will be a mixed approach based on industry. We expect to see a departure of production bases for some industries, as we have observed in apparel manufacturing. Conversely, we believe China will likely retain production for many industries — it has some of the world's most modern infrastructure (including digital infrastructure based on 5G technology and related applications), clusters of highly efficient supply chains, a very large and well-educated workforce, and a huge domestic market. China will likely also evolve, in our view, making proactive adjustments. We focus on businesses and management teams that have the vision, resources and ability to execute and adapt to this changing environment.

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### Investment grade bonds may be the 'sweet spot' of the fixed income market

**Todd Schomberg:** Swift, unprecedented action by central banks around the world – interest rate cuts, asset purchases and lending facilities – have pumped trillions of dollars of monetary stimulus into economies around the world. I believe central banks will likely continue to provide powerful tailwinds to the fixed income market. As such, we maintain our theme of "follow the central banks" —and what they are buying: investment grade corporate bonds, agency mortgages, municipal bonds and those structured securities that qualify under the Term Asset-Backed Securities Loan Facility (TALF).

Valuations within investment grade credit and select securitized assets remain attractive, in our view, and should benefit from a one-two punch of economic reopening and central bank purchases. Major central banks such as the Federal Reserve, Bank of Canada and European Central Bank have all committed to buying more investment grade credit, which provides not only a backstop, but also potential future price appreciation. As central banks have provided that backstop, we've witnessed private capital follow their lead with inflows into investment grade credit, providing further upside potential.

While central bank intervention has stabilized the corporate bond market, companies are ultimately going to have to stand on their own fundamentals, and recent balance sheet improvement actions will allow them to do so, in our view. Many investment grade corporate issuers have built cash positions by ending share buybacks, cutting dividends and issuing more than US$1 trillion of debt year-to-date.[1] As companies solidify their balance sheets, we expect this to benefit debt holders and allow issuers to successfully navigate what we believe will be a "U-shaped" economic recovery. With over $12 trillion in negative-yielding debt globally,[2] we believe North American investment grade bonds may be particularly attractive to foreign buyers, which could provide the asset class with another demand boost.

At some point far down the road, I believe central banks will have to begin shrinking the money supply, but I don't think that is on the near-term horizon. Until we see a significant uptick in growth and inflation, central banks are poised to keep the spigot wide open with extremely accommodative policies. With low global growth, low inflation and a large supply of negative yielding debt globally, I believe that high quality fixed income, particularly in North America, should be in the sweet spot of the fixed income market.

### ESG: Stewardship in the era of COVID-19

**Cathrine De Coninck-Lopez:** Across the world COVID-19 has rocked working patterns and arguably changed beliefs about the interrelations between people, corporations and governments. The questions have come in phases. At the start of the pandemic the focus was on whether environmental, social and governance (ESG) issues would fall to the bottom of investor priorities. As ESG funds and strategies proved relatively more resilient in terms of first-quarter performance,[3] the question shifted to whether ESG is the new normal. Most recently, as the world is slowly returning to a more balanced approach to life, we have been asked whether we will be shifting our focus and changing the nature of stewardship in the future. As we have explored these questions with our clients, companies and regulators, we believe that if there ever was a time for ESG, it is now.

To the first question: Would the pandemic push ESG to the bottom of investor priorities? This has not been the case for a variety of reasons. Firstly, the institutions that have committed to the Principles for Responsible Investment (PRI) manage more than $100 trillion of assets, an increase of 20% for 2019-2020.[4] The first principle states that investors should integrate ESG issues into their investment process. The financial market ecosystem has thus decided collectively that ESG is important and forms part of the responsibility of the industry, as owners of the world's biggest corporations. We see this in all flavors across a spectrum, from a risk-based integration philosophy to a more thematic and impact-oriented product focus. Both the US and Europe flows into ESG products grew by more than four times between 2018 and 2019, and the trend has continued into 2020.[5] As a result of these trends, regulators have taken a keen interest across the world on these topics, and in some cases are starting to diverge. One thing they have in common is that transparency of definitions, approaches and impact on financial performance is paramount.

To the second question: There is no surprise that the focus on ESG product performance has been top of mind. Indeed, as the majority of the market looks at these issues there is a natural demand and supply for ESG. Equity and fixed income research, specialist research and in-house researchers are increasingly looking at and valuing these issues in my view. While some brokers have been looking at this for a long time, the broader broker community has really gotten involved on this topic in the last two years. ESG is now being priced in a way that is playing out in the markets, and Morningstar has noted that sustainable funds have largely held up better than conventional funds during the first quarter.[3]

Finally, will stewardship be changed in the new normal is a question that I have been reflecting on. At Invesco we recently issued our 2019 Global Stewardship Report where we seek to be more transparent than ever before. We address the new definition of stewardship broadening beyond proxy voting and engagement to ESG integration and consideration of systemic risks such as climate change. While this may be new to some, we see the future as sticking to the priorities of making these considerations more systematic across all our investments, executing on our commitment to be responsible owners and to ask ESG questions of our companies. Climate change remains a top issue of concern, but the 'S' in ESG has risen to the forefront and is already presenting itself much more prominently in our dialogue. As we seek to help our clients respond to these trends, we are increasingly co-creating solutions that we believe can meet both financial and ESG objectives.

1 Source: Bloomberg, L.P., as of May 28, 2020
2 Source: NASDAQ, as of April 1, 2020
3 Sources: Morningstar, "Sustainable Funds Weather the First Quarter Better Than Conventional Funds," April 3, 2020
4 Source: Principles for Responsible Investment
5 Sources Morningstar, "Investors Back ESG in the Crisis," May 12, 2020; Invesco analysis

# Authors

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Kristina Hooper has 25 years of investment industry experience. Prior to joining Invesco, she was the US investment strategist at Allianz Global Investors. Prior to Allianz, she held positions at PIMCO Funds, UBS (formerly PaineWebber) and MetLife. She has a BA degree cum laude from Wellesley College; a J.D. from Pace University School of Law; an MBA in finance from New York University, Leonard N. Stern School of Business, where she was a teaching fellow in macroeconomics and organizational behavior; and a master's degree from the Cornell University School of Industrial and Labor Relations, where she focused on labor economics. She holds the Certified Financial Planner, Chartered Alternative Investment Analyst, Certified Investment Management Analyst and Chartered Financial Consultant designations.

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Global Head of ESG

Based in the UK, Cathrine De Coninck- Lopez is Global Head of ESG for Invesco, with global responsibility for environmental, social and governance (ESG) research and engagement. She joined Invesco in October 2017 as Head of ESG for Invesco's Henley Investment Centre following nine years at Columbia Threadneedle Investments. Cathrine started her career in 2008 as a responsible investment analyst and has experience across the responsible investment spectrum of ESG integration to specific fund strategies. She is a non-executive board member of the UK Sustainable Investment and Finance Association (UKSIF). She holds an MBA from London Business School, a MSc in Water Science, Policy and Management from Oxford University and a BSc in Environmental Science from Nottingham University. She also holds the Investment Management Certificate from the CFA Society of the UK.

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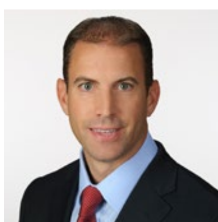
Mr. Feng joined Invesco Canada in 2009, transferring to IHKL in 2015. Prior to joining the firm, he was a vice president at Burgundy Asset Management Ltd., where he co-managed Asia- Pacific assets and was a senior member of the EAFE Equities team. Earlier in his career, he was an investment analyst at Trans-East Investment Counselling Ltd. and a research analyst at Sunrise Investment Ltd. He began his investment career in 1997.

Mr. Feng earned a BA in Finance from Xiamen University in China and an MBA from the Richard Ivey School of Business at the University of Western Ontario. He is a Chartered Financial Analyst® charterholder.



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