Principal Hong Kong
4Q 2024 Market Outlook

Key themes for 4Q 2024

- **A globally synchronized downturn produces a globally synchronized policy easing.**
  As global growth has weakened, policymakers have started to respond. The U.S. Federal Reserve is committed to avoiding recession, while China's recent policy measures also raise the odds of a global soft landing.

- **The U.S. economy: Slowdown does not imply recession.**
  Labor market cooling has triggered recession concerns, but the continued strength of consumer and corporate balance sheets implies that job layoffs, and therefore recession, could be avoided. A moderation to trend growth is likely.

- **Central banks are determined to secure soft landings.**
  The Fed is set to lower rates toward 3% and may frontload rate cuts if there are further signs of labor market weakness. The Fed's commitment to a soft landing may be mirrored by other central banks keen to avoid overly strong currencies.

- **Equity markets confront valuation challenges, but Fed cuts should support continued gains.**
  Historically, a Fed cutting cycle without recession has resulted in a strong equity market performance. While stretched valuations suggest gains may be more limited this time, a broadening of gains beyond just tech presents opportunities.

- **Fixed income typically shines in a late cycle slowdown.**
  Fixed income spreads are tight, but elevated yields continue to draw investor interest. Combined with strong growth, Fed cuts should reduce default risk, extending the credit cycle.

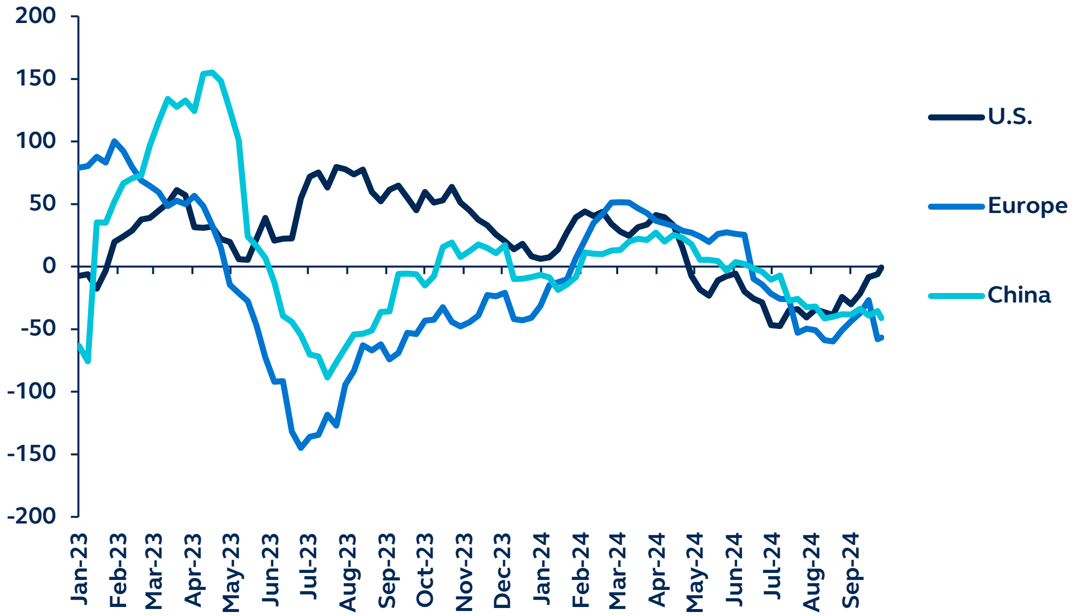
- **With potential gains across asset classes, staying in cash is the leading risk.**
  With the Fed's rate cutting cycle now underway, the attractiveness of cash is rapidly diminishing. As global stimulus lifts prospects for risk assets across the globe, investors should be optimizing this constructive environment.

Global economic growth finds support in central banks

Global policymakers have responded to weakening economic growth, raising the odds of a global soft landing.

U.S., Europe, and China economic surprises

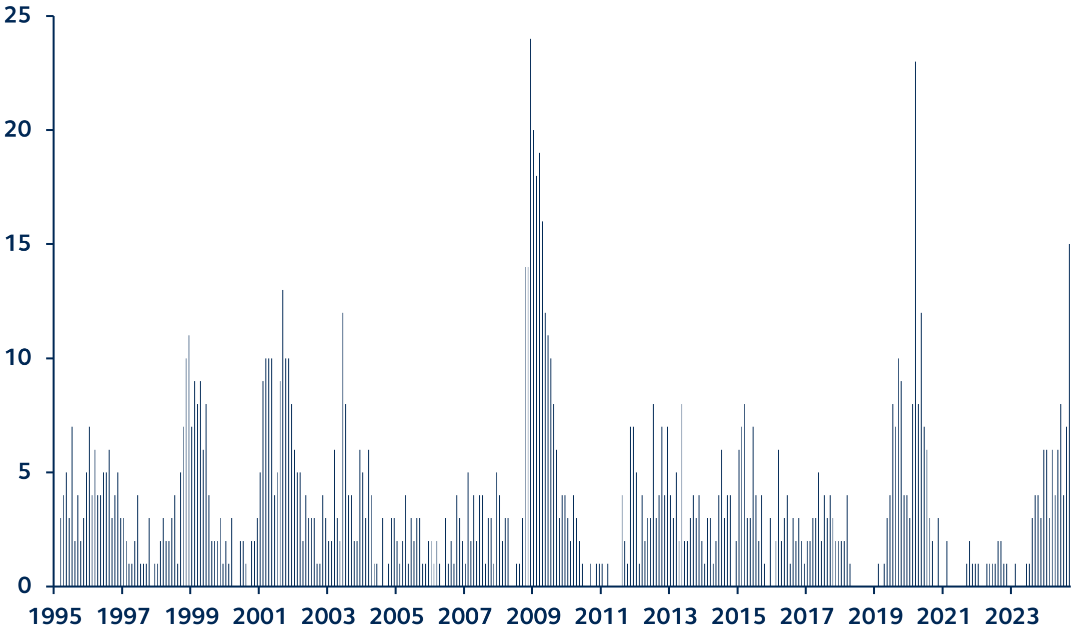
Citi Economic Surprise Index level, weekly, 2023–present



Source: Bloomberg, Citi, Principal Asset Management. Data as of September 30, 2024.

Global central bank easing

Number of central bank cuts, monthly, 1995–present



Source: Bloomberg, Principal Asset Management. Data as of September 30, 2024.

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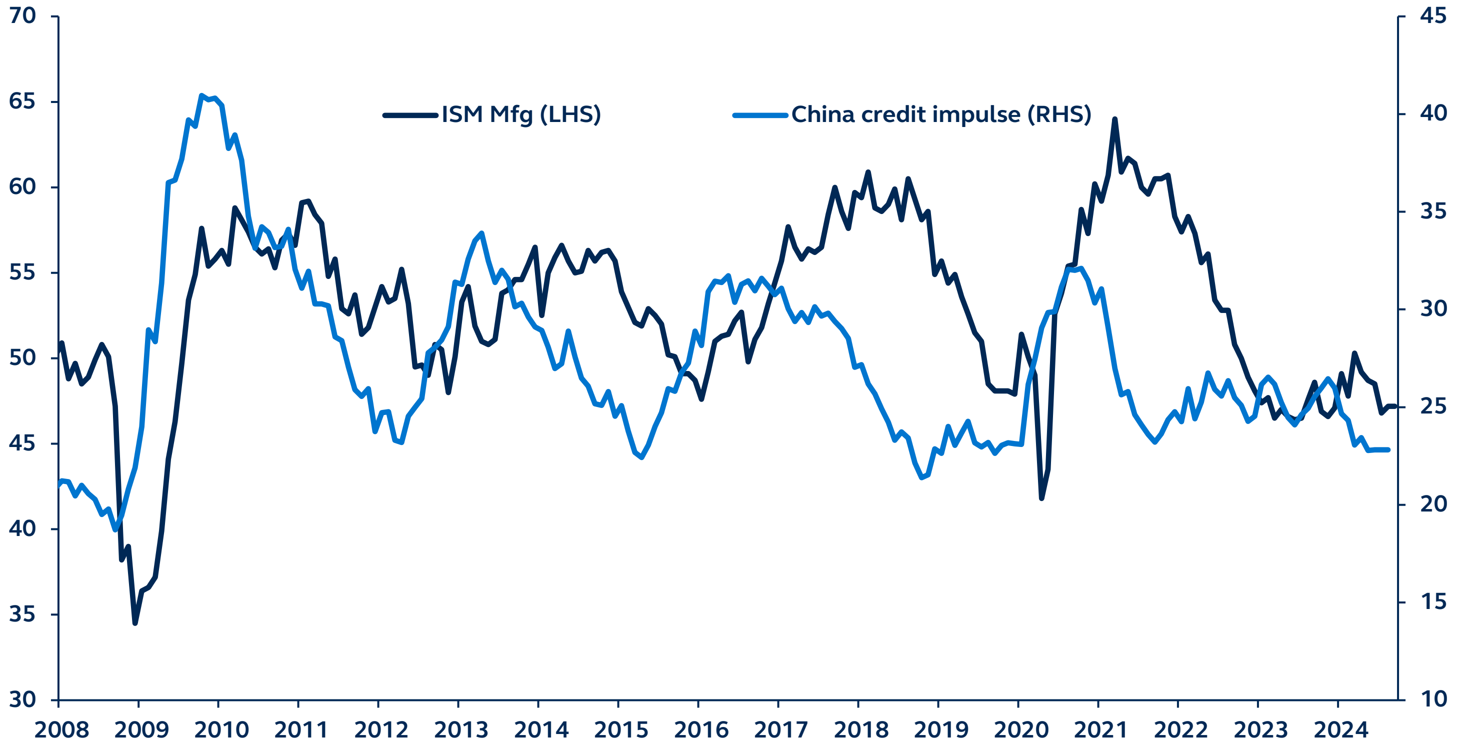
China stimulus: Potentially a pivotal moment

China's policy measures have the potential to lift the economy and provide a sustained boost to markets.

China's credit impulse and U.S. ISM Manufacturing Index

Index level, 2008–present



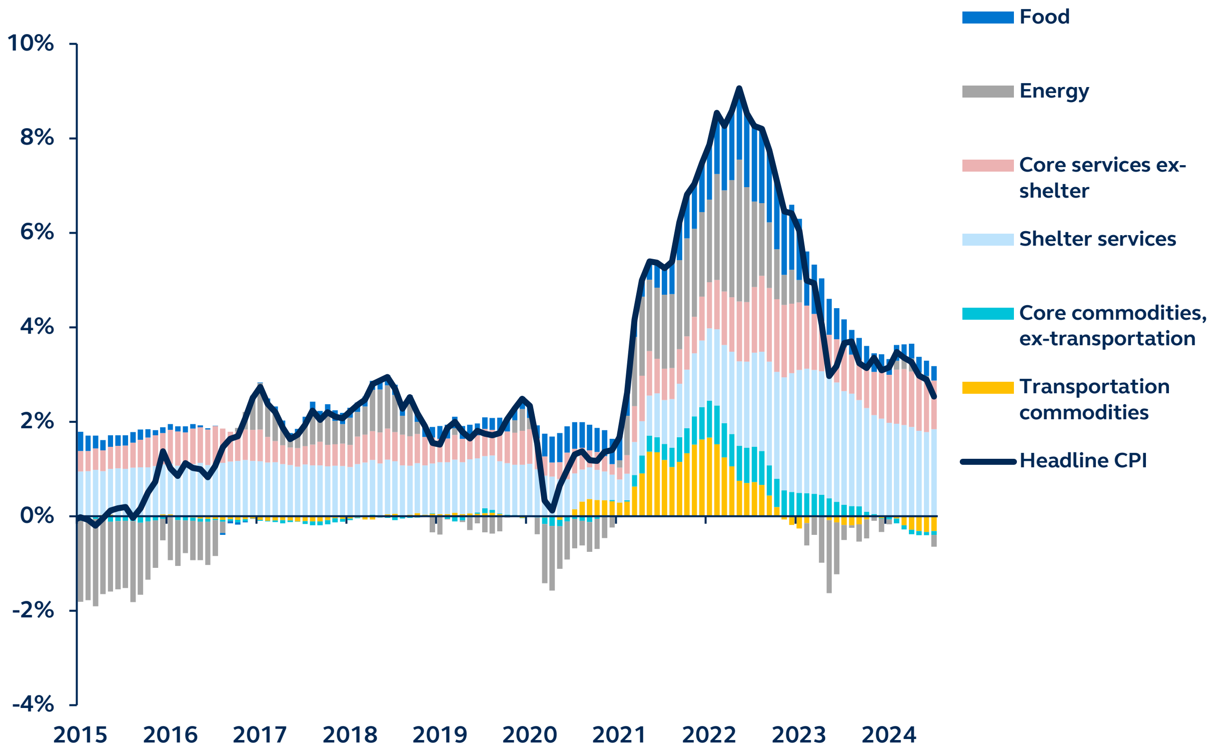
Source: Bloomberg, Principal Asset Allocation. Data as of September 30, 2024.

Global inflation: Heading back toward target

Inflation globally is heading back toward target levels. Upside risks remain but would require both a supply-side shock and a tightening labor market to trigger a concerning spike.

Contribution to headline U.S. inflation

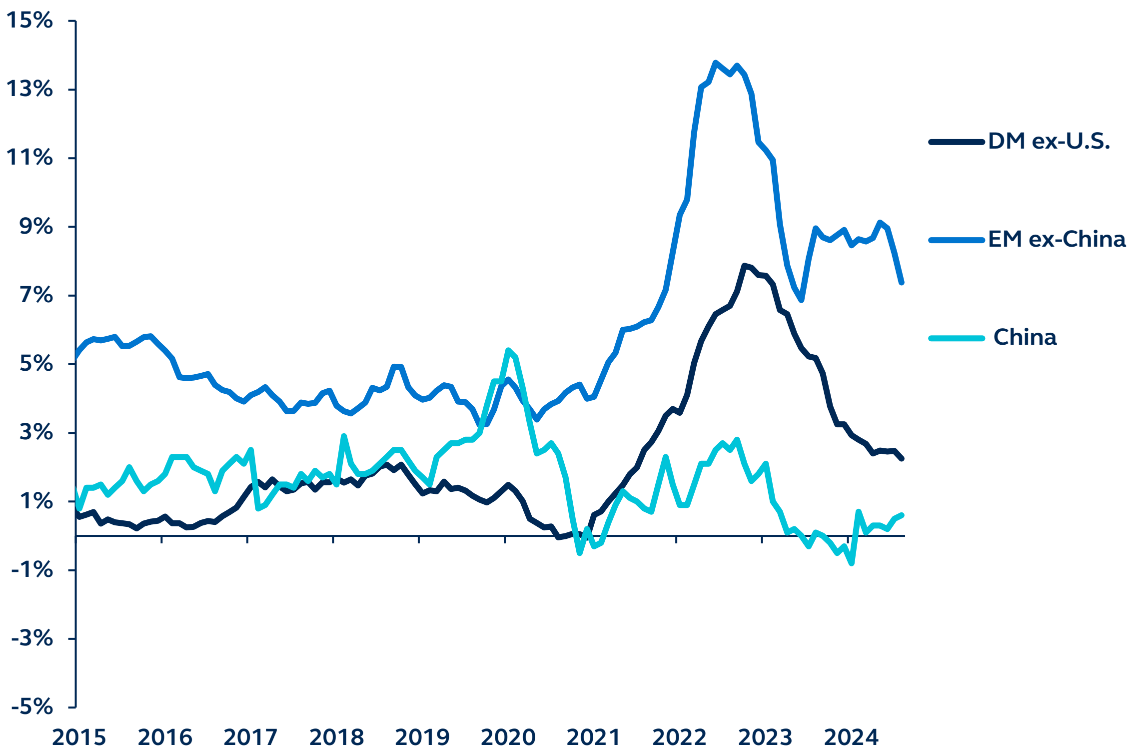
Year-over-year, January 2015–present



Source: Bureau of Labor Statistics, Principal Asset Management.
Data as of September 30, 2024.

Global inflation rates

Principal Asset Allocation GDP-weighted inflation, 2015–present



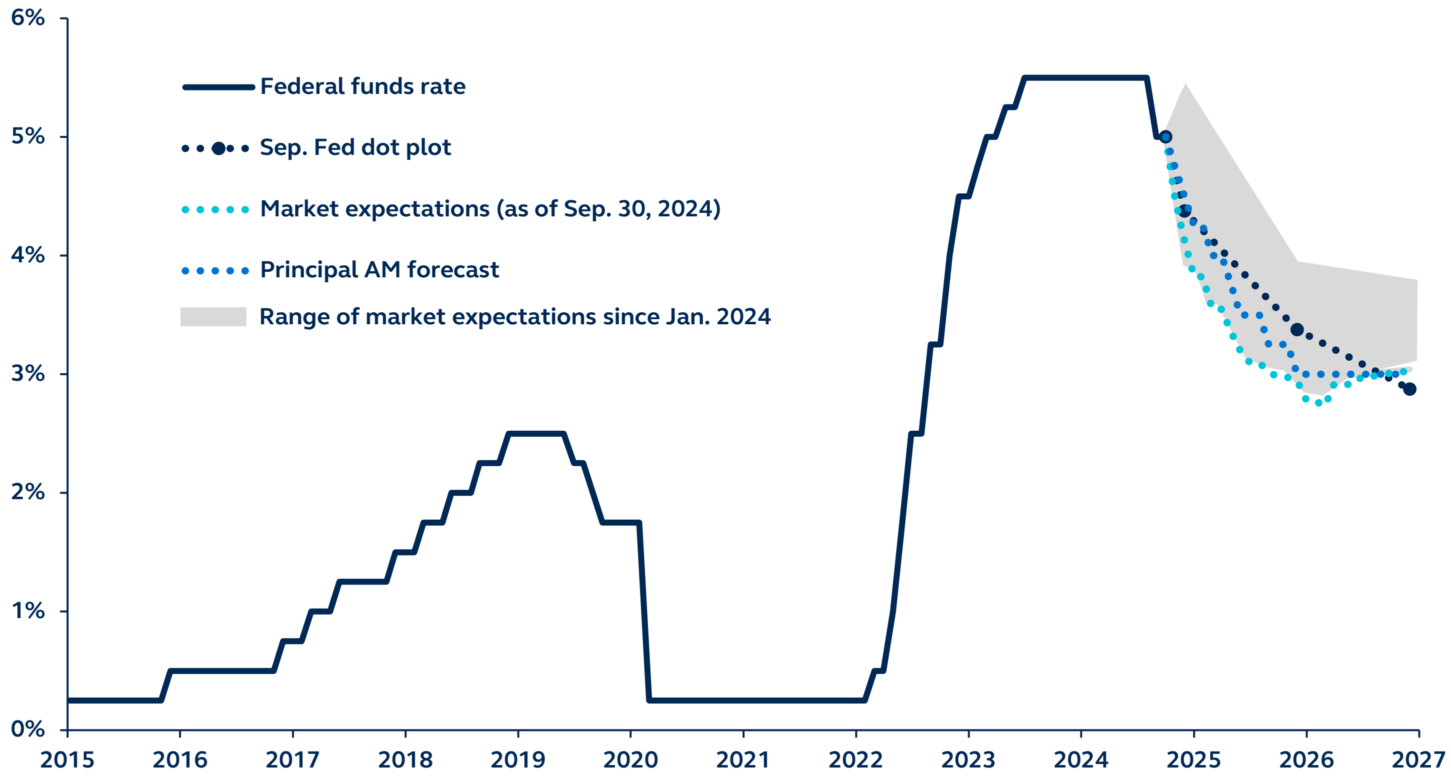
Source: Bloomberg, Principal Asset Management.
Data as of September 30, 2024.

Federal Reserve: Committed to securing a soft landing

The Fed's initial 50bps cut shows a commitment not to fall behind the curve. We expect a series of reductions, taking rates down to almost 3% by end-2025.

Federal Reserve policy rate path

Fed funds rate and projections, 2015–present



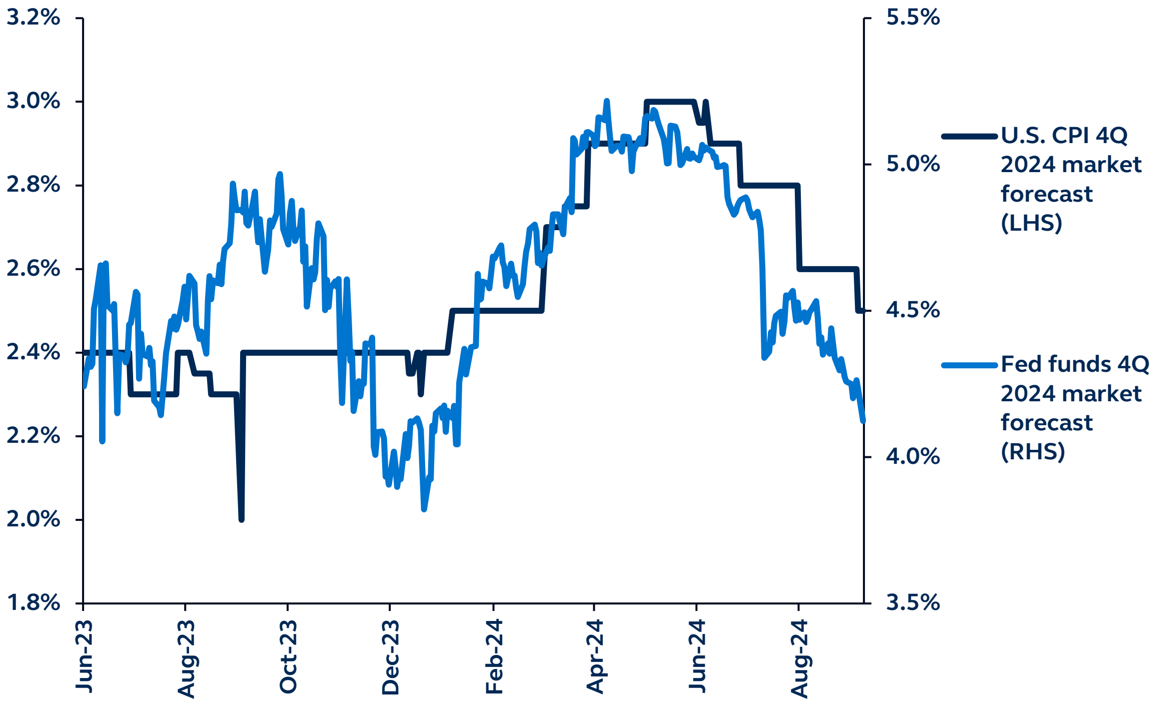
Source: Federal Reserve, Bloomberg, Principal Asset Management. Data as September 30, 2024.

Fed easing should avoid recession

Although the U.S. economy is cooling, strong household and corporate balance sheets mean that the expected 200bps of Fed cuts should be sufficient to avoid recession.

Evolution of market 4Q 2024 inflation and Fed rate forecasts

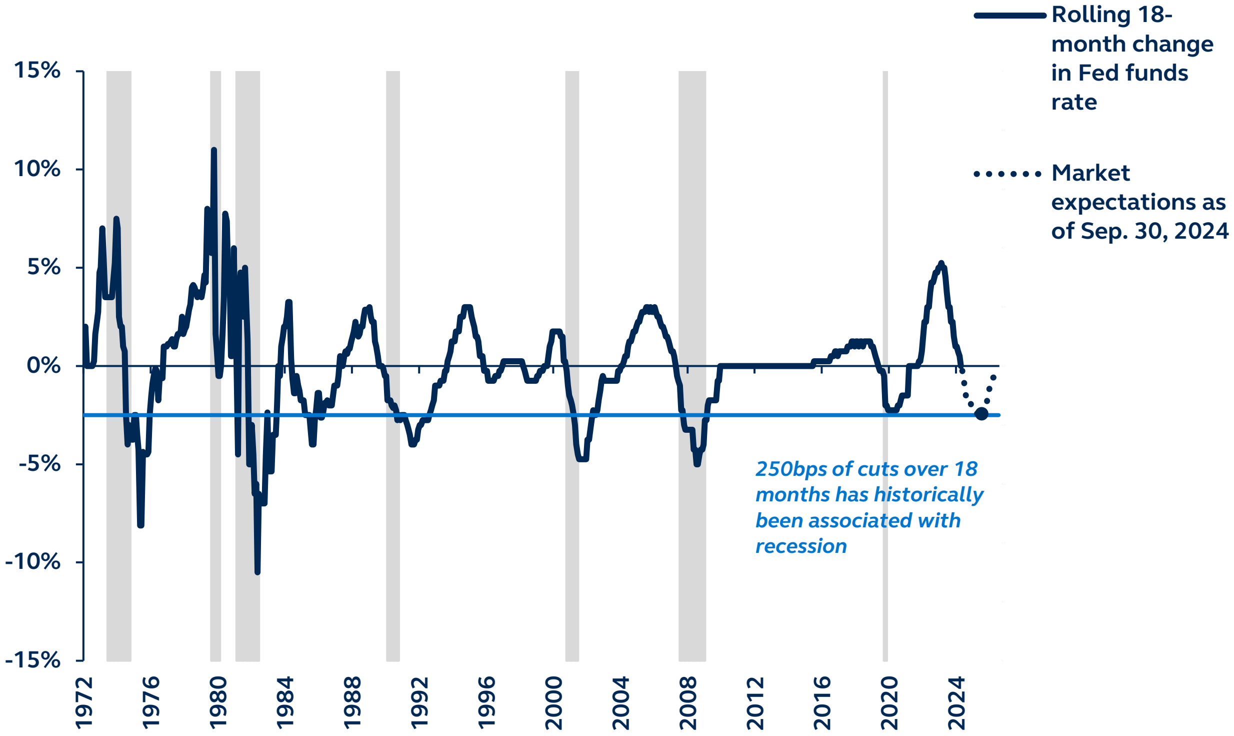
U.S. CPI at 4Q24 forecast and market implied Fed rate for Dec. 2024, June 2023–present



Source: Federal Reserve, Bloomberg, Principal Asset Management. Data as of September 30, 2024.

Change in Fed funds rate versus 18-months prior

Recessions are shaded, 1972–present



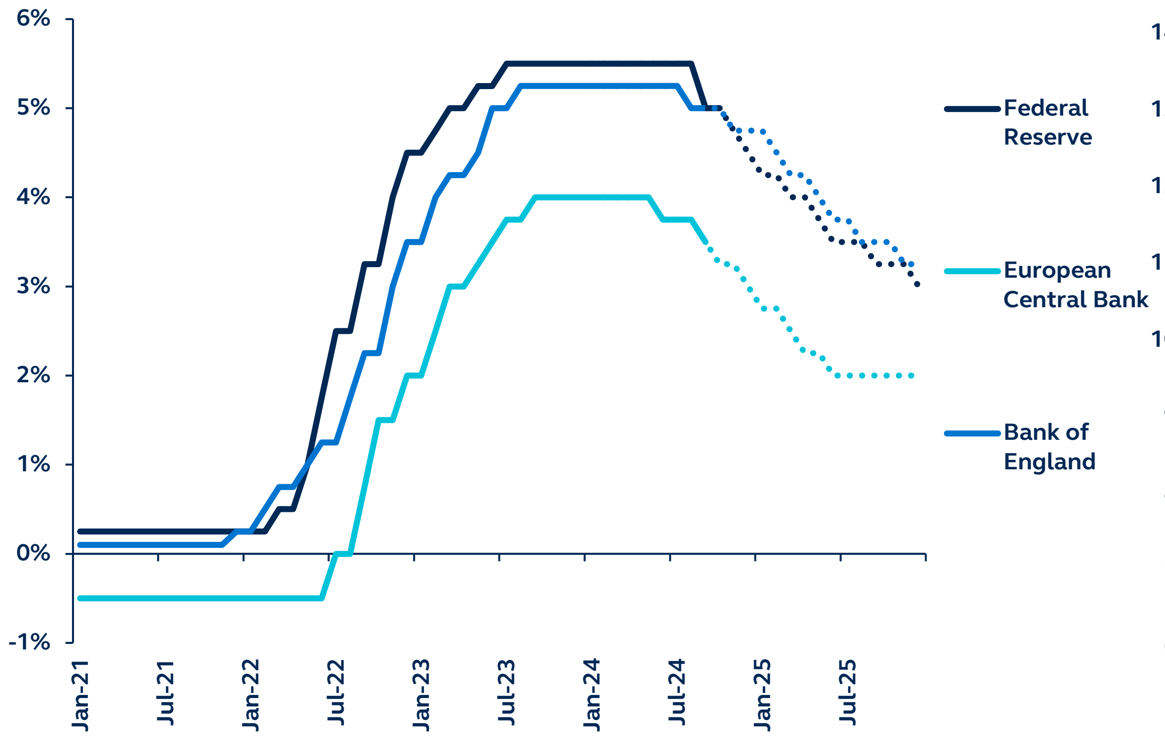
Source: Federal Reserve, Bloomberg, Principal Asset Management. Data as of September 30, 2024.

Synchronized easing cycles to limit dollar downside

As global central banks confront slowing growth and strengthening currencies, they will likely accelerate their pace of easing to match the Fed's.

Global central bank rates

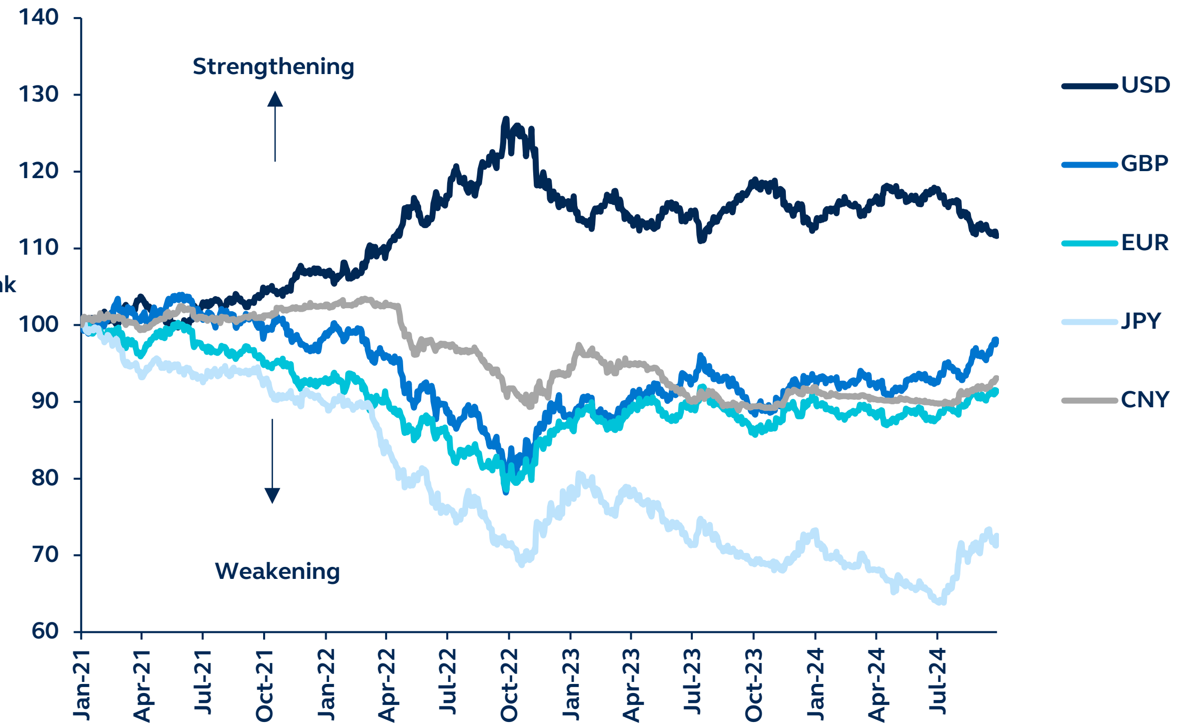
January 2021–present, forecasted through 2025



Source: Federal Reserve, European Central Bank, Bank of England, Principal Asset Management. Data as of September 30, 2024.

Major currencies

Rebased to 100 at January 2021



Source: LSEG, Bloomberg, Principal Asset Management. Data as of September 30, 2024.

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Investment Perspectives

A cautiously risk-on environment for investors

Despite global economic and geopolitical risks, coordinated central bank easing offers a prime risk-on investing opportunity.

Equities *Diversify via global equities, tactically leveraging small-cap for more risk-on*

- Attractive international valuations suggest opportunities outside the U.S.
- Explore opportunities beyond the Mag 7, including tactical exposure to small- and mid-cap stocks.
- Falling rates and slowing growth have historically been constructive for equity markets.

Fixed income *Increase exposure to high-quality credit and extend duration*

- Leverage core fixed income during a mild economic slowdown.
- Extend duration as a hedge against growth disappointment.
- Emerging market debt may offer total return potential during global central bank easing.
- High yield maintains a substantial carry advantage for income-seeking investors.

Alternatives *Pursue less correlated real asset exposures*

- Real return-focused strategies gain attractiveness when nominal growth slows.
- Infrastructure offers resiliency and attractive valuations.
- REITs offer relatively attractive valuations and constructive fundamentals as rates move lower.

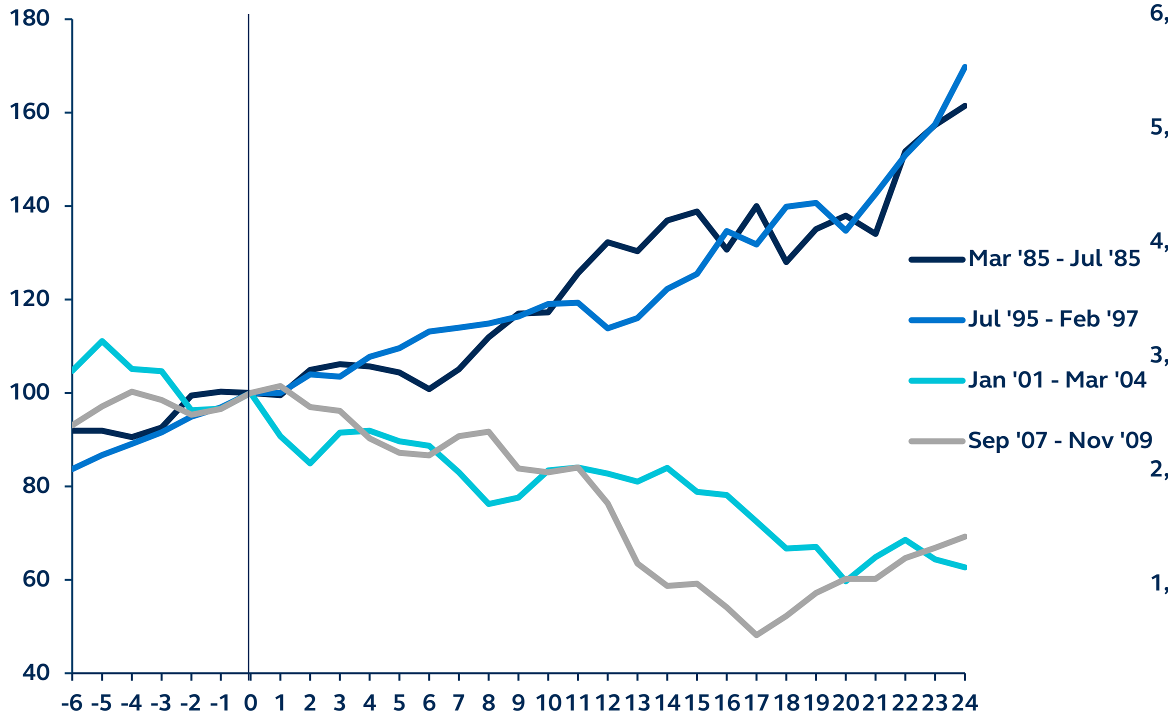
Equities

U.S. equities: Dependent on Fed soft landing success

Fed success in piloting a soft landing could drive further positive gains in earnings and, therefore, U.S. equities.

S&P 500 performance preceding and following the first Fed cuts in four select cutting cycles

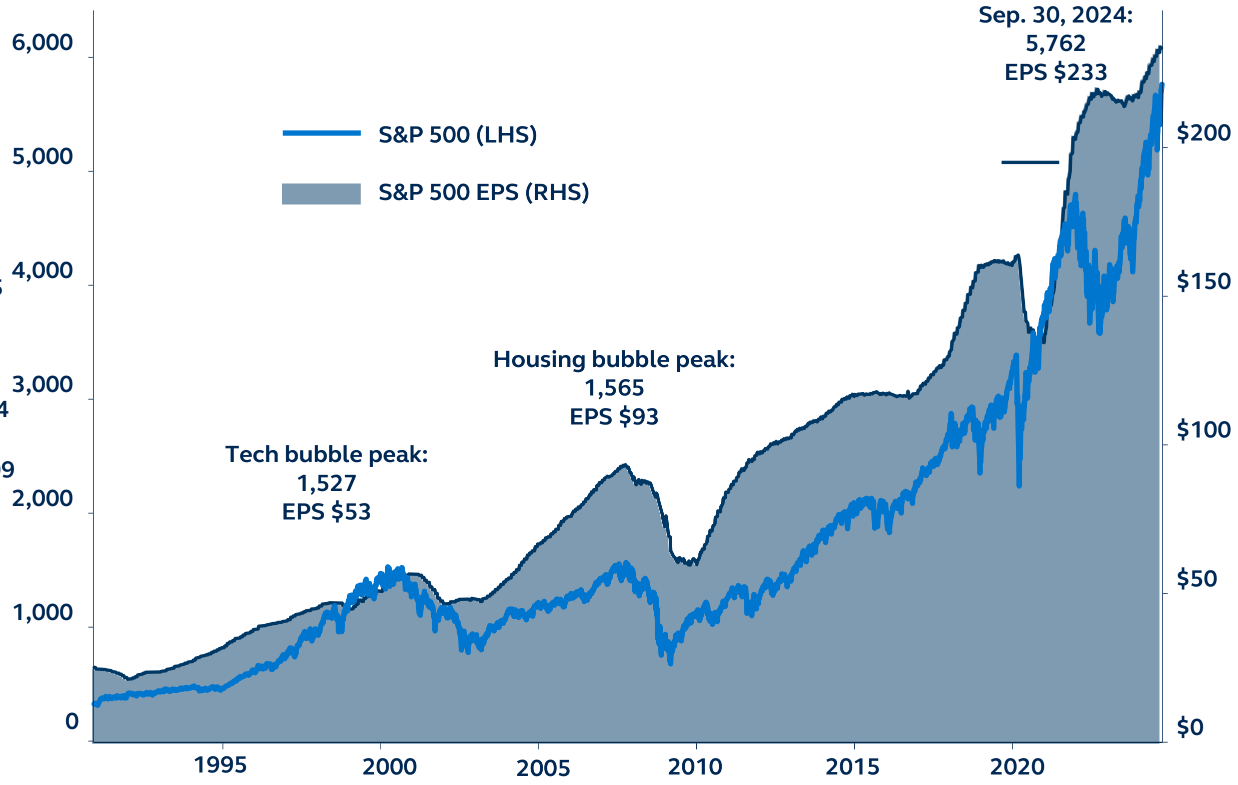
Month 0=beginning of rate cutting cycle, rebased to 100 at month 0



Source: Bloomberg, Federal Reserve, Principal Asset Management.
Data as of September 30, 2024.

The stock market and earnings

S&P 500 Index price and trailing earnings-per-share, 1990–present



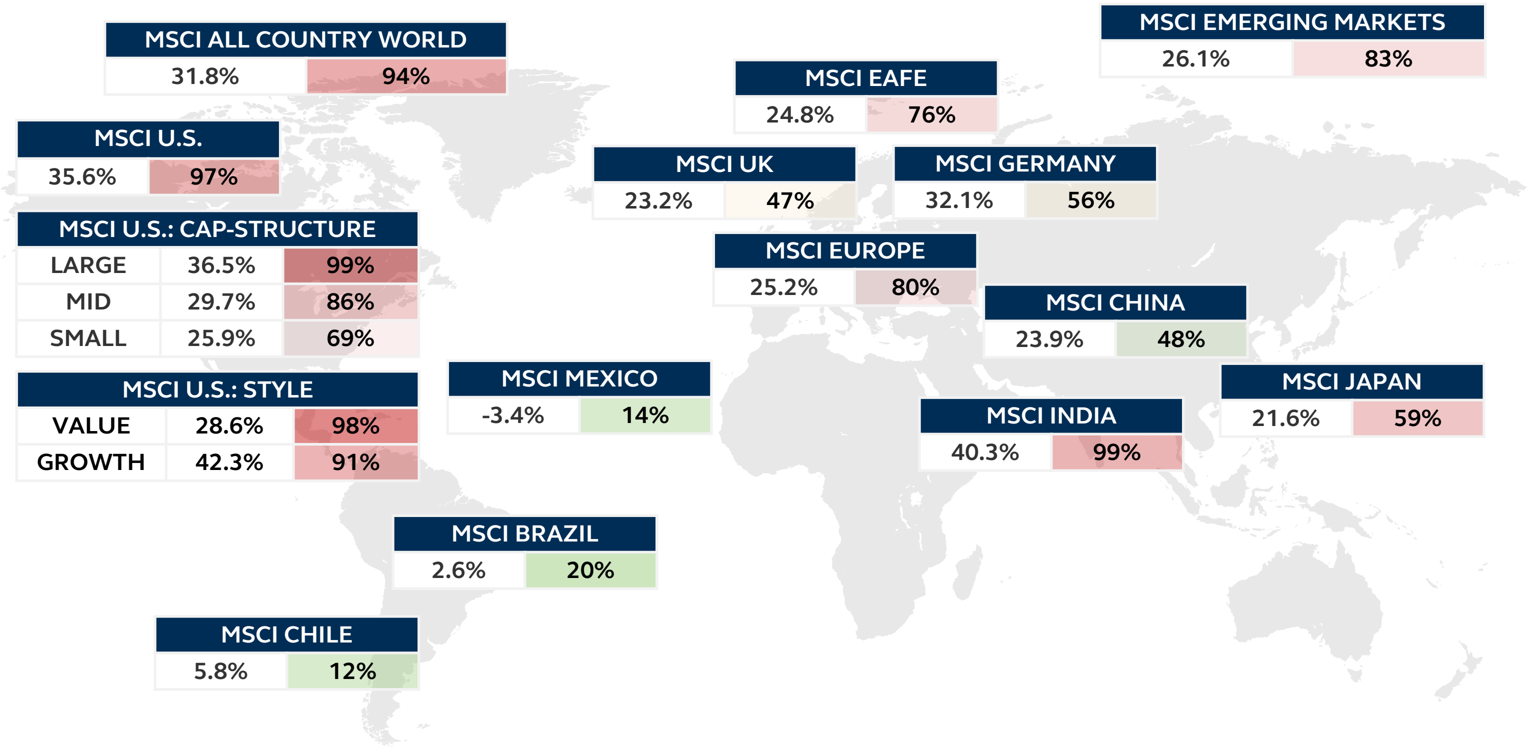
Source: Clearnomics, Standard & Poor's, Bloomberg, Principal Asset Management.
Data as of September 30, 2024.

Global equity valuations increasingly in focus

Global stimulus measures should drive gains, particularly in markets where valuations are historically attractive. Increasingly, investors may consider global diversification.

Global equity returns and valuations

Last twelve months returns and % times cheaper, MSCI indices



INDEX	
LTM return (%)	% time cheaper

Source: FactSet, Bloomberg, MSCI, Principal Asset Allocation. LTM (last twelve months) returns are total return and in USD terms. % Time Cheaper is relative to PAA Equity Composite Valuation history. PAA Equity Composite Valuation is a calculated measure, comprised of 60% price-to-earnings, 20% price-to-book and 20% to dividend yield. Composite started in 2003. EAFE is Europe, Australasia, Far East. See disclosures for index descriptions. Data as of September 30, 2024.

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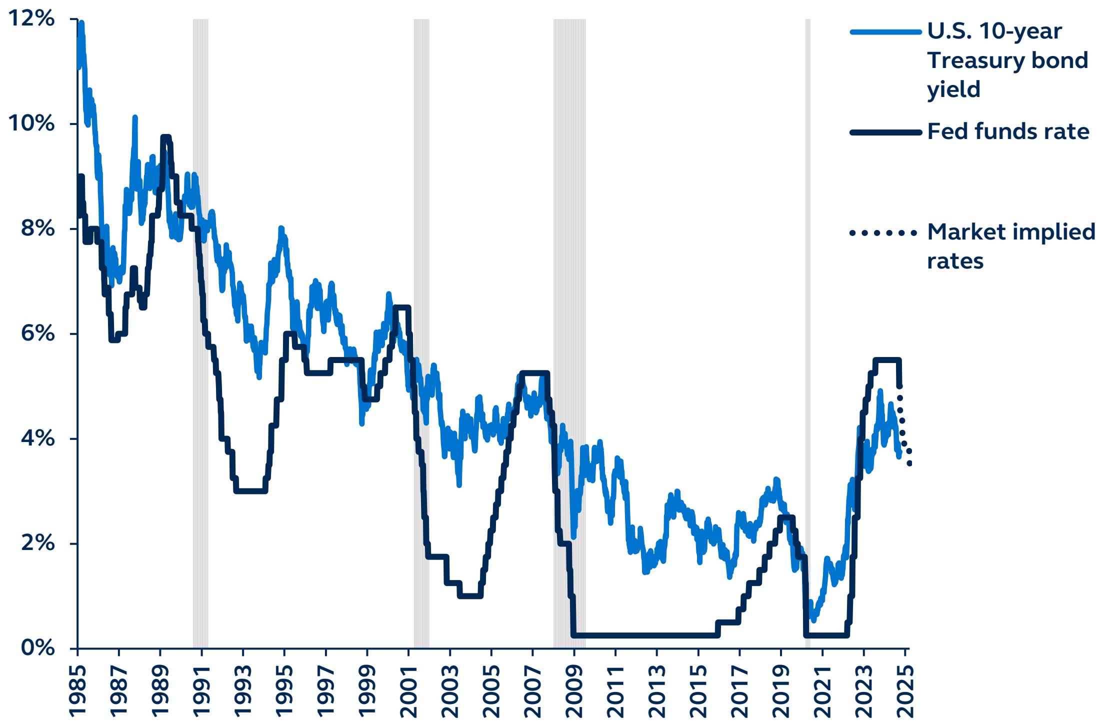
Fixed Income

Realization of a soft landing could provide a lift to yields

While history suggests Fed cuts should push yields lower, the improvement in economic outlook suggests some mild upward drift in long-end yields, resulting in a steeper yield curve.

Fed funds rate and U.S. 10y Treasury bond yield

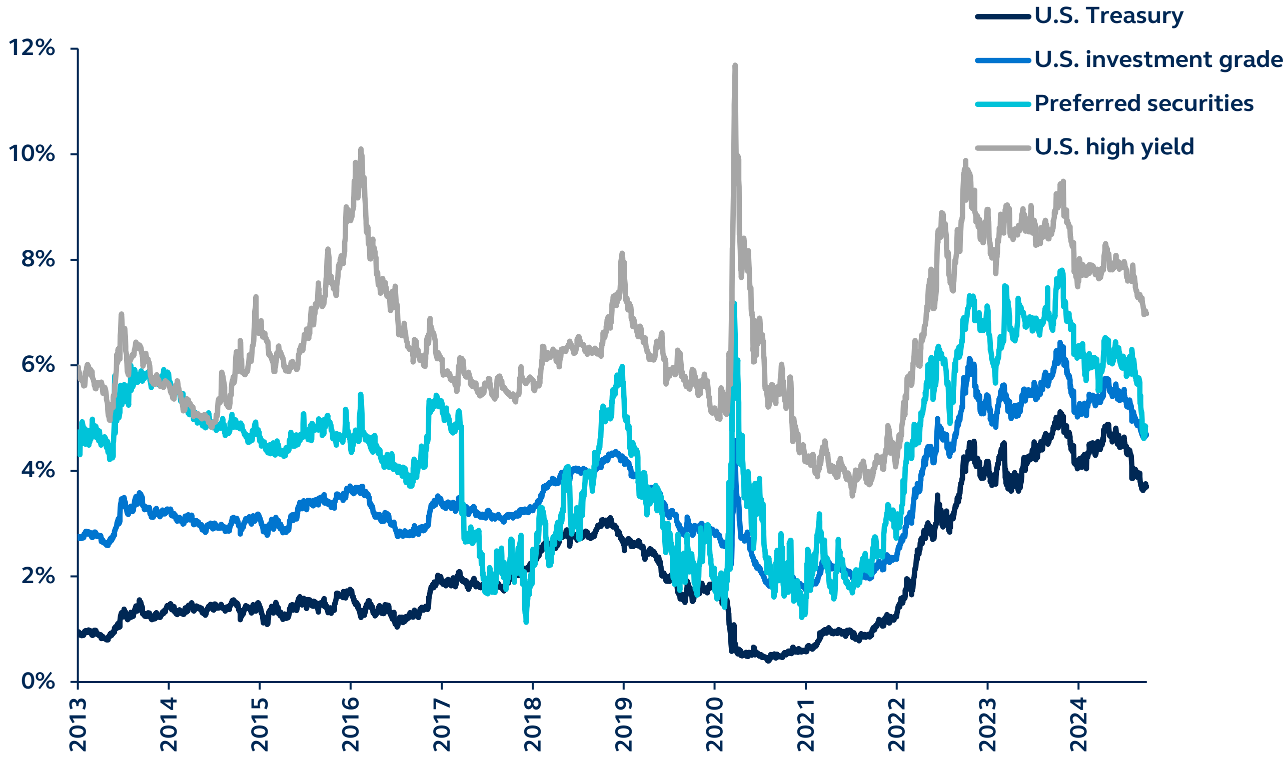
Recessions are shaded, 1985–present



Source: Federal Reserve, Bloomberg, Principal Asset Allocation. Data as of September 30, 2024.

Yield comparison

Yield-to-worst, 2013–present



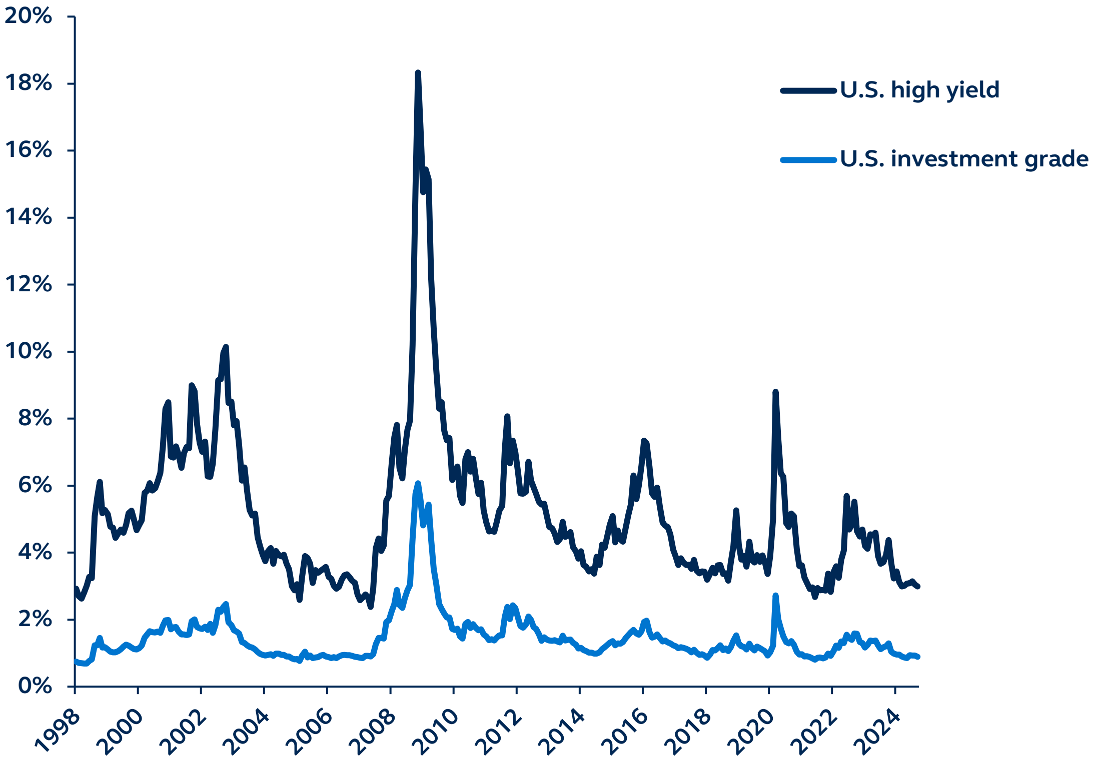
Source: Bloomberg, Principal Asset Management. Data as of September 30, 2024.

Tight spreads a reflection of solid fundamentals

IG credit should remain attractive as Fed rate cuts support strong demand for high-quality corporate bonds. High yield should also prosper in this constructive growth environment.

U.S. high yield and investment grade spreads

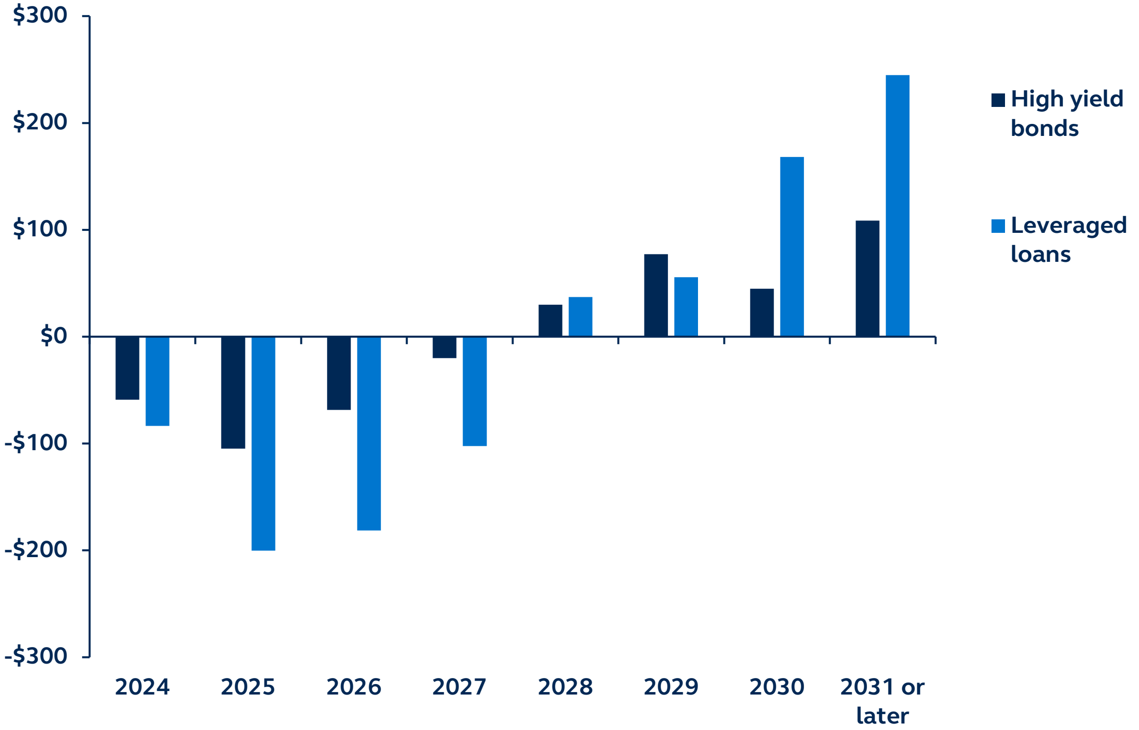
Option-adjusted-spread, 1998–present



Source: Bloomberg, Principal Asset Management.
Data as of September 30, 2024.

Change in maturities since year-end 2022

$ billions



Source: J.P. Morgan, Principal Asset Management. Data as of August 31, 2024.

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