



Investment Philosophy and Process

Invesco Mid Cap Core Portfolio

Investment philosophy

We believe a portfolio of attractively valued companies, managed by good stewards of capital, may outperform the market over the long term. We seek to invest in good businesses with high or increasing returns on invested capital (ROIC) and that have strong future growth prospects or are temporarily mispriced.

Universe definition

We begin with the universe of domestic stocks generally defined by the Russell Midcap Index. We then identify companies trading at favorable valuations on both current and historical basis relative to several measures, including ROIC, free cash flow, growth potential and operating margins. This defines our universe of potentially undervalued businesses and helps focus our fundamental research efforts.

Security selection

Through fundamental research, we attempt to gain a thorough understanding of the prospects for each business, its appreciation potential and the degree to which it may sustain or grow ROIC. The overall investment process can be separated into two phases: The deconstructive phase involves forensic analysis of the company and industry, and the constructive phase helps create the overall investment thesis. Both phases of the investment process include the following types of analysis:

- Financial
- Business
- Valuation

Financial analysis provides vital insight into historical and potential ROIC, which we believe is an indicator of the quality of the business and the responsibility of its management. We also consider the sources of capital and the capital intensity of the firm to determine its financial flexibility. The business analysis allows us to understand the key drivers of the company, appreciate the industry challenges and evaluate the sustainability of competitive advantages. The financial and business analyses serve as a basis to construct the valuation models.

We triangulate an estimate of a company's value using a combination of methods. The three primary techniques are:

- Discounted cash flow
- Traditional valuation multiples (price-earnings ratio (P/E), enterprise value/ROIC, etc.)
- Net asset value (sum of the parts)

The combination of these efforts results in the fundamental aspects of our risk management framework. In addition, we diversify across industry and thematic exposures, initiate positions based on conviction tiers and generally limit positions to less than 5% of the portfolio.

Investment Process

Universe Definition

Companies generally in the market-capitalization range of the Russell Midcap Index

Financial Analysis

- Return on invested capital
- Management action
- Capital allocation
- Free cash flow

Business Analysis

- Competitive advantages
- Industry challenges
- Business risks
- Scenario analysis

Valuation

- Discounted cash flow
- Net asset value
- Traditional multiples

Growth/Value Candidate

Portfolio Construction/Risk Management

- Target 50-55 holdings
- Consider downside
- Implement tier weights
- Balance risk and reward
- Diversify fully
- Research new information
- Conduct maintenance research

Portfolio construction

In constructing portfolios, we attempt to protect against volatile price movements and preserve and grow capital in a framework that accounts for the likelihood and consequence of disappointment. We consider the relative attractiveness of stocks based on the trade-off between risk and reward and rank them along a continuum. This is done both in absolute and industry terms. We intend for the majority of our returns to come from stock selection, so we incorporate sector-relative considerations into portfolio construction.

We generally include stocks we expect will require a maximum of 18 to 24 months to capture their anticipated upside to our price target. The confidence we have in this scenario and the estimated probability of disappointment help determine a stock's active position in the portfolio. This is reflected in a tiered approach where stocks are weighted in four ranges. The most attractive stocks will have an initial maximum weighting of 3.25%. The remaining three tiers include stocks with decreasing weightings down to a minimum initial weighting of 1.35%. Smaller weightings imply lower anticipated upside potential and higher downside risks.

We may also maintain a cash position as a means to limit volatility in narrow market environments. We seek a well-diversified, style-pure, mid-cap core portfolio of 50 to 55 stocks.

Sell discipline

We will consider a stock for sale for any of the following reasons:

- Price target is exceeded.
- Eighteen- to 24-month time horizon is surpassed without demonstrable improvements in fundamentals.
- Fundamentals deteriorate.
- More compelling investment opportunities exist.

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