Market Outlook – Asset Class 3Q 2022

Equities

Neutral

- With supply bottlenecks persist, high inflation denting consumer confidence, and tighter financial conditions, the global economy may continue to slow in the coming months
- As geopolitical tensions continue and Chinese demand recovers, commodity and food prices may continue to add upward pressure on global and US inflation
- Global central banks are likely to continue to pursue a tightening stance despite rising uncertainties. Financial conditions are heading into the "tight" zone from neutral
- Global equity valuations have cheapened and come down closer to fair value. Earnings revisions may stay negative with the global economy on the downside and inflation elevated
- Retail investors expectations remain in deep oversold territory. There is a chance for a bear market rally. But once recession fears rise sharply, the stock market may pull back significantly

Fixed Income

Neutral

- Government yields are likely to remain elevated in the third quarter before real interest rates retracting later this year due to worsening economic conditions
- As the Fed continues to raise interest rates significantly towards the middle to end of the rate hike cycle, yield curve inversion may be inevitable
- Given fundamentals still solid and low default rate expectations, there might be limited room for spreads to widen further from the current fair value zone

Overweight **Slightly Overweight** **Neutral** **Slightly Underweight** **Underweight**

Source: Principal Asset Management Company (Asia) Ltd.

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Market Outlook – Equities 3Q 2022

U.S.

Neutral

- As fiscal support is set to generally decline in 2022 and 2023, tighter monetary policy by the Fed to stabilize price in times of high inflation may exert further pressure on economic growth, and even lead to an early recession
- Valuation of US equities is not attractive compared to other global major markets
- S&P 500 companies have increased the pace of share buybacks as market declines depress stock prices. The amount is expected to hit a record this year, which may boost earnings per share

Eurozone

Slightly Underweight

- Given supply chain tensions and direct impact from the reduction in Russian oil supply, Eurozone inflation pressures may not be quickly eroded in the future. The European Central Bank may have to deliver its first rate hike in more than a decade and further normalization is expected. The era of monetary policy normalization will come and financial conditions in the region will likely tighten
- With this higher inflation and lower growth outlook, the Euro area is the key developed market economy facing prominent stagflation risk
- As tensions between Russia and Ukraine continue, earnings expectations are likely to face more pressure amid falling PMIs with increasing costs

Asia ex-Japan

Slightly Overweight

- Asia in general has limited direct trade links to Russia and Ukraine. The spillover effects will be limited to the commodity price channel and to indirect impacts via weaker demand from key trading partners
- Despite higher inflationary pressure caused by sharp increase in food and energy price, Asian central banks likely tighten at a less aggressive pace compared to developed countries with limited wage increase and currency depreciation
- The reopening of ASEAN countries accelerates, while China continues to introduce measures to stabilize economy, which may lead to the pickup of the domestic economy and the recovery of trades

Japan

Slightly Overweight

- Faced with relatively weak economy and controlled inflation, the Bank of Japan will likely remain the only major central bank to maintain ultra-loose monetary policy
- Japan's government has tweaked the wording around its balanced budget commitment to gain more fiscal flexibility to shore up its economic recovery
- Valuation of Japan equities is relatively attractive. The current backdrop of elevated inflation and major central banks tightening are supportive for value investing like Japanese equities

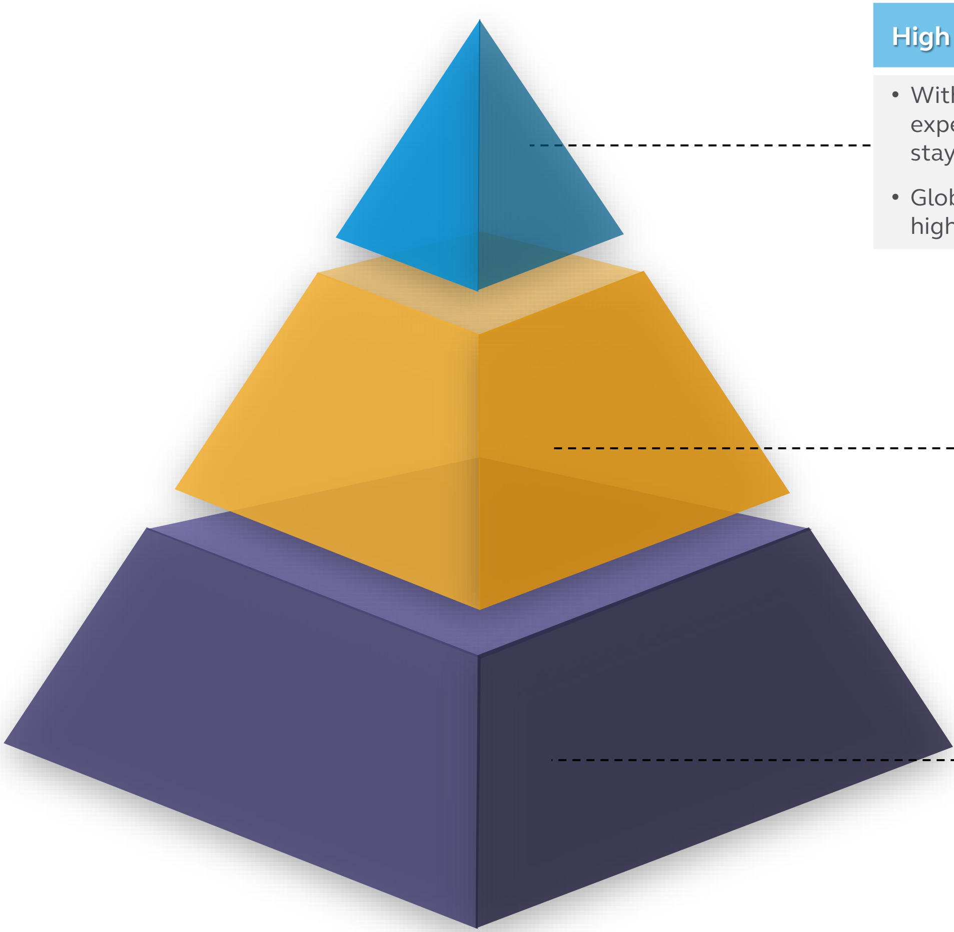
HK (Slightly Overweight) / China (Neutral)

- As the central government further implements economic stimulus measures, and individual cities such as Shanghai reopens, China's economy is expected to be better in the second half of the year than the first half. Fiscal and monetary policies remain accommodative. With investors sentiment improves, it may benefit HK and China equities
- Hong Kong equities become more attractive based on PB at historical lows and A/H Shares Premium above 10-year average. There may be greater upside potential for Chinese stocks listed in Hong Kong

Overweight | **Slightly Overweight** | **Neutral** | **Slightly Underweight** | **Underweight**

Source: Principal Asset Management Company (Asia) Ltd.
The geographical classification of above listed equity markets is based on MSCI 2021 annual market classification review.
For more information, please refer to https://www.msci.com/market-classification

Market Outlook – Fixed Income 3Q 2022



High Yield

- With strong corporate fundamentals backdrop, expectations for 12-month forward defaults is likely to stay below the historical average
- Global economic slowdown may pose threats to the high yield market and limit total returns

Investment Grade

- Rising Treasury yield may pose headwinds to investment grade corporate bonds which generally have longer duration
- Corporate spreads have widened into fair value zone. The technical picture remains challenging given market volatility
- The hunt for yield in corporate bonds from investors remains strong

Sovereign

- Treasury yields may still go higher as high inflation and tight labor markets may inhibit the Fed from decelerating the pace of policy tightening in the short term
- With markets increasingly pricing in an aggressive rate hike cycle and recession risks, Treasury yields may peak later this year

Overweight | Slightly Overweight | Neutral | Slightly Underweight | Underweight

Source: Principal Asset Management Company (Asia) Ltd.

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