

Principal Global Investors
Morley Capital Management

Economic and market review

3Q 2020 | As of September 30, 2020



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

Agenda



- > **Setting the stage**
- > **Macro Insights**
- > **Outlook**

> Setting the stage

Key themes for Q3

As global economies recover, stimulus-aided markets continue to thrive

- **Global activity is not yet at pre-COVID levels**
The global economic recovery has progressed faster than anticipated, but activity has some way to go before returning to its pre-COVID peak
- **Central banks underpin market**
Ample central bank liquidity, coupled with fiscal stimulus, will continue to underpin positive risk market performance – albeit, with fewer additional policy actions
- **Growth style performs**
Market conditions remain supportive for growth relative to value styles, yet market leadership is evolving
- **Equities expensive globally**
Equities are expensive in almost all markets, but an earnings recovery in 2021 should reinforce valuations
- **Seek yield from credit**
Credit spreads are near long-term averages and the sturdy monetary policy outlook drives investors to seek yield

What impact have we seen on global index returns?

June marked the strongest calendar month S&P 500 performance since 1998

	3-months	YTD	1-year	3-year	5-year	10-year
U.S. Equities						
Russell 1000 Value Index	5.59%	-11.57%	5.03%	2.63%	7.65%	9.94%
S&P 500 Index	8.93%	5.57%	15.15%	12.26%	14.13%	13.73%
Russell 1000 Growth Index	13.22%	24.32%	37.41%	21.63%	20.08%	17.24%
Russell Midcap Index	7.46%	-2.35%	4.55%	7.12%	10.12%	11.75%
Russell 2000 Index	4.93%	-8.69%	0.39%	1.77%	7.99%	9.84%
Non-U.S. Equities						
MSCI EAFE NTR Index	4.80%	-7.09%	0.49%	0.62%	5.26%	4.61%
MSCI ACWI Ex USA Index	6.25%	-5.44%	3.00%	1.16%	6.22%	4.00%
MSCI Emerging Markets Index	9.56%	-1.16%	10.54%	2.41%	8.96%	2.50%
Fixed Income						
B of A ML U.S. Treasury Bill 3-month Index	0.04%	0.64%	1.10%	1.69%	1.20%	0.64%
Bloomberg Barclays Aggregate Bond Index	0.62%	6.79%	6.98%	5.23%	4.17%	3.63%
Bloomberg Barclays U.S. Corp High Yld 2% Issuer Capped Index	4.58%	0.57%	3.19%	4.18%	6.77%	6.46%
Bloomberg Barclays Long-Term Govt/Credit Index	0.78%	8.04%	8.03%	5.84%	4.65%	3.87%
Other						
MSCI U.S. REIT Index	1.34%	17.86%	-18.77%	-0.95%	2.66%	6.58%
S&P GSCI® Index	4.61%	-33.38%	-27.84%	-9.44%	-7.88%	-8.84%
U.S. Dollar Index	-3.49%	-0.64%	-3.41%	0.48%	-0.61%	1.80%

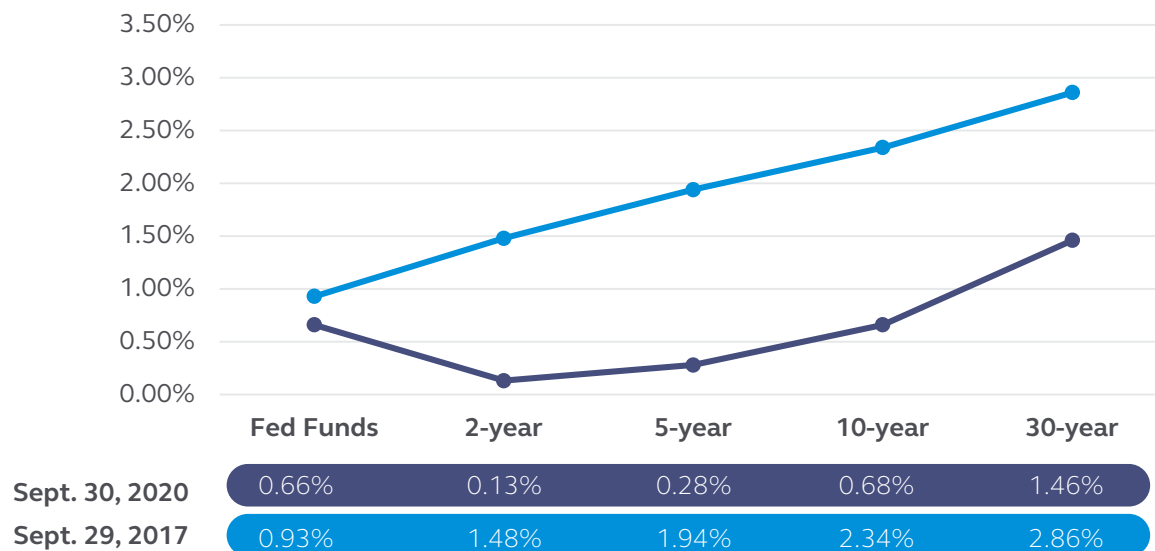
Source: FactSet. Returns are annualized. Past performance does not guarantee future results. Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index. See Important Information for index descriptions.

The history of interest rates



How have interest rates changed in recent years?

	Sept. 30, 2017	Sept. 30, 2018	Sept. 30, 2019	Sept. 30, 2020
2-year	1.48%	2.82%	1.62%	0.13%
5-year	1.94%	2.95%	1.54%	0.28%
10-year	2.34%	3.06%	1.66%	0.68%
2- to 10-year spread	0.85%	0.24%	0.04%	0.56%
30-year	2.86%	3.21%	2.11%	1.46%



Asset Class Returns of Sept. 30, 2020

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD
Best ↑ ↓ Worst	Real Estate 35.97 %	Emerging Markets 39.38 %	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 1.86 %	Large Cap 31.49 %	Government Treasury 21.35 %
	Emerging Markets 32.18 %	Commodities 16.23 %	Intl Bonds 11.40 %	High Yield 56.28 %	Small Cap 26.85 %	Real Estate 9.24 %	Mid Cap 17.88 %	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 %	Mid Cap 9.78 %
	Intl Stocks 26.34 %	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 21.83 %	Intl Bonds -1.66 %	Real Estate 25.76 %	Intermediate Bond 6.79 %
	Small Cap 18.37 %	Intl Stocks 11.17 %	Cash 1.80 %	Intl Stocks 31.78 %	Emerging Markets 18.88 %	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 %	Asset Allocation 6.68 %
	Large Cap 15.79 %	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 %	Intl Bonds 5.63 %
	High Yield 11.64 %	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 %	Large Cap 5.57 %
	Asset Allocation 11.12 %	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 %	Cash 0.56 %
	Mid Cap 10.32 %	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 %	High Yield -0.23 %
	Intl Bonds 6.84 %	Large Cap 5.49 %	Mid Cap -36.23 %	Asset Allocation 18.40 %	Government Treasury 9.38 %	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 %	Emerging Markets -1.16 %
	Cash 4.76 %	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 -2.60 %	Emerging Markets -2.19 %	High Yield -4.55 %	Intl Bonds 1.86 %	Real Estate 4.18 %	Mid Cap -11.08 %	Intermediate Bond 8.72 %	Intl Stocks -7.08 %
	Intermediate Bond 4.34 %	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 %	Commodities -12.08 %
	Commodities 2.07 %	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 %	Small Cap -12.98 %
	Government Treasury 1.85 %	Real Estate -17.55 %	Emerging Markets -53.33 %	Government Treasury -12.92 %	Cash 0.10 %	Emerging Markets -18.42 %	Commodities -1.06 %	Government Treasury -12.66 %	Commodities -17.01 %	Commodities -24.66 %	Cash 0.27 %	Cash 0.84 %	Emerging Markets -14.58 %	Cash 2.25 %	Real Estate -16.73 %

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.

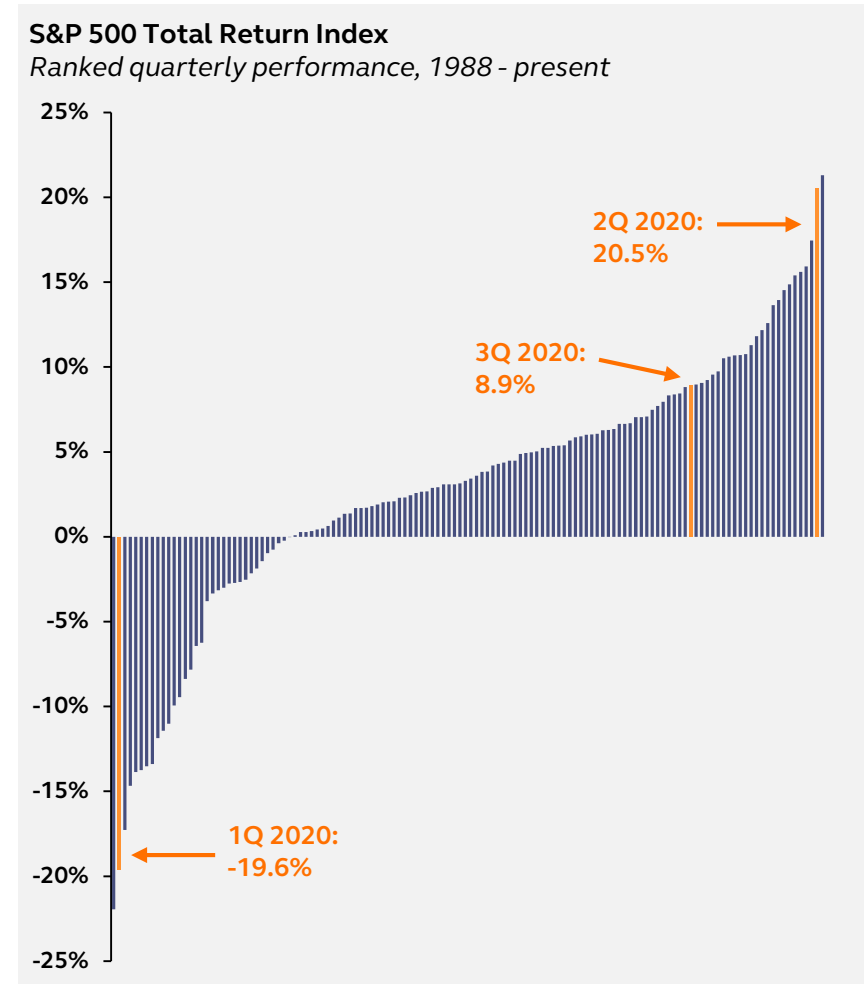
> Macro Insights

A rapid market rebound followed by a September swoon

Even with the pullback, it was the best two-quarter performance since 2009



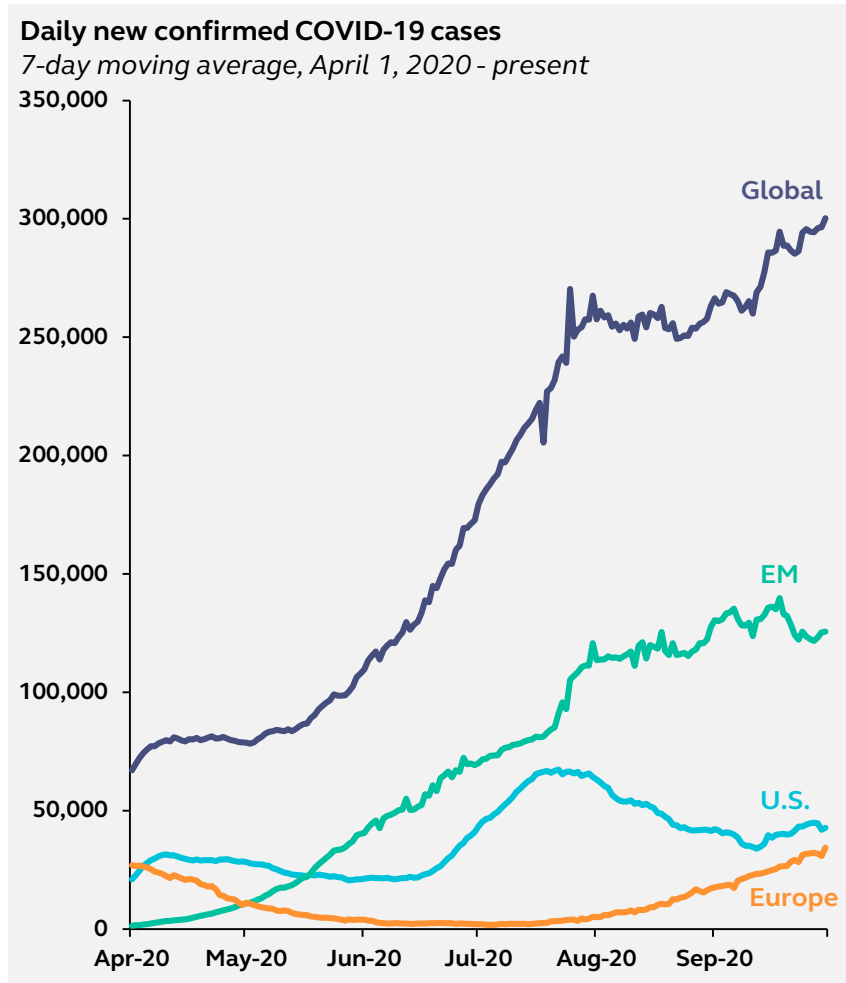
Source: Bloomberg, Principal Global Investors. Data as of September 30, 2020.



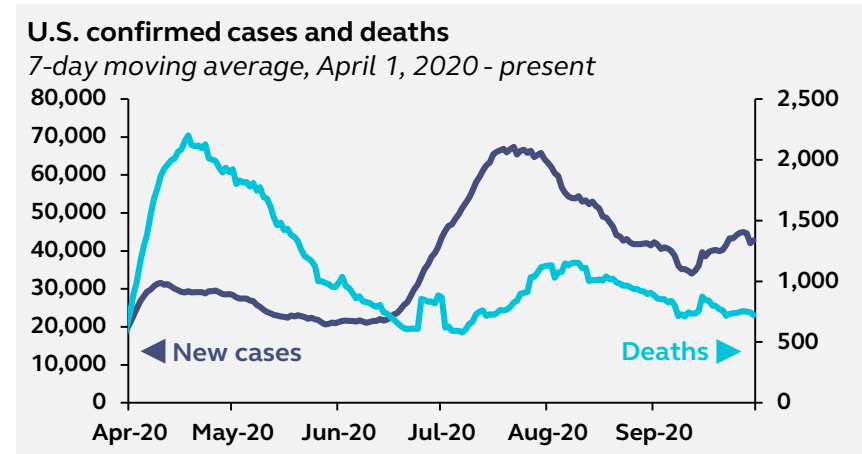
Source: Bloomberg, Principal Global Asset Allocation. Data as of September 30, 2020.

COVID-19 containment remains a serious challenge

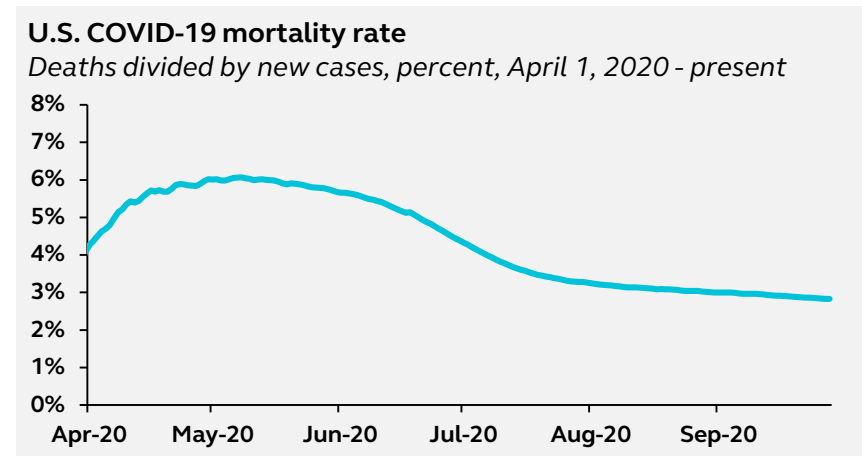
However, low mortality rates enable governments to prioritize re-openings



Source: Bloomberg, Johns Hopkins CSSE, Principal Global Investors. 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 September 30, 2020.



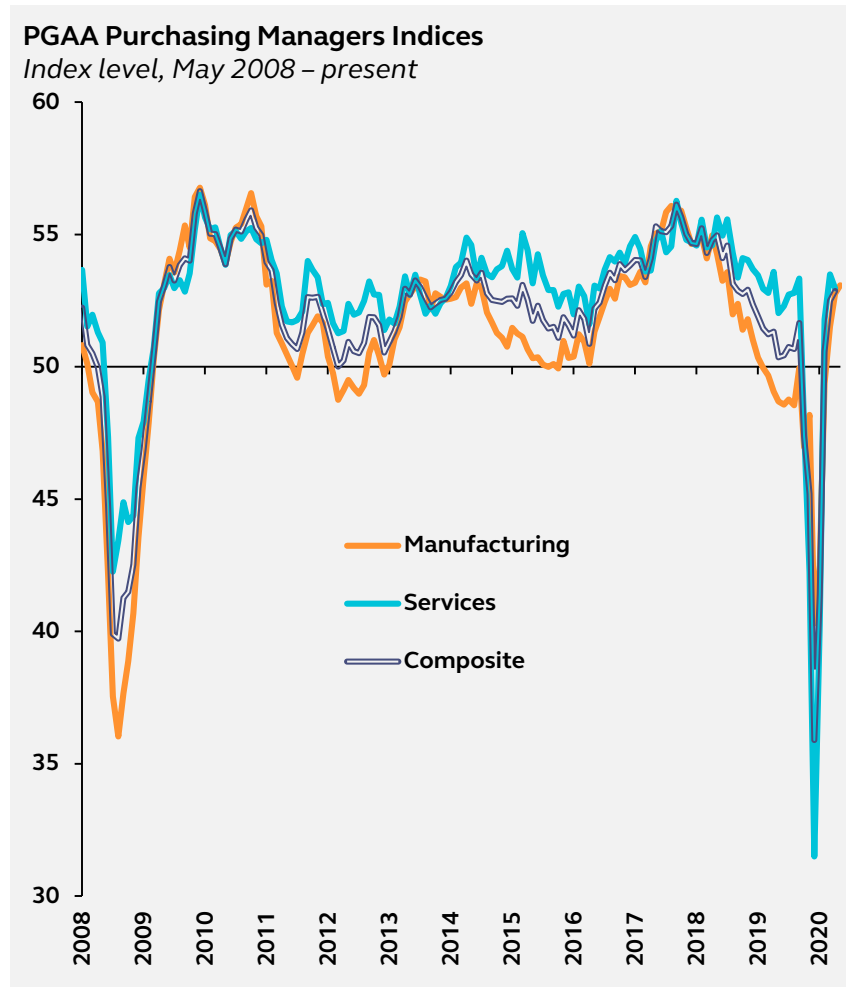
Source: Bloomberg, Johns Hopkins CSSE, Principal Global Investors. Data as of September 30, 2020.



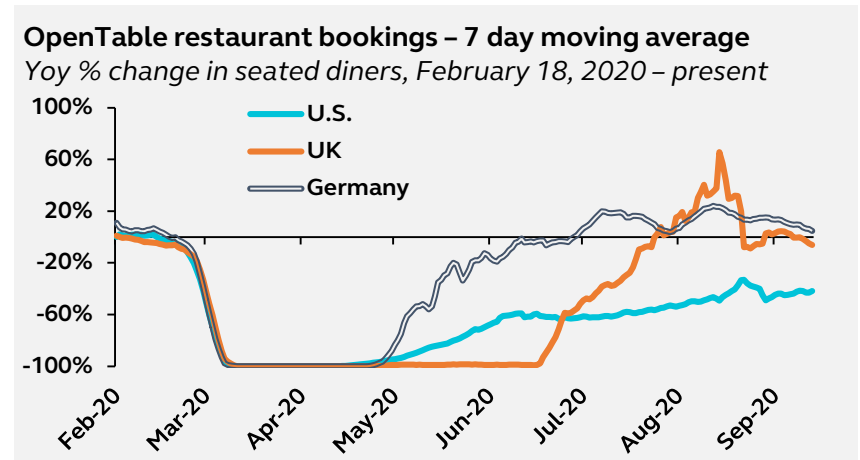
Source: Bloomberg, Johns Hopkins CSSE, Principal Global Investors. Data as of September 30, 2020.

The global recovery has progressed faster than expected

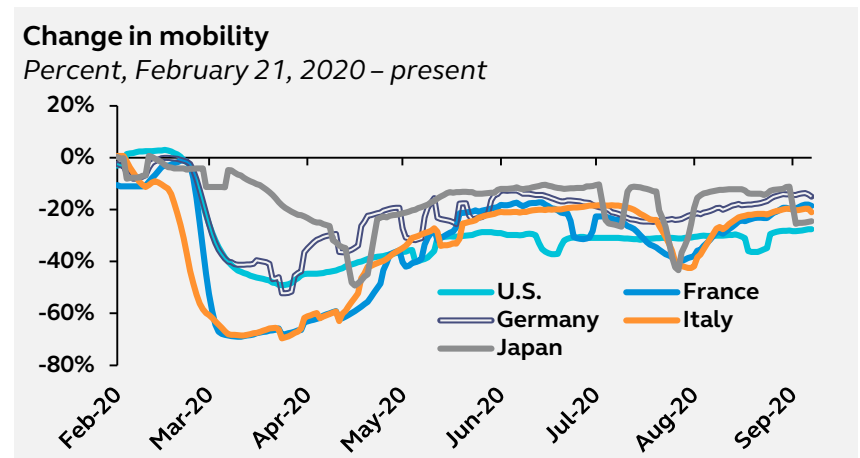
Yet, activity is still a ways off its “pre-COVID” peak



Source: Bloomberg, FactSet, Principal Global Asset Allocation. Data as of September 30, 2020.



Source: Opentable, Principal Global Asset Allocation. Data as of September 30, 2020.



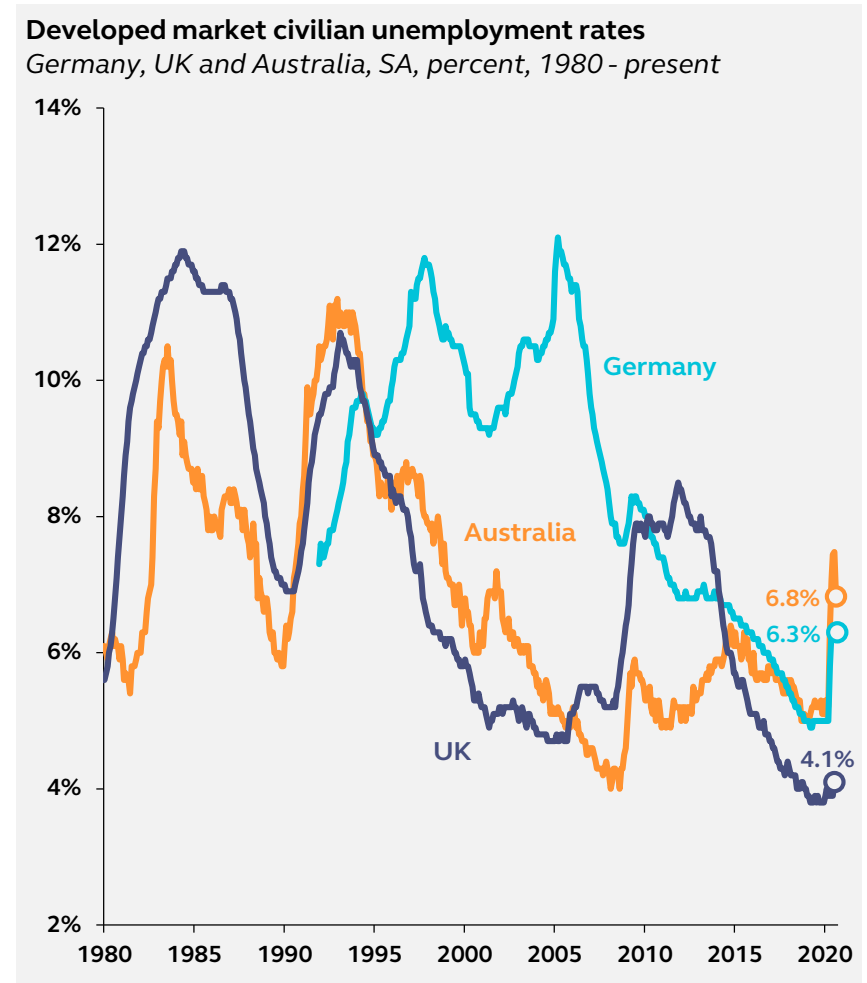
Source: Google Mobility Reports, Principal Global Asset Allocation. Data is based on the 7-day moving avg. of the workplace category of Google’s Mobility Reports. Data as of October 5, 2020.

The U.S. has recovered half of pandemic job losses

Easy gains are behind us, economic scarring to become more evident



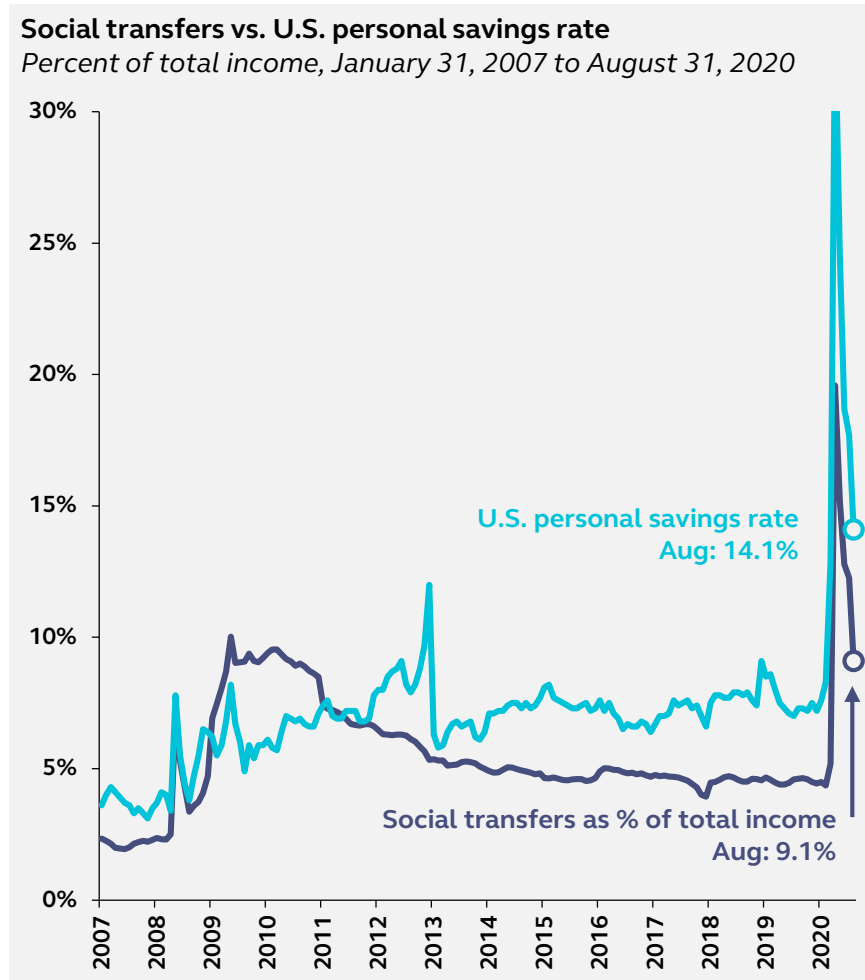
Source: Bureau of Labor Statistics, FactSet, Principal Global Asset Allocation.
Data as of September 30, 2020.



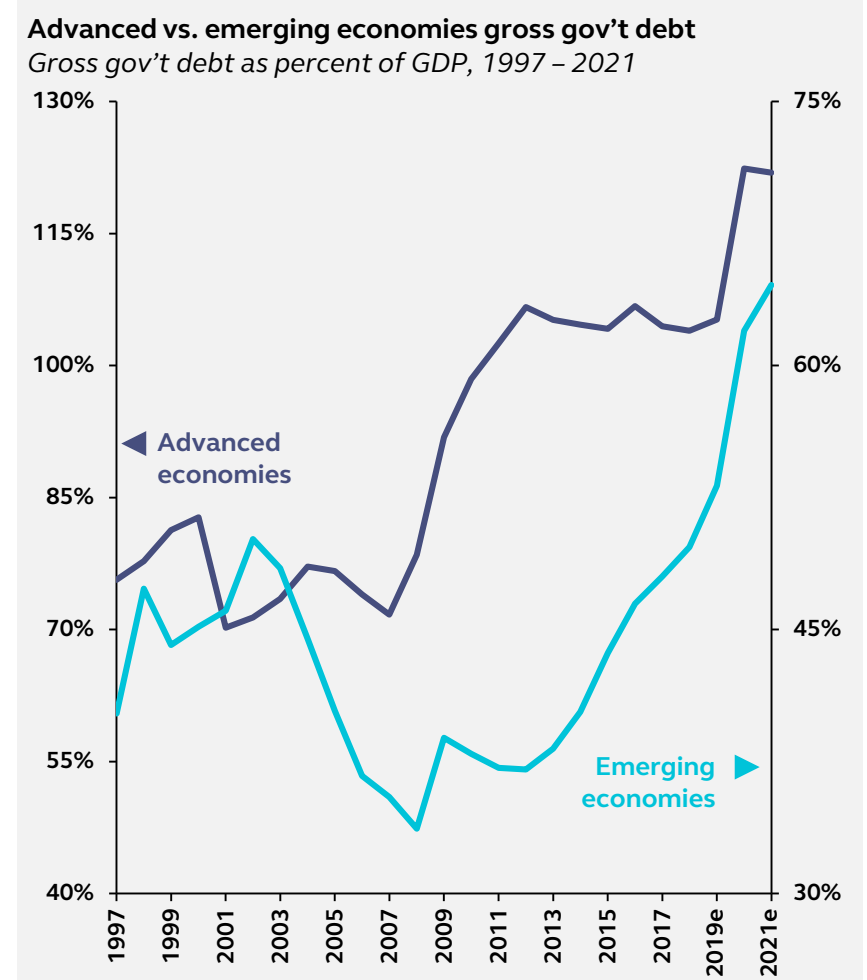
Source: Bloomberg, Principal Global Asset Allocation. SA= seasonally adjusted.
Data as of September 30, 2020.

Policymaker fiscal support has been significant

But additional support packages will be harder to come by



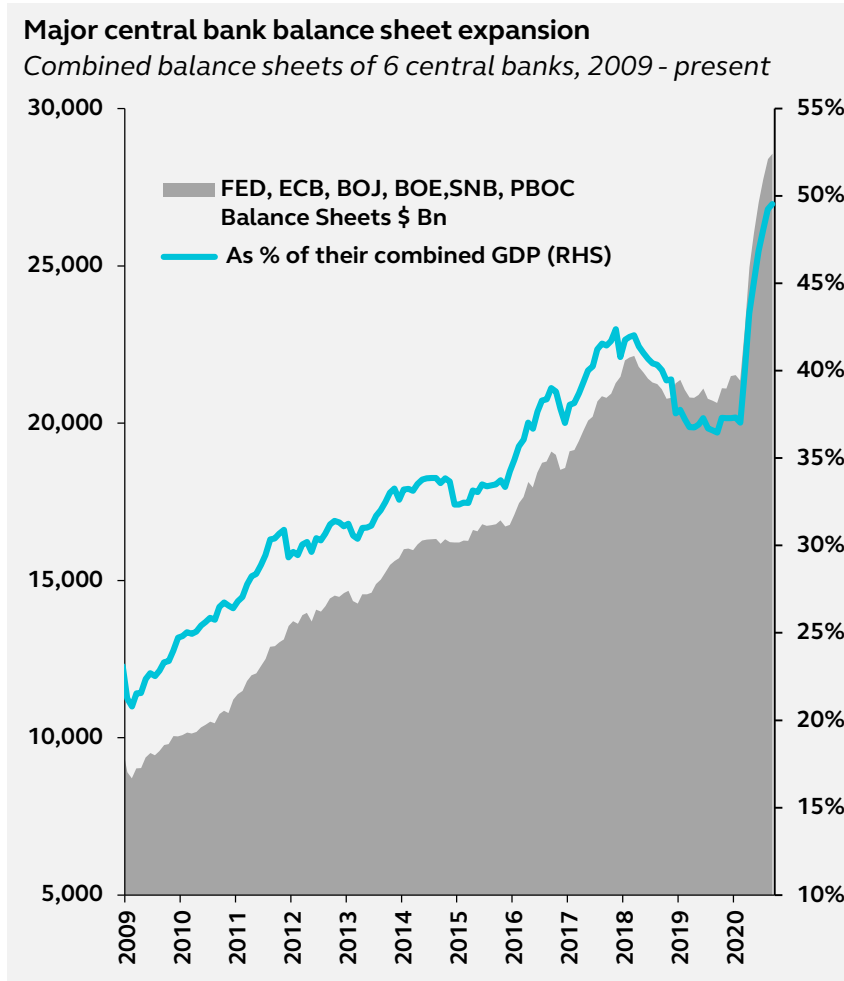
Source: Bloomberg. Data as of August 31, 2020



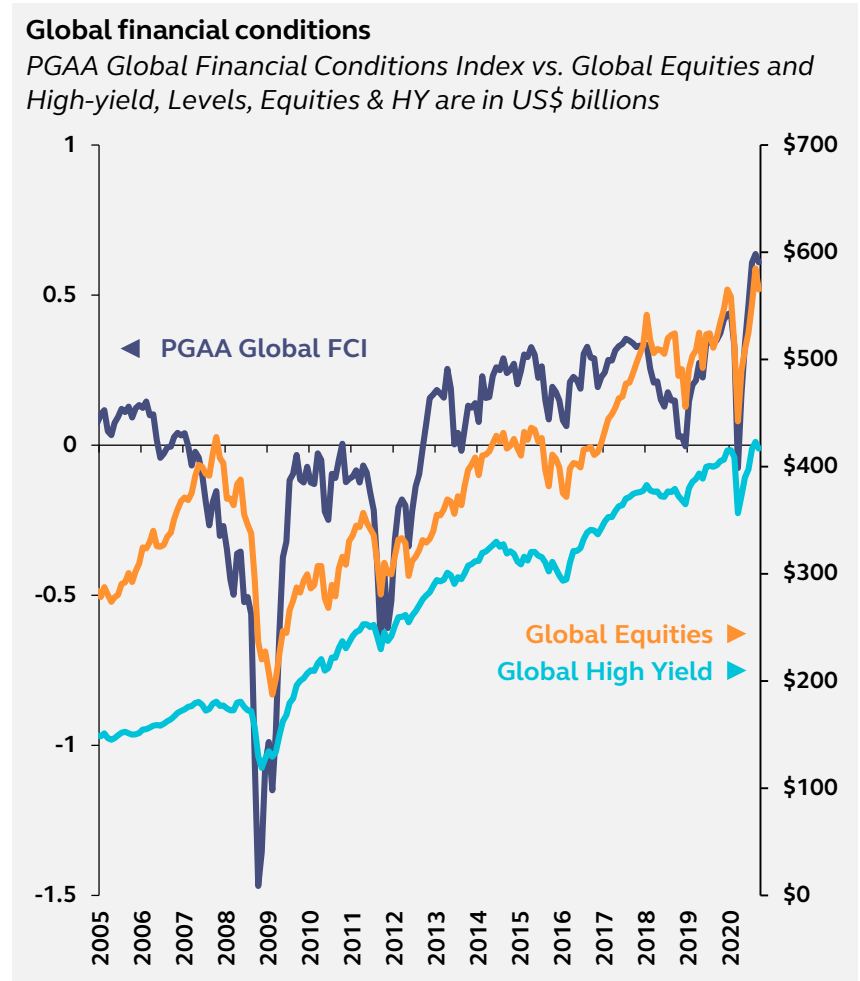
Source: IMF, Principal Global Investors. 2019 – 2021 are IMF estimates. Data as of September 30, 2020.

Central banks have been extraordinarily active

Easy financial conditions are strongly supporting markets



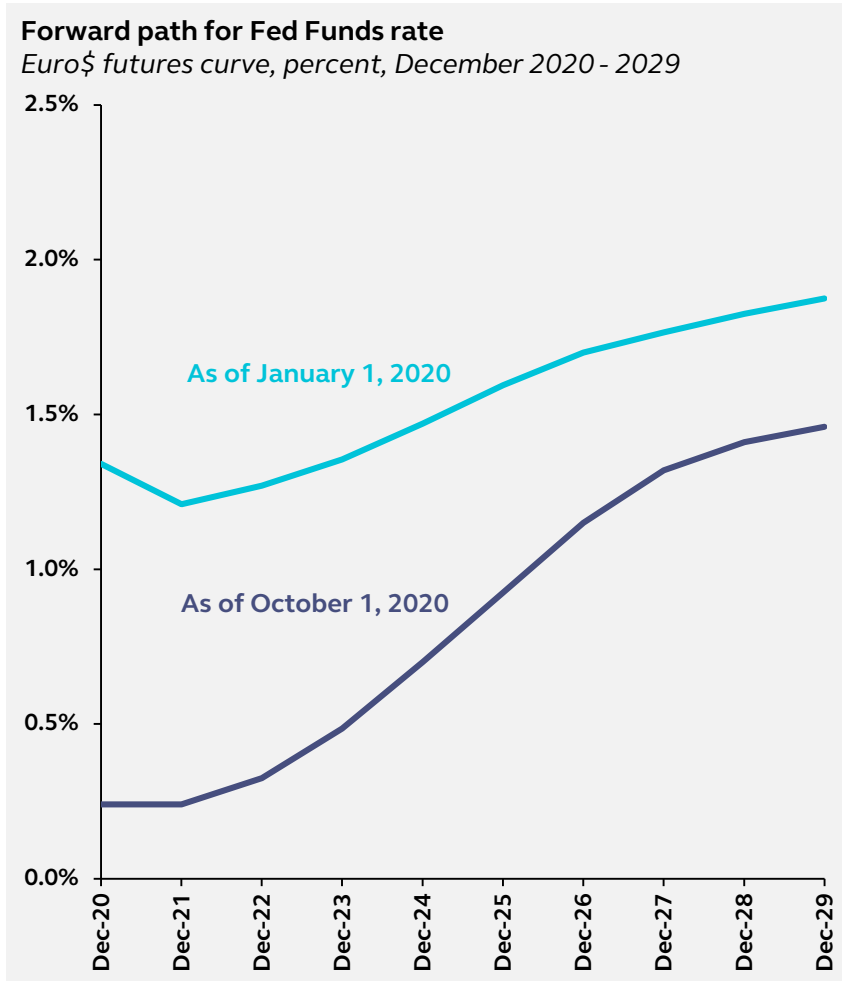
Source: Bloomberg, FactSet. Data as of September 30, 2020.



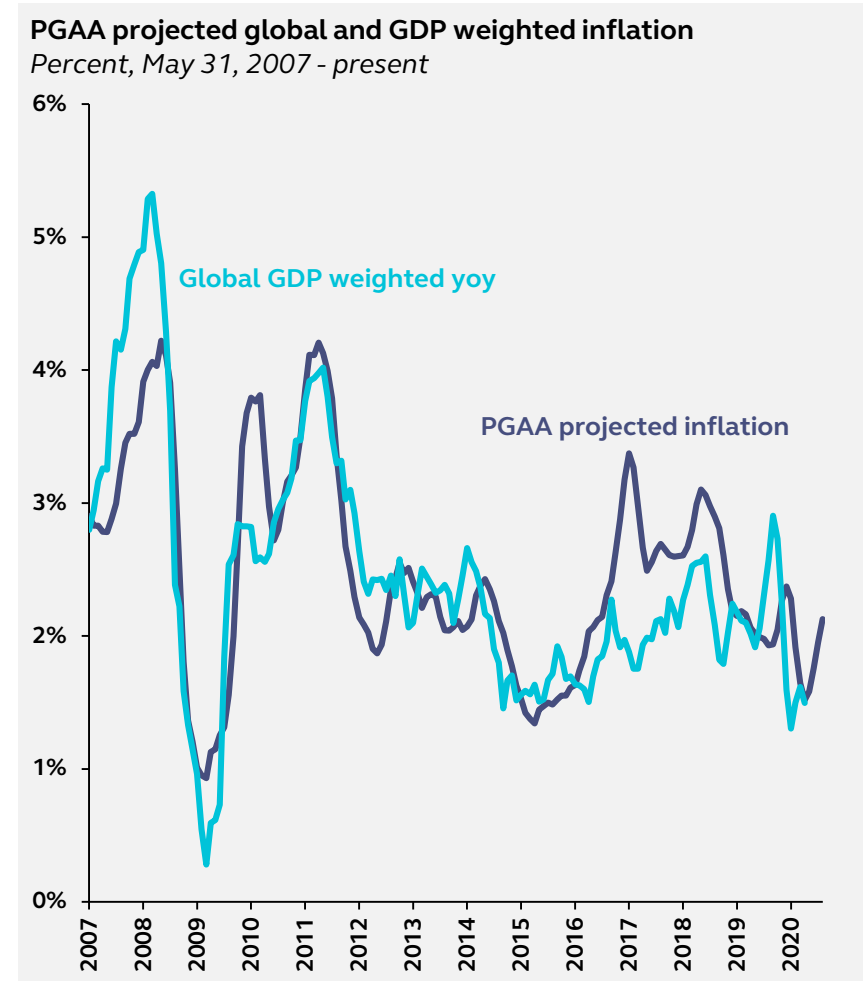
Source: Bloomberg, Principal Global Asset Allocation. Data as of September 30, 2020.

Inflationary pressures remain muted

The wave of central bank liquidity and near zero interest rates expected through 2022



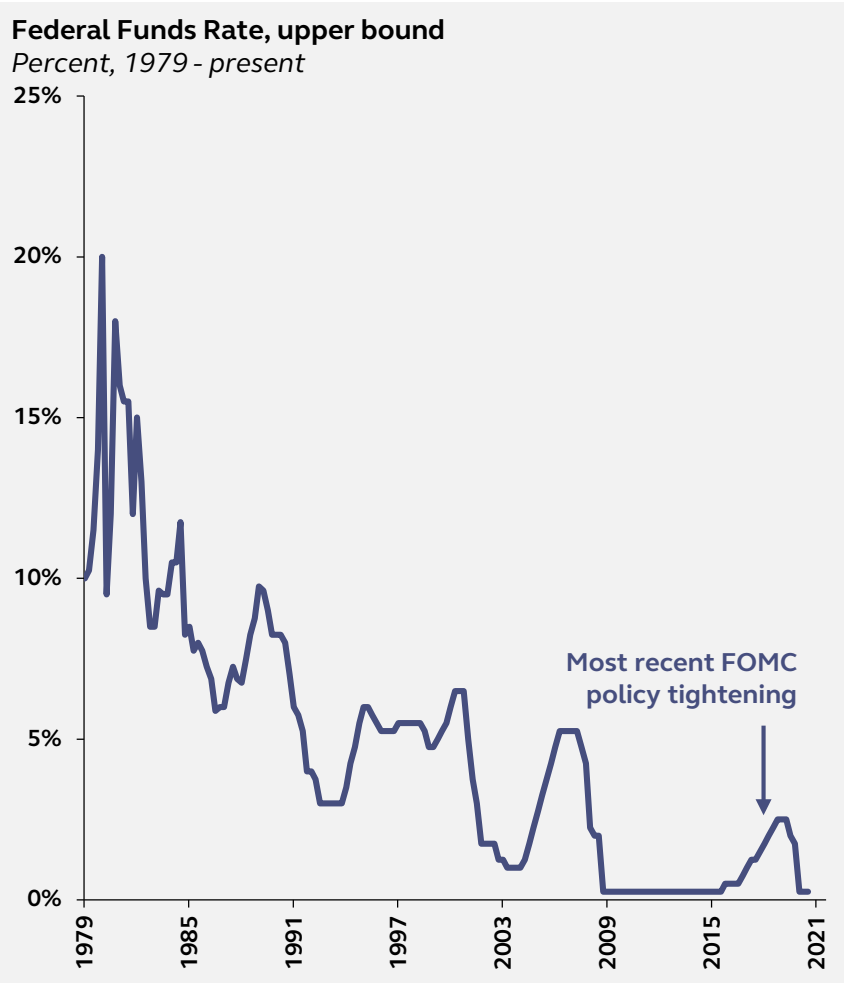
Source: Bloomberg, U.S. Federal Reserve, Principal Global Investors. Data as of October 1, 2020.



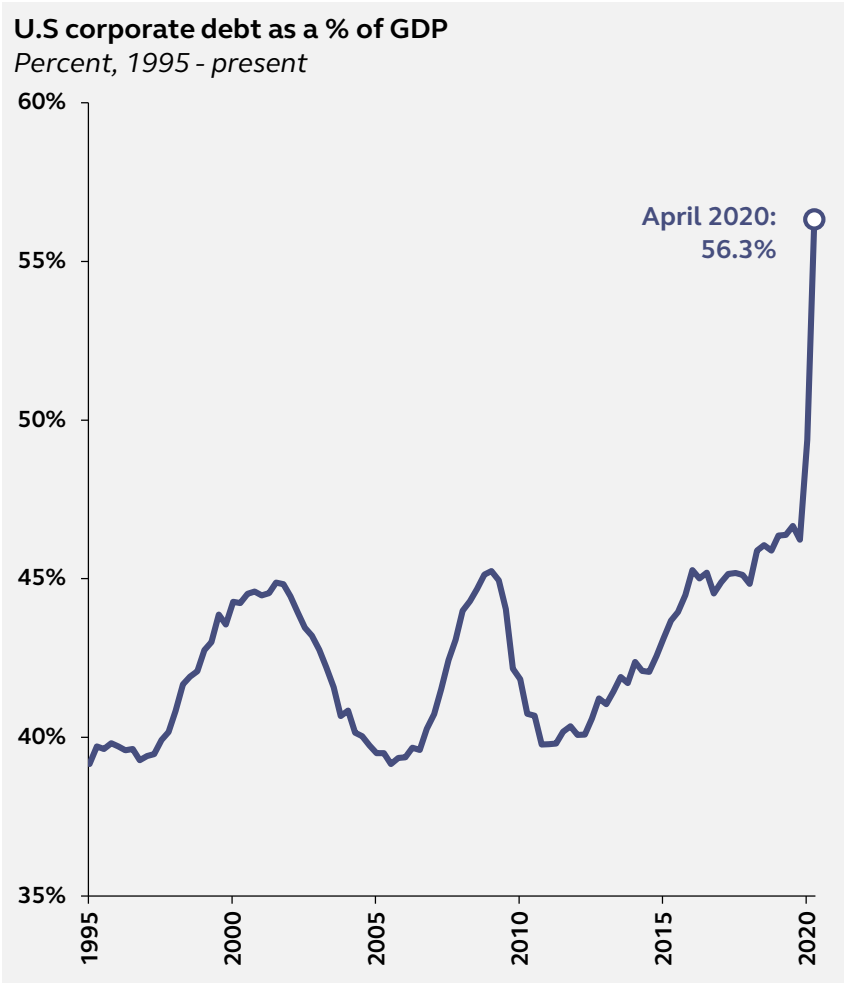
Source: Bloomberg, Principal Global Asset Allocation. Data as of September 30, 2020.

The Fed will need to carefully navigate the unwind of stimulus

Easy money has encouraged a sharp build-up of public and private debt



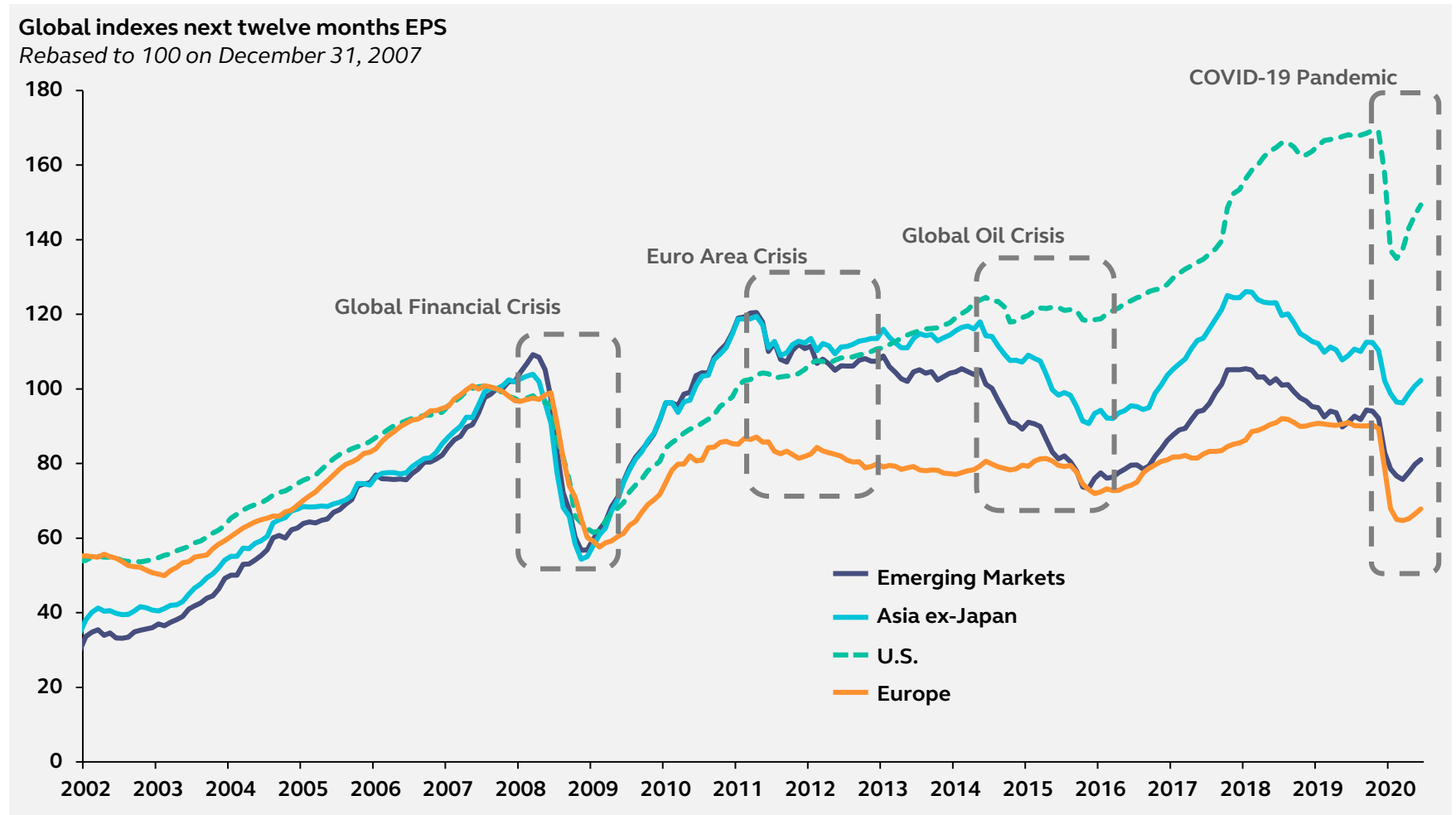
Source: Bloomberg, Principal Global Investors. Data as of September 30, 2020.



Source: Federal Reserve Bank of St. Louis, Principal Global Asset Allocation. Data as of September 30, 2020.

COVID-19 has negatively impacted earnings estimates

Yet, expectations of the size and pace of recovery appear established



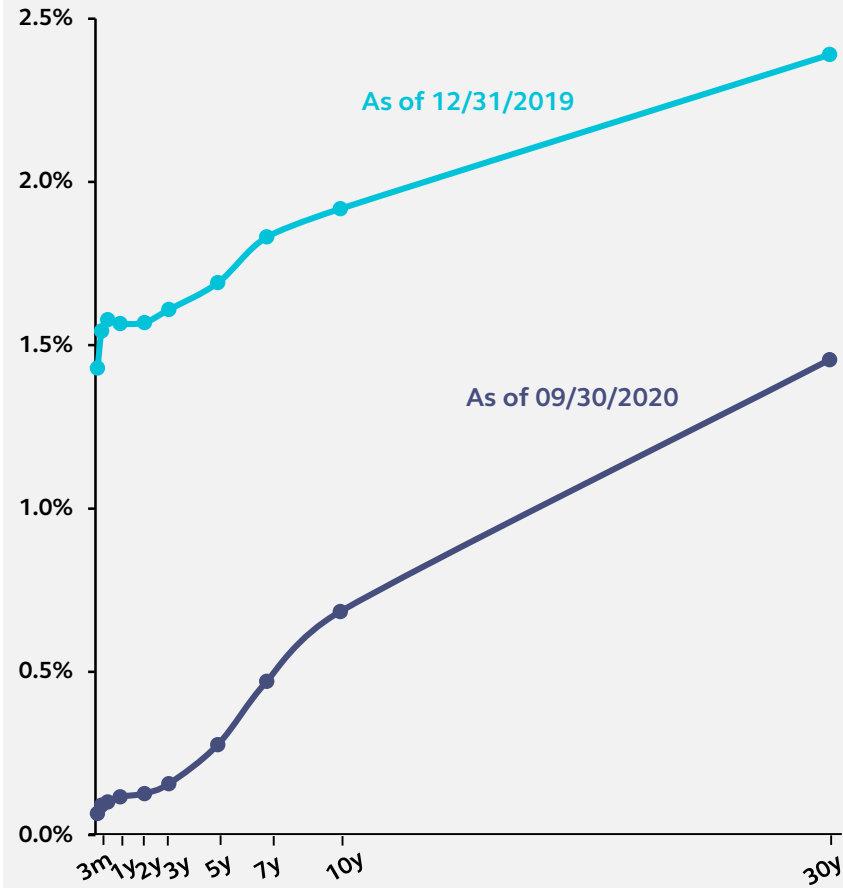
Source: Bloomberg, FactSet, MSCI, Principal Global Asset Allocation. Emerging Markets M – MSCI Emerging Markets, Asia ex-Japan – MSCI Asia ex-Japan, U.S. – S&P 500, Europe – MSCI Europe. Data as of September 30, 2020.

U.S. short-term rates are anchored near zero with increasing slope

Corporate bond spreads are near long-term averages

U.S. Treasury yield curve

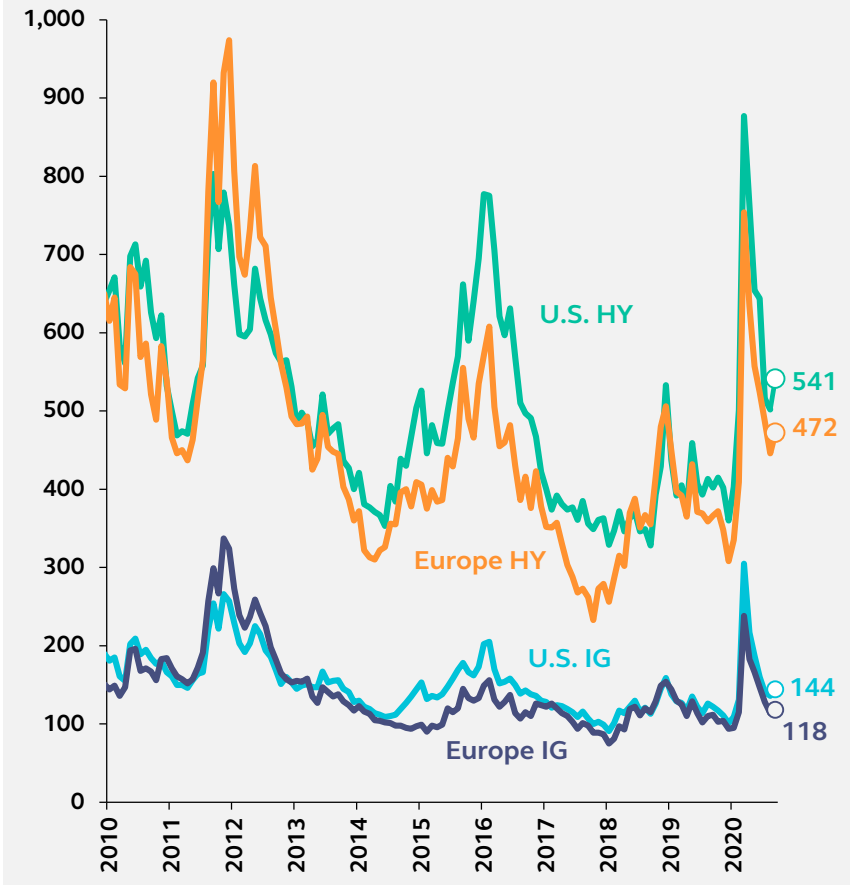
Percent, December 31, 2019 vs. September 30, 2020



Source: Bloomberg, Principal Global Investors. Data as of September 30, 2020.

Investment grade and high yield credit spreads

Option-adjusted spread vs. gov't bonds, bps, 2010 - present



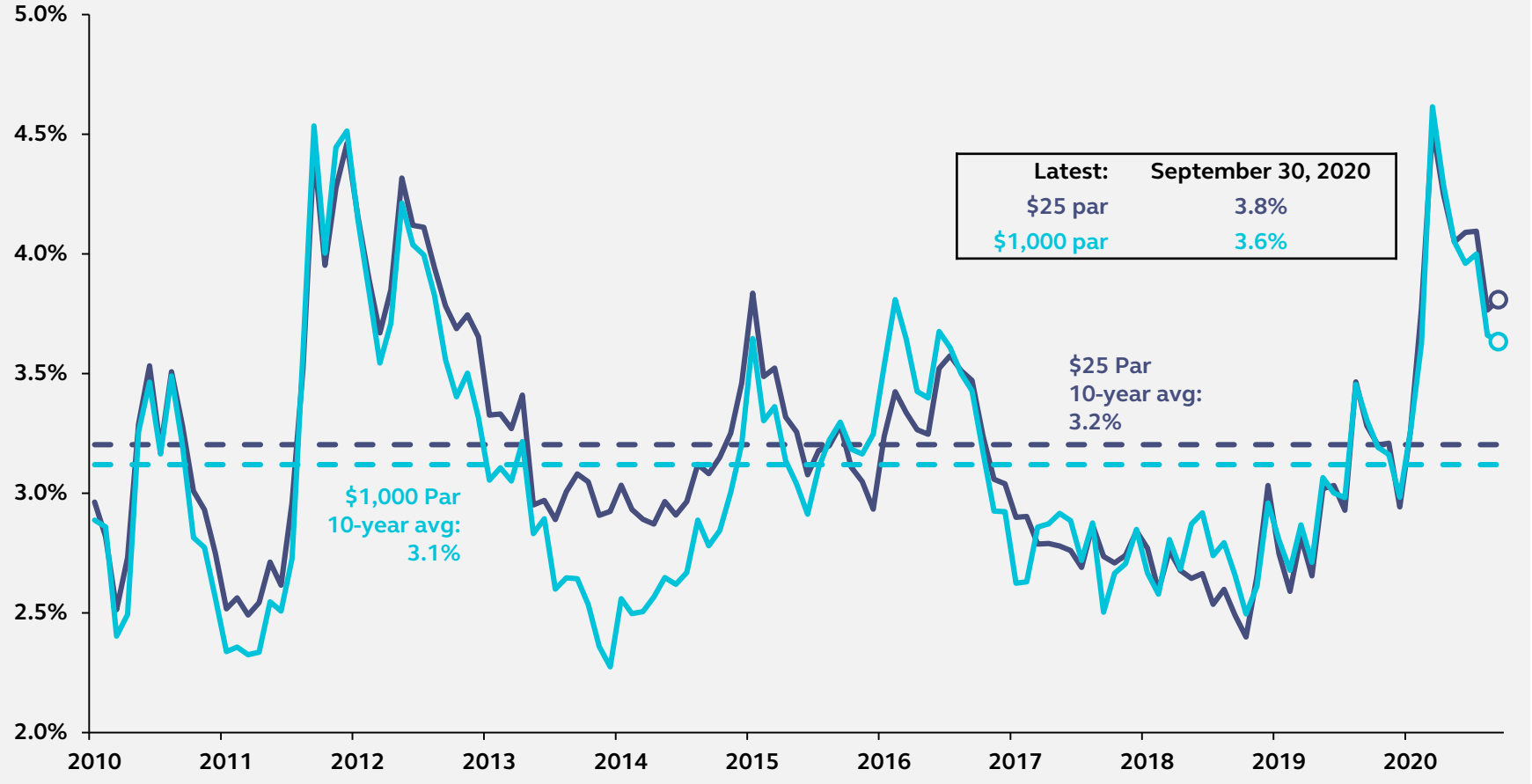
Source: Bloomberg, Principal Global Asset Allocation. All indices are ICE BofaML Indices. Data as of September 30, 2020.

Yield opportunity still available in preferred securities

Spreads are wider than 10-year historical averages

\$25 and \$1,000 par current yield spreads to 30-year U.S. Treasury

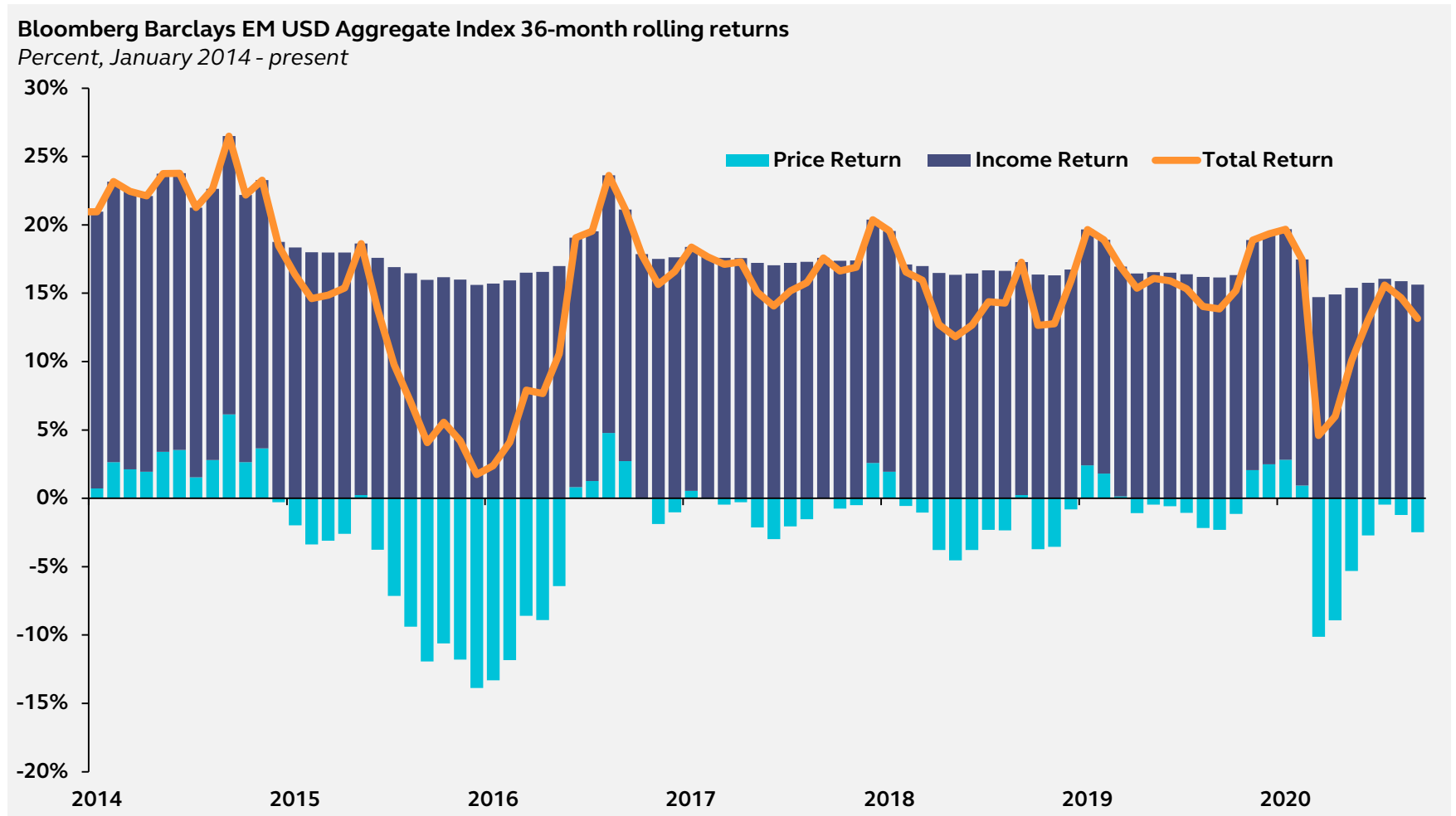
Percent, 2010 – present



Source: Barclays Live, Bloomberg, Principal Global Investors. \$25 Par - ICE BofA Preferred Stock Fixed Rate Index. \$1,000 Par - ICE BofA U.S. Capital Securities Index. Data as of September 30, 2020.

Emerging market debt offers income potential

Unlike DM, EM fixed income has not been reliant on falling rates



Source: Bloomberg, Principal Global Asset Allocation. Data as of September 30, 2020.

> Outlook

Short-term threats abound, long-term opportunities remain

Our base-case economic scenario for the remainder of 2020

1 U.S. economy shrinks by 4.1% in 2020, the impressive rebound in Q3 makes way for a slower recovery in Q4 as economic scarring sets in.

3 Massive stimulus from developed market central banks provides support for risk assets in short term but will be partially offset by smaller fiscal impulse.

2 Corporate earnings end the year down -20% but investor focus has already shifted to a more robust 2021.

4 Risk appetite will be highly sensitive to the outlook for an effective vaccine, continuation of re-opening, and exogenous forces e.g. election, tech regulation.

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

- A second wave of the virus is sizable, preventing governments from prioritizing re-opening.
- Bankruptcies and job losses increase dramatically, despite the promise of governmental aid.
- Additional fiscal stimulus packages are not forthcoming, weighing on confidence, and consumers.
- A contested U.S. election result creates significant volatility and risk-aversion.
- Inflationary pressures build up quicker than expected raising questions around the Fed's dovish resolve.
- A vaccine becomes widely available and distributed before year end, prompting cyclical rotation.
- The U.S. Congress accelerates sweeping regulatory and competition reforms of the tech sector.
- Investors, having just experienced 13 years of consistent growth and calm markets, react impulsively to volatility. Their flight to safety further upends markets that are struggling to regain a steady footing, putting downward pressure on returns amidst significant outflows.

Important information

Index definitions

Bloomberg Barclays Global Aggregate Bond Index comprises global investment grade debt including treasuries, government-related, corporate, and securitized fixed-rate bonds from developed and emerging market issuers. There are four regional aggregate benchmarks that largely comprise the Global Aggregate Index: the US Aggregate, the Pan-European Aggregate, the Asian-Pacific Aggregate, and the Canadian Aggregate Indices. The Bloomberg Barclays Global Aggregate Bond Index also includes Eurodollar, Euro-Yen, and 144A Index-eligible securities and debt from other local currency markets not tracked by regional aggregate benchmarks. ©2020 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

This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

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