

Principal Global Investors
Morley Capital Management

Economic and market review

2Q 2020 | As of June 30, 2020



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

Virus activity and fiscal response are key market drivers

Our base-case economic scenario for the remainder of 2020

1 U.S. economy shrinks by 3.9% in 2020, as the worst of the crisis felt in 2Q; Expect a mild bounce in 3Q, but softening in 4Q as fiscal stimulus is eased.

3 Massive stimulus from developed market central banks provides support for risk assets in short term. Rates to remain lower and grow slower, for longer.

2 Risk appetite will be highly sensitive to the outlook of the virus and the impact of the lockdown; Selectivity remains key across all asset classes.

4 Uncertainty is the theme of 2020, with COVID, U.S./China trade, oil, and the U.S. election casting a fog over the investment landscape.

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

- The virus resurges later in the year, forcing renewed lockdowns.
- Bankruptcies increase dramatically, despite the promise of governmental aid.
- Global governments remain divided, even as central banks work together.
- The U.S. election cycle creates volatility, especially if markets start pricing in election risks caused by polling challenges & social distancing measures
- Supportive government aid could come with strings attached, including stricter laws on buybacks, distributions, leverage, etc.
- Investors, having just experienced 13 years of consistent growth and calm markets, react impulsively to the recent volatility. Their flight to safety further upends markets that are struggling to regain a steady footing, putting downward pressure on returns amidst significant outflows.

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
Fixed Income						
B of A ML U.S. Treasury Bill 3-month Index	0.02%	0.60%	1.63%	1.77%	1.19%	0.64%
Bloomberg Barclays Aggregate Bond Index	2.90%	6.14%	8.74%	5.32%	4.30%	3.82%
Bloomberg Barclays U.S. Corp High Yld 2% Issuer Capped Index	10.14%	-3.83%	0.00%	3.32%	4.79%	6.67%
Bloomberg Barclays Long-Term Govt/Credit Index	0.28%	20.97%	25.14%	11.96%	9.21%	7.71%
U.S. Equities						
Russell 1000 Value Index	14.29%	-19.26%	-8.84%	1.82%	4.64%	10.41%
S&P 500 Index	20.54%	-3.08%	7.51%	10.73%	10.73%	13.99%
Russell 1000 Growth Index	27.84%	9.81%	23.28%	18.99%	15.89%	17.23%
Russell Midcap Index	24.61%	-9.13%	-2.24%	5.79%	6.76%	6.95%
Russell 2000 Index	25.42%	-12.98%	-6.63%	2.01%	4.29%	10.50%
Non-U.S. Equities						
MSCI EAFE NTR Index	14.88%	-11.34%	-5.13%	0.81%	2.05%	5.73%
MSCI ACWI Ex USA Index	16.12%	-11.00%	-4.80%	1.13%	2.26%	4.97%
MSCI Emerging Markets Index	18.08%	-9.78%	-3.39%	1.90%	2.86%	3.27%
Other						
MSCI U.S. REIT Index	11.70%	-18.45%	-12.87%	0.08%	4.08%	9.06%
S&P GSCI® Index	-41.42%	-41.42%	-41.14%	-13.01%	-8.42%	-7.04%
U.S. Dollar Index	2.76%	2.76%	1.81%	-0.50%	0.14%	2.02%

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.

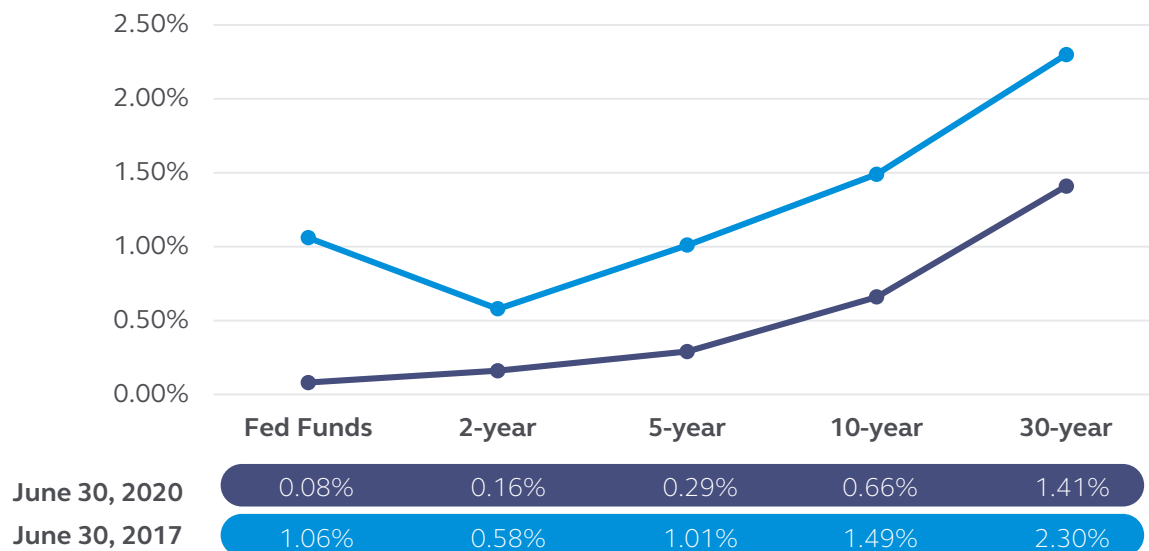
The history of interest rates

As of June 30, 2020



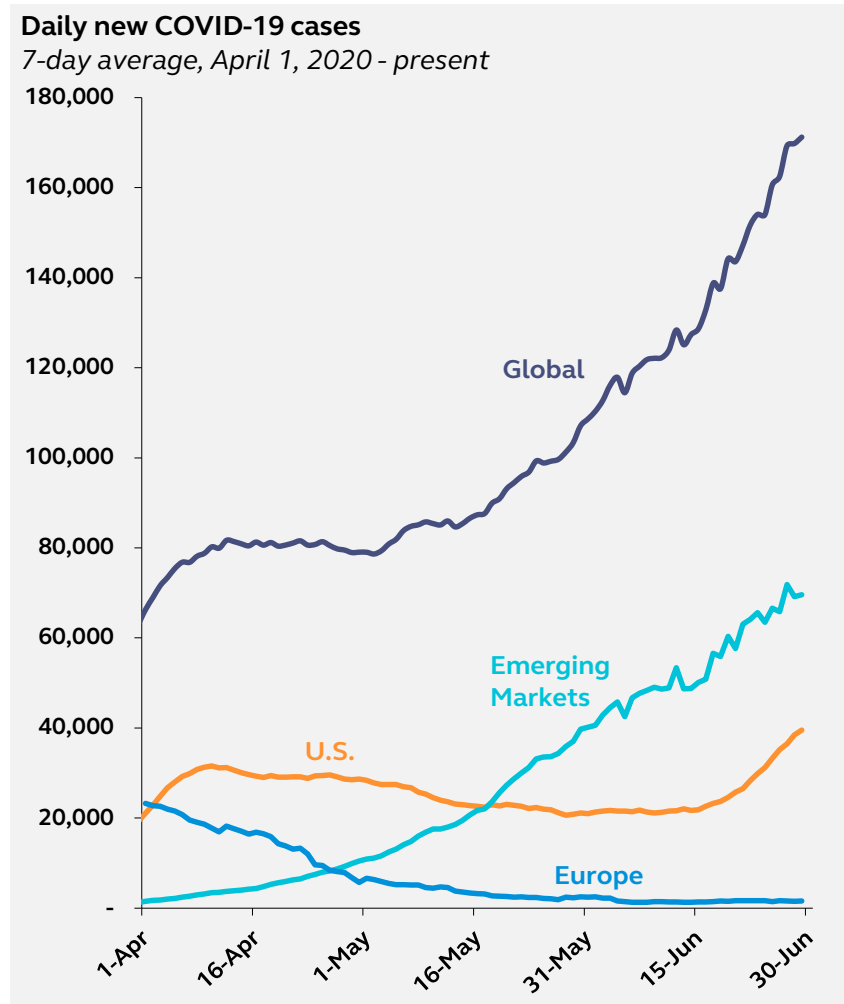
How have interest rates changed in recent years?

	June 2017	June 2018	June 2019	June 2020
2-year	0.58%	1.38%	1.75%	0.16%
5-year	1.01%	1.89%	1.76%	0.29%
10-year	1.49%	2.31%	2.00%	0.66%
2- to 10-year spread	0.91%	0.93%	0.25%	0.50%
30-year	2.30%	2.98%	2.52%	1.41%

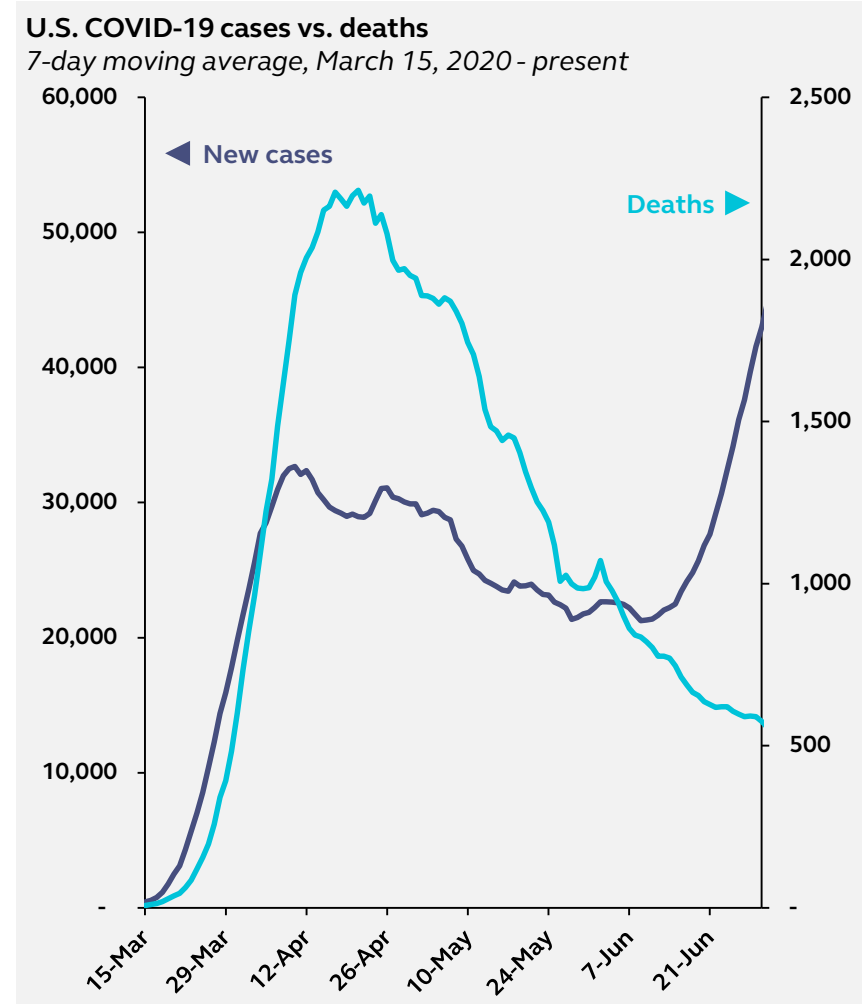


Progress toward defeating COVID-19 remains paramount

New cases are again on the rise as governments grapple with reopening



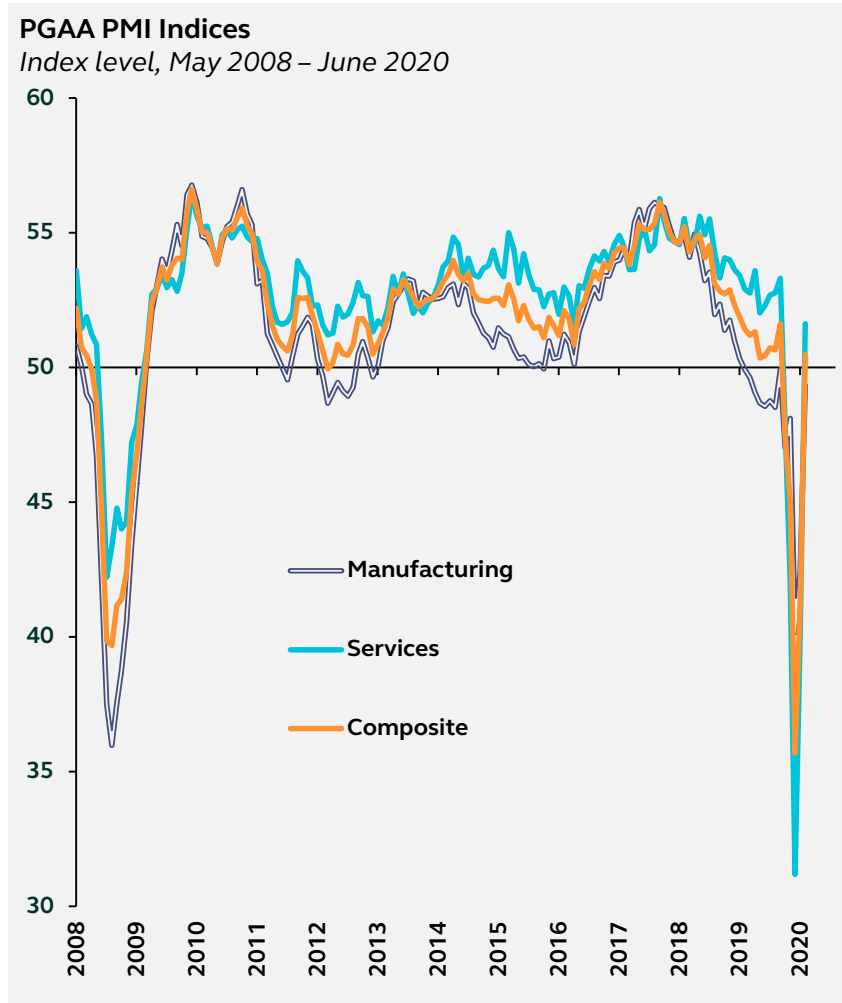
Source: Bloomberg, Johns Hopkins CSSE, Principal Global Investors. Europe – France, Germany, Italy & Spain. Global is cumulative of all reporting countries. Data as of June 30, 2020.



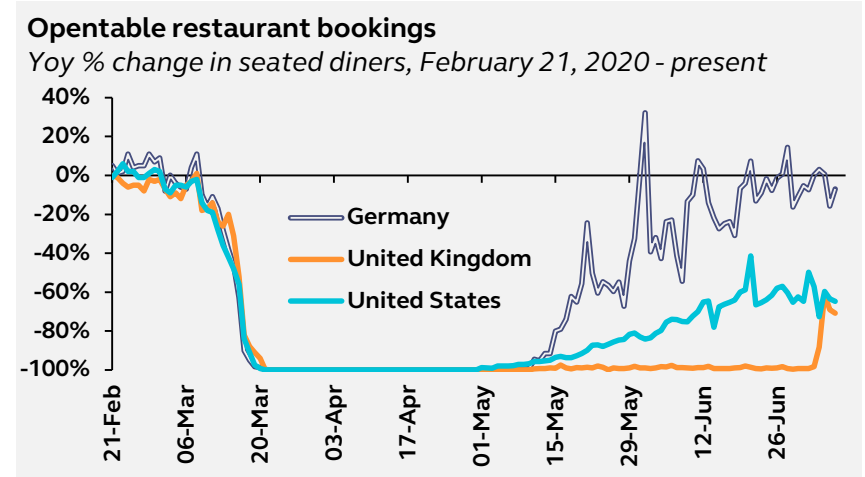
Source: Bloomberg, Johns Hopkins CSSE, Principal Global Investors. Data as of June 30, 2020.

There has been a bit of a rebound in the high-frequency data

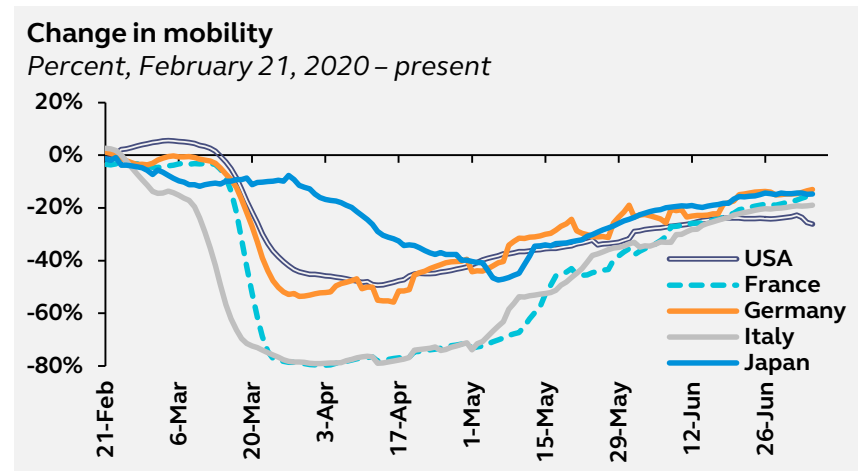
Much activity is still a ways off its “pre-COVID” peak



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



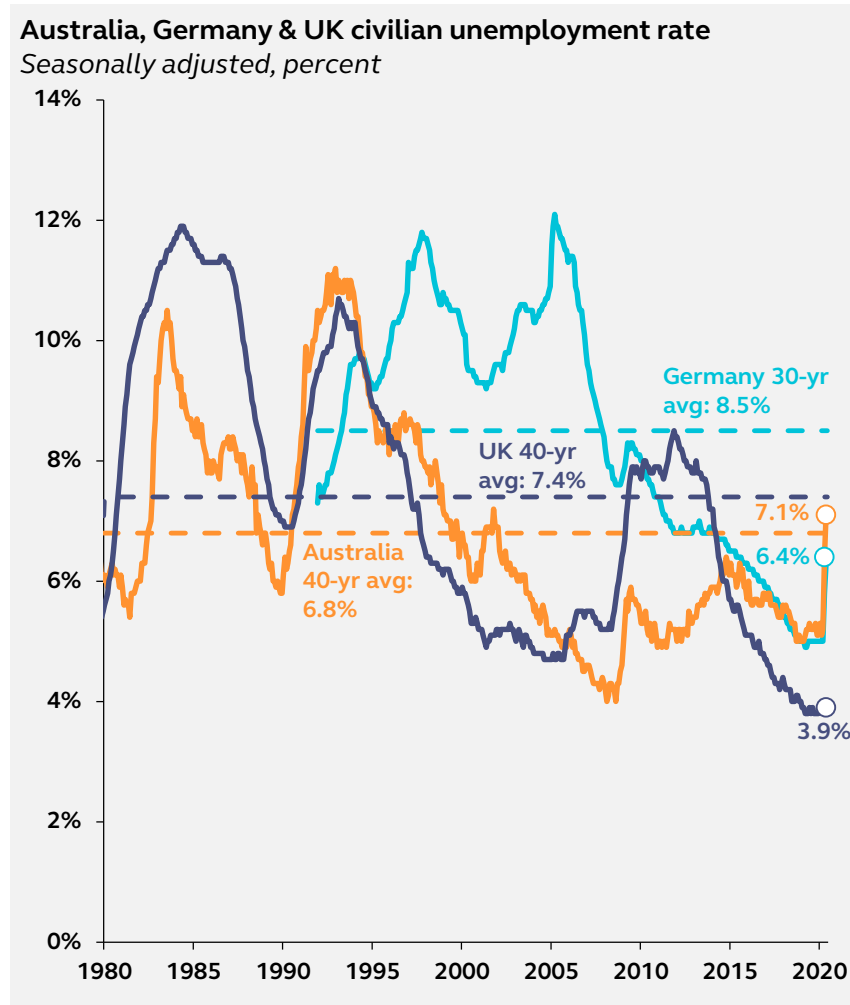
Source: Opentable, Principal Global Asset Allocation. Data as of July 7, 2020.



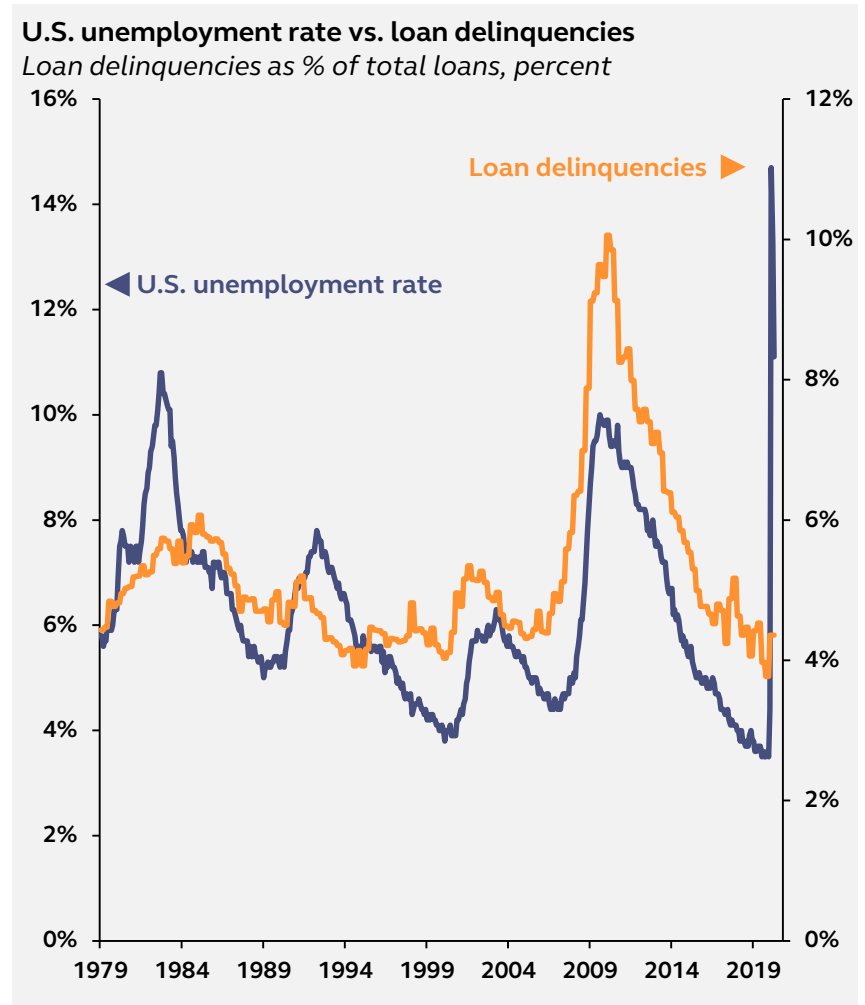
Source: Google Mobility Reports, Principal Global Asset Allocation. Data is based on the 7-day moving avg. of retail & recreation, workplace & transit categories of Google’s Mobility Reports. Data as of July 7, 2020.

Government support has limited some of the job losses

Elevated unemployment and rising bankruptcies suggest economic scarring



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

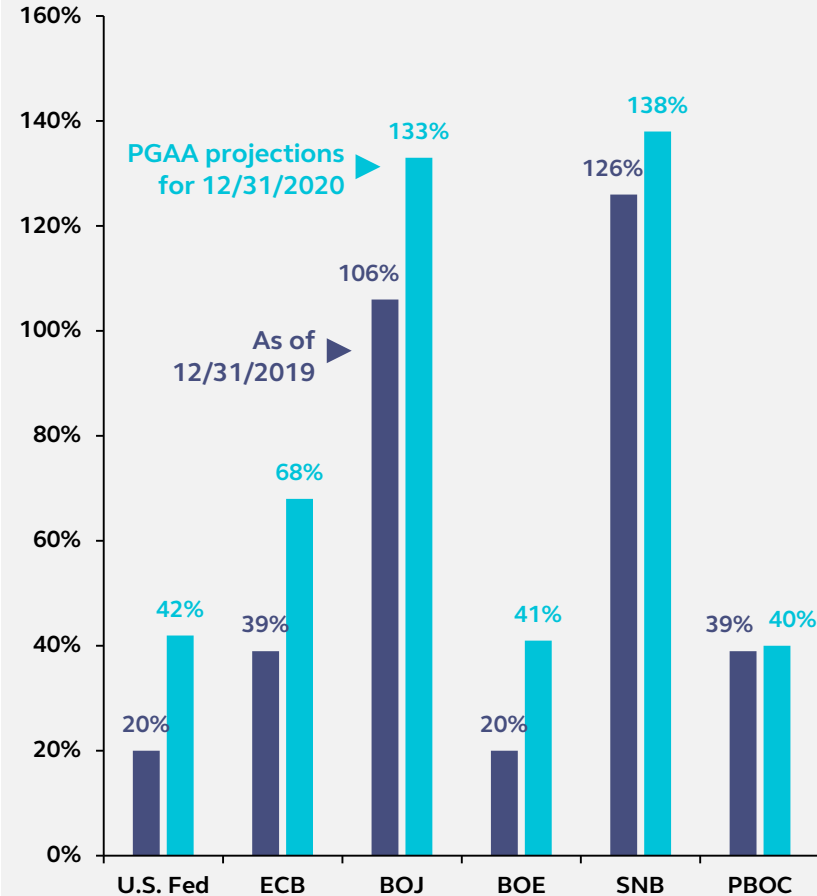


Source: Bureau of Labor Statistics, FactSet, Principal Global Asset Allocation. Data as of June 30, 2020.

An extreme, and necessary, central bank response

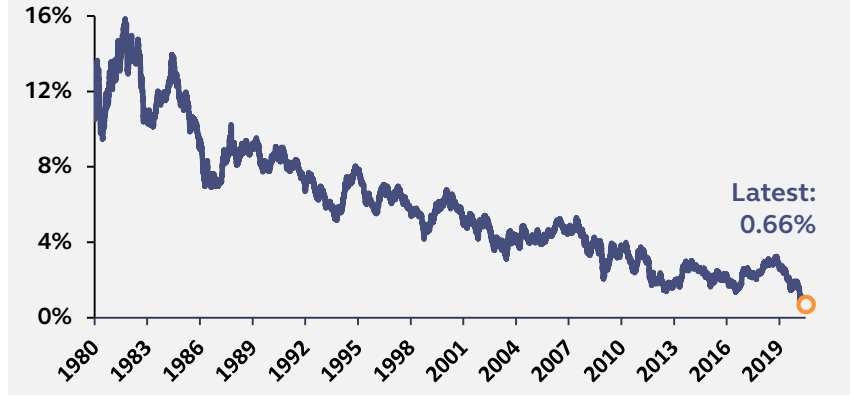
The lowest UST yield in 40 yrs. and the easiest financial conditions in 15 yrs.

Major central bank balance sheets as percentage of GDP
12/31/2019 vs. PGAA projections for 12/31/2020



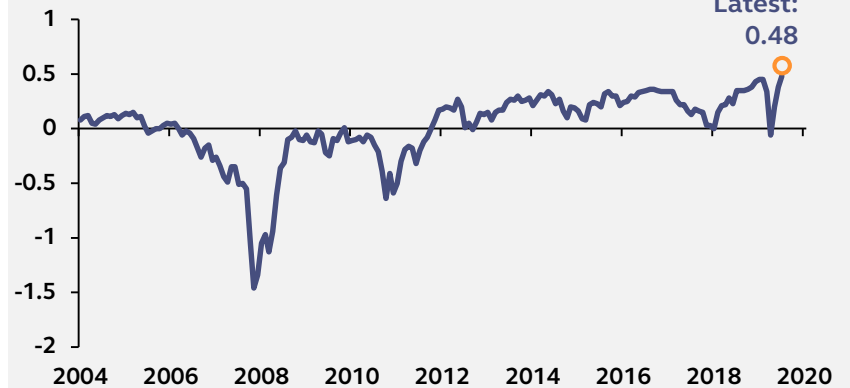
Source: Bloomberg, Principal Global Asset Allocation. U.S. Fed – U.S. Federal Reserve; ECB – European Central Banks; BOJ – Bank of Japan; BOE – Bank of England; SNB – Swiss National Bank; PBOC – People Bank of China. Data as of June 30, 2020.

U.S. Treasury 10-year yield
1980 – present, percent



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

PGAA Global Financial Conditions Index
Level, 2004 - present

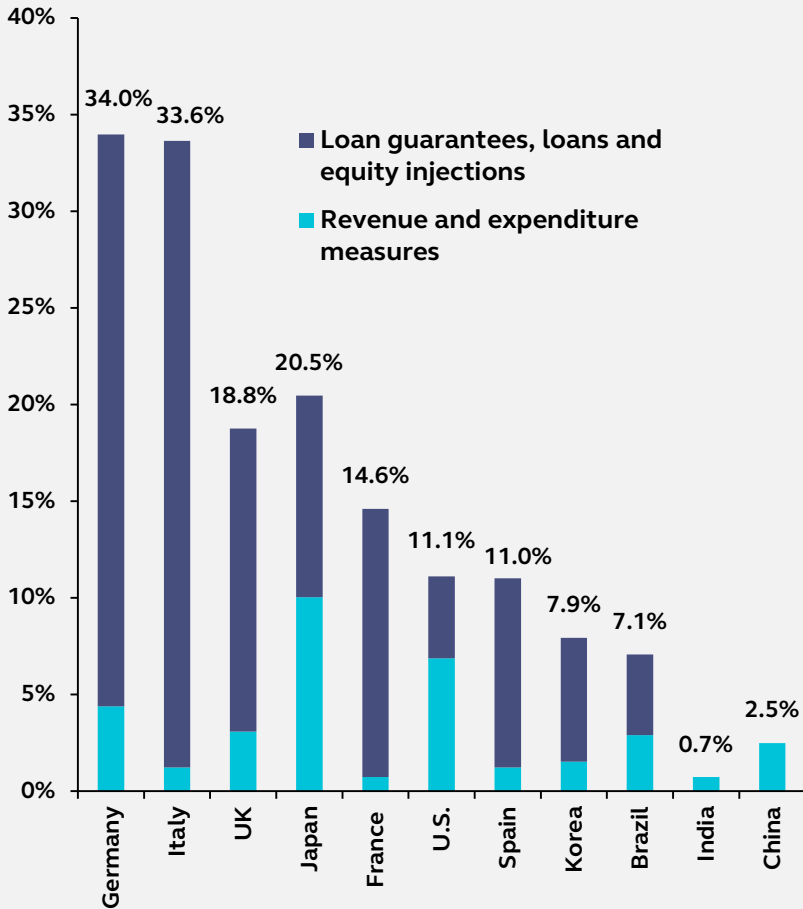


Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2020.

Gauging the potential impact of further policy decisions

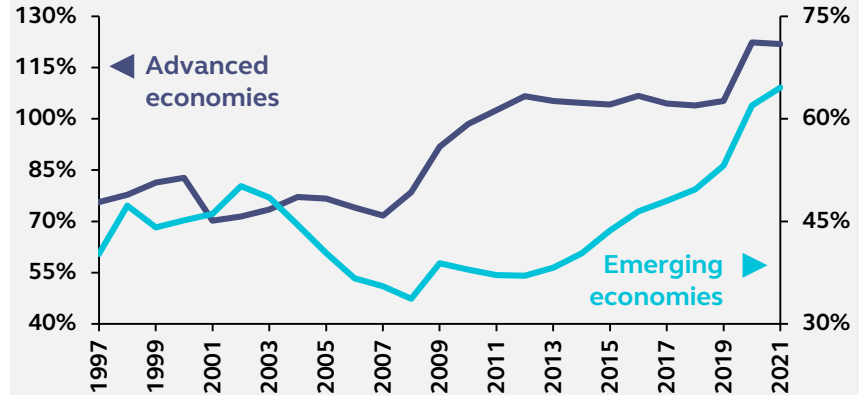
Fed Chair Powell: “We’re not even thinking about raising rates...” July 29, 2020

Fiscal response to COVID-19
Percent of GDP



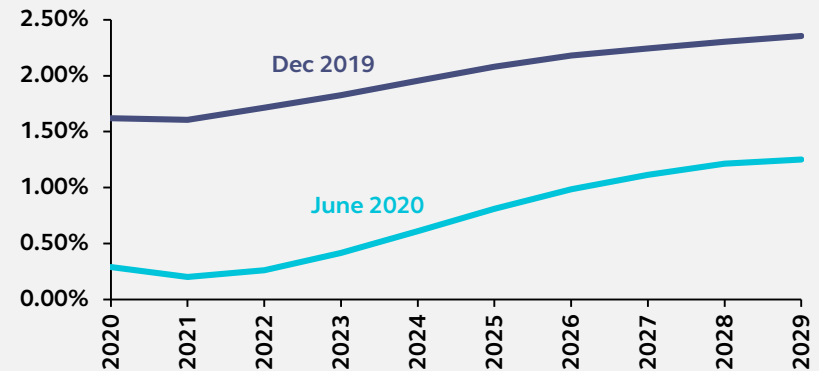
Source: IMF, Principal Global Investors. Fiscal measures are estimates from the IMF’s Fiscal Monitor Database from June 2020. Data as of June 30, 2020.

Advanced vs. emerging economies gross gov’t debt
Gross gov’t debt as percent of GDP, 1997 - present



Source: IMF, Principal Global Investors. Data as of June 30, 2020.

Market participants don’t foresee rate hikes until late 2022
3 month LIBOR implied Euro\$ futures



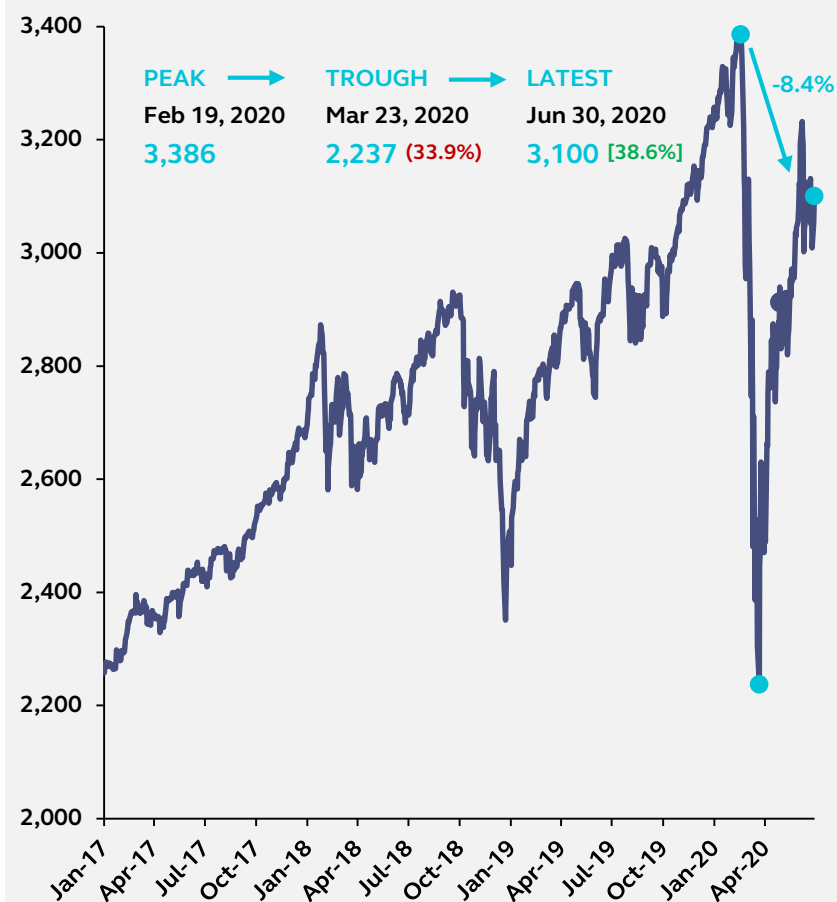
Source: FactSet, Principal Global Asset Allocation. Data as of June 30, 2020.

Markets have come roaring back...

A v-shaped recovery and the 2nd largest quarterly return in 30+ years

S&P 500 Total Return Index

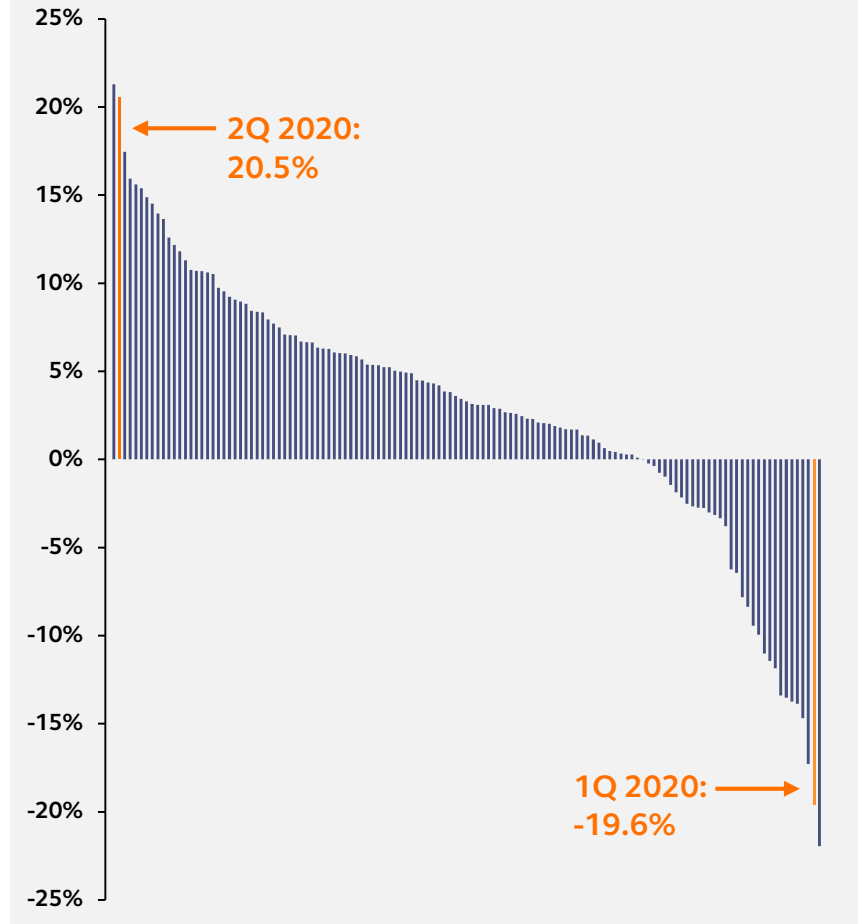
Index level, January 2017 - present



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

S&P 500 Total Return Index

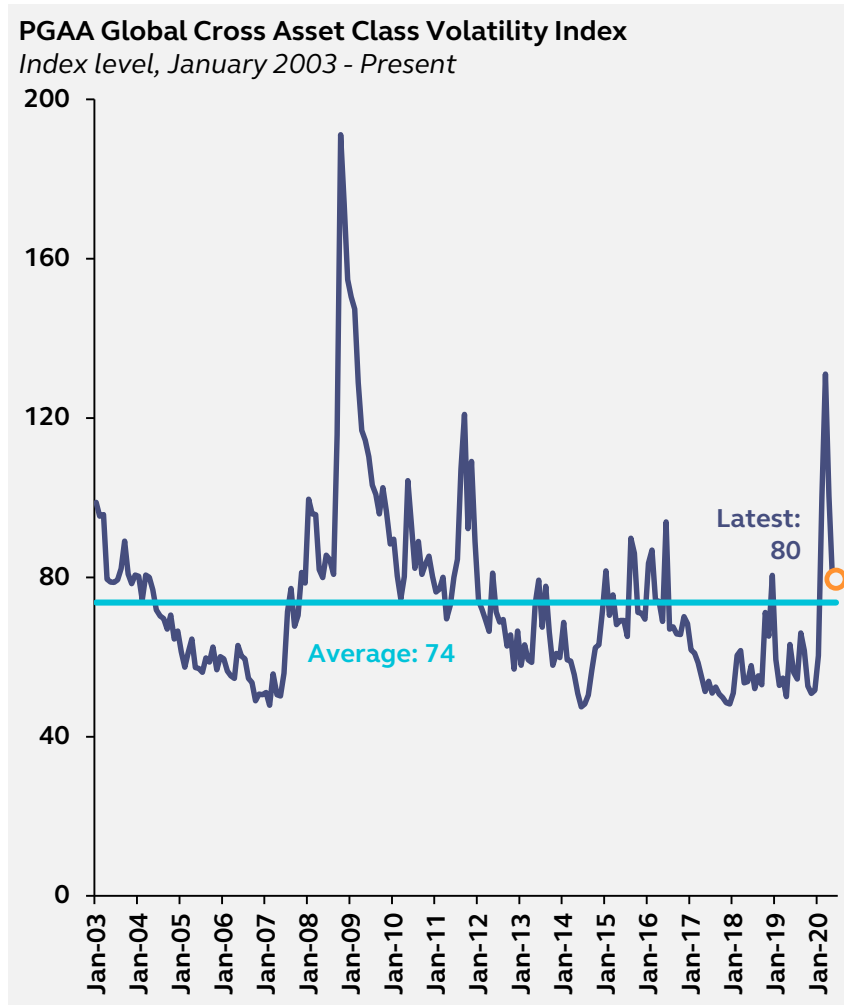
Ranked quarterly performance, 1988 - present



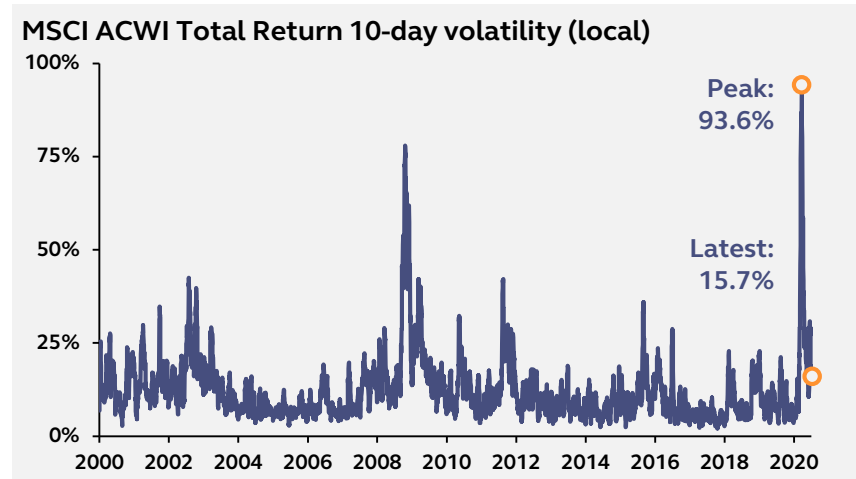
Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2020.

... while volatility has returned to long-term averages

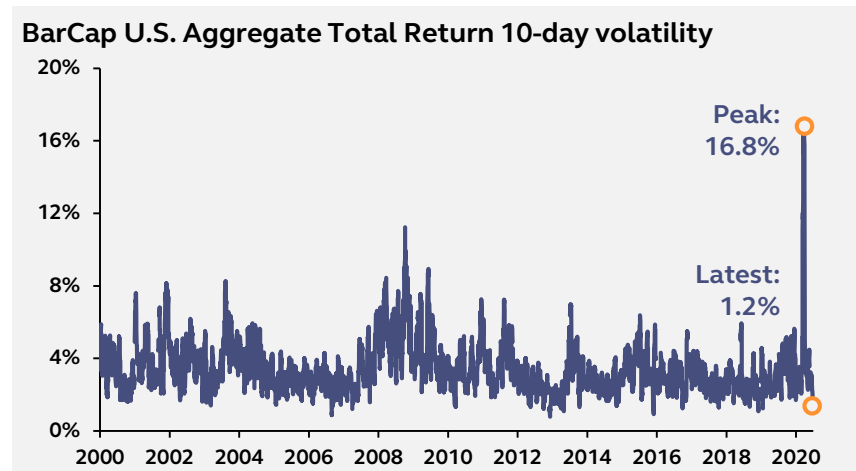
After a COVID-induced eruption in 1Q, volatility has normalized



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



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



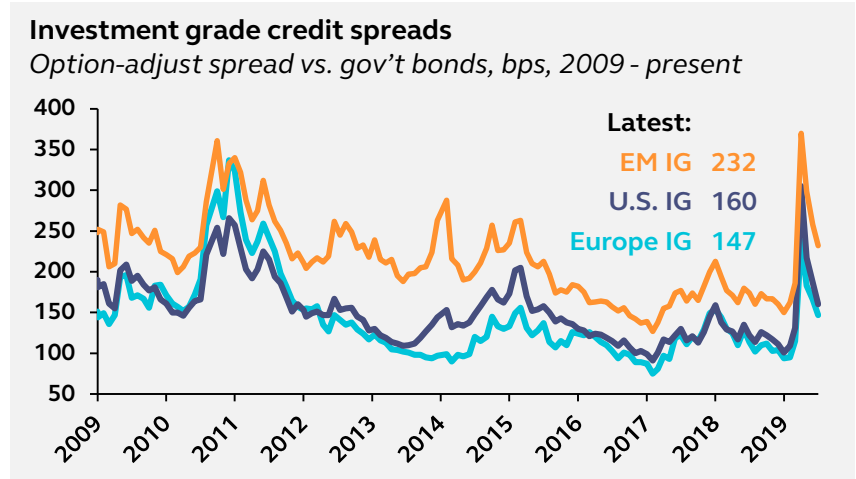
Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2020.

Global credit market segments benefit from central bank support

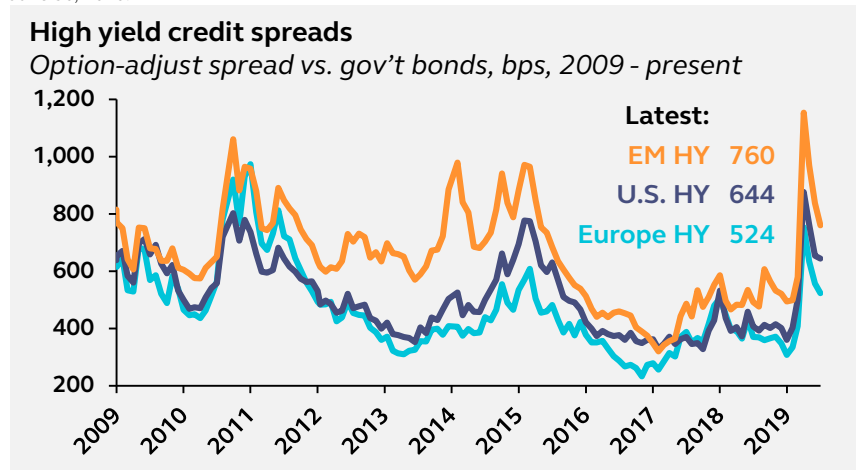
The spread and rate outlook indicates stability and relative attractiveness



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



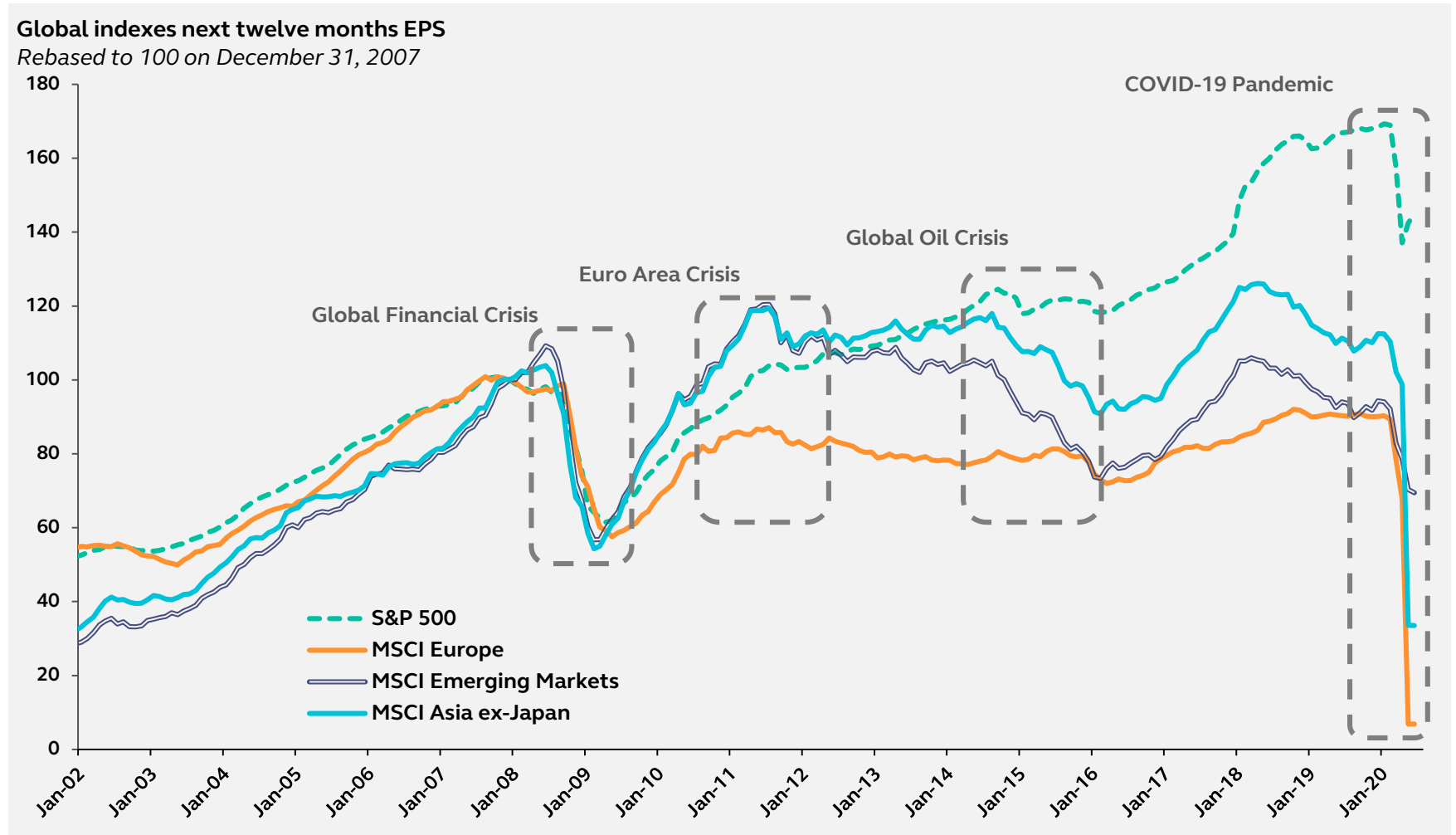
Source: Bloomberg, Principal Global Asset Allocation. All indices are ICE BofaML Indices. Data as of June 30, 2020.



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

Markets need earnings to support the recovery

More than 180 companies in the S&P 500 have paused earnings guidance



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

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Index definitions

B of A ML U.S. Treasury Bill 3-Month Index is an unmanaged index that is comprised of a single U.S. Treasury issue with approximately three months to final maturity, purchased at the beginning of each month and held for one full month.

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.

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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.

Standard & Poor's GSCI Index serves as a benchmark for investment in the commodity markets and as a measure of commodity performance over time.

U.S. Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

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.

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Important Information

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