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Global Investors' Summit June 2016

July 15, 2016

Invesco Fixed Income (IFI) held its semi-annual Global Investor's Summit in June, gathering around 50 of IFI's investment professionals from around the world to discuss key themes affecting global bond markets and determine our strategic views for the next 12-18 months. The following represents our current views and outlook.

Global macro overview

As events develop in the aftermath of the UK vote to leave the European Union (EU), we believe financial market volatility has the potential to feed through to consumption and domestic demand, adversely affecting growth in the UK and Europe.

Globally, we expect the direct impact of the Brexit vote on growth to be limited. It remains to be seen whether tighter financial conditions amid the fallout from the vote, including a potentially stronger US dollar, will dampen global growth. However, we believe uncertainty generated by the "Brexit" outcome is likely to curb investment, not only in the UK and the EU, but perhaps elsewhere, until the outcome of the complicated exit negotiations can clarify the trade and business landscape.

With heightened uncertainty and potential market volatility post-Brexit, we favor a market neutral stance. Though market dislocations such as this one can often present opportunities, we currently do not favor taking significant active risk-on positions in credit, currencies or interest rates. Catalysts for a reversal of the risk-off move are not yet clear, in our view, and uncertainties remain. In our view, this backdrop does not warrant significant risk taking.

We are watching global central banks closely. Both the Bank of England (BoE) and the European Central Bank (ECB) have announced that they stand ready to act as necessary. The BoE increased its liquidity measures by £250 billion immediately after the vote, and signaled that it expects to implement fresh stimulus measures in August. In the US, the bond market does not appear to be pricing in a Federal Reserve (Fed) interest rate hike until 2018. We believe that central bank action is only likely in the event of further market dislocations. The post-Brexit vote market reaction has been orderly thus far, in our view, and unlikely to draw immediate central bank intervention.

While events in the UK and Europe are likely to command the spotlight for the foreseeable future, we are also closely watching developments in China as it seeks to stabilize growth. We believe China's macro policy has pivoted away from monetary and fiscal stimulus toward supply side reform and efforts to curb leverage in the economy. We believe this shift marks a policy sea change which is likely to cap China's growth momentum in the coming months.

In emerging markets (EM), several indicators suggest that EM generally has entered into a credit cycle downturn. We expect EM growth to slow as balance sheets are impaired and repaired and other risks associated with slow growth rise, including fiscal and financial sector strains.

We also see evidence of a late cycle emerging in global corporate credit markets. We place most global credit sectors (US loans, US investment grade, US high yield, emerging markets and Asian credit) in the mid-to-late phases of their credit cycles. We believe European sectors (European loans, European investment grade and high yield) are in the early to mid-cycle expansionary phase.

In the financial sector, changes in global banking regulations have pushed capital, liquidity and asset quality metrics to their strongest levels in decades, but they have also impaired revenue growth and profitability. We believe credit quality differentiation among banks will play an increasingly important role as we enter a more challenged global growth environment.

Key macro conclusions

- The global political backdrop is creating uncertainty. Downward pressure on global growth is a risk.
- Financial market volatility is creating opportunities but we are watching for catalysts before increasing risk.
- The US Federal Reserve (Fed) is likely on hold. Political risk will likely play a key role in monetary policy globally going forward.
- In emerging markets, a potentially stronger US dollar and rising domestic leverage are continued headwinds to growth.
- We have downgraded our forecast of US GDP trend growth in the coming year to 2.3% from 2.5% to reflect softer than expected economic data since the November Summit. While US consumption and consumer confidence appear to be healthy, other important sectors have disappointed.
- We expect Europe to grow by around 1.2% over the next year. The risk is to the downside, however, due to the economic and political uncertainty created by the UK's decision to leave the EU.
- We expect China to grow by around 6% annually for the foreseeable future, a bit below the government's target. Inflation is expected to remain at around 2%, also somewhat below target.
- While there are some idiosyncratic bright spots, we believe that overall EM growth prospects are challenged.

Regional macro views

US: We have downgraded our forecast of US GDP trend growth for the coming year to around 2.3% from around 2.5% to reflect softer than expected economic data since the November Summit. We have seen consumer confidence, autos and some housing measures decline from their cyclical high levels. In addition, capital expenditures and productivity have posted lower than expected performance this year. We now expect capital expenditure to be flat while productivity growth remains highly uncertain. The bounce in the June payroll report brings the three-month moving average of job growth more in line with our 2.3% economic growth estimate.[1] Given the decline in other measures of growth, we are not expecting the moving average to meaningfully surpass current levels.

There is good news on US inflation, which has been firming. While driven initially by rents, inflation has become more broad-based. We expect core consumer price inflation (CPI) to reach 2.4% over the next year. We are finally seeing signs of wage inflation, but not as much as we would have expected by this point in the cycle. However, the decline in labor force participation in the last few months and other measures of labor market slack now point to more positive signs of wage inflation after initially slowing over the last six months.

What does this moderate growth and inflation backdrop mean for Fed policy? Near-target levels of unemployment and inflation would typically point to Fed action to raise interest rates. However, the UK's vote to leave the EU (Brexit) may cause the Fed to remain on hold until it sees greater clarity on the outcome's impact on global growth, financial market volatility and the path of the US dollar. Tighter financial conditions following the Brexit vote could lower inflation expectations and dissuade the Fed from tightening. US bond markets do not appear to be pricing in a Fed rate hike until 2018. Based on our outlook for US growth and inflation, we expect the Fed to be comfortable raising interest rates in December, with risks to a later move.

We remain cautious on US interest rates, given their historically stretched valuations. The US 10-year Treasury (currently yielding around 1.5%) is the most expensive it has been since the 1960s, according to our estimates, but global deflationary forces are likely to keep some downward pressure on US interest rates.[2]

Europe: We now expect the eurozone to grow by around 1.2% o ver the next year (down from our previous estimate of around 1.5%), and e xpect inflation to measure 0-0.5% (current CPI is running at about 0%, w ell below the ECB's 2% t arget).The risks to both growth and inflation are tilted to the downside, however, due to economic and political uncertainty created by the Brexit referendum result. While domestic demand has recovered somewhat over the past year, anemic growth had already reflected a host of constraints on potential growth, including Europe's unfavorable demographics, a high debt burden, ongoing deleveraging, weak external demand for European exports and eurozone fiscal constraints. Even though the ECB has substantially expanded liquidity, market indicators suggest that investor confidence in the ECB's ability to achieve full-fledged reflation remains low. Core government yield curves, for example, have collapsed and breakeven inflation rates remain at historical lows.

Beyond our central scenario of slower growth and lower inflation spilling over into the EU and eurozone from an increasingly likely UK recession, political challenges - as opposed to market-led financial risks -could constrain the ECB's efforts to restore price stability and growth momentum. In addition to the formation of a new UK government and opposition leadership and eventual UK-EU negotiations around Brexit, Italy's October referendum on Senate reform could be a major risk barometer. The referendum is ostensibly domestic rather than EU-oriented, however, Prime Minister Renzi has said he will resign if it does not pass. As such, the referendum could be interpreted as another protest vote or create relief, as the Spanish election did just after the Brexit referendum.

The run-up to the second quarter 2017 French presidential election and the October 2017 German federal election will also be monitored closely. Other countries that should be closely watched in terms of sentiment toward EU membership are Finland, the Netherlands and Denmark. Political signals about the direction of Europe from these political events and trends will likely influence business investment and household spending, especially on big-ticket items, and hence growth and inflation.

China: At the November Summit, we had expected monetary and fiscal stimulus to boost Chinese growth. Indeed, earlier this year, investors appeared to be pricing in a modest growth recovery. However, a May article in a major government newspaper, the 'Peoples' Daily,' suggested that China's macro policy has pivoted away from stimulus toward supply side reform and efforts to curb leverage in the economy. We believe this article marks a policy sea change which is likely to cap future growth momentum.

We continue to expect Chinese GDP to grow by around 6% annually f or the foreseeable future, a bit below the government's target. Inflation is expected to remain below the government's 3% objective at around 2%. Going f orward, we expect a "zig-zag" policy approach to achieving desired growth. When GDP growth is below desired levels, we expect increased stimulus. Growth at or above desired levels is likely to bring focus on controlling leverage. Uncertainty around our view centers on two key issues: 1) low productivity growth amid high leverage; and 2) possible policy-maker personnel changes later this year. Low productivity growth suggests that leverage is becoming inefficient and that adding more leverage may not lead to higher growth outcomes. This may hinder the authorities' ability to influence growth in the future. Policy-maker personnel changes could cause material changes in policy approach or direction.

We are cautious on Chinese bond markets. We believe there is limited room for additional monetary easing. At the same time, Chinese credit spreads have reached historically tight levels. As China pushes through supply side reform and deleveraging of its corporate and financial sectors, we expect some financial market volatility in the second half of this year. Given our expectations for continued deceleration in growth and a pick-up in corporate defaults, we expect credit spreads to widen from current levels. We believe the central bank's desire for financial market stability means it will carefully try to maintain renminbi stability against its target basket of foreign currencies.

Emerging markets: While there are some idiosyncratic bright spots, we believe that overall EM growth prospects are challenged. We believe that EM, in general, is at the later stage of its credit cycle or into a credit cycle downturn. This implies a poor growth outlook, as balance sheets are impaired and repaired, and risks associated with slow growth rise, such as fiscal and financial sector strains. Our work suggests that there is quite a bit of differentiation regarding where countries are in their respective credit cycles - some continue a credit expansion, some are in repair/recovery and most are in the late-expansion/early downturn phase. This dynamic highlights the differentiation that we foresee in macroeconomic and market outcomes for EM countries.

Before the volatility generated by Brexit, the failure of much of EM to participate in the reprieve in financial market volatility fostered by stability in China, a commodity price bounce and a pause in Fed policy normalization is evidence of late credit cycle conditions in EM, in our view. We would have expected EM credit conditions to have shown improvement in that environment, but instead, they had deteriorated sharply. We believe this suggests that much of the EM universe may have entered a credit cycle downturn. The uncertainty and volatility due to the Brexit vote, especially with respect to US dollar strength, is likely to reinforce these conditions, in our view. That said, stability in the US dollar and global risk sentiment may help ease financial conditions and push out the turn in the cycle.

The downturn in the EM credit cycle tends to elevate macro-related risk, including uncertainty over policy direction, and will likely have adverse implications for EM assets, in our view. Markets have already priced in a fair amount of risk over the last year or so due to other factors, such as US dollar strength and concerns about Fed interest rate hikes and now Brexit. We believe the rise in risk premia has left EM markets generally fairly priced, but if credit cycle risks begin to be priced in, EM risk premia could become further elevated in the coming months and years. We are monitoring financial conditions in EM countries, including, for example, credit growth and non-performing loans. To the extent that EM financial conditions continue to tighten as the credit cycle advances, we would expect knock-on effects to growth and repercussions in terms of financial sector and fiscal stresses.

While low commodity prices have helped the commodity-consuming EM countries overall, we believe the best may be over as commodity prices stabilize, especially oil, although not at levels high enough to save commodity producers. Against this backdrop, we favor EM local duration (local government bonds) given its attractive yield potential. There is probably some scope for EM currencies to overshoot, but they have adjusted significantly in the last few years and, in many cases, have reached attractive levels, in our view. We believe EM credit markets have experienced the least in terms of adjustment, and, going forward, we expect further adjustment in EM credit overall, given credit cycle dynamics.

Focus on global financials: In the US, we believe the credit quality of the banking sector relative to other countries is very strong. That said, tighter US regulations have squeezed profitability out of investment banking and mortgage businesses, leading to lower returns on equity compared to the past. In addition, loan quality metrics have started to normalize from record levels, so the release of credit loss reserves will no longer provide a boost to earnings. So while credit quality for the group as a whole is strong, it is unlikely to improve much going forward, in our view. For the remainder of 2016, we expect senior debt of US banks to perform broadly in line with the US corporate credit market, as strong fundamentals are offset by heavy potential supply and fair valuations. We still see potential for capital securities of high quality US banks to outperform given strong fundamentals, attractive yields in a low-yield environment and a much more benign supply outlook.

In Europe, we believe negative interest rate policy (NIRP) has constrained profitability in some cases and made it difficult for banks to grow their returns on equity (ROE) back to pre-financial crisis levels. We see Brexit's impact on bank fundamentals as relatively muted in the short term, but, over the longer term, the impact will likely flow through from an economic slowdown in the form of slower top line growth and weaker asset quality. Valuations are likely to be negatively impacted by volatility and more internationally diversified banks are likely to fair relatively better. European banks have been reluctant to pass on negative interest rates to retail depositors. Rather, they have increased lending rates as interest rates drop further into negative territory. We expect this to impair broader credit creation and potentially economic growth. We favor the Scandinavian and Benelux banks and seek to avoid the southern European banks, such as Italian and Spanish banks, which are challenged by asset quality concerns, in our view.

In Asia, bank credit growth has decelerated, even in the more developed markets such as Hong Kong and Singapore where it has turned negative. However, capital ratios have improved sharply and Asian bank bonds have performed well, despite global market volatility in the first quarter. We believe this resilience was likely due to strong local investor support and the high proportion of lower beta Chinese banks in the Asian bank universe. In the second half of 2016, we expect continued slow loan growth but less regulatory pressure compared with European and US peers. We expect some deterioration in asset quality as economic growth slows, but do not foresee systemic-level stress. We anticipate heavy supply (in the form of senior and capital bonds) to potentially weigh on the market, especially in the investment grade space. We therefore expect general spread widening from current levels, but expect it to be contained by generally strong domestic and foreign demand. Relative stability in the Asia Pacific region could attract more investment flows to the region post-Brexit vote.

Global credit cycle update: We believe determining where economies are in their credit cycles provides insight into their current stage of economic formation and the potential performance of risk assets. We observe that banking sector-induced financial crises tend to elongate credit cycles and, following a financial crisis, we observe that cycles can last about twice as long as the typical cycle (around 65 months from peak to trough). According to our estimates, the current cycle has lasted about 84 months. We believe that most global credit sectors (US loans, US investment grade, US high yield, emerging markets and Asian credit) are in the mid-to-late phases of their credit cycles. European sectors (European loans, European investment grade and high yield) appear earlier on, in our view, in the early-to-mid expansionary phase.

In the US investment grade sector, flat earnings growth and higher leverage in response to debt-financed mergers and acquisitions (M&A) and other shareholder friendly initiatives are some indicators that suggest late cycle. Energy remains in a downturn but appears to be past the bottom of its cycle, based on the recent rebound in crude prices and due to an increased focus on balance sheet repair in the sector. A host of other macro and credit indicators suggest that several other US sectors are moving into late cycle: slowing US GDP growth, bottoming unemployment, slowing corporate revenue growth and flattening profit margins, low corporate credit risk premia compared to fundamentals and rising corporate default rates. Debt-to-GDP among non-financials is approaching cycle highs and the high volume of M&A, some characterized by mega deals and rich valuations, suggests late cycle behavior, in our view. In terms of overall credit quality, we also see the US and Europe displaying a trend toward more credit downgrades compared to upgrades, a further sign of late cycle conditions, in our view.

Risks to our views

US economy stalls: In the US, strong labor market performance has supported consumption, which has underpinned our above-trend growth outlook. Deterioration in US labor market conditions could pose risks to consumer spending overall, feeding through to weaker growth. Financial market volatility due to increased global growth uncertainties could also dampen US consumer confidence and spending.

European downside risks now span economic, financial and political arenas: Risks out of Europe now pose perhaps the most significant global economic and financial event risks as China devaluation fears recede. If risks of political fragmentation rise, the eurozone is likely to underperform our baseline scenario of weaker growth and inflation. Anti-EU and/or anti-eurozone political forces could exacerbate headwinds, causing declines in consumer confidence and animal spirits in both the corporate and financial sectors.

Financial and economic instability in China: As China focuses more on supply side reform and controlling private sector leverage, we could see greater than expected financial market volatility and/or downside pressure on Chinese economic growth. Shifts in policy direction due to possible personnel changes among key policy makers could also affect economic outcomes. Chinese capital outflows and associated volatility were some of the drivers of Q1 risky asset underperformance. Renewed volatility in China is likely to have impacts on the global financial markets.

Geopolitical shocks causing generalized global risk-off sentiment: Destabilizing geopolitical events could have systemic implications for developed market and EM countries. Following the surprising "leave" result in the UK referendum, a push for additional referenda across Europe could pose significant risks to financial markets and sentiment.

IFI macro views and 2016 outlook

	US	Eurozone	Japan	China
GDP growth	Expect 2.0-2.3% gr owth in coming year. Labor market improvement on track.	Expect annual growth of 0.8 – 1.2% o ver the next year with risks skewed to downside.	Expect 0.7% gr owth in 2016. Investment weak and wage growth insufficient to boost demand.	Expect growth to moderate to around 6%. Growth appears to be stabilizing, but risk of further slowdown.
Inflation	Expect core inflation to near 2.4% b y the end of 2016, barring further drops in energy prices.	Expect annual inflation of 0.0 – 0.5% o ver the next year with risks skewed to downside.	Expect 0.3% in flation in 2016 due to soft oil prices and stronger yen.	Expect 1.5-2.0% inflation, below central bank's 3% objectiv e.
Monetary policy	Expect first 2016 Fed rate hike in December. Fed continues to be data dependent and risk sensitive through 2016.	Expect greater chance of ECB increases in asset purchases if downside risks to growth materialize. We do not rule out rate cuts but believe they are less likely.	Expect further easing from Bank of Japan at July or October monetary policy meetings.	Large-scale monetary easing is unlikely. Targeted easing measures are being adopted.
Fiscal policy	Neutral	Currently neutral, but likely to change to expansionary.	Expansionary	Easy
Currency	Expect US dollar to continue to appreciate, but at more modest pace than previously.	Expect euro depreciation if more political risks materialize but solid fundamentals should offer support.	Expect yen to trade between Y100-115 per US dollar this year. A yen below 100 will likely be unwelcome by Japanese authorities due to its deflationary impact.	Expect the Chinese currency (RMB) to move generally in line with target basket of currencies.

1 Source: US Department of Labor, Invesco, July 8, 2016.
2 Source: Bloomberg L.P., July 13, 2016.

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