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Principal Hong Kong 4Q 2025 Market Outlook

Key themes for 4Q 2025

- **Global economic strength has withstood U.S. trade policy shocks**
  Growth forecasts have recovered since Liberation Day and have even improved for 2026. Yet, elevated inflation and U.S. dollar weakness are the lingering scars of the trade policy shocks, adding to already rising global fiscal concerns.

- **U.S. recession fears have been dismissed, helped along by strong consumers and AI capex spend**
  Broad macro data have been resilient, supported by robust household and corporate balance sheets. Weakness in labor demand likely stems not from economic distress, but from structural shifts that reduce the need for job growth.

- **The Federal Reserve does not need to cut policy rates below neutral yet**
  Resilient U.S. growth and persistent inflation pressures are likely to prevent the Fed from easing policy aggressively. At the same time, the OBBBA and recent deregulatory measures point to mildly stimulative fiscal policy in 2026.

- **Equity markets still have further upside, supported by policy and AI-driven capex**
  The Fed's non-recessionary rate-cutting cycle underpins a constructive outlook for 2026 U.S. earnings and equity performance. U.S. small-caps and segments of global markets offer compelling valuations and solid fundamentals.

- **Fixed income credit: Tight spreads but benefiting from robust macro tailwinds**
  Credit spreads are at multi-year tights, but a supportive macro backdrop suggests limited default risk and continued strength in higher-yielding fixed income solutions.

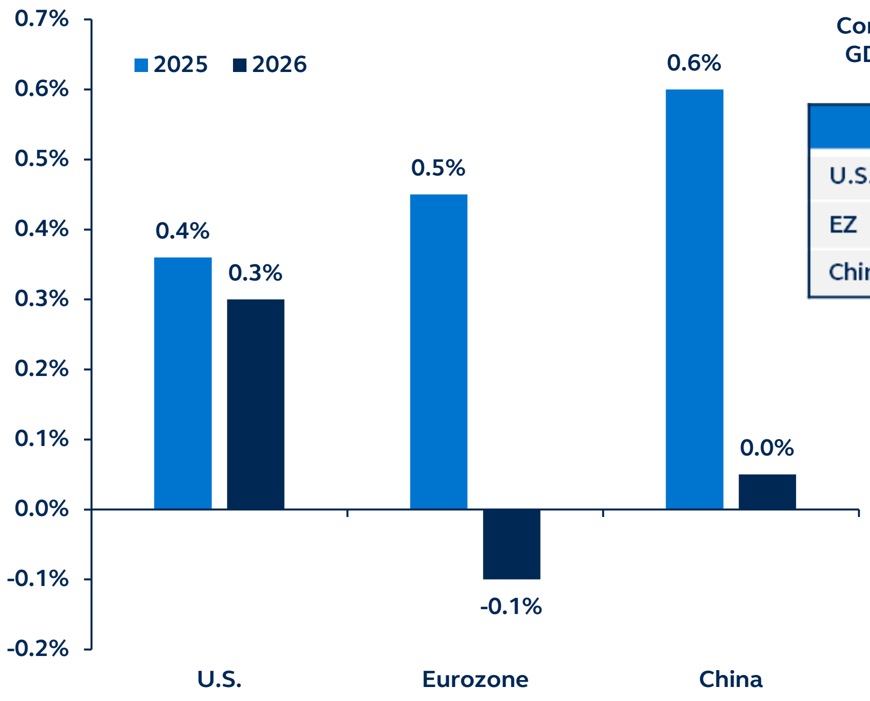
- **Focus on balance and diversification**
  The outlook for risk assets remains constructive, but stretched valuations underscore the need for balance and diversification. Opportunities may be found among second-order beneficiaries of major investment themes, attractively valued global markets, and selective private market exposures.

Near-term defiance, long-term vulnerability

Despite policy upheaval, a constructive global outlook has been re-established. However, fiscal fears are becoming more pertinent, potentially weighing on longer-term growth.

Change in consensus 2025 and 2026 real GDP growth forecasts

Percentage point change in consensus between April 2025 and September 2025



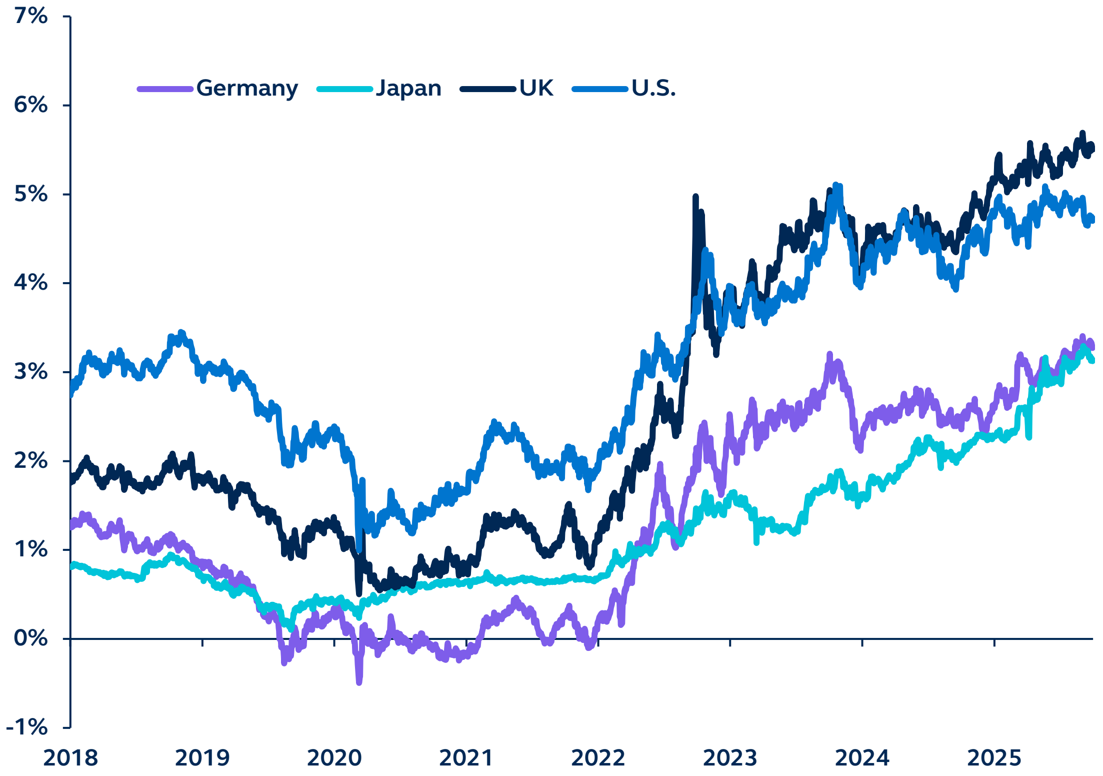
Consensus 2025-26 real GDP growth forecasts

	2025	2026
U.S.	1.8%	1.8%
EZ	1.3%	1.1%
China	4.8%	4.2%

Note: Chart reflects the increase or decrease in consensus GDP forecasts for 2025 and 2026.
Source: Bloomberg, Principal Asset Management. Data as of September 30, 2025.

Global sovereign yields

30-year yield, January 2018–present



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

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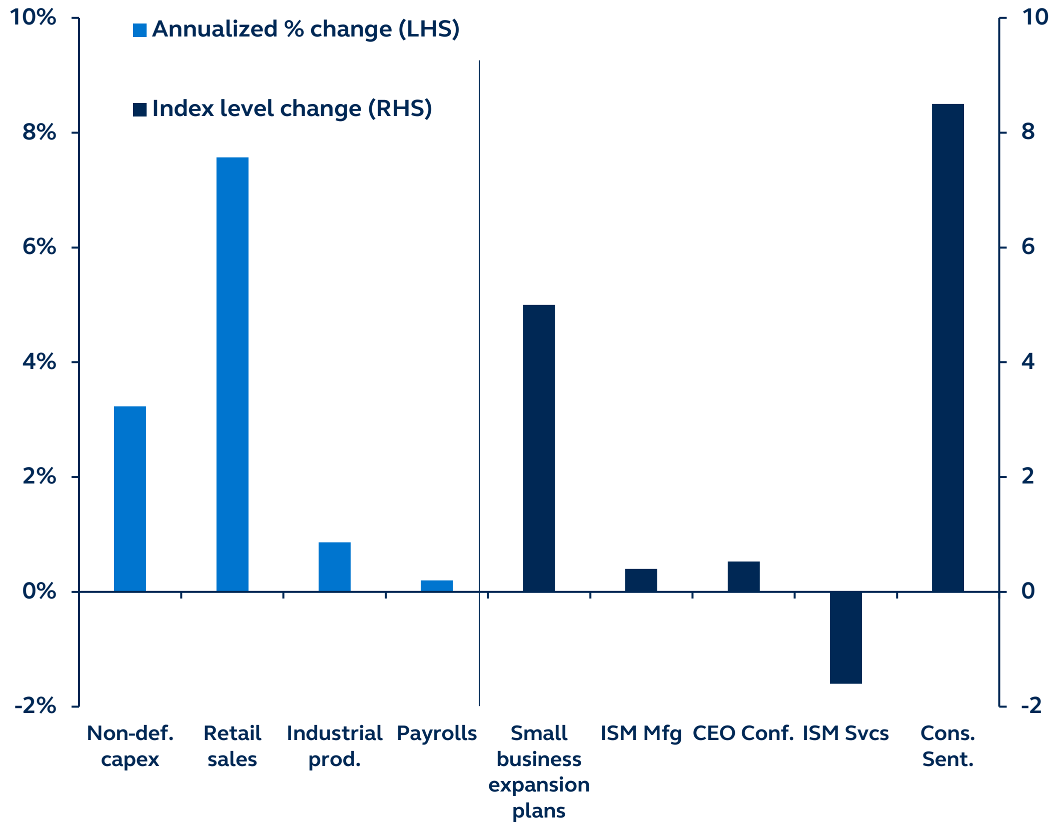
U.S. economy dismisses post-Liberation Day fears

Apart from the labor market, broad U.S. economic data has been resilient. Stimulative policy could revive broader economic indicators.

Hard vs. soft data change since post Liberation Day

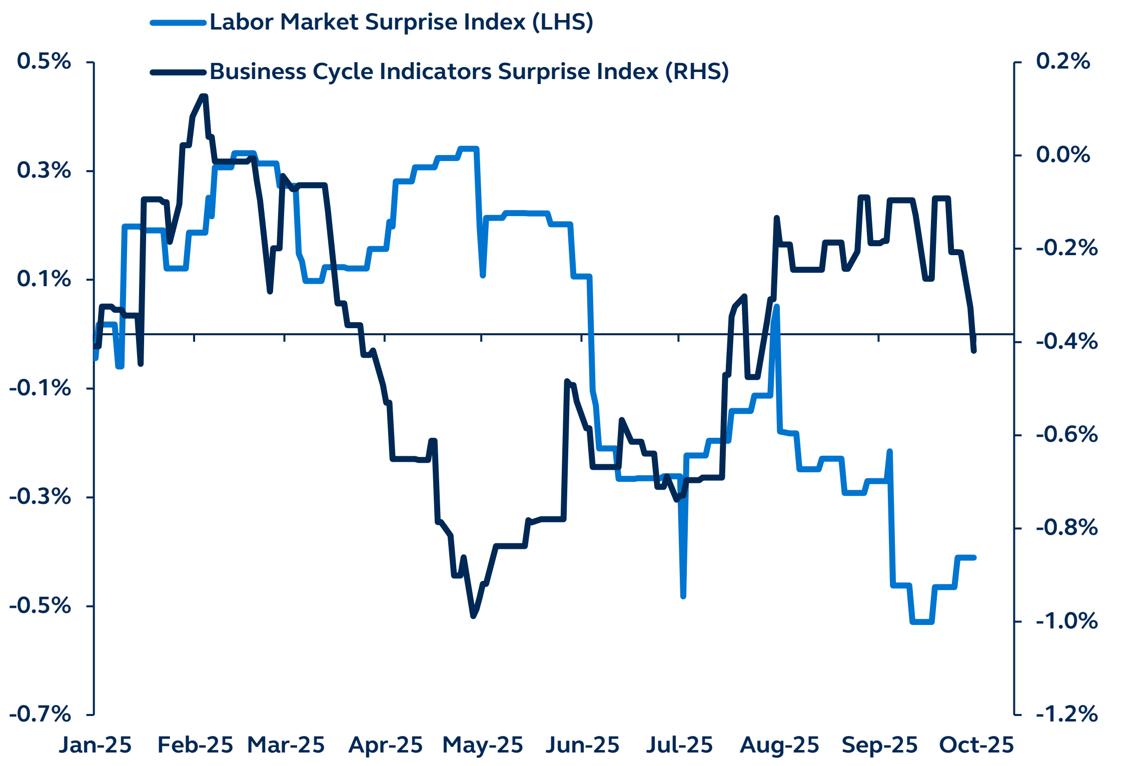
Annualized percentage change, Index level change, April 2025-present



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

Bloomberg Economic Surprise Indices (labor market & business cycle)

Percent difference between forecasts and actual data releases, January 2025–present



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

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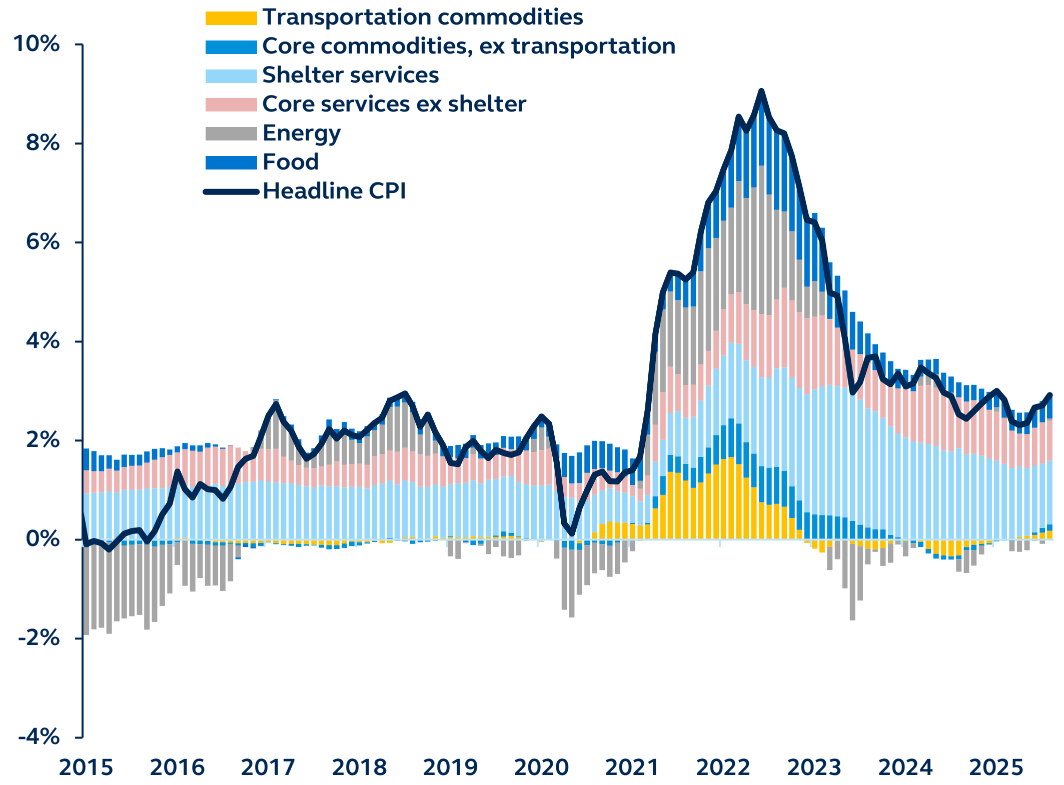
Muted tariff pass-through, but inflation risks linger

Inflation pressures from tariffs have remained surprisingly limited in aggregate so far, but it's still too early to completely dismiss their eventual impact.

Contribution to headline U.S. inflation

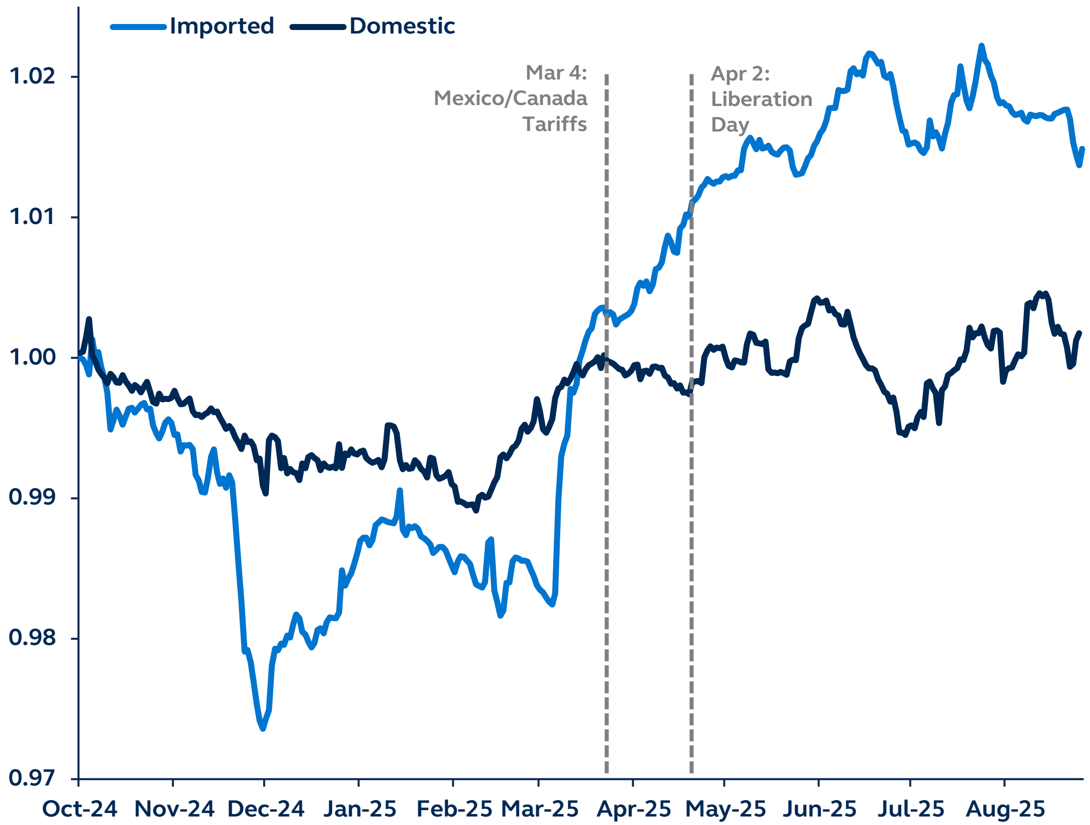
Year-over-year, January 2015–present



Source: Bureau of Labor Statistics, Principal Asset Management. Data as of September 11, 2025.

Prices of goods imported vs. domestically produced

Daily price indices for goods sold across major retailers, indexed to 1 at October 2024



Source: Harvard Business School Pricing Lab, Principal Asset Management. Data as of August 25, 2025.

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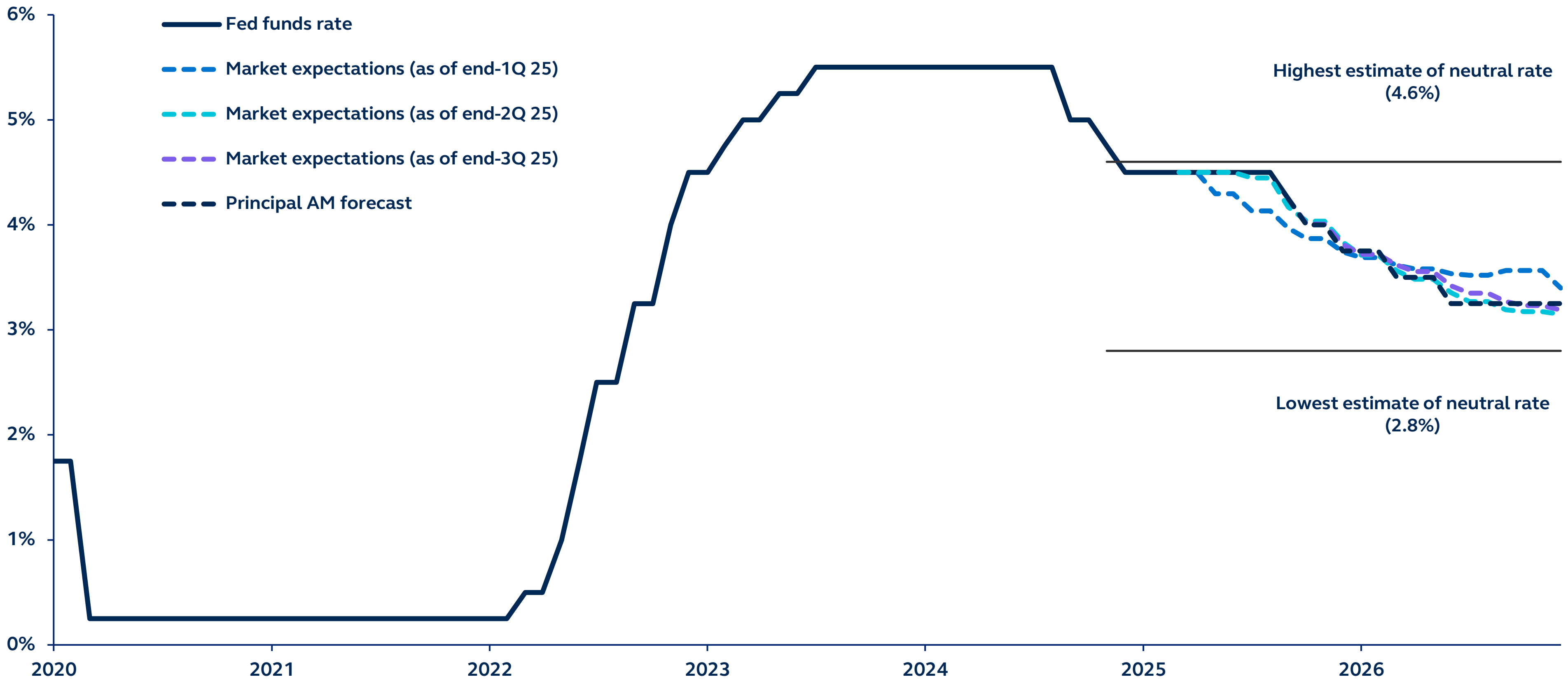
Federal Reserve: Insurance cuts, not recession cuts

Continued economic resilience indicates that the Fed is unlikely to take policy rates meaningfully below neutral—provided politics don't get in the way.

Federal Reserve policy rate path

Fed funds rate and projections, 2020–present



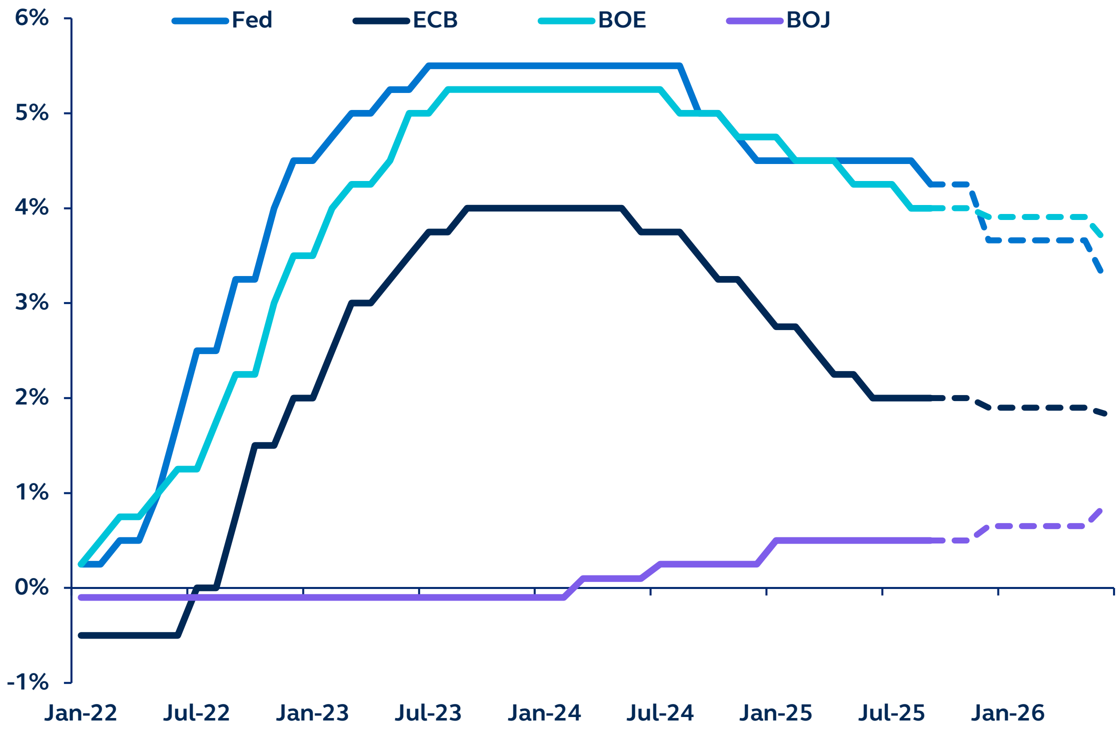
Source: Federal Reserve, Bloomberg, Principal Asset Management. Highest and lowest neutral rate estimate levels are derived from a wide range of Wall Street analysts and models. Data as of September 30, 2025.

Global economy: Different shades of strength

Global growth has been supported by active policy-making, although there are rising concerns around global fiscal health.

Global central bank policy rate path

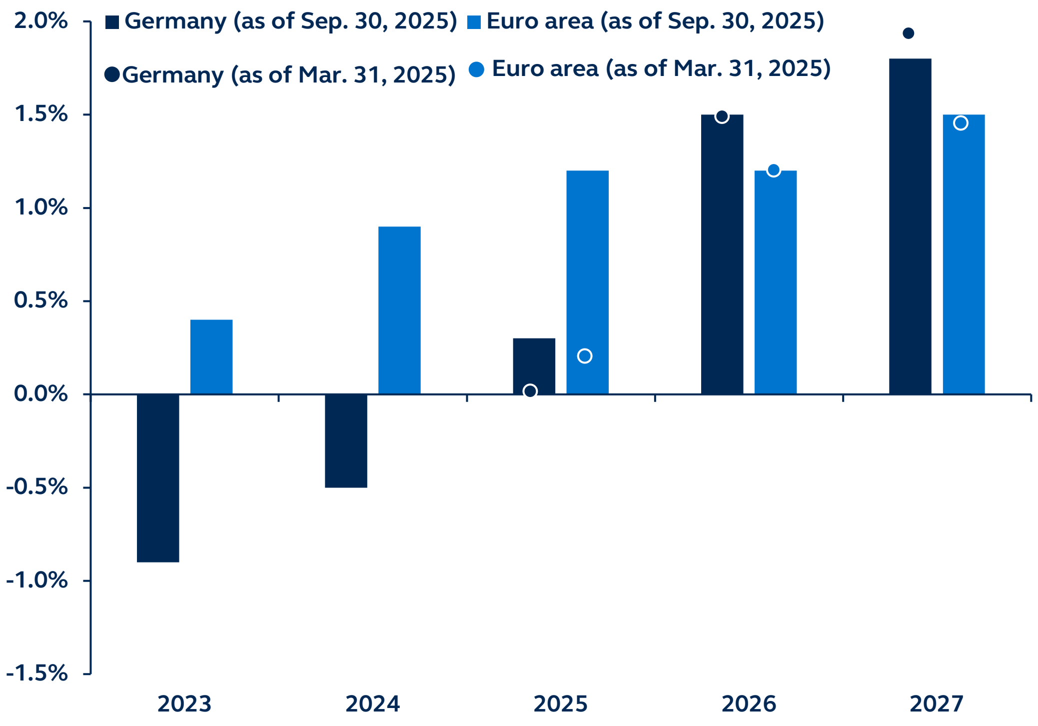
Rate and projections, 2022–present



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

Germany and Euro area GDP growth forecast revisions

2023 and 2024 are actual growth numbers, 2025-2027 show forecast revisions



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

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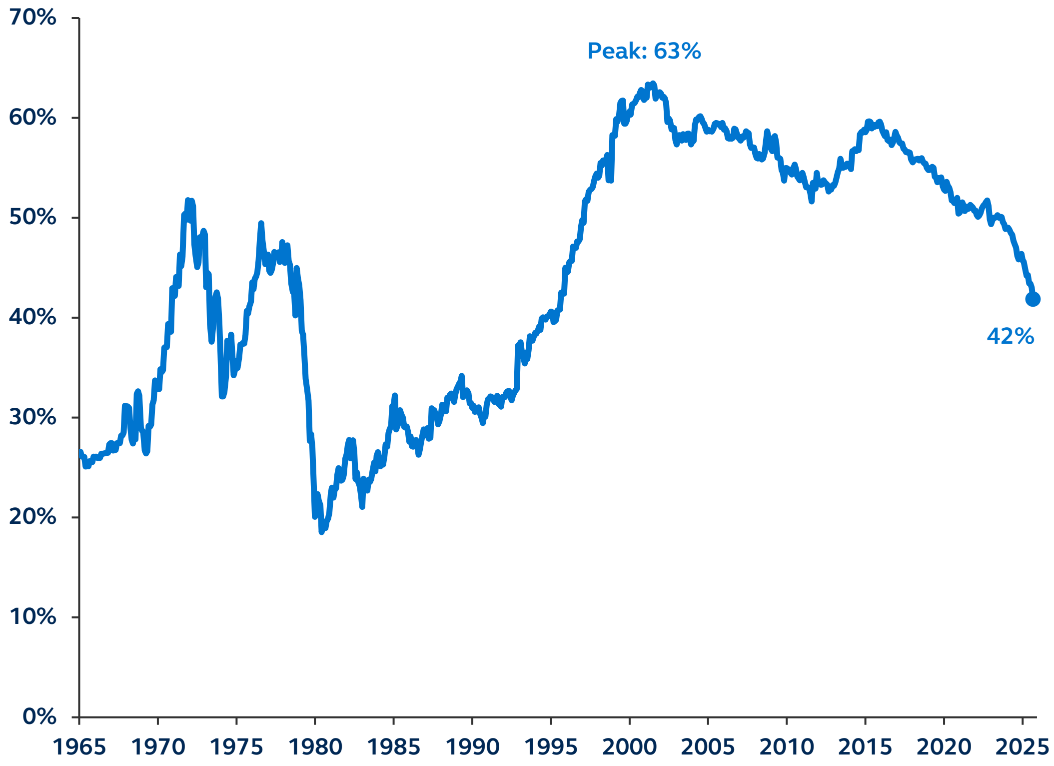
Dollar weakness: Cyclical pressures, structural concerns

The USD may have further to slide amid institutional concerns and growing global interest rate differentials. Yet, its position as the world's reserve currency is secure.

U.S. dollar share of global FX reserves

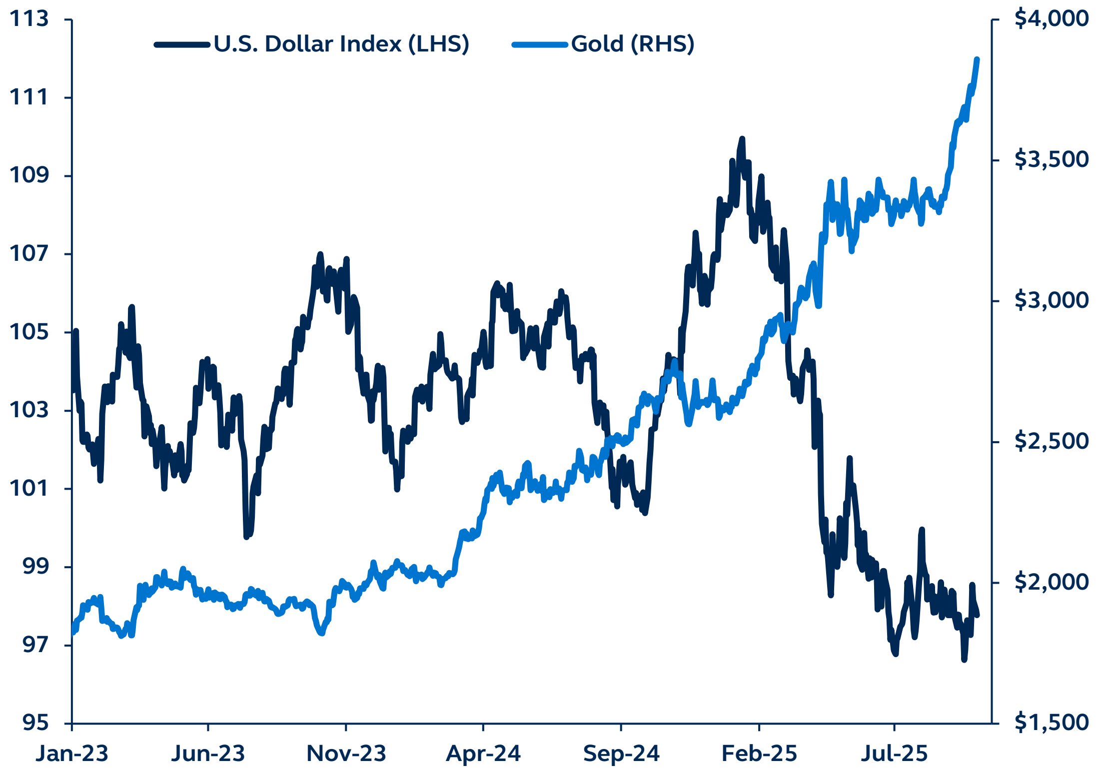
Percentage of total, 1965–present



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

U.S. dollar vs. Gold

January 2023–present



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

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Investment perspectives

Balancing resilience and risk in a maturing expansion

Resilient growth and supportive policy argue for select risk-taking, but valuation and policy risks call for thoughtful diversification

Equities *Position for broadening market participation with quality and cyclical exposure*

- Emphasize companies with solid balance sheets, durable cash flows, and exposure to AI capex or policy tailwinds
- Take advantage of the recovery in U.S. small-caps, which remain attractively valued and tied to domestic growth
- International markets offer compelling relative value and benefit from a weaker dollar and policy easing

Fixed income *Focus on income and quality amid tight spreads and rising risk premiums*

- Maintain a bias toward investment grade credit with solid fundamentals and stable cash flows
- Selectively extend duration to hedge against slower growth and potential market volatility
- Consider emerging market debt and preferreds as diversifiers, as Fed easing supports carry strategies
- Healthy leverage and interest coverage suggest contained default risk, supporting active high yield exposure

Alternatives *Diversify through real assets and less correlated return streams*

- Target private real estate in sectors benefiting from secular demand: data centers, healthcare, residential, and logistics
- REITs remain compelling amid falling yields and defensive rotation
- Prioritize real return and multi-strategy alternatives to hedge against sticky inflation and policy volatility

Implementation

- Quality-biased active managers
- Active small-cap strategies
- Active global and emerging market strategies

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

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

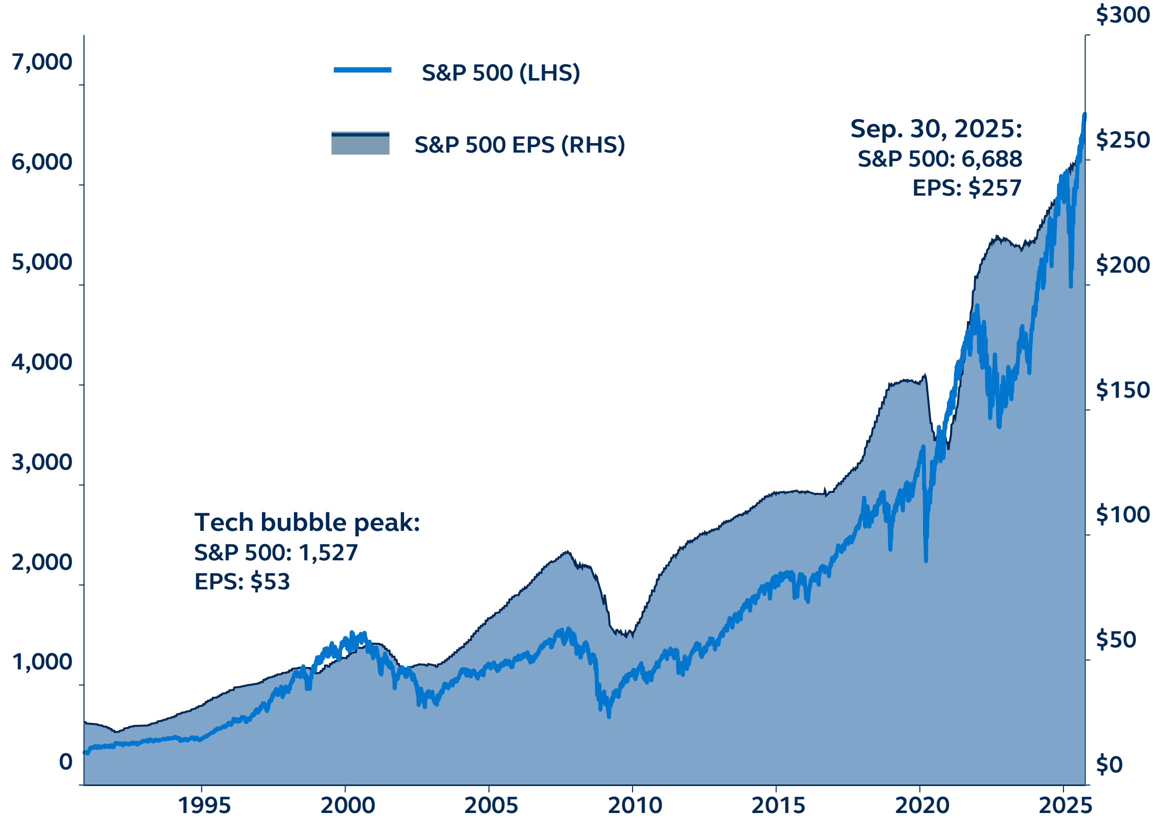
Equities

U.S. equities: Boosted by policy support and AI capex

Despite lingering risks, the combination of policy support and a non-recessionary rate-cutting cycle points to a constructive outlook for 2026 earnings and equity performance.

The stock market and earnings

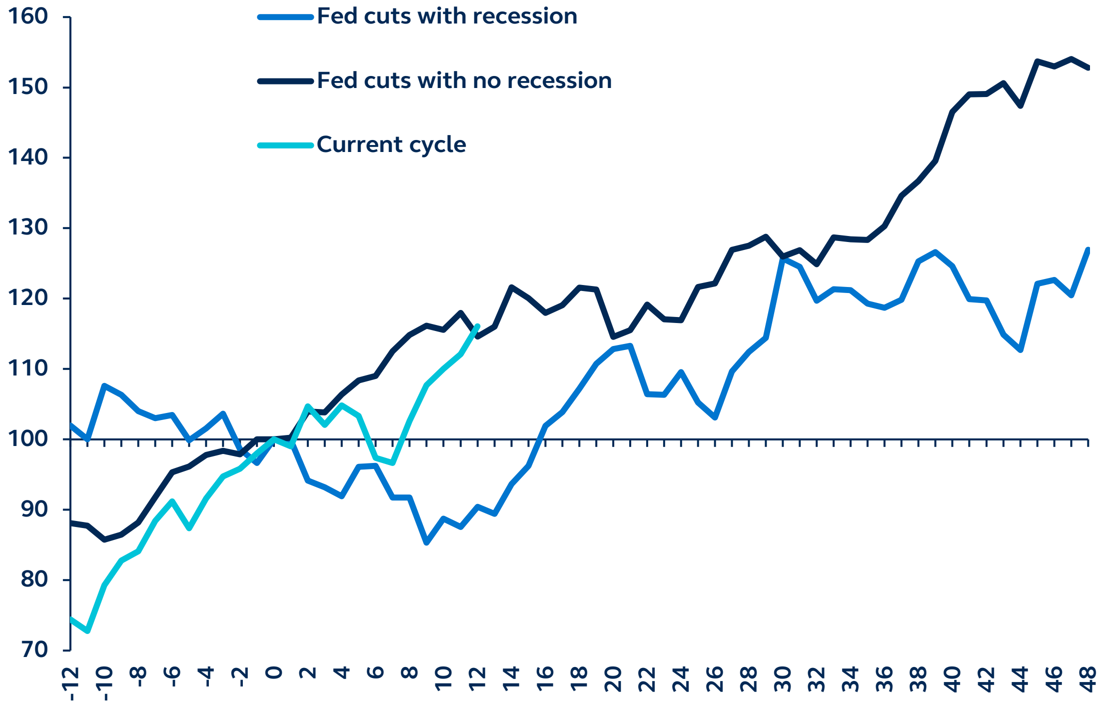
S&P 500 Index price and trailing earnings-per-share, 1990–present



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

S&P 500 performance around Fed cuts in recessionary and non-recessionary environments

Median S&P 500 performance after Fed cuts rates since 1970, month 0 = first cut



Note: COVID excluded from analysis.
Source: Bloomberg, Principal Asset Management. Data as of September 30, 2025

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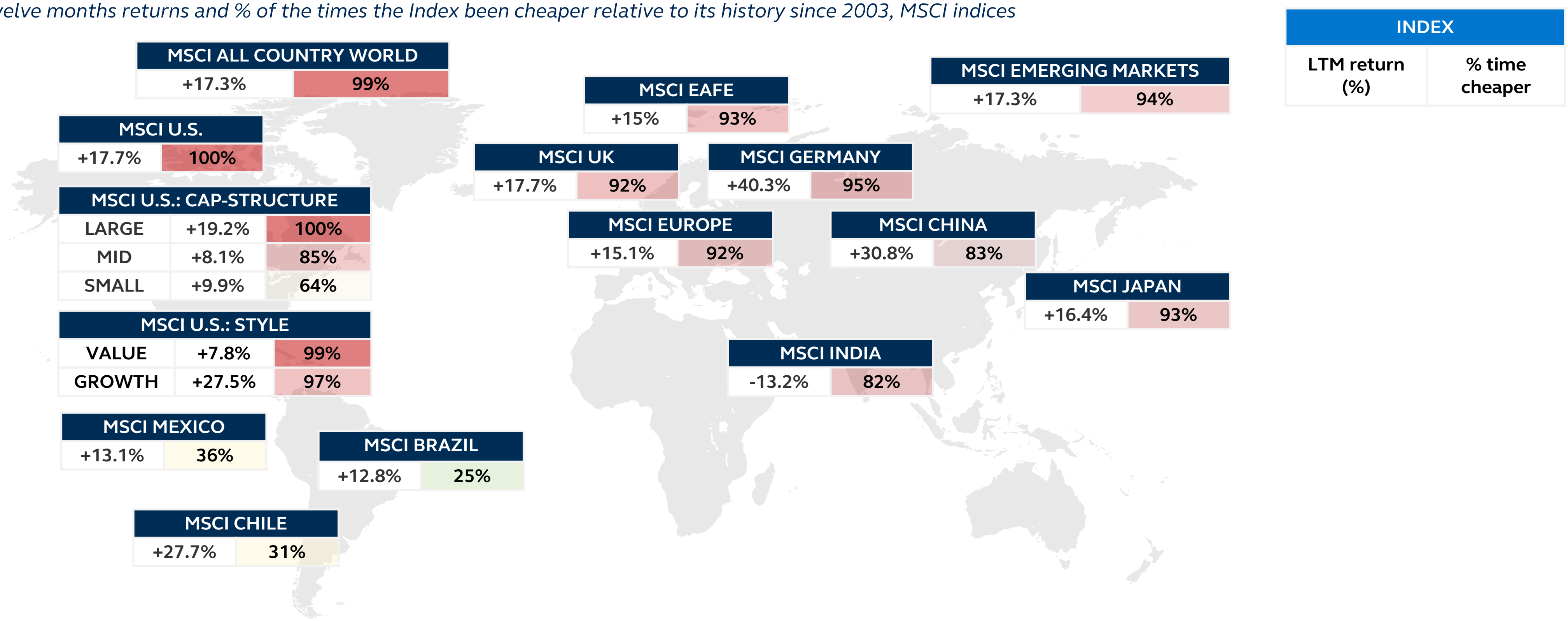
Global valuations

Global equities have rallied since April, but with valuations stretched, future gains will hinge on earnings delivery in the U.S., new catalysts in Europe, and supportive policy in EM.

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 September 30, 2025.

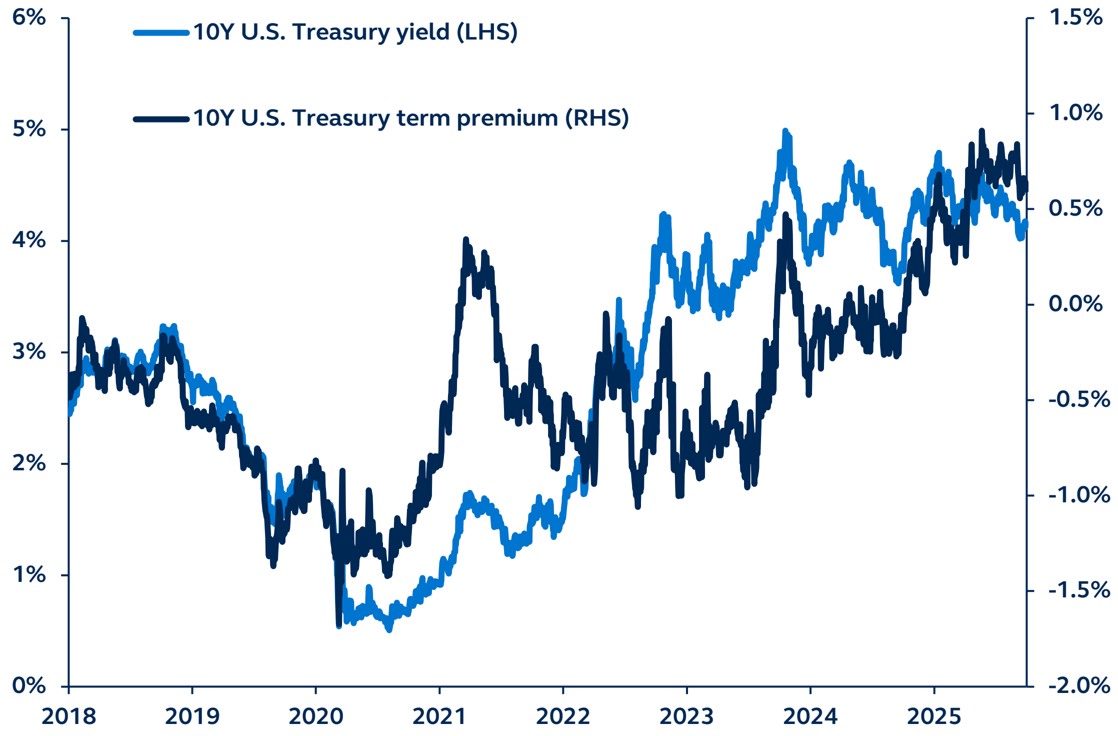
Fixed income

Higher risk premiums pose a challenge to U.S. Treasurys

Despite subdued inflation and Fed easing, rising risk premiums tied to fiscal and institutional concerns suggests limited scope for a sustained decline in long-term rates.

10-year U.S. Treasury term premium vs. yield

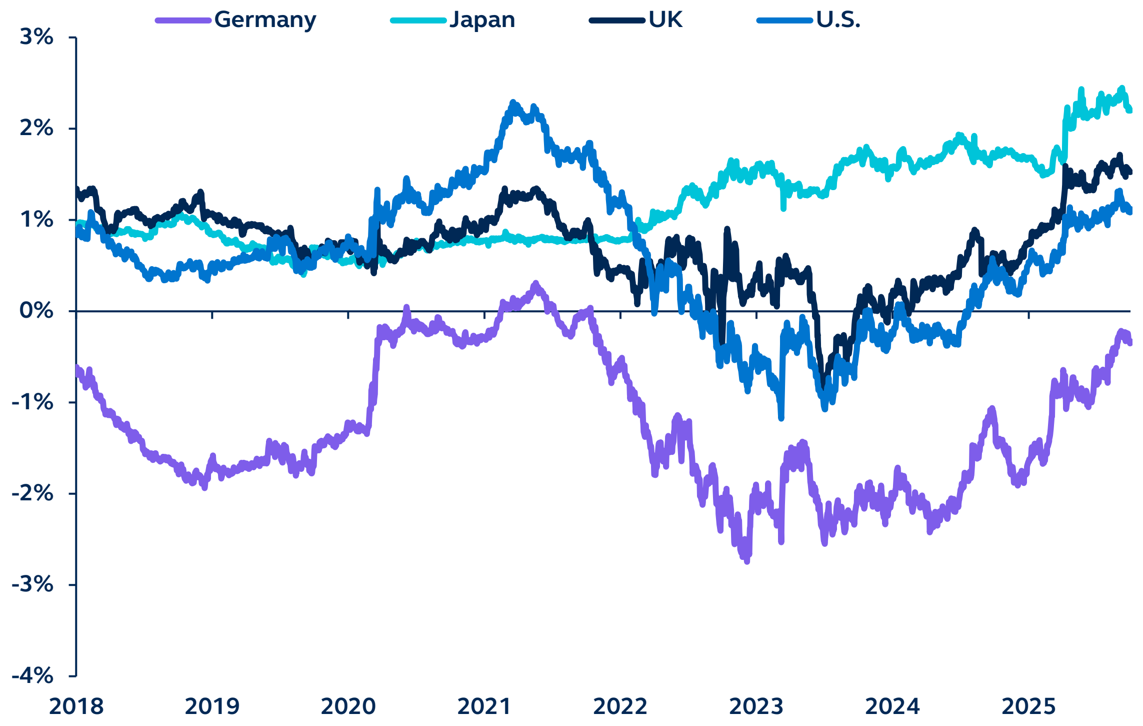
January 2018–present



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

Global sovereign yield spread

30-year yield minus 2-year yield, January 2018–present



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

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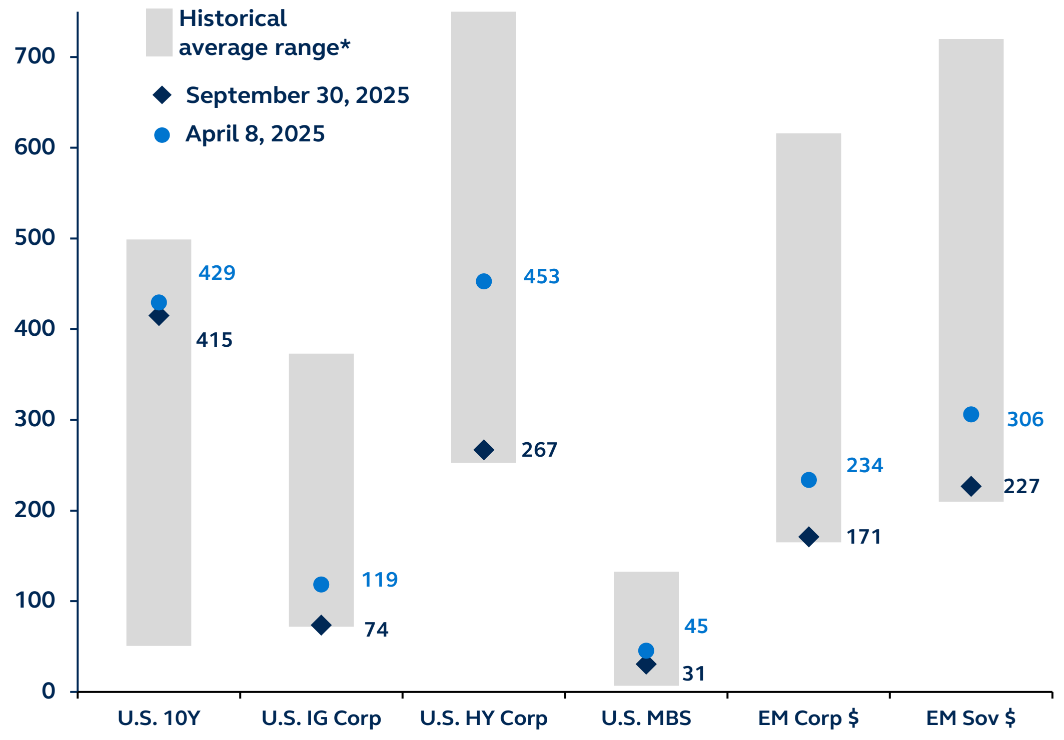
Corporate credit: Riding the robust macro tailwinds

Robust corporate fundamentals and pro-growth policies support a constructive credit outlook, though tight spreads put focus on relative value and income opportunities.

Historical spread range over the past 10 years

Yield and option-adjusted-spread, basis points, 2015–present

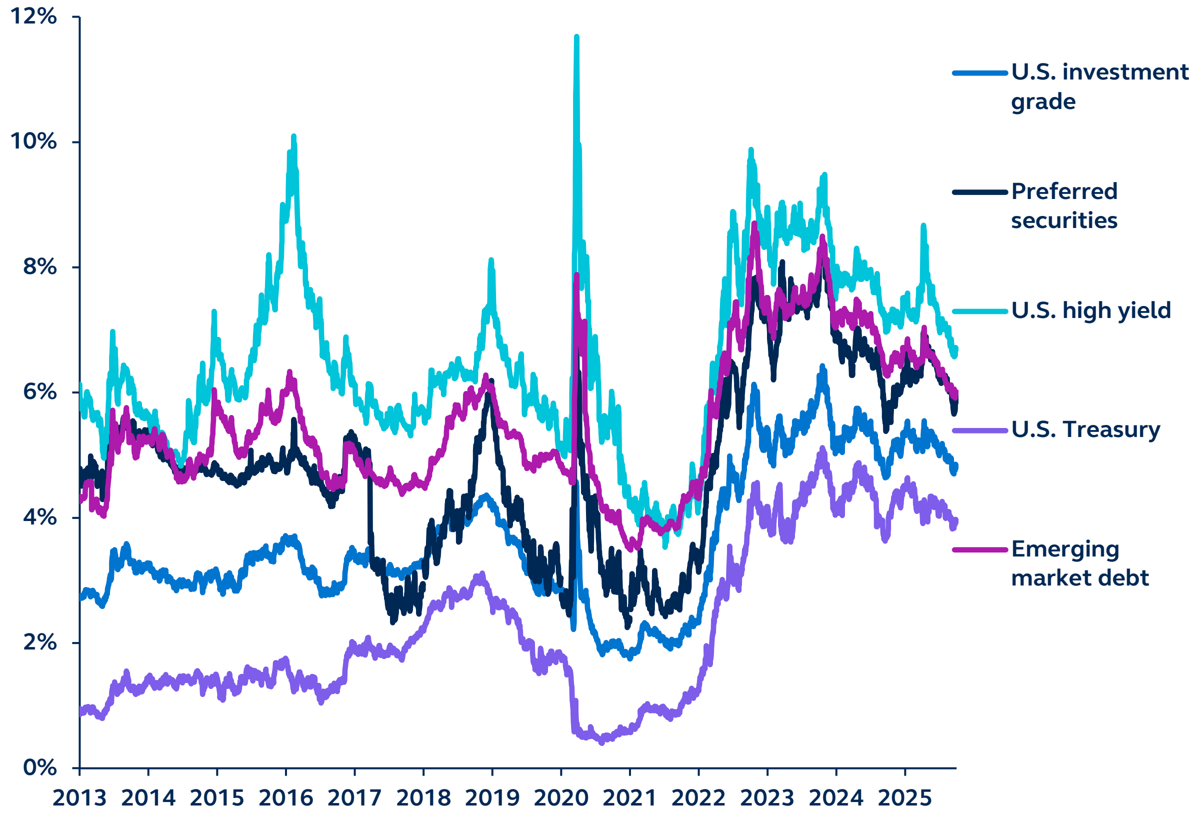


*The historical average range represents the maximum and minimum yield or OAS values over the past 10 years for each asset class. U.S. HY Corporates widened to 1100bps in March 2020.

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

Yield comparison

Yield-to-worst, 2013–present



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

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