Principal Hong Kong
1Q 2024 Market Outlook

1Q 2024 Global Asset Allocation Viewpoints

Key themes for 1Q 2024

- **Global growth is coming off the boil.**
  Economic growth is now cooling as global monetary tightening gradually takes its toll. U.S. recession risk has diminished, although consumer headwinds are rising. China and Europe are likely to see another year of tepid growth.

- **Global disinflation continues unabated.**
  Price pressures have eased significantly, largely due to resolved supply chains. The last mile of disinflation toward central bank targets may require some economic slowdown and job market weakness.

- **A central bank pivot is upon us.**
  Most central bankers have now adopted a more dovish stance and rate cuts are likely in 2024. Yet, they may come slightly later than markets anticipate and will likely be gradual—unless economic growth surprises to the downside.

- **Equities will likely see volatility in H1 followed by a rally in H2 as policy easing arrives.**
  Falling bond yields have driven a sharp market rally, but this can only be sustained if earnings deliver. An economic slowdown in H1, coupled with slightly later than expected rate cuts, suggest some volatility.

- **Fixed income credit spreads are very tight going into an economic slowdown.**
  Rate cuts failing to materialize may drive extended U.S. Treasury disappointment in 1Q. Higher-quality credit should perform better than lower-quality credit as the economy slows, and as the maturity wall becomes more pressing.

- **Alternatives provide important diversification against traditional equities and fixed income.**
  Commodities are facing an unclear near-term future as investors weigh up geopolitical risks versus greater U.S. oil supply. With real bond yields likely having peaked, REITs are facing a much brighter outlook.

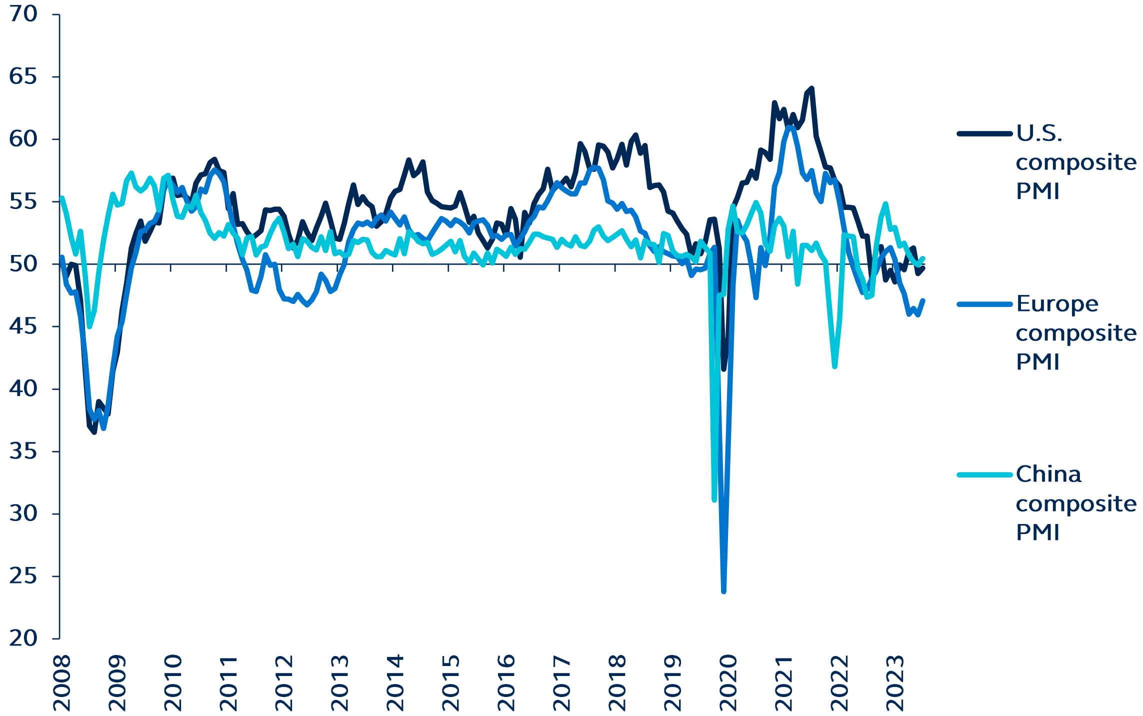
Asset allocation	Investment preference Less <<		Neutral		>> More
Equities	○	○	●	○	○
Fixed income	○	○	●	○	○
Alternatives	○	○	●	○	○
Equities					
U.S.	○	○	◌	→ ●	○
Large-cap	○	○	○	●	○
Mid-cap	○	○	●	○	○
Small-cap	○	◌	→ ●	○	○
Ex-U.S.	○	●	○	○	○
Europe	○	●	○	○	○
UK	○	●	○	○	○
Japan	○	○	● ←	◌	○
Developed Asia Pacific ex-Japan	○	○	●	○	○
Emerging markets	○	○	● ←	◌	○
Fixed income					
U.S.	○	○	●	○	○
Treasurys	○	○	●	○	○
Mortgages	○	○	● ←	◌	○
Investment grade corporates	○	○	○	●	○
High yield/Senior loans	○	○	●	○	○
Preferreds (debt & equity)	○	●	○	○	○
TIPS	○	○	●	○	○
Ex-U.S.	○	○	●	○	○
Developed market sovereigns	○	○	●	○	○
Developed market credit	○	○	●	○	○
Emerging market local currency	○	○	○	●	○
Emerging market hard currency	○	○	●	○	○
Alternatives					
Infrastructure	○	○	●	○	○
REITs	○	○	◌	→ ●	○

Global economic growth comes off the boil

The global economy is cooling now as monetary tightening gradually takes its toll. This may drain out the most stubborn of price pressures, opening the door to global policy easing.

Developed market and China Purchasing Managers' Index (PMI)

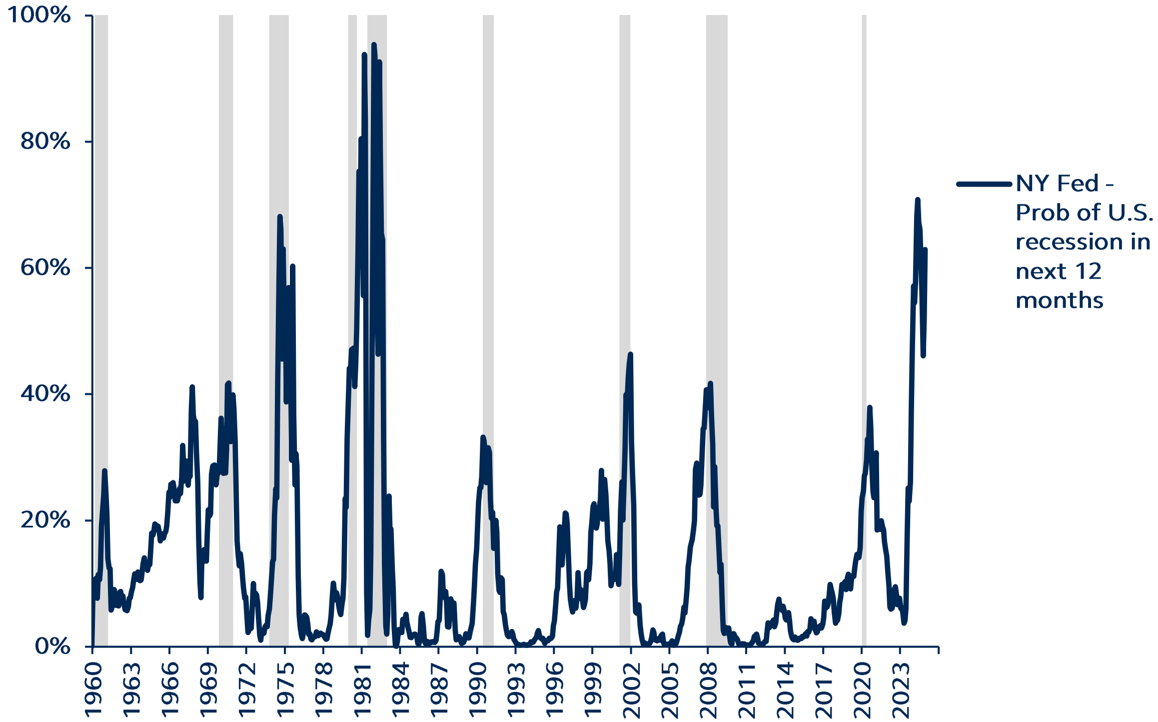
May 2008–November 2023



Source: Bloomberg, Principal Asset Management. Data as of November 30, 2023.

U.S. recession probability in the next 12 months

Federal Reserve Bank of New York, Recessions are shaded, January 1960–present



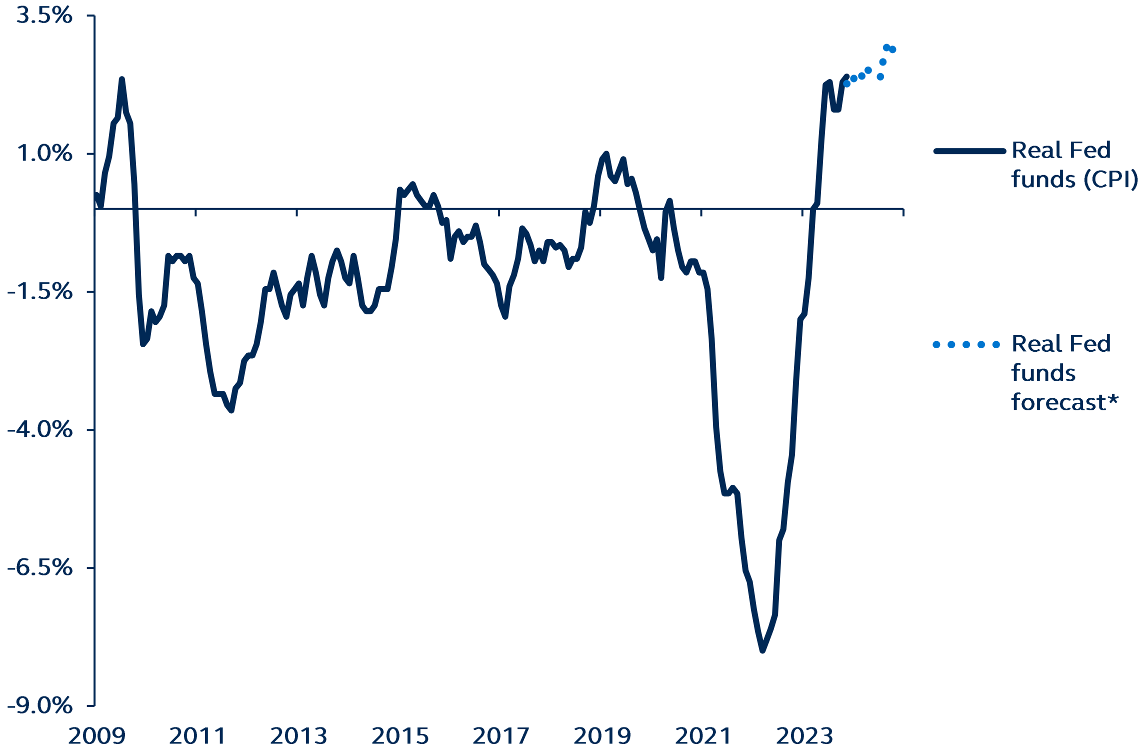
Source: Federal Reserve Bank of New York, Bloomberg, Principal Asset Management. Data as of December 31, 2023

Central banks: pivot, *pivot*, *PIVOT*

Fed policy rates are set to fall in 2024. Clear evidence that inflation has been tamed likely needs to emerge before cuts can commence, likely around mid-year.

Real Fed funds rate

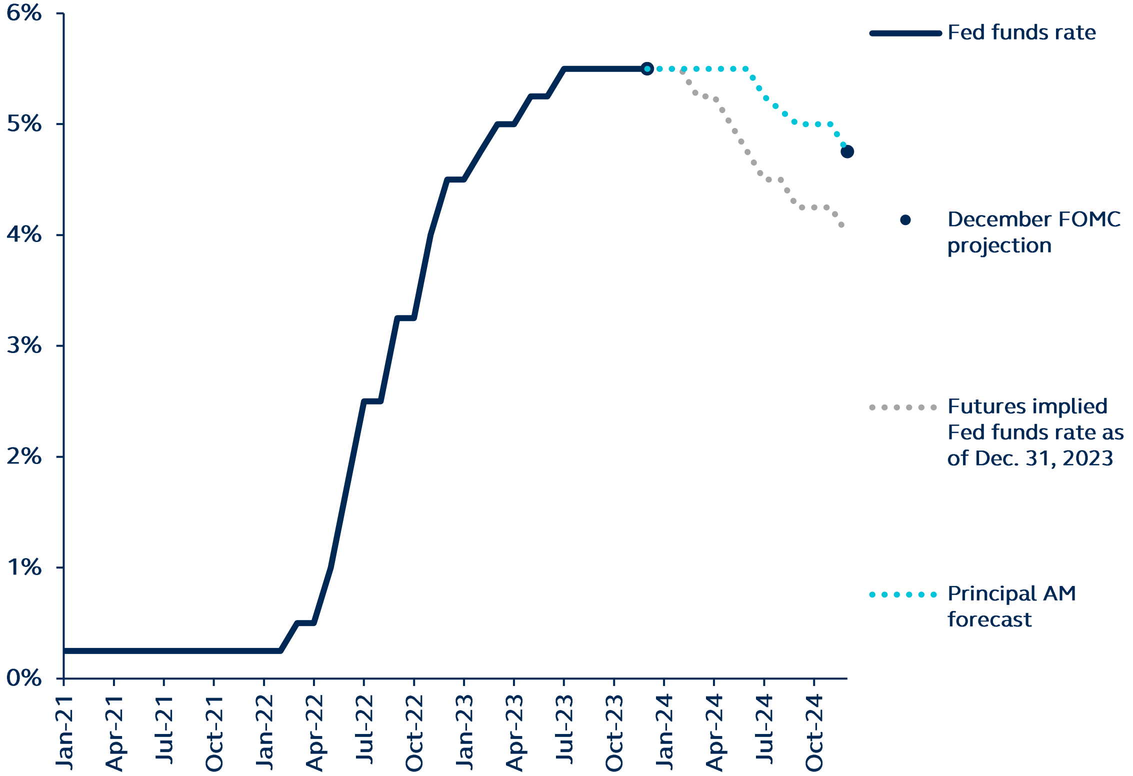
January 2009–present



*Assuming Fed funds held at 5.5% and using Headline CPI forecast.
Source: Federal Reserve, Bureau of Labor Statistics, Bloomberg, Principal Asset Management. Data as of December 31, 2023.

Federal Reserve policy rates path

Fed funds rate and projections, 2021–present



Source: Federal Reserve, Bloomberg, Principal Asset Management. Data as of December 31, 2023.

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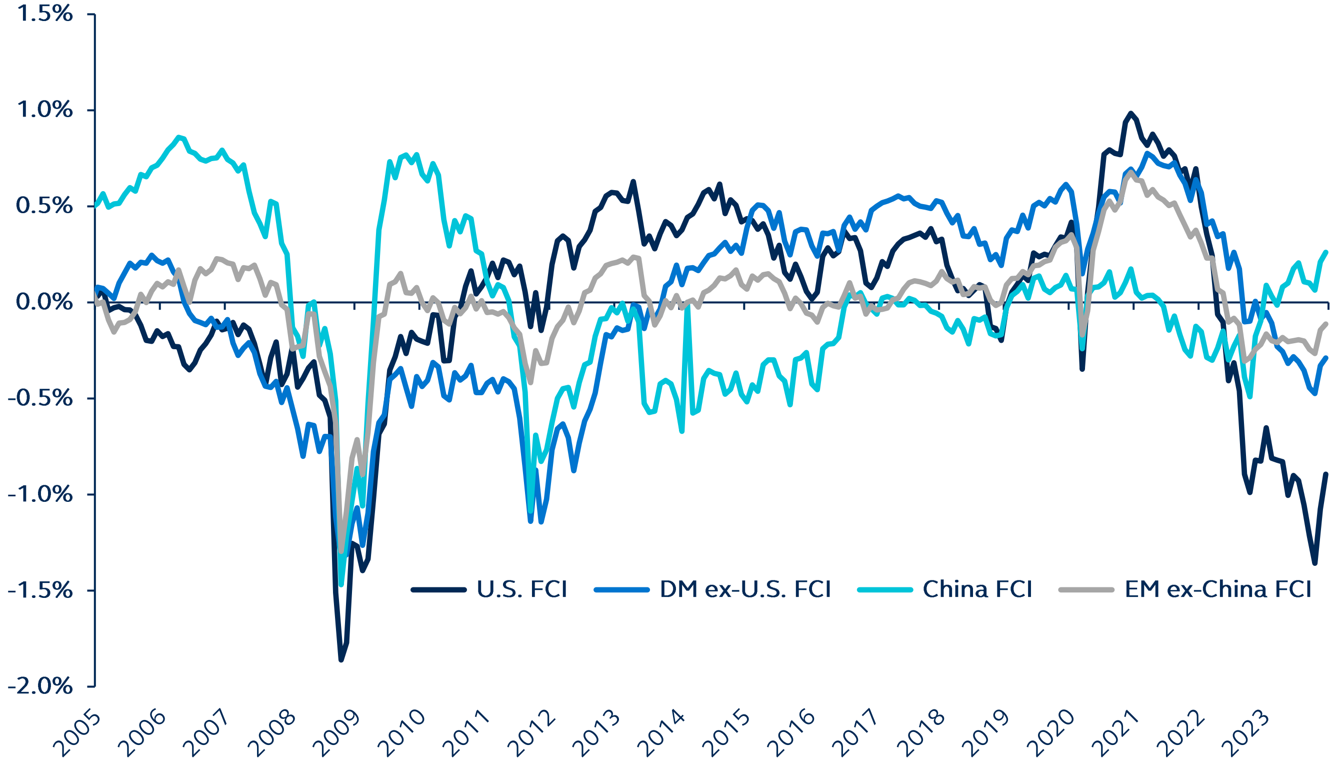
A shift in financial conditions sets up a constructive 2024

Financial conditions may be volatile in early 2024 amidst market repricing of rate cut expectations. Even so, the general trend for 2024 may be easier financial conditions, suggestive of a generally constructive backdrop for risk assets.

Developed market and emerging market financial conditions

Principal Asset Allocation Financial Conditions Index (FCI), Z-score, 2005–present



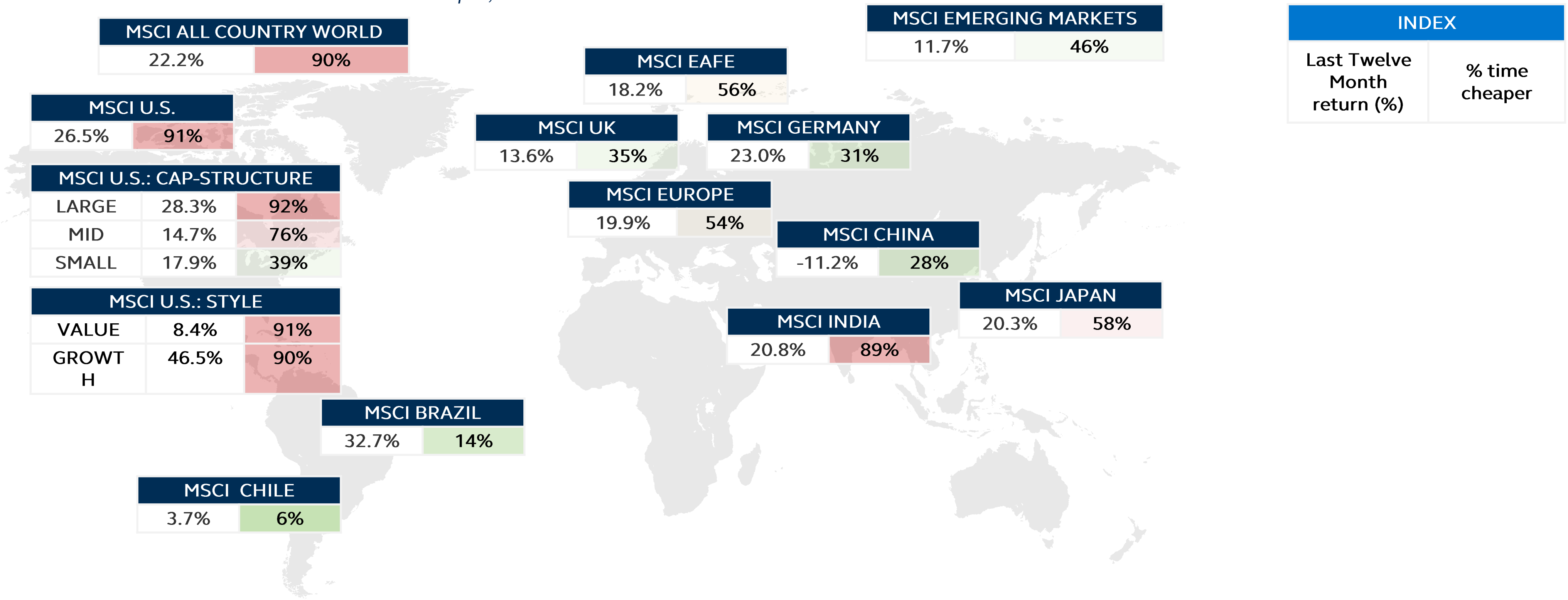
Source: Bloomberg, Principal Asset Allocation. Data as of December 31, 2023.

Global equity valuations remain stretched

Global equity valuations remained stretched. The U.S. remains the most expensive market globally, while Latin America has rarely been cheaper.

Global equity returns and valuations

Last twelve months returns and % times cheaper, MSCI indices

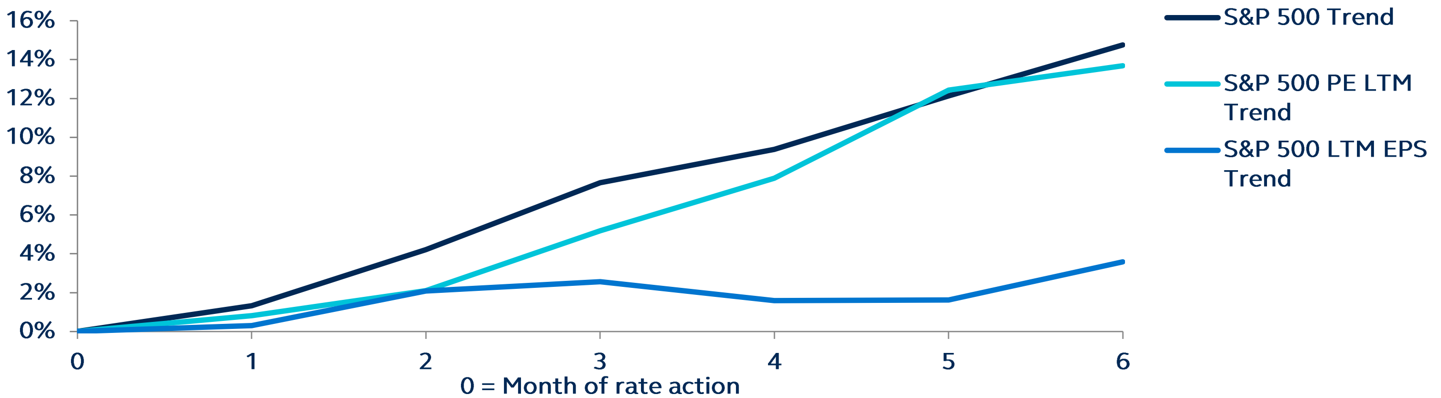


Source: FactSet, Bloomberg, MSCI, Principal Asset Allocation. LTM (last twelve months) returns are total return and in USD terms. % Time Cheaper is relative to PAA Equity Composite Valuation history. PAA Equity Composite Valuation is a calculated measure, comprised of 60% price-to-earnings, 20% price-to-book and 20% to dividend yield. Composite started in 2003. EAFE is Europe, Australasia, Far East. See disclosures for index descriptions. Data as of December 31, 2023.

Equities: Our positioning remains neutral

S&P 500 performance during Fed easing cycles where recession was avoided

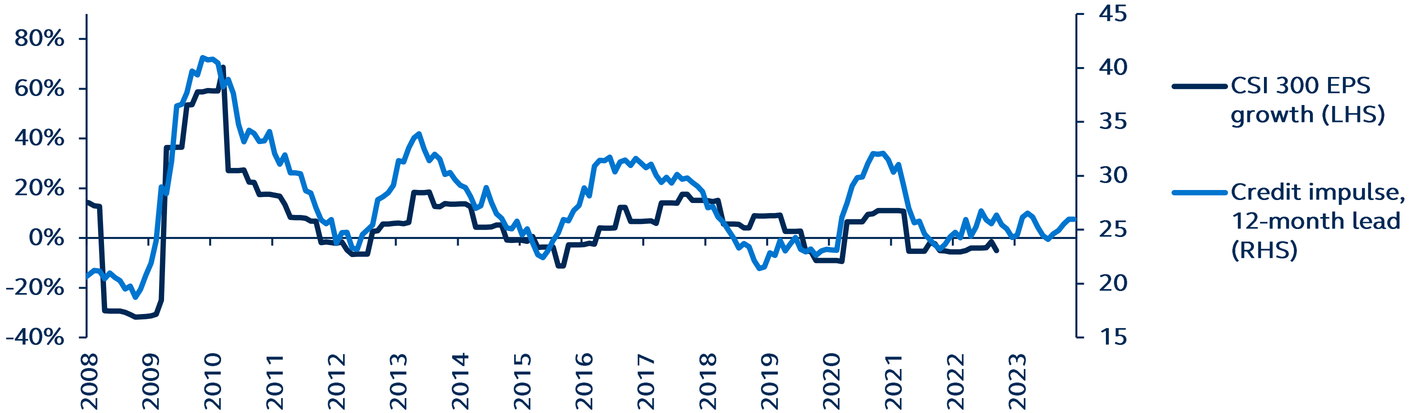
Performance after Fed cuts successfully ward off recession, amidst a moderate inflation environment



**LTM=Last Twelve Month. Note: Pre-emptive and successful Fed cuts in moderate inflation includes periods when Fed cut and there was no recession, it also includes periods when recessions occurred due to unforeseeable incidents (COVID, spiking oil price etc.). Source: Bloomberg, Principal Asset Management. Data as of December 31, 2023.

China credit impulse versus earnings growth

2008-present



Source: Bloomberg, Principal Asset Management. Data as of December 31, 2023.

Rich equity valuations are likely to be challenged in early 2024 as elevated earnings growth expectations are tested by slowing consumer demand and margin pressure. However, in acknowledgement of the improved U.S. outlook and strong potential for rate cuts, we shift U.S. equities to overweight. Within U.S. equities, attractive small-cap valuations and potential for improving growth in 2Q prompt an upgrade to neutral.

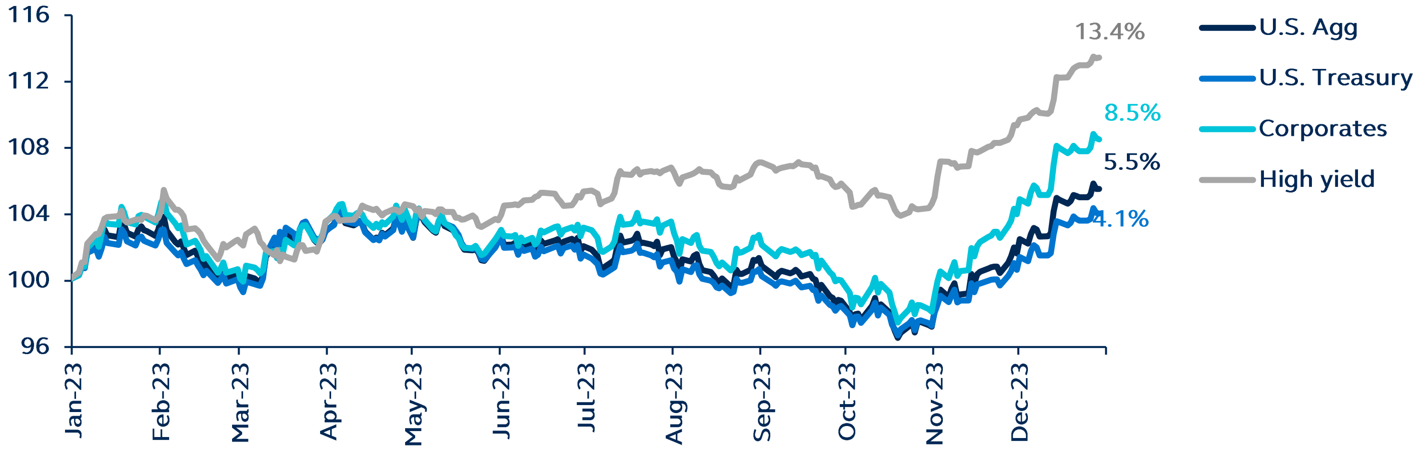
Our exposure to ex-U.S. developed markets remains at an underweight, weighed down by worries about European growth as well as concerns that a rapidly appreciating yen could hurt earnings and trigger profit taking.

We move our EM position to neutral, concerned about China's outlook, but also with tilts towards Latin America as both valuations and fundamentals are attractive.

Fixed income: Our positioning remains neutral

Fixed income asset class performance

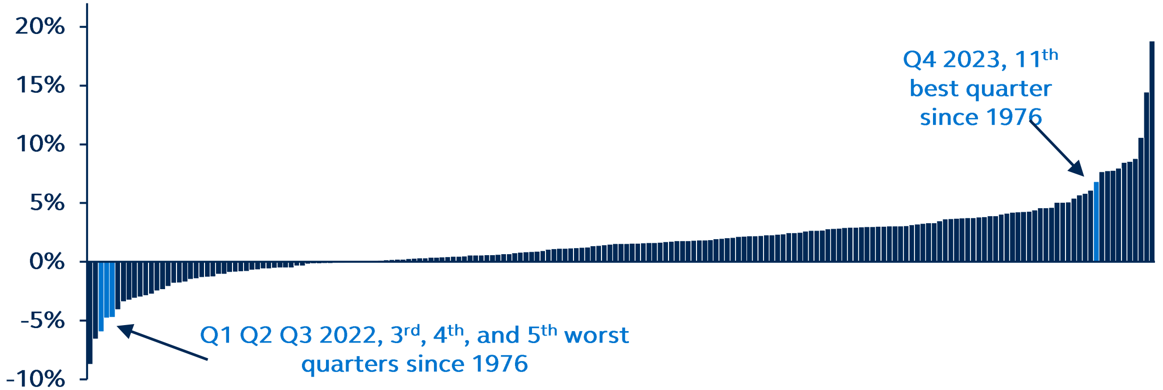
Total return, rebased to 100 at January 1, 2023



Source: Bloomberg, Principal Asset Management. U.S. Agg = Bloomberg U.S. Aggregate Bond Index; U.S. Treasury = Bloomberg U.S. Treasury Index; Corporates = Bloomberg U.S. Corporate Index; High yield = Bloomberg U.S. Corporate High Yield Index. Data as of December 31, 2023.

Bloomberg U.S. Aggregate Index ranked quarterly performance

1976–present



Source: Bloomberg, Principal Asset Management. Data as of December 31, 2023.

Our fixed income positioning also remains at neutral. After a strong 4Q, Treasury yields are likely to remain volatile in 1Q and may even see some upward pressure if rate cut expectations prove optimistic.

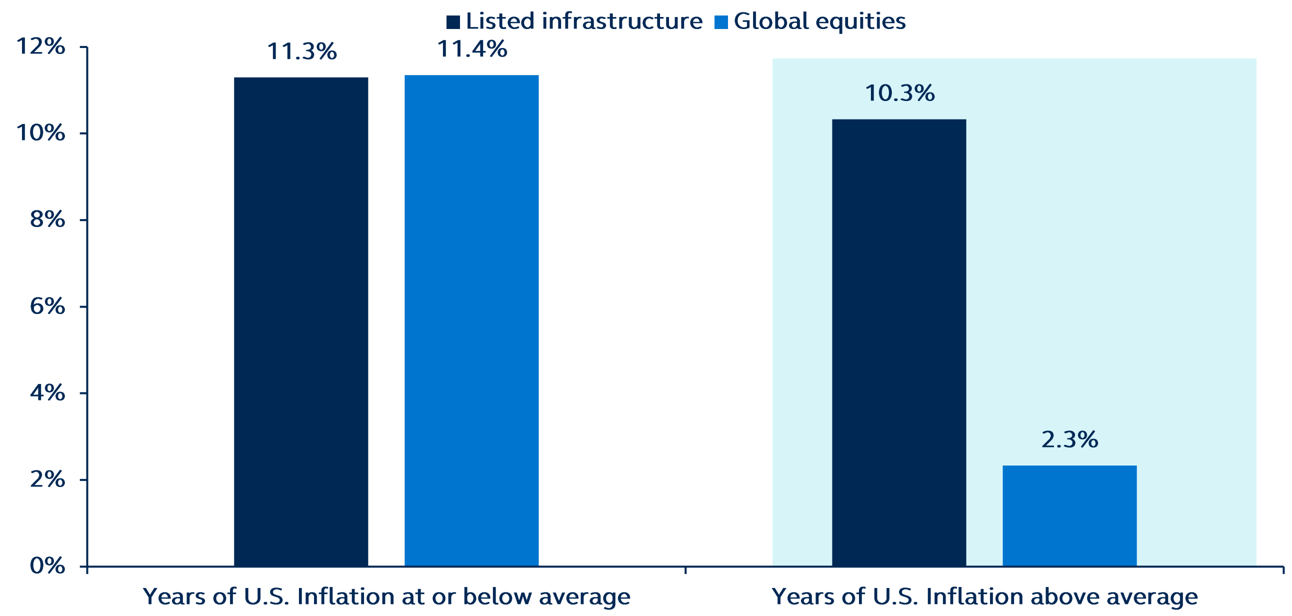
Within credit, we keep our core bonds position at a slight overweight. Investment grade spreads are narrow, but they are supported by resilient economic growth and subdued default risk.

High yield remains at neutral but could be pressured by rising default risks. Local currency emerging market debt remains at an overweight as central bank rate cuts should enhance returns—but we acknowledge that the U.S. dollar is unlikely to provide much of a tailwind, while a deeper than expected U.S. downturn would hurt the outlook.

Alternatives: Our positioning remains neutral

Listed infrastructure versus global equities in differing inflation environments

1993–2023



Note: Global equities is represented by MSCI All Country World Index. Global listed Infrastructure is represented by the MSCI ACWI Utilities Index from 2003 through 2006, a 50/50 blend of MSCI ACWI Utilities Index and the Alerian MLP Index from 2007 through 2015, and the FTSE Global Core Infrastructure 50/50 Index thereafter. Past performance does not guarantee future results. Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index. Source: U.S. Bureau of Labor Statistics, CPI ex-food & energy, FactSet, Principal Asset Management. Data as of December 31, 2023.

Infrastructure remains at neutral given the more resilient economic backdrop and continued disinflation trend, while it should benefit from its equity beta.

REITs valuations have improved significantly and, with real yields having peaked, there is a strong case for a REITs overweight.

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