Principal Hong Kong
3Q 2025 Market Outlook

Key themes for 3Q 2025

- **The global growth outlook has stabilized amid shifting trade dynamics**
  Global economic resilience is emerging despite recent macro, policy, and geopolitical shocks, while investor focus has shifted away from U.S. dominance toward a more balanced global outlook.

- **U.S. tariff threats have receded but will leave a bad taste on growth, the labor market, and inflation**
  Recession odds have receded, but tariffs and policy uncertainty may soon manifest in slowing macro data. Yet, household and corporate balance sheets should provide a cushion, limiting layoffs and consumer weakness.

- **The Federal Reserve needs an inflation or labor market nudge to cut rates this year**
  The Fed will keep policy rates on hold until late 2025 unless there is a sustained run of soft inflation or labor market prints. On the fiscal front, a gradual improvement in the budget deficit would come at the expense of growth.

- **U.S. equity markets: positive gains to persist even amidst continued macro and policy volatility**
  The U.S. market's full recovery implies a limited cushion against policy disappointment in the near term. Yet positive, albeit slower, economic growth implies continued earnings growth, with markets likely still trending higher.

- **Elevated fixed income yields should continue to attract investors**
  Credit spreads have re-tightened back close to historic lows. With the constructive global macro backdrop meaning that fundamentals remain solid, investors can once again consider higher-yielding fixed income solutions.

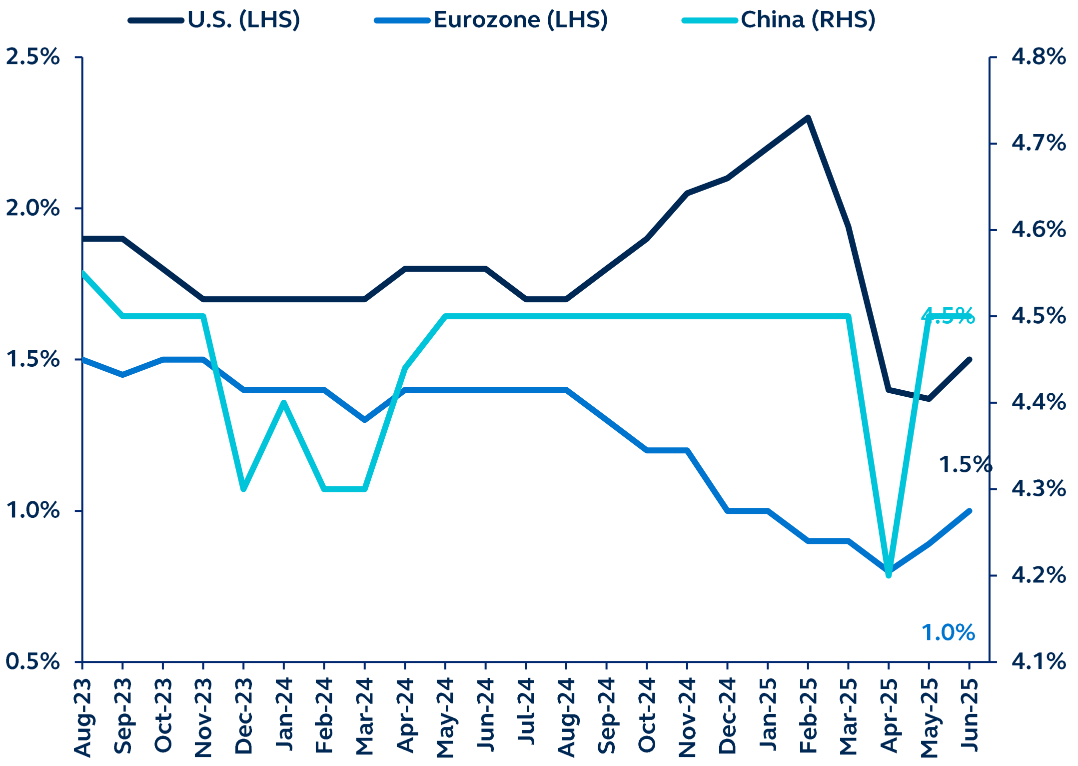
- **Diversification has rarely looked so attractive**
  In an era of active global policymaking and higher for longer rates, diversification - both geographic and across a broader set of assets, will be critical. U.S. exceptionalism hasn't disappeared; its key structural advantages remain intact. But as other global economies gain momentum, U.S. outperformance is likely to be more muted.

A series of global shocks test long-term trends

The global economy has absorbed the multiple shocks of recent months without suffering long-term damage. Yet, the U.S. exceptionalism narrative has sustained a severe blow.

GDP forecasts

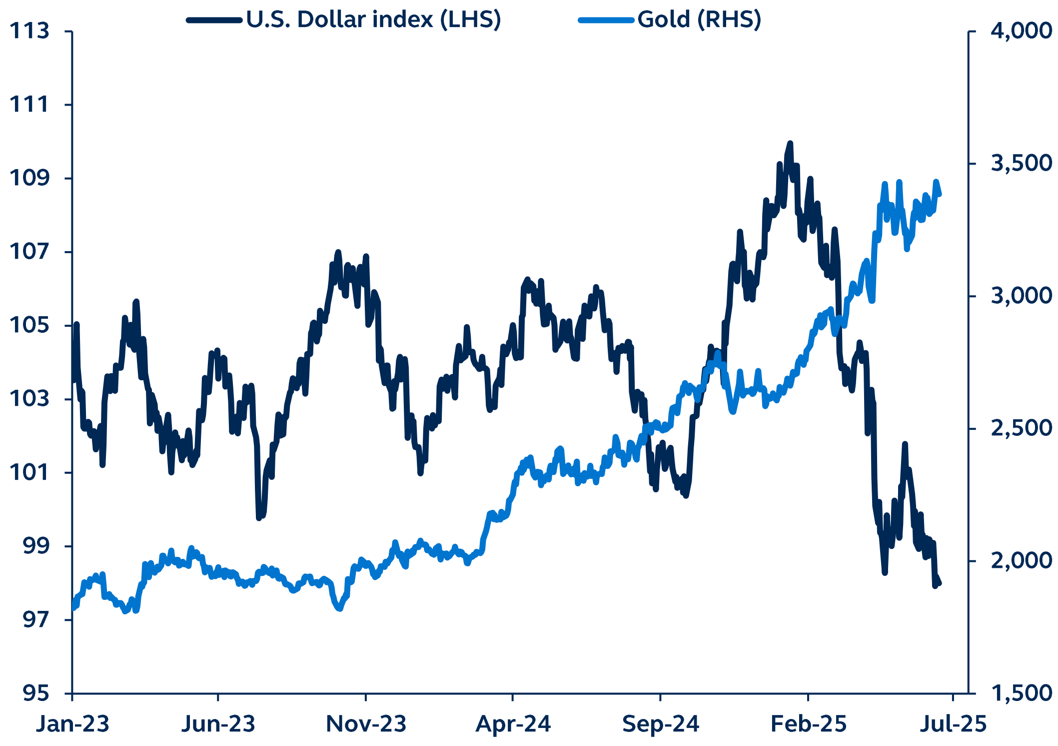
Progression of consensus 2025 real GDP growth forecasts for U.S., Eurozone and China, August 2023–present



Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

U.S. Dollar and Gold

U.S. Dollar Index spot rate vs. Gold spot price, January 2023–present



Source: Bloomberg, Principal Asset Management. Gold spot price quoted as U.S. dollars per troy ounce. Data as of June 30, 2025.

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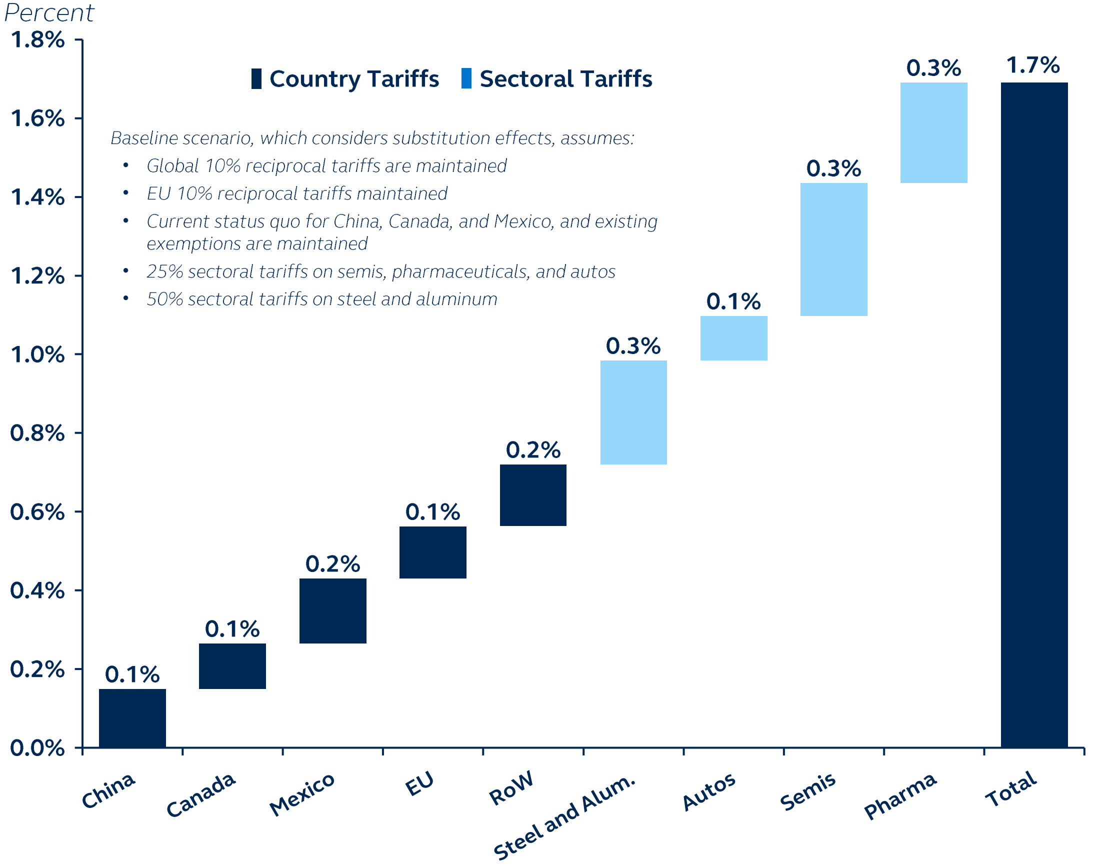
Tariffs: A (less) punishing picture for U.S. growth

The average U.S. tariff rate is likely to settle at around 15-17%, meaningfully higher than at the start of the year, suggesting some potential for economic scarring.

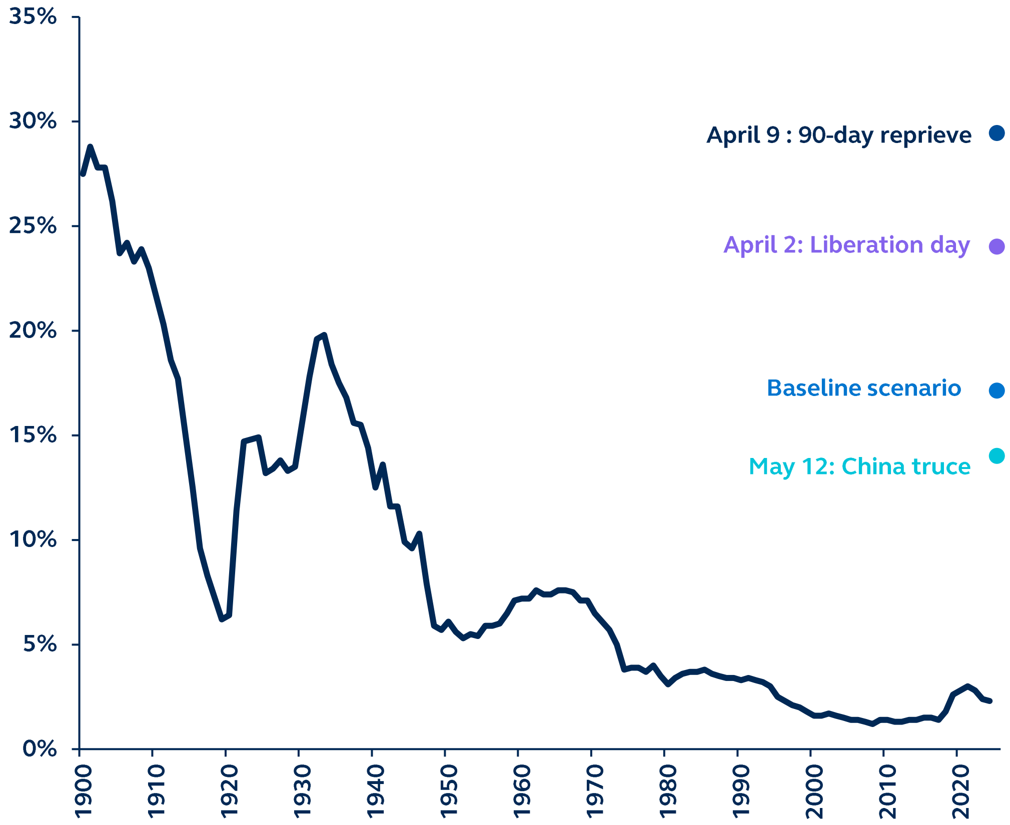
End-2025 baseline tariff scenario: negative impact of tariff increases on U.S. GDP



Source: International Monetary Fund, World Trade Organization, Census Bureau, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

U.S. average effective tariff rate

1900–present



Source: United States International Trade Commission, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

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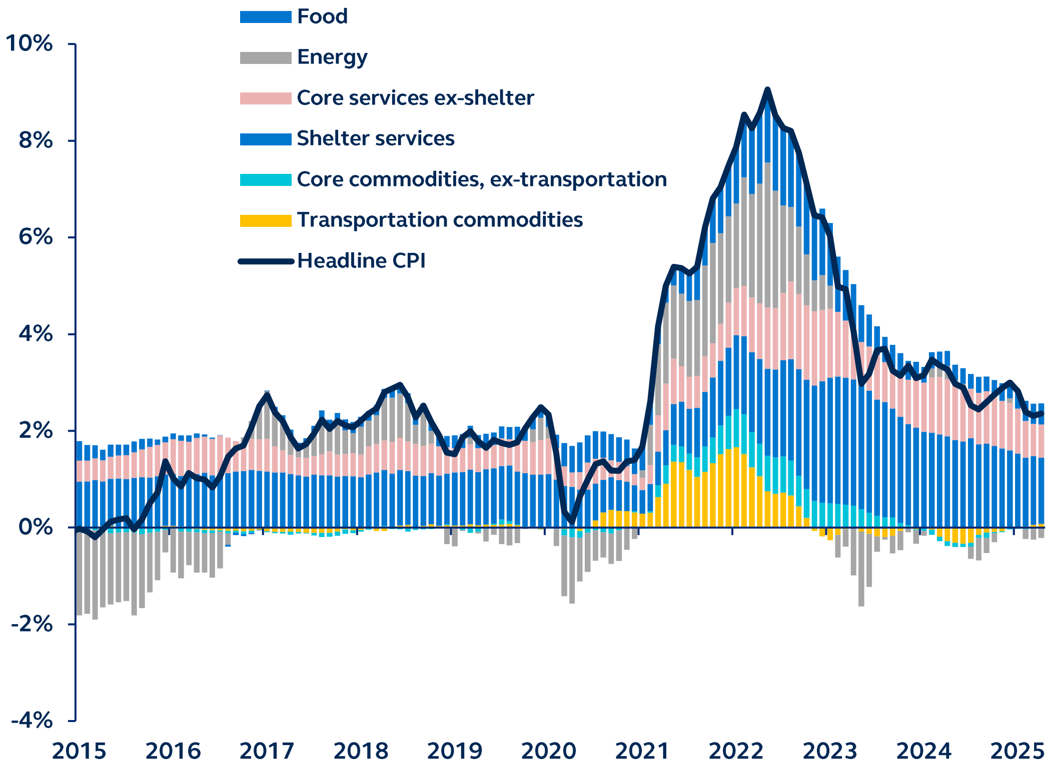
U.S. inflation: no time to sound the all-clear

Inflation pressures have remained muted so far, but tariffs will eventually feed through pushing prints higher and creating some discomfort for the Fed.

Contribution to headline U.S. inflation

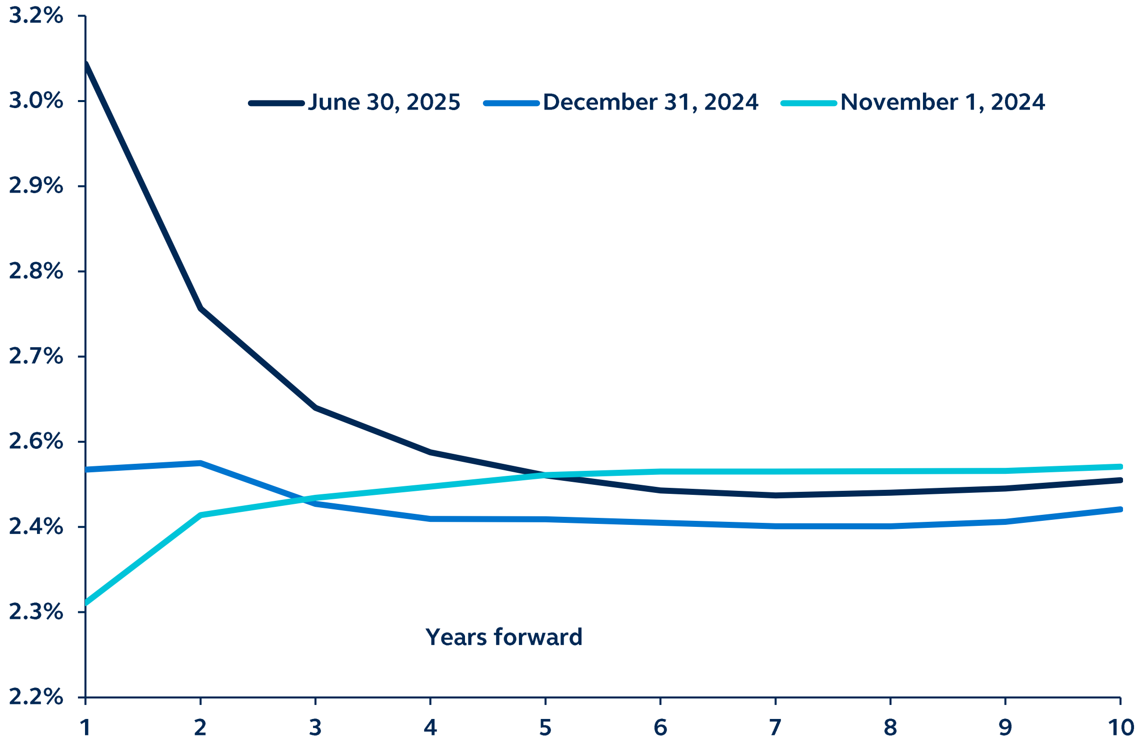
Year-over-year, January 2015–present



Source: Bureau of Labor Statistics, Principal Asset Management. Data as of June 30, 2025.

Market inflation expectations

Zero coupon inflation swap curve, by number of years forward



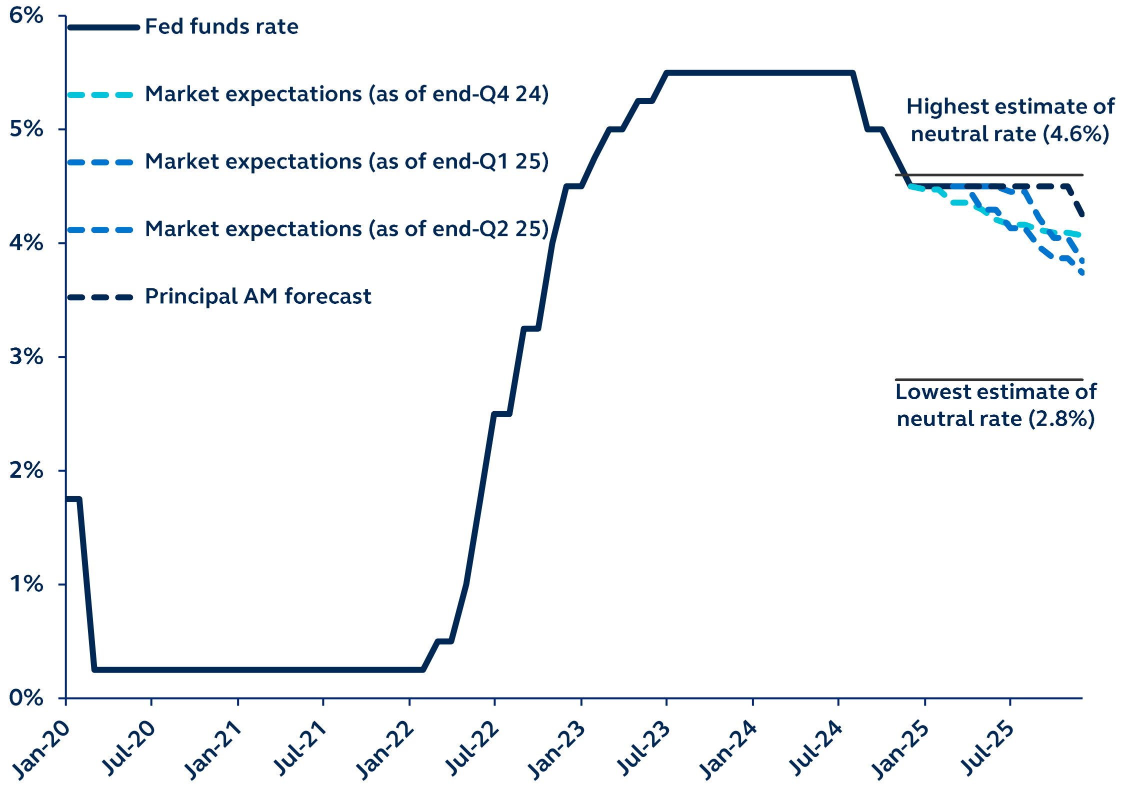
Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

Both monetary and fiscal policy play a tough game

Rising inflation and low layoffs will keep the Fed on the sidelines until Q4. The positive growth impact from the tax bill will be more than offset by the negative impact from tariffs.

Federal Reserve policy rate path

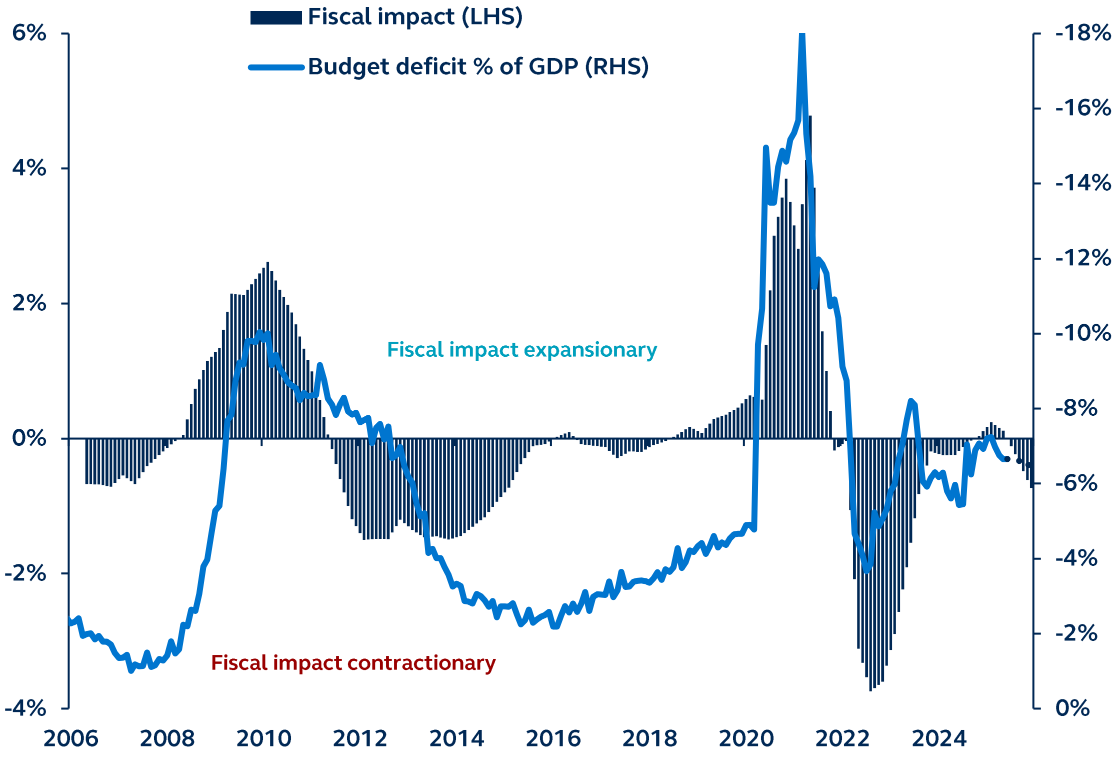
Fed funds rate and projections, 2020–present



Source: Federal Reserve, Bloomberg, Principal Asset Management. Highest and lowest neutral rate estimate levels are derived from a wide range of Wall Street analysts and models. Data as June 30, 2025.

Fiscal impact vs. budget deficit

% of GDP, 2006–present



Note: The Fiscal Impact Measure, sourced from Brookings, shows how much government tax and spending policy adds to or subtracts from overall economic growth. Source: Brookings, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

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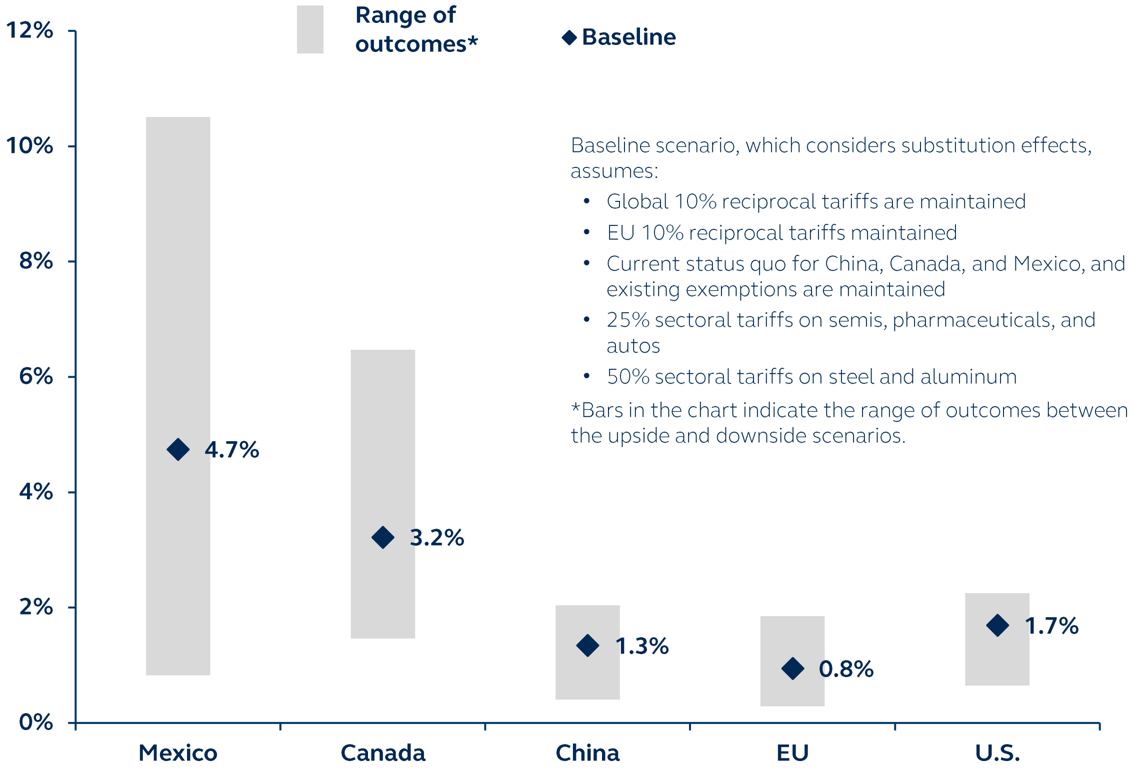
Shifting trade sands re-draw the global macro picture

The global economy is facing trade headwinds, but stimulus should work to offset the impact next year.

End-2025 baseline tariff scenario: negative impact of tariff increases on country GDP

Percent



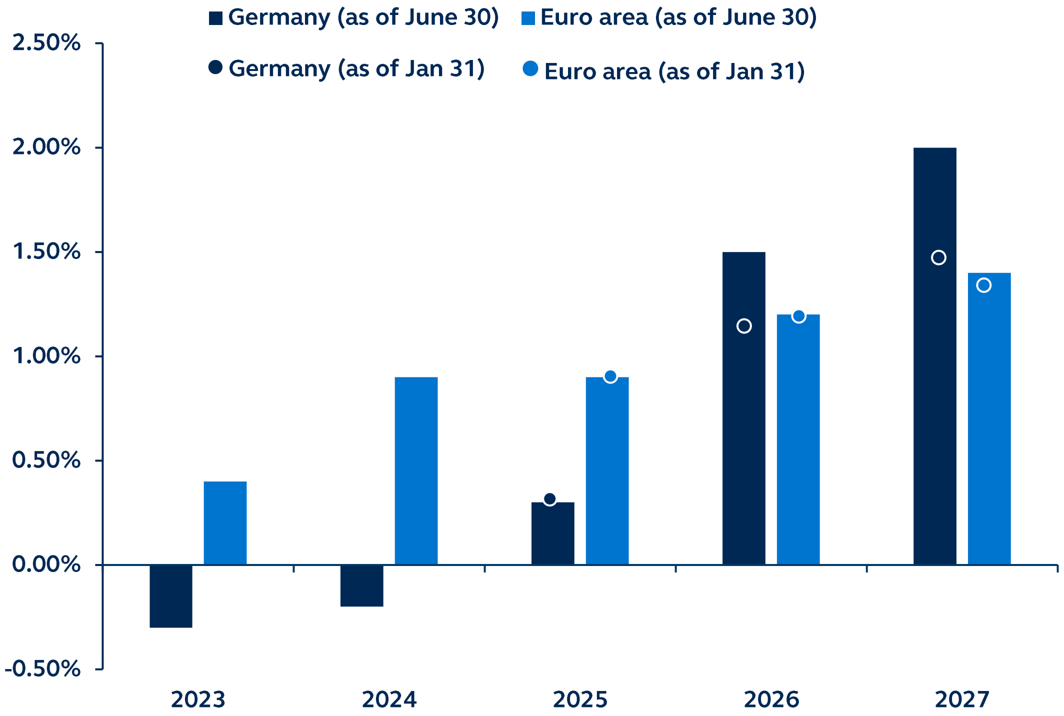
Baseline scenario, which considers substitution effects, assumes:

- Global 10% reciprocal tariffs are maintained
- EU 10% reciprocal tariffs maintained
- Current status quo for China, Canada, and Mexico, and existing exemptions are maintained
- 25% sectoral tariffs on semis, pharmaceuticals, and autos
- 50% sectoral tariffs on steel and aluminum

*Bars in the chart indicate the range of outcomes between the upside and downside scenarios.

Source: International Monetary Fund, World Trade Organization, Census Bureau, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

Germany and Euro area GDP growth forecast revisions



Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

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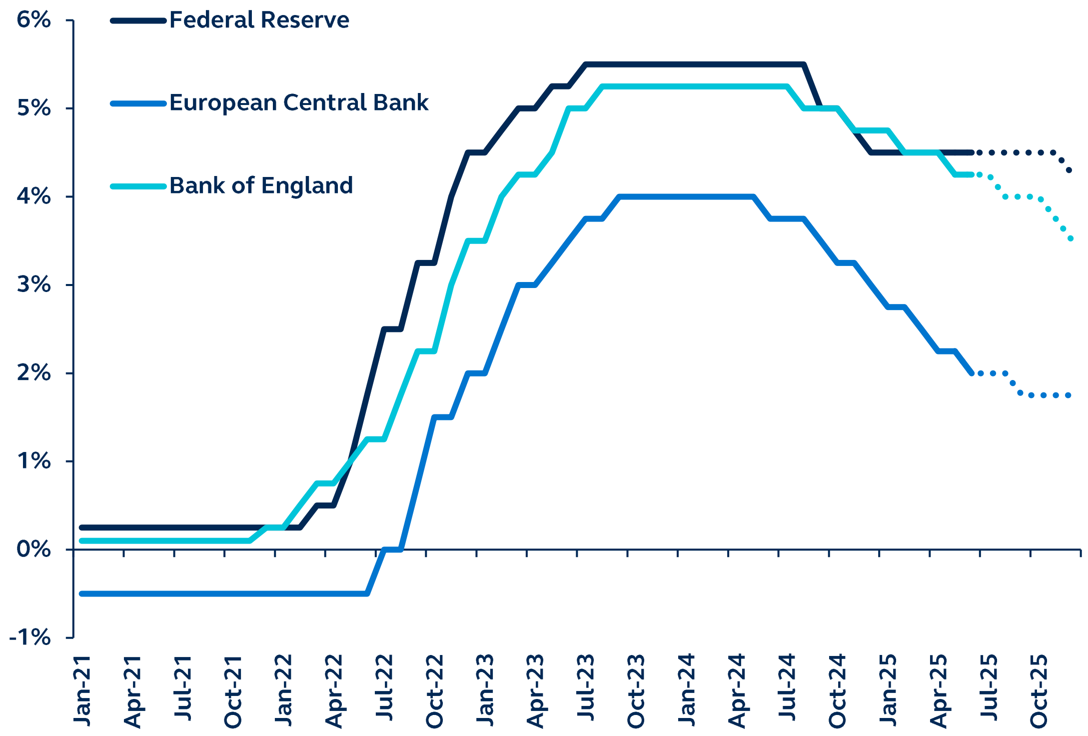
The U.S. dollar—more than cyclical weakness?

The dollar remains vulnerable to further downward adjustment. Yet, without an alternative reserve currency, a sharp downward spiral is unlikely.

Global central bank policy rate expectations

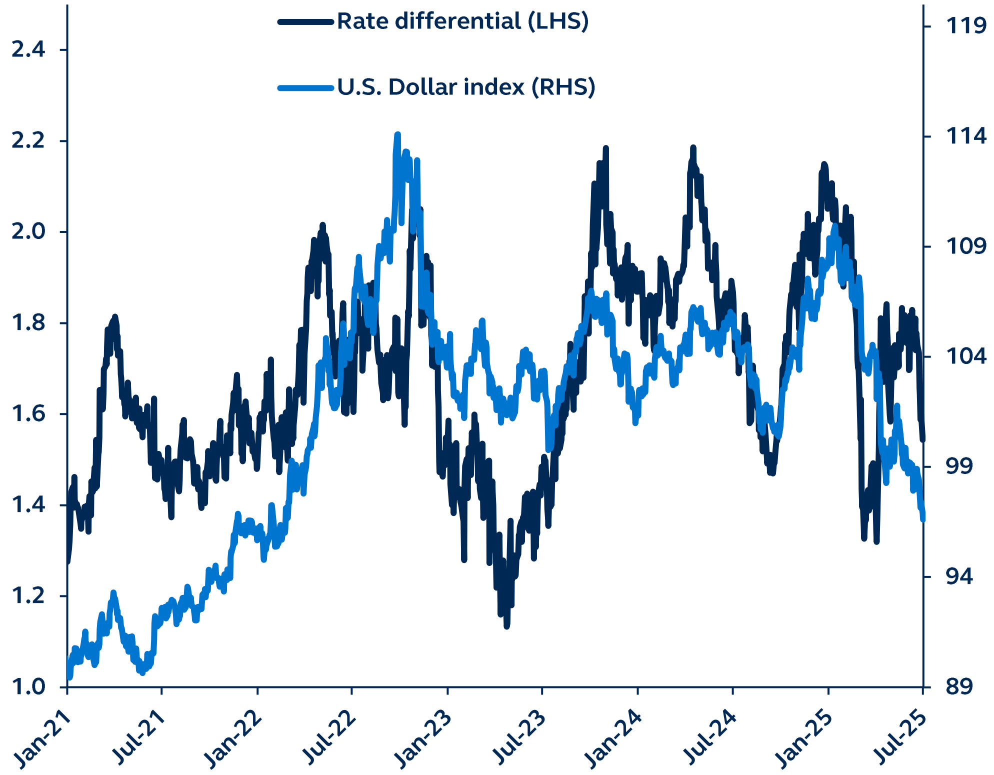
Percentage points, January 2021–present



Source: Bloomberg, Principal Asset Allocation. Data as of June 30, 2025.

Rate differentials vs. U.S. Dollar

Weighted average 10-year rate differential, January 2021–present



Source: Bloomberg, Principal Asset Management. Weighted average rate differential calculated as U.S. minus Europe, Japan, U.K.Data as of June 30, 2025.

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Investment perspectives

Defense and diversification in a disrupted cycle

With policy shocks roiling markets and global growth expectations, investors should pivot toward caution and quality

Equities *Lean into quality and global breadth as volatility rises*

- Emphasize fundamentally sound companies with strong free cash flows less prone to economic headwinds
- Explore opportunities beyond the Mag 7, including tactical exposure to small- and mid-cap stocks
- Narrowing valuation differentials suggest a broadening global opportunity set

Implementation

- Well-diversified, active international managers
- Quality-biased active managers
- Active mid- and small-cap strategies
- Large-cap U.S. strategies

Fixed income *Further spread tightening is unlikely, but elevated yields remain attractive*

- Increase allocation to investment-grade (IG) credit with strong balance sheets
- Extend duration selectively—attractive hedge in a slowing growth environment
- U.S. policy uncertainty can create diversification opportunities in emerging market debt
- Consider deploying cash assets in higher-yielding income options, minimizing reinvestment risks

Implementation

- IG credit heavy core fixed income
- Flexible emerging market debt strategies
- Active high yield strategies
- Preferred and capital securities

Alternatives *Pursue less correlated exposures*

- Fundamentals and selectivity remain key in private real estate – focus on opportunities in data centers,
  residential, healthcare (U.S.), and logistics (Europe)
- REITs remain compelling amid falling yields and defensive rotation
- Prioritize real return strategies in a stagflationary risk scenario

Implementation

- Private real estate markets
- Proven REIT strategies
- Multi-strategy alternatives

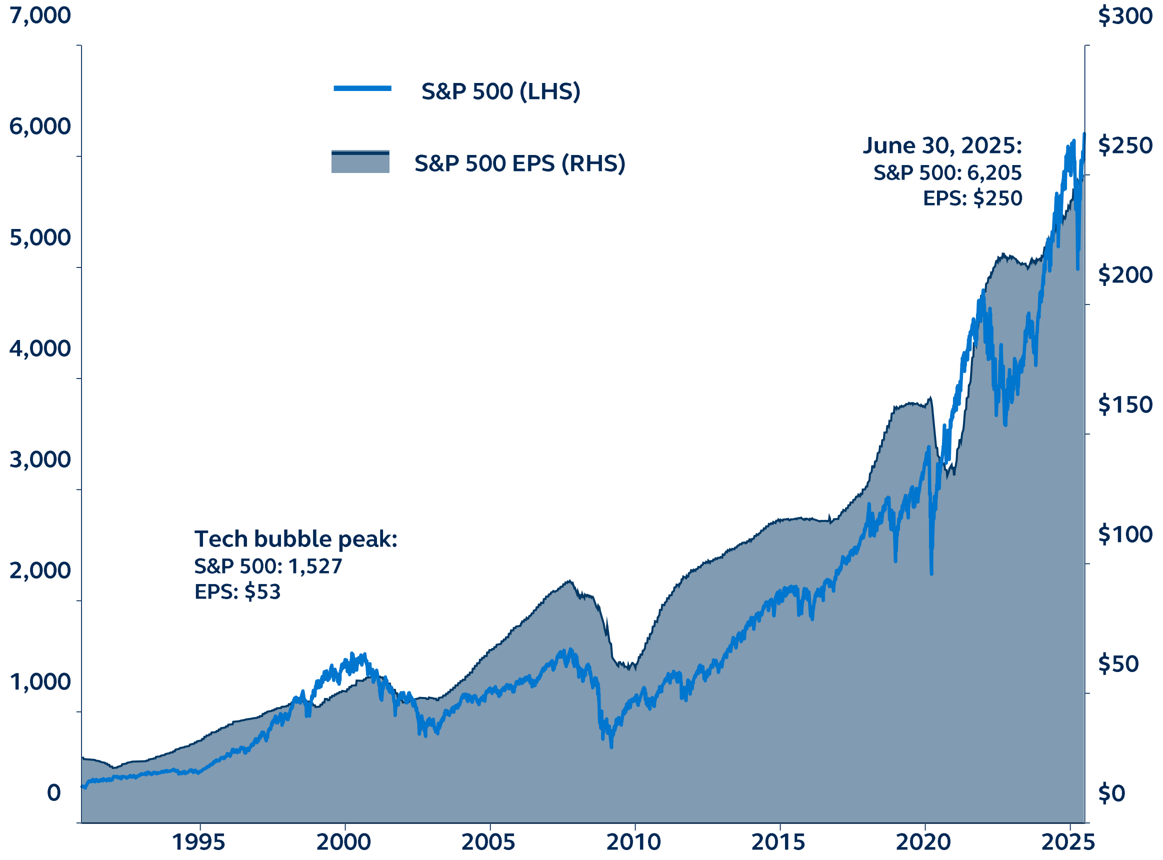
Equities

U.S. equities: Resilience amid macro shocks

In the near-term, the diminished cushion of caution implies U.S. markets are vulnerable to disruption. Beyond that, however, earnings growth should ensure positive returns.

The stock market and earnings

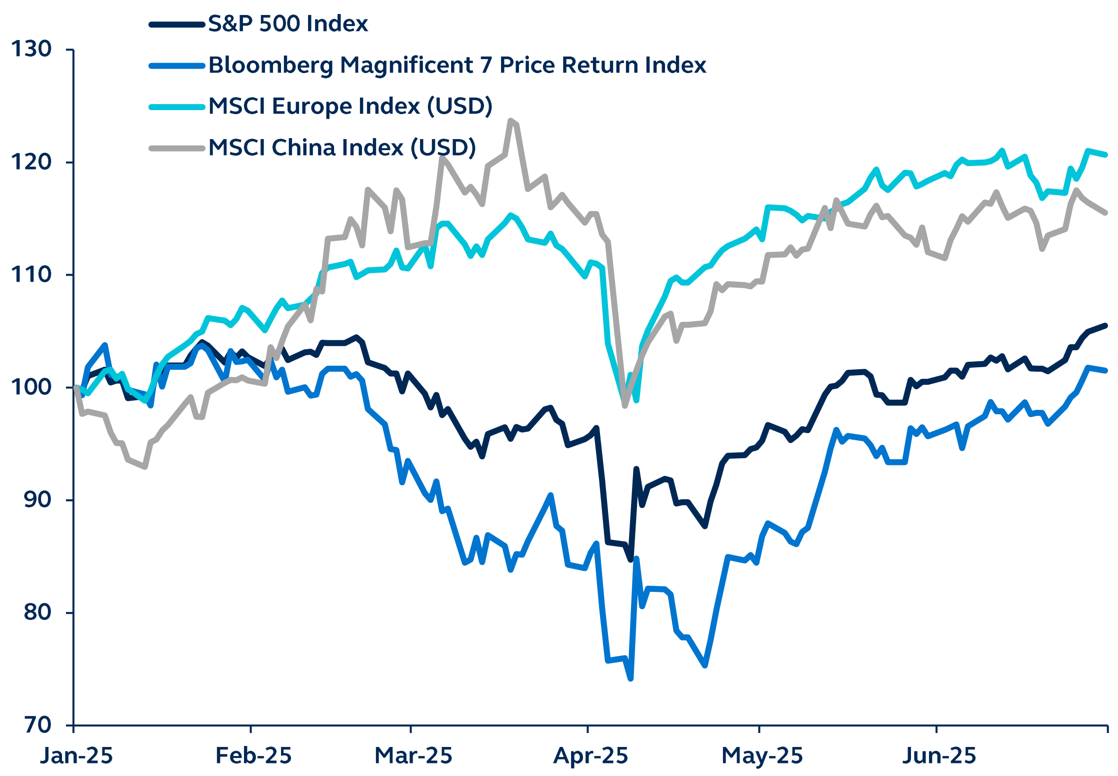
S&P 500 Index price and trailing earnings-per-share, 1990–present



Source: Clearnomics, Standard & Poor's, Principal Asset Management. Data as of June 30, 2025.

Magnificent 7 performance vs. major indices year-to-date

Index price return, rebased to 100 January 1, 2025



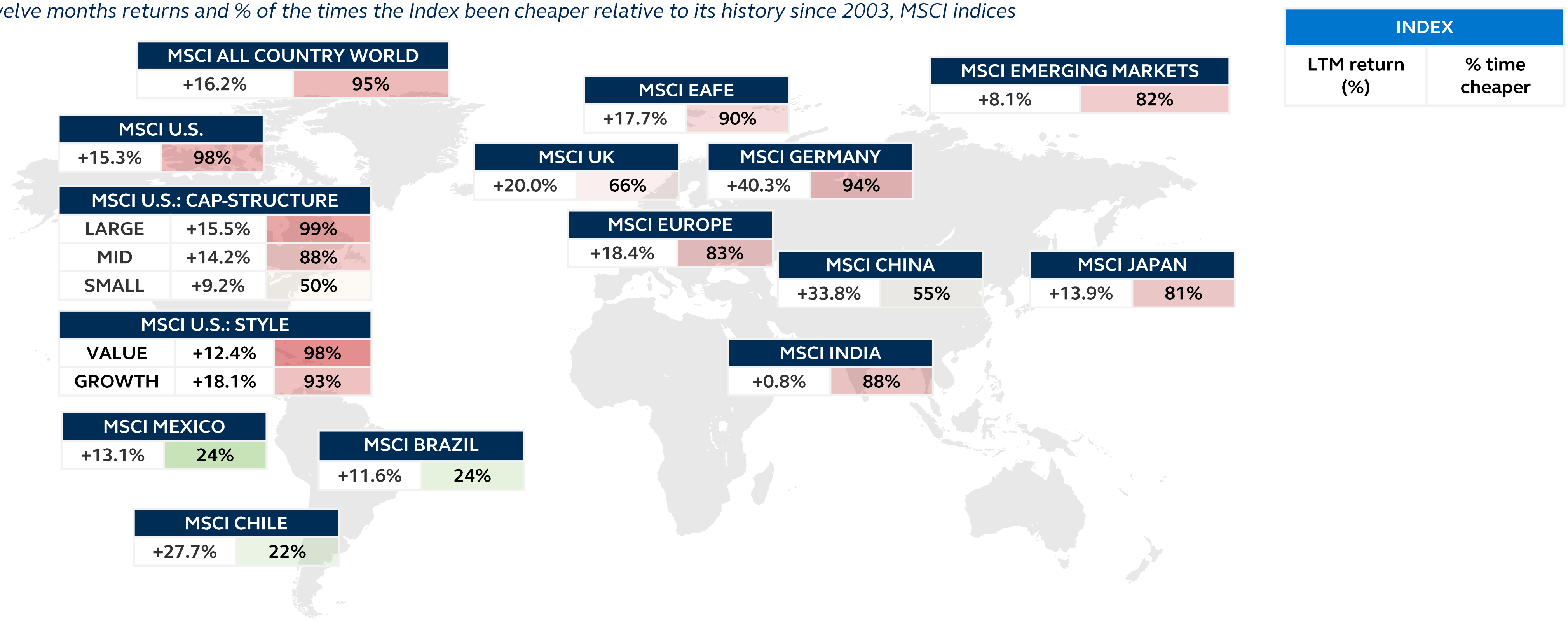
Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

Global valuations

European equities are now flagging expensive and valuation differentials with the U.S. have narrowed.

Global equity returns and valuations

Last twelve months returns and % of the times the Index been cheaper relative to its history since 2003, MSCI indices



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 June 30, 2025.

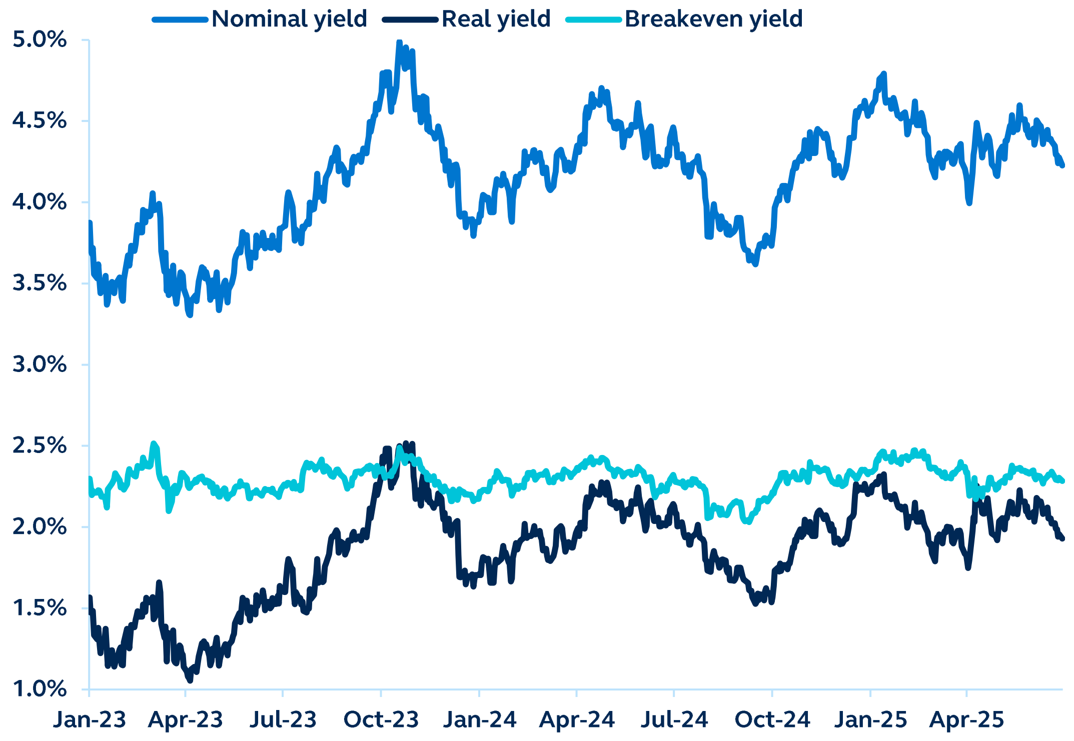
Fixed income

U.S. bonds market reflecting higher risk premiums

Even if inflation remains subdued and the Fed is cutting rates, fiscal concerns and reduced demand for U.S.-dollar assets may mean borrowing costs see limited relief in the months ahead.

10-year Treasury yield decomposition

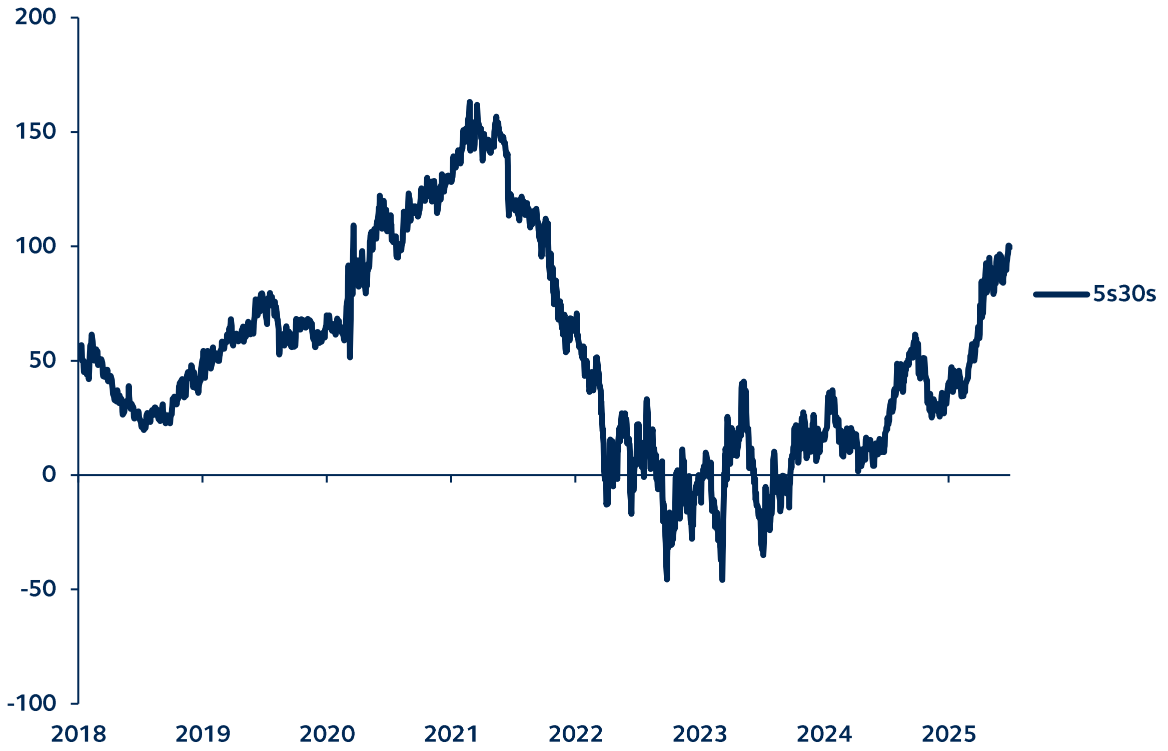
January 2023–present



Source: Federal Reserve, Bloomberg, Principal Asset Allocation. Data as of June 30, 2025.

U.S. yield curve spread

30-year Treasury yield minus 5-year Treasury yield, basis points, January 2018–present



Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

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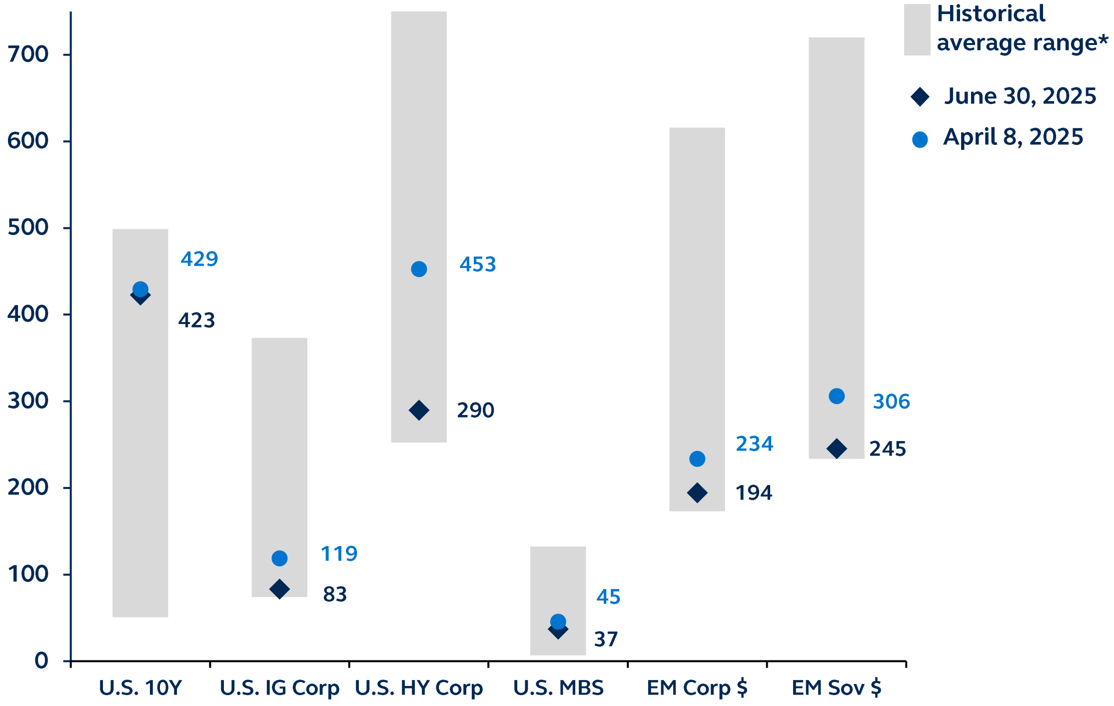
Corporate credit: looking at the income on offer

Credit remains well positioned to perform strongly for the latter half of the year. Further spread tightening is unlikely, but credit offers investors an important source of income.

Historical spread range over the past 10 years

Option-adjusted-spread, basis points, 2015–present

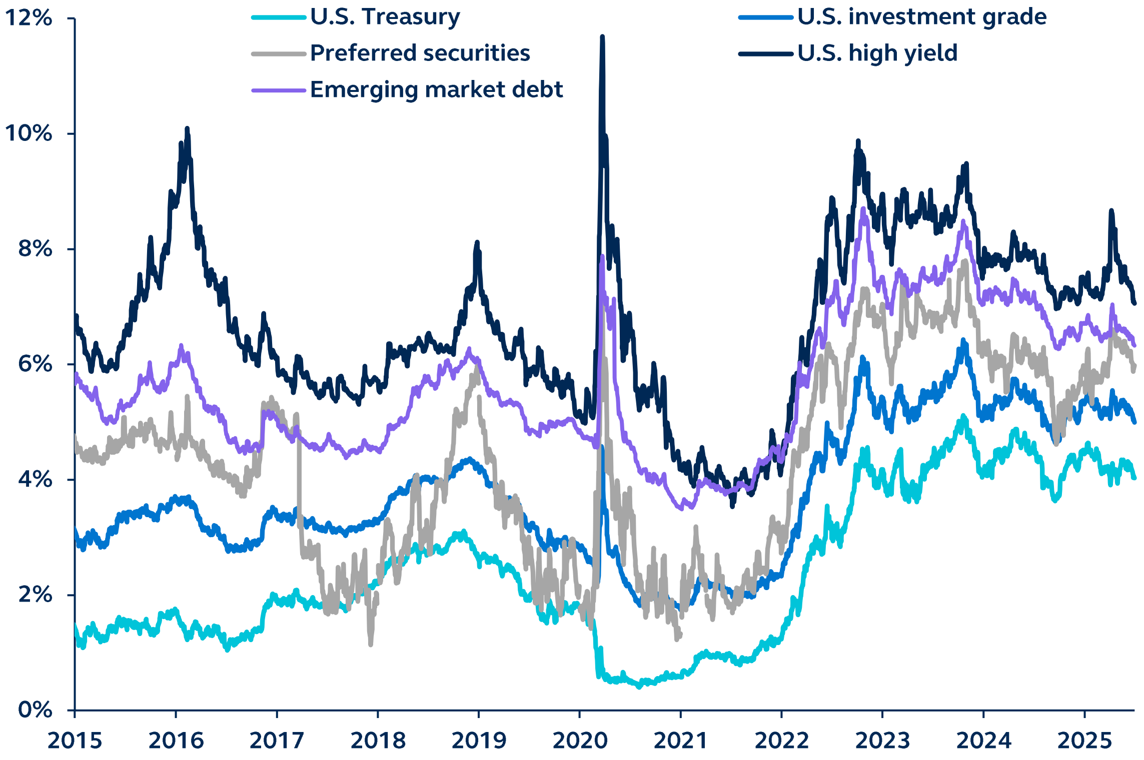


*The historical average range represents the maximum and minimum yield or OAS values over the past 10 years for each asset class. U.S. HY Corporates widened to 1100bps in March 2020.

Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025.

Yield comparison

Yield-to-worst, 2015–present



Source: J.P. Morgan, Principal Asset Management. Data as of June 30, 2025.

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