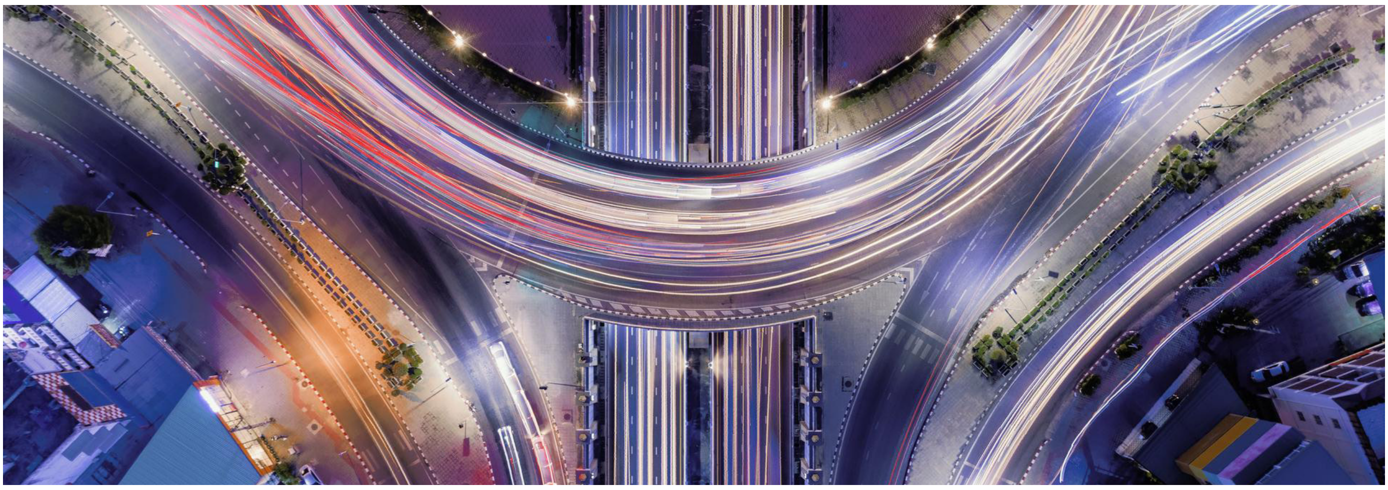
Future Forward: Invesco's Latest Capital Markets Assumptions



Invesco Investment Solutions, a global multi-asset investment center, utilizes two proprietary frameworks in managing assets. The first is Capital Market Assumptions (CMAs), which are key inputs into strategic asset allocation (SAA) with the second being a macro regime framework for tactical asset allocation (TAA).

Tactical Asset Allocation (TAA)

Applying a tactical asset allocation framework to portfolio construction can provide insight on "which part of the business cycle we are in and how we expect various asset classes to perform during that phase," says Drew Thornton, Head of Thought Leadership, Invesco Investment Solutions.

He told the Benefits and Pensions Monitor Meetings & Events 'Future Forward: Invesco's Latest Capital Markets Assumptions,' with Paisley Nardini, Strategist, Invesco Investment Solutions, that there are four "regimes," corresponding to various risk and return profiles within a standard business cycle.

"Right now, we're positioned for a recovery, as indicated by our signals which show growth below trend, but picking up," he said, and "we allocate portfolios to take on extra credit and equity risk in this upswing of the business cycle."

The other regimes include an Expansion, where growth is above trend and accelerating, a Slowdown and finally, a Contraction, which is where "we were in late 2022," he said.

Strategic Asset Allocation (SAA)

Invesco's CMAs are the first set of building blocks used when it comes to putting together an overall view on the long-term asset allocations. CMAs are updated quarterly for over 170 asset classes in 20 different currencies, across equities, fixed income, and alternatives, including private assets. The forward-looking CMA projections for asset classes are strongly predicated on mean reversion, with key inputs being earnings growth and valuation.

The goal is to try to understand what the drivers of return are, how they differ from the past, and, therefore, "how we should allocate going forward." Packaging this together in a portfolio is the difficult thing to do, he said.

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>
> – *PAISLEY NARDINI*

Asset Allocation Insights – TAA + SAA

This is the point where plan sponsors and asset allocators ask how to incorporate these insights into "actionable portfolio ideas," said Nardini.

Theme #1: Applying TAA to navigate equity markets

Although factors have historically proven to compensate investors over the long term, they can experience periods of material underperformance in the short term. History has shown us that the factor performance has coincided with the business cycle, given equity style factors are tied to fundamental economic sensitivities. The cyclicality of factors is one of the things an equity portfolio can exploit to navigate the business cycle.

By applying a multi-factor, rather a single-factor, approach, "ideally we can provide a more stable return pattern," she said.

"Through research and application, we have designed and developed a strategy that seeks to really navigate through the business cycle by using equity factors to tilt portfolios towards the historically rewarded style factors. The investment results are compelling, both from an excess return perspective, as well as downside risk mitigation perspective," said Nardini.

Theme #2: A productive inflation hedge

Today's higher inflation environment can be addressed more productively via multi-objective, real return assets.

"What we have found is that real assets can potentially hedge inflation, while also providing multi-objective outcomes such as growth and income, in addition to the main desire to inflation hedge," she said.

"Incorporating a more diversified set of assets including infrastructure, direct or indirect real estate, commodities, and real return bonds creates a more diversified, more efficient portfolio which will help meet broader portfolio needs," she said. **BPM**

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