Trending towards Multi Sector Credit
Invesco Active Multi-Sector Credit strategy

October 2020

This marketing document is exclusively for use by Professional Clients, Financial Advisers, Qualified Investors and Qualified Clients/ Sophisticated Investors. This is not for consumer use, please do not redistribute.

The challenges of the current low interest-rate environment require different approaches and disciplines than were necessary in the strong bull market for bonds of the past two decades. Multi-sector credit can be an efficient and unique approach to global credit investing.

By leveraging the global opportunity set and overlaying risk management to minimise drawdowns, this segment can help to achieve an appropriate risk-adjusted return. Invesco Fixed Income's multi-sector credit strategies continue to attract growing attention from those investors looking to boost their fixed income allocations' diversification, yield and risk-adjusted return potential.

These actively managed strategies offer a dynamic allocation mix across global credit segments that can be continuously adapted in an effort to optimize overall positioning and security selection as market conditions and investment opportunities evolve.

This paper discusses the reasons why, in our view, the multi-sector credit segment has become an increasingly popular choice for so many investors and offers an overview of the distinct characteristics and potential benefits of the Invesco Active Multi-Sector Credit strategy. It also highlights various portfolio applications for effective implementation.

A steadily growing choice for investors

In the current challenging fixed income landscape, investors continue to search for new ways to help optimize their fixed income allocations and strengthen portfolio risk-adjusted return potential. One of the most popular areas of growth in helping to achieve these goals is in multi-sector credit strategies.

These portfolios generally share several key characteristics in that they combine multiple fixed income sectors in an effort to outperform broad bond market benchmarks, such as the Bloomberg Barclays U.S. Aggregate Index, with notably less volatility and lower correlations to traditional fixed income asset classes.

To accomplish this, they tend to allow significant flexibility to the investment team around sector, region, duration, credit rating and security exposures, based on current and anticipated market conditions.

There are three primary reasons why multi-sector credit strategies continue to attract the attention of investors:

1. In our view, multi-sector credit strategies are particularly well suited for today's markets.

Years of incredibly low yields have created a slow but persistent risk creep in many fixed income allocations. There simply is not a lot of yield to be had in higher credit quality segments, and it requires much greater relative risk exposure to capture the same levels of yield targets and overall total returns than in the past.

Actively managed multi-sector credit strategies can offer investors a practical way to help increase portfolio income-generation potential without unduly increasing overall risk levels. By actively positioning assets across a wide range of credit sectors, these strategies can help increase yield potential with less expected volatility and drawdown exposure.

2. The segment has experienced significant asset flow growth.

The institutional multi-sector credit segment has seen significant inflows and asset growth since the financial crisis. Over the past five years, the segment has experienced average annual net asset inflows of 5.7% – more than three times higher than the traditional U.S. credit segment.

This consistent rise in asset flows has naturally prompted more investors to take a closer look at the segment and the potential benefits it may offer. In response to this strong demand, there are also more individual offerings available today.

Given the dynamic nature of these portfolios and the different approaches each investment team can take, this offers investors greater choice in the type of strategy ideally situated for their specific needs, whether they are looking for an unconstrained, an absolute-return or a more balanced strategy.

Some investment teams follow a more conservative style, others a more aggressive one, while others apply a risk-parity focus that shifts exposures as market volatility dynamics change.

There may also be major points of differentiation around levels of sector diversification and active duration management. All of this offers investors a more expansive selection to find the right strategy match for their portfolios.

3. Skilled managers can potentially save investors both time and money.

Fixed income markets are changing every minute of every day. Multi-sector credit strategies can offer investors quicker ability to pivot in changing market conditions to pursue opportunistic returns and proactively adjust portfolio risk exposures.

These strategies can also capture cost efficiencies. When used as a portfolio's primary fixed income allocation, they can be less expensive than maintaining separate strategies for multiple bond segments.

They also offer practical solutions for many mid- and smaller-sized institutions or individual investors that lack the staff and/or research resources to actively manage exposures to various fixed income sectors.

Furthermore, in terms of risk management, many investors may not have a mechanism in place to monitor overall real-time portfolio risk when utilizing separate strategies to implement their fixed income asset allocations.

Spotlight on Invesco Active Multi-Sector Credit

The Invesco Active Multi-Sector Credit strategy is managed to pursue returns approaching those achieved in the global high yield market while exposing the portfolio to significantly less risk and notably lower maximum drawdowns. It was developed in 2012 to help investors access an actively managed asset allocation approach of underlying fixed income credit exposures under one umbrella structure.

The strategy is differentiated by these core features:

It is managed by one of the leading fixed income platforms in the industry.

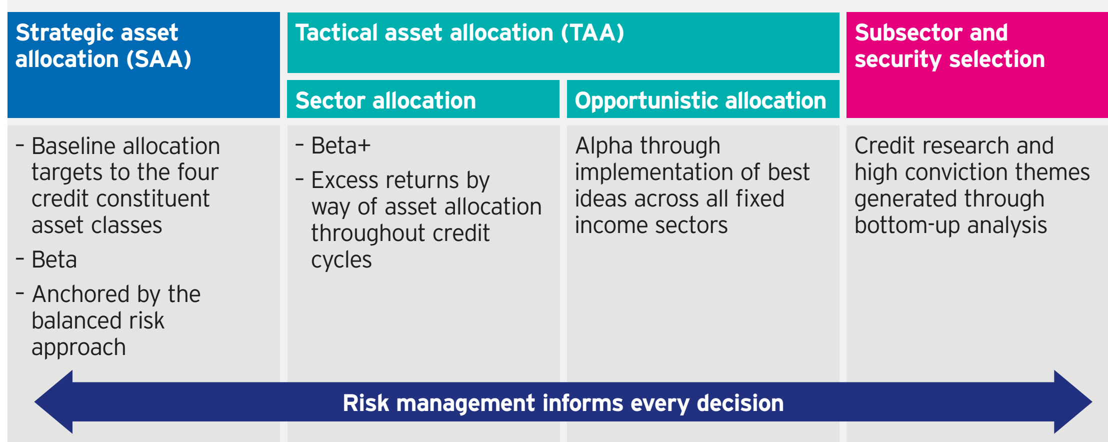
The increasingly complex and interconnected nature of global credit markets can create a wealth of investment opportunity, but it can take specialized expertise, experience and agility to translate these opportunities into consistent return potential.

The Invesco Fixed Income platform is one of the largest in the world, offering extensive resources that span the globe, with more than 170 investment professionals collectively managing more than USD 360 billion in assets in 12 key market locations (as at 30 June 2020).

This research capability depth across sectors allows for the expertise and skill to help support a wide range of potential portfolio levers designed to target stronger risk-adjusted performance.

The strategy's main investment scope includes investment grade bonds, bank loans, emerging market debt, high yield bonds and cash–all notable areas of Invesco Fixed Income expertise. The investment team can apply these insights across the strategy through their experience in sector allocation and individual security selection.

Figure 1
Investment process



Source: Invesco. For illustrative purposes only.

It follows a distinct, time-tested methodology. The strategy offers a diversified credit portfolio built through a disciplined, research-intensive process. It combines top-down and bottom-up analysis to help capitalize on the outperformance rotation that can occur in fixed income segments. This highly discretionary approach is constructed utilizing five layers:

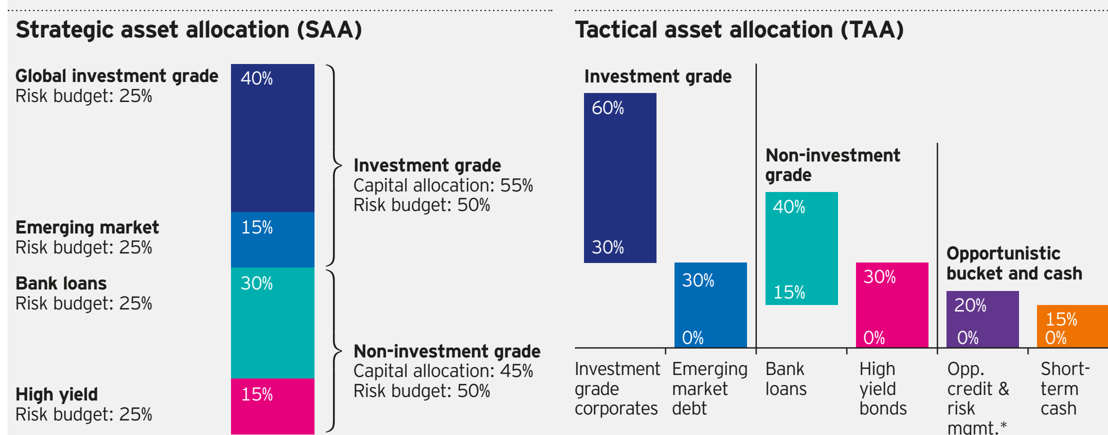
- Strategic asset allocation to balance risk
- Tactical asset allocation (sectors) to seek a beta-plus tilt
- Tactical asset allocation (opportunistic) to further enhance return potential
- Subsector rotation and security selection designed to generate additional alpha
- Continuous risk management for holistic portfolio oversight

These layers work collectively together to pursue an enhanced overall risk/reward profile. The first layer in this process is to implement a carefully constructed full-cycle strategic asset allocation that is diversified across four core global credit sectors: global investment grade, global high yield, emerging market debt and bank loans.

These four categories offer structural breadth by encompassing two distinct market segments: higher quality credits through investment grade and emerging markets debt, and more speculative credits through high yield and bank loans (emerging market debt has migrated steadily toward investment grade in terms of credit rating and market spread, hence the linkage of these asset classes).

The contrast between floating-rate bank loans and fixed-rate credit is another example of the portfolio's structural breadth and provides a source of interest-rate sensitivity diversification. Relatively lower correlations among these segments-and at times even negative to U.S. Treasuries-can also help reveal

Figure 2
Active multi-sector credit design - combining structure and discretion



Risk parity across sectors ensures return is driven by high-conviction tactical allocation and security selection decisions.

Well-defined tactical allocation ranges establish opportunity for portfolio managers to exercise discretion.

* Opportunistic credit can consist of bonds from sectors including (but not limited to) RMBS, CMBS, Convertible Bonds
Source: Invesco. For illustrative purposes only. There can be no assurance that the fund's actual investment allocations will be within the minimum and maximum investment allocation boundaries described herein or will match the investment parameters set forth above. Please note: Bank Loans cannot be invested in directly by the fund. Exposure to eligible loans will generally be taken via investment in Collateralised Loan Obligations (CLOs), collective investment schemes, Floating Rate Notes (FRNs) as well as swaps and other derivatives on UCITS eligible loan indices. Portfolio weightings are subject to change without notice.

additional multi-sector opportunities to help diversify risk/return characteristics.

This strategic asset allocation has historically outperformed over longer timeframes.

It serves as the baseline allocation to the four constituent asset classes, constructed so that each asset class should contribute an equal amount of risk to the overall portfolio, based on historical full-cycle volatilities.

Applying a risk parity approach allows the strategy to seek to deliver a more stable, diversified asset allocation over time. It also establishes a balanced baseline around which the investment team can create and manage credit exposures. While the strategy is benchmark agnostic, the strategic asset allocation acts as an internal benchmark to measure performance.

The next layers are two tactical asset allocation bands: one focused on sector allocation and one on opportunistic investments. These bands allow the team to capitalize on market volatility.

Through leveraging the Invesco Fixed Income platform and the depth of experience on the team, we can modulate our sector allocations through the economic cycle with the goal of adding additional value over that achieved through the strategic asset allocation alone.

The opportunity set for risk/return enhancements tied to tactical changes in portfolio positioning offers a way to adjust for this natural outperformance rotation and seeks to add additional value over that achieved through the strategic asset allocation alone.

Tactical asset allocation across sectors applies a rigorous top-down macroeconomic review and bottom-up sector analysis to adjust weightings toward fundamentally driven relative value opportunities, seeking to capture intra-cycle valuation gap.

These views lead to the regular adjustment of capital allocations to the constituent asset classes. However, the portfolio also applies limits on how much can deviate tactically from the strategic asset allocation to help preserve its risk control framework.

The opportunistic tactical asset allocation band is designed to generate alpha through the implementation of the investment team's highest conviction investment ideas across the four main credit sectors, as well as other fixed income sectors, such as municipals, securitized products and convertible securities, among others.

One of the main requirements for a bond's inclusion in this layer is high potential for a quantifiable catalyst to spark outperformance.

It can also serve as an efficient way of managing aggregate exposures, duration and overall portfolio risk, as well as quickly and dynamically expressing sector views and modulating volatility when there are short-term technical market dislocations.

In this process, the portfolio can employ derivative instruments, such as swaps, swaptions and futures, which can provide fast, cost-effective ways to help manage overall risk in the face of changing market conditions.

Layer four encompasses subsector rotation and security selection decisions that strive to capture the strongest risk-adjusted return opportunities within each credit asset class. This process is the responsibility of individual, specialized sleeve portfolio managers.

Working closely with sector analysts, they apply consistent top-down and bottom-up views in their respective credit asset classes through disciplined fundamental research and relative value analysis to identify potential idiosyncratic performance that appears uncorrelated with market beta.

This helps to define subsector positioning based on country, industry, capital structure and credit quality. It also seeks to generate additional alpha through fundamental issuer analysis and superior security selection.

Layer five is risk management, which runs throughout the entire process as a continuous and on-going part of daily investment decisions–at the most granular security level, within each individual sleeve allocation and across the entire aggregate portfolio.

This disciplined framework closely reviews risk from multiple angles, evaluating potential areas of concentration and specific exposures around issuers, market movements, interest rates and inflation. In addition to this integrated process, there is also independent portfolio oversight and monitoring through multiple Invesco governance structures.

Delivering returns with less volatility

The strategy looks to deliver an enhanced return profile similar to the global high yield market with significantly less volatility and downside exposure. It seeks to achieve these optimized characteristics through active, ongoing risk/reward positioning, which can help potentially position it for added performance in strong markets, while providing downside mitigation in difficult markets.

The investment team can make quick, tactical, cost-efficient adjustments as market conditions change to shift the portfolio's risk profile across asset class, sector, region, duration and individual security holdings.

This, coupled with low correlations between asset classes, has significantly enhanced the portfolio's overall risk/return characteristics. Inputs can include global investment grade spreads, emerging market spreads, high yield spreads, bank loan spreads, global duration and changing correlations, among others.

Potential portfolio applications

The Invesco Active Multi-Sector Credit strategy can be employed in a number of ways. The overarching goal is usually to help access greater alpha potential and expanded diversification from fixed income investments.

This can be achieved as a professionally managed single offering to cover overall credit allocations, usually paired with higher-quality government bond investment strategies and/or an institution's internal capabilities in these segments.

Alternatively, the strategy can be utilized to complement a broader set of fixed income strategies by introducing a new source of potential income and total return designed to help enhance investors overall risk-adjusted performance profile.

Investors continue to look for new ways to extract more value from their fixed income assets. Multi-sector credit strategies can offer a unique, advanced toolset to help deliver on this goal. An integrated approach to investing in diverse credit markets can potentially offer attractive performance opportunities not available in segregated single sector allocations.

The Invesco Active Multi-Sector strategy offers broad credit exposure and diversifies performance across tactical beta and fundamental alpha can help enhance investors' ability to navigate today's challenging fixed income environment.

More sources of return have the potential to create more opportunity, in our view. Indeed, in our own approach we diversify primary potential return drivers across a multi-sector strategic asset allocation utilizing modified risk parity paired with sector and opportunistic tactical asset allocations that apply qualitative expertise and judgment of experienced teams.

Alpha through bottom-up subsector and high conviction security selection also seeks to add outperformance potential. This time-tested process allows us to target global high yield-like returns over a full market cycle with dramatically less risk.

As more investors experience the practical applications in multi-sector credit portfolios, we expect the shift to these strategies to continue. The compelling mix of potentially higher yields, lower risk and greater time and cost efficiencies should continue to capture greater investor attention, particularly given many of today's fixed income market challenges.

Risk Warnings

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. As a large portion of the strategy is invested in less developed countries, you should be prepared to accept significantly large fluctuations in value. The strategy will invest in derivatives (complex instruments) which will result in leverage and may result in large fluctuations in value. Debt instruments are exposed to credit risk which is the ability of the borrower to repay the interest and capital on the redemption date. Investments in debt instruments which are of lower credit quality may result in large fluctuations in value. Changes in interest rates will result in fluctuations in value. The strategy may invest in distressed securities which carry a significant risk of capital loss. The strategy may hold a large amount of Asset Backed Securities (ABS) (complex instruments) as well as lower quality debt securities which may impact liquidity under certain circumstances. Performance may be adversely affected by variations in the exchange rates between the base currency of a portfolio and the currencies in which the investments are made.

Important Information

This marketing document is exclusively for use by Professional Clients and Financial Advisers in Continental Europe (as defined below), Qualified Investors in Switzerland, Qualified Clients/Sophisticated Investors in Israel and Professional Clients in Cyprus, Dubai, Jersey, Guernsey, Ireland, Isle of Man, Malta and the UK. By accepting this document, you consent to communicate with us in English, unless you inform us otherwise. This document is not for consumer use, please do not redistribute.

This document is marketing material and is not intended as a recommendation to invest in any particular asset class, security or strategy. Regulatory requirements that require impartiality of investment/investment strategy recommendations are therefore not applicable nor are any prohibitions to trade before publication. The information provided is for illustrative purposes only, it should not be relied upon as recommendations to buy or sell securities.

Data as at 30 September 2020, unless otherwise stated.

Where individuals or the business have expressed opinions, they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice. Further information on our products is available using the contact details shown. Past performance is not a guide to future returns. Forecasts are not reliable indicators of future performance.

For the distribution of this document, Continental Europe is defined as Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Netherlands, Norway, Spain and Sweden.

Issued by Invesco Management S.A., President Building, 37A Avenue JF Kennedy, L-1855 Luxembourg, regulated by the Commission de Surveillance du Secteur Financier, Luxembourg.

Dubai: Issued by Invesco Asset Management Limited, Po Box 506599, DIFC Precinct Building No 4, Level 3, Office 305, Dubai, United Arab Emirates. Regulated by the Dubai Financial Services Authority. **Israel:** Issued by Invesco Asset Management Limited, Perpetual Park, Perpetual Park Drive, Henley-on-Thames, Oxfordshire RG9 1HH, UK. Authorised and regulated by the Financial Conduct Authority. This document may not be reproduced or used for any other purpose, nor be furnished to any other person other than those to whom copies have been sent. Nothing in this document should be considered investment advice or investment marketing as defined in the Regulation of Investment Advice, Investment Marketing and Portfolio Management Law, 1995 ("the Investment Advice Law"). Investors are encouraged to seek competent investment advice from a locally licensed investment advisor prior to making any investment. Neither Invesco Ltd. Nor its subsidiaries are licensed under the Investment Advice Law, nor does it carry the insurance as required of a licensee thereunder. **Switzerland:** This document is issued in Switzerland by Invesco Asset Management (Schweiz) AG, Talacker 34, CH-8001 Zurich.

[EMEA7571/2020]