Strategic Sector Selector

Rotating into cyclicals

The initial enthusiasm may have faded after the US Presidential election, but global equities still had positive returns in Q4 2024. Market leadership changed with early-cyclicals outperforming, especially consumer discretionary and financials. We expect global growth to move towards trend in 2025 (we think recession is a tail risk), and we assume inflation to remain contained. We think equity markets will “grind higher” even after strong returns in 2024, and we do not expect the market expansion to end. With that in mind, we increase our allocation to cyclical sectors by upgrading energy and media to Overweight and basic resources and industrial goods & services to Neutral. At the same time, we reduce our allocation to defensives by downgrading personal care, drug & grocery stores to Neutral, and healthcare and utilities to Underweight. Finally, with the support from increasing bond yields fading, we downgrade insurance to Neutral.

Changes in allocations:

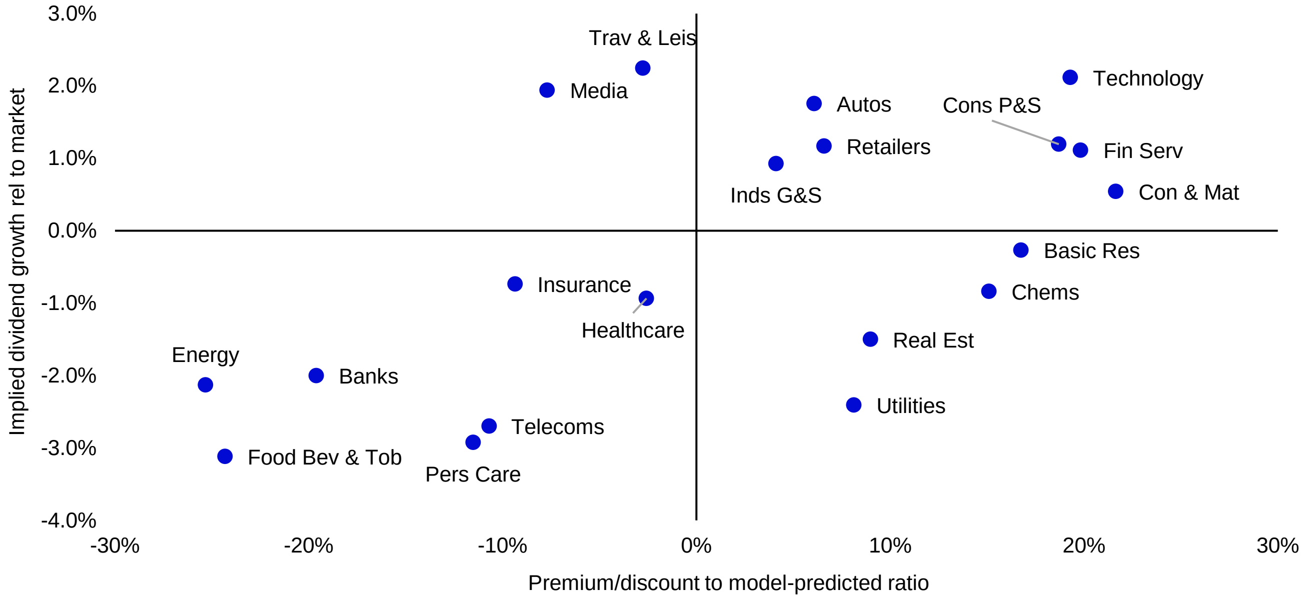
- Upgrades: energy, media (N to OW), basic resources, industrial goods & services (UW to N)
- Downgrades: personal care, drug & grocery stores, insurance (OW to N), utilities (N to UW), healthcare (OW to UW)

Most favoured	Least favoured
US retailers	US utilities
US banks	European telecommunications

Sectors where we expect the best returns:

- Retailers: well-diversified sector, exposure to growth factor and potential rebound in consumer spending
- Banks: steepening yield curve, attractive valuations, exposure to accelerating growth
- Financial services: exposure to pick-up in investment banking cycle, tends to outperform in mid-cycle phase

Figure 1 – Global sectors valuation matrix



Notes: Data as of 31 December 2024. On the horizontal axis, we show how far a sector’s valuation is above/below that implied by our multiple regression model (dividend yield relative to market). The vertical axis shows the perpetual real growth in dividends required to justify current prices relative to that implied for the market. We consider the sectors in the top right quadrant expensive on both measures, and those in the bottom left are considered cheap. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

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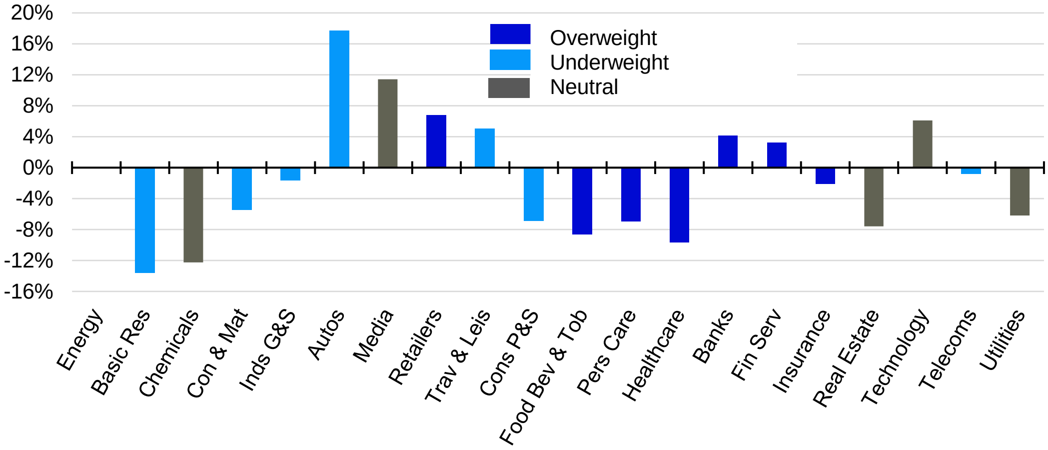
Summary and conclusions

Since the last time

The initial enthusiasm about the result of the US Presidential election may have waned somewhat, but global equities still eked out modest gains: the MSCI All-Country World index returned 1.4% in Q4 2024 in local currency terms. Investors grappled with trying to account for the impacts of policies aimed at deregulating several industries, most prominently oil & gas and technology. At the same time, proposed tariffs and tighter controls on immigration raised the prospect of higher inflation in the US implying fewer rates cuts by the US Federal Reserve (Fed).

Figure 2 – 3m Global sector returns relative to market in USD



Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Returns shown between 30 September 2024 and 31 December 2024. Colours indicate allocations in period considered. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

As **Figure 2** demonstrates, returns narrowed in Q4 2024 after a period of broadening in Q3. The best performers were early-cyclicals, especially consumer discretionary (excluding consumer products & services) even if the automobiles & parts sector was boosted mostly by the outperformance of its largest constituent potentially benefitting from a close relationship with the incoming Trump administration. Our preference for a balanced model allocation had a mixed quarter as we were Underweight both the best performing (automobiles & parts) and the worst performing sector (basic resources). Our defensive Overweights underperformed, while our Overweights in retailers, banks and financial services outperformed.

Asset allocation backdrop

Our central scenario is based on the following assumptions: inflation continues to move towards central bank targets; most central banks continue to ease and economies accelerate throughout 2025 (from below trend growth). All else being equal, we think that would be good for asset performance during 2025. However, some assets performed very well during 2024, leaving valuations stretched, so we embraced risk cautiously.

Perhaps the single most important forecast is that Fed and other Western central bank policy rates will continue to fall during 2025, approaching what we consider "neutral" (see **Figure 3**). However, we expect little movement in long-term bond yields, so that yield curve steepening will be due to movements at the short end. This is why we are more neutral in our duration preferences than we would expect to be when central banks are easing. We are more aggressive than the markets when it comes to Fed easing and expect the dollar to weaken during 2025 (especially after recent gains).

Within our Model Asset Allocation (published on 17 November 2024), we chose to reduce the cash allocation to zero (from 6%) and government bonds to a Neutral 25% from 30% (with a preference for UK and EM markets). IG was raised from an already

Overweight 15% to 18%, with Japan reduced to zero (the only market not at the maximum allocation), while we boosted US and Eurozone allocations.

Though HY performed better than we expected in 2024, and despite our forecast of a slight widening of spreads and marginally higher default rates, the expected returns were enough to raise the allocation from zero to 4% (Neutral is 5%).

Out of the desire to embrace risk, we boosted the allocation to real estate (REITS), going to an Overweight 6% (from the Neutral 4%), with a preference for European and Japanese markets. We see the risks but think a lot is in the price and expect the real estate sector to benefit from falling policy rates. We also boosted the commodity allocation to the Maximum allowed 4% (from the Neutral 2%), in anticipation of support for industrial commodities from accelerating economies and a weakening dollar.

Otherwise, we made no change to the maximum 8% allocation to bank loans (we think it offers the best risk-reward potential). We left the equity allocation at an Underweight 35% (Neutral is 45%). Though equities normally perform well in economic upswings, they have already shone in 2023 and 2024, and stretched US valuations make it hard for us to be optimistic about global equity returns. We added to Europe but reduced EM ex-China (we still like Chinese stocks). Finally, we remained Zero allocated to gold, the best performing asset in 2024 but expensive in real terms, in our opinion.

Regionally, we are Overweight European and EM assets. We maintained the partial hedge out of US dollar into Japanese yen, believing the latter will rally as the BOJ normalises.

Figure 3 – Market forecasts

	Current (31/12/24)	Forecast 12-month
Central Bank Rates		
US	4.50	3.50
Eurozone	3.00	2.25
China	3.10	3.00
Japan	0.25	0.75
UK	4.75	3.50
10y Bond Yields		
US	4.57	4.30
Eurozone	2.36	2.25
China	1.68	2.00
Japan	1.08	1.20
UK	4.57	4.20
Exchange Rates/US$		
EUR/USD	1.04	1.12
USD/CNY	7.30	7.00
USD/JPY	157.20	130.00
GBP/USD	1.25	1.35
USD/CHF	0.90	0.85
Equity Indices		
S&P 500	5882	5800
Euro Stoxx 50	4896	5100
FTSE A50	13513	15250
Nikkei 225	39895	41500
FTSE 100	8173	8700
Commodities (US$)		
Brent/barrel	75	80
Gold/ounce	2625	2500
Copper/tonne	8653	10000

Notes: Forecasts were first published on 17 November 2024. There is no guarantee that these views will come to pass. See Appendices for definitions, methodology and disclaimers. See The Big Picture for a full explanation. Source: LSEG Datastream and Invesco Global Market Strategy Office

Changes to model sector allocations

We normally do not assign great significance to political events as we tend to view them as temporary drivers of market returns. Nevertheless, the US Presidential election changed the direction of global equity sector returns in Q4 2024 although that effect faded somewhat. Early-cyclicals, such as consumer discretionary and financials, outperformed alongside the technology sector, while late-cyclicals and defensive sectors underperformed. In our view, a combination of hope for higher economic growth and deregulation was behind this change of market leadership.

We think that growth is likely to remain the main focus of equity markets in 2025, especially if inflation remains subdued. However, some of the policies from the incoming Trump administration imply a less certain trajectory for interest rates. There has been a significant repricing of future rates, especially as the US labour market seemed resilient in Q4 2024. Although the Fed is now expected to cut rates by a further 25-50bps and the Bank of England (BOE) by up to 75bps, they have indicated that they are still looking to ease policy alongside most developed market central banks with the Bank of Japan (BOJ) the most prominent exception. The recent strength in the US dollar, however, puts Emerging Market central banks in a bind as weakening currencies may push inflation higher.

We expected softer economic growth before a reacceleration in 2025, but the US showed little sign of a significant slowdown as we approached the end of 2024. Elsewhere, macroeconomic indicators presented a more mixed picture especially in Europe, but we think it likely that the global economy will avoid a deep recession. Recent positive sentiment about the global economy may even contribute to an earlier reacceleration led by the US. At the same time, inflation may prove stickier than we previously expected, but we think it will remain in the “comfort zone” of within one percentage point of central bank targets. Geopolitical concerns could push energy prices higher, especially if the prospects for the global economy improve.

What does this mean for our sector allocations? If our base case turns out to be correct, growth moving towards trend should support equity markets implying that global equities could remain in the mid-cycle stage of consistent, but moderate returns. If monetary policy remains tighter for longer, this could constrain equity returns, especially in rate-sensitive sectors, such as real estate and utilities. The higher discount rate may also put pressure on the valuations of growth sectors, but that may be offset by potentially stronger earnings growth. Thus, even as we balance these countervailing forces, we think a gradual tilt towards cyclicals may be warranted in our model sector allocation.

One consequence of a higher risk of conflict near major energy exporting regions (both Ukraine and the Middle East) is that the price of oil and gas could remain near current levels supporting the revenues and margins of the **energy** sector. Based on our macroeconomic outlook, plentiful supply and discounts offered by major producers could only partially offset the upward pressure on pricing driven by geopolitical risk and stronger economic growth, thus we upgrade our allocation to **Overweight**.

Concerns over rates staying higher for longer, potential weakness in most economies outside the US and the relatively narrow leadership in global equities drove the underperformance of **basic resources** in Q4 2024, in our view. The current premium in valuations versus our multiple regression model is easier to justify after the decline in industrial metals prices opens the opportunity for catch-up, especially if our base case of global economic growth moving towards trend and a weakening US dollar turns out to be correct. Therefore, we think an Underweight allocation is no longer warranted, although relatively rich valuations make us cautious, hence the upgrade to **Neutral**.

Another sector which we think could be boosted by reaccelerating economic growth is **industrial goods & services**. Its slight underperformance in Q4 2024 may have been partially driven by the threat of tariffs, but we think that may not influence sector returns in the next 12 months. Valuations have remained at a slight premium on both our models, but we think that as one of the most diversified sectors through its exposures to aerospace & defence, payment systems, vehicle manufacturers and logistics providers, it could provide exposure to a broad upturn in the global economy. Nevertheless, with valuations slightly above "fair value", we only upgrade to **Neutral**.

Despite its outperformance in Q4 2024, **media** has retained its discount on our multiple regression model, which suggests that it may be able to continue outperforming, especially in a more benign economic environment. Although as a growth sector, its valuations may be under pressure if rates stay higher for longer, we think it makes sense to increase our allocation to cyclical sectors in general if growth reaccelerates. The sector's relatively low gearing and good margins could stand it in good stead even if inflation were to stay slightly above central bank targets. Thus, we upgrade to **Overweight**.

In preparation for a potential cyclical upturn, we downgrade the **personal care, drug & grocery stores** sector to **Neutral** from Overweight. Although its valuations appear attractive, we think it may struggle to outperform if equities remain in the mid-cycle phase underpinned by a stronger global economy. At the same time, it does not have enough cyclical exposure to benefit from higher growth and therefore may struggle to keep up with cyclical sectors if equities continue to "grind higher".

We view **healthcare** as another defensive sector that may struggle in the next 12 months, especially if rates stay higher than we expect for a prolonged period. Regulatory pressure from the incoming Trump administration may also impact providers servicing the US market. The sector's valuations also look richer than most other defensive sectors even after being one of the worst performers in Q4 2024: it looks the most expensive on implied growth and the second most expensive on our multiple regression model. Therefore, we downgrade it to **Underweight** in our model allocation.

Rising bond yields provided a boost to **insurance** in the period after COVID-related restrictions were lifted. However, we think that bond yields have less scope to rise from current levels. As that tailwind potentially disappears, we think the rising cost of natural disasters will become a more important driver of returns. At the same time, the sector seems less cyclical to us than other financials, and therefore an economic recovery may provide less of a boost. With that said, valuations look favourable on both of our models compared to most other sectors, which may offset some of the pressure on earnings, especially if inflation does not allow premiums to rise significantly. Therefore, we reduce our allocation to **Neutral**.

Utilities may have briefly outperformed in Q3 2024 as volatility increased and the Fed started easing monetary policy. Nevertheless, the cyclical rally in Q4 put it at a disadvantage even as several technology companies announced investments into power generation. Despite that underperformance in the fourth quarter valuations rose to a premium versus our multiple regression model. The sector's high gearing could also prove a disadvantage if interest rates stay high. At the same time, we expect a reaccelerating economy to support equities, and thus reduce our exposure to defensives by downgrading utilities to **Underweight**.

The best and worst of the rest

Chemicals could be boosted by higher product prices, but we think it may struggle to outperform in the current economic environment, because its input costs have remained high. Although we expect a turnaround in industrial production in the next 12 months, we think it may be too early to upgrade the sector as it trades at a premium to the relative dividend yield implied by our multiple regression model. We maintain our **Neutral** allocation.

Although house prices seem to be stabilising and real wage growth is positive, relatively high mortgage rates may hinder the **construction & materials** sector. We are also concerned that higher costs of labour and materials will put pressure on profit margins, while regulatory uncertainty can weigh in the US. The sector also looks overvalued on our multiple regression model and its implied dividend growth rate is above that of the market even after its recent underperformance. We believe its valuations reflect a lot of good news, and therefore we stay **Underweight**.

After being the best performing sector in Q4 2024 mainly driven by its largest constituent, **automobiles & parts** now looks overvalued versus the relative dividend yield implied by our multiple regression model. Although we consider the sector an early-cyclical, and therefore think it can benefit from a reacceleration in economic growth, we think its valuations and narrow leadership may make further outperformance unlikely. The sector may start outperforming when more sustainable drivers are behind its returns, thus we stay **Underweight** for now.

At the same time, we maintain exposure to the growth factor through **retailers**, which could be useful even if the Fed cuts rates more gradually than previously expected. The sector’s relative dividend yield may be slightly below of that implied by our multiple regression model, but it is a diversified sector, which we think will provide resilience during any potential market weakness should the economy perform weaker than we expect. Sector earnings may also be supported if inflation falls further, and real wage growth remains positive. We maintain our **Overweight** allocation.

We expect **travel & leisure** to remain under pressure as long as oil prices stay high even though real incomes may rise in 2025, thus we think it is appropriate to keep our **Underweight** allocation. We believe the many headwinds the sector faces are proving too much: labour costs have risen, fuel costs could remain high, and demand may not fully recover until economic growth picks up, while higher costs could eat further into disposable incomes as excess savings are depleted. Nevertheless, there may be regional differences in returns if Asian tourists continue travelling in greater numbers, offset by weakness in the US and Europe.

We also keep our allocation to **consumer products & services Underweight**. We think luxury groups will continue to struggle unless consumer spending growth accelerates, especially in China. The sector also trades at a premium compared to the relative dividend yield implied by our multiple regression model, some of which may be justified by its relative resilience and diversification benefits (which we value). However, we are concerned that its high valuations may present a risk if interest rates remain high, while it tends to underperform in the mid-cycle stage of the equity market cycle.

At this stage of the cycle, assuming our interest rate expectations are proven correct, we believe that defensive growth offers an attractive way to mitigate equity market volatility and an inflation and economic growth undershoot. Therefore, we stay **Overweight food, beverage & tobacco**. After underperforming in Q4 2024, its valuations look attractive, well above the relative dividend yield implied by our multiple regression model. At the same time, the sector has the lowest implied perpetual dividend growth rate under 1%, which we think is appealing.

At the same time, we think the probability of major issues in the banking sector will be lower if monetary policy becomes less restrictive, especially if the global economy avoids a recession. We also expect a steepening yield curve, which coincided with outperformance in the past, especially in the US and UK. Valuations look attractive both compared to the relative dividend yield implied by our multiple regression model and versus historical norms. Of course, we cannot sound the all-clear that the risk stemming from higher interest rates has passed (for example via lending risk to the real estate sector), but valuations suggest that at least some of that is priced in, in our view. We stay **Overweight banks**.

Based on our assumption that we remain in the mid-cycle phase of the equity market cycle, we expect financials to outperform. We are also encouraged by early signs of a turnaround in capital raising and mergers & acquisitions activity, which bodes well for **financial services**. As long as the market expansion continues and the interest rate cycle turns, we think their relatively rich valuations will not be a cause for concern. We stay **Overweight**.

At the same time, we keep our **Neutral** allocation to **real estate**. The start of Fed easing has boosted sentiment towards the sector in Q3 2024, but that reversed as rate expectations rose in Q4. Gradual easing in financing costs imply only gradual improvement in sector returns, in our view. At the same time, valuations look rich based on our multiple regression model, although attractive on implied growth.

The biggest decision we face every quarter concerns the largest sector (based on market cap): **technology**. After outperforming in Q4 2024, valuations remain high and the sector has one of the largest premiums based on our multiple regression model, which makes it vulnerable to any turnaround in sentiment, in our view. We remain positive about the sector’s long-term growth potential, which we think will continue to benefit from increasing investment and boosted by the focus on generative artificial intelligence. We also value its high margins and solid cash generation, but valuations keep us cautious, thus we stay **Neutral**.

As we expect little turbulence in equities in the near term we stay **Underweight telecommunications**. We assume that an economic recovery will start in 2025, so we would expect defensive sectors, such as telecommunications, to underperform in the next 12 months. Although the sector trades at a discount based on our multiple regression model, it has no advantage in valuations compared to consumer staples, while it may not be boosted as much by either a rebound in consumer spending or a reduction in interest rates.

Sector in focus: Utilities

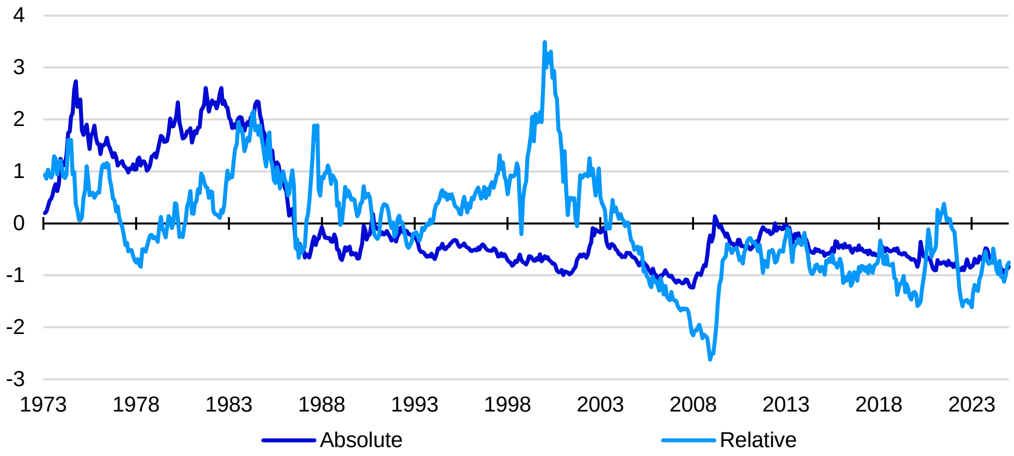
Defensive sectors tend to be an afterthought during market expansions when they spend long periods underperforming. Nevertheless, utilities entered the spotlight in Q3 2024, as a period of turbulence in global equities was followed by a reduction of rate expectations driven partly by concerns about economic growth. As a rate-sensitive sector with its high gearing it stood to benefit from falling rates, while its stable profits could have been attractive in an economic downturn. As optimism about the economy took over in Q4 2024, it was left behind again despite proposed investments in power generation to support projects in artificial intelligence by mega-cap technology firms.

We think that economic growth will reaccelerate and move towards trend in 2025, which should support equity markets. This does not bode well for defensive sectors, such as utilities, which are likely to underperform as cyclicals take leadership. Monetary policy may be somewhat supportive with rate futures pricing in no more than two 25bps rate cuts by the Fed by the end of 2025 at the time of writing (although we expect more – see **Figure 3**), and we think that may not be enough to significantly reduce interest costs for the sector. At the same time, if energy prices rise, it could increase earnings growth for utilities if they are able to pass it through to consumers.

Interestingly, utilities is a well-balanced sector geographically with the US accounting for 45% of market capitalisation, followed by developed Europe at 23% and EM at 15%. Unsurprisingly, the two dominant subsectors are made up of conventional electricity providers and multi-utilities accounting for just under 75% of market capitalisation, followed by alternative electricity, waste & disposal services, gas distribution and water making up the other 25%. At the same time there is no dominant stock (the top ten account for about 27% of market capitalisation as of 31 December 2024) and the sector has a long tail of small constituents.

As ever, there are multiple moving parts when trying to determine how utilities will fare in the next 12 months. The path of energy prices is perhaps the biggest influence on how sector earnings may develop, thus we would expect revenue growth and profitability to be healthy based on our forecasts. Having said that, earnings growth could be less relevant to relative returns compared to whether we can expect turbulence or not.

Figure 4 – Global utilities dividend yields versus historical averages (z-scores)



Notes: Data as of 31 December 2024. **Past performance is no guarantee of future results.** We use monthly data based on the 12-month trailing dividend yield on the Datastream World Utilities Index and the Datastream World Total Market Index. Relative dividend yields are calculated by dividing the yield on the utilities index by the yield on the total market index. Z-scores are calculated by dividing the difference from the long-term average since 2 January 1973 by the standard deviation of respective dividend yields.
Source: LSEG Datastream and Invesco Global Market Strategy Office

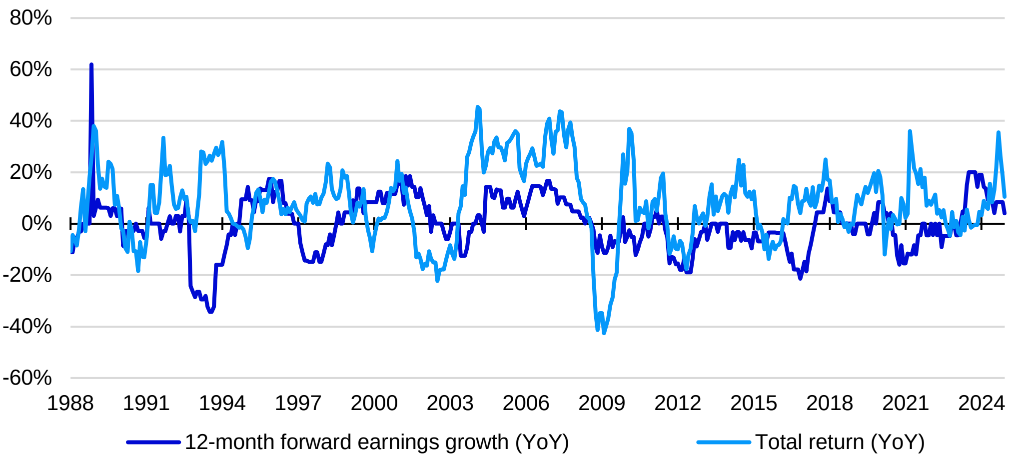
At the same time, despite being the best performing defensive sector in 2024 and outperforming resource-related sectors, real estate and construction & materials, utilities underperformed the broad global index by 4%. This kept sector valuations looking mixed, in our view.

When it comes to sector allocations, we start by comparing the relative dividend yield implied by our multiple regression model to what the sector trades at. This suggests that the sector is overvalued versus what our model implies (**Figure 12**). We then cross-check that using our perpetual dividend growth model, which shows that dividends would have to grow by a real 1.4% per year into perpetuity for the sector to generate the hurdle rate of return, well-below that of the market at 3.9% and suggesting it is relatively cheap, although that still makes it the most expensive defensive sector (**Figure 13**).

Comparing other valuation metrics to their own respective historical averages paints a more negative picture. All four valuation ratios we monitor, namely price/earnings, dividend yield, price/book and price/cash flow suggest utilities is overvalued in absolute terms (see **Figure 25**). Relative valuations paint a similar picture with, for example, relative dividend yields at 0.8 standard deviations below the historical average (**Figure 4**), while relative P/E ratios are close to historical norms. However, it is important to consider that as a so-called “bond proxy” sector, part of the overvaluation present in dividend yields may be a reflection of relatively lower bond yields since the Global Financial Crisis (GFC).

The dividend yield of utilities has been fluctuating in a relatively tight range between 2.5% and 5.1% since 1 January 1987 with an average of 3.7% (we think a return to pre-1987 levels is unlikely). The current yield at 3.2% (as of 31 December 2024) is below that average and also well-below 10-year Treasury yields, for example. We think that for the sector to become attractive yields would have to rise. For that to happen, either share prices would have to fall, or dividends would have to rise. In our view, neither is likely, as share prices do not tend to fall in market expansions (our base case), and dividends are unlikely to rise unless sector profitability increases (EBITDA margins are near 30-year highs as of 31 December 2024).

Figure 5 – Global utilities forward earnings growth vs total returns since 1988



Notes: Data as of 31 December 2024. **Past performance is not a guarantee of future results.** The data shown in the chart is monthly starting in February 1988. The index used to represent global utilities is the Datastream Utilities World index in US dollars. We use IBES consensus 12-month forward EPS and calculate year-on-year change to represent earnings growth.
Source: LSEG Datastream and Invesco Global Market Strategy Office

In our view, it is likely that the sector will continue underperforming. First, 12-month trailing dividend growth is -2%. Second, defensives tend to outperform mostly during significant market pull-backs, which we view only as a tail risk. Also, as **Figure 5** shows, 12-month forward earnings forecasts have been falling recently with analysts expecting around 4% growth (as of 31 December 2024), hardly enough to increase dividends significantly, in our view.

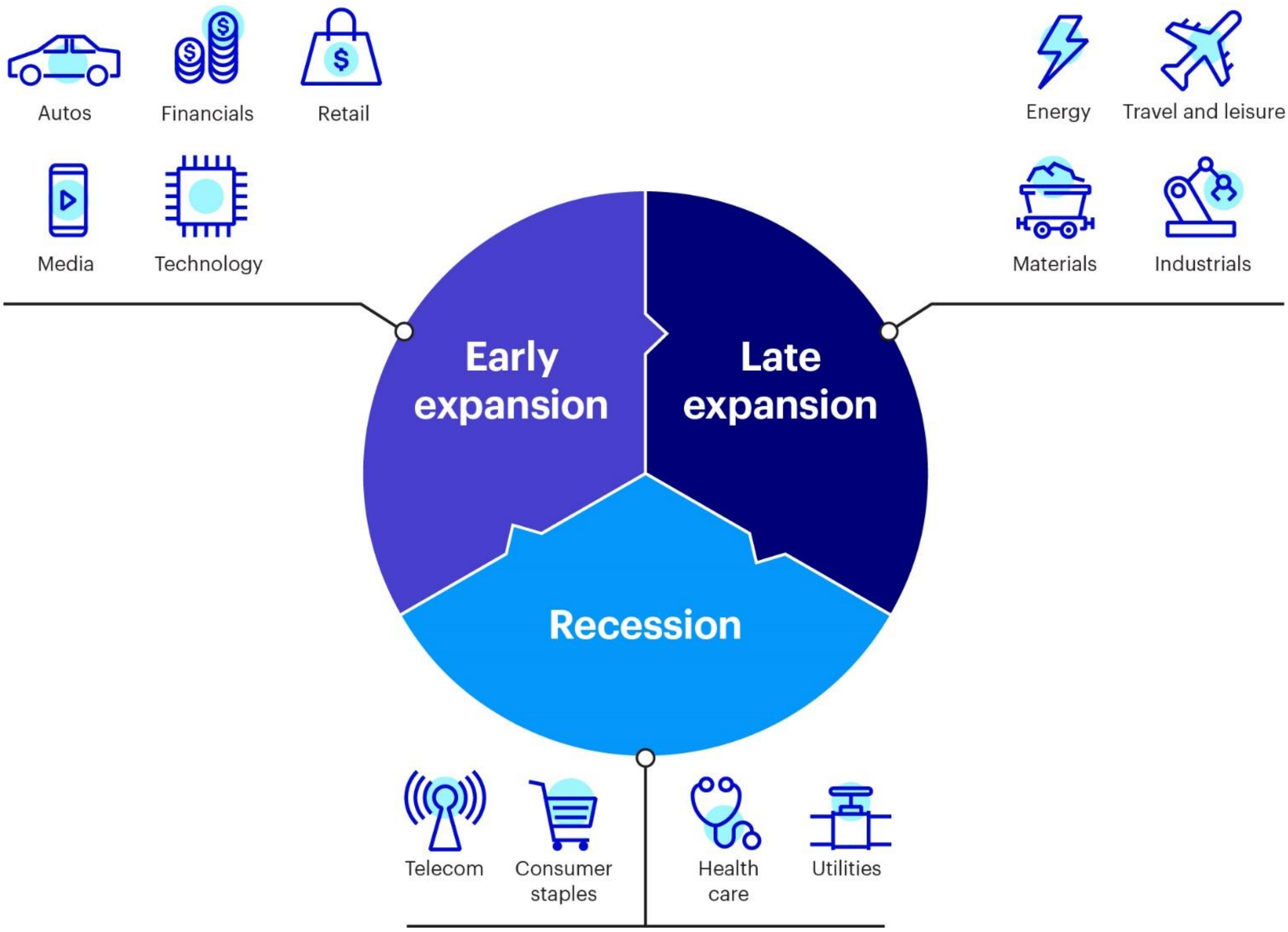
Where does all that leave us? As a defensive sector, utilities usually outperforms in periods of high volatility, which is currently not our base case. If we are correct, and markets remain in the mid-cycle stage, its relatively rich valuations and lack of growth prospects support our downgrade to Underweight.

Figure 6 – Model allocations for Global sectors

	Neutral	Invesco		Preferred Region
Energy	**6.1%**	**Overweight**	↑	**EM**
Basic Materials	**3.3%**	**Neutral**	↑	**Japan**
Basic Resources	2.0%	Neutral	↑	Japan
Chemicals	1.3%	Neutral		US
Industrials	**12.9%**	**Underweight**		**US**
Construction & Materials	1.7%	Underweight		US
Industrial Goods & Services	11.2%	Neutral	↑	US
Consumer Discretionary	**14.8%**	**Underweight**		**US**
Automobiles & Parts	2.8%	Underweight		Europe
Media	1.2%	Overweight	↑	US
Retailers	5.6%	Overweight		US
Travel & Leisure	2.0%	Underweight		EM
Consumer Products & Services	3.1%	Underweight		Japan
Consumer Staples	**4.9%**	**Neutral**	↓	**US**
Food, Beverage & Tobacco	3.1%	Overweight		US
Personal Care, Drug & Grocery Stores	1.8%	Neutral	↓	Europe
Healthcare	**8.4%**	**Underweight**	↓	**US**
Financials	**16.1%**	**Overweight**		**US**
Banks	7.6%	Overweight		US
Financial Services	5.5%	Overweight		US
Insurance	3.0%	Neutral	↓	US
Real Estate	**2.6%**	**Neutral**		**Japan**
Technology	**24.4%**	**Neutral**		**EM**
Telecommunications	**3.3%**	**Underweight**		**US**
Utilities	**3.2%**	**Underweight**	↓	**US**

Notes: Arrows indicate latest changes in allocations versus the previous edition. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

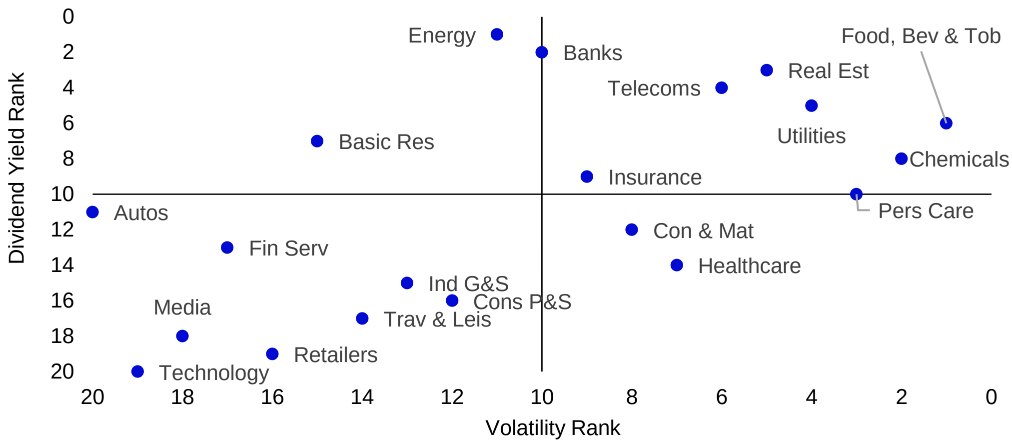
Figure 7 – Economic cycle and main sector allocation decisions



Note: The chart shows our opinion about which sectors tend to perform best at which stage of the economic cycle, based on our analysis of previous cycles.
Source: Invesco Global Market Strategy Office

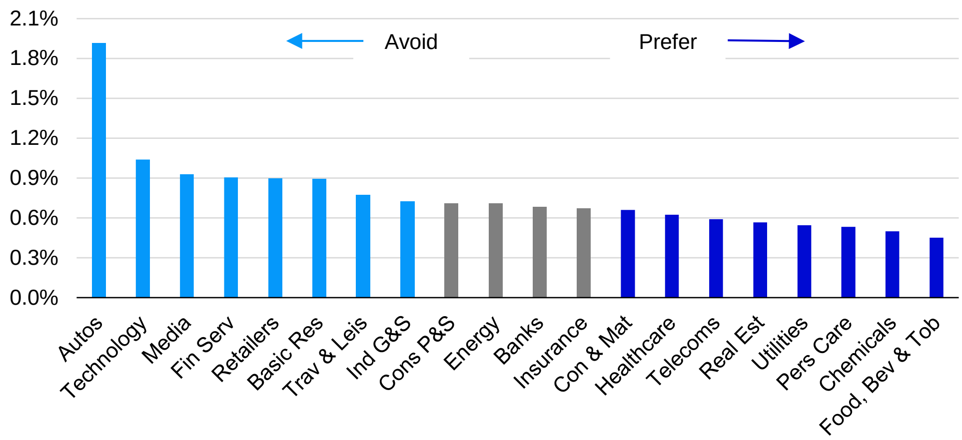
Systematic strategy – Global

Figure 8 – Global sectors ranked by volatility and dividend yield



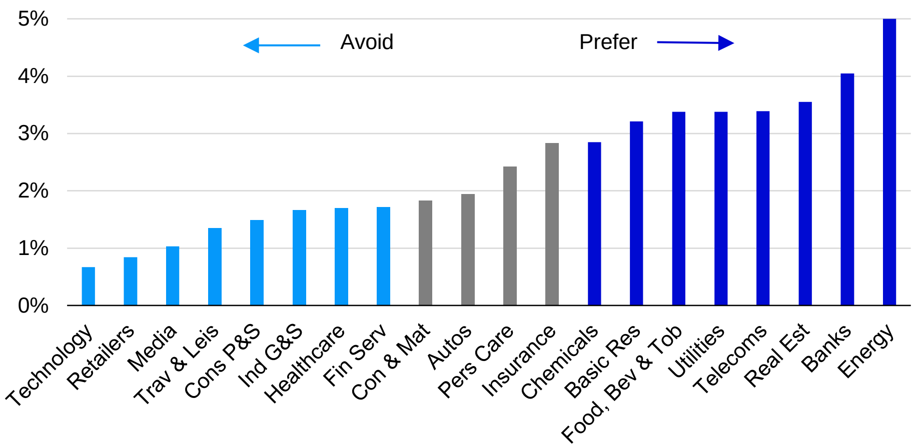
- A purely systematic approach would favour sectors in the top right corner: food, beverage & tobacco, chemicals and utilities.
- The approach would avoid sectors in the bottom left, such as technology and media.

Figure 9 – Global sector volatility of daily returns (using standard deviation in the past 3 months)



- The daily returns of autos, technology and media were the most volatile in the past 3 months.
- Food, beverage & tobacco, chemicals and personal care were the least volatile.

Figure 10 – Global sector dividend yield (12-month trailing)

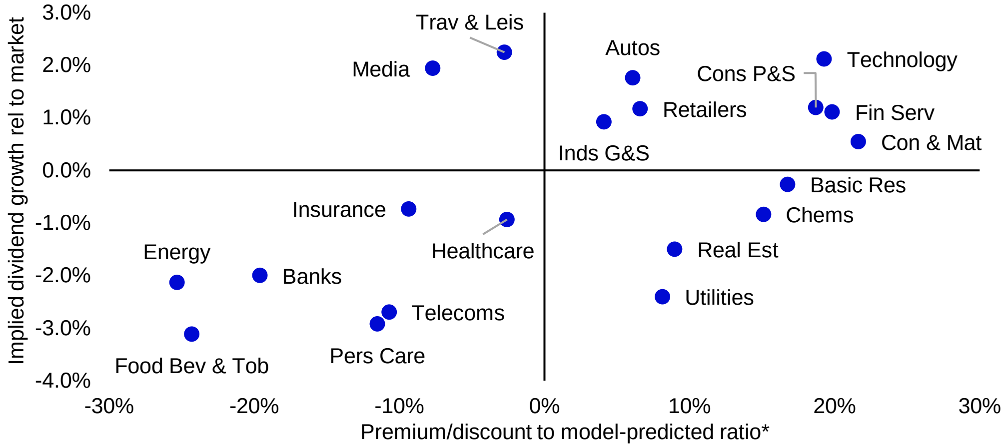


- Energy, banks and real estate look the cheapest based on their dividend yield.
- The lowest yielding sectors include technology, retailers and media.

Notes: Data as of 31 December 2024. **Past performance is no guarantee of future results.** In Figure 6, we rank sectors on the vertical axis by their current 12-month trailing dividend yields. On the horizontal axis, the sectors are ranked by the 3-month standard deviation of their daily returns. See appendices for methodology and disclaimers. Any reference to a ranking, a rating or an award provides no guarantee for future performance results and is not constant over time.
Source: LSEG Datastream and Invesco Global Market Strategy Office

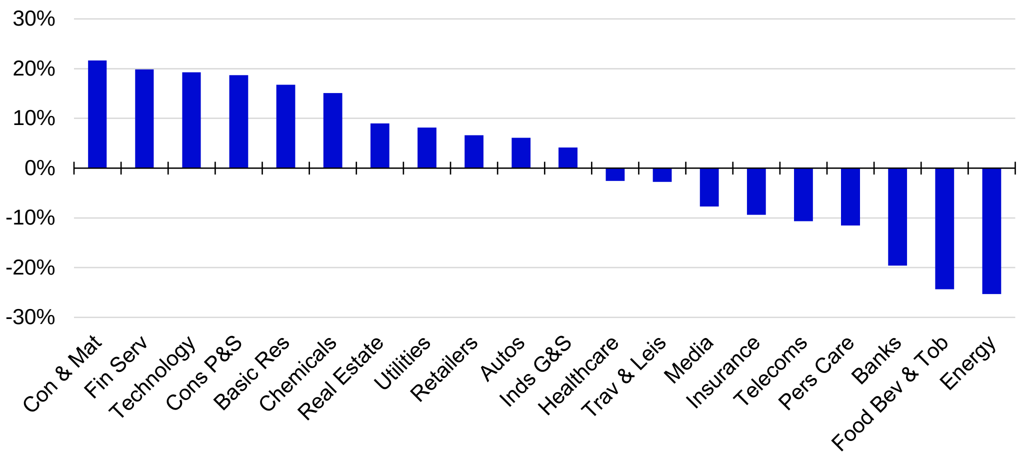
Valuations – Global

Figure 11 – Global sectors valuation matrix



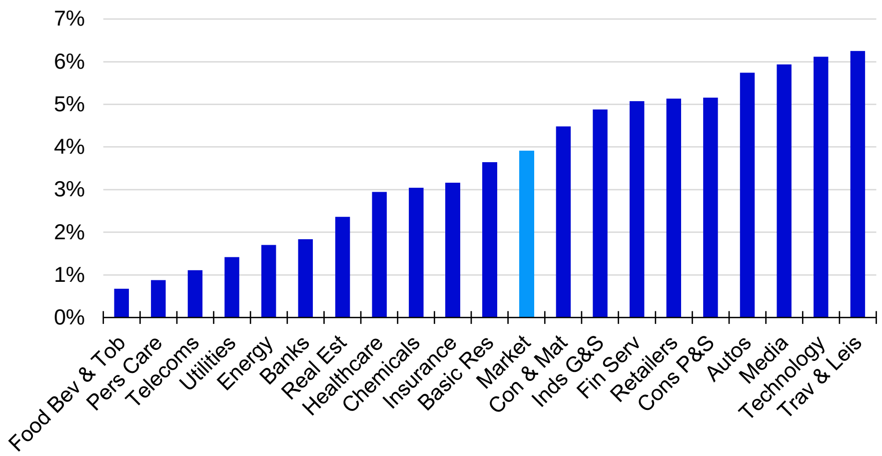
- Sectors in the top right corner look overvalued on both measures, while those in the bottom left appear undervalued
- This approach would avoid, for example, tech, financial services and construction.
- Food, beverage & tobacco, energy, and banks look better value

Figure 12 – Premium/discount to model-predicted ratio*



- Construction, financial services and technology look the most overvalued versus our model
- Energy, food, beverage & tobacco and banks seem the most undervalued versus our model-predicted ratios

Figure 13 – Global implied perpetual real dividend growth

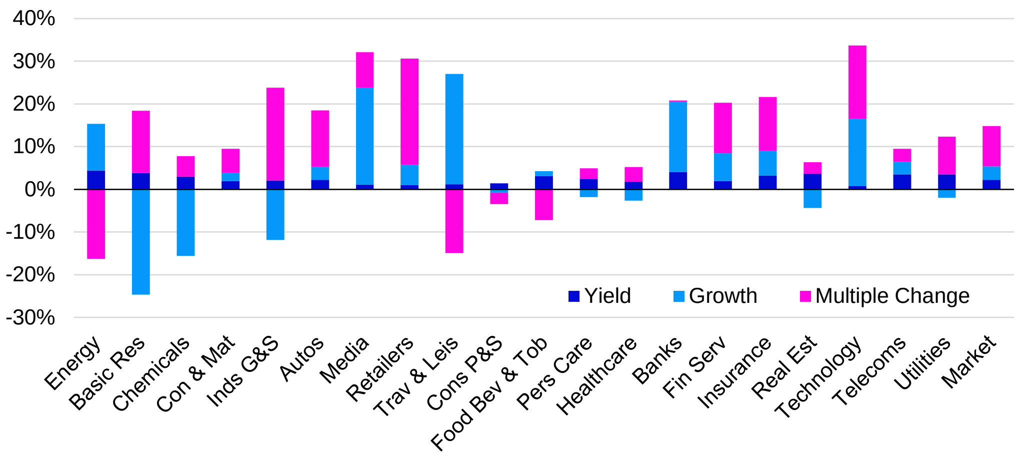


- Shows the future real growth required to justify current prices
- Travel & leisure, technology, and media appear priced for over 5% real growth in dividends (expensive)
- Only two defensive sectors seem priced for sub-1% growth (cheap)

Notes: *% above/below using dividend yield. Data as of 31 December 2024. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

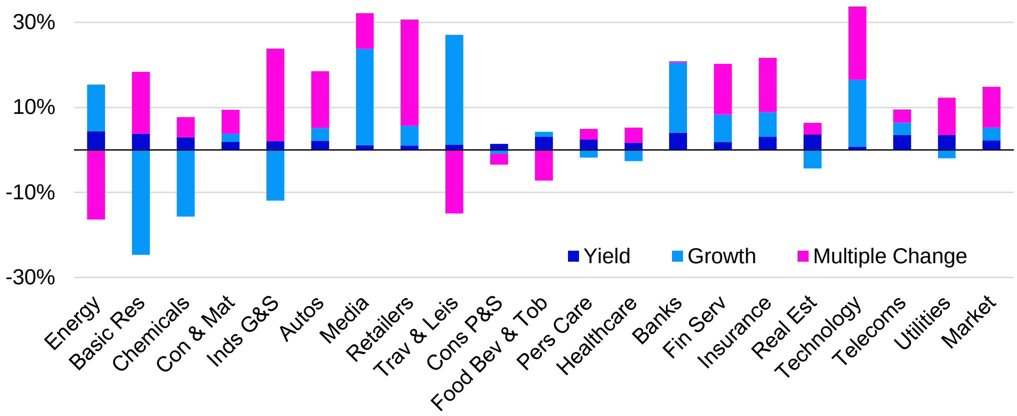
Decomposed returns – Global

Figure 14 – Global year-to-date total returns decomposed (annualised)



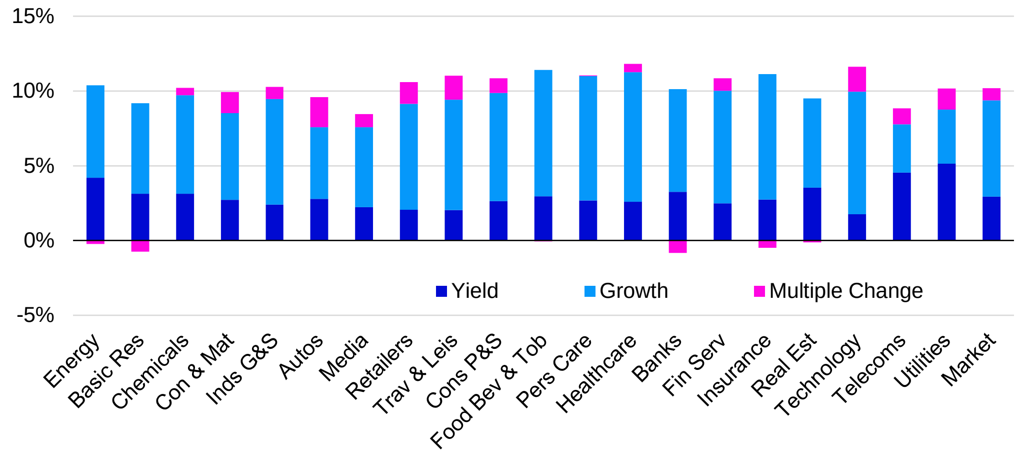
- Only four sectors had multiple contraction: energy, travel & leisure, consumer products & services and food, beverage & tobacco.
- Five sectors had over 10% dividend growth: energy, media, travel & leisure, banks and technology.

Figure 15 – Global rolling 12-month total returns decomposed



- Five sectors had negative total returns: energy, basic resources, chemicals, consumer products & services and food, beverage & tobacco.
- Two sectors had a yield above 4%: energy and banks.

Figure 16 – Global overall total returns decomposed (annualised, since 1973)



- Growth and yield drive long-term returns
- Growth is the most important, except for telcos and utilities
- Six sectors suffered from a multiple-related performance drag: energy, basic resources, food & bev, banks, insurance and real estate

Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Past performance is not a guarantee of future results.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendices

Appendix 1: Coefficients for variables used in multiple regression model

Figure 17 – Regression coefficients of Global defensive sectors

	Food, Bev & Tobacco	Personal Care	Health Care	Telecoms	Utilities	Market
Real Oil		-0.21			0.42	
Real Copper		0.01	0.00	0.02	-0.01	
Consumer Confidence	0.00		0.00	0.00	0.00	-0.01
Manufacturing Confidence	0.00	0.00	0.01	0.01		
IP		0.55	1.14	-0.64	2.53	-5.12
10y Yield			2.03	-5.32	10.34	-11.38
CPI	3.67		-2.92	-2.04	-7.40	3.68
Net Debt/EBITDA		0.07		0.12		
ROE	-2.69	-1.20	0.92	0.96	-4.97	

Notes: Data as of 31 December 2024. IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Bev = beverage. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 5 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 18 – Regression coefficients of Global resource-related and industrial sectors

	Energy	Basic Resources	Chemicals	Construction & Materials	Industrial G&S	Market
Real Oil	-2.10	-0.89				
Real Copper	0.02	-0.01	0.00	-0.01	0.00	
Consumer Confidence	0.01	0.01	0.01	0.00		-0.01
Manufacturing Confidence	-0.01	-0.02	-0.01	-0.01	-0.01	
IP	-2.35		-0.79	1.45	0.25	-5.12
10y Yield		-8.78		2.02	0.39	-11.38
CPI	12.38	29.28	7.37	6.59	0.92	3.68
Net Debt/EBITDA	-0.20	-0.11	0.06	0.24		
ROE	-3.61	-2.17	-1.21	-0.93		

Notes: Data as of 31 December 2024. IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. G&S = goods & services. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 5 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 19 – Regression coefficients of Global consumer discretionary and technology sectors

	Autos & Parts	Media	Retail	Travel & Leisure	Cons P&S	Tech	Market
Real Oil	1.02		0.28	0.48	0.99	0.41	
Real Copper	-0.01		0.00	0.00	-0.01		
Consumer Confidence	0.01	0.00	0.00	0.00	0.00	0.00	-0.01
Manufacturing Confidence			0.00	0.00		0.02	
IP	-3.26		0.99	-0.44	0.69	-1.69	-5.12
10y Yield	3.80	6.21	1.93	-1.05	5.02	-1.99	-11.38
CPI	-1.78	-5.77	-4.52	-3.22	-3.92	-2.73	3.68
Net Debt/EBITDA	-0.07	0.04	0.24		-0.24	0.09	
ROE		1.45		0.61	-2.53	0.52	

Notes: Data as of 31 December 2024. IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Cons = consumer. P&S = products & services. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 5 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

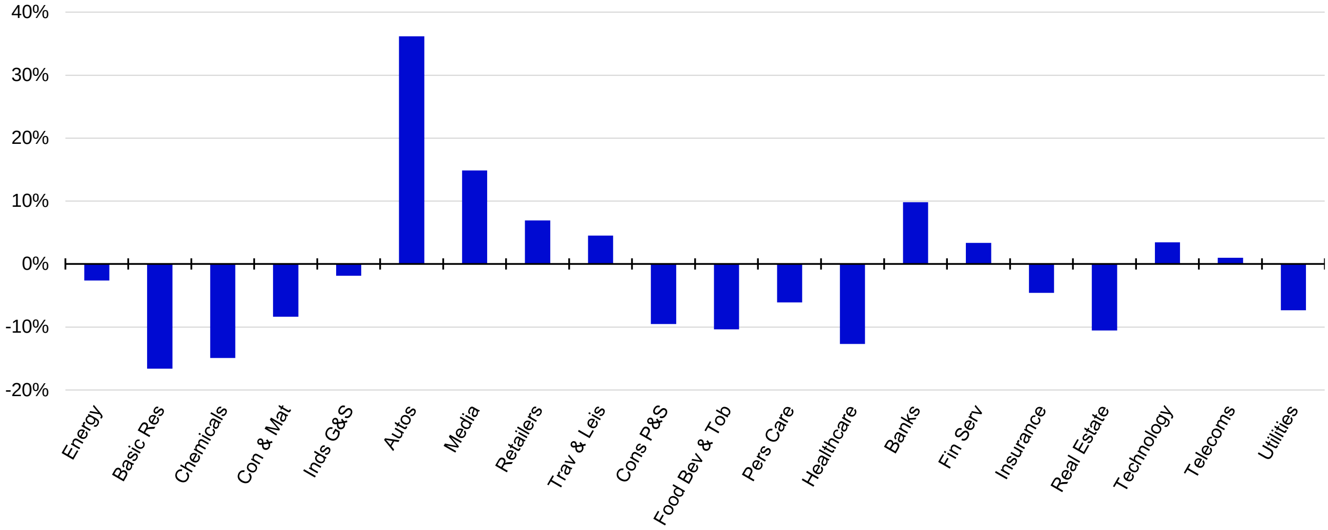
Figure 20 – Regression coefficients of Global financial sectors

	Banks	Financial Services	Insurance	Real Estate	Market
Real Oil			-0.53	0.56	
Real Copper		-0.01	0.01	-0.02	
Consumer Confidence	0.01	0.00	0.00	0.01	-0.01
Manufacturing Confidence	-0.01	-0.01		-0.03	
IP	-2.75	1.84		3.76	-5.12
10y Yield	-7.38		-5.27	2.22	-11.38
CPI	6.05		9.83		3.68
ROE	3.89	0.67	-1.12	-3.30	

Notes: Data as of 31 December 2024. IP = industrial production. CPI = consumer price index. EBITDA = earnings before interest, taxes, depreciation and amortization. ROE = return on equity. Only showing coefficients that have a statistically significant relationship with valuations at the 0.05 level. We use the dividend yield relative to market as our dependent variable. See the Methodology in Appendix 5 for more details. Source: LSEG Datastream and Invesco Global Market Strategy Office

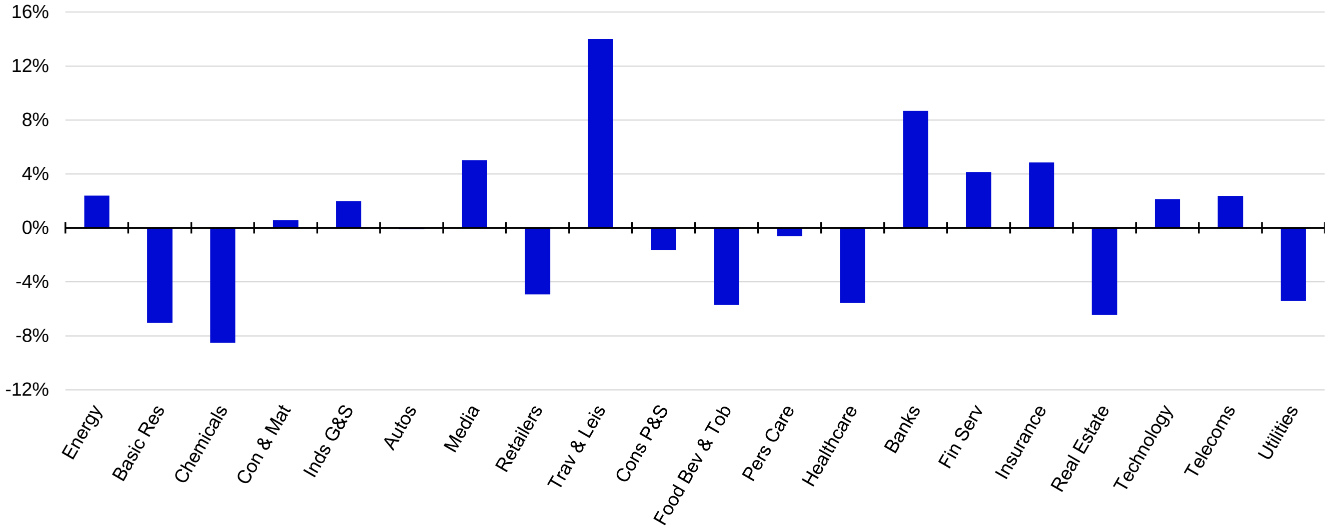
Appendix 2: Sector returns by region

Figure 21 – 3m US sector returns relative to market



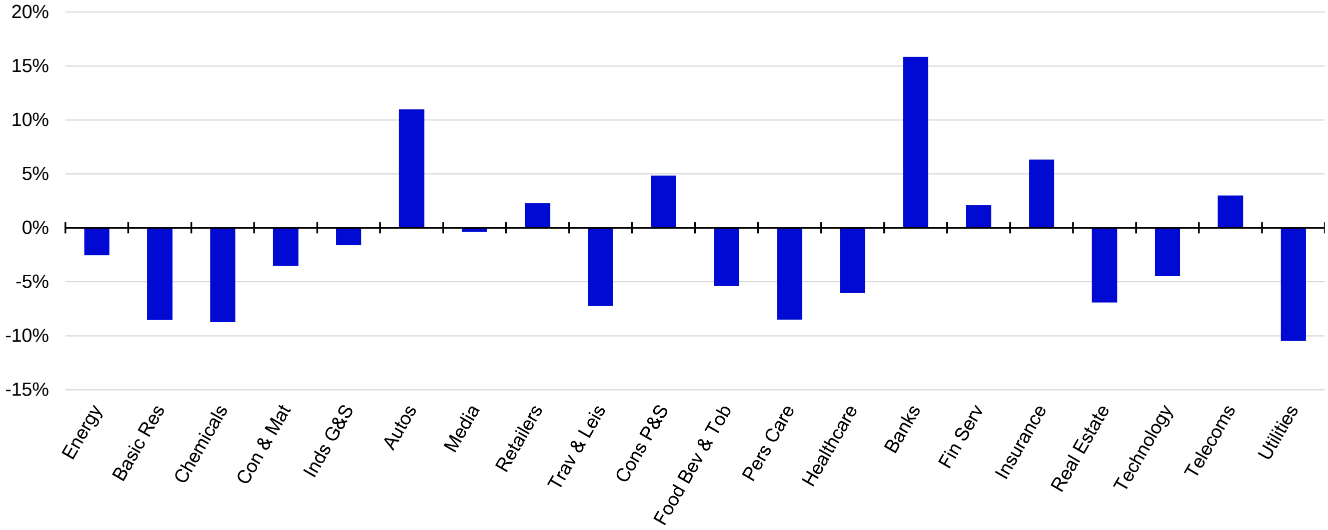
Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Returns shown between 30 September 2024 and 31 December 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 22 – 3m European sector returns relative to market



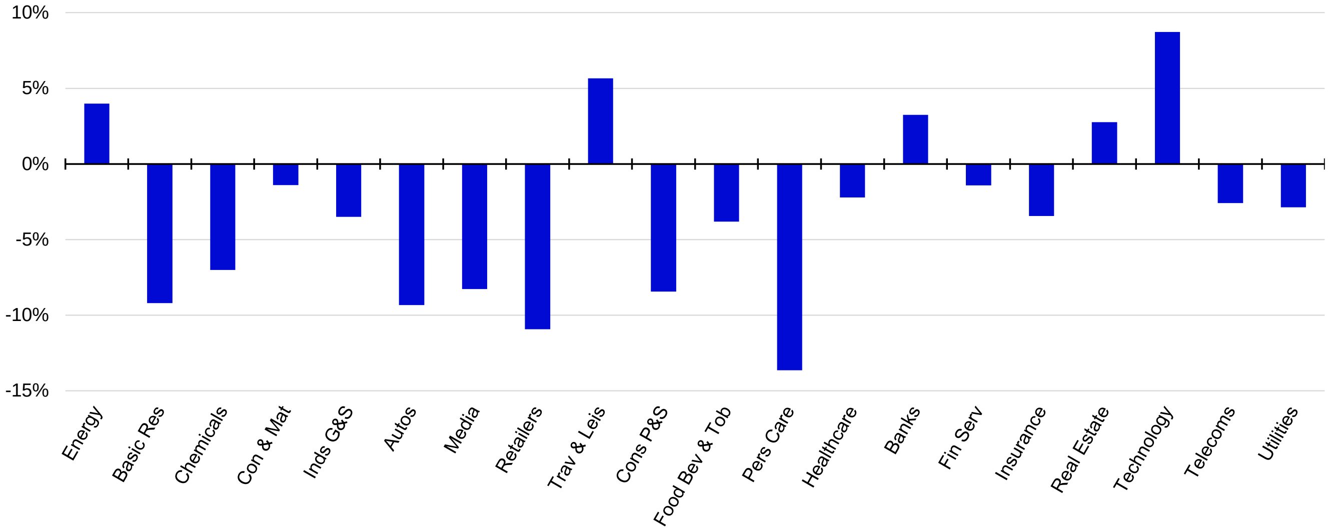
Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Returns shown between 30 September 2024 and 31 December 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 23 – 3m Japanese sector returns relative to market



Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Returns shown between 30 September 2024 and 31 December 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 24 – 3m Emerging Market sector returns relative to market



Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. Returns shown between 30 September 2024 and 31 December 2024. **Past performance is not a guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 3: Valuations tables

Figure 25 – Global absolute valuations

	Price/Earnings			Dividend Yield			Price/Book Value			Price/Cash Flow		
	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*
Energy	**13.4**	**14.4**	**-0.2**	**5.2**	**3.9**	**1.1**	**1.4**	**1.8**	**-0.7**	**6.6**	**6.3**	**0.2**
Basic Materials	**19.3**	**16.7**	**0.6**	**3.1**	**2.8**	**0.4**	**1.8**	**1.8**	**-0.1**	**8.8**	**7.5**	**0.8**
Basic Resources	16.9	16.8	0.0	3.2	2.9	0.3	1.6	1.7	-0.1	7.7	7.3	0.2
Chemicals	24.4	17.2	1.4	2.9	2.9	0.0	2.0	2.0	0.1	11.2	8.0	1.9
Industrials	**22.0**	**18.2**	**0.8**	**1.7**	**2.3**	**-0.8**	**3.2**	**2.2**	**2.2**	**13.6**	**9.3**	**2.3**
Construction & Mat.	21.1	16.8	1.1	1.8	2.5	-1.1	2.6	1.8	1.9	12.1	9.2	1.1
Industrial G&S	22.2	18.7	0.7	1.7	2.2	-0.8	3.3	2.3	2.1	13.9	9.3	2.4
Consumer Disc.	**23.8**	**18.9**	**0.9**	**1.3**	**2.2**	**-1.1**	**3.4**	**2.1**	**2.5**	**12.2**	**8.4**	**2.2**
Automobiles & Parts	15.5	15.0	0.1	1.9	2.6	-0.6	1.8	1.5	0.8	7.5	5.5	1.8
Media	33.9	21.9	1.5	1.0	2.0	-1.2	1.4	2.2	-0.9	8.9	8.7	0.0
Retailers	31.4	21.7	1.5	0.8	1.8	-1.2	7.3	3.6	3.1	17.8	13.5	1.3
Travel & Leisure	21.4	23.3	-0.2	1.4	1.8	-0.6	6.7	2.7	3.8	11.2	9.4	0.5
Consumer Prod & Serv	23.9	19.5	0.9	1.5	2.4	-1.3	3.6	2.2	2.1	14.7	11.0	1.4
Consumer Staples	**21.2**	**17.0**	**0.8**	**3.0**	**2.5**	**0.5**	**3.0**	**2.8**	**0.3**	**11.5**	**10.9**	**0.2**
Food, Bev & Tobacco	19.7	18.4	0.3	3.4	2.7	0.8	2.8	2.7	0.1	11.6	11.1	0.2
Personal Care	24.4	20.5	0.7	2.4	2.4	0.0	3.6	3.0	0.6	11.5	10.5	0.4
Healthcare	**33.0**	**20.5**	**2.1**	**1.7**	**2.3**	**-0.8**	**4.2**	**3.4**	**0.7**	**18.0**	**12.9**	**1.4**
Financials	**12.8**	**15.5**	**-0.6**	**3.0**	**2.7**	**0.4**	**1.0**	**1.4**	**-0.8**	**8.1**	**5.9**	**1.6**
Banks	10.2	14.1	-0.8	4.1	3.0	1.1	1.2	1.3	-0.4	6.4	6.2	0.1
Financial Services	18.6	18.3	0.1	1.7	2.3	-0.8	0.7	1.4	-1.2	16.9	9.3	3.4
Insurance	13.4	15.9	-0.5	2.8	2.5	0.4	2.0	1.7	0.4	6.2	3.9	2.3
Real Estate	24.6	19.2	0.9	3.6	3.3	0.4	1.3	1.4	-0.4	14.9	13.7	0.4
Technology	**36.1**	**24.5**	**1.1**	**0.7**	**1.6**	**-0.9**	**8.8**	**3.4**	**3.9**	**25.6**	**12.1**	**3.0**
Telecommunications	**18.0**	**17.3**	**0.1**	**3.4**	**4.2**	**-0.4**	**2.0**	**2.6**	**-0.5**	**5.9**	**6.1**	**-0.1**
Utilities	**17.7**	**14.6**	**0.8**	**3.2**	**4.8**	**-0.8**	**2.0**	**1.6**	**1.0**	**8.0**	**5.7**	**1.6**
Market	**21.2**	**17.2**	**0.9**	**2.1**	**2.7**	**-0.7**	**2.4**	**2.0**	**0.8**	**11.9**	**7.9**	**2.3**

Notes: *in standard deviations from historical average. Data as of 31 December 2024. Mat. = materials. G&S = goods & services. Disc. = discretionary. Prod & Serv = products & services. Bev = beverage. Data starts on 1st January 1973 for price/earnings and dividend yield and 1st January 1980 for price/book and price/cash flow. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

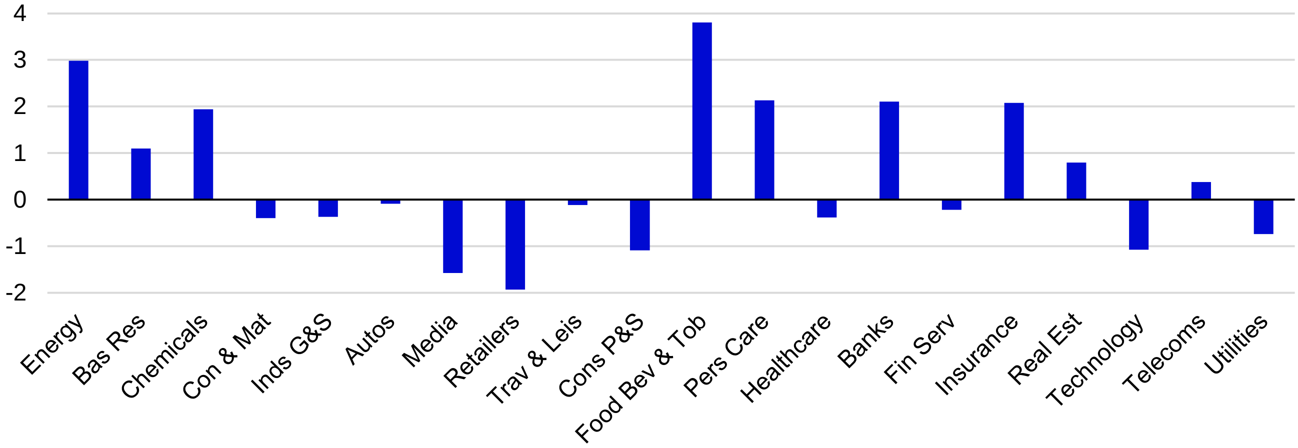
Figure 26 – Global cyclically-adjusted valuations

	Price/Earnings			Dividend Yield			Price/Book Value			Price/Cash Flow		
	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*	Now	Avg	Now vs Avg*
Energy	**15.7**	**18.6**	**-0.4**	**4.0**	**2.9**	**1.1**	**1.5**	**2.6**	**-0.9**	**6.9**	**8.6**	**-0.6**
Basic Materials	**16.6**	**23.0**	**-0.9**	**2.9**	**1.9**	**1.9**	**1.7**	**2.4**	**-0.9**	**8.0**	**9.9**	**-0.8**
Basic Resources	15.8	21.2	-0.7	3.1	2.2	1.3	1.6	2.2	-0.6	7.3	9.3	-0.6
Chemicals	17.8	24.2	-1.2	2.7	1.9	1.8	1.9	2.7	-1.5	9.2	10.8	-0.9
Industrials	**27.4**	**26.6**	**0.2**	**1.4**	**1.5**	**-0.2**	**3.5**	**3.1**	**0.7**	**15.3**	**12.9**	**1.0**
Construction & Mat.	25.3	23.9	0.1	1.6	1.9	-0.5	2.6	2.3	0.5	13.6	11.8	0.5
Industrial G&S	27.8	27.3	0.1	1.4	1.4	-0.2	3.6	3.1	1.0	15.6	12.8	1.4
Consumer Disc.	**29.9**	**27.0**	**0.6**	**1.1**	**1.4**	**-1.0**	**3.5**	**3.0**	**1.2**	**14.0**	**11.6**	**1.3**
Automobiles & Parts	18.3	18.8	-0.1	1.5	1.7	-0.4	1.8	2.0	-0.5	8.4	6.7	1.2
Media	31.2	29.8	0.2	1.0	1.4	-1.3	1.6	3.0	-0.9	8.3	11.1	-0.6
Retailers	46.0	32.4	2.1	0.7	1.1	-1.4	8.0	5.2	2.5	23.9	20.3	0.8
Travel & Leisure	27.7	33.7	-0.6	1.2	1.2	0.1	4.7	3.5	1.2	14.0	13.1	0.3
Consumer Prod & Serv	27.3	28.6	-0.3	1.4	1.6	-0.5	3.8	3.0	1.3	16.1	15.5	0.2
Consumer Staples	**20.1**	**22.5**	**-0.6**	**2.5**	**1.7**	**2.1**	**3.2**	**3.8**	**-1.1**	**13.0**	**14.6**	**-0.8**
Food, Bev & Tobacco	22.2	28.0	-1.2	2.7	1.6	2.4	3.0	4.1	-2.2	13.3	16.3	-1.8
Personal Care	25.0	31.3	-0.9	2.1	1.5	1.6	3.7	4.6	-1.1	12.6	16.1	-1.4
Healthcare	**32.9**	**31.7**	**0.2**	**1.4**	**1.4**	**0.0**	**4.8**	**5.2**	**-0.4**	**19.2**	**19.6**	**-0.1**
Financials	**17.6**	**23.1**	**-0.5**	**2.2**	**2.0**	**0.2**	**1.3**	**1.9**	**-1.0**	**8.5**	**7.4**	**0.7**
Banks	13.8	20.4	-0.7	2.9	2.4	0.5	1.2	1.7	-0.8	7.3	7.8	-0.2
Financial Services	25.2	29.1	-0.2	1.3	1.5	-0.4	1.0	1.8	-1.3	17.2	11.6	2.2
Insurance	20.1	23.6	-0.4	2.0	1.7	0.6	2.0	2.4	-0.4	5.5	5.0	0.5
Real Estate	14.6	25.8	-0.8	3.7	2.6	1.3	1.2	1.7	-1.1	13.7	16.8	-0.8
Technology	**58.2**	**39.4**	**0.9**	**0.5**	**0.9**	**-0.9**	**11.2**	**5.2**	**2.3**	**36.0**	**19.6**	**1.7**
Telecommunications	**17.0**	**22.6**	**-0.6**	**3.6**	**3.1**	**0.4**	**2.0**	**3.3**	**-0.9**	**5.6**	**7.6**	**-0.7**
Utilities	**20.6**	**18.6**	**0.4**	**3.0**	**3.5**	**-0.6**	**2.0**	**2.0**	**-0.1**	**8.1**	**7.0**	**0.9**
Market	**25.7**	**24.7**	**0.2**	**1.7**	**1.8**	**-0.3**	**2.7**	**2.8**	**-0.2**	**13.0**	**10.8**	**1.2**

Notes: *in standard deviations from historical average. Data as of 31 December 2024. Mat. = materials. G&S = goods & services. Disc. = discretionary. Prod & Serv = products & services. Bev = beverage. Data starts on 1st January 1983 for price/earnings and dividend yield and 1st January 1990 for price/book and price/cash flow. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

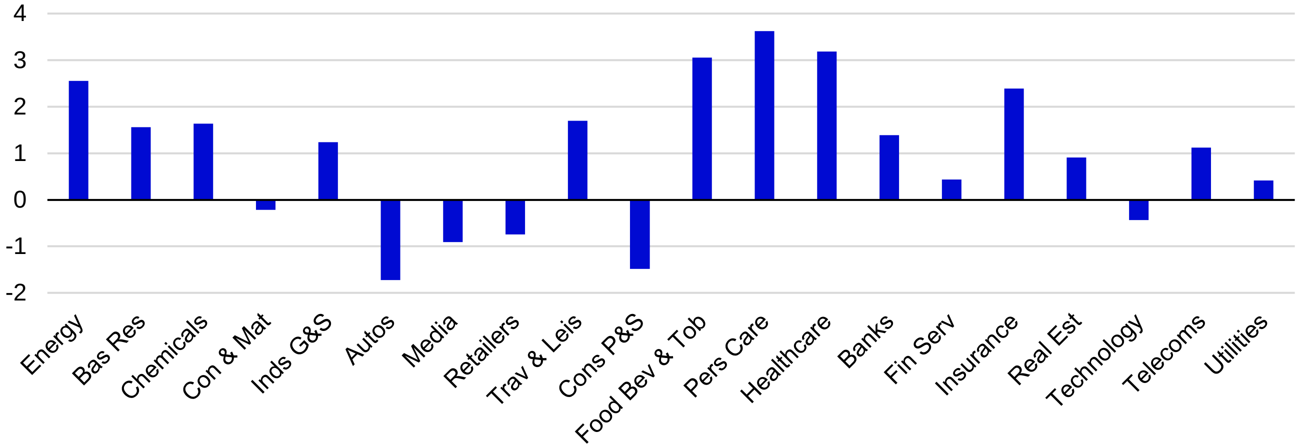
Appendix 4: Sector valuations by region

Figure 27 – Global dividend yields relative to market (z-score)



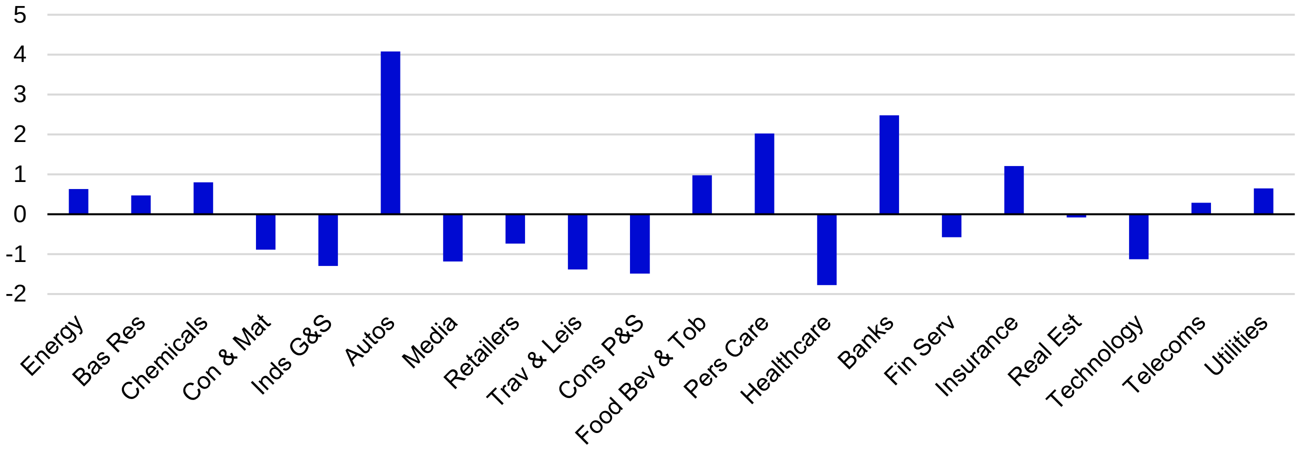
Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers.
Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 28 – US dividend yields relative to local benchmark (z-score)



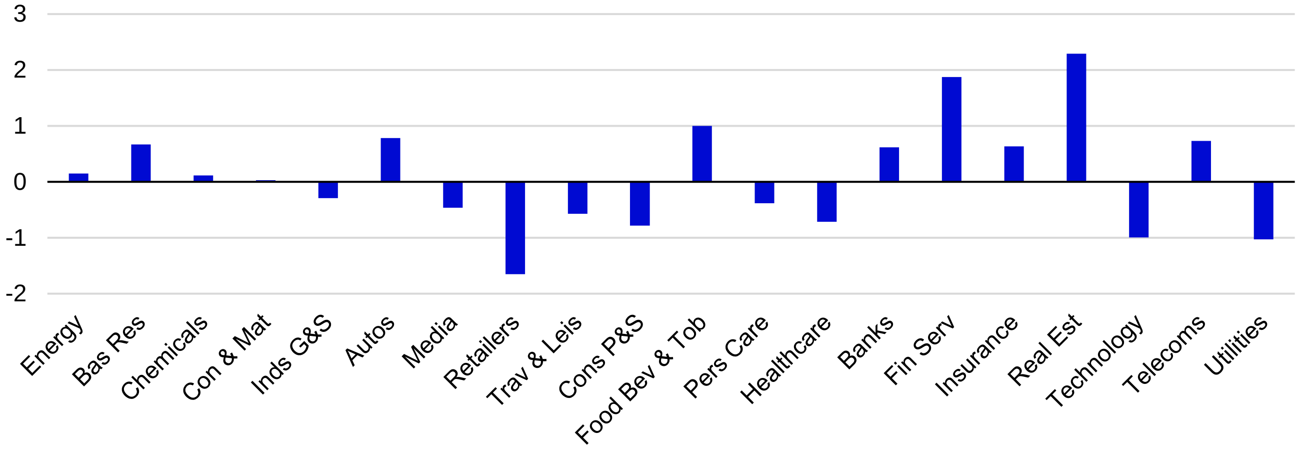
Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream US Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 29 – Europe dividend yields relative to local benchmark (z-score)



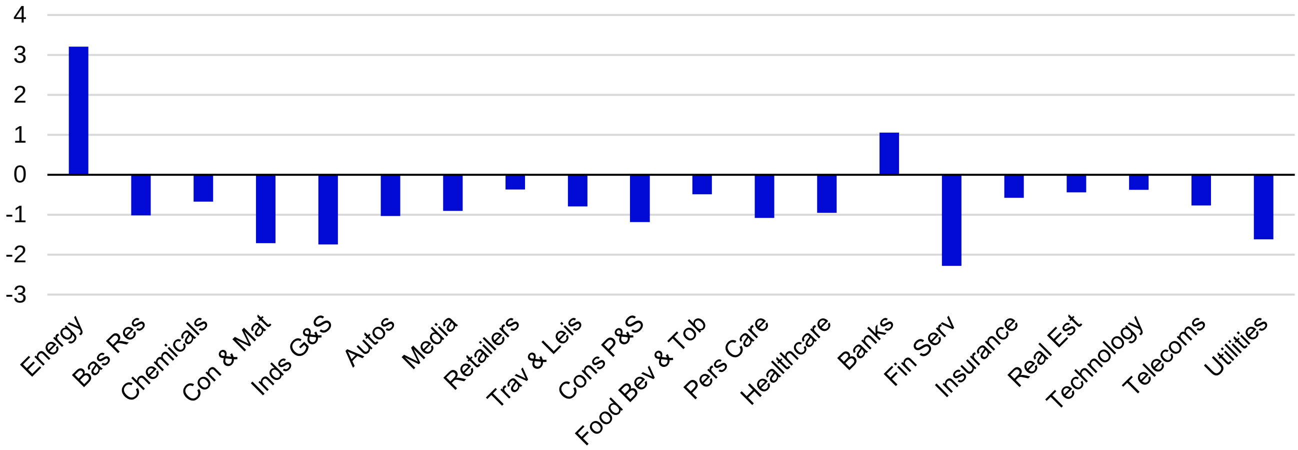
Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Europe Ex-Emerging Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 30 – Japan dividend yields relative to local benchmark (z-score)



Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Japan Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Figure 31 – Emerging markets dividend yields relative to local benchmark (z-score)



Notes: Data as of 31 December 2024. See appendices for methodology and disclaimers. The local benchmark is the Datastream Emerging Markets Total Market Index. Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 4: Performance tables

Figure 32 – Global equity sector total returns relative to market

Data as at 31/12/2024	Global				
	3m	YTD	12m	5y*	10y*
Energy	**-0.1**	**-13.7**	**-13.7**	**-4.7**	**-5.0**
Basic Materials	**-13.1**	**-19.8**	**-19.8**	**-2.6**	**-2.0**
Basic Resources	-13.6	-19.3	-19.3	-0.1	-0.7
Chemicals	-12.3	-20.4	-20.4	-5.8	-3.8
Industrials	**-2.2**	**-3.0**	**-3.0**	**-0.8**	**0.0**
Construction & Materials	-5.4	-4.7	-4.7	0.5	-0.7
Industrial Goods & Services	-1.7	-2.8	-2.8	-1.0	0.1
Consumer Discretionary	**5.5**	**2.4**	**2.4**	**-1.1**	**-0.5**
Automobiles & Parts	17.7	3.5	3.5	4.5	-0.7
Media	11.4	15.2	15.2	-3.2	-2.2
Retailers	6.8	13.8	13.8	1.3	1.6
Travel & Leisure	5.1	-2.2	-2.2	-5.5	-3.0
Consumer Products & Services	-6.9	-14.8	-14.8	-3.4	-1.0
Consumer Staples	**-8.0**	**-13.8**	**-13.8**	**-6.6**	**-4.1**
Food, Beverage & Tobacco	-8.7	-15.6	-15.6	-6.7	-4.5
Personal Care, Drug & Grocery Stores	-6.9	-10.3	-10.3	-6.4	-3.9
Healthcare	**-9.7**	**-10.9**	**-10.9**	**-3.4**	**-1.2**
Financials	**2.6**	**5.6**	**5.6**	**0.1**	**-0.6**
Banks	4.1	5.9	5.9	-1.1	-2.1
Financial Services	3.2	4.8	4.8	1.7	1.8
Insurance	-2.1	6.2	6.2	0.7	0.2
Real Estate	**-7.6**	**-11.3**	**-11.3**	**-9.3**	**-5.1**
Technology	**6.1**	**16.5**	**16.5**	**10.4**	**9.3**
Telecommunications	**-0.8**	**-4.5**	**-4.5**	**-4.2**	**-4.3**
Utilities	**-6.2**	**-4.0**	**-4.0**	**-2.9**	**-2.1**

Notes: *showing annualised returns. Returns shown are for Datastream sector indices versus the total market index. **Past performance is no guarantee of future results.** Source: LSEG Datastream and Invesco Global Market Strategy Office

Appendix 5: Methodology

Multiple regression analysis

We have run a multiple regression analysis to examine how macroeconomic factors influence sector valuations. We have used the dividend yield relative to market as the dependent variable and have run the regressions with the following independent variables:

Monthly series since 31/01/1991:

- **1-year change in:** industrial production, consumer price index
- **The level of:** real oil price (US CPI adjusted), real copper price (US CPI adjusted), consumer confidence index, manufacturing confidence index, 10-year benchmark government bond yield, net debt/EBITDA (only for non-financial sectors), return on equity

We calculate a global measure of industrial production growth, consumer price index growth, consumer confidence, manufacturing confidence and government bond yields using data from four regions or countries representing 65% of global Gross Domestic Product: United States, Europe, Japan and China. The global measures are weighted averages using Datastream global index market capitalisations as weights.

This analysis shows us which independent variables have a statistically significant relationship with sector valuation ratios. In addition, the regression coefficients tell us how much each independent variable influences those ratios. Finally, we use those coefficients to calculate what the valuation ratios should be, based on the model, and compare them to currently observed valuations. In theory, this allows us to determine whether a sector is undervalued or overvalued based on the macroeconomic factors we have used.

Sector classification

We use the Industry Classification Benchmark (ICB).

Leverage and profitability ratios

We calculate Net Debt/EBITDA from sector and market level aggregates supplied by LSEG Datastream. They define Net Debt as Total Debt minus Cash, where Cash represents Cash & Due from Banks for Banks, Cash for Insurance companies and Cash & Short Term Investments for all other industries. We tend to exclude Financials from Net Debt/EBITDA comparisons for it is difficult to distinguish debt they sell as a product and debt they incur during the operation of the business. In addition, LSEG Datastream define EBITDA – Earnings before Interest, Taxes and Depreciation – as the earnings of a company before interest expense, income taxes and depreciation. It is calculated by taking the pre-tax income and adding back interest expense on debt and depreciation, depletion and amortisation and subtracting interest capitalised.

Decomposed returns

We break down total returns into 3 components to examine what has driven sector performance year-to-date, in the last 12 months and for the whole history of the index. “Yield” shows the income investors received from dividends paid during the period concerned. “Growth” shows the rate of dividend growth, calculated using the percentage change in dividend per share (DPS) values for the sector indices. DPS is calculated as dividend yield times the price index. “Multiple Change” refers to the change in dividend yield between the two periods indicated, plus the change in dividend yield times dividend growth. We use it to measure investor expectations and sentiment regarding the sectors.

Implied perpetual growth models

A valuation cross-check is sought by calculating the perpetual real growth in dividends required to justify current prices. This then allows an evaluation of whether those implied growth rates are realistic.

We use a simple perpetual growth model to calculate implied growth. If Price = Dividend/(Discount Factor - Growth), then Growth = Discount Factor – Dividend Yield. The Discount Factor is equal to Risk Free Rate + (Beta x Market Risk Premium). Everything is expressed in real terms to eliminate the distorting influence of inflation, the output being growth in real terms. The important ingredients are derived as follows:

- The risk-free rate is an equity market capitalisation weighted average of US, UK, Eurozone, Japanese and Chinese 10-year real yields.
- Sector betas are calculated using five years of weekly price movements relative to the global market index.
- The risk premium is derived from US equity and treasury market returns since 1871.
- The dividend yield for each sector is the 12-month trailing yield calculated by Datastream.

Sector allocations

We start by considering where the equity markets are in their respective economic cycles, which determines whether cyclical or defensive sectors are more likely to outperform. Our preferred measure of cyclical sensitivity is beta. Sector betas are calculated using five years of weekly price movements relative to the local market index.

Next, we refine our decisions by looking at how sector yields relative to the market relate to the ratio calculated by our multiple regression model and how much dividend growth is implied in current trailing 12-month dividend yields relative to market.

Finally, we rank sectors by their recent volatility, using the standard deviation of daily returns for the three months before our cut-off date. After that we rank sectors by their 12-month trailing dividend yield. Based on our thematic report about sector strategies, Sector strategies: Control your volatility, combining these approaches provided the best cost-adjusted and risk-adjusted returns in the US, and was among the best in cost-adjusted returns in Europe.

An investment decision is the result of balancing a range of factors and the weightings applied to those factors can vary across time and sectors. “Overweight” suggests that we prefer to hold more of the given sector than suggested by the market capitalisation-weighted “neutral” position. “Underweight” suggests we prefer to hold less of the given sector than suggested by the market capitalisation-weighted “neutral” position. “Neutral” suggests a holding in line with the market capitalisation-weighted benchmark.

Preferred regions

We measure sector valuations relative to their respective local benchmarks in the United States, Europe, Japan and Emerging Markets. We calculate a z-score comparing the latest relative dividend yield to its historical average, which gives us a standardised way to measure how far valuations are from those averages in each region. Our normal preference would be for the cheapest region based on this measure, but we also take into account thematic and other fundamental considerations.

Appendix 6: Abbreviations

Changes in allocations on the front page: OW = Overweight, N = Neutral, UW = Underweight

Sector name abbreviations:

Autos = Automobiles & parts
Basic Res = Basic Resources
Chem = Chemicals
Con & Mat = Construction & Materials
Cons P&S = Consumer Products & Services
Fin Serv = Financial Services
Food, Bev & Tob = Food, Beverage & Tobacco
Ind G&S = Industrial Goods & Services
Pers Care = Personal Care, Drug & Grocery Stores
Pers & Hh Gds = Personal & Household Goods
Real Est = Real Estate
Tech = Technology
Telecoms = Telecommunications
Trav & Leis = Travel & Leisure

Appendix 7: Definitions of data and benchmarks

Sources: we source data from LSEG Datastream unless otherwise indicated.

Government bonds (Figure 3): Current values use LSEG Datastream benchmark 10-year yields for the US, Eurozone, Japan and the UK and the Thomson Reuters China benchmark 10-year yield for China.

Value sectors: stocks or sectors that have low price/book value or price/earnings multiples or high dividend yields. Some of these stocks or sectors may generally trade at a discount compared to the market if investors expect their earnings or dividends to grow at a slower pace than the market. Examples of such sectors are utilities, telecommunications, banks and oil & gas.

Growth sectors: stocks or sectors that have high price/book or price/earnings multiples or low dividend yields, because investors expect them to have high earnings or dividend growth. Examples of these sectors are technology, healthcare and food & beverage.

Defensive sectors: stocks or sectors that have business models that investors consider to be relatively stable throughout the business cycle. We refer to the following sectors as defensive: food & beverage, personal & household goods, healthcare, telecommunications and utilities.

Cyclical sectors: stocks or sectors that have business models that investors consider to be sensitive to the economic cycle. We refer to the following sectors as cyclical: oil & gas, basic resources, chemicals, construction & materials, industrial goods & services, automobiles & parts, media, retail, travel & leisure, banks, financial services, insurance, real estate and technology.

Growth factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and 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 factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on the standard deviation of their daily returns in the previous three months.

Price momentum factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the top quintile based on their performance in the previous 12 months.

Quality factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and 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 factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on their market value in US dollars for the US and euros for Europe.

Value factor: a subset of the S&P 500 in the US and the Stoxx 600 index in Europe and includes stocks in the bottom quintile based on their price to book value ratios.

Data as of 31 December 2024 unless stated otherwise. This publication is updated quarterly.

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Telephone calls may be recorded.

Authors

András Vig
Multi-Asset Strategist
Telephone +44(0)20 3370 1152
andras.vig@invesco.com
London, EMEA

Global Market Strategy Office

Kristina Hooper
Chief Global Market Strategist
kristina.hooper@invesco.com
New York, Americas

Ashley Oerth
Associate Global Market Strategist
ashley.oerth@invesco.com
London, EMEA

Brian Levitt
Global Market Strategist, Americas
brian.levitt@invesco.com
New York, Americas

James Anania
Investment Strategy Analyst, Americas
james.anania@invesco.com
New York, Americas

David Chao
Global Market Strategist, Asia Pacific
david.chao@invesco.com
Hong Kong, Asia Pacific

Thomas Wu
Market Strategy Analyst, Asia Pacific
thomas.wu@invesco.com
Hong Kong, Asia Pacific

Tomo Kinoshita
Global Market Strategist, Japan
tomo.kinoshita@invesco.com
Tokyo, Asia Pacific

Arnab Das
Global Macro Strategist
arnab.das@invesco.com
London, EMEA

Paul Jackson
Global Head of Asset Allocation Research
paul.jackson@invesco.com
London, EMEA

András Vig
Multi-Asset Strategist
andras.vig@invesco.com
London, EMEA