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# QDIA Validation

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## Invesco Balanced-Risk Allocation Fund

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March 2014

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DALBAR, Inc.  
Audit & Due Diligence Division

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## QDIA Validation - Status as of March 17, 2014

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DALBAR APPROVED

VALIDATED for QDIA

DALBAR has evaluated the **Invesco Balanced-Risk Allocation Fund** offered by **Invesco Advisers, Inc.** to determine if it complies with the requirements to be used as a qualified default investment alternative (QDIA) as defined by the Employee Retirement Income Security Act of 1974, as amended [ERISA] Section 404(c)(5) and associated regulations.



The *Invesco Balanced-Risk Allocation Fund (Investment)*, an open end regulated investment company managed by *Invesco Advisers, Inc (Manager)* was examined in relation to requirements for use as a Qualified Default Investment Alternative under ERISA Section 404(c)(5). Findings are:

### Validation Grid

The following table summarizes the ways in which the *Invesco Balanced-Risk Allocation Fund* qualifies as a QDIA.

In each case the *Investment* being validated may be applicable as the only one used (stand alone) or may be used in conjunction with other investments (sleeve) in a model portfolio managed by an investment adviser that qualifies under ERISA section 3(38). The QDIA validation determines which QDIA alternative(s) apply and whether the *Investment* may be used stand-alone and/or as a sleeve in a portfolio.

INVESCO BALANCED-RISK ALLOCATION FUND			
QDIA Alternative		Stand Alone	Sleeve of portfolio
1	Age Based	No	Yes
2	Risk Based	Yes	Yes
3	Managed Account	No	Yes
4	Short Term	N/A	N/A
5	Grandfathered	N/A	N/A

**NOTEWORTHY OBSERVATIONS:**

- The *Invesco Balanced-Risk Allocation Fund* is superior to other balanced funds that simply rely on a static allocation of equities for capital appreciation and a static fixed income allocation for capital preservation. Instead, the *Invesco Balanced-Risk Allocation Fund* includes a monthly risk management process and uses commodities to enhance capital appreciation and prescribed strategies for capital preservation that are selected based on the current economic phase (inflationary growth, non-inflationary growth or recession).
  - ➔ **We consider this to be an innovative as well as industry leading response to the dual requirement of preserving capital while optimizing appreciation.**
  
- The *Invesco Balanced-Risk Allocation Fund* is designed to achieve maximum flexibility at minimum cost by the addition of cash to moderate risk to the level required for specific plan participants. The use of cash to moderate risk offers several advantages, including:
  - Target risk is not limited to pre-set levels but can be tuned to meet specific risk tolerances.
  - The expense associated with holding cash is estimated at one quarter (25%) of the cost of the traditional method of using fixed income securities.
  - Cash eliminates the market risk. (Exposure to currency and inflation risk remains).
  - ➔ **We find the use of cash to moderate risk to be superior to other methods and avoids the necessity of selecting, monitoring, managing and maintaining multiple funds to achieve varying levels of risk.**

## Introduction

This report contains DALBAR's independent analysis of the *Invesco Balanced-Risk Allocation Fund* and *Invesco Advisers, Inc.* and is intended to supplement the duty of fiduciaries to prudently select investments for use as a qualified default investment alternative. Since this is a supplement, the content of this report is intended as a guideline and is not a substitute for the evaluation required by regulations.

As an independent expert, DALBAR has no affiliation with the *Invesco Balanced-Risk Allocation Fund* or Invesco Advisers, Inc. and has the training, experience and proficiency to conduct this analysis. DALBAR has a 30-year history recognized by industry and government as an independent third-party expert in the business of providing evaluations, ratings and due diligence. DALBAR certifications are recognized as marks of excellence in adviser services, communications, electronic and telephone services. DALBAR is the only ratings firm with an SEC no-action letter exempting certain of its evaluations from the testimonial rule.

This analysis consists of three separate evaluations that are designed to validate if the *Invesco Balanced-Risk Allocation Fund* and *Invesco Advisers, Inc.* meet requirements of ERISA section 404(c)(5) and related regulations. These evaluations are:

- A. A determination of which class or classes of QDIA are appropriate uses of the *Invesco Balanced-Risk Allocation Fund*.
- B. An evaluation of the qualifications of *Invesco Advisers, Inc.* to meet the regulatory requirements for a QDIA manager.
- C. An assessment of whether *Invesco Balanced-Risk Allocation Fund* meets the DALBAR standard of reasonableness.

For more information concerning this report, please contact DALBAR at:



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## Capital Preservation/Appreciation Analysis

This analysis addresses the fundamental requirement of every asset allocation strategy to preserve capital while realizing appreciation.

The *Invesco Balanced-Risk Allocation Fund* is compared to benchmarks of aggressive, moderate and conservative balanced funds in four critical periods to identify how responsive the *Investment* has been during these periods. The periods are:

- **Down Market (2008)**. Test of capital preservation capability.
- **Up Market (2009)**. Test of capital appreciation capability.
- **Turbulent Market (2011)**. Test of preservation and appreciation capability in volatile conditions.
- **Recent Market (2013)**. Test of performance consistency in the most recent year.

The benchmarks of balanced funds are used to illustrate the relative performance in each of these market conditions. When successful, more aggressive investments should be above the median in Up Markets and below in Down Markets. When successful, more conservative investments should be above the median in Down Markets and below in Up Markets.

*Invesco Balanced-Risk Allocation Fund*

**Capital Preservation and Appreciation Findings**

The *Invesco Balanced-Risk Allocation Fund* had not been in place in 2008 and could not be evaluated for consistency with the goals of capital appreciation and appreciation during the most stressful period in recent history. The fund performed well during the turbulent market of 2011 but fell below the universe of target risk funds in 2009 and the most recent calendar year of 2013.

***Emphasizing Capital Preservation***

The *Invesco Balanced-Risk Allocation Fund* ranked among the highest during 2011 where capital preservation was tested.

***Emphasizing Appreciation***

The *Invesco Balanced-Risk Allocation Fund* ranked below normal in 2009 and 2013 when the capital appreciation opportunity was the greatest.

**Outcomes for *Invesco Balanced-Risk Allocation Fund***

*(Referred to as IBRA in table)*

Return Range	Up Year Return % 2009		Down Year Return % 2008		Turbulent Year Return % 2011		Recent Year Return % 2013	
High	38.02		0.12		10.84	IBRA 10.30	28.68	
Above Normal	M 23.97		C (19.90)		C 1.57		A 20.99	
Median	C 20.80		A (24.32)	N/A	M 1.12		M 17.66	
Below Normal	A 18.67		M (26.60)		A (0.81)		C 9.67	
Low	10.17	IBRA 10.38	(40.13)		(5.20)		(0.61)	IBRA 2.07

Abbreviations used in the table above:

**A** = Aggressive Benchmark (11 funds)

**M** = Moderate Benchmark (92 funds)

**C** = Conservative Benchmark (29 funds)

## Applicability as QDIA Alternative

There are five types of investments that are named as possible QDIA alternatives. In each case the *Investment* being validated may be applicable as the only one used (stand alone) or may be used in conjunction with other investments (sleeve). The alternatives are:

1. Age Based
2. Risk Based
3. Managed Account
4. Short Term (Omitted: Not suitable for this alternative)
5. Grandfathered (Omitted: Not suitable for this alternative)

The Applicability phase of the QDIA validation examines the *Investment* to determine which alternatives apply and whether it may be used stand-alone and/or as a sleeve.

A. APPLICABILITY AS QDIA ALTERNATIVE			
REQUIREMENT FOR QDIA ALTERNATIVE	STAND ALONE	SLEEVE	COMMENTS
<b>1. Age Based</b> - An investment fund product or model portfolio that:			
a) ...applies generally accepted investment theories,	Yes	Yes	The investment approach used is consistent with well established principles and theories. <i>Invesco Balanced-Risk Allocation Fund</i> is a long-only strategy that invests in liquid global equity markets, global government bonds, and commodity markets using a 3-step investment process (Asset Selection, Portfolio Construction and Tactical Allocation).
b) ...is diversified so as to minimize the risk of large losses,	Yes	Yes	<i>Investment</i> is diversified among asset classes, industries and geographic regions.
c) ...is designed to provide varying degrees of long-term appreciation and capital preservation	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan varies the degree of capital appreciation and capital preservation through the use of cash or other low volatility components.
d) ...through a mix of equity and fixed income exposures	Yes	Yes	<i>Investment</i> contains both equities and fixed income in addition to commodities.
e) ...based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy.	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan selects the degree of capital appreciation and capital preservation based on the participants' age.

A. APPLICABILITY AS QDIA ALTERNATIVE			
REQUIREMENT FOR QDIA ALTERNATIVE	STAND ALONE	SLEEVE	COMMENTS
f) Such products and portfolios change their asset allocations and associated risk levels over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age.	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan changes the risk levels over time with the objective of becoming more conservative.
<p>➔ <b>SUMMARY:</b> The Invesco Balanced-Risk Allocation Fund qualifies to be used as part of a qualified model portfolio in conjunction with other investments but may NOT be used as an AGE-BASED QDIA.</p>			

A. APPLICABILITY AS QDIA ALTERNATIVE			
REQUIREMENT FOR QDIA ALTERNATIVE	STAND ALONE	SLEEVE	COMMENTS
<b>2. Risk Based</b> - An investment fund product or model portfolio that:			
a) ...applies generally accepted investment theories	Yes	Yes	The investment approach used is consistent with well established principles and theories. <i>Invesco Balanced-Risk Allocation Fund</i> is a long-only strategy that invests in liquid global equity markets, global government bonds, and commodity markets using a 3-step investment process (Asset Selection, Portfolio Construction and Tactical Allocation).
b) ...is diversified so as to minimize the risk of large losses	Yes	Yes	<i>Investment</i> is diversified among asset classes, industries and geographic regions.
c) ...is designed to provide long-term appreciation and capital preservation	Yes	Yes	<i>Investment</i> is designed to manage the risk of capital loss and produce appreciation that is consistent with capital preservation.
d) ...through a mix of equity and fixed income exposures	Yes	Yes	<i>Investment</i> contains both equities and fixed income in addition to commodities.
e) ...consistent with a target level of risk appropriate for participants of the plan as a whole.	Yes	Yes	The <i>Investment</i> seeks total return with a low to moderate correlation to traditional financial market indexes. When used as a sleeve of a larger investment, cash may be added when lower levels of risk are desired.
 <b>SUMMARY:</b> The Invesco Balanced-Risk Allocation Fund qualifies as a RISK-BASED QDIA either as a standalone investment or when used as part of a qualified model portfolio in conjunction with other investments.			

A. APPLICABILITY AS QDIA ALTERNATIVE			
REQUIREMENT FOR QDIA ALTERNATIVE	STAND ALONE	SLEEVE	COMMENTS
<b>3. Managed Account</b> - An investment management service with respect to which:			
a) ...a fiduciary that is either, I. an investment manager, within the meaning of section 3(38) of ERISA; II. a trustee of the plan that meets the requirements of section 3(38)(A), (B) and (C) of ERISA; or III. the plan sponsor who is a named fiduciary, within the meaning of section 402(a)(2) of ERISA,	No	N/A	The <i>Investment</i> is not appropriate by itself as a managed account but may be included in a managed account by a qualified QDIA manager of the plan.
b) ...applying generally accepted investment theories,	Yes	Yes	The investment approach used is consistent with well established principles and theories. <i>Invesco Balanced-Risk Allocation Fund</i> is a long-only strategy that invests in liquid global equity markets, global government bonds, and commodity markets using a 3-step investment process (Asset Selection, Portfolio Construction and Tactical Allocation).
c) ...allocates the assets of a participant's individual account	No	N/A	The <i>Investment</i> is not appropriate by itself as a managed account but may be included in a managed account by a qualified QDIA manager of the plan.
d) ...to achieve varying degrees of long-term appreciation and capital preservation,	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan varies the degree of capital appreciation and capital preservation through the use of cash or other low volatility components.
e) ...through a mix of equity and fixed income exposures,	No	N/A	<i>Investment</i> contains both equities and fixed income in addition to commodities.
f) ...offered through investment alternatives available under the plan,	No	N/A	The <i>Investment</i> is appropriate for inclusion in the plan and thus be made available to a qualified QDIA manager of the plan.

A. APPLICABILITY AS QDIA ALTERNATIVE			
REQUIREMENT FOR QDIA ALTERNATIVE	STAND ALONE	SLEEVE	COMMENTS
g) ...based on the participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy.	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan varies the degree of capital appreciation and capital preservation based on the participant's age, target retirement date or life expectancy.
h) Such portfolios are diversified so as to minimize the risk of large losses and	Yes	Yes	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan varies the degree of capital appreciation and capital preservation through the use of cash or other low volatility components.
i) ...change their asset allocations and associated risk levels for an individual account over time with the objective of becoming more conservative (i.e., decreasing risk of losses) with increasing age.	No	N/A	<i>Investment</i> may be used as a sleeve if the QDIA manager of the plan varies the degree of capital appreciation and capital preservation through the use of cash or other low volatility components for an individual account over time with the objective of becoming more conservative.
 <b>SUMMARY:</b> The Invesco Balanced-Risk Allocation Fund does NOT qualify to be used in a MANAGED-ACCOUNT QDIA by itself but may be used as part of a qualified model portfolio in conjunction with other investments.			

## Qualification Analysis

No violations of self-dealing prohibitions were found and *The Invesco Balanced-Risk Allocation Fund* was found to meet the QDIA requirements for the alternatives shown in the table above. The analysis included the following findings:

B. QUALIFICATION ANALYSIS			
REGULATORY GUIDELINE	DALBAR EVALUATION	RESULT	COMMENTS
1. SELF-DEALING PROHIBITIONS - A fiduciary with respect to a plan shall not:			
a) ...deal with the assets of the plan in his own interest or for his own account,	Does <i>Manager</i> have discretion to vary its compensation based on changing holdings within the <i>Investment</i> ?	Pass	<i>Manager's</i> compensation is unaffected by investment decisions made for the <i>Investment</i> .
b) ...in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or	Does <i>Manager</i> have interests that are adverse to those of participants?	Pass	<i>Manager's</i> interests are not adverse to participants' by virtue of the fact that <i>Manager's</i> compensation increases with growth in asset value in participants' accounts and decreases if assets decline.
c) ...receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.	Does <i>Manager</i> receive compensation from another party for managing the <i>Investment</i> ?	Pass	Manager does not use compensated structures such as fund of funds or soft dollar arrangements.

B. QUALIFICATION ANALYSIS																											
REGULATORY GUIDELINE	DALBAR EVALUATION	RESULT	COMMENTS																								
<b>2. CONDITIONS FOR QDIA FIDUCIARY RELIEF</b>																											
a) Consider investment fees and expenses in choosing a QDIA	Do expenses for this <u>Investment</u> fall within the normal range of other investments of this type?	Pass	Actual Expenses for <u>Invesco Balanced-Risk Allocation Fund</u> are below the Benchmark for all share classes for which measurements are available:  <table border="1"> <thead> <tr> <th>Class</th> <th>Actual</th> <th>Benchmark</th> </tr> </thead> <tbody> <tr> <td>A</td> <td>1.24</td> <td>1.70</td> </tr> <tr> <td>B</td> <td>1.99</td> <td>2.09</td> </tr> <tr> <td>C</td> <td>1.99</td> <td>2.29</td> </tr> <tr> <td>R</td> <td>1.49</td> <td>1.53</td> </tr> <tr> <td>R5</td> <td>0.92</td> <td>N/A</td> </tr> <tr> <td>R6</td> <td>0.91</td> <td>N/A</td> </tr> <tr> <td>Y</td> <td>0.99</td> <td>N/A</td> </tr> </tbody> </table>	Class	Actual	Benchmark	A	1.24	1.70	B	1.99	2.09	C	1.99	2.29	R	1.49	1.53	R5	0.92	N/A	R6	0.91	N/A	Y	0.99	N/A
Class	Actual	Benchmark																									
A	1.24	1.70																									
B	1.99	2.09																									
C	1.99	2.29																									
R	1.49	1.53																									
R5	0.92	N/A																									
R6	0.91	N/A																									
Y	0.99	N/A																									
b) Material is provided to participant relating to his/her QDIA.	Is <u>Investment</u> material appropriate for plan participants?	Pass	Material contains description that can be extracted to be appropriate for participants with only minimal investment knowledge.																								
c) Notice must be written in a manner calculated to be understood by the average plan participant.	Is the information provided for inclusion in the required notice understandable to an average participant? <u>Note: Plan fiduciary must determine that the entire notice can be understood.</u>	Pass	Under most circumstances, the average plan participant will be able to understand the information extracted from the materials.																								
<b>3. QDIA Requirements</b>																											
a) QDIA shall not permit employer securities except as investments within regulated investment companies or as employer match.	Does <u>Investment</u> permit use of employer securities outside of the QDIA exceptions?	Pass	<u>Investments</u> are registered investment companies and qualify under the exemption applicable to employer securities.																								
b) QDIA may not impose financial penalties or restrict the ability of a participant to transfer.	Are there restrictions or fees to transfer out of <u>Investment</u> which are prohibited under QDIA regulations?	Pass	No restrictions, except that <u>Manager</u> reserves the right to use restrictions in the event that short term trading activity is discovered.																								

B. QUALIFICATION ANALYSIS			
REGULATORY GUIDELINE	DALBAR EVALUATION	RESULT	COMMENTS
c) QDIA is either managed by an investment manager, as defined in section 3(38) of ERISA, or plan trustee, or plan sponsor who is a named fiduciary or is a registered investment company or a stable value fund under State or federal regulation.	Does the <i>Manager</i> meet the criteria appropriate for the type of QDIA being validated?	Pass	<i>Investments</i> are registered investment companies.

## Reasonableness as an Investment

QDIA regulations require that investments be reasonable, which DALBAR has further defined as falling within a normal range of comparable investments. The Reasonableness Analysis presented reflects this standard.

Plan fiduciaries are responsible for reviewing current investment information and making the determination that the *Invesco Balanced-Risk Allocation Fund* is a reasonable investment for the plan. Plan fiduciaries, including plan sponsors, are encouraged to seek independent expert advice in making the selection and monitoring of investments. In order to assist in the determination DALBAR provides the following observations based on information available at the time of this evaluation.

C. REASONABLENESS INVESTMENT ANALYSIS	
DALBAR INVESTMENT CRITERIA	OBSERVATIONS
<b>1. Minimum track record</b>	
The average history for each underlying asset class investment strategy should be at least three years.	The history of underlying asset classes is over three years. The <u><i>Investment</i></u> has a history of five years.
<b>2. Stability of the organization</b>	
The average tenure of the portfolio management team for each underlying asset class investment strategy should be at least two years.	Tenure of management of each underlying asset class investment strategy exceeds the threshold.
<b>3. Assets in the product</b>	
The average underlying asset class investment strategy should have at least \$75 million under management (can include assets in other funds with the same strategy).	The assets under management of the <u><i>Investment</i></u> and each underlying asset class exceed the threshold.
<b>4. Holdings consistent with style</b>	
a) The allocation to equities is evaluated against the peer group – highest allocation to least - the screening threshold being set at the bottom quartile;	The equity allocation of the <u><i>Invesco Balanced-Risk Allocation Fund</i></u> fund is within the norm for moderate risk balanced funds. Allocation to capital appreciation investments is enhanced by the addition of commodities.
b) The allocation to fixed income is evaluated against the peer group – highest allocation to least - the screening threshold being set at the bottom quartile.	The fixed income allocation of the <u><i>Invesco Balanced-Risk Allocation Fund</i></u> fund is within the norm for moderate risk balanced funds.

C. REASONABLENESS INVESTMENT ANALYSIS	
DALBAR INVESTMENT CRITERIA	OBSERVATIONS
<b>5. Correlation to style or peer group</b>	
The number of asset classes that make up the QDIA are evaluated against the peer group - most asset classes to least - the screening threshold being set at the peer group median.	The underlying assets of <i>Invesco Balanced-Risk Allocation Fund</i> are primarily exchange traded futures contracts and highly diversified with respect to asset classes. There are no known peer groups to which this strategy applies.
<b>6. Expense ratios/fees</b>	
a) The wrapper expense is evaluated against the peer group – cheapest to most expensive - the screening threshold being set at the bottom quartile.	Total expenses for the <i>Invesco Balanced-Risk Allocation Fund</i> class A shares is 124 bps which is below the norms of 170 bps for Tactical Allocation Funds.
b) The average expense ratio of each underlying asset class investment strategy is evaluated against the peer group - cheapest to most expensive - the screening threshold being set at the bottom quartile.	N/A - Underlying investments are not mutual funds.
<b>7. Performance relative to assumed risk</b>	
This analysis evaluates historical performance within the context of overall risk. It examines the number of positive and negative annual returns, the average of the positive and negative annual returns, and the best and worst annual returns, for a minimum of three years (max: 10 years).	Over the five years ended 12/31/13, the <i>Investment</i> had positive returns in all calendar years. Average positive return: +9.25% Average negative return: None Best annual return: +12.93% Worst annual return: +2.07%
<b>8. Performance relative to a peer group</b>	
The average 1-, 3-, and 5-year performance of each asset class investment strategy is evaluated against the peer group's median.	Underlying investments are primarily exchange traded futures contracts which by definition track the respective indices. We found no material variation from the performance of the respective indices.

## Appendices

- A. Asset Allocators
- B. Risk/Return Analysis
- C. Performance Analysis
- D. Expense Analysis

### A. Asset Allocators

INVESTMENT	ALLOCATOR	Total Years Exp.	Yrs With Fund
Invesco Balanced-Risk Allocation Fund	Mark Ahnrud, CFA	29	5
	Chris Devine, CFA	18	5
	Scott Hixon, CFA	22	5
	Christian Ulrich, CFA	27	5
	Scott Wolle, CFA	23	5

### B. Risk/Return Analysis

INVESTMENT	No. UP YEARS	No. DOWN YEARS	AVG. OF UP YEARS (%)	AVG. OF DOWN YEARS (%)	BEST QUARTER	WORST % QUARTER
1 Invesco Balanced-Risk Allocation Fund –Class A	5	0	9.25	N/A	7.04%	-0.64%

### C. Performance Analysis

Investment	1 Year	3 Year	5 Year	10 Year	Expense
Invesco Balanced-Risk Allocation Fund –Class A	2.07	<b>7.57</b>	<b>10.06<sup>(2)</sup></b>		<b>1.24</b>
Tactical Allocation Funds <sup>(1)</sup>	9.23	5.04	9.56		1.70
S&P 500	32.39	16.18	17.94		

Notes: Items in **BOLD** indicate at or better than average peer group results.

(1) Categorization has changed from *World Allocation Funds* in 2013 to *Tactical Allocation Funds* in 2014.

(2) Return since inception which is marginally less than 5 years.

## E. Expense Analysis

### → Fees and Expenses vs. Peer Group at 12/31/2013

Note: Items in **BOLD** indicate at or lower than average peer group expenses.

Investment	12b-1 Fee	Front Load	Deferred Load	Expense Ratio
<b>Invesco Balanced-Risk Allocation Fund</b>				
Class A	<b>0.25</b>	5.50	-	<b>1.24</b>
Tactical Allocation Group	0.26	5.24	-	1.70
Class A –Load Waived	<b>0.25</b>	-	-	<b>1.24</b>
Tactical Allocation Group	0.26	-	-	1.70
Class B	1.00	-	5.00	<b>1.99</b>
Tactical Allocation Group	0.72	-	4.42	2.09
Class C	1.00	-	1.00	<b>1.99</b>
Tactical Allocation Group	0.96	1.00	1.00	2.29
Class Y	-	-	-	<b>0.99</b>
Tactical Allocation Group (Institutional)	0.12	-	-	1.30
Class R	0.50	-	-	<b>1.49</b>
Tactical Allocation Group	0.48	-	-	1.53
Class R5	-	-	-	0.92
Class R6	-	-	-	0.91



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