

Principal Global Investors  
Morley Capital Management

# Economic and market review

1Q 2021 | As of March 31, 2021



Morley Capital Management (Morley), a specialized investment boutique of Principal Global Fixed Income.

# Key themes for 2Q 2021

## Fiscal stimulus, monetary policy, and vaccine rollout can accelerate recovery

- **Successful vaccine rollout likely to instill confidence in recovery and risk assets**  
Despite winter lockdowns, confidence in vaccine success is driving positive momentum for economic recovery and equities
- **Largest U.S. fiscal injection since WWII has boosted world economy**  
U.S. fiscal stimulus providing consumers with the ability to spend while the reopening provides the opportunity. We should see meaningful positive spillovers to global GDP growth
- **Transitory inflation imminent and Fed resolved to let economy heat up**  
Base effects and supply/demand imbalances could temporarily drive up inflation
- **Sovereign bond yields could drift higher against a backdrop of stronger growth**  
We prefer to reach our yield targets by going down in quality vs extending duration in this current yield environment

# What impact have we seen on global index returns?

## A change in leadership across stock and bond markets

	3-months	1-year	3-year	5-year	10-year
<b>Fixed Income</b>					
B of A ML U.S. Treasury Bill 3-month Index	0.03%	0.12%	1.52%	1.23%	0.65%
Bloomberg Barclays Aggregate Bond Index	-3.37%	0.71%	4.87%	3.30%	4.02%
Bloomberg Barclays U.S. Corp High Yld 2% Issuer Capped Index	0.86%	23.65%	7.30%	9.45%	8.72%
Bloomberg Barclays Long-Term Govt/Credit Index	-4.28%	0.86%	5.25%	3.60%	4.38%
<b>U.S. Equities</b>					
Russell 1000 Value Index	11.26%	56.09%	12.21%	14.84%	18.37%
S&P 500 Index	6.17%	56.35%	19.75%	22.54%	26.79%
Russell 1000 Growth Index	0.94%	62.74%	28.39%	31.98%	36.58%
Russell Midcap Index	8.14%	73.64%	17.01%	19.66%	22.38%
Russell 2000 Index	12.70%	94.85%	17.05%	22.65%	20.19%
<b>Non-U.S. Equities</b>					
MSCI EAFE NTR Index	3.48%	44.57%	6.39%	10.65%	7.11%
MSCI ACWI Ex USA Index	3.49%	49.41%	6.94%	11.86%	6.18%
MSCI Emerging Markets Index	2.29%	58.39%	6.90%	15.35%	4.32%
<b>Other</b>					
MSCI U.S. REIT Index	8.50%	36.13%	8.87%	4.35%	10.07%
S&P GSCI® Index	13.55%	50.22%	-4.69%	1.21%	-5.93%
U.S. Dollar Index	-3.52%	-5.45%	-1.14%	-1.89%	1.39%

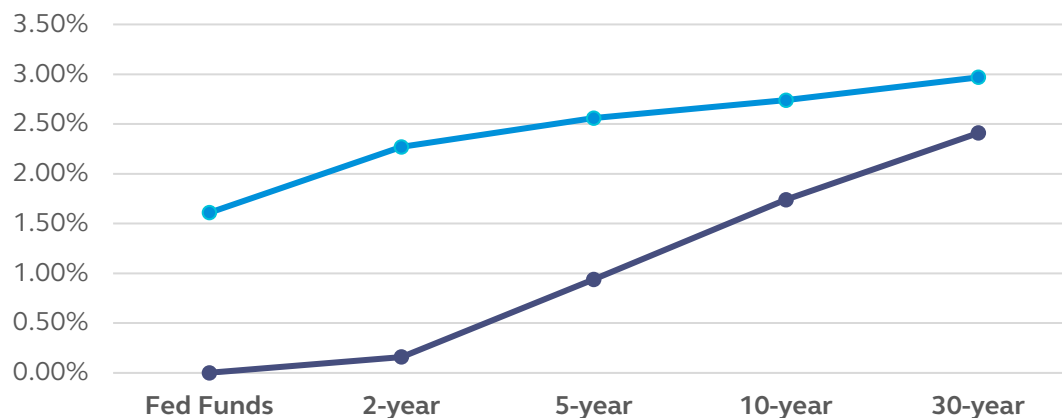
As of 3/31/2021

Source: FactSet. Returns are annualized. **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. See Important Information for index descriptions.

# The history of interest rates

How have interest rates changed in recent years?

	Mar. 31, 2018	Mar. 31, 2019	Mar. 31, 2020	Mar. 31, 2021
<b>2-year</b>	2.27%	2.26%	0.25%	0.16%
<b>5-year</b>	2.56%	2.23%	0.38%	0.94%
<b>10-year</b>	2.74%	2.41%	0.67%	1.74%
<b>2- to 10-year spread</b>	0.47%	0.15%	0.42%	1.58%
<b>30-year</b>	2.97%	2.81%	1.32%	2.41%



Mar. 31, 2021

0.00%    0.16%    0.94%    1.74%    2.41%

Mar. 30, 2018

1.61%    2.27%    2.56%    2.74%    2.97%

# Asset Class Returns as of March 31, 2021

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD
Best	Emerging Markets 39.42%	Government Treasury 24.03%	Emerging Markets 78.51%	Real Estate 28.60%	Government Treasury 29.93%	Emerging Markets 18.23%	Small Cap 38.82%	Real Estate 31.78%	Real Estate 4.23%	Small Cap 21.31%	Emerging Markets 37.28%	Cash 1.88%	Large Cap 31.49%	Small Cap 19.96%	Mid Cap 13.47%
	Commodities 16.23%	Intl Bonds 11.40%	High Yield 56.28%	Small Cap 26.85%	Real Estate 9.24%	Mid Cap 17.86%	Mid Cap 33.50%	Government Treasury 25.07%	Large Cap 1.38%	Mid Cap 20.74%	Intl Stocks 25.03%	Intermediate Bond 0.01%	Mid Cap 26.20%	Large Cap 18.40%	Small Cap 12.70%
	Intl Bonds 11.30%	Intermediate Bond 5.24%	Mid Cap 37.38%	Mid Cap 26.64%	Intermediate Bond 7.84%	Real Estate 17.59%	Large Cap 32.39%	Large Cap 13.69%	Asset Allocation 1.28%	High Yield 17.34%	Large Cap 21.63%	Intl Bonds -1.66%	Real Estate 25.76%	Emerging Markets 18.31%	Real Estate 8.81%
	Intl Stocks 11.17%	Cash 1.80%	Intl Stocks 31.78%	Emerging Markets 18.89%	Intl Bonds 5.93%	Intl Stocks 17.32%	Intl Stocks 22.78%	Asset Allocation 10.62%	Intermediate Bond 0.55%	Large Cap 11.96%	Mid Cap 16.24%	Government Treasury -1.84%	Small Cap 25.53%	Government Treasury 17.70%	Commodities 6.92%
	Government Treasury 9.81%	Asset Allocation -22.06%	Real Estate 28.60%	Commodities 16.83%	Asset Allocation 4.69%	Small Cap 16.35%	Asset Allocation 17.56%	Mid Cap 9.77%	Cash 0.03%	Commodities 11.77%	Small Cap 14.65%	High Yield -2.26%	Asset Allocation 22.18%	Asset Allocation 14.73%	Large Cap 6.17%
	Mid Cap 7.98%	High Yield -26.21%	Small Cap 27.17%	High Yield 15.24%	High Yield 4.50%	Large Cap 16.00%	High Yield 7.38%	Intermediate Bond 5.97%	Intl Stocks -0.81%	Emerging Markets 11.19%	Asset Allocation 14.21%	Asset Allocation -2.35%	Intl Stocks 22.01%	Mid Cap 13.66%	Intl Stocks 3.48%
	Intermediate Bond 6.97%	Small Cap -33.79%	Large Cap 26.46%	Large Cap 15.06%	Large Cap 2.11%	High Yield 15.44%	Real Estate 1.86%	Small Cap 4.89%	Government Treasury -1.21%	Asset Allocation 8.31%	Intl Bonds 9.92%	Large Cap -4.38%	Emerging Markets 18.44%	Intl Bonds 10.52%	Asset Allocation 2.31%
	Asset Allocation 6.22%	Commodities -35.65%	Commodities 18.91%	Asset Allocation 12.13%	Cash 0.06%	Asset Allocation 11.31%	Cash 0.06%	High Yield 2.44%	Mid Cap -2.18%	Real Estate 7.24%	Government Treasury 8.53%	Real Estate -4.84%	Government Treasury 14.83%	Intl Stocks 7.82%	Emerging Markets 2.29%
	Large Cap 5.49%	Mid Cap -36.23%	Asset Allocation 18.40%	Government Treasury 9.39%	Mid Cap -1.73%	Intermediate Bond 4.21%	Intermediate Bond -2.02%	Cash 0.02%	Small Cap -4.41%	Intermediate Bond 2.65%	High Yield 7.48%	Small Cap -11.01%	High Yield 14.40%	Intermediate Bond 7.51%	High Yield 0.81%
	Cash 4.74%	Large Cap -37.00%	Intermediate Bond 5.93%	Intl Stocks 7.75%	Small Cap -4.18%	Government Treasury 3.56%	Emerging Markets -2.80%	Emerging Markets -2.19%	High Yield -4.55%	Intl Bonds 1.86%	Real Estate 4.18%	Mid Cap -11.08%	Intermediate Bond 8.72%	High Yield 6.20%	Cash 0.02%
	High Yield 2.17%	Real Estate -39.20%	Intl Bonds 3.94%	Intl Bonds 6.78%	Intl Stocks -12.14%	Intl Bonds 0.85%	Intl Bonds -5.06%	Intl Bonds -2.53%	Intl Bonds -4.84%	Government Treasury 1.33%	Intermediate Bond 3.54%	Commodities -11.25%	Commodities 7.69%	Cash 0.58%	Intermediate Bond -3.37%
	Small Cap -1.57%	Intl Stocks -43.38%	Cash 0.16%	Intermediate Bond 6.54%	Commodities -13.32%	Cash 0.09%	Commodities -9.52%	Intl Stocks -4.90%	Emerging Markets -14.92%	Intl Stocks 1.00%	Commodities 1.70%	Intl Stocks -13.79%	Intl Bonds 5.23%	Commodities -3.12%	Intl Bonds -6.39%
Worst	Real Estate -17.55%	Emerging Markets -53.33%	Government Treasury -12.92%	Cash 0.10%	Emerging Markets -18.42%	Commodities -1.06%	Government Treasury -12.86%	Commodities -17.01%	Commodities -24.66%	Cash 0.27%	Cash 0.84%	Emerging Markets -14.58%	Cash 2.25%	Real Estate -7.90%	Government Treasury -13.51%

The returns above reflect performance of certain indexes as defined below. This information is general in nature and is not intended to be reflective of any specific plan. Cash- FTSE 3 month T-bill, Government Treasury-BBgBarc Long Treasury, Commodities-Bloomberg Commodity Idx, Intermediate Bond-BBgBarc US Agg Bond Idx, High Yield Bond-ICE BofAML High Yield Idx, Intl Bonds-JPMorgan GBI Global ex U.S., Asset Allocation-portfolio assumes the following weights: 60% S&P 500 and 40% BBgBarc US Agg, Large Cap-S&P 500, Mid Cap - S&P Midcap 400, Small Cap-Russell 2000, Intl Stocks-MSCI EAFE (net), Emerging Markets-MSCI EM (net), Real Estate-Wilshire U.S. REIT. **Past performance does not guarantee future results**

> **Macro Insights**



# Markets stayed broadly optimistic despite challenging conditions

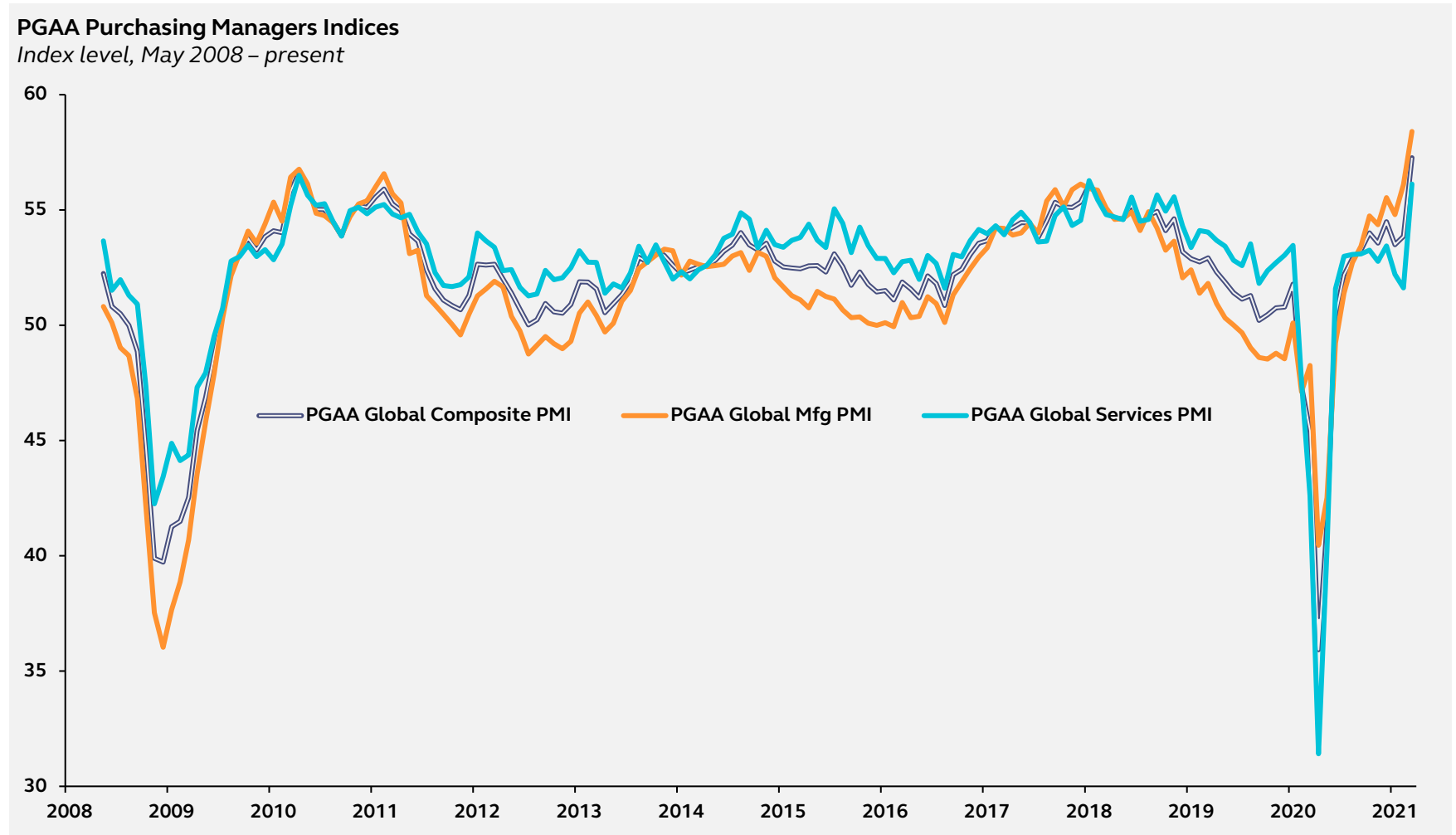
## March marked the largest rolling 12-month increase in the S&P 500 since 1936



Source: Bloomberg, Principal Global Investors. Data as of March 31, 2021.

# Economic data signal a continuation of a strong rebound

Lockdowns have proved less disruptive on global activity, manufacturing thrives

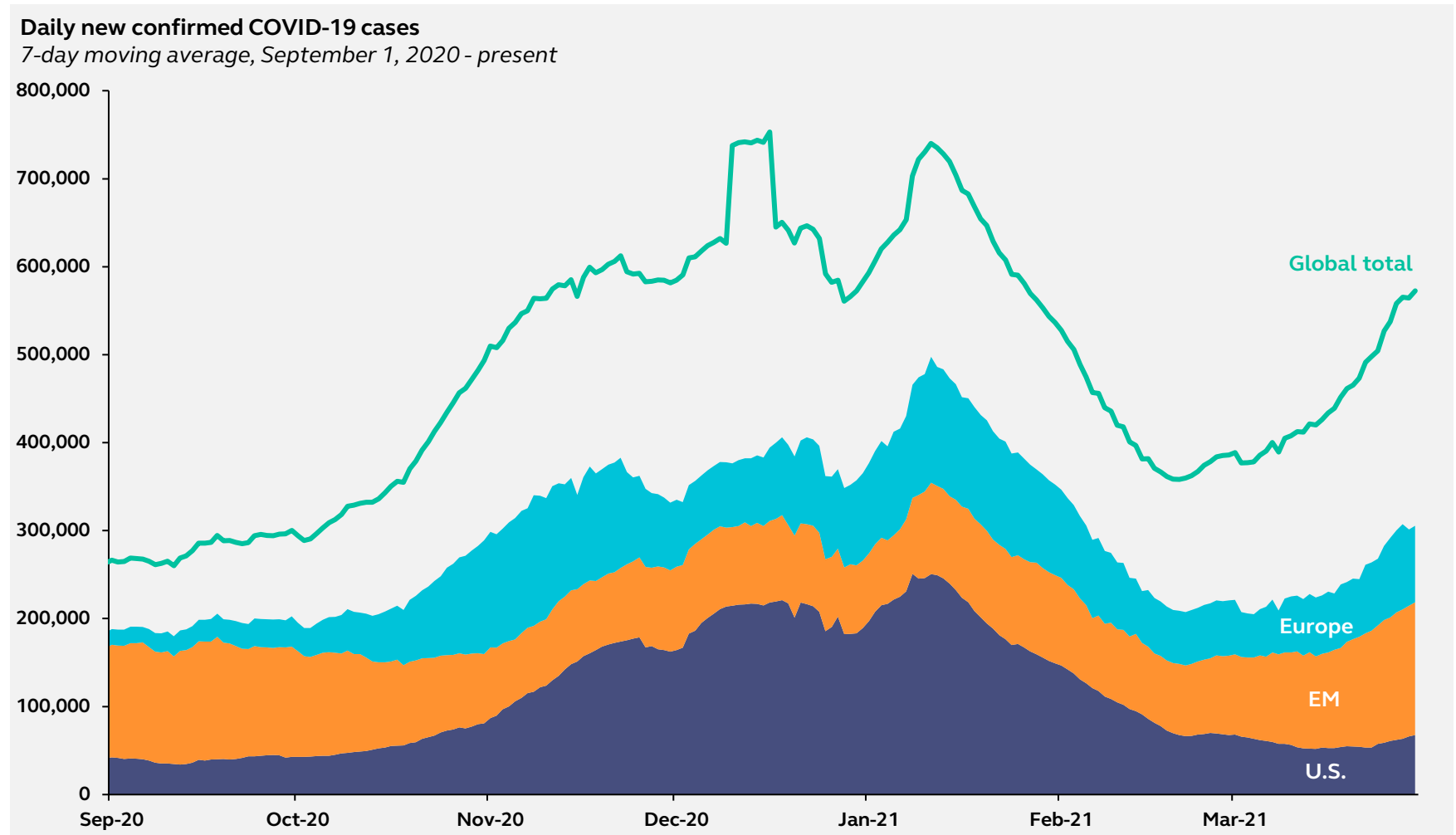


Source: Bloomberg, FactSet, Principal Global Asset Allocation. PGAA Purchasing Manager Index models start in May 2008. Data as of March 31, 2021.



# After peaking in January 2021, COVID-19 is on the rise again

## But social restrictions and vaccine rollouts helping to restrict the increase



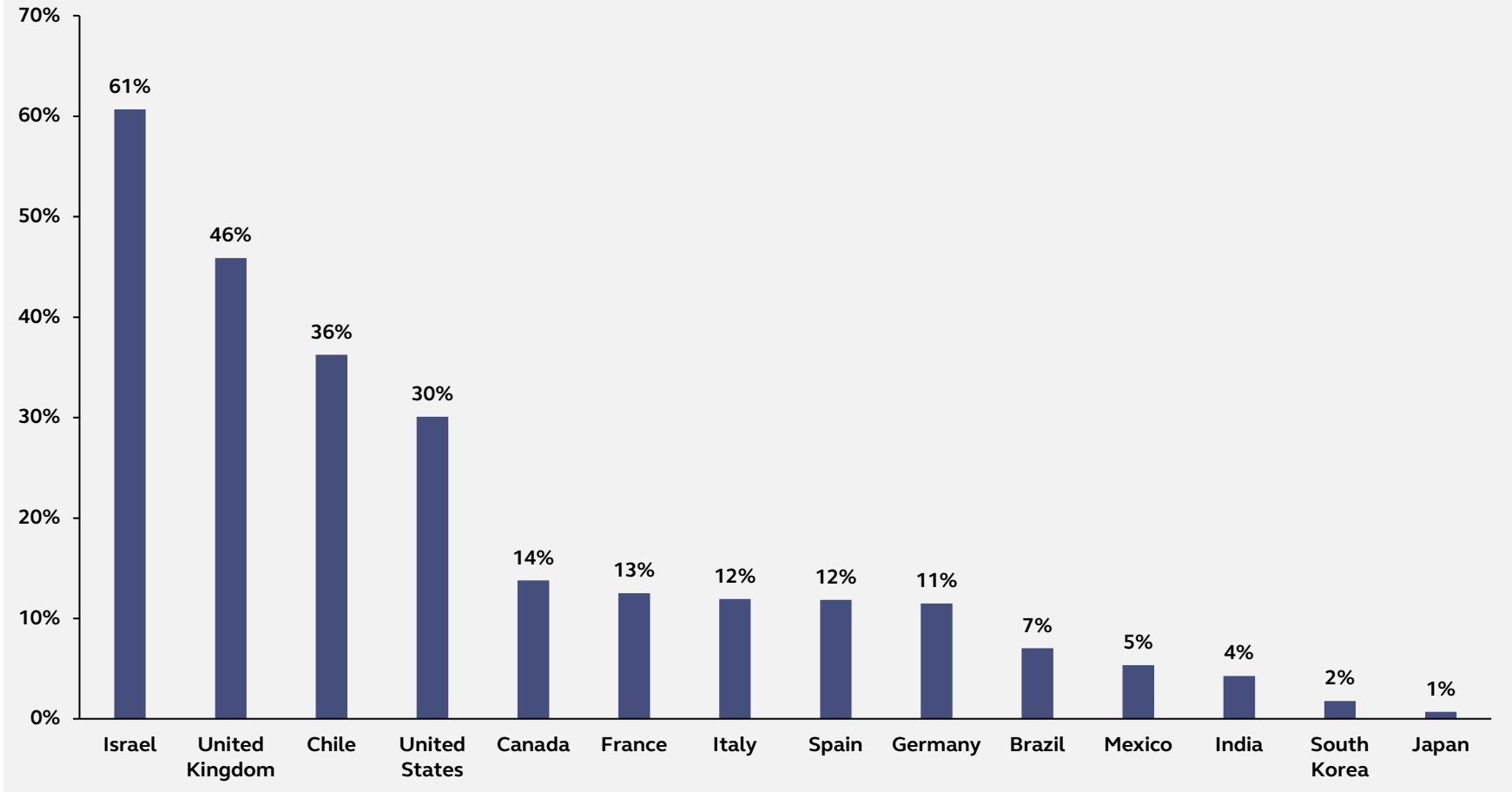
Source: Bloomberg, Johns Hopkins CSSE, Principal Global Asset Allocation. Europe – France, Germany, Italy & Spain. Emerging Markets – Brazil, Chile, India, HK SAR, Mainland China, Malaysia, Mexico, Singapore. Global is cumulative of all reporting countries. Data as of March 31, 2021.

# Success of the vaccine rollout varies significantly

Global vaccinations should accelerate in 2Q, enabling country re-openings

## Vaccination rates in selected countries

*% of population that has received at least one vaccine dose*

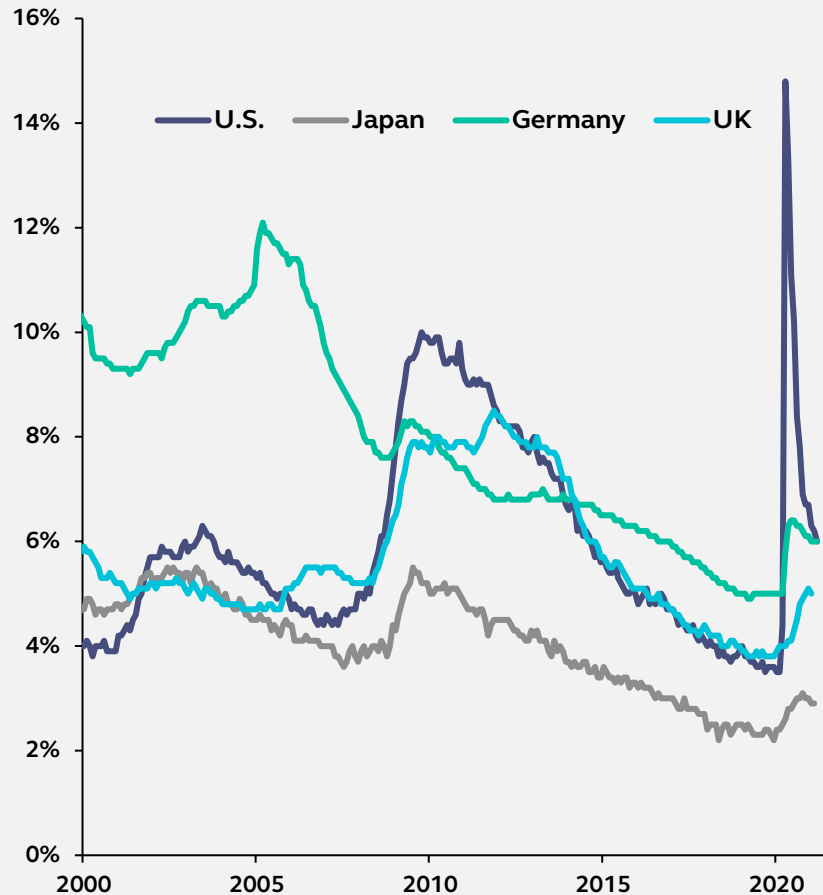


Source: Our World in Data, Principal Global Investors. Data as of April 1, 2021.

# As country re-openings increase, jobs growth should gain momentum

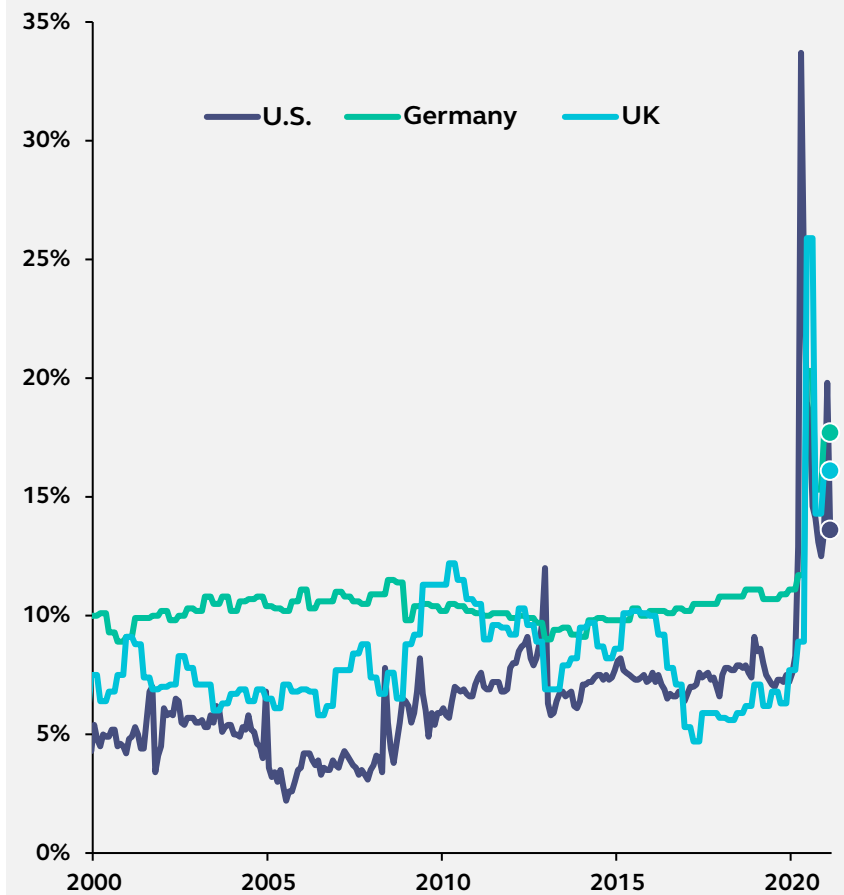
## Savings rates have soared and may unleash a spending boom

**U.S., Germany, UK, and Japan civilian unemployment rate**  
Seasonally adjusted, percent, 2000 – present



Source: Bureau of Labor Statistics, Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

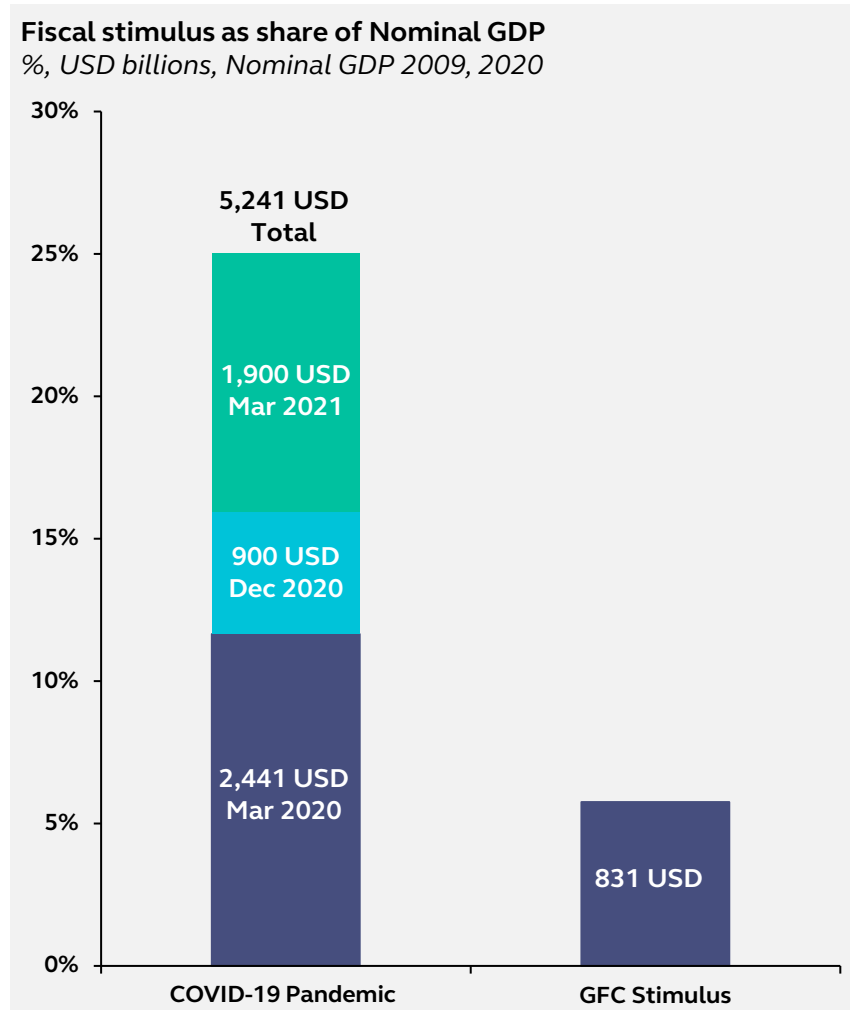
**U.S. Germany, UK personal savings rate**  
As % of disposable income, 2000 – present



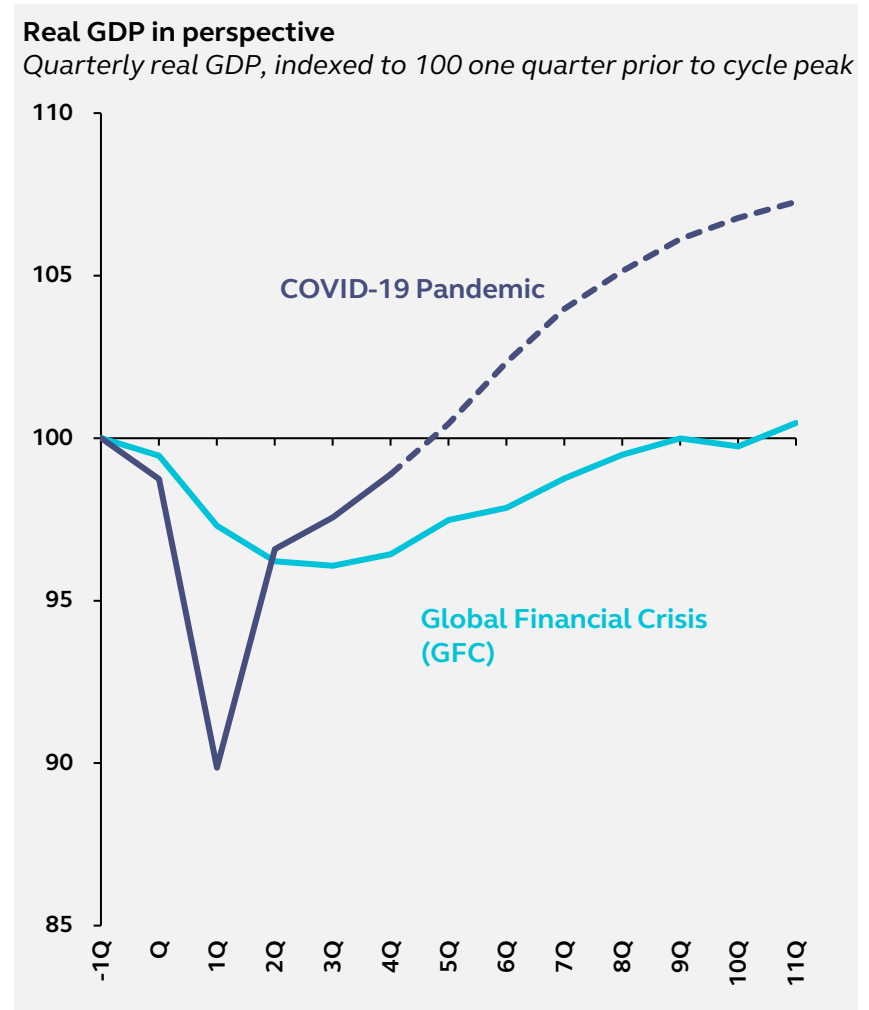
Source: Bureau of Labor Statistics, Deutsche Bundesbank, UK Office for National Statistics, Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

# COVID-19 fiscal stimulus has far exceeded that during the GFC

## U.S. economy likely to reach pre-pandemic level in 2Q 2021



Source: CBO, Bloomberg, Principal Global Investors. Data as of March 25, 2021.



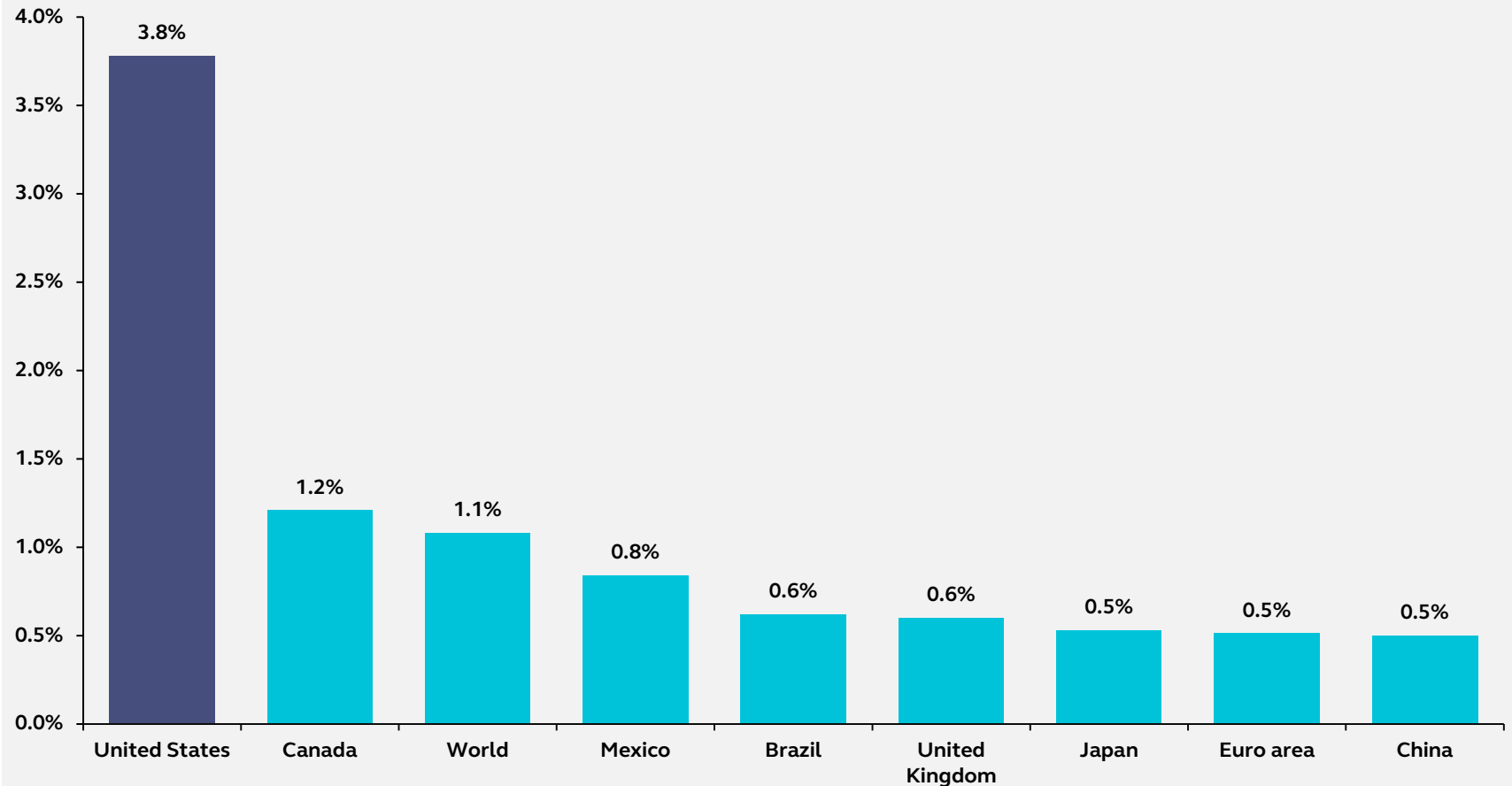
Source: Bloomberg, Principal Global Investors. Data as of March 25, 2021.

# A rising tide lifts all boats

## U.S. fiscal stimulus is helping secure the global reflation narrative

### GDP anticipated impact of U.S. fiscal stimulus on global economies

% increase in expected global GDP growth as a result of the American Rescue Plan



Source: OECD (2021), OECD Interim Economic Outlook, OECD Publishing, Principal Global Asset Allocation. Note: The chart shows the average percentage difference in GDP relative to baseline over the first full year of the package (2021Q2-2022Q1). Simulation of the planned fiscal stimulus in the United States, set out in the American Rescue Plan. The new measures are worth up to USD 1.9 trillion (around 8 ½ per cent of baseline GDP). Measures are assumed to take effect over 2021Q2-2022Q2. Data as of March 2021.

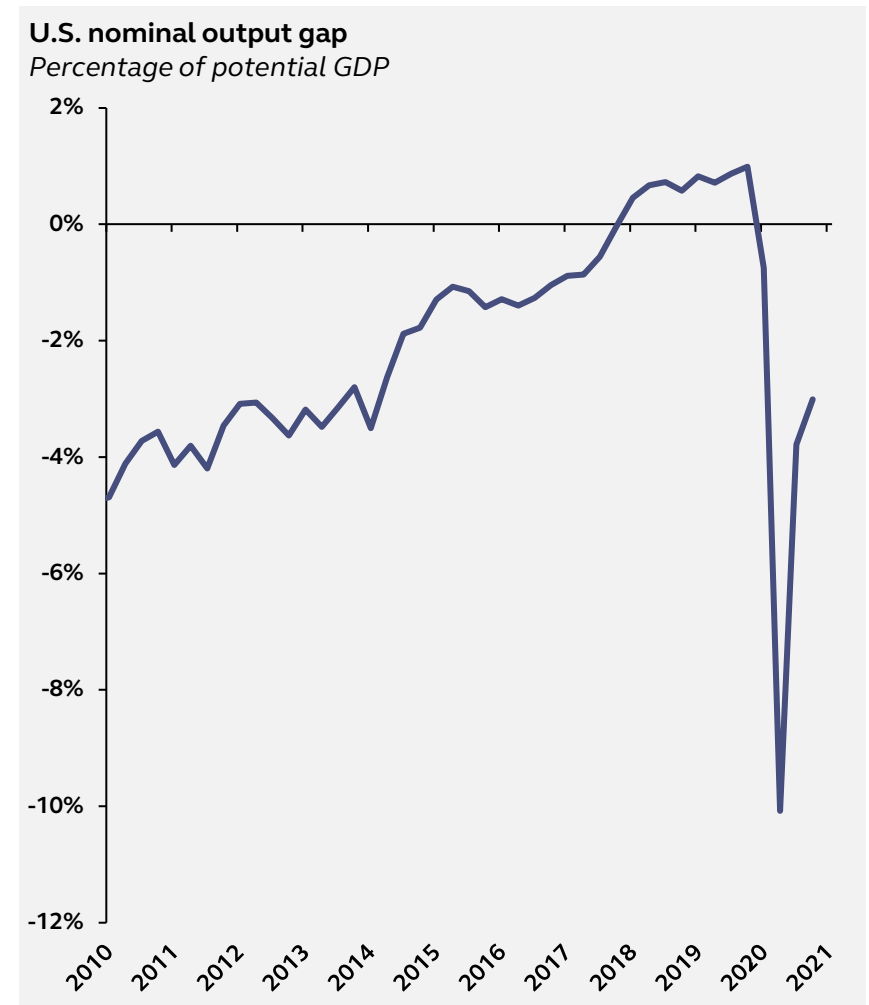
Past performance does not guarantee future results.

# Running a high-pressure economy is not without risk

Markets see inflation making a comeback, albeit a short-lived one



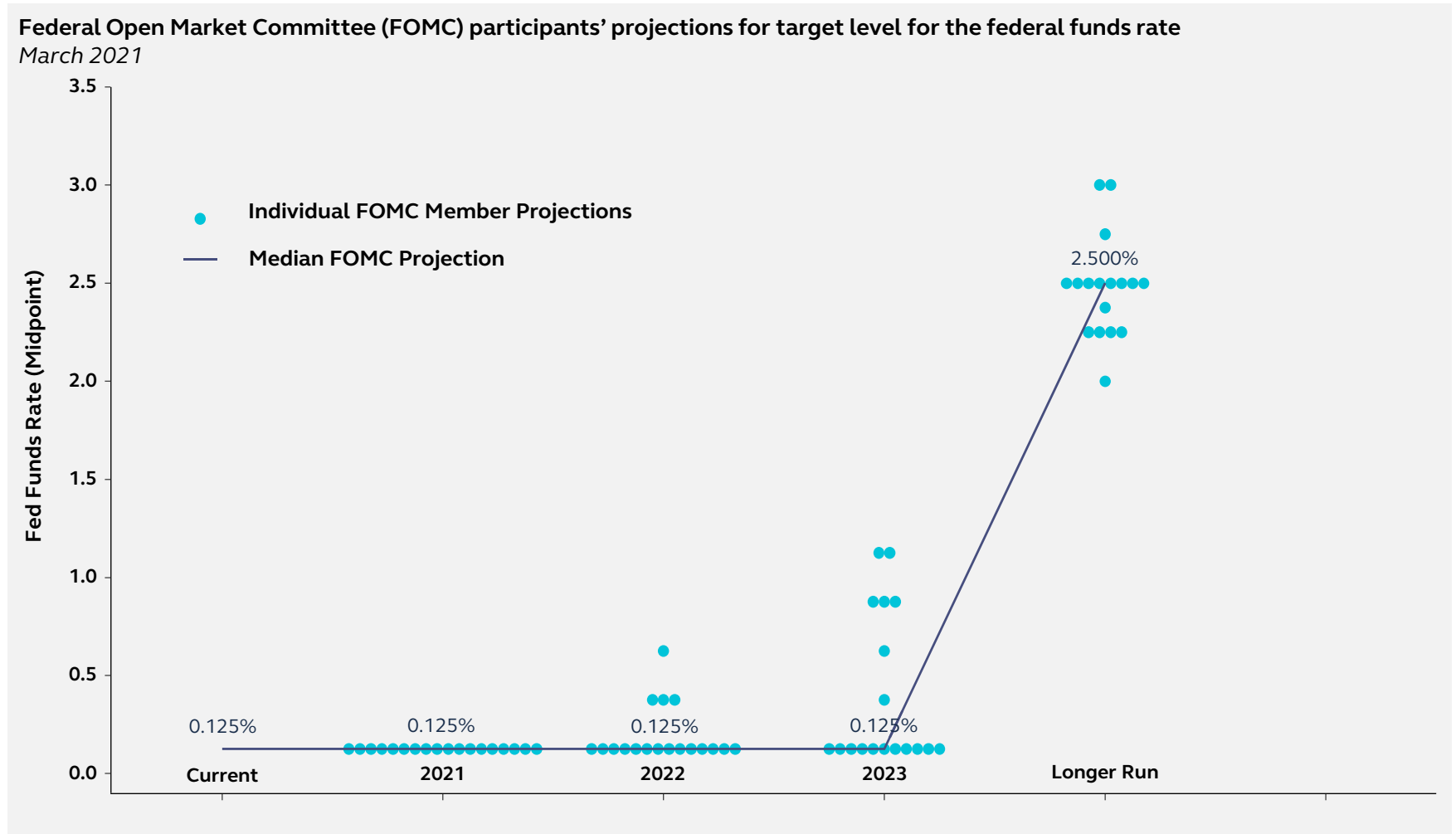
Source; Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.



Source; Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

# Fed to remain patient, even in the face of above 2% inflation

## FOMC median dot plot shows rates likely on hold to 2024, but growing detractors



Source: Federal Reserve, Clearnomics, Principal Global Investors. Data as of March 17, 2021.

# Low real rates and easy financial conditions likely to remain in 2021

## Developed market central banks leading monetary explosion

### Global Financial Conditions Index

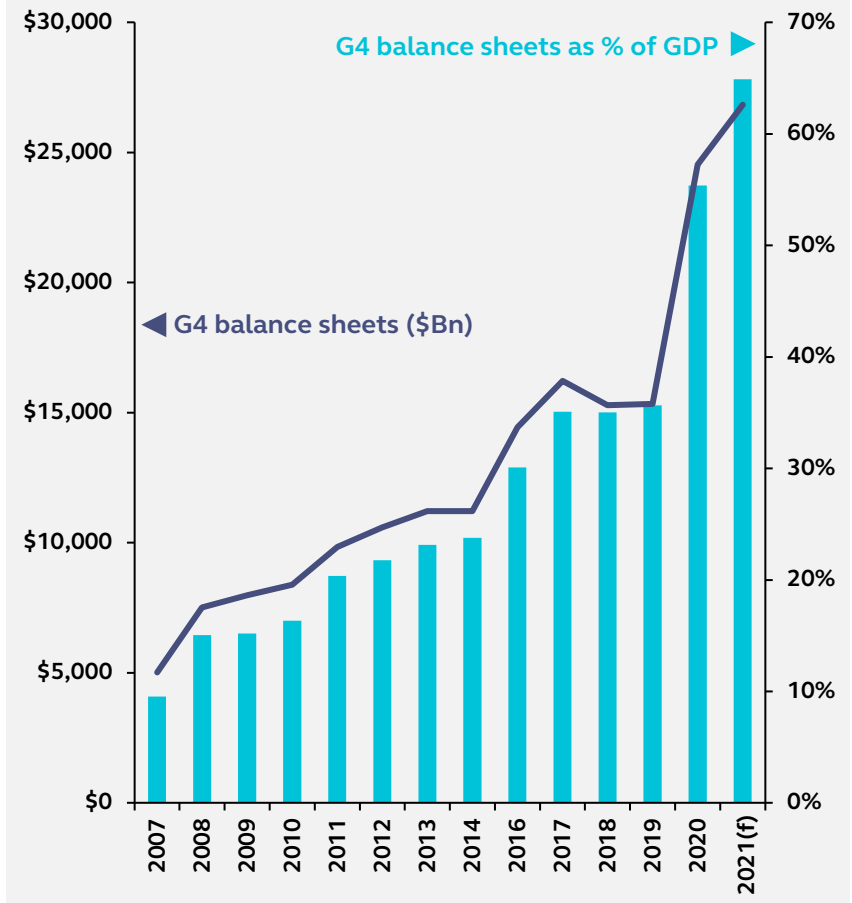
Z-Score, January 31, 2005 - present, forecasted through 2021



Source: Bloomberg, Principal Global Asset Allocation. Forecasted to year end 2021. Data as of March 31, 2021.

### G4 balance sheets (Fed, ECB, BOJ, BOE)

Percent of GDP, sum in US\$ Bn, 2007 - present, forecasted 2021

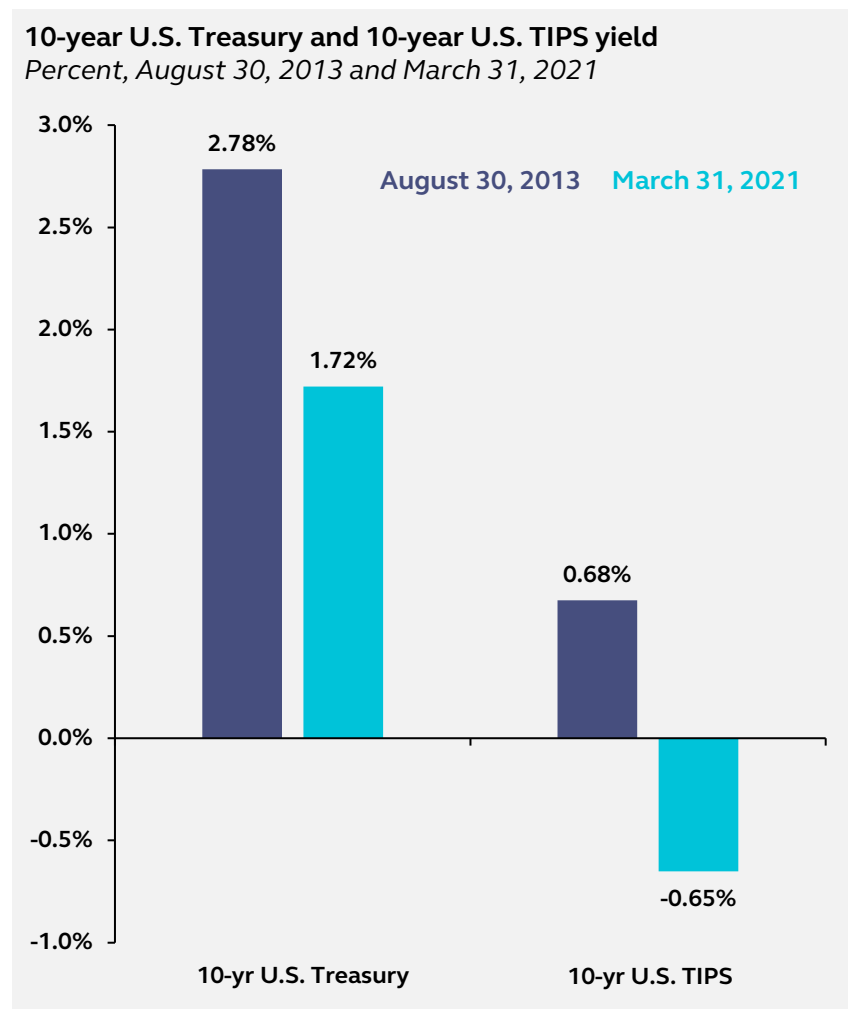


Source: Bloomberg, Principal Global Asset Allocation. Forecasted to year end 2021. Data as of March 31, 2021.

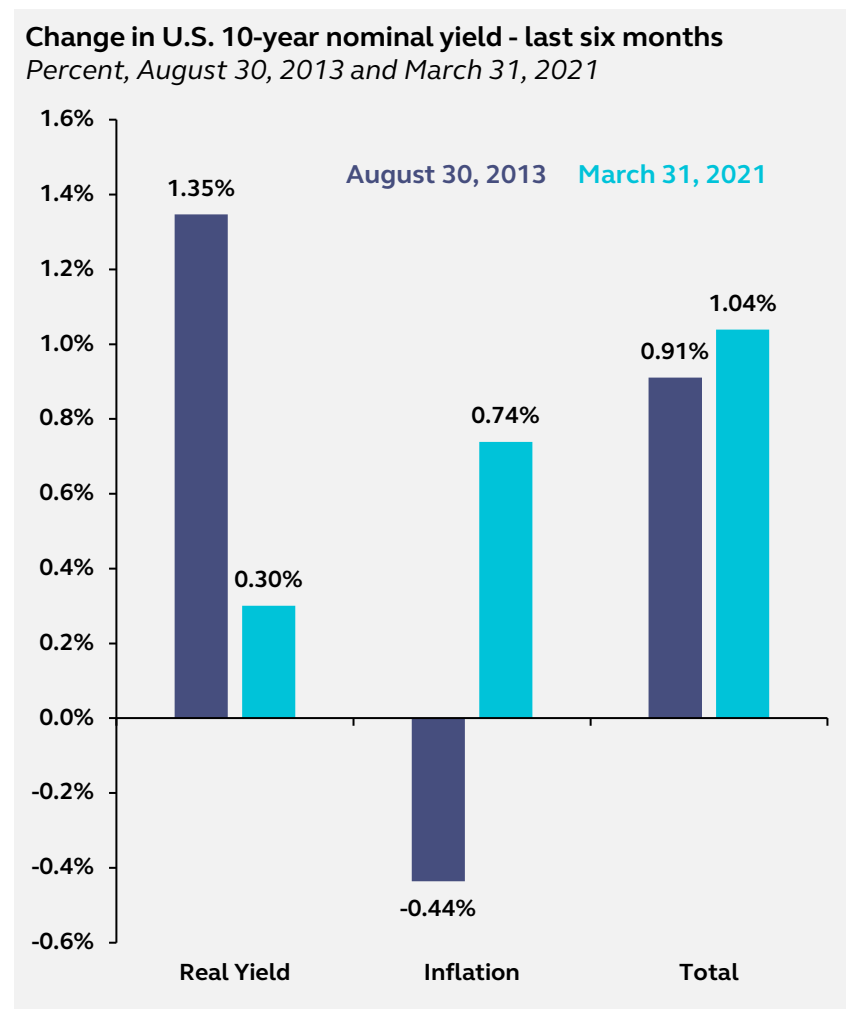


# The latest rise in bond yields was driven less by real yields

## 2013 taper tantrum characterized by sharply higher real yields



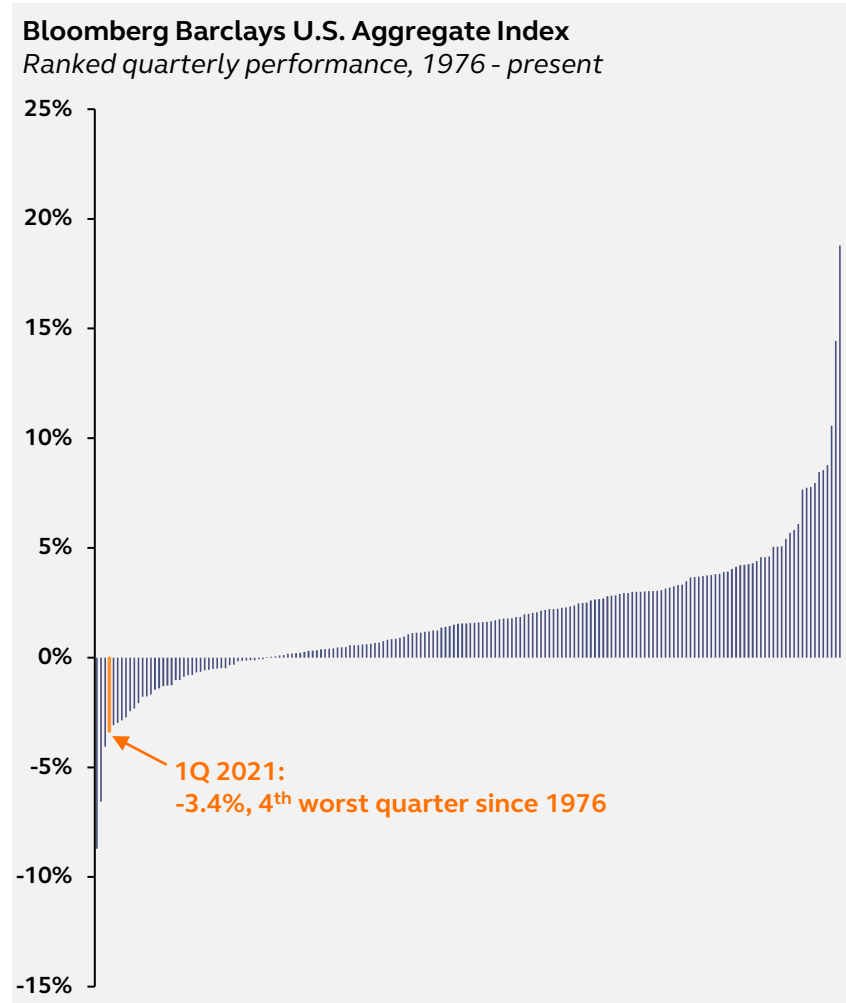
Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.



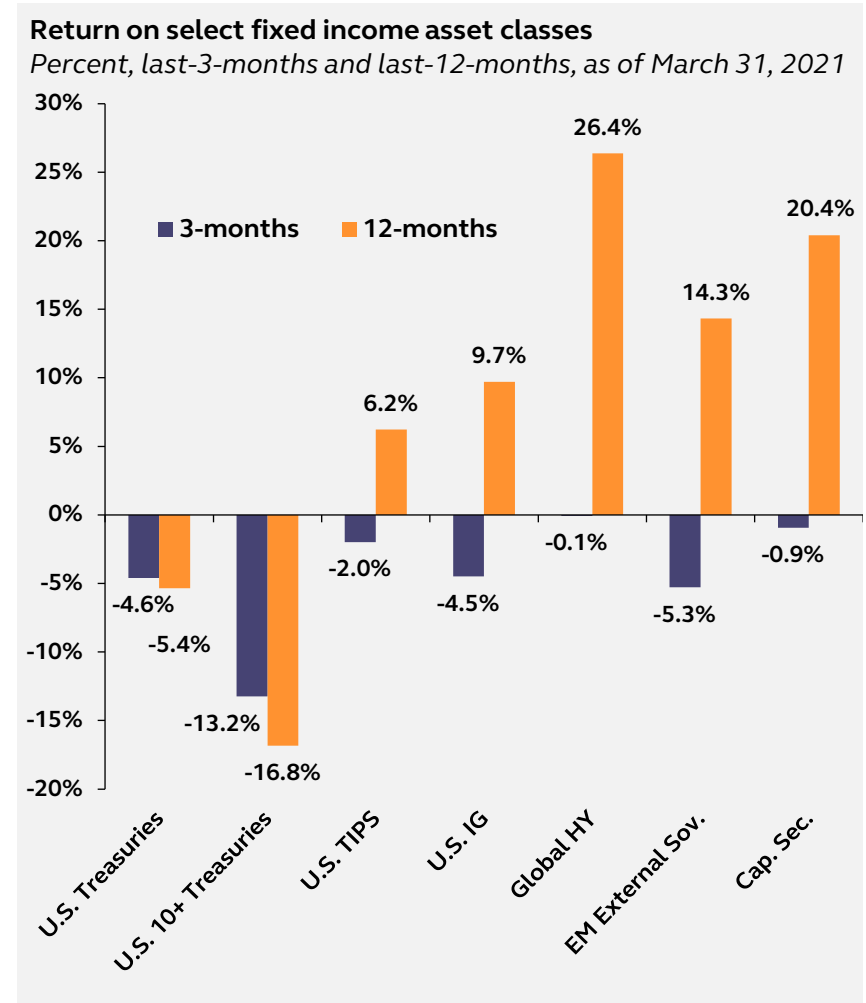
Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

# 4<sup>th</sup> worst quarter for core bonds since 1976

Increasing nominal rates are the culprit



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021



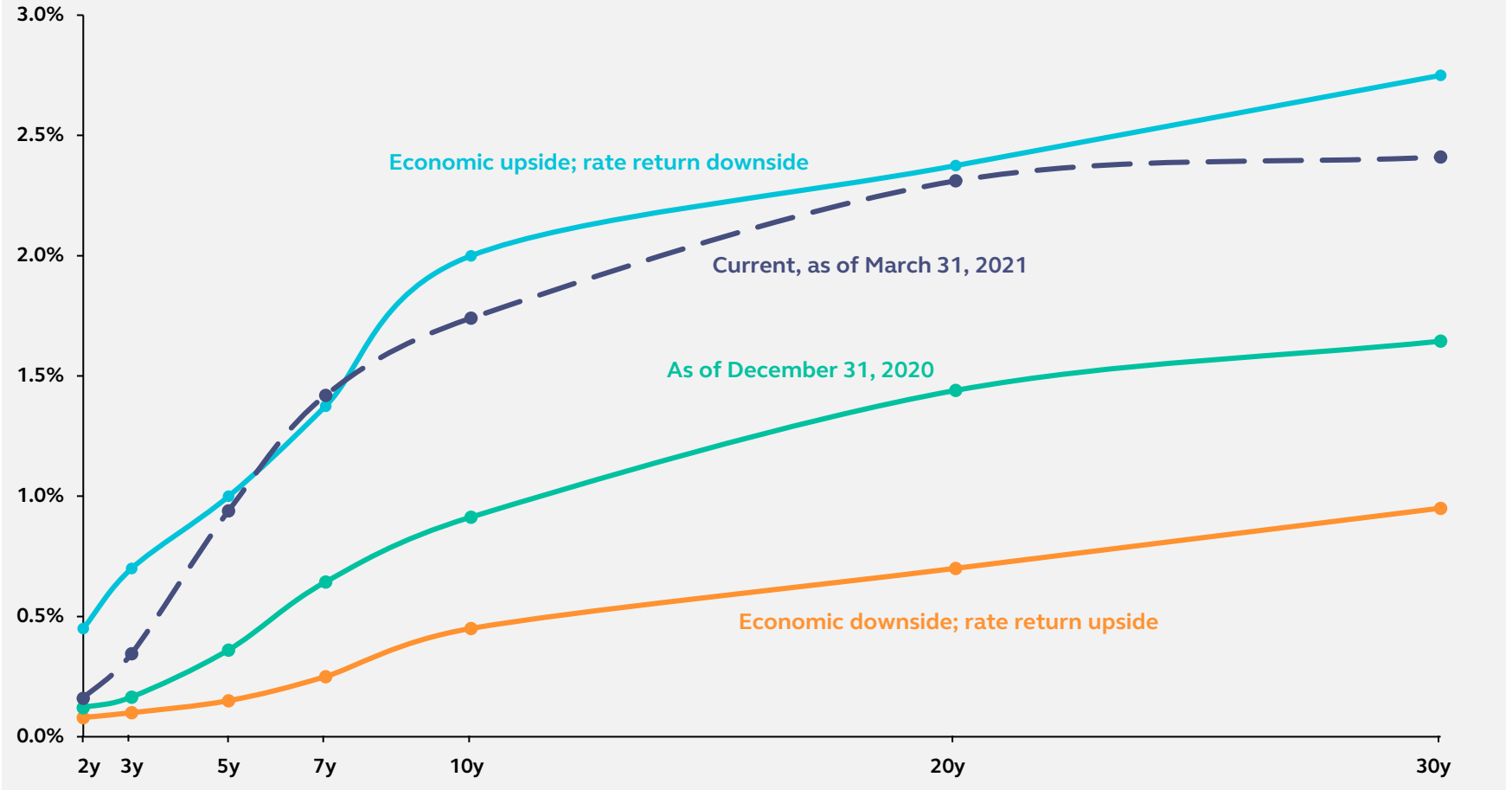
Source: Bloomberg, Principal Global Asset Allocation. See disclosures for index descriptions. Data as of March 31, 2021

# U.S. rates have surprised higher

## Bond markets see the economic acceleration and inflation surge

### U.S. 10-year Treasury yield curve

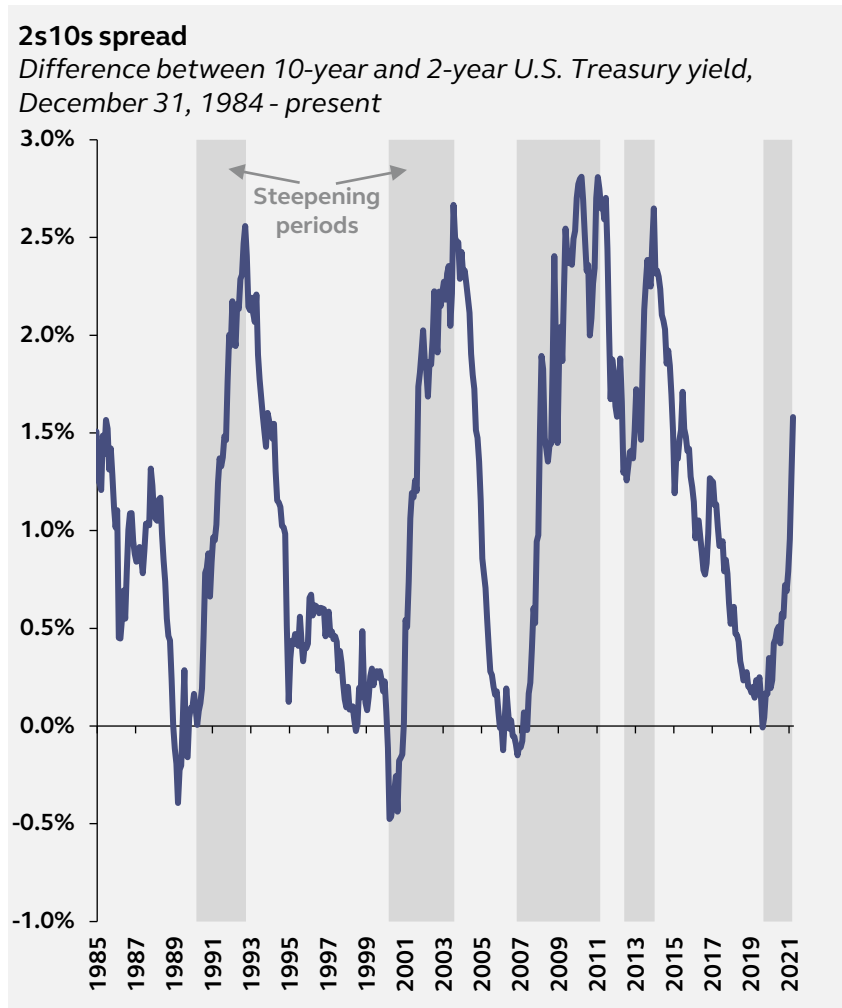
Percent, current yield curve vs. upside and downside risk scenarios



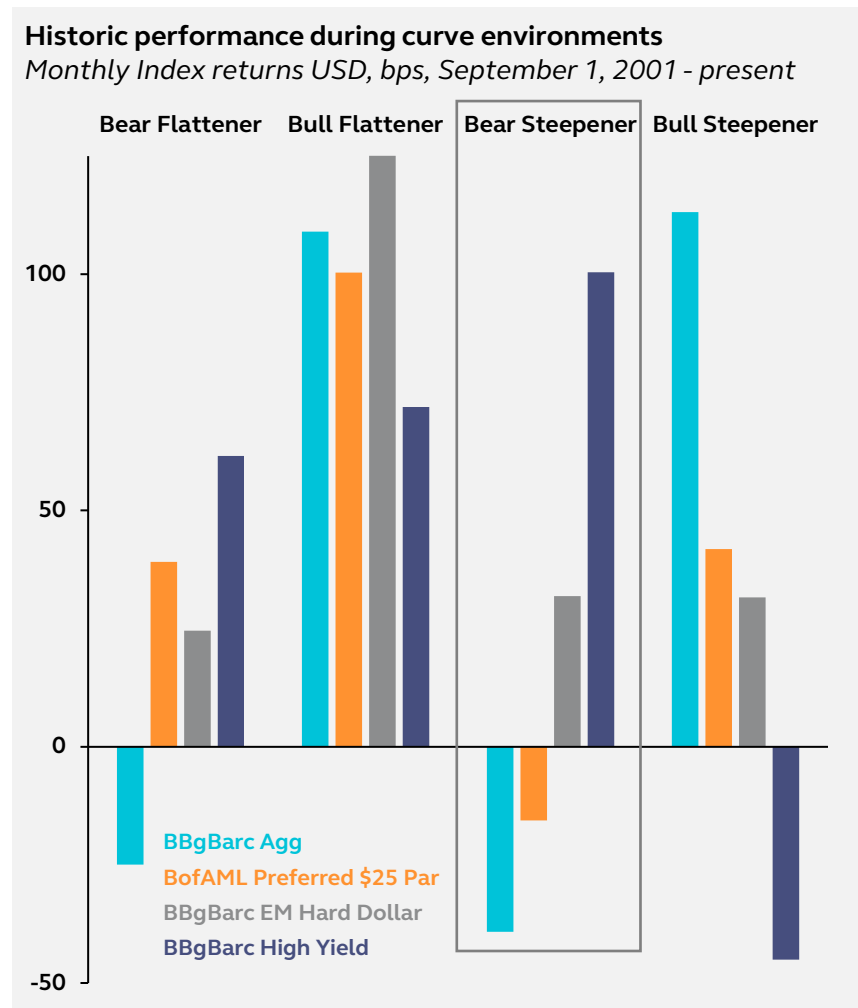
Source: Bloomberg, Principal Global Asset Allocation. Projected upside and downside ranges based on historical data from November 30, 1995. Data as of March 31, 2021.

# Bear steepener environment persists

## Credit historically leads duration in similar environments



Source: Bloomberg, Principal Global Asset Allocation, Principal Global Fixed Income. Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Bear Steeper: widening of yield curve caused by long-term rates increasing at a faster rate than short-term rates. This causes a larger spread between the two rates as the long-term rate moves further away from the short-term rate.

Past performance does not guarantee future results.

> Outlook



# Growth and inflation acceleration in 2021

## Our base-case economic scenario improves due to U.S. fiscal stimulus

**1** U.S. economy to lead global growth, expanding 6% (up from 4.8%) in 2021, with GDP reaching new high in 2Q 2021.

**2** By year-end, U.S. EPS to exceed 2019 peak by 8%. EMs to also show positive EPS growth from 2019, while Europe just falls short.

**3** Stimulus from developed market central banks continues, albeit at a slower pace, providing strong support for risk assets through 2021.

**4** Risk appetite to be less sensitive to virus activity, but inflation fears to grow as recovery gains momentum. U.S. PCE inflation will end 2021 between 2.25-2.50%.

### At this stage, we envision three key risks to our base case:

- **Growth scare:** Triggered by additional significant waves of virus activity, worsened by virus variants and/or vaccine missteps in distribution, efficacy, or acceptance. Bankruptcies and additional job losses would result.
- **Premature tightening:** Inflationary pressures build up quicker than expected raising questions around the Fed's dovish resolve, driving yields sharply higher, financial conditions tighter and triggering a credit event.
- **Regulatory clampdown:** The U.S. Congress, led by a Democratic majority, accelerates sweeping regulatory, competition and taxation reforms of the tech sector.

# Important information

## Index definitions

Bloomberg Barclays U.S. Aggregate Bond Index, focusing on shorter maturities, and providing diversified exposure to debt from the government, credit and securitized sectors.. ©2021 Bloomberg Finance L.P. All rights reserved.

Bloomberg Barclays U.S. Corp High Yield 2% Issuer Capped Index is an unmanaged index comprised of fixed rate, non-investment grade debt securities that are dollar denominated. The index limits the maximum exposure to any one issuer to 2%.

Bloomberg Barclays U.S. Corporate Investment Grade Index includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity and quality requirements. To qualify, bonds must be SEC-registered. The corporate sectors are industrial, utility and finance, which include both US and non-US corporations.

Bloomberg Barclays U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint. STRIPS are excluded from the index because their inclusion would result in double-counting.

MSCI AC Asia ex Japan Index captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries (excluding Japan) and 9 Emerging Markets (EM) countries in Asia.

MSCI ACWI Index includes large and mid cap stocks across developed and emerging market countries. © 2020 MSCI Inc. All rights reserved.

MSCI Brazil Index is designed to measure the performance of the large and mid cap segments of the Brazilian market.

MSCI China Index captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs).

MSCI EAFE Index is listed for foreign stock funds (EAFE refers to Europe, Australia, and Far East). Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes.

MSCI Emerging Markets Index consists of large and mid cap companies across 24 countries and represents 10% of the world market capitalization. The index covers approximately 85% of the free float-adjusted market capitalization in each country in each of the 24 countries.

MSCI Europe Index captures large and mid cap representation across 15 Developed Markets (DM) countries in Europe.

MSCI Germany Index is designed to measure the performance of the large and mid cap segments of the German market.

MSCI India Index is designed to measure the performance of the large and mid cap segments of the Indian market.

MSCI Japan Index is designed to measure the performance of the large and mid cap segments of the Japanese market.

MSCI Russia Index is designed to measure the performance of the large and mid cap segments of the Russian market.

MSCI United Kingdom Index is designed to measure the performance of the large and mid cap segments of the UK market.

MSCI USA Growth Index captures large and mid cap securities exhibiting overall growth style characteristics in the US. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend.

MSCI USA Index is a market capitalization weighted index designed to measure the performance of equity securities in the top 85% by market capitalization of equity securities listed on stock exchanges in the United States.

MSCI USA Large Cap Index is designed to measure the performance of the large cap segments of the US market.

MSCI USA Mid Cap Index is designed to measure the performance of the mid cap segments of the US market.

# Important information

## Index definitions

MSCI USA Small Cap Index is designed to measure the performance of the small cap segment of the US equity market.

MSCI USA Value Index captures large and mid-cap US securities exhibiting overall value style characteristics. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield.

PGAA Global Cross Asset Class Vol: Commodity, Equity, Currency and Fixed income implied volatility measures combined and rebased to 100 = 12/31/2002.

PGAA Global Manufacturing PMIs: GDP Weighted Country Purchasing Managers Indexes (PMI).

Russell 1000® Index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership.

Standard & Poor's 500 Index is a market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market.

Market indices have been provided for comparison purposes only. They are unmanaged and do not reflect any fees or expenses. Individuals cannot invest directly in an index.

### Risk considerations

**Investing involves risk, including possible loss of principal. Past performance is no guarantee of future results. Asset allocation and diversification do not ensure a profit or protect against a loss.** Equity investments involve greater risk, including higher volatility, than fixed-income investments. Fixed-income investments are subject to interest rate risk; as interest rates rise their value will decline. International and global investing involves greater risks such as currency fluctuations, political/social instability and differing accounting standards. Potential investors should be aware of the risks inherent to owning and investing in real estate, including value fluctuations, capital market pricing volatility, liquidity risks, leverage, credit risk, occupancy risk and legal risk.

### Important Information

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