

Tactical Asset Allocation

The global recovery moves along. Overweight equities, credit, cyclical factors, and non-US equities.

Our macro process drives tactical asset allocation decisions over a time horizon between six months and three years, on average, seeking to harvest relative value and return opportunities between asset classes (e.g., equity, credit, government bonds, and alternatives), regions, factors, and risk premia.



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Senior Portfolio Manager,
Head of Investments,
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Synopsis

- Improving leading indicators outside the US, signaling the potential for broadening participation in the global recovery, further upside for risky assets, and outperformance in non-US equities.
- Overweight portfolio risk in the Global Tactical Asset Allocation model,¹ favoring equities relative to fixed income, non-US equities, value, and smaller capitalizations. Overweight risky credit, neutral duration, and underweight the US dollar.

Macro update

Despite reduced expectations of monetary policy easing in 2024 and the prospect of a “higher for longer” interest rate environment, risk assets continue to reflect optimism and confidence toward a favorable macro environment with muted volatility in the near term. Based on our framework, we expect global growth to remain below its long-term trend, but to potentially see a more balanced contribution from other parts of the world. While the United States has led the global recovery since late 2022, recent economic data point to a broadening out of growth momentum to other developed markets and emerging markets, except for China.

Leading economic indicators continue to improve at a rapid clip in the eurozone, UK, and Japan, led by rising consumer confidence and manufacturing business surveys. Improving orders and demand expectations, particularly in export-oriented industries, are lifting the prospect for a cyclical rebound in Europe after a prolonged period of anemic growth (**Figures 1a-c** and **2**). Similarly, global earnings revisions have started to reflect improving economic prospects outside the US, with a modest but encouraging upturn across developed markets and emerging markets, apart from China, while US earnings prospects continue to lead (**Figure 3**). In some respect, the relative performance between major equity markets has started discounting the potential for this rotation. After the pronounced leadership of US equities in January of this year, developed ex-US and emerging market equities have performed remarkably in line with US equities, despite the extraordinary outperformance of mega-cap US technology names.

China continues to lag. Stability in the manufacturing sector is more than offset by the housing downturn and weak domestic demand. Monetary policy support has been somewhat limited, constrained by considerations around FX stability due to capital outflow pressures, among other factors. However, a recently announced package of housing policy relaxation includes steps to support housing demand with lower down payment requirements and lower mortgage rates, as well as relending facility from the PBOC to support the purchase of unsold homes and reduction of housing inventories. These policies provide a step in the right direction to contain downside risks, but it is unclear how much additional policy support will be needed to support a turnaround in the housing market.

Overall, our macro framework confirms a favorable outlook with low but stable global growth and rising risk appetite, a backdrop that has historically compensated investors for risk taking.

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¹ Global 60/40 benchmark (60% MSCI ACWI, 40% Bloomberg Global Aggregate USD Hedged).



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Figure 1a: Global macro framework remains in a recovery regime

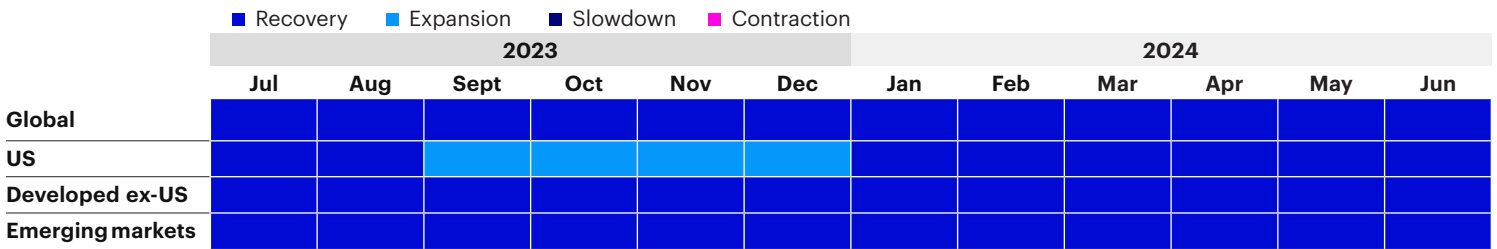
Regional regime signals and components

LEIs		Global risk appetite	Expected macro regimes
Region	Current level of growth		
Global	Below trend	Change in global growth expectations Growth expectation improving	Recovery
United States	Below trend		Recovery
Developed markets ex-USA	Below trend		Recovery
Europe	Below trend		Recovery
United Kingdom	Below trend		Recovery
Japan	Above trend		Expansion
Emerging markets	Below trend		Recovery
China	Below trend		Recovery
Emerging markets ex-China	Above trend		Expansion

Sources: Bloomberg L.P., Macrobond, Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of May 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment. Developed markets ex-USA include the eurozone, UK, Japan, Switzerland, Canada, Sweden, Australia. Emerging markets include Brazil, Mexico, Russia, South Africa, Taiwan, China, South Korea, India.

Figure 1b: Trailing 12-month regime history by region

Global economy in a recovery phase with LEIs below the long-term trend and improving growth expectations

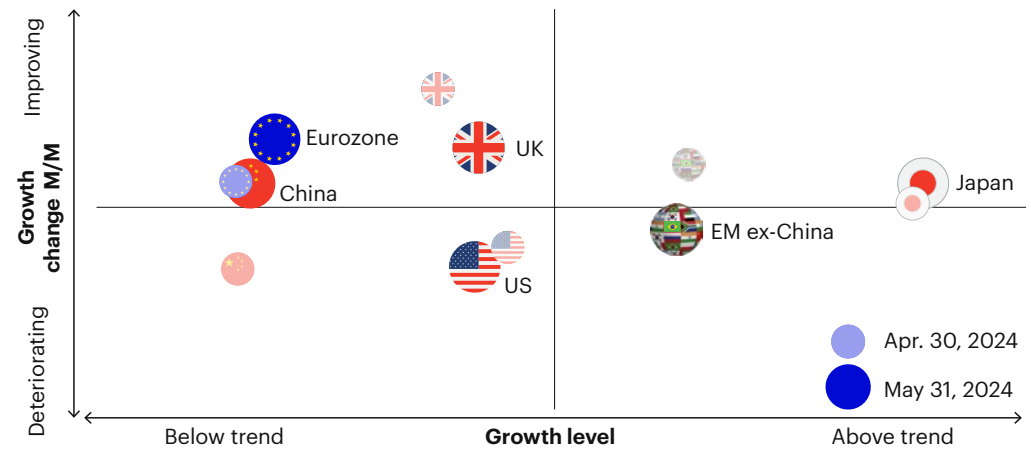


Source: Invesco Solutions, as of May 31, 2024.



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Figure 1c: Positive growth momentum outside the US, suggesting broadening participation in the global recovery



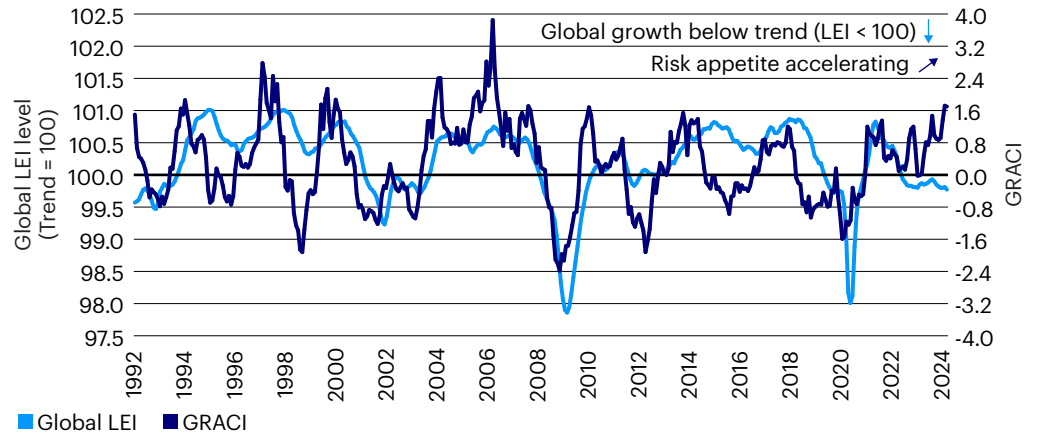
Sources: Bloomberg L.P., Macrobond, Invesco Solutions research and calculations. Proprietary leading economic indicators of Invesco Solutions. Macro regime data as of May 31, 2024. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.



Despite reduced expectations of monetary policy easing in 2024 and the prospect of a “higher for longer” interest rate environment, risk assets continue to reflect optimism and confidence toward a favorable macro environment with muted volatility in the near term.

Figure 2: Global risk appetite remains strong, evidenced by the outperformance of equity and credit markets

GRACI and Global LEI



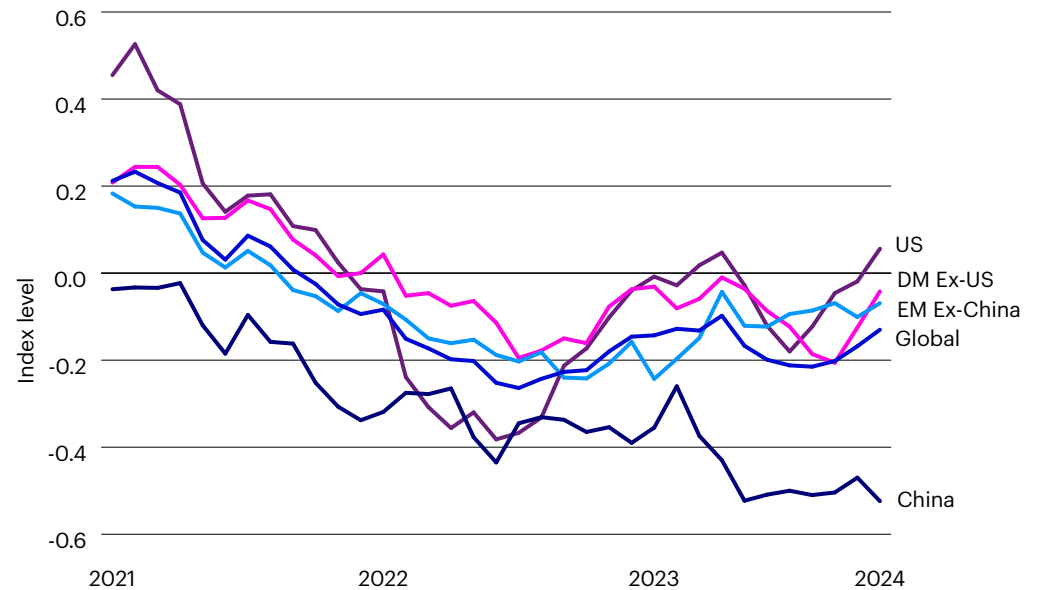
Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Invesco Solutions research and calculations, from Jan. 1, 1992, to May 31, 2024. The Global Leading Economic Indicator (LEI) is a proprietary, forward-looking measure of the growth level in the economy. A reading above (below) 100 on the Global LEI signals growth above (below) a long-term average. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets’ risk sentiment. A reading above (below) zero signals a positive (negative) compensation for risk-taking in global capital markets in the recent past. **Past performance does not guarantee future results.**



After the pronounced leadership of US equities in January of this year, developed ex-US and emerging market equities have performed remarkably in line with US equities, despite the extraordinary outperformance of mega-cap US technology names.

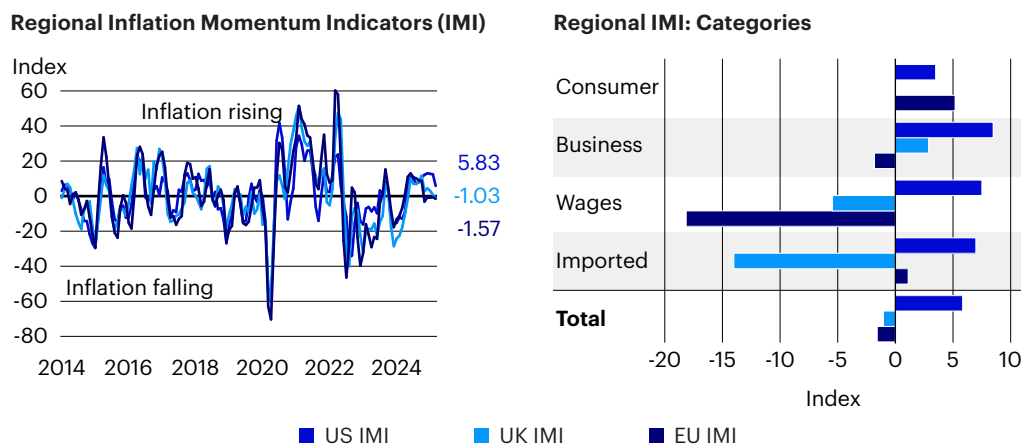
Figure 3: Global earnings revision improving, initially led by the US, and more recently supported by other developed markets and EM ex-China

12-month forward earnings revisions



Sources: Bloomberg L.P. and Invesco, May 31, 2024. Earnings revision over the next 12-months.

Figure 4: Inflation declining in eurozone and UK, while moderately increasing in the US



Sources: Bloomberg L.P. data as of May 31, 2024, Invesco Solutions calculations. The US Inflation Momentum Indicator (IMI) measures the change in inflation statistics on a trailing three-month basis, covering indicators across consumer and producer prices, inflation expectation surveys, import prices, wages, and energy prices. A positive (negative) reading indicates inflation has been rising (falling) on average over the past three months.

Investment positioning

There are minimal changes in portfolio positioning this month. We overweight risk relative to the benchmark in the Global Tactical Allocation Model, overweighting equities over fixed income, favoring non-US equities, cyclical sectors, value, and smaller capitalizations, and remain underweight the US dollar. In fixed income, we maintain an overweight to credit risk² via lower quality sectors, maintaining a neutral duration posture, favoring TIPS over nominal bonds, albeit with reduced exposure compared to last month (**Figures 5 to 8**). In particular:

- In **equities**, we overweight value, mid and small caps at the expense of quality, low volatility, and momentum factors. Growth is stable, just below its long-term trend, while global risk appetite continues to improve, signaling improving growth expectations. This backdrop has historically favored cyclical factors with high operating leverage and a higher sensitivity to a rebound in growth expectations, such as value and smaller capitalizations. Furthermore, we continue to see early signs of broadening equity market participation, with recent performance convergence between styles/factors and regions. Similarly, we favor exposures to cyclical sectors such as financials, industrials, materials, and energy at the expense of health care, staples, utilities, and technology. From a regional perspective, we overweight emerging markets and developed ex-US equities, supported by improving risk appetite, expectations for US dollar depreciation, and improving leading indicators in European growth.
- In **fixed income**, we overweight credit risk via high yield, bank loans, and emerging markets hard currency debt. Credit spreads continue to gradually tighten with subdued volatility, offering a stable yield advantage over government bonds in a supportive macro backdrop with rising risk appetite and reach for yield. In sovereigns, we favor inflation-protected securities (TIPS) in the US, but with reduced exposure, while we moved back into nominal bonds in Europe, given the recent deceleration in inflation (**Figure 4**).
- In **currency markets**, we underweight the US dollar, as regimes of cyclical recoveries are typically accompanied by strong reflationary flows into non-US assets. Within developed markets, we favor the euro, the British pound, the Norwegian kroner, the Swedish krona, and the Singapore dollar relative to the Swiss Franc, the Japanese yen, the Australian dollar, and the Canadian dollar. In EM, we favor high yielders with attractive valuations, such as the Colombian peso, the Brazilian real, the South African rand, and the Indonesian rupiah relative to low yielding and more expensive currencies, such as the Korean won, the Mexican peso, the Philippines peso, and the Chinese renminbi, but still expect these currencies to do well in a the US dollar depreciation scenario.



Furthermore, we continue to see early signs of broadening equity market participation, with recent performance convergence between styles/factors and regions.

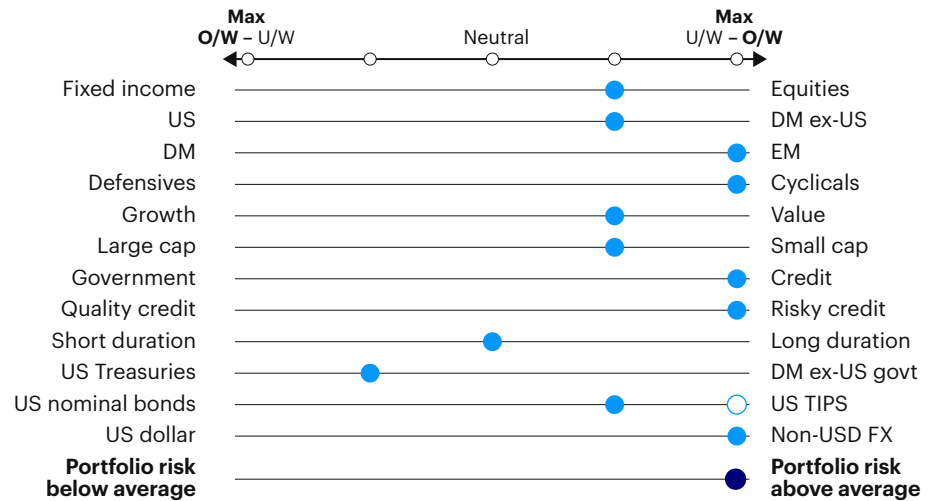
In sovereigns, we favor inflation-protected securities (TIPS) in the US, but with reduced exposure, while we moved back into nominal bonds in Europe, given the recent deceleration in inflation.

² Credit risk defined as duration times spread (DTS).

Figure 5: Relative tactical asset allocation positioning

Overweight portfolio risk vs. benchmark, favoring non-US equities, value and smaller capitalizations

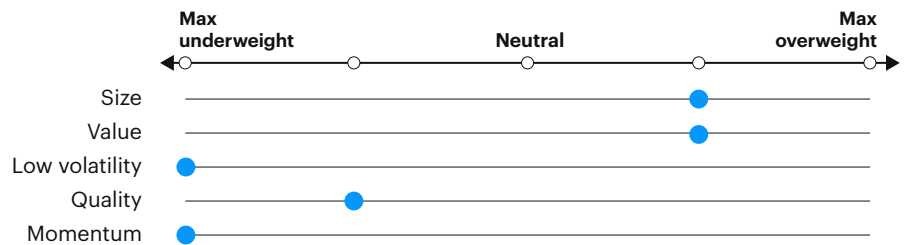
● Current positioning ○ Prior positioning



Source: Invesco Solutions, June 1, 2024. DM = developed markets. EM = emerging markets. Non-USD FX refers to foreign exchange exposure as represented by the currency composition of the MSCI ACWI Index. For illustrative purposes only.

Figure 6: Tactical factor positioning

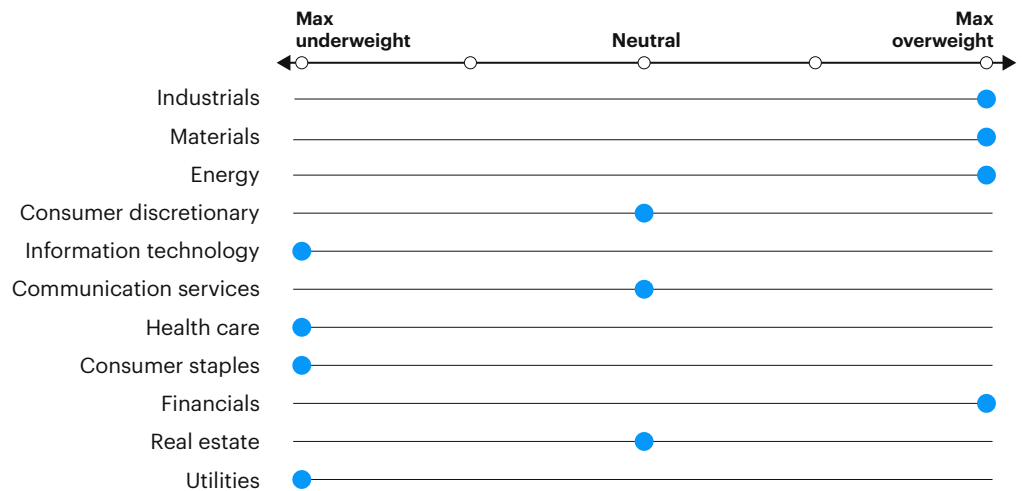
Overweight value and small size; underweight quality, low volatility, and momentum



Source: Invesco Solutions, June 1, 2024. For illustrative purposes only. Neutral refers to an equally weighted factor portfolio.

Figure 7: Tactical sector positioning

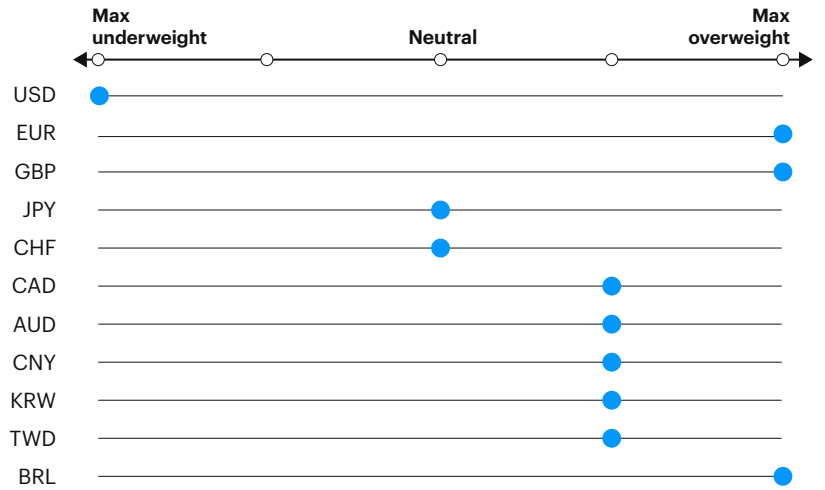
Sector exposures favoring cyclicals



Source: Invesco Solutions, June 1, 2024. For illustrative purposes only. Sector allocations derived from factor and style allocations based on proprietary sector classification methodology. As of December 2023, Cyclicals: energy, financials, industrials, materials; Defensives: consumer staples, health care, information technology, real estate, utilities; Neutral: consumer discretionary and communication services.

Figure 8: Tactical currency positioning

Underweight the US dollar, favoring the euro and British pound in developed markets



Source: Invesco Solutions, June 1, 2024. For illustrative purposes only. Currency allocation process considers four drivers of foreign exchange markets: 1) US monetary policy relative to the rest of the world, 2) global growth relative to consensus expectations, 3) currency yields (i.e., carry), 4) currency long-term valuations.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations), and investors may not get back the full amount invested.

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