

Invesco Developing Markets Fund

Shareholder Letter

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Justin Leverenz, CFA
CIO Developing Markets
Equities and Senior
Portfolio Manager

Assessing emerging markets opportunities in an uncertain world

The new year is perhaps the most dangerous time of year when pontification is most rife. Perhaps this is a result of relatively low stakes - with perceived space to course correct (or entirely forget) opinions while putting the past aside and starting anew. The collective track record of economists' and investors' predictions in early 2023 should give us all pause for reflection.

The future is ultimately unknown. And in great part unknowable. Even the most powerful generative Artificial Intelligence (AI) computing models are ill placed to unpack the complex, adaptive systems that are economies and markets. Financial markets have deep and ambiguous feedback loops and are prone to generate unexpected emergent properties as a result of shocks (endogenous and exogenous) and unintended policy consequences.

Given latent uncertainty, it seems appropriate to begin the year by questioning what markets seem to agree upon. Since the "Fed turn" in December 2023 - "the pivot" and the broad bull market that followed - financial markets seem to extrapolate the following: immaculate disinflation, lower US dollar (USD) interest rates, lower energy prices, and a weaker dollar. In essence, a soft landing and a retreat towards lower sovereign rates. In emerging markets, there is near complete agreement that China remains in a structural funk and that the Indian renaissance is inevitable. And, of course, there are BIG thematic agreements — generative AI has the potential to be huge, and waistlines are going to shrink with proliferation of GLP-1 prescriptions.

Beyond these, uncertainty seems in command. Geopolitics are a mess. The neoliberal order is unraveling as power becomes more diffused regionally. Nationalist frustrations remain on the boil. The US is prospectively still in "the foothills" of a new Cold War with China. And democracies around the planet are struggling with unsettling levels of division, largely around issues of fairness (inequality) and culture. Ahead of us lies a potentially very turbulent period of elections and rhetoric. The world is disturbed.

The year ahead: 2024

So, what do we do? First, we continue to believe that investing in emerging market equities — over the long haul — is ultimately about getting exposure to globally advantaged companies, whether those markets are domestic (such as for FEMSA or H World) or international (such as for Taiwan Semiconductor Manufacturing Co. or Tata Consultancy Services)¹. We refrain from the view that investing in Emerging Markets (EM) is about access to superior macroeconomic growth or economic notions of "convergence."

Second in the short term, we are relatively bullish on emerging market equities, which hinges on a few theses:

- **Macroeconomic resilience.** We think investors will increasingly recognize that after a decade of challenge, many of the large, non-China economies have embraced both economic reform and macroeconomic orthodoxy — something that has clearly been lost in the industrialized economies of the G7.² In 2023, non-China EM equities outperformed developed international equities over the past year despite a challenging global backdrop.³ In essence, EM equities are no longer simply global beta tied to the global economic cycle.⁴
- **Coiled springs.** In our view, EM nominal and real interest rates remain unnecessarily high. We believe that a peak in USD sovereign rates may generate a positive feedback loop in terms of economic growth, investment (pent up), currencies (stability), USD earnings momentum, and equity market performance across non-China EM equities in 2024.

Not a Deposit Not FDIC Insured Not Guaranteed by the Bank May Lose Value
Not Insured by any Federal Government Agency

1. As of Dec. 31, 2023, FEMSA, H World, Taiwan Semiconductor Manufacturing Co. and Tata Consultancy Services represented 2.2%, 3.8%, 8.6% and 4.4% respectively, of the Invesco Developing Markets Fund

2. The G7 includes Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States

3. Non-China EM equities are represented by (MSCI Emerging Markets ex. China Index) and developed international equities are represented by (MSCI EAFE Index) Source: Bloomberg, as of Dec. 31, 2023

4. Beta is a concept that measures the expected move in a stock relative to movements in the overall market.

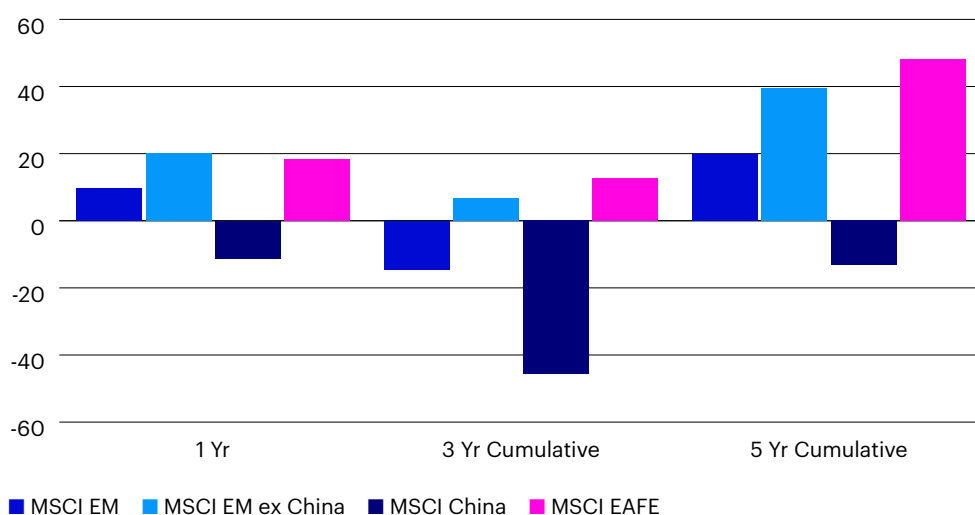
- **China.** Cheap and abandoned would best characterize the Chinese equity landscape. While we remain unconvinced about the viability (or wisdom) of more pronounced economic recovery in China, we think it holds a handful of terrific idiosyncratic investment opportunities. The structural retreat in economic growth is generating positive change in corporate strategy across China's private sector, including more rational competitive discipline and better capital allocation. Our holdings in China have uniformly refocused on improving costs, margins, and cash flow generation. Like Silicon Valley over the past 18 months, these companies are abandoning (mis)adventures and bolstering cash generation from their leading franchises. And (at last) returning significant cash to shareholders. In 30 years of working on China, I have never seen more aggressive shareholder distributions (dividends and buybacks), as high-quality companies believe that shares are significantly undervalued. China cannot be ignored. And for the discerning, there appear to be some great companies at very good prices.

The year behind: 2023

2023 was a charitable year for equity investors worldwide, with China being the glaring exception. MSCI World USD returns were nearly 24% last year. Emerging market equities broadly (as measured by the MSCI EM Index) posted nearly 10% USD gains. Broad developing markets equity returns were significantly obfuscated by dismal returns in China with the MSCI China Index down 11%. However, MSCI EM ex-China returns were up 20% in USD. These returns outperformed the broader MSCI EAFE gains (18% in USD).⁵

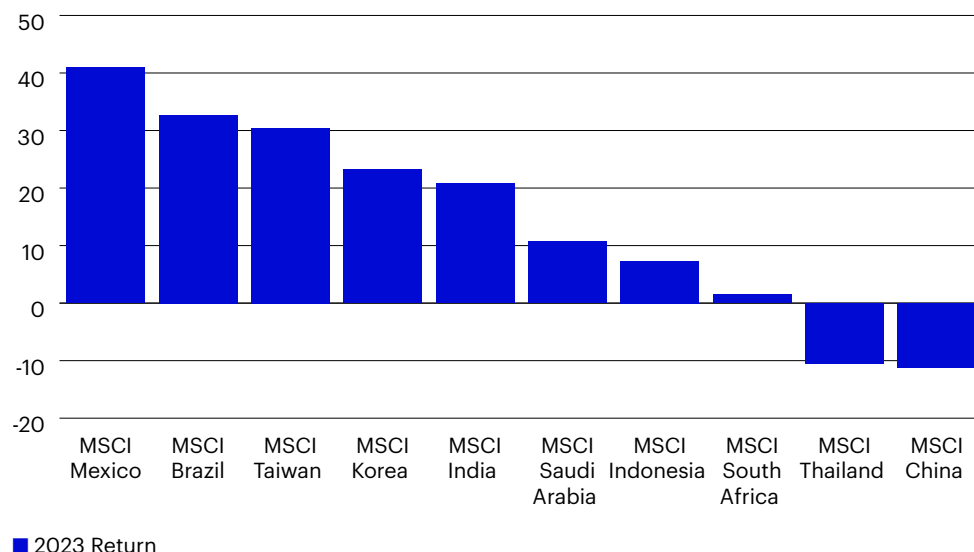
It was certainly a very merry year across most developing market bourses (see Exhibits 1 and 2). And then there was China, the 800-pound gorilla in the room (occupying nearly 27% of the MSCI Emerging Markets Index (USD) weight at the end of 2023). MSCI China returns were down 11% in 2023, extending their 3-year USD losses to 18% annualized and 47% cumulative over the 3-year period ending Dec. 31, 2023.

Exhibit 1: China was the exception to broadly positive returns in 2023



Source: Morningstar as of 12/31/2023. **Past performance does not guarantee future results. An investment cannot be made directly into an index.**

Exhibit 2: China lagged emerging markets in 2023



Source: Morningstar as of 12/31/2023. **Past performance does not guarantee future results. An investment cannot be made directly into an index.**

Beyond headline returns, there were some interesting observations:

- **Latin American currencies were strong.** Some of the strongest currencies globally were in Latin America given high real interest rates and (rare) orthodox macroeconomic policies. The Mexican peso appreciated nearly 13% against the US dollar, and the Brazilian real gained more than 8%.⁶
- **Mexican equities tallied strong performance.** The MSCI Mexico Index recorded nearly 41% USD returns. Mexico is our single largest geographical overweight, with more than 12% of Fund assets versus the benchmark weight of 2.75%.⁷
- **Tech helped lift Taiwan and South Korea.** Returns in the industrialized economies of Taiwan and South Korea did well. A nascent cyclical recovery in semiconductors and the thematic bleed of AI excitement into dynamic random-access memory and technology downstream hardware names lifted both markets. We see reasonable evidence to support the broader semiconductor cyclical expansion but believe hyperbolic gains in tangential AI downstream hardware stocks — most notably in Taiwan — are likely unsustainable.
- **Indian equities continued a long stretch of outperformance.**⁸ This came alongside a feverish view that the Indian growth renaissance is going to be the Information Technology story of the next decade. However, large cap India performance was relatively muted, with almost all the big gains concentrated in cyclical (infrastructure, real estate, capital goods) and mid-cap stocks. While we accept the long-term case for India, we would be cautious about valuations and excessive enthusiasm in the near term. And we doubt ‘mid-cap madness’ is sustainable. Even great things go through cycles.
- **The funk in China’s economy is incontestable.** China’s investment-led growth model is clearly beyond expiry. Economic reforms to address excess savings (and mercantilism) are necessary to unleash consumption, encourage productivity, and get beyond the malaise. The equity markets reflect such malaise, with the CSI 300 Index⁹ down 11% in USD terms in 2023 and declining 14% annualized and 39% cumulative over the past 3 years in USD.¹⁰ However, it is a tale of two Chinas. The recent pain in equities has ironically been concentrated amongst China’s best companies —technology, consumer, and health care stocks. Large state-owned equities have performed rather strongly as domestic investors have moved into these high-dividend-paying companies against a backdrop of very low cash rates. In essence, foreign investors have abandoned China, which continues to dominate the MSCI EM benchmark.

6. Source: Bloomberg, as of Dec. 31, 2023

7. Source: Bloomberg, as of Dec. 31, 2023

8. Source: MSCI. MSCI India Index that measures broad performance of Indian equities outperformed MSCI Emerging Markets Index that measures broad performance of emerging markets equities during calendar year 2023, over the past 3 years and 5 years on an annualized and cumulative basis as of December 31, 2023.

9. CSI 300 Index is a capitalization-weighted stock market index designed to replicate the performance of the top 300 stocks traded on the Shanghai and the Shenzhen Stock Exchanges in China.

10. Source: Bloomberg, as of Dec. 31, 2023

2023 performance and attribution

2023 was a good year for emerging market investors — and a demonstration that investing passively in EM equities holds many pitfalls. The MSCI Emerging Markets Index (USD) returned nearly 10% and ranks in the 63rd percentile of the Morningstar Diversified Emerging Markets category. Invesco Developing Markets Fund (class A shares) returned 11.17% in USD terms and delivered 1.34% outperformance over the MSCI Emerging Markets benchmark.

While, as always, contributors to return were multi-faced, some of our largest and longest held investments were key drivers, including Grupo Mexico (+66%), Taiwan Semiconductor Manufacturing Co. (+34%), and Tata Consultancy Services (+20%). We also witnessed notable gains from Nu Holdings (+104%), NetEase (+31%), Pinduoduo (+109%), and FEMSA (+70%). Perhaps unsurprisingly, most of the year's biggest detractors were our largest investments in China including Yum China (-21%), H World (-19%), and ZTO Express (-20%). China macro cloud concerns simply overwhelmed what were outstanding operational results for all three companies.¹¹

Standardized performance (%) as of December 31, 2023

		YTD	3 month	1 year	3 years	5 years	10 years	Since inception
Class A shares inception: 11/18/96	NAV	11.17	6.96	11.17	-8.36	2.27	1.48	9.46
	Max. load 5.5%	5.06	1.08	5.06	-10.08	1.12	0.91	9.23
Class R6 shares inception: 12/29/11	NAV	11.54	7.04	11.54	-8.01	2.67	1.90	3.99
Class Y shares inception: 09/07/05	NAV	11.40	6.99	11.40	-8.14	2.52	1.73	6.38
MSCI Emerging Markets Index		9.83	7.86	9.83	-5.08	3.68	2.66	—
S&P 500 TR (1989)		7.50	7.50	-7.73	18.60	11.19	12.24	—
Total return ranking vs. Morningstar Diversified Emerging Mkts category (Class A shares at NAV)		—	—	52% (388/812)	80% (518/717)	85% (550/656)	80% (315/403)	—

Calendar year total returns (%)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Class A shares at NAV	-4.80	-14.06	6.89	34.77	-12.14	23.99	17.22	-7.50	-25.16	11.17
MSCI Emerging Markets Index	-2.19	-14.92	11.19	37.28	-14.57	18.42	18.31	-2.54	-20.09	9.83

Expense ratios per the current prospectus: Class A: Net: 1.24%, Total: 1.24%; Class Y: Net: 0.99%, Total: 0.99%; Class R6: Net: 0.84%, Total: 0.84%.

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be lower or higher. Visit [invesco.com](https://www.invesco.com) for the most recent month-end performance. Performance figures reflect reinvested distributions and changes in net asset value (NAV). Investment return and principal value will vary so that you may have a gain or a loss when you sell shares. Returns less than one year are cumulative; all others are annualized. As the result of a reorganization on May 24, 2019, the returns of the fund for periods on or prior to May 24, 2019 reflect performance of the Oppenheimer predecessor fund. Share class returns will differ from the predecessor fund due to a change in expenses and sales charges. Index source: RIMES Technologies Corp. Had fees not been waived and/or expenses reimbursed in the past, returns would have been lower. Performance shown at NAV does not include the applicable front-end sales charge, which would have reduced the performance.

Class Y and R6 shares have no sales charge; therefore performance is at NAV. Class Y shares are available only to certain investors. Class R6 shares are closed to most prospectus for more details.

We have always contended the reason to be invested in emerging market equities has little to do with macro conditions, relative growth, or themes. Ultimately, in our view, the motivation to invest in the developing world is about the opportunity to invest in globally advantaged businesses. We remain long-term investors in highly differentiated businesses that generate their base of earnings and cash flow from the developing world. These businesses have durability of growth, sustainable competitive advantage, strong governance (and thereby capital allocation) and a host of real options embedded in their franchises and balance sheets that we believe will emerge over many years. Today, 25 of these investments represent over 80% of the Fund's assets.¹²

11. As of Dec. 31, 2023, Grupo Mexico, Taiwan Semiconductor Manufacturing Co. and Tata Consultancy Services represented 5.5%, 8.6% and 4.4% respectively, of the Invesco Developing Markets Fund. Other holdings including Nu Holding, NetEase, Pinduoduo and FEMSA represented 1%, 1.3%, 0.7% and 2.2% respectively, of the Invesco Developing Markets Fund. Yum China, H World and ZTO Express represented 4.3%, 3.8% and 3.3% respectively, of the Invesco Developing Markets Fund.

12. Source: Invesco, as of Dec. 31, 2023

Disclosures

The funds listed are subject to certain other risks. Please see the current prospectus for more information regarding the risks associated with an investment in the fund. Derivatives may be more volatile and less liquid than traditional investments and are subject to market, interest rate, credit, leverage, counterparty and management risks. An investment in a derivative could lose more than the cash amount invested.

MSCI Emerging Markets Index (Net) is an unmanaged index considered representative of stocks of developing countries. The index is computed using the net return, which withholds applicable taxes for non-resident investors.

MSCI World Index (Net) is an unmanaged index considered representative of stocks of developed countries. The index is computed using the net return, which withholds applicable taxes for non-resident investors.

MSCI China Index (Net) is an unmanaged index considered representative of Chinese stocks. The index is computed using the net return, which withholds applicable taxes for non-resident investors.

The MSCI Emerging Markets ex China Index captures large and mid cap representation across 23 of the 24 Emerging Markets (EM) countries excluding China. With 675 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI EAFE® Index (Net) is an unmanaged index considered representative of stocks of Europe, Australasia and the Far East. The index is computed using the net return, which withholds applicable taxes for non-resident investors.

The MSCI Mexico Index is designed to measure the performance of the large and mid cap segments of the Mexican market. With 24 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Mexico.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Stocks of small and mid-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

Growth stocks tend to be more sensitive to changes in their earnings and can be more volatile.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investing in securities of Chinese companies involves additional risks, including, but not limited to: the economy of China differs, often unfavorably, from the U.S. economy in such respects as structure, general development, government involvement, wealth distribution, rate of inflation, growth rate, allocation of resources and capital reinvestment, among others; the central government has historically exercised substantial control over virtually every sector of the Chinese economy through administrative regulation and/or state ownership; and actions of the Chinese central and local government authorities continue to have a substantial effect on economic conditions in China.

The performance of an investment concentrated in issuers of a certain region or country, such as China and the Asia Pacific, is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

Following Russia's invasion of Ukraine in February 2022, various countries, including the U.S., NATO and the European Union, issued broad-ranging economic sanctions against Russia and Belarus. As a result, responses to military actions (and further potential sanctions related to continued military activity), the potential for military escalation and other corresponding events, have had, and could continue to have, severe negative effects on regional and global economic and financial markets, including increased volatility, reduced liquidity, and overall uncertainty. Russia may take additional counter measures or retaliatory actions (including cyberattacks), which could exacerbate negative consequences on global financial markets. The duration of ongoing hostilities, corresponding sanctions and related events cannot be predicted. As a result, the value of an investment in the Fund and its performance may be negatively impacted, particularly as it relates to Russia exposure.

Environmental, Social and Governance (ESG) considerations may vary across investments and issuers, and not every ESG factor may be identified or evaluated for investment. The Fund will not be solely based on ESG considerations; therefore, issuers may not be considered ESG-focused companies. ESG factors may affect the Fund's exposure to certain companies or industries and may not work as intended. The Fund may underperform other funds that do not assess ESG factors or that use a different methodology to identify and/or incorporate ESG factors. ESG is not a uniformly defined characteristic and as a result, information used by the Fund to evaluate such factors may not be readily available, complete or accurate, and may vary across providers and issuers. There is no guarantee that ESG considerations will enhance Fund performance.

Holdings are subject to change and are not buy/sell recommendations.

The Fund may hold illiquid securities that it may be unable to sell at the preferred time or price and could lose its entire investment in such securities.

The opinions expressed are those of the Portfolio Managers of the Invesco Developing Markets Fund and are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The investment techniques and risk analysis used by the portfolio managers may not produce the desired results.

Before investing, investors should carefully read the prospectus and/or summary prospectus and carefully consider the investment objectives, risks, charges and expenses. For this and more complete information about the fund(s), investors should ask their financial professional for a prospectus/summary prospectus or visit [Invesco.com](https://www.invesco.com).