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## Where do portfolio managers see opportunities in today's environment?

PMs weigh in on business trends, balance sheets, disciplined approaches and Federal Reserve policy

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**Apr 03, 2020 | Kristina Hooper, Chief Global Market Strategist**

The three-pronged fight against COVID-19 and its economic impact continues. Central banks are providing monetary policy support to keep banks and markets functioning, national governments are providing fiscal policy support to consumers and businesses, and governments at all levels are taking public health policy steps to contain the spread of the virus. (Not to mention the tireless dedication of the health care workers on the front lines and the scientists searching for treatments and vaccines.)

Of course, each policy decision in this fight has consequences for stocks, bonds, commodities, and other asset classes, and investors are wondering how to position their portfolios in such an environment. This is something that I discuss with Invesco's portfolio managers on a regular basis. Today, I've collected some highlights from them to share. Below, we hear from:

- George Evans, Chief Investment Officer of Global Equities
- Scott Wolle, Head of Systematic and Factor Investing, Chief Investment Officer and Portfolio Manager for the Invesco Global Asset Allocation team
- Meggan Walsh, Senior Portfolio Manager and Head of the Dividend Value team
- Matt Brill, Head of US Investment Grade for Invesco Fixed Income

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**Global equities: Spending on IT, health care expected to rise**

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**George Evans:** Current market prices are reflecting the near-term effects of the coronavirus and the oil price war that has begun between OPEC members. Without a doubt the effect of the coronavirus on near-term growth and corporate earnings is going to be terrible. That said, it is important to remember that this effect is one of disruption, not damage. The financial system is intact. Global production capacity is likewise in good shape. Production has been halted for a while, the flow of goods has been interrupted, and demand for them is temporarily suppressed. But the production capacity remains in place to fill demand when it revives.

In our opinion, this event has accelerated trends, increasing pressure on many traditional business models, as well as on some industries, and driving others to the fore. For instance, how many of us were familiar with Zoom two weeks ago? As recovery comes through, where you are and are not exposed will be very important for investors. In our opinion, we will see increased spending on information technology hardware and software as companies move to increase the robustness of their remote working capabilities. We will see increased spending on health care. We are likely to see a release of pent-up consumer demand for some discretionary goods and services.

Markets like this have been very rare, arriving only every decade or so. This one, like those before it, has thrown up opportunities in my view to buy strong franchises at extraordinarily attractive prices.

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## Risk parity: Focusing on economic diversification

**Scott Wolle:** The market movements we've witnessed over the past few weeks have been truly breathtaking. Investors could be forgiven for thinking that this crisis feels similar to the global financial crisis in 2008 - because the speed and magnitude of the current decline is reminiscent of the one that unfolded after the Lehman Brothers bankruptcy in September of that year. This is due to the fact that we're essentially dealing with three crises at the same time: 1) the fundamental decline in economic activity related to the response to the virus; 2) an oil price war between the Saudis and Russians; and 3) a credit crunch based on banks' inability to provide liquidity to the system. Policymakers are, of course, trying to address each of these but still have much work to do.

None of us knows how long we'll be dealing with the coronavirus and its aftermath, and that's really the type of situation that we believe increases the appeal of risk parity. Risk parity is a strategy based on economic diversification, in which a portfolio manager invests in stocks, bonds, and commodities - but weights the allocations so that each asset class contributes an equal amount of risk to the portfolio. This means that the performance of a single asset class doesn't overshadow the others in terms of overall portfolio return, which can allow investors to participate in up markets and play defense in down markets.

We are confident that discipline and diversification will be crucial ingredients for navigating the next few months. These are hallmarks of the risk parity approach, and it's how my team managed portfolios during the GFC, the Euro crisis, the 2014-15 oil crash and other challenging environments. One of the virtues of systematic processes is that they help to keep you on track when human nature tempts you to panic.

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## Dividend Value stocks: Corporate balance sheets matter

**Meggan Walsh:** Dividend-paying stocks can play an important role in a portfolio, providing capital appreciation potential and current income. The substantial disruption to economic activity caused by the coronavirus outbreak, and the uncertain duration of this disruption, has caused investors to question the ability of corporations to maintain dividend payouts to shareholders. Indeed, market participants are now forecasting a very sharp decline in earnings estimates in the second quarter of 2020, and there is the potential for dividend payout ratios to be reduced in some industries, particularly those more tied to cyclical end markets, look to improve liquidity and preserve capital during this difficult environment.

In this environment, it's important to note that dividend investing is not about simply finding the highest yields: Investors also need to pay attention to a company's balance sheet. Often, high dividend yielding stocks can be quite volatile and may indicate that a company is facing challenges. In these cases, dividend cuts have been quite common. The challenge is to differentiate between an ailing company that is simply paying a higher yield, and a strong, dividend-paying company with a solid capital structure, earnings power, and the ability to return capital to shareholders. For my team, our fundamental research process begins with the balance sheet, emphasizing firms with sound capital structures that are less prone to capital stress in cyclical downturns.

It is too early to estimate what the path of earnings recovery will look like, but history tells us to expect dividend payout ratios to grow again as the profit backdrop normalizes. Of note, as of March 31, the S&P 500 Index's dividend payout ratio is still below its long-term average.<sup>1</sup>

**Matt Brill:** As Kristina mentioned at the start of this piece, monetary policy support is critical for supporting markets in this environment. And the Federal Reserve's recently announced programs have helped to stabilize high-quality bond markets - including the investment grade debt market. In particular, the Fed announced on March 23 that it would begin purchasing corporate bonds for the first time in history. I believe this is a complete game-changer, and I wouldn't underestimate its potential impact.

As liquidity became very challenged in mid-March, the investment grade market saw a fall-off in buyers. Bid-ask spreads (the difference between the highest price that a buyer is willing to pay for a bond and the lowest price that a seller is willing to accept) widened to levels not seen since the global financial crisis. In some cases, there were no bids for even high-quality, short-term paper. That's when the Fed stepped in as a buyer. Since that March 23 announcement - even before the Fed has made any actual purchases - liquidity has returned to near-normal levels. Bid-ask spreads remain wider than they typically are in "normal markets," but investors now seem to view that as a buying opportunity given the Fed's commitment to support functioning markets.

We realize US economic data will be very negative in the near term, but I believe we are experiencing a potential opportunity in the investment grade market - a rally that I believe has substantial support from the major catalyst of Fed purchases.

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**Source**

<sup>1</sup>Source: NYU Stern. Long-term average calculated from 1960.

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**Important information**

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

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

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

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments. Common stocks do not assure dividend payments. Dividends are paid only when declared by an issuer's board of directors and the amount of any dividend may vary over time.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

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