Invesco Fixed Income

Global Fixed Income Strategy

June 30, 2017

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Global macro strategy

June 2017 IFI Global Investors' Summit: update on IFI's strategic and regional views

Over 50 investors gathered in London in June for Invesco Fixed Income's (IFI) semiannual Global Investors' Summit where we discussed our 12-18 month strategic view of global macroeconomic, credit and market trends. In this issue of the strategy report, we highlight the meetings' major themes and conclusions and provide our regional macro views. These views serve as key inputs into our investment process over the strategic horizon

Bringing macro themes to markets

Macro themes play an important role in IFI's investment process, and we have developed a series of quantitative macro models that complement our qualitative investment process. In addition to forecasting macro trends, we use a macro factor framework to identify key macro factors, such as growth, inflation and financial conditions that drive returns among major asset classes, such as duration, credit and currencies. We believe our macro factor framework can help improve asset allocation and the risk-return profiles of portfolios. Below, we discuss some of the major themes that we believe are driving key macro factors and how these themes influence our asset allocation decisions.

For a more detailed update of our Summit conclusions, please read our upcoming report "**Invesco Fixed Income White Paper Series, Global Investors' Summit June 2017.**"

For more on macro factors, please read "**How macro factors can aid asset allocation**," in the second quarter 2017 edition of Risk & Reward.

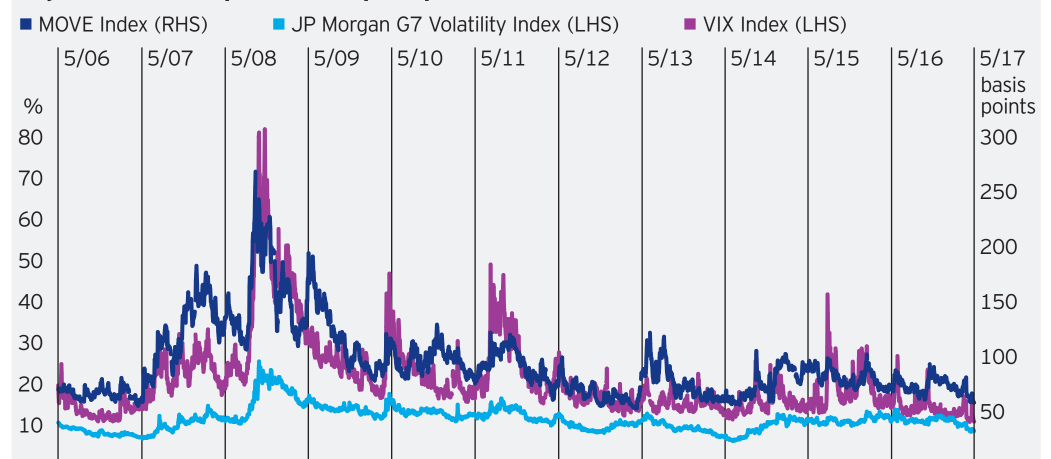
Macro theme 1: From global growth divergence to convergence

Since the global financial crisis, global financial conditions have been the main driver of markets. However, in recent months, we believe that growth has become more influential on market returns and behavior. In particular, we believe the longtime growth "divergence" theme – where the US was growing faster than the rest of the world – is now transitioning to a global "convergence" theme - in which the US expansion is moderating and the expansion elsewhere in the world is robust. This comparison is most visible between the US and Europe.

Macro theme 2: Global financial conditions remain benign

As world economies pick up, the winding down of quantitative easing (QE) appears to be gradual. Phasing out QE means a transition away from an environment in which global central banks have maintained tight control over asset markets via the implementation of QE policies. However, while the process of ending QE has begun in the US as its economic cycle matures, markets have easily absorbed policy normalization. We expect the same pattern to cascade across the rest of the world the longer we stay in a global expansionary environment. This creates a market backdrop of strong growth, benign inflation and, for the time being, very easy financial conditions, supported by still accommodative monetary policy. We believe this backdrop has resulted in persistently low market volatility.

Figure 1: Volatility subdued by easy financial conditions



Source: Bloomberg L.P., data from May 30, 2006 to May 26, 2017. Volatility is represented by the three indices shown. The MOVE Index is the Merrill Option Volatility Estimate Index. The VIX Index is the Chicago Board Options Exchange Standard and Poor's Volatility Index.

Asset allocation decisions

We believe broad-based global growth, benign inflation and easy financial conditions set the stage for credit, and risk assets generally, to perform well. We make allocation decisions corresponding to these conditions according to our macro factor framework. For example, our macro factor framework suggests that improving growth, low inflation and loose financial conditions support being long credit and emerging markets, short global duration and neutral the US dollar.

Risks to our view

The main risks to our views emanate from the prospect of a policy mistake or a major political disruption that could tighten financial conditions and disrupt economic activity and markets. Our base case, however, points to a benign macro environment in which volatility remains subdued and global growth and easy monetary policies keep financial conditions loose. We believe this combination is generally supportive for credit and other risk assets.

Ray Uy, Head of Macro Research and Currency Portfolio Management, Rob Waldner, Chief Strategist

Regional macro views
US

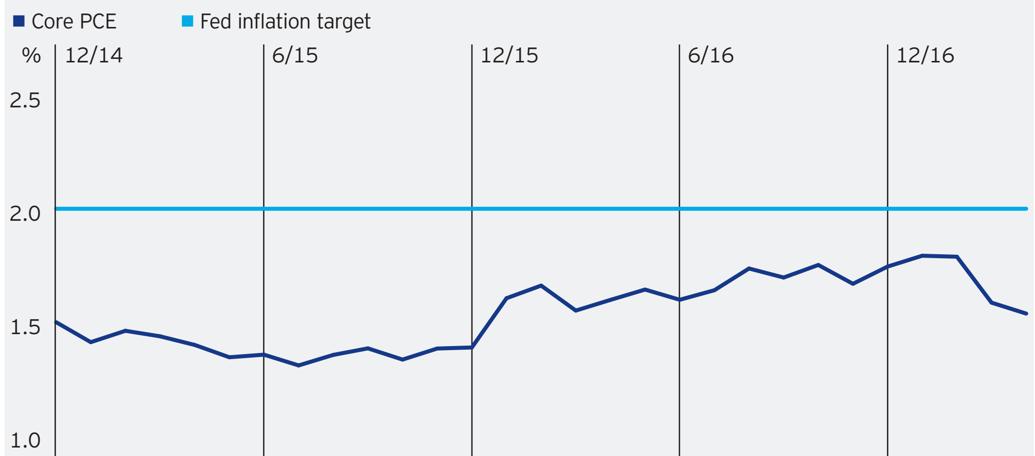
A note about our quantitative models: Our macro models provide a consistent starting point for the qualitative analysis of a wide range of economies. Our model output concentrates on trends, not single data points, as we base macro-oriented investment decisions on trends. We filter out the most economically significant data points (and those that are least often revised), and generate a distribution around them, allowing us to gauge the likely upper and lower bounds of data points - thus indicating upside and downside risks.

Growth
At the last Summit in November, we forecasted above-trend growth, which has indeed materialized. Although first quarter growth was relatively low, underlying economic growth trends have been positive and our year-end gross domestic product (GDP) growth trend forecast remains generally unchanged at 2.3-2.5%.

A key factor in our relatively unchanged GDP growth outlook is our skepticism around the success of the Trump administration policy agenda. As such, we view the US as late-cycle and likely past the peak levels of growth seen a few years ago.

Inflation
Inflation has dipped lately due to some statistical and other temporary factors, such as a drop in rents and an oversupply of core goods such as used autos. But, while inflation could slow further in the near term, we expect it to rebound in 2018 to around 2.3-2.5%, as strong housing demand, especially from younger entrants to the housing market, resumes pressure on rents and other inflation components stabilize.

Figure 2: Inflation softer, but Fed looking through



Source: Bloomberg L.P., data from Jan. 31, 2015 to April 30, 2017. Core PCE is the personal consumption expenditures index excluding food and energy prices.

Policy (financial conditions)
At the last Summit, we forecast two Federal Reserve (Fed) interest rate hikes this year. It now looks like we will see three, meaning one more in December, although this is likely to depend on the path of inflation. US monetary policy currently remains very easy and the credit cycle appears extended. We believe the current low level of inflation gives the Fed room to remain easy if needed to extend the cycle.

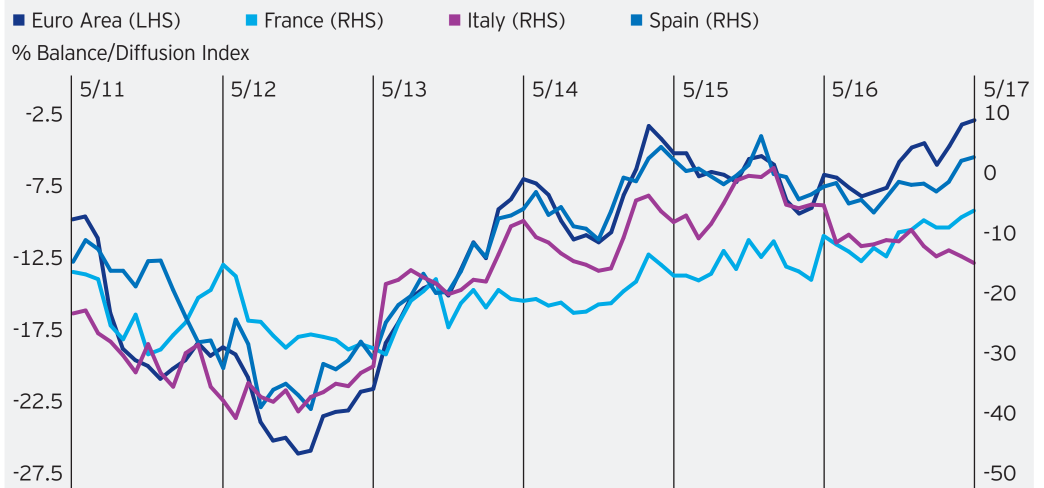
Risks to our view
While a Fed policy mistake is an important risk, we believe the biggest downside risks exist outside the US, for example, a slowdown of the Chinese economy or a rate increase by the European Central Bank (ECB) that shocks markets, especially reinforced by the phase-out of Fed reinvestment. Political uncertainty inside the US could also hurt consumer confidence and dampen economic activity.

Eurozone

Growth

Our eurozone macro outlook is generally positive. We expect to see growth and inflation gradually pick up over the strategic time horizon, although not meet ECB targets. Across the eurozone, strong manufacturing and consumer confidence data have especially stood out, showing a broadening of growth across the region, after previously being largely confined to northern Europe.

Figure 3: European Commission consumer confidence indicator



Source: Macrobond, data from May 1, 2011 to May 1, 2017. The data are published as the balance i.e. the difference between positive and negative answers (in percentage points of total answers), as index, as confidence indicators (arithmetic average of balances). Axes, therefore, show the percentage of data that are improving or showing positive momentum.

Inflation

We forecast low inflation over the next year, at around 1.5%. Some of the recent downturn has been due to softer energy prices, but we do not expect a significant pull on inflation from domestic demand. Rather, structural drivers point to continued low inflation, including demographics and wide output gaps that continue to hinder wage growth, especially in southern Europe.

Policy (financial conditions)

With growth in the US peaking, we believe there are few catalysts for higher interest rates in Europe. European financial conditions have loosened dramatically since the start of QE, but we do not envision a sharp reversal toward financial conditions tightening in the near term. The message from the June ECB meeting was a continuation of its dovish stance.

Risks to our view

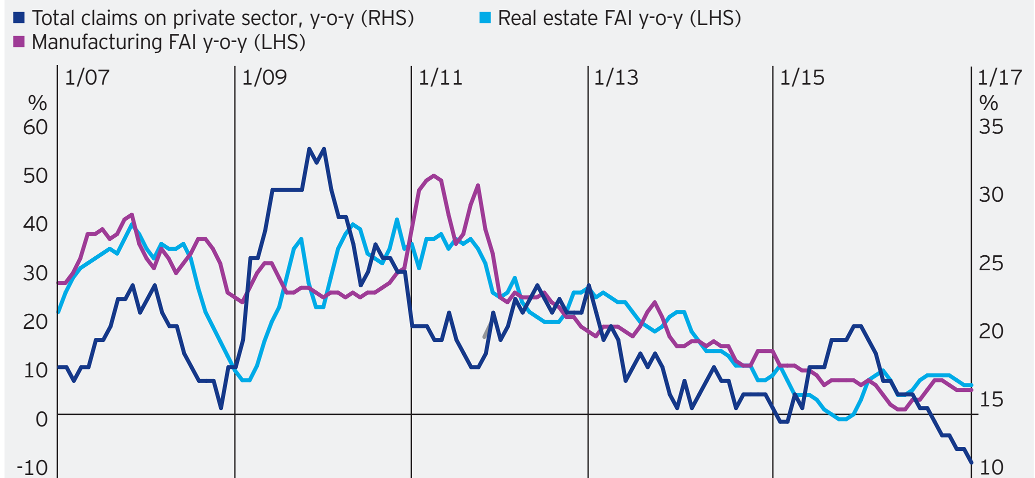
Risks include Brexit negotiations and another possible UK election. Italian elections could also be brought forward. The popularity of euro-skeptic parties remains a risk, although recent French elections quelled some concerns. We could see resurgence in anti-European Union sentiment, however, if unemployment, especially youth unemployment, does not improve.

China

Growth

At the November Summit, we projected a modest slowdown in Chinese growth in the second half of 2017, as the government pushed for financial sector deleveraging. Higher interest rates and tighter macro-prudential measures have, as expected, led to slower credit creation, especially in the large shadow banking sector and again lowered our expectations for trend growth going forward. We expect trend growth to slow to around 6.0-6.5% by the end of 2017.

Figure 4: Private sector credit growth has led economic activity and has fallen sharply



Source: CEIC, Invesco, Data from Jan. 31, 2007 to May 31, 2017. FAI is fixed asset investment.

Inflation

We expect consumer price inflation to remain within the central bank's desired range and measure around 2% at the end of 2017. Producer price inflation, on the other hand, may continue to decline, as the impact of financial deleveraging on economic growth takes hold.

Policy (financial conditions)

We believe financial deleveraging policies will continue and could accelerate, unless they trigger a small-scale financial "crisis" or sharp slowdown in growth. A change in the People's Bank of China's (PBoC) benchmark interest rate is unlikely and we believe the PBoC will provide adequate, though not excessive, liquidity to the financial system if needed.

Risks to our view

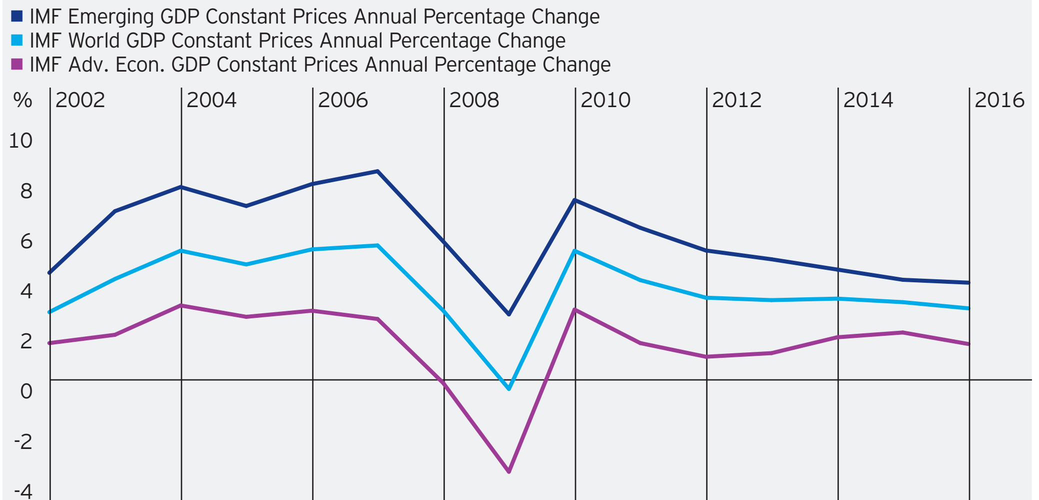
The main risk to our view is a sharp reversal in official policy away from our base case of gradually tighter policy and slowing growth. A dramatic growth slowdown or sharp move in interest rates or the currency away from desired levels could cause policy makers to adopt large-scale stimulus and aggressively loosen monetary and fiscal policies.

Emerging markets

Growth

Our long-term view of higher emerging markets (EM) potential growth versus the developed markets (DM) supports positive flows into EM assets. We foresee reduced long-term potential growth prospects across DM due to declining labor force participation and productivity. EM potential growth is also on the decline, especially in Asia, but the rate of EM potential growth and inflation still remain high relative to the DM economies. This suggests that EM bond yields will likely remain high relative to DM. We believe the EM-DM yield differential will continue to make EM assets relatively attractive over the medium term, despite issues and challenges faced by individual EM countries. Any progress made on EM structural reform and inflation reduction would likely reinforce this dynamic.

Figure 5: IMF Global, DM and EM growth



Source: Invesco, IMF WEO, data from Jan. 1, 2002 to Jan. 1, 2016.

Inflation

Inflation remains low, almost missing in action, in the current synchronized cyclical global upswing especially in DMs. Some EM countries experienced surging inflation as their currencies came under strong pressure but this inflation is already being contained in most cases by domestic monetary and fiscal tightening as well as economic slowdown or recession, depending on the country.

Policy (financial conditions)

We expect the major central banks to normalize monetary policy gradually, but with modest risk of a sharp tightening in global financial conditions. Low inflation provides the room to go slowly now rather than rapidly later, when and if inflation rises. This gradualism should extend the current global growth cycle to the benefit of EM, in our view.

Risks to our view

Over-tightening by the Fed or China are key risks to the current cycle. If either the US or China slows significantly or sharply, global growth would likely take a major hit and low inflation could shift towards deflation. EM, highly geared to global growth and a key beneficiary of easy financial conditions (as countries that export commodities or import capital), would likely be hard hit. Such actions would be policy errors given the Fed's formal triple mandate for price stability, full employment and moderate long-term interest rates, and China's stated growth and inflation goals.

Rob Waldner, Chief Strategist, Ray Uy, Head of Macro Research and Currency Portfolio Management, James Ong, Senior Macro Strategist, Noelle Corum, Macro Analyst, Gareth Isaac, CIO EMEA, Arnab Das, Head of EMEA and EM Macro Research

IFI macro views and 2017 outlook

	US	Eurozone	China
GDP trend growth	Expect 2.2%-2.5% growth in coming year. Labor market improvement on track.	Expect 1.6%-2.0%, growth driven by domestic consumption as the labor market continues to improve.	Expect trend growth to slow to around 6.0%-6.5% by end of 2017 as financial deleveraging continues.
Inflation	Expect core inflation to disappoint in the near term, but rise to around 2.0% by the end of 2017.	Expect headline inflation to remain below ECB's 2% target, with core stable at around 0.9-1.2%.	Expect CPI to remain within the central bank's desired range and reach around 2% at the end of 2017.
Monetary policy	Expect at least one more rate hike in 2017. Tapering of reinvestment to begin in September. Additional rate hikes depend on inflation outlook.	Expect ECB to taper purchases further from January to EUR40 billion per month and extend QE program by six months.	A change in the benchmark interest rate is unlikely and PBoC will likely provide adequate, though not excessive, liquidity if needed.
Fiscal policy	Slightly expansionary.	No change to fiscal policy expected in near term.	Neutral, but could turn expansionary if growth slows sharply in the second half of 2017.
Government yields	US Treasury yields dependent on global growth and policy. Changes in global policy are needed for rates above fair value of 2.65% on the 10-year US Treasury.	Expect 10-year bund yields to be range-bound between 0.25% – 0.50% in near term.	Expect 10-year CGB yields to range between 3.0%-3.5% in the second half of 2017, with risks to the downside.
Currency	Expect US dollar performance to be mixed.	Broadly positive on the euro but scope for appreciation limited by ECB dovishness.	Expect the RMB to trade within the range of 6.80-6.99 in the second half of 2017.

Interest rate outlook

US: US rates outperformed other global interest rate markets after May's US inflation data surprised to the downside for the third month in a row. While we expect US growth to continue at a solid pace, inflation is likely to stay low for the next several months before moving higher in 2018. We do not expect the downside surprise in inflation to affect our call for the beginning of a tapering of Fed reinvestment beginning in September. However, the inflation outcome will be critical in determining when the Fed raises the fed funds rate again. If inflation stays low, this may not occur until the middle of 2018.

Europe: Given the French election's market-friendly outcome and a reduced chance of Italian elections this year, markets will likely continue to focus on the ECB, which remains dovish, despite strong economic data. The ECB is focused singularly on inflation, which has remained subdued due to weak wage growth and falling oil prices. We expect this backdrop to anchor short-term yields and push 10-year European government yields upward.

China: The onshore Chinese government bond (CGB) yield curve inverted in May, as shorter-term bonds underperformed longer-term bonds amid tighter short-term liquidity conditions. However, this inversion reversed after the Ministry of Finance purchased one-year CGBs for the first time in June. We think this move sends an important signal about the government's role in managing the CGB yield curve. As financial deleveraging continues, we expect broad credit growth to slow in the third quarter, which will likely negatively impact economic growth in the second half of this year. We believe short-term government yields may still be subject to interbank liquidity fluctuations, but we expect longer-term yields to be more stable and outperform in the second half of 2017.

Japan: The Japanese economy continues to experience growth in excess of its potential, driven primarily by a pick-up in consumption, and unemployment has declined to 2.8%.[1] Wages must to continue to increase if this momentum is to be maintained going forward and this is something that Prime Minister Abe will likely encourage. The pick-up in the Japanese economy has not gone un-noticed. The International Monetary Fund recently described Abenomics as a "success." It did, however, warn against fiscal tightening and an exit from monetary easing. In terms of the latter, we expect the Bank of Japan (BoJ) to keep policy unchanged for the time being, although it will likely continue to quietly taper asset purchases, should conditions allow.

UK: The UK general election outcome in June took everyone by surprise. What was expected to be a one-horse race turned into something much closer. So close that the Conservative party lost its outright majority in parliament and only maintained control by teaming up with the Democratic Unionist Party to form a coalition. Coalitions with such a slim majority have not traditionally fared very well in the UK, many holding together for less than a year. If Prime Minister May is to buck this trend, she will need to compromise more than she has in the past, not only with opposition parties, but also with her own members of parliament. This could prove to be too challenging and a leadership challenge or another election this year cannot to be ruled out. In the shorter term, we expect many of the pre-election manifesto pledges to be downplayed and for there to be a far more conciliatory approach towards Brexit discussions. These talks are likely to be fractious in the early stages, but we expect cool heads to prevail in the longer term and for the UK to agree to a softer Brexit at worst. The probability of the UK remaining in the EU is also likely to increase. We expect the Bank of England to keep interest rates on hold and for gilts to underperform US Treasuries in the near term.

Interest rate outlook

Canada: 10-year rates bounced off their lowest levels of the year in June, to 1.53% currently, as first quarter growth came in somewhat above expectations.[2] The Bank of Canada (BoC) is reviewing its economic outlook ahead of the next policy meeting in July. They appear to be somewhat less worried about some previous concerns, such as uncertain US trade policy and another substantial drop in oil prices. Their optimism may prove to be premature, but, nevertheless, we are watching their stance closely. We expect interest rates in Canada to rise from current levels.

Australia: The Reserve Bank of Australia (RBA) held its benchmark interest rate steady at 1.50% as expected at its June 6 meeting. The statement was rather upbeat about the economy's prospects but conceded that first quarter growth would be weak. The unemployment rate fell to 5.5% in May, which is a new cyclical low.[3] The RBA continues to be concerned with the leverage-driven housing market. This concern will likely keep the RBA from lowering interest rates and stubbornly low inflation should keep them from raising rates, thus they will likely be on hold for the foreseeable future. We remain neutral on Australian interest rates.

Rob Waldner, Chief Strategist, James Ong, Senior Macro Strategist, Sean Connery, Portfolio Manager, Brian Schneider, Head of North American Rates, Scott Case, Portfolio Manager, Josef Portelli, Portfolio Manager, Yi Hu, Senior Credit Analyst, Ken Hu, CIO Asia Pacific, Alex Schwiersch, Portfolio Manager

1 Source: Ministry of Internal Affairs, May 29, 2017.
2 Source: Bloomberg L.P., June 19, 2017.
3 Source: ABS, June 15, 2017.

Currency outlook

USD: Our strong global growth view indicates a mixed environment for the US dollar. Downside surprises in US inflation may cause the Fed to hesitate to raise rates later this year. In addition, major global central banks like the ECB have more significant moves to make in terms of normalizing their policies. Global policy normalization will likely favor currencies of countries whose central banks are scaling back their QE programs, for example the euro versus the US dollar.

EUR: We remain constructive on the prospects for further euro appreciation. The European fundamental backdrop continues to be supportive of a stronger euro, in our view. In general, we believe that the US dollar cycle has reached its zenith, due to global growth convergence, and that ECB policy adjustments going forward are likely to be skewed toward supporting longer-term euro strength as political risks recede.

RMB: We expect the CNY and CNH currencies to trade on the stronger side of the 6.80-6.99 range in the weeks ahead. The direction of the RMB/USD exchange rate within this range will likely be subject to US dollar strength, but softening in the US dollar is expected to provide support. We don't think the new "counter-cyclical" factor for the CNY fixing, introduced at the end of May, is a game changer. The new method may have increased the discretionary element in the fixing, but we believe it is borne out of the authorities' desire for a smoother movement of the currency.

JPY: The yen continues to trade in a relatively tight range of 110-115 against the US dollar and we expect this range to hold in the near term.[1] Non-domestic events are likely to have more influence on the yen in the next few months, with improved US economic data and Fed rate hike expectations providing the most likely catalysts for a move higher in the USD/JPY exchange rate. An escalation of geopolitical events would likely limit any yen weakness, since the yen is typically viewed as a safe haven.

GBP: We remain constructive on sterling over the longer term, based on a more optimistic outlook for Brexit discussions, valuations and investor positioning. That said, the currency could struggle in the near term given uncertainty over the sustainability of the new UK government. Jeremy Corbyn of the Labour Party is waiting in the wings to take over should the new coalition not survive. However, investors would not likely view his appointment positively, given the spending pledges he has made during the recent election campaign. Brexit discussions could also prove to be a headwind to sterling as preliminary discussions likely prove challenging.

CAD: The Canadian dollar has been in a slow decline over the last year, but has shown some strength recently. As economic growth rebounded in the first quarter, the BoC appears to be rethinking its level of caution regarding the economic outlook. Oil prices appear to have peaked for the year due to US oil production, presenting a headwind for the currency. We remain underweight the Canadian dollar due to the overleveraged Canadian consumer and our expectation that oil prices have peaked, but we are monitoring BoC rhetoric closely.

AUD: The RBA held its benchmark interest rate steady at 1.50% as expected at its June 6 meeting. The statement was upbeat overall but conceded that first quarter growth would be weak. The RBA continues to be concerned with the housing market and that, combined with stubbornly low inflation, should keep it on hold and keep its target rate at 1.50% for the foreseeable future. We remain neutral on the Australian dollar.

Ray Uy, Head of Macro Research and Currency Portfolio Management, James Ong, Senior Macro Strategist, Brian Schneider, Head of North American Rates, Scott Case, Portfolio Manager, Sean Connery, Portfolio Manager, Yi Hu, Senior Credit Analyst, Ken Hu, CIO Asia Pacific, Alex Schwiersch, Portfolio Manager

1 Source: Bloomberg L.P., June 20, 2017.

This section highlights the key themes driving Invesco Fixed Income's global and credit research process and views. Themes are updated based on evolving trends and expectations.

Global investment themes

Global credit themes

Geographical themes

Investment grade (IG): Global central bank forces, global growth impulse, fiscal policy changes

Rationale

US, Europe and Asia IG have seen strong investor demand due to easy global monetary policy. Fundamentals are stable to improving due to positive global growth outlook. Leverage remains at cycle highs but is stabilizing. US tax policy changes could lead to less issuance going forward. European credit markets are generally earlier in the cycle and less levered, although Brexit and political uncertainties remain.

IFI strategy

Favor gaining exposure to selected senior and higher quality subordinate financials, consumer cyclical, technology, media and telecommunications (TMT) and pipelines. Remain cognizant of selective tight valuations.

Emerging markets (EM): Reversal of reflation trade, favorable financial conditions supportive

Rationale

Combination of reversal in reflation trade and still-favorable financial conditions should support EM risk markets but the risk of further commodity price weakness – triggering a selloff – remains. There are no signs as yet of stretched momentum or trend breaks for EM credit spreads/currencies.

IFI strategy

Favor focusing on a diversified basket of high quality, longer dated credits. In particular we think 30-year bonds will likely do well. Brazil, Mexico, Pemex, Indonesia, Qatar, Kazakhstan, Morocco, Oman, Turkey are all good options and fit with our tactical overweights.

US commercial mortgage backed securities (US CMBS): Notable decline in primary market issuance, watching retail industry fundamentals

Rationale

Negative retail news has recently dominated the headlines. However, we are generally not advocates of selling stronger US CMBS credits given they are often difficult to replace. Further, we think the space should continue to benefit from limited supply as property price growth continues.

IFI strategy

We think AAA-rated US CMBS look less attractive. Given the significant move in spread tightening we prefer seasoned US CMBS as cycle progresses. Credit-differentiation is accelerating, placing a premium on selection. Rich valuations and poor hedge-adjusted carry weigh on shorter-term high quality paper.

US residential mortgage backed securities (US RMBS): Favorable fundamentals, valuations fair, Credit Risk Transfer (CRT) securities market depth improving

Rationale

Mortgage underwriting quality remains high, the home price outlook remains supported by limited housing supply, and long-term negative net issuance remains the dominant force in US RMBS. But following outperformance in recent months in legacy US RMBS and below-IG CRT, valuations appear stretched relative to other asset classes.

IFI strategy

Favor higher quality legacy prime, alt-A, and seasoned BBB-rated CRT. Avoiding sub-prime, coastal concentrations, and option adjustable rate mortgages.

US asset backed securities (US ABS): Value in floaters, fundamentals normalizing, favorable technicals

Rationale

Normalization of credit underwriting and forecast for a healthier economy should support consumer credit performance in 2017. Recent widening in swap spreads and LIBOR rates provide an opportunity to add at fairly attractive levels. As the overall market continues to weigh the longer-term impact of a Trump administration and additional rate hikes this year, such uncertainty should be supportive of a more stable, shorter-duration US ABS market.

IFI strategy

Favor adding exposure to floaters where collateral performance remains stable. Believe senior prime auto US ABS and esoteric issuers can provide opportunities. Avoiding deep subprime auto US ABS.

Sector themes

Commodities: Global supply concerns creating energy volatility, prefer pipelines

Rationale

Expect global IG credit risk premia to remain volatile as energy and metals credits reflect supply imbalances, offset by credit friendly financial engineering. Credit quality in focus due to still-modest economic growth and risk of volatility due to OPEC, US crude supply, fiscal policy implementation and Fed uncertainty.

IFI strategy

Favor gaining exposure to selected higher quality energy and pipeline issuers where shorter-term maturities are well covered by liquid assets and positive corporate actions support financial profiles.

Consumer story more nuanced globally, watching US fiscal policy influences

Rationale

Solid US labor market and consumer confidence are supportive, but consumers more value and delivery conscious, while international retail demand remains uneven, due partly to the strong US dollar and volatile capital markets. Watching European consumer for post-Brexit behavior shift.

IFI strategy

Favor selected US consumer sectors including leisure and housing-related sectors. Negative on “big box” retailers that lack differentiated products. Favor EM consumer sectors on a selective basis. Incrementally more cautious on automotive original equipment manufacturer (OEM) sector.

Post-merger and acquisitions (M&A) deleveraging plays

Rationale

M&A activity has moderated but remains a risk, driven by large overseas cash balances, low all-in financing cost, still soft organic revenue growth, and need to reposition business portfolios.

IFI strategy

Preference to play post-transaction bond issuance typically characterized by size, liquidity, concessions and plans to deleverage. Believe a discriminating approach to this strategy is warranted due to lower, but still large, M&A-related pipeline.

Global technology – big data

Rationale

Expect global use of data to grow and transition to cloud-based platforms.

IFI strategy

Prefer to gain exposure to software and services, cell towers and select wireless issuers. Have avoided hardware original equipment manufacturers.

Yield curve themes

Credit curve positioning, long end valuations getting full

Rationale

Global interest rate policy has forced cash investors and sovereign wealth funds into 3-5 year part of the credit yield curve, creating a steep 5-7 year part of the curve. Lately, sovereign wealth funds have targeted the 10-year part of the curve. We expect demand for 5-10 year paper to be resilient.

IFI strategy

Favor 7-10 and select 30-year points on US IG and EM credit yield curve. New issuance has remained strong year-to-date, but is expected to decline as the pace of mergers returns to normal.

Tony Wong, Head of Global Research, Joe Portera, CIO High Yield and Multi-Sector Credit, Michael Hyman, CIO Global Investment Grade and Emerging Markets, Mario Clemente, Head of Structured Investments

Nick Tolchard
Head of Invesco Fixed Income EMEA

The bottom line

We believe our consistency, connectivity and creativity can add value for clients

The London Summit was a chance for Invesco Fixed Income (IFI) to share our investment philosophy and capabilities with distribution colleagues and other Invesco professionals. Senior IFI leaders talked about IFI's "value proposition," highlighting our strengths and explaining how our approach differentiates us in the marketplace. Below, we follow up with Nick Tolchard, head of IFI EMEA for his views on IFI's unique culture and how it enhances our investment process and performance.

Q: Nick, what are IFI's aspirations in the marketplace?
Nick: Five years ago, we set out to leverage our wide range of single-sector capabilities globally, develop strong capabilities in macro and credit research and asset allocation and better integrate our geographical teams – which are located in several US cities and major global regions - onto one global platform. We have fulfilled many of these goals and constantly pursue continuous improvement to build on what we have accomplished.

Q: What is IFI's investment philosophy?
Nick: Our investment philosophy is founded on the importance of research. The bulk of IFI's team members – 90 out of 229 people – are research professionals. We have set a global standard for local research– meaning our research processes everywhere around the globe are consistent and equivalent. Our macro and credit research teams work closely together to draw investment themes from their research and communicate them in a timely manner. Communication is facilitated via technology to portfolio managers who utilize ideas in portfolio positioning across the platform. Although it's hard to capture this dynamic in words, we came up with three that we think describe us and provide a framework to think about us and our value proposition: consistency, connectivity and creativity.

Q: Let's start with consistency. What does it mean in practice?
Nick: All of IFI's research analysts around the world use structured research processes, including common ways of looking at issuers and credits, and a common language to talk to each other. They also use consistent ways of communicating with portfolio managers so that managers are confident of how they are assembling risk in portfolios. We think dependable, thorough research provides portfolio managers access to a wide array of ideas from which they can generate alpha and better information ratios.

We also assess risk similarly across the platform, at the research level and in portfolio construction. For example, because some ideas are correlated and some are not, we have sophisticated tools to help us understand how these ideas work together and how best to implement them in client portfolios.

Q:How does IFI stay connected?
Nick: We have formal, purposeful meetings within and across teams and asset classes. But we also encourage lots of informal dialogue across the platform via informal channels. We are able to examine ideas from multiple angles, using technology that communicates, documents and stores our views and positioning. This allows timeliness of communication, which is so crucial today when local events can quickly become global phenomena. We believe collaboration also leads to stronger levels of conviction when identifying investment ideas. The semi-annual Summits are a good example of a regular forum that brings IFI members together to get to know each other better and promote interchange between teams that are situated all around the world.

Q: Can you give us a real life example of how IFI's connectivity led to a better investment outcome?

Nick: A good example was a few years ago, when our structured credit team forecast that US housing prices would likely rise faster than consensus expectations. Given the importance of the housing market in overall GDP growth, the structured team's positive view influenced our macro team's constructive view on US growth. Healthier house prices also meant healthier tax revenues for municipal issuers. At the same time, the "taper tantrum" drove the municipal market's largely retail-based investors to flee the market over fears of rising interest rates, leaving municipal bond prices battered. The following year, IFI invested in high yield municipal bonds, taking advantage of reduced prices that we believed were not justified given improving housing market and growth fundamentals. The structured team, macro team, municipal team and credit portfolio managers were continually in touch and worked together to develop an idea over time that was implemented in client portfolios and that, in the end, we believe added value for clients.

Q: What is the role of creativity in differentiating the IFI platform?

Nick: The markets are ever-changing and we recognize that we must continually adapt. In our collaborative culture, we are open to new ideas and individuals can make a difference. For example, the incorporation of macro factors into our macro research process has been an innovative and collaborative effort of our macro team that we continue to develop, including expanding it to credit factors.

Customized client solutions represent another differentiating feature of IFI. As a global fixed income manager, we recognize the need to work collaboratively with clients worldwide as a partner to help them resolve the investment challenges they face. The breadth of our platform gives us enviable scope to develop some really innovative solutions for clients. One recent example is a solution developed for an existing sovereign client in the multi-asset space. Working with our colleagues in Invesco Quantitative Strategies (IQS), we were able to provide the client with multiple proposals for mandate designs incorporating blends of IFI-managed global bonds, mortgage-backed securities (MBS) and convertibles with the global equities and commodities managed by IQS.

Market monitors

Fixed income market monitor

	Coupon (%)	Yield to worst (%)	1 month change in YTW	Option-adjusted spread				Returns			
				current	1 month change in spread	10 year range min	10 year range max	1 mth (%)	3 mth (%)	YTD (%)	12 mth (%)
Global Aggregate (USD hedged)	2.70	1.52	-0.05	42	-2	23	156	0.58	1.22	1.71	1.77
U.S. Aggregate	3.05	2.46	-0.07	42	-1	32	258	0.77	1.49	2.38	1.58
U.S. Mortgage-backed	3.53	2.73	-0.08	26	-2	-16	181	0.62	1.31	1.76	1.16
Global Inv Grade Corporate (USD hedged)	3.60	2.49	-0.09	114	-3	55	515	0.95	1.76	3.12	4.71
U.S. Investment Grade Corporate	4.02	3.15	-0.09	113	-3	76	618	1.15	1.99	3.48	4.26
Emerging Market USD Sovereign	n/a	5.26	-0.05	305	2	157	906	0.88	2.77	6.34	9.77
Emerging Market Corporate	n/a	4.55	-0.01	258	5	120	1,032	0.64	2.09	4.79	8.50
Global High Yield Corporate (USD hedged)	6.19	4.92	-0.17	353	-10	231	1,845	0.85	1.95	4.83	12.95
U.S. High Yield Corporate	6.46	5.48	-0.15	363	-8	233	1,971	0.87	1.81	4.79	13.58
Bank Loans	4.91	5.04	0.02	n/a	n/a	n/a	n/a	0.38	0.90	2.03	7.60
Municipal Bond	4.75	2.14	-0.23	n/a	n/a	n/a	n/a	1.59	2.55	3.94	1.46
High Yield Municipal Bond	5.10	6.05	-0.10	n/a	n/a	n/a	n/a	1.53	2.45	6.36	4.60

Treasury market monitor

	Coupon (%)	Yield to worst (%)	1 month change in YTW	Returns in local currency			
				1 mth (%)	3 mth (%)	YTD (%)	12 mth (%)
United States	2.08	1.80	-0.04	0.65	1.31	2.04	0.00
Canada	2.31	1.14	-0.06	0.78	2.09	2.49	0.66
United Kingdom	3.51	1.01	-0.02	0.48	1.08	2.29	7.09
Germany	2.08	-0.09	-0.01	-0.06	-0.99	-0.72	-0.66
Italy	3.47	1.34	-0.08	0.70	0.63	-1.07	-2.17
Japan	1.06	0.11	0.03	-0.18	0.18	-0.08	-2.40
China	3.45	3.73	0.32	-1.08	-1.74	-2.05	-1.42
EM Local Currency Governments	n/a	n/a	n/a	0.74	3.11	4.98	8.46

FX market monitor[1]

	Current	10 year range		Returns			
		min	max	1 mth (%)	3 mth (%)	YTD (%)	12 mth (%)
EURUSD	1.12	1.05	1.60	2.88	6.31	7.25	0.22
USDJPY	111.37	75.82	124.77	0.43	2.12	5.56	-1.64
GBPUSD	1.29	1.22	2.11	-0.03	4.79	4.92	-10.64
USDCNY	6.81	6.04	8.28	1.36	1.02	2.22	-3.38
USDCHF	0.97	0.75	1.39	2.54	3.84	5.36	1.70
AUDUSD	0.74	0.60	1.10	-2.02	-3.95	2.64	1.61
CADUSD	0.74	0.72	1.09	1.23	-1.40	-0.54	-3.23
EURJPY[2]	124.86	94.31	169.49	-2.35	-3.94	-1.56	-1.86
EURGBP[2]	0.87	0.70	0.86	-2.81	-1.42	-2.15	-10.82

Sources: Bloomberg Barclays, J.P. Morgan, as of May 31, 2017. Credit Suisse Leveraged Loan data as of May 31, 2017. Within the Treasury monitor, United States is represented by Bloomberg Barclays US Treasury Index; Canada is represented by Bloomberg Barclays Global Treasury Canada Index; United Kingdom is represented by Bloomberg Barclays Sterling Gilts Index; Germany is represented by Bloomberg Barclays Global Treasury Germany Index; Italy is represented by Bloomberg Barclays Global Treasury Italy Index; Japan is represented by Bloomberg Barclays Global Treasury Japan Index; China is represented by Bloomberg Barclays China Aggregate Treasuries Index; EM Local Currency Governments is represented by J.P. Morgan GBI_EM Broad Diversified Index. In the Fixed Income Monitor, Global Aggregate is represented by Bloomberg Barclays Global Aggregate (US$ Hedged) Index; US Aggregate is represented by Bloomberg Barclays US Aggregate Index; US Mortgage-backed is represented by Bloomberg Barclays US Mortgaged-backed Index; Global Investment Grade Corporate is represented by Bloomberg Barclays Global Aggregate Corporate (US$ hedged) Index; U.S. Investment Grade Corporate is represented by Bloomberg Barclays Aggregate Corporate Index; Emerging Market USD Sovereign is represented by the J.P. Morgan EMBI Global Diversified Index; Emerging Market Corporate is represented by J.P. Morgan CEMBI Broad Diversified Index; Global High Yield Corporate is represented by the Bloomberg Barclays Global High Yield Corporate (US$ hedged) Index; U.S. High yield Corporate is represented by Bloomberg Barclays U.S. Corporate High Yield Index; Bank Loans is represented by the Credit Suisse Leveraged Loan Index; Municipal Bond is represented by Bloomberg Barclays Municipal Bond Index; High Yield Municipal Bond is represented by Bloomberg Barclays Municipal Bond High Yield Index. Yield to Worst (YTW) is the lowest expected yield calculation given maturity and call features. Option Adjusted Spread (OAS) is the yield difference relative to similar maturity Treasuries that incorporates call, put, sinking fund or paydown features of a bond. Past performance cannot guarantee future results. An investment cannot be made directly in an index. Returns less than one year are cumulative.

1 Positive number represents the currency appreciated against USD, negative number represents currency depreciated against USD.
2 Positive number represents the currency appreciated against EUR, negative number represents currency depreciated against EUR.

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10. **Investor double take: US Agency MBS, Allocating to US Agency MBS during a Fed tightening cycle**, Dec. 2016, John Anzalone, Head of Structured Securities Portfolio Management

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