

Invesco Main Street US Small Cap Class

Q2 2023

Key takeaways

1 The Fund outperformed its benchmark

The Fund's outperformance during the quarter mainly resulted from stock selection in the health care, energy and materials sectors. Weaker stock selection in the information technology, real estate, and communication services sectors partially offset these results.

2 Modest changes to Portfolio positioning

There was no significant change to the Fund's overall positioning during the quarter as we sought to keep most sector, factor and other macro-related exposures similar to the Russell 2000 Index. We view this as especially important given the economic uncertainty.

3 U.S. equities had robust gains during the quarter

Investors appear to have moved past the recent banking turmoil and U.S. equities delivered solid gains for the quarter. Larger-cap stocks had the largest gains, especially technology stocks, with exposure to the artificial intelligence (AI) theme.

Investment objective

Invesco Main Street U.S. Small Cap Class seeks to provide strong capital growth over the long term. The Fund invests mainly in common shares of a diversified group of U.S. companies with small market capitalizations.

Portfolio managers

Matthew Ziehl, CFA
 Adam Weiner
 Raman Vardharaj, CFA
 Joy Budzinski
 Magnus Krantz

Manager perspective and outlook

- Regional bank stocks recovered somewhat during the second quarter after declining in March and April as investors seem to have moved past recent banking turmoil. U.S. equities had solid gains led by larger-cap technology stocks, especially stocks with exposure to the AI theme
- The overall U.S. economy has been surprisingly resilient, and we have even seen some rebound in the housing market despite high mortgage rates
- While economic risks remain elevated, the much-anticipated recession is not here yet. Economic indicators and consensus estimates all point to 1% or higher growth for gross domestic product (GDP) in the second quarter, following the first quarter's 2% GDP growth
- The latest inflation data showed price increases slowing sequentially as expected, but inflation is still running above the Fed's 2% target. Employment growth, job openings and initial unemployment claims have shown softening but still indicate a robust job market with a net shortage of available workers
- U.S. equity markets seem to have become more comfortable with the higher interest rate regime as evidenced by the federal funds rate likely being near a peak and the economy slowing but still not contracting. We believe it is likely that the U.S. Federal Reserve will raise rates in late July and possibly again at the next Federal Open Market Committee meeting in September

Portfolio positioning

There was no significant change to the Fund's overall positioning during the quarter as we sought to keep most sector, factor and other macro-related exposures similar to the Russell 2000 Index. We consider this especially important amid the current economic uncertainty.

We maintain our valuation discipline and focus on companies with skilled management teams that are executing better than their peers. We also strive to maintain a Portfolio that can outperform in most market environments. The Fund's two structural exposures continue to be underweights in micro-cap stocks – generally sub-\$1 billion market cap – and the biotechnology industry.

New positions added to the Fund during the quarter include the following companies:

Marqeta offers a suite of services including advanced card issuing, transaction processing and spending management, which allow for highly customizable physical or virtual payment cards. Marqeta has a large cash balance and is doing a share buyback.

Portland General Electric is a fully regulated, integrated Oregon utility that we believe has a stable regulatory regime with solid long-term growth in demand for industrial power.

Wintrust Financial is a well-capitalized Chicago area bank that from our perspective has a diverse deposit base and strong credit metrics



For more information, including the Investment process, prospectus, and commentary, please visit [Invesco.ca](https://www.invesco.ca)

Evolent Health provides healthcare technology services for plans and providers to lower costs and improve outcomes in complex medical specialties such as cardiology and oncology, with an opportunity to cross-sell new areas such as radiology and musculoskeletal.

DigitalBridge Group is a digital infrastructure asset manager transitioning to an asset-light fee revenue model. The company is positioned to benefit from demand growth in data centre, wireless and fiber.

The largest positions sold during the quarter included the following companies:

National Storage Affiliates Trust was sold due to reduced confidence in execution after management reported disappointing occupancy rates year-to-date, on top of declines versus peers in 2022.

National Fuel Gas Company was sold as we do not consider the some-of-the-parts valuation for this company attractive enough to justify the complexity of a business model that combines natural gas exploration and production (E&P), pipeline and regulated utility businesses.

Evoqua Water Technologies was liquidated ahead of its acquisition by Xylem (not a Fund holding) because the combined company's market capitalization will be too big. The sale also helped to reduce an overweight in the industrials sector.

Northwest Natural was swapped for Portland General because we favour an electric utility over a gas utility.

Foot Locker was sold as management credibility has come into question after a surprisingly large earnings miss and a reduction in earnings guidance shortly after sounding bullish on its Analyst Day calls.

Performance highlights

Invesco Main Street U.S. Small Cap Class, Series I returned 3.54% (\$C) over the second quarter outperforming its benchmark, the Russell 2000 Index, which returned 2.87% (\$C). The Fund's outperformance mainly resulted from stock selection in the healthcare, energy and materials sectors. Weaker stock selection in the information technology, real estate and communication services sectors partially offset these results.

Contributors to performance

Prometheus Biosciences, a biotechnology company, was acquired by Merck (not a Fund holding) for \$200 a share, a 75% premium over the prior price. The deal closed in June 2023.

Inspire Medical Systems, a medical technology company treating sleep apnea, reported a solid first quarter with strong revenue growth that beat analyst estimates. Management also raised revenue guidance for the remainder of the year.

Tenet Healthcare reported a strong first quarter with both the acute care hospital and ambulatory surgery centres beating expectations, while labour costs declined. Management raised its guidance for 2023 earnings before interest, taxes, depreciation and amortization (EBITDA). Moreover, many medical device companies have been commenting about stronger volumes in the ambulatory surgical setting.

Detractors from performance

BJ's Wholesale Club gave back some of its first-quarter gains due to slowing same-store sales and easing grocery inflation.

National Storage Affiliates Trust, a self-store real estate investment trust (REIT), has experienced a sharp reversal of operating trends since mid-2022. After benefiting from best-in-class occupancy and rental rate growth in 2021 and early 2022, the company's occupancy has declined more than peers over the past year. We exited the stock during the quarter because our confidence in management execution has waned.

Ziff Davis reported solid quarterly results but the stock sold off due to demand concerns in the digital advertising market. While the company has been disciplined regarding mergers and acquisitions (M&A), its low organic growth likely needs to be complemented by accretive M&A to get investors more excited about its trajectory of the financials.

Performance of Invesco Main Street US Small Cap Class, Series I, as at June 30, 2023:

	1-Year (%)	3-Year (%)	5-Year (%)	10-Year (%)
Invesco Main Street US Small Cap Class, Series I	19.20	13.37	6.28	10.35
Russell 2000 Index	15.21	9.76	4.33	10.74

Important information

Sources: Invesco Canada Ltd., as at June 30, 2023.

The above securities were selected for illustrative purposes only and are not intended to convey specific investment advice.

On October 15, 2020, the Fund's investment strategies and portfolio advisor were changed. The performance of this Fund for the period prior to this date would have been, and the quartile ranking may have been, different had the current investment strategies and portfolio advisor been in place during that period.

The Russell 2000 Index is a market-capitalization-weighted index of the 2,000 smallest companies in the Russell 3000 Index. It is widely accepted representation of the U.S. small-cap market.

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