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Principal Hong Kong
2022 2H Economic and Asset Allocation Outlook

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Principal Hong Kong today released the 2022 2H Economic and Asset Allocation Outlook, in which Ms. Crystal Chan, Head of Investment Specialist, Principal Asset Management Company (Asia) Limited shares her views on the global economy, inflation trends and more.

Global Economy

With bottlenecks in the supply chain persisting, high inflation denting consumer confidence, and the tightening of financial conditions, the global economy may continue to slow in the coming months. Global growth rate may settle at about 3% in 2022.

U.S.: The economic growth rate may slow to below the long-term trend in the second half of the year. However, supported by relatively high levels of savings, consumer demand and business investment, the U.S. economy may be more resilient than the other developed markets. Our base case is that recession risks may not rise sharply until the second half of 2023 or in early 2024.

Europe: Among the major economies, we are more pessimistic on Europe. With high inflation, the era of negative interest rates may end quite soon. If the Russia-Ukraine conflict drags on, the probability of a recession before the end of the year may rise rapidly.

China: The economy is expected to improve in the second half of the year. The central government may continue to accelerate the intensity of economic stimulus measures. Instead of conventional monetary tools, the central government may focus on fiscal front or supportive policies for individual industries to stabilize economic development. However, with the risk of a resurgence of cases, the economic growth rate may be impacted negatively again if the zero-Covid policy remains the place. Coupled with weakening external demand, the full-year growth rate may fall short of the 5.5% target.

Inflation

While oil and food prices stay high, the decline in inflation is expected to be extremely slow. Before the end of the year, the U.S. CPI may only fall slightly to about 6%. The Fed may continue to hike quite aggressively to fight inflation. Benchmark rates may reach at least 3.25% by year-end. U.S. inflation may decline to a greater extent in 2023 and return to about 3% by the end of next year.

Stock Market

As the market has accumulated some losses, there is a chance for a bear market rally backed by extreme oversold and relatively reasonable fundamentals. However, once the economic data turns distinctly worse and recession fears rise sharply, the stock market may pull back significantly again. Overall, we maintain neutral on equities. Among them, we are slightly bullish on Asia, Japan and Hong Kong. While neutral on the U.S. and China, we are slightly bearish on Europe.

Under the interest rate hike cycle, the trend on value investment may continue with relevant sectors being benefited. In addition, large companies with relatively high dividends and better defensiveness may be able to shield against market uncertainties.

Bond Market

Although valuations are relatively reasonable, the Fed may not be able to slow the pace of policy tightening in the short term, real rates and overall bond yields may remain high in the third quarter. Our view on sovereign bonds is neutral. As for investment-grade bonds, even though total returns may be affected by higher bond yields, backed by relatively solid corporate fundamentals, our view is neutral.

Foreign Exchange

The U.S. dollar remains strong owing to the geopolitical risks in Russia and Ukraine along with the tightening of monetary policy by the Fed. The degree of deviation between the monetary policies of the United States and other major central banks has the potential to further widen, especially relative to Japan and China. The U.S. dollar interest rate is relatively high or continues to benefit from arbitrage trading. On the other hand, the global economy is in a downward cycle, financial conditions may return to the contraction zone in the relative short term. The current condition of the U.S. economy is still relatively stable. Coupled with a high level of risk aversion, a series of factors have the potential to continuously push up the U.S. dollar index. Accordingly, the U.S. exchange index could possibly hit 108 before the end of the year.

Summary of Analysis

- **The US economy may slow down in the second half of the year, possibly higher recession risk in Europe within the year.**
- **China's economy in 2H is expected to improve compared to 1H. However, the pandemic poses a structural risk.**
- **Oil and food prices stay high, while the U.S. inflation rate may fall slightly to about 6% by year-end.**
- **The Fed's benchmark rates may reach 3.25% by year-end, while the interest rate hike cycle may end by mid-2023.**
- **Maintain neutral stance on equities. There is a chance for a bear market rally and pull back again.**
- **Slightly overweight on Asia, Japan and Hong Kong. Pay attention to value and defensive sectors.**

- **An inversion of the 3-month and 10-year Treasury yields curve by end of the year. Remain neutral stance on fixed income overall.**
- **The U.S. Dollar Index may climb up to 108.**

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About Principal

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Media enquiries, please contact:

Principal Investment & Retirement Service Limited
Ms. Cissie Tang | 2263 0282 | tang.cissie@principal.com
Senior Manager, Marketing & Corporate Communications
Ms. Teaki Keung | 2263 0286 | keung.teaki@principal.com
Assistant Manager, Marketing & Corporate Communications

Edelman Public Relations Worldwide
Ms. Vicky Lo | 2837 4786 | vicky.lo@edelman.com
Ms. Sonia Leung | 2837 4721 | sonia.leung@edelman.com