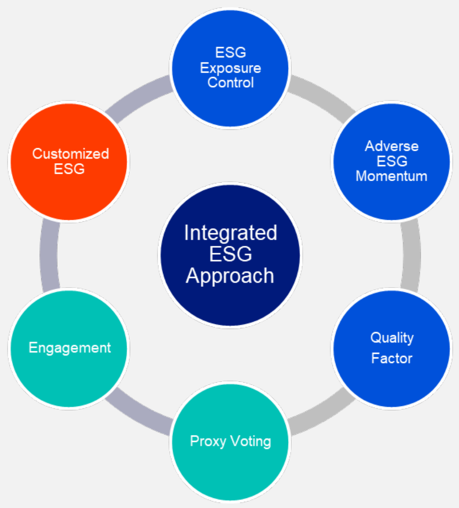
FAQ - Invesco Sustainable Pan European Structured Equity Fund / Invesco Sustainable Global Structured Equity Fund

For professional investors/qualified investors/qualified clients only.

Introduction

Invesco Quantitative Strategies (IQS) has implemented ESG focused mandates for more than 20 years. Since 2018 we integrate ESG considerations into all steps of our investment process for all products demonstrating our commitment towards sustainability (see graph 1). After years of in-depth research we now believe that data coverage and consistency has reached sufficient quality allowing us to promote ESG beyond a pure risk-based approach. In April 2021, we will adjust our Pan European Structured Equity and Global Structured Equity funds, both sub-funds of Invesco Funds, which will evolve into the Invesco Sustainable Pan European Structured Equity Fund and Invesco Sustainable Global Structured Equity Fund by rigorously applying a thoughtful combination of strict ESG criteria and parameters. At the same time, we will introduce recent research findings expected to improve portfolio diversification and risk management. Investors will be informed about the ESG promotion in a shareholder mailing, which will be sent on 8th March 2021.

Graph 1: IQS approach to ESG Integration



Source: Invesco – for illustrative purposes only

The changes will be effective on 8th April 2021 with the funds promoting environmental and social characteristics as defined in Article 8 of the Sustainable Finance Disclosure Regulation (SFDR).

In the below document we would like to discuss relevant questions regarding the ESG promotion and evolution in the investment process.

In a nutshell: How will the funds evolve?

We are promoting ESG considerations to a third dimension of the funds' strategy. With that, the three investment objectives comprise of:

- Promote sustainability by targeting superior ESG characteristics
- Improve risk-adjusted returns based on our low volatility positioning
- Enhance performance potential with our multi-factor model.

How is this evolution implemented?

The funds simultaneously target to deliver superior ESG characteristics, provide downside protection and benefit from extra return potential of equity factors. As portfolio optimizations become less effective with an increasing number of objectives and constraints, we apply a tiered portfolio construction, separating the different objectives:

The first step focuses on ESG and risk management: We aim to create a sustainable low volatility portfolio based on our ESG screened investment universe, while considering diversification parameters with respect to its country, industry, and single stock allocation. At the same time, we ensure that the portfolio's greenhouse gas emission intensity is meaningfully reduced compared to the capitalization weighted.

Taking this ESG-focused, low volatility portfolio as an interim portfolio, the second optimization step seeks to add balanced exposures to our return enhancing factors Momentum, Quality and Value.

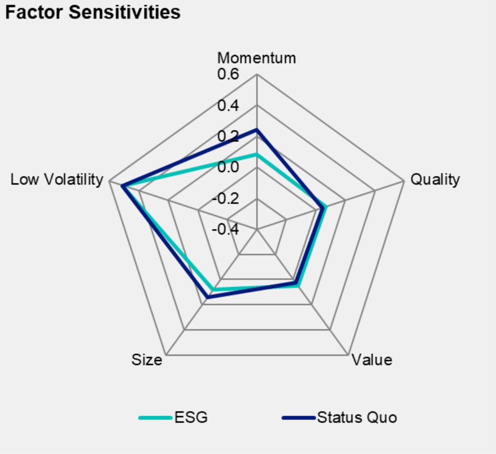
Will the portfolio profile change?
The resulting portfolio will hold a diversified mix of stocks which are deemed attractive from a factor and/or risk perspective while adhering to the ESG policy of the funds.

Following the ESG promotion, the portfolio will exhibit a favorable ESG profile when compared to the benchmark: Weighted average ESG scores will increase, while scope 1 and scope 2 carbon emissions will decrease meaningfully.

The number of stocks in the portfolio will increase as part of our risk management enhancement. This should decrease the impact of stock-specific effects on the portfolio and hence increase dependence on our intended factors Momentum, Quality and Value as well as Low Volatility.

The spiderweb graph 2 shows the fund's sensitivities to our factors Momentum, Quality, Value, Low Volatility as well as Size. The similarity in sensitivities before and after the funds' ESG promotion confirm that key portfolio characteristics will remain unchanged.

Graph 2: Shown are the t-stats of each factor when regressing daily active fund returns against daily factor returns.



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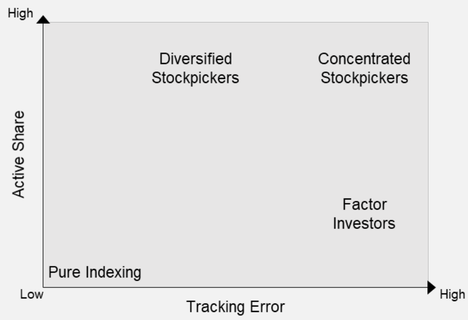
Will increased diversification reduce the portfolio's level of activeness?
No – our strategy will remain highly active. Moreover, with a broader diversification and a balanced factor profile, we expect to further increase the explanatory power of intended factors on our active returns. More than 85% of the funds' active performance is expected to be driven by the factor performance of Momentum, Quality, Value and Low Volatility fully aligning the profile of our portfolio with the desired outcome.

There are two common measures of a fund's activeness – active share and tracking error.

As shown in the illustrative graph 3, factor investors often exhibit lower active share, but higher tracking errors compared to the broader group of active managers. This allows the fund to benefit from factor returns in an efficient and diversified manner.

Active share is often regarded as the standalone measure of a manager's level of activeness. In our opinion, this picture is somewhat different for factor-based investment strategies. When allocating risk exposure to Momentum, Quality, Value and Low Volatility, a strategy needs to take active positions driving active share up. However, the goals of minimizing unintended effects such as extreme country & sector positioning as well as diversifying stock-specific effects leads to smaller active positions, consequently driving active share down. Hence, the activeness of factor-based strategy should not be purely judged by its active share, but rather in conjunction with a tracking error.

Graph 3: Investor Types characterized by active share and tracking error of their strategies.



Source: Invesco – for illustrative purposes only

What is the expected impact on portfolio return and risk?
Based on the similar factor profile shown in graph 2, the risk and return characteristics of the funds should remain consistent. Through improved diversification we expect to reduce the return impact from unrewarded style factors, active country/sector positioning, while also controlling the contribution from stock specific effects.

While ESG is predominantly a risk factor today, avoiding negative ESG companies and providing reduced greenhouse gas intensity in the portfolio should help to mitigate the impact from materialized ESG risks and hence improve risk-adjusted performance.

How is ESG integrated into the portfolio?

ESG has been an integral part of the investment process for over 20 years, particularly with our Quality factor and its link to Governance, as well as ESG Exposure Control and Adverse ESG Momentum in our portfolio construction. In addition, we now promote explicit ESG measures in our Structured suite. We combine:

- a best in class screening using an energy transition measure
- a greenhouse gas intensity reduction
- exclusions of controversial activities (e.g. coal and other fossil energy sources, weapons, nuclear power, tobacco, UN Global Compact violations)

The below graphic summarizes the comprehensive ESG measures integrated into our sustainable structured funds (hereafter the "Sustainable Structured Funds):

Graph 4: ESG integration in a systematic approach

Invesco approach towards the Invesco Sustainable Structured Equity Funds

IQS' integrated ESG approach	Focus on environmental issues	Exclusion of controversial areas:
IQS Quality – Governance – Linkage	Best-in-Class using an energy transition measure	Weapons
ESG Exposure Control	Carbon intensity management	Nuclear power
Adverse ESG Momentum	Firm's environmental policy	Tobacco production & distribution
Proxy Voting / Engagement	Climate change & greenhouse gases ▪ Restrictions on fossil fuel industry ▪ Restrictions with particular focus on coal, tar sands and oil shale	UN Global Compact violations
	Monitoring controversies[1] considering ▪ Biodiversity ▪ Pollution	Monitoring controversies[1] considering ▪ Community involvement

Source: Invesco, Vigeo Eiris. As of 31 December 2020. Detailed information on exclusion criteria are shown in the appendix. 1 Controversies involvement is screened based on international standards and norms.

What is the impact of introducing ESG in the investable universe?

Overall, this is expected to leave 60% of the investable universe eligible for selection, which currently represents 500 stocks.

Is ESG a factor?

Factors are typically described as quantifiable characteristics explaining a significant portion of a portfolio's risk and return. By investing into a factor, one would expect to earn a factor premium. Given its short data availability it is difficult to find statistical evidence today to confirm that ESG delivers a persistent factor premium. However, IQS believes ESG is best considered from a risk perspective. Based on increasing awareness from societies, regulators and capital market participants, we see sustainability risks in markets, which are currently not adequately reflected in the asset valuations. As an example: balance sheets of leading ESG companies are more reflective of their future return potential than those of ESG laggards where low-carbon economy transition risks are not yet fully known. Hence, ESG is a risk factor that should be considered in portfolio construction, whilst it could develop into a commonly accepted return factor in the future.

Why is IQS taking that step towards ESG now?

As factor investors, IQS relies on available data to evaluate attractiveness and risks of equity portfolios. When looking at the data from a factor perspective, it needs to fulfill two key criteria:

- Very broad data coverage for the applicable investment universe
- Reliable and stable data quality (both cross-sectional and over time)

With growing demand from the global investor base as well as regulatory pressure, a variety of new ESG data providers have emerged with significantly broadened product offerings. Growing investor demand has contributed to IQS increasing their efforts in the area of sustainability. We stick to our own philosophy and values by putting coordinated research efforts into this topic from a variety of angles with data quality and coverage being foundational. An increase in reliable data coverage across our investment universe has allowed us to advance subsequent research as a basis for ESG promotion into the fund.

What are the key benefits of the Sustainable Structured Equity Funds?

1. Factor investing and ESG are perfect partners. Systematically applying ESG in a multi factor portfolio can maintain the factor characteristics and deliver a long-term profile of positive actives returns.

2. With more than 35 years of experience in multi-factor investing and 20+ years of ESG integration, IQS' approach offers a transparent, systematic implementation and can be applied across a large investable universe. The result is a broadcap blend portfolio that provides equity market exposure in an ESG framework.

3. Invesco as a global investment manager takes active ownership seriously. As a result, investors in the funds will benefit from our ongoing ESG focused shareholder engagement and centrally coordinated proxy voting efforts across investment teams with the significance of $1.3tn assets under management.

Risk warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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