Tactical Asset Allocation

Invesco Investment Solutions

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The recovery continues, despite the challenge of a second wave.

Synopsis:

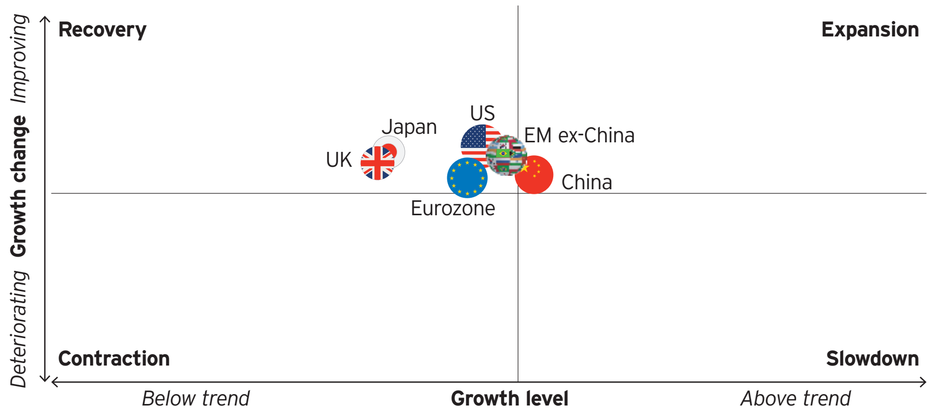
- The probability of a double-dip recession in Q4 2020 is certainly increasing across multiple regions, but it does not need to translate into the same economic and financial shock experienced with the first wave.
- Our forward-looking measures of economic activity and market sentiment continue to suggest the global economy should remain in a **recovery regime.**
- We maintain a **higher risk posture** than our benchmark[1] in our Global Tactical Asset Allocation model, sourced through an overweight exposure to equities, with a tilt towards emerging markets (EM), value and (small) size, and credit at the expense of government bonds.

Macro update

The return of the virus across Europe and the Americas represents an important risk factor for the global economic recovery. We contemplated this risk back in the spring and outlined a baseline scenario of a meaningful second wave of COVID-19 infections across the northern hemisphere upon the return of colder temperatures. The probability of a double-dip recession in Q4 2020 is certainly increasing across multiple regions, but it does not need to translate into the same economic and financial shock experienced with the first wave. A combination of ample monetary and fiscal policy support, together with economic adjustments and measures implemented over the past seven months, are likely to reduce the uncertainty associated with this second wave compared to the first. While it is certainly too early to draw definitive conclusions, as the situation remains very fluid, our forward-looking measures of economic activity and market sentiment continue to suggest the global economy should remain in a **recovery regime** in the near term **(Figure 1)**.

Figure 1: Leading economic indicators and market sentiment suggest the global economic recovery continues, with emerging markets moving to an expansion regime.

Current Leading Economic Indicators (LEIs)



Sources: Bloomberg L.P., Macrobond as of Oct. 31, 2020. Invesco Investment Solutions research and calculations. Proprietary leading economic indicators of Invesco Investment Solutions.

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1. Global 60/40 benchmark (60% MSCI ACWI / 40% Bloomberg Barclays Global Agg USD Hedged).

Despite recent underperformance in equity markets and increased volatility, our measure of global market sentiment suggests some resilience and confidence in the marketplace on the global recovery for now.

The speed of the recovery is flattening across regions as the V-shaped rebound begins to normalize and most economies begin to approach trend-growth rates. Notably, the relative growth momentum between the United States and other developed markets has tilted in favor of the former, as a result of catch-up effects and the anticipation of new, selective lockdown measures implemented in the Eurozone and the UK. Emerging markets, particularly Asia, continue to lead the cycle and, according to our framework, have now entered an expansion regime with growth above-trend and improving. Despite recent underperformance in equity markets and increased volatility, our measure of global market sentiment suggests some resilience and confidence in the marketplace on the global recovery for now. Current events ranging from the US election to the evolution of the pandemic will drive the path of investor confidence and growth expectations over the next couple of months. We will closely monitor the evolution of our framework and reposition our investment strategies accordingly.

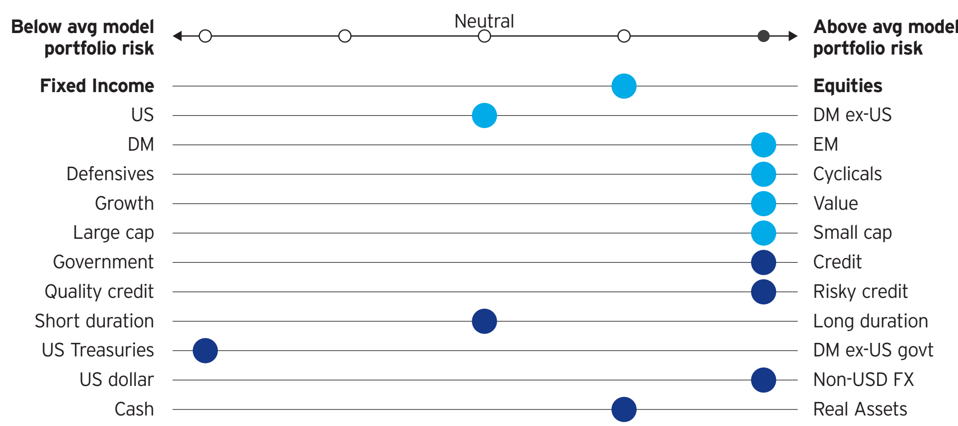
Investment Positioning

We have implemented one change this month, closing our overweight exposure to developed market equities outside the US.

We have implemented one change this month, closing our overweight exposure to developed market equities outside the US. While local market and currency valuations remain supportive, their relative growth momentum is weakening, leading us to a neutral stance between the two regions (**Figure 2**). We maintain a **higher risk posture** than our benchmark[2] in our Global Tactical Asset Allocation model, sourced through an overweight exposure to equities and credit at the expense of government bonds. In particular:

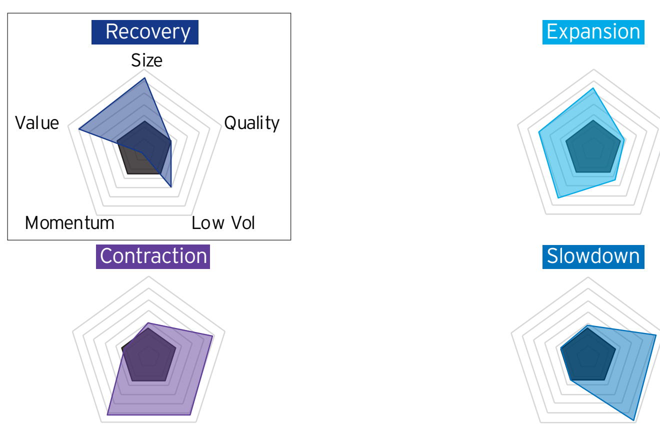
- Within **equities** we hold large tilts in favor of emerging markets compared to developed markets, driven by favorable cyclical conditions, improving risk appetite, attractive local asset valuations and an expensive US dollar. We continue to hold a large underweight to quality and momentum stocks, given our tilts in favor of value and (small) size factors, which have recently begun to outperform as the global earnings cycle bottoms out and bond yields marginally increased over the past few months (**Figure 3**).
- In **fixed income** we maintain an overweight exposure to US high yield credit, emerging markets sovereign dollar debt, and event-linked bonds at the expense of investment grade corporate credit and government bonds, particularly in developed markets outside the US. Overall, we are overweight credit risk and neutral duration[2] versus the benchmark.
- In **currency markets** we maintain an overweight exposure to foreign currencies, positioning for long-term US dollar depreciation. Within developed markets we favor the Euro, the Canadian dollar and the Norwegian kroner. In emerging markets, we favor the Indian rupee, Indonesian rupiah and Russian ruble.

Figure 2: Relative Tactical Asset Allocation Positioning



Source: Invesco Investment Solutions, Oct. 31, 2020. For illustrative purposes only.

Figure 3: Regime Dependent Factor Exposures – Dynamic (shaded) vs. Benchmark (black)



Source: For illustrative purposes only. Invesco, Benchmark (Russell 1000 Index), Dynamic (US Large Cap Dynamic Multifactor Model), Jan. 31, 1989 to June 30, 2020. Spider plots for the four regime portfolios, reflecting the factor exposures for their excess returns versus the benchmark.

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

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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