



Investment Philosophy and Process

AIM Intrinsic Value/Large Cap Value Portfolio

Investment Process

Universe Definition

Intrinsic value database made up of:

- 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 (40-60 Stocks)

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

Our objective is to create wealth by maintaining a long-term investment horizon and investing in companies that we believe are significantly undervalued on an absolute basis. The portfolio's philosophy is based on two elements that have extensive theoretical and empirical support:

- Companies have a measurable intrinsic value¹ that 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 that the common stocks of companies trading below our estimate of their intrinsic value because of excessive short-term investor pessimism offer attractive investment potential. We further believe a diversified portfolio of such stocks provides the best opportunity 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 the assumptions at least annually. The primary drivers in our calculation of intrinsic value are free cash flow, incremental return on invested capital, growth and 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 estimated intrinsic value database.

Security 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. Additionally, purchase candidates with the requisite upside potential are subject to exhaustive fundamental analysis and an assessment of portfolio suitability, including:

- Historic economic financial statements that correct for distortions permitted by generally accepted accounting principles (GAAP).
- A discounted cash flow model with 10 years of projected income statements, balance sheets and cash flow statements driven by growth and marginal return assumptions.
- A detailed analysis of normalized earnings power.
- An estimate 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.

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.

Portfolio construction

We construct portfolios of 40 to 60 stocks that are 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. We do not mimic a static benchmark in an attempt to neutralize short-term relative performance risk. We believe that popular risk management tools based on short-term volatility relative to a market index 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 our investment horizon.
- 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 risk, including industry exposure, common macro-business drivers, capital market dependency and other factors that may create correlation among holdings.

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 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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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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