



## Investment Philosophy and Process

### AIM Basic Balanced Fund

#### Investment Process (Equity Portfolio)

##### Universe Definition

Intrinsic value database comprising:

- 1,000 largest U.S. companies
- Consistent valuation assumptions
- Absolute valuations independent of market

50% Upside Potential

##### Fundamental Analysis

- Competitive position
- Management execution
- Economic financial statements
- Intrinsic value inputs

##### Portfolio Candidates

##### Portfolio Construction

Seeks to:

- Improve portfolio upside
- Maintain or reduce portfolio risk
- Limit industry concentration
- Diversify common business drivers
- Minimize common macro-dependence
- Control capital market dependency
- Measure transient risk factors

Portfolio  
rebalance

- New information
- Maintenance research

##### Sell Discipline

#### Investment philosophy

We believe a portfolio that blends equities of companies that are significantly undervalued with the relative stability of bonds may provide strong risk-adjusted returns over the long term. We therefore generally target a portfolio allocation of 60% equity and 40% fixed-income securities.

Within the equity portfolio, our objective is to create wealth by maintaining a long-term investment horizon and investing in companies that we believe are significantly undervalued. The fund's philosophy is based on two elements that have extensive theoretical and empirical support:

- Companies have a measurable intrinsic value<sup>1</sup> that we believe is based on the future cash flows generated by the business. Importantly, this value is independent of the stock market.
- Market prices are more volatile than business values, and investors regularly overreact to negative news.

We believe the common stocks of companies trading below estimated intrinsic value because of excessive short-term investor pessimism offer attractive investment potential. We further believe a diversified portfolio of such stocks provides the potential for superior long-term investment results.

#### Universe definition

Our investment universe includes the largest 1,000 U.S. companies but is generally focused on those companies with market capitalizations in excess of \$5 billion (about 500 companies).

We maintain a proprietary database of intrinsic value estimates for these 500 companies. We use consistent valuation assumptions across the universe and review them at least annually.

The primary drivers in our calculation of estimated intrinsic value are:

- Free cash flow
- Incremental return on invested capital
- Growth
- Capital structure

As a result, the database puts every company on a level playing field and enables us to rank stocks based on appreciation potential across the universe. We believe this is a significant competitive advantage. We also use a variety of simple screens and quantitative models to identify potential investments that may not be included in our database of intrinsic value estimates.

1. Managers believe intrinsic value represents the inherent business value of portfolio holdings during a two- to three-year investment horizon based on their estimates of future cash flow. Intrinsic value estimates are independent of market price and as a result market price may never reflect intrinsic value estimates, especially for an entire portfolio.

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## Stock selection

To purchase a stock, we require a minimum of 50% upside potential to our estimate of intrinsic value over our two- to three-year investment horizon. Remaining candidates are subject to exhaustive fundamental analysis and an assessment of portfolio suitability, including:

- Historical economic financial statements that correct for distortions permitted by generally accepted accounting principles (GAAP).
- Discounted cash flow models with 10 years of projected income statements, balance sheets and cash flow statements driven by growth and marginal return assumptions.
- Detailed analysis of normalized earnings power.
- Estimates of sustainable growth and marginal return on invested capital.
- Traditional competitive analysis of the company and its industry.
- Assessment of financial strength and capital adequacy.
- Intangible considerations, such as management performance.

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## Bond selection

We focus on the three largest sectors of the U.S. bond market and generally target an allocation similar to the Barclays Capital U.S. Aggregate Index: 30% U.S. government securities, 30% U.S. corporate bonds and 40% mortgage-backed securities. The primary goal of the fixed-income component of the fund is to provide maximum total return with preservation of capital. We use a fixed-income discipline to select an intermediate maturity portfolio of high-quality bonds.

Our investment process includes both top-down and bottom-up decision making. We assess the overall economic environment and its likely effect on interest rates, the level and direction of rates and the shape of the yield curve. We then determine the optimal sector allocation and make shifts based on changes in relative valuations among different classes of bonds. We use our own research, the research from various Wall Street analysts, spread matrixes and macroeconomic factors to help evaluate sector opportunities. Because credit selection is critical to determine the financial health of a company, we use input from several rating agencies, Wall Street analysts, internal analysis and private sources to identify investment opportunities.

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## Portfolio construction

Our blended portfolio of stocks and bonds is designed to provide equity-like returns with reduced volatility. While the equity holdings may provide appreciation, the fixed-income holdings are intended to reduce volatility and provide income.

Within the equity portion, we construct a portfolio of 40 to 60 stocks that is diversified across economic sectors and other risk factors. Portfolio construction is largely a function of our bottom-up process of identifying value opportunities with careful attention to the diversification of risk. Within the equity portion of the portfolio, we do not mimic a static benchmark in an attempt to neutralize short-term relative performance risk. Many popular risk management tools are based on short-term volatility relative to the market index. We believe these tools more accurately capture benchmark risk rather than the more complex nature of investment risk. We interpret investment risk as:

- A permanent loss of investment capital.
- A lower-than-expected return over the fund's investment horizon.
- A poor diversification or limitation of portfolio commonality.

In an attempt to manage these risks, we strive to limit portfolio concentrations across multiple dimensions of potential risks, including industry exposure, common macro-business drivers, capital market dependency and other factors that may create correlation among holdings.

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### Equity sell discipline

We strongly believe the key to successful execution of our strategy is a well-honed buy decision. However, a strong sell discipline is also an important element of optimizing risk and reward. We review a stock for sale for any of the following reasons:

- We seek to capitalize on a more attractive investment opportunity.
- A stock is trading significantly above our estimate of intrinsic value.
- Permanent, fundamental deterioration results in a reduction in estimated intrinsic value with inadequate upside potential or unexpected deterioration in financial strength.

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### Fixed-income sell discipline

We review a bond for sale for any of the following reasons:

- The bond becomes fully valued as investors recognize the opportunity.
- Macroeconomic or microeconomic market and technical analysis indicates that the market-sector emphasis should be changed.
- Valuations in industry sectors or credit spreads deteriorate.
- Fundamentals fall out of favor (e.g., issuer/credit downgrades).
- Unanticipated changes occur in company or sector fundamentals.

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### About risk

The values of convertible securities in which the fund invests may be affected by market interest rates, the risk that the issuer may default on interest or principal payments, and the value of the underlying common stock into which these securities may be converted.

Prices of equity securities change in response to many factors, including the historical and prospective earnings of the issuer, the value of its assets, general economic conditions, interest rates, investor perceptions and market liquidity.

Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, relative lack of information, relatively low market liquidity, and the potential lack of strict financial and accounting controls and standards.

The prices of securities held by the fund may decline in response to market risks.

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### NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

**Consider the investment objectives, risks, and charges and expenses carefully. For this and other information about AIM funds, obtain a prospectus from your financial advisor and read it carefully before investing.**

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

The Barclays Capital U.S. Aggregate Index is an unmanaged index considered representative of the U.S. investment-grade, fixed-rate bond market. An investment cannot be made directly in an index.

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

Discounted cash flow is an investment valuation method that considers the time value of money to estimate future cash flow.

Commonality measures the similarity of holdings between two portfolios using the lowest common percentage method. This method looks at the percentage of total net assets each security represents within its respective portfolio and aggregates the lower of the two percentages. Commonality is a determinant of portfolio correlation.

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## Supplemental Information

After the close of business on Dec. 31, 2009, Invesco Aim Advisors, Inc., Invesco Aim Capital Management, Inc., Invesco Aim Private Asset Management, Inc. and Invesco Global Asset Management (N.A.), Inc. merged into Invesco Institutional (N.A.), Inc., which was renamed Invesco Advisers, Inc.

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