Identifying ideas for a low-growth, low-rate environment

2016 investment outlook: Multi-asset strategies

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Divergence in economic growth and monetary policy around the world has led to an increasingly volatile market environment in 2015. Specifically, while the United States (US) and the United Kingdom (UK) have been preparing to raise interest rates from rock-bottom levels, Europe and Japan have continued to employ quantitative easing measures. China also stepped up monetary easing policies during the year through several interest rate cuts and a surprise devaluation of its currency.

What is important to know about our team's investment process is that we take a two- to three-year view of the world, which helps us avoid some of the short-term noise in the markets, looking across asset classes, currencies, geographies and sectors to identify good long-term ideas[1] wherever they may be. Going forward, we believe the following themes will likely prevail over the next two to three years:

Low, but positive, global economic growth

- We believe that structural economic growth will remain subdued on a global basis. However, regional differences could continue, with inventory and capital expenditure concerns acting as a potential drag on consumption-led US growth, and the economic slowdown in China posing a potential risk to Europe's cyclical recovery.

Interest rates to remain low

- At the beginning of 2015, we acknowledged that interest rates could start to rise in the US and the UK, and that impacted our appetite for having duration in the portfolio. Given the modest economic outlook, we expect interest rates to remain low over the next few years even if rates do tentatively start to rise in the US and UK. We believe the outstanding question is whether the monetary policies that are driving these changes will be effective in sustaining a healthy economic recovery.

Low inflation to continue globally

- We expect low inflation to continue globally, exacerbated by ongoing competitive currency devaluation. We believe underlying inflation will remain low in the face of structural factors, such as debt overhang, and that implied inflation priced into forward interest rates will remain high.

Select opportunities in risk assets

- We believe that select opportunities exist in risk assets, but current equity valuations must be navigated with care as earnings trends show differences between regions. Within fixed income, the search for yield appears to be distorting valuations, although US corporate bonds look, in our view, more fairly priced.

Higher levels of market volatility to persist

- Volatility has risen in 2015, but we believe that divergent economic policy globally, as well as non-market forces such as political interference, could underpin persistently higher levels of absolute volatility over the coming years.

Given this two- to three-year outlook of the market, in the shorter-term we believe that 2016 could potentially bring with it some significant changes across financial markets. The beginning of a rate-tightening cycle could lead to a very different landscape for investing, as compared to the past few years which were defined by very loose monetary policy. This is important for a multi-asset portfolio like ours. For example, if interest rates rise, bonds may not provide the diversification[2] investors need.

Another general theme, which extends through 2016 and beyond, is the use of different policy tools around the world. Ongoing competitive currency devaluation is a theme that may dominate across Asia in particular as economies fight for their share of global trade. In this environment, taking views on individual countries rather than broad-based regions makes sense as individual countries are responding to global economic pressures in very different ways, in our view. As policy and economic factors diverge across regions, this typically underpins higher asset class volatility than we have experienced over the past few years.

Important Information

1 The opinions of the ideas expressed are those of Invesco Multi-Asset Team and are based on current market conditions which are subject to change without notice. These opinions may differ from those of other investment professionals.

2 Diversification does not guarantee a profit or eliminate the risk of loss.

Volatility measures the amount of fluctuation in the price of a security or portfolio.

About risk

There is a risk that the Federal Reserve Board (FRB) and central banks may raise the federal funds and equivalent foreign rates. This risk is heightened due to the potential "tapering" of the FRB's quantitative easing program and other similar foreign central bank actions, which may expose fixed income investments to heightened volatility and reduced liquidity, particularly those with longer maturities. As a result, the value of the Fund's investments and share price may decline. Changes in central bank policies could also increase shareholder redemptions, which may increase portfolio turnover and fund transaction costs.

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. These risks are greater for the Fund than most other funds because its investment strategy is implemented primarily through derivatives rather than direct investments in more traditional securities.

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.

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The Fund is non-diversified and may experience greater volatility than a more diversified investment.

Short sales may cause an investor to repurchase a security at a higher price, causing a loss. As there is no limit on how much the price of the security can increase, exposure to potential loss is unlimited.

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