



# Invesco Perspective

Q&A with Invesco's Clas Olsson

January 2009

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## Quality Growth - A Durable Approach to International Investing

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The Invesco Aim International Growth strategy has significantly outperformed<sup>1</sup> the MSCI EAFE Growth benchmark both during the global financial market crisis in 2007-2008 and over 3, 5, and 10 year time frames. Lead Portfolio Managers [Clas Olsson](#) and [Barrett Sides](#) believe this success is attributable to an investment philosophy founded on three key factors:

- (1) Independent bottom-up stock picking with a disciplined focus on earnings, quality, and valuation ("EQV") - the last 2 components being traits that are often not emphasized by growth managers,
- (2) Active management that is benchmark agnostic, and
- (3) Investing with a long-term time horizon.

Olsson and Sides lead a team of seasoned international equity portfolio managers and analysts, several of whom have worked together for over a decade. They view the long tenure and stability of this team as important factors for investing successfully and maintaining discipline through varying market conditions. Olsson and Sides also point out that many investors and clients are significantly underweight in international growth, relative to their overweight in international value strategies. This level of concentration on value can cause the international component of an asset allocation strategy to underperform over a full market cycle. For example, since the start of 2007, value has significantly underperformed growth, due in large part to the substantial weighting of financial stocks in the value benchmarks.

This Q&A with Clas Olsson provides some insight into the investment approach and philosophy of Invesco's international growth team as well as thoughts on the opportunities for clients to benefit from this asset class.

**Q: Clas, what is your overall philosophy to investing internationally and, more specifically, to investing in International Growth strategies?**

A: Based on historical evidence we have strong conviction that adding international equity can provide long-term investors with attractive risk/reward diversification benefits to an overall asset allocation strategy. For a start, just consider the huge opportunity set that international investing provides. Approximately 75% of the world's GDP is produced outside the U.S., 96% of the world's population lives outside the U.S., and over half of the MSCI AC World Index's market-cap is based outside of the U.S.<sup>2,3</sup>

Those statistics emphasize the importance of international investing, rather than isolating a portfolio's equity exposure to just the U.S. economy and stock market. In addition to the opportunities in the developed world markets, many emerging markets also offer plenty of attractive investment opportunities. Moreover, looking at the historical performance of international equities vs. U.S. equities, international has

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<sup>1</sup> Outperformance is on a net basis through 9/30/2008.

<sup>2</sup> GDP and population figures are projections and are as of Dec. 31, 2007.

<sup>3</sup> Market cap figures are based on MSCI AC World Index and are as of Dec. 31, 2007. Sources: MSCI Inc., International Monetary Fund, World Economic Outlook Database, October 2007. The MSCI All Country World Index is an index considered representative of stock markets of developed and emerging markets. Performance quoted is past performance and cannot guarantee comparable future results; current performance may be lower or higher. An investment cannot be made directly into an index.



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outperformed during three of the past four decades by a fairly wide margin. (See chart on page 3.) And so we are clearly strong proponents of the long-term attractiveness and effectiveness of investing in international markets as we believe it provides significant diversification benefits.

In terms of the second part of your question, why one should specifically invest in international growth, the answer is simple: just like in the U.S., where investors prefer to balance growth and value stocks to benefit from cyclical outperformance of one style over the other, international equity markets are no different. A strong and proven international growth strategy should be just as important in an investor's portfolio as a strong and proven international value strategy. Right now, it is also important to be aware that financial stocks comprise 35% of the MSCI EAFE Value Index (at 11/30/08) and, as such, an overweight in value style might also result in a significant exposure to financials.

**Q: Explain what you look for in stocks—how does it differ relative to some of your international growth peers.**

A: We like to describe ourselves as “Quality Growth” managers. Different from many other growth managers, we put a lot of emphasis on quality and valuation. We refer to our investment process as EQV; Earnings-Quality-Valuation, each having similar importance. We believe this is a more balanced approach for finding growth opportunities than your typical growth manager.

By our standards, we look for a growth stock to satisfy three important criteria: Attractive Earnings growth, as measured by past success and the future earnings prospects; Quality, as in strong cash return on invested capital (CFROI), a strong balance sheet and a management team with a proven ability to allocate capital successfully; and, attractive Valuations of companies that we believe will produce long term stock appreciation. Attractive valuation is not necessarily the top criteria that some other growth managers seek, but we believe it is one of the critical factors in forecasting capital appreciation potential.

A noteworthy by-product of our focus on quality and valuation is the low turnover our strategy maintains in comparison to many other growth managers. Since our focus is to identify and invest in long-term winners with durable earnings prospects at attractive valuations, we can take a longer-term view of our investments. We will thus hold securities longer in our strategy, as long as we continue to have strong conviction in a stock's underlying businesses and investment case. So overall, we believe there are a number of key aspects in our strategy that differentiate us from many other international growth strategies.

**Q: So does your EQV philosophy and “Quality Growth” approach mean your portfolio does not closely mirror the holdings of the MSCI EAFE Growth benchmark?**

A: That is correct. While we obviously won't be negatively correlated with the index, we do not pay attention to specific benchmark holdings or sector weights. Our primary focus is on bottom-up stock selection and identifying great companies, while avoiding the mistake of ‘hugging’ the benchmark. In fact, our portfolio usually has less than 20% overlap with the benchmark, reflecting a high “active share” component for investors. The stock weightings in our portfolio reflect the level of our conviction in a stock, whether or not they are included in the index. Many managers will say they are bottom-up stock pickers while at the same time they are principally constrained by the index. That is fine if you are looking for index returns, but do you want to pay an active manager to “hug” the index?



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We instead generate ideas from as large an opportunity set as possible (World ex-U.S.) and weight our stock positions based on conviction in each company. Sector, country, and index weighting parameters are secondary to us behind stock selection. Looking back on our long-term performance, both on an absolute basis and versus the benchmark, this independent "high active share" approach has benefited our performance tremendously.

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<sup>4</sup> Greenwich Associates, U.S. IMF data, 2008.

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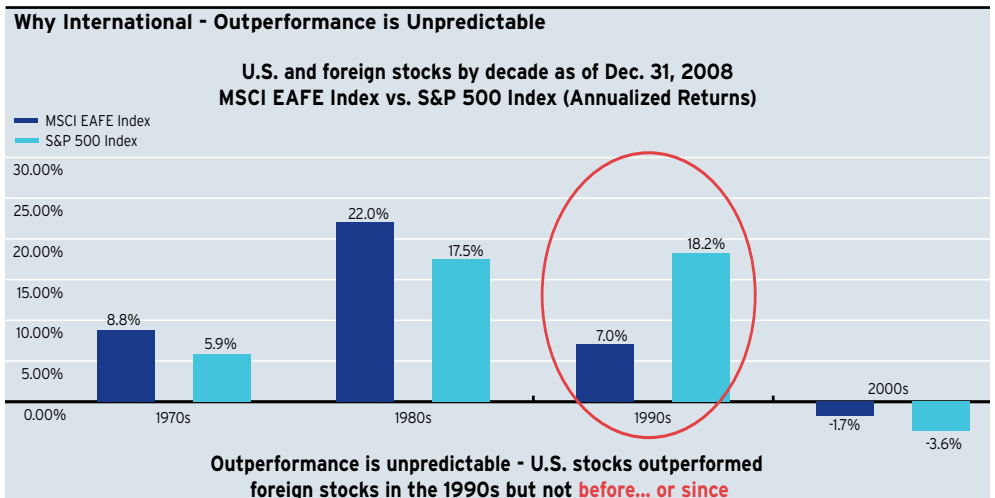
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**Q: You have asserted that clients, by and large, are under-allocated to international growth. Why is this and why should they consider increasing their exposure?**

**A:** Data on client exposure to international assets shows international value tends to have higher overall weighting among client portfolios than international growth, whether this exposure comes from a high percentage of value stocks in a core strategy or directly from value-oriented international strategies.<sup>4</sup> This trend was amplified throughout the first half of this decade, as financial stocks came to dominate the value index, and their price appreciation, both in the U.S. and overseas, caused a dramatic shift in the weighting of international managers towards this sector.

There are many good value investors and obviously there is nothing wrong with investing in value strategies. Our contention is that just like in the U.S., it is very important to "style diversify" by complementing exposure to "value" with exposure to "growth" investments. This approach can help balance the cyclical nature of these two types of strategies. While investors saw mostly negative returns from equities in 2008, one would have been less worse off during 2007-2008 if you'd been invested in international growth over value (and vice-versa during the early part of this decade).

The current environment provides a much-needed opportunity for investors to review their current positioning and decide if some "style" rebalancing and diversification is necessary in their portfolios. And, during periods when growth is scarce, like the one we're experiencing right now, investors may have a natural bias towards seeking out those companies that may offer better growth prospects despite the challenging environment.



Sources: Invesco Aim, Lipper Inc. Foreign securities have additional risks, including exchange rate changes, political and economic upheaval, the relative lack of information about these companies, relatively low market liquidity and the potential lack of strict financial and accounting controls and standards. The MSCI EAFE® Index is an unmanaged index considered representative of stocks of Europe, Australasia and the Far East. The S&P 500® Index is an unmanaged index considered representative of the U.S. stock market. Performance quoted is past performance and cannot guarantee comparable future results; current performance may be lower or higher. An investment cannot be made directly in an index.