



## Tactical Asset Allocation

We remain overweight risk relative to benchmark, favoring equities over fixed income with an emphasis on emerging markets, cyclicals, and value. We moderately increased credit risk given wider spreads.



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Head of Tactical Asset  
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### Synopsis

- Global equity markets have underperformed since we increased portfolio risk in early April, and leading economic indicators have deteriorated further. However, our market-based sentiment framework shows more stability and still points toward positive growth revisions ahead.
- We are overweight risk relative to benchmark in the Global Tactical Asset Allocation model<sup>1</sup>, favoring equities over fixed income with an emphasis on emerging markets, cyclical sectors, value, and small/mid-caps. We have moderately increased credit risk and stay underweight duration.

### Macro update

Our leading economic indicators declined sharply for the second consecutive month, reflecting the impact of the war in Ukraine, China’s zero-COVID policy, and higher cost of capital. Unsurprisingly, the decline in economic activity has been most pronounced in China, the Eurozone, and the United Kingdom which, based on our indicators, are now likely to grow below trend over the next few quarters. Despite the resilience in other large economies (US and Japan), the global economic picture has weakened substantially, and our Global LEI is fast declining toward its long-term average, i.e., our proxy for trend growth (Figure 1 and Figure 2).

**Figure 1a: Macro framework points to an Expansion regime**

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

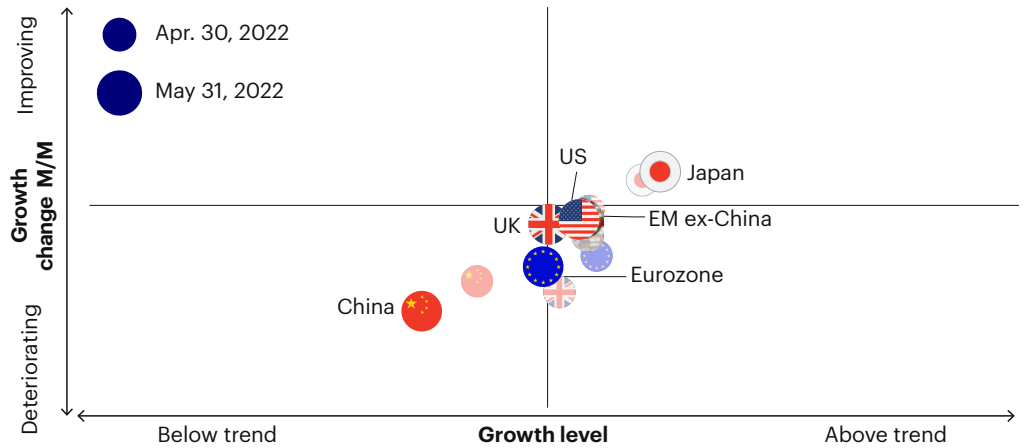
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1. Global 60/40 benchmark (60% MSCI ACWI / 40% Bloomberg Barclays Global Agg USD hedged)



Despite the resilience in other large economies (US and Japan), the global economic picture has weakened substantially.

**Figure 1b: Leading economic indicators deteriorated further, especially in Europe and China**

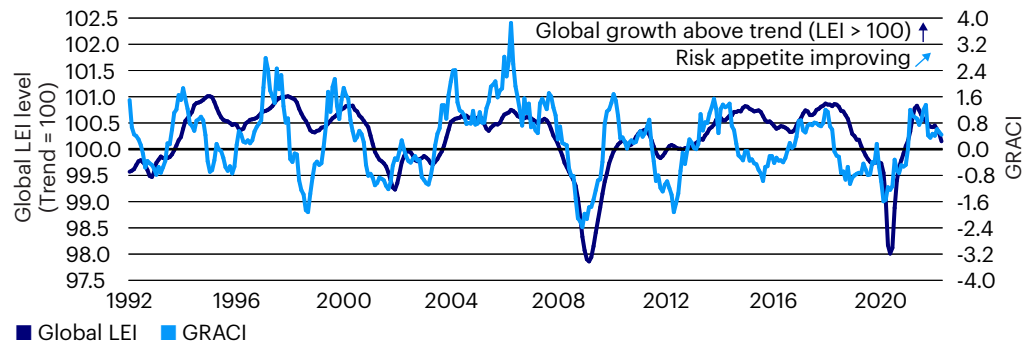


Sources: Bloomberg L.P., Macrobond. Invesco Investment Solutions research and calculations. Proprietary leading economic indicators of Invesco Investment Solutions. Macro regime data as of May 31, 2022. The Leading Economic Indicators (LEIs) are proprietary, forward-looking measures of the level of economic growth. The Global Risk Appetite Cycle Indicator (GRACI) is a proprietary measure of the markets' risk sentiment.



Business surveys across manufacturing and service sectors have declined from the peak, but they continue to show resilience and still suggest above-trend business prospects.

**Figure 2: Global risk appetite is accelerating, signaling improving growth expectations**  
GRACI and the global LEI



Sources: Bloomberg L.P., MSCI, FTSE, Barclays, JPMorgan, Invesco Investment Solutions research and calculations, from Jan. 1, 1992 to May 31, 2022. 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.

In terms of economic sectors, consumer confidence surveys across countries have already declined to the recessionary lows experienced in 2008. However, strong labor market conditions today provide a very different backdrop of consumer resilience relative to other recessionary episodes. Business surveys across manufacturing and service sectors have declined from the peak, but they continue to show resilience and still suggest above-trend business prospects. China is the noticeable but not surprising exception. New COVID-related lockdowns since April have caused a meaningful decline in industrial production, construction activity and retail spending, which have led the People's Bank of China to release a broad range of stimulative tools. However, stimulus efforts may have limited effect if mobility restrictions remain in place.



While equity and fixed income markets have continued to post negative returns since then, our framework still suggests this underperformance is predominantly driven by higher discount yields rather than deteriorating earnings expectations.

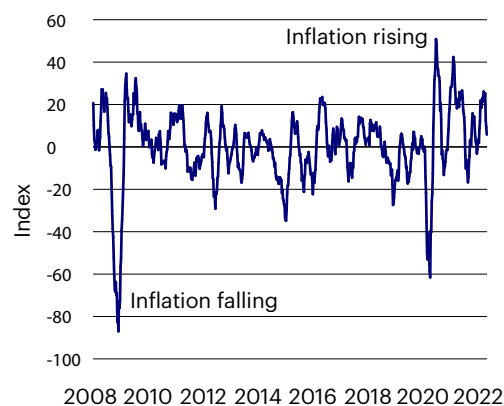


Downside surprises in inflation statistics may represent the most powerful catalyst for a rebound in markets, alleviating risks of excessively restrictive monetary policy.

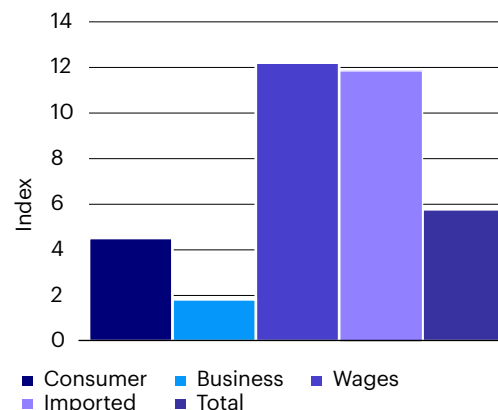
At the end of Q1 our macro regime framework moved back into an expansionary regime, led by an improvement in global market sentiment and above average economic activity. While equity and fixed income markets have continued to post negative returns since then, our framework still suggests this underperformance is predominantly driven by higher discount yields rather than deteriorating earnings expectations. The recent outperformance of cyclical market segments such as value equities, small/mid-caps, and emerging markets relative to more defensive segments such as growth, large-cap and US equities provides some support to this hypothesis. In other words, more than an “inflation scare” turning into a “growth scare,” we believe markets have moved from an inflation scare to a de-rating of valuations, particularly in high-duration US growth stocks. Nonetheless, economic risks are rising and a stabilization in credit spreads would be required to prevent further declines in equity markets.

Inflation remains the primary driver of markets. Downside surprises in inflation statistics may represent the most powerful catalyst for a rebound in markets, alleviating risks of excessively restrictive monetary policy. We continue to register accelerating inflation in the near term, but at a somewhat lower pace than the past few months (Figure 3). Interestingly, the rollover in US breakeven inflation expectations seems to suggest a likely peak in actual inflation in the near term<sup>2</sup>.

**Figure 3a: US Inflation Momentum Indicator (IMI)**



**Figure 3b: IIS Inflation Momentum Indicator: Categories**



Sources: Bloomberg L.P. data as of May 31, 2022, Invesco Investment 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

**We maintain an overweight risk stance relative to benchmark in the Global Tactical Asset Allocation model<sup>1</sup>, overweighting equities relative to fixed income, favoring emerging markets over developed markets, and tilting toward cyclical sectors and factors. We moderately increased credit risk<sup>3</sup>, shifting from short to intermediate credit maturities, and remain underweight duration risk in aggregate while maintaining a flattening yield curve bias. (Figure 4, 5, 6).** In particular:

- Within **equities** we overweight cyclical factors like (small) size, value, and momentum, and favor cyclical sectors such as financials, industrials, materials, and energy at the expense of information technology, communication services, and other defensive sectors (Figure 6). We expect cyclicals to continue outperforming in an environment of rising bond yields and improving risk appetite. From a regional perspective, we overweight emerging markets relative to developed markets as stable risk appetite and attractive valuations tend to benefit the asset class.
- In **fixed income** we have reduced the overweight in inflation-linked bonds relative to nominal Treasuries given the recent softening in inflation momentum (Figure 3). We maintain an underweight duration stance in aggregate, with a bias toward a flatter curve. We added some credit exposure by increasing spread duration in high yield, looking for some spread compression after the widening of the past few months.

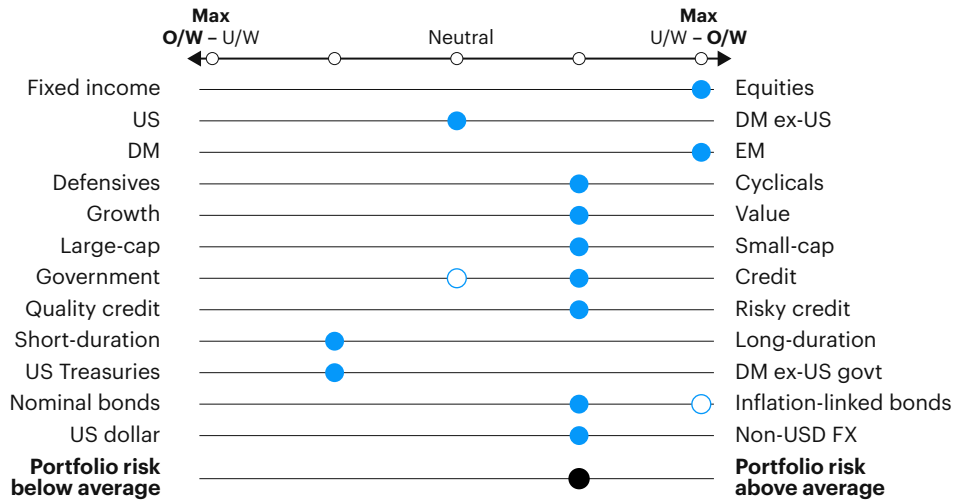
2. US breakeven inflation expectations have declined by 100bps, 70bps and 50bps from the peak in 2-year, 5-year and 10-year maturities, respectively.

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

- In **currency markets** we remain underweight the US dollar, a position driven by expensive valuations and positive economic surprises in the Eurozone and emerging markets relative to consensus expectations. Within developed markets we favor the euro, Japanese yen, Canadian dollar, Singapore dollar, Norwegian kroner, and Swedish krona. In EM we favor high yielders with attractive valuations such as the Indonesian rupiah, Colombian peso, and Brazilian real. We underweight the British pound, Swiss franc, Australian dollar, and Korean won.

**Figure 4: Relative tactical asset allocation positioning**

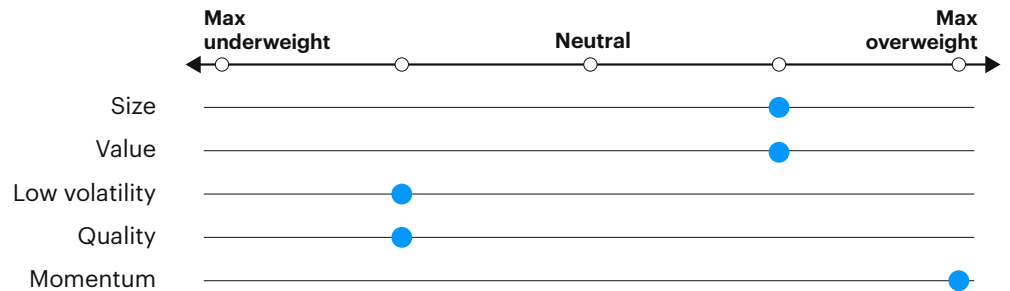
Portfolio risk above benchmark, overweight EM and cyclicals. Reduced overweight in TIPS versus nominal bonds.



Source: Invesco Investment Solutions, May 31, 2022. DM = developed markets. EM = emerging markets. FX = foreign exchange. For illustrative purposes only.

**Figure 5: Tactical factor positioning**

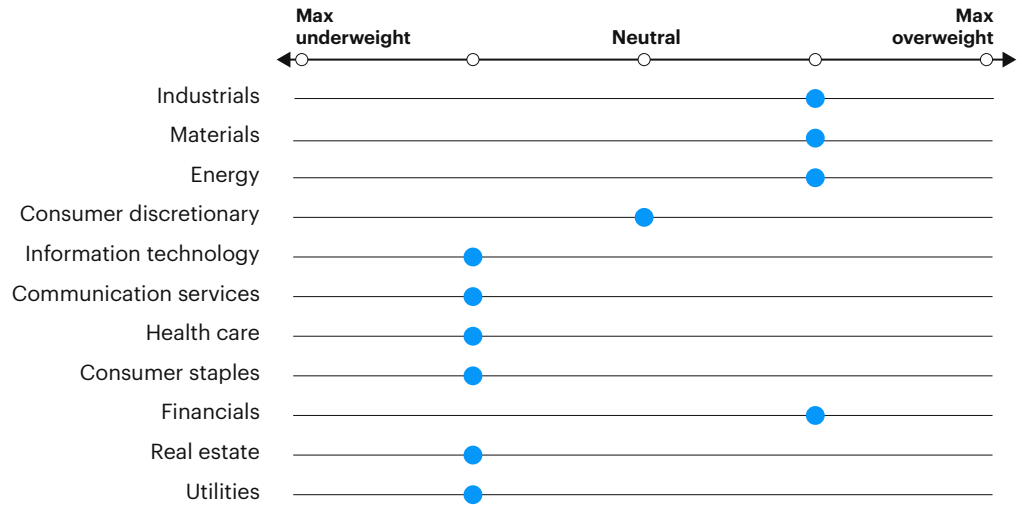
Factor tilts within the expansion regime are toward size, value and momentum



Source: Invesco Investment Solutions, May 31, 2022. For illustrative purposes only. Neutral refers to an equally weighted factor portfolio.

### Figure 6: Tactical sector positioning

In an expansionary regime, sector tilts favor cyclicals relative to defensives.



Source: Invesco Investment Solutions, May 31, 2022. For illustrative purposes only. Sector allocations derived from factor and style allocations based on proprietary sector classification methodology. As of March 2022, Cyclicals: energy, financials, industrials, materials; Defensives: consumer staples, health care, information technology, real estate, communication services, utilities; Neutral: consumer discretionary.

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## 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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