



Relative Value with Focus on Risk and Reward

The market and companies experience cycles—and this creates investment opportunities. Thomas Bastian and his team at the Invesco Growth and Income Fund look for out-of-favor companies that have a catalyst in place to potentially regain appreciation and generate wealth in the process for patient investors.

What is the history of the fund?

Our fund, which started in August of 1946, has a long-term record of nearly 70 years, and has been through multiple economic and business cycles. The current investment process, which began 25 years ago, in 1990, is oriented to finding relative value ideas. .

The fund has a large-cap focus and typically invests in companies with market cap of \$10 billion and above.

Who makes up the team and what are the assets under management?

Our senior team is composed of individuals who have been in the industry and with the firm for a considerable period of time. It is comprised of four portfolio managers, each of whom on average possess more than 20 years of experience in the industry and 15-plus years with this firm. The team also has a seasoned group of analysts that has weathered a number of cycles.

We manage \$32 billion in total. Of that, approximately \$13 billion is in the growth and income strategy that we are talking about today, and approximately \$19 billion is in the equity and income strategy. Regarding equities, in total we manage about \$26 billion, all managed in exactly the same way.

What are your core beliefs and principles for managing your fund?

Philosophically our view is that we believe stocks get mispriced and that happens for a reason; and we believe that longer-term investors can take advantage of these price anomalies by identifying those companies that are underpriced and experiencing a positive change or a catalyst. If that catalyst occurs, then we have the potential to outperform the market.

In terms of our core beliefs, there are two we focus on. The most important thing we do in our process is geared around always trying to get risk/reward in our favor, seeking to protect the shareholders downside in the portfolio, while also being positioned to participate in the upside.

We also believe in cycles. We believe they provide opportunities and we attempt to take advantage of the opportunities they present. It can be economic and market cycles. It can be industry and company cycles. All of them present opportunities and we try to take advantage of those.

What is your investment process?

Our process is 'value with a catalyst'. We look for companies that are undervalued, unloved, that are under-earning, and we look to identify a catalyst that can potentially change that. We start by screening for valuation, which is critical to achieving a favorable risk/reward ratio and may help to limit our downside.

Then, we measure the sell-side ratings and find those value companies that are under-loved and underappreciated. If a company ranks low on the sell side, chances are that sentiment is low, and expectations are low, which also may help limit our downside.



Thomas Bastian CFA is the lead manager for Invesco large-cap relative value strategies. He joined Invesco in 2010. Prior to joining the firm, he was a portfolio manager for the US large-cap relative value products at Van Kampen, which he joined in 2003. Before Van Kampen, he was a portfolio manager at Eagle Asset Management and an analyst at Bank One. He entered the industry in 1997. Bastian earned a BA degree in accounting from St. John's University and an MBA from the University of Michigan. He is a CFA charterholder and a member of the CFA Institute and the Houston Society of Financial Analysts.

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Then we look at returns. As we said earlier, we believe in cycles and as such, there are times when companies earn normal returns and times when they over-earn or under-earn, relative to normal levels. We seek to find those companies that are under-earning relative to their norm.

Lastly, we search to identify a catalyst that provides us the opportunity to outperform and avoid 'dead money'. Catalysts may be fundamental in nature; the company is hitting historical trough operating margin levels, earnings expectations might be getting modestly better (or less inferior) and revenues may be accelerating. There might be sector opportunities such as consolidation. Or there may be management changes, to which we pay a lot of attention. We pay close attention to management change, as we believe this can have considerable impact. Typically, a management change occurs when a company has been operating in a period of disappointment. The board is disappointed, so they bring in a new management team, and give them a mandate to do what is necessary in order for the company to perform at more optimal levels.

What sets the fund apart from its peers?

Our process and the experience level of our team. As alluded to earlier, our investment process was developed over the past 25 years, is predicated on getting the risk/reward in our favor, and has proven durable through a number of cycles. Additionally, we have a senior team who has also been through a number of cycles and has proven an ability to execute and perform. We believe our long-term performance is reflective of this proven process and experienced team.

Would you expand on your research process?

Let's look at Voya Financial, Inc. as one example. Voya is a life insurance company, a United States branch of Holland-based ING Groep N.V., the European financial services company that was spun off in May of 2013.

It was attractively valued and priced at a big discount to book value. It was unloved, as sentiment was either negative or absent altogether. Not much was known about it, it was not in the indexes, and the sell-side was not formally covering it. These factors lined up with our tenets.

Investors were skeptical, wary, because the newly spun-off life insurance company didn't have a track record as an independent entity. It had low returns relative to others in the industry and relative to where we thought ultimately they could achieve, measured on a return-on-equity basis.

What makes companies with these tenets attractive?

In the case of spinoffs, these have never been run as a public company, so there is often low visibility behind them. When there's no quarterly or annual data on how these former business units operate, investors are naturally skeptical and overall sentiment is either negative or absent.

Typically, such companies are also underachieving, having been inside a

large organization, and oftentimes have not been held accountable to the same standards that public companies are. They are not typically in the indexes when they are spun off, so many investors are oblivious to their existence because they aren't paying enough attention.

The final component is the sell-side. Wall Street just isn't up to speed on these newly listed companies; they're not watching the official coverage.

Spinoffs typically operate in the void where buy-side investors who mirror the indexes aren't forced to own them and the sell side isn't publishing anything on them because either it takes more time and effort than they're willing to put in or, if they are involved in the spinoff deal, they aren't permitted to publish information on them.

Essentially, these companies don't have any public track record from which to give investors any level of comfort. As such, the parent company is forced to spin them off at an attractive valuation. Voya Financial, Inc. boasted a particularly attractive valuation because it was earning at low return levels and expectations were for it to continue that way.

What got us excited about Voya to start was that we believed all those negatives were in our favor. On the positive side, they had a brand new management team, whose members we were already historically familiar with. This team would have a public currency, and were incentivized to do the right thing on behalf of the shareholders.

We liked that Voya was not well known to the Street, and that it came at a discount, an artificial discount we believed would be reduced or eliminated over time. The new management team laid out a detailed plan as to how they were going to drive returns higher and transition the model from a life insurance business that was capital intensive to more of an asset accumulation model that was less capital intensive.

So, we had a management team that was incentivized to improve returns and would transition to a higher-multiple business from a lower-multiple business. Voya came out inexpensively and with the low expectations we look for.

When they eventually were spun off, they were more than adequately capitalized. If they continued to earn money, they would have excess capital. Their stated intent was that as capital became available, they were going to be shareholder friendly. Although they didn't start out with much of a dividend, what excess capital they generated was used to purchase and buy back stock. They have been disciplined about buying stock that is selling at a discount to book value.

Can you provide another example?

Target Corporation would be another. It lost a tremendous amount of momentum under the prior management team. They had a data breach, which garnered them a lot of negative publicity and led to some mistrust on the part of consumers.

And Target Corporation had expanded fairly dramatically into Canada—something that was not going particularly well. They were pouring in more money, without looking like they would earn their cost in capital anytime soon. They lost momentum on the branding and merchandizing side of things. Their CEO, Gregg Steinhafel, appeared to have lost the backing of the troops, something that was well documented in financial media.

As a result, Target Corporation was attractively valued, and given what was going on in Canada, the investment required there, in addition to a loss of momentum in merchandise and branding, they were under-earning relative to past history.

Sell-side sentiment was at a 10-year low. Under-earning and unloved, there were the inevitable low expectations. Sentiment was negative, valuation was attractive, and there was a welcome change of CEO. The new CEO had good managerial experience in well-run retailing, at PepsiCo, Inc. and Sam's Club, a subsidiary of Wal-Mart Stores, Inc.

So, all the tenets were present: it was attractively valued, unloved, under-earning, and we had a manager change. The new CEO came in, stabilized the organization, and when he couldn't foresee getting returns in Canada in excess of costs to capital, he shuttered it, opening the door to improved returns in the U.S.

Because the company had lost momentum on the branding side of things, he focused on improving their brand. They've been slowly but surely turning things around on the merchandising side of things. We still think there exists opportunity for improvement and for the stock to appreciate, absolutely and relatively.

What is the strategy that you employ when it comes to portfolio construction and diversification?

We are a value fund and so we benchmark ourselves against the Russell 1000 Value Index, and pay attention to where our peers are positioned via the Lipper Value Index. There are typically anywhere between 65 and 75 securities in the portfolio. We are bottom up oriented, but aware of our sector exposure. As a rule of thumb, we don't have sector exposures greater than 10 percentage points vs. the Russell 1000 Value Index sector weightings.

We apply our risk reward thought processes and quantification metrics to focus on how big of a position we might have. Within that construct, we are mindful of upside and downside opportunities and position sizes are weighted by conviction. We start positions at 75 basis points and we do not add to positions that are at the 5% level. Our maximum ownership of foreign securities is 25%. Historically, we have ranged anywhere from 4% up to 20%.

What is your decision-making process?

Our four senior portfolio managers each have specific sector coverage and buy/sell authority. They develop screens that they think are most applicable to their individual subsectors, all predicated on bottom-up stock selection, first by screening for valuation, and then assessing sentiment. They pay attention to returns, and who's earning at normal levels, who's under-earning, and who's over-earning. They go through that and develop ideas from a bottom-up perspective.

Then we sit down and parse the tenets of each candidate. Is it attractively valued? Is it under-earning relative to normal levels? Is sentiment negative? What are the possible catalysts? What are the upside and downside? Our bottom-up work includes company analysis, talking with management teams. The individual portfolio managers are charged with driving the ideas and the weightings in the portfolio.

Invesco Growth and Income Fund

Company	Invesco
Symbol	ACGIX (A Shares)
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Source: Company Documents

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What drives your buy-and-sell discipline?

In terms of our buy discipline, we focus on our tenets: attractive valuation, whether the company is under-earning, whether the sentiment is neutral or negative, and what catalysts exist. Experience has taught us that when we get all four of those lined up, our chance of success relative to the market and our peers rises considerably.

We set price targets, and revisit and reevaluate them regularly. In terms of sell discipline, it's fairly straight forward: the stock hits our price target, there's a relative opportunity that's more attractive, or something's occurred to make us think that we're wrong about the perceived catalyst, or the catalyst isn't going to happen, or it's gotten pushed out so far that we no longer have confidence in it. If we lose confidence, we exit the position.

How do you define and manage risk?

We think less about defining risk, except in terms of downside, than about trying to control it, which we do through portfolio construction, by trying to pick good stocks. Our process is predicated on protecting the customer's downside and giving them an opportunity to participate in the upside.

Again, we look for companies that are attractively valued in order to achieve a good risk/reward relationship, and screen for negative sentiment and sub-normal returns. This helps get valuation and sentiment on our side – and may serve to help limit our downside.

To avoid dead money situations, and give our customers a chance for upside, we seek catalysts: fundamental catalysts, sector catalysts, and/or a management change. Working with a team that can identify catalysts and visualize how they might play out potentially enables us to take advantage of valuation opportunities and outperform our peers.

Confidence in the team is very important. Every team member has professional longevity—they have weathered numerous cycles, which helps them navigate the cycles. Having such good investors is what helped us navigate the financial crisis so well. We take a long-term view and have the patience to see it through. Portfolio turnover has been about 25% over the past five years and thus, equates to holding positions for an average of four years.

Has your way of approaching the market changed since the financial crisis?

The financial crisis reinforced that our process of getting risk/reward in our favor continues to be relevant. Stocks get mispriced. We believe that longer-term investors can take advantage of these price anomalies by identifying companies that are underpriced and experience positive change or a catalyst.

We focus on two things: getting the risk/reward ratio in our favor and protecting the shareholders on the downside in order to give them an opportunity to participate in the upside. We believe in cycles—economic, market, industry, or company cycles—as all provide opportunities, and we try to take advantage of them.

To us, the financial crisis was simply another cycle. It reinforced our core beliefs focused on getting risk/reward ratios in our favor and taking advantage of such cycles. Looking back to the 2004–2005 period, financials were expensive, widely loved in the marketplace, and overearning relative to historical levels, the very antithesis of what we seek. So we reduced our position fairly substantially and this helped us in the 2008 to 2009 financial crisis.

Healthcare and consumer staples helped us in the 2007-08 time period. We owned quite a bit in these sectors, because that was where the relative values existed, and it served us well through that cycle. As the cycle played out, the healthcare and the staples area became more expensive.

Toward the end of 2008 and into 2009 some of the more cyclical areas, like technology, industrials, etc., began to screen more attractively. As such, we began buying names in these areas that screened a lot less expensively and reduced our exposures in healthcare and staples as they become relatively more expensive.

Although the fund's Class A shares at NAV had a negative return of -32.19% in 2008, it outperformed the Russell 1000 Value Index, which was down -36.85%. Then, in 2009, the fund was up 24.26%, again outperforming the index, which was up 19.69%. Despite experiencing a negative return, the fund was one of only 25% of funds that outperformed the index in both 2008 and 2009 because we focused on getting the risk/reward ratio in our favor, looking for relative valuation, and being alert to cycles and taking advantage of them.

That financial crisis was just another cycle, although admittedly an awful cycle. We believe we were well positioned going into it, rotated through the cycle, and were well positioned coming out of it. **T**

Fund Objective

The fund seeks income and long-term growth of capital.

Average Annual Total Returns (%) as of June 30, 2015

Class A Shares

Inception 8/1/46

Period	Max Load 5.5%	NAV
Inception	9.50	9.59
25 Years	10.02	10.27
20 Years	9.48	9.79
15 Years	6.59	6.99
10 Years	6.81	7.41
5 Years	14.33	15.64
1 Year	-0.58	5.20

Performance quoted is past performance and cannot guarantee comparable future results; current performance may be lower or higher. Visit invesco.com/performance for the most recent month-end performance. Performance figures reflect reinvested distributions and changes in net asset value (NAV). Investment return and principal value will vary, and you may have a gain or a loss when you sell shares. Performance shown at NAV does not include applicable CDSC or front-end sales charges, which would have reduced the performance. Had these proceeds not been received, total return would have been lower. Returns less than one year are cumulative; all others are annualized. Fund performance reflects any applicable fee waivers and/or expense reimbursements. Had the adviser not waived fees and/or reimbursed expenses currently or in the past, returns would have been lower. See current prospectus for more information. Index returns do not reflect any fees, expenses, or sales charges.

Calendar Year Performance of Class A Shares at NAV

2008	2009	2010	2011	2012	2013	2014
-32.19	24.26	12.65	-2.09	14.58	33.84	10.15

The Russell 1000 Value Index returned -36.85% in 2008 and 19.69% in 2009.

Expense Ratios	% Net	% Total
Class A Shares	0.84	0.85

Per the current prospectus

Net = Total annual operating expenses less any contractual fee waivers and/or expense reimbursements by the adviser in effect through at least June 30, 2016. See current prospectus for more information.

30-Day SEC Yield

Class A Shares 1.26

Had fees not been waived and/or expenses reimbursed, the SEC yield would have been 1.25% for Class A shares.

Top 10 Holdings

JP Morgan Chase & Co	4.66
Gitigroup Inc	4.62
General Electric Co	3.00
Morgan Stanley	2.68
Bank of America Corp	2.46
Royal Dutch Shell Pic A	2.18
Target Corp	1.91
Carnival Corp	1.88
Pnc Financial Services Group	1.86
Comcast Corp CI A	1.73

Holdings are subject to change and are not buy/sell recommendations.

About Risk

Convertible securities may be affected by market interest rates, the risk of issuer default, the value of the underlying stock or the issuer's right to buy back the convertible securities.

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.

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

A value style of investing is subject to the risk that the valuations never improve or that the returns will trail other styles of investing or the overall stock markets.

The fund is subject to certain other risks. Please see the current prospectus for more information regarding the risks associated with an investment in the fund.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Before investing, investors should carefully read the prospectus and/or summary prospectus and carefully consider the investment objectives, risks, charges and expenses. For this and more complete information about the fund(s), investors should ask their advisors for a prospectus/summary prospectus or visit invesco.com/fundprospectus.

Note: Not all products, materials or services available at all firms. Advisors, please contact your home office.

All data as of June 30, 2015 unless otherwise stated.

Holdings mentioned are for informational purposes only and are not buy sell recommendations.

A basis point is a unit that is equal to one one-hundredth of a percent. Valuation is the process of determining the current worth of an asset or company. Return on equity (ROE) is net income divided by net worth. Book value is a company's total assets minus intangible assets and liabilities, such as debt. A discount to that book value is the company's book value lower than its market value.

The Russell 1000 Value Index is an unmanaged index considered representative of large-cap value stocks. The Russell 1000 Value Index is a trademark/service mark of the Frank Russell Co. Russell® is a trademark of the Frank Russell Co. An investment cannot be made directly in an index.

The financial crisis referred to in this article is from 2008 to March 2009.

The Lipper Value Index is an unmanaged index considered representative of value funds tracked by Lipper. An investment cannot be made directly in an index.

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