Principal Morley

Principal Asset Management℠

Economic and market review

Principal Asset Allocation Viewpoints

As of June 30, 2024

Q3 2024 key themes

- **A U.S economic moderation, but cyclical upturns elsewhere.**
  U.S. growth is softening as lower-income households feel the bite of higher interest rates. Other developed markets are now enjoying cyclical upturns, yet the limited nature of their recoveries suggests that U.S. economic dominance still holds.

- **Global inflation tentatively resumes its last mile of deceleration.**
  The inflation scare of 1Q24 is now waning, but a few more months of soft inflation data are required to validate that disinflation is proceeding as necessary. Without a sharp labor market slowdown, global inflation will unlikely reach central bank targets until late 2025, if not 2026.

- **Central bank cutting cycles are set to be slow and shallow.**
  A first Fed rate cut could occur in September, provided inflation continues to decelerate and economic activity does not reaccelerate. Other central banks have started easing, but their next moves will fall back in line with the Fed's actions.

- **Elevated fixed income yields continue drawing investor interest.**
  Macro resilience should ensure a gradual rise in defaults rather than a sudden spike, meaning credit spreads are unlikely to widen significantly from their current levels. Fixed income yields are markedly higher than a few years ago.

- **With potential gains across asset classes, staying in cash is the leading risk.**
  Assets in money market funds have ballooned to a record $6 trillion, with investors attracted by elevated yields. Now, this cash represents a potential tailwind to risk assets.

Equities returns were mixed for the quarter with U.S. large cap growth outperforming the broader market.

Fixed income markets were also mixed for the quarter with high quality long-term bonds delivering negative returns.

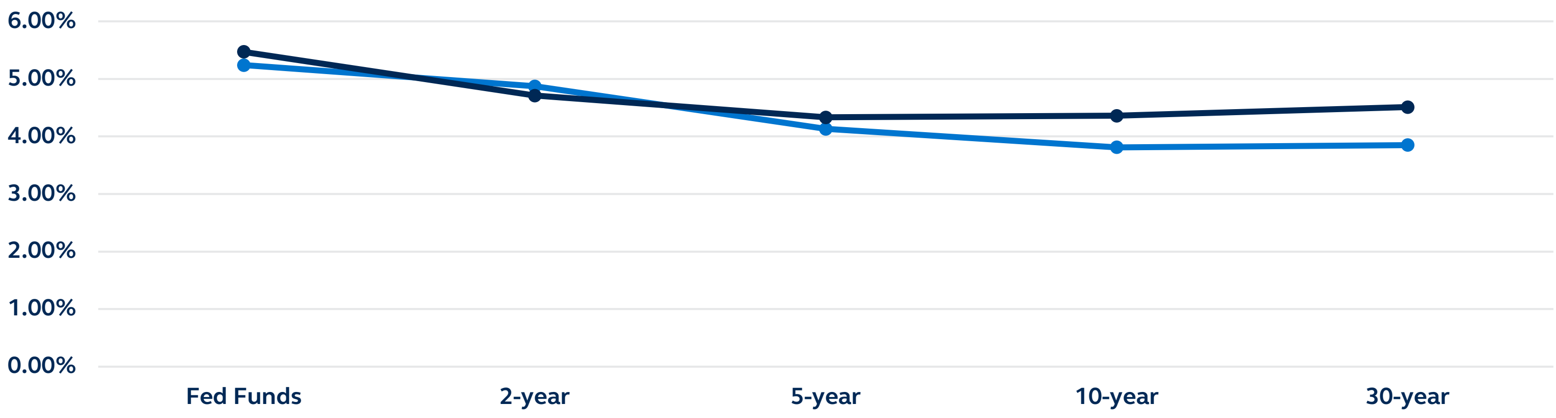
	3-month	YTD	1-year	3-year	5-year	10-year
Fixed Income						
ICE BofA U.S. Treasury Bill 3-month Index	1.32%	2.63%	5.40%	3.03%	2.16%	1.51%
Bloomberg Aggregate Bond Index	0.07%	-0.71%	2.63%	-3.02%	-0.23%	1.35%
Bloomberg U.S. Corp High Yld 2% Issuer Capped Index	1.09%	2.58%	10.43%	1.64%	3.09%	4.30%
Bloomberg Long-Term Govt/Credit Index	-1.73%	-4.10%	-1.58%	-8.51%	-2.22%	1.65%
U.S. Equities						
Russell 1000 Value Index	-2.17%	6.62%	13.06%	5.52%	9.01%	8.23%
S&P 500 Index	4.28%	15.29%	24.56%	10.01%	15.05%	12.86%
Russell 1000 Growth Index	8.33%	20.70%	33.48%	11.28%	19.34%	16.33%
Russell Midcap Index	-3.35%	4.96%	12.88%	2.37%	9.46%	9.04%
Russell 2000 Index	-3.28%	1.73%	10.06%	-2.58%	6.94%	7.00%
Non-U.S. Equities						
MSCI EAFE NTR Index	-0.42%	5.34%	11.54%	2.89%	6.46%	4.33%
MSCI ACWI ex-USA Index	0.96%	5.69%	11.62%	0.46%	5.55%	3.84%
MSCI Emerging Markets Index	5.00%	7.49%	12.55%	-5.07%	3.10%	2.79%
Other						
MSCI U.S. REIT Index	-0.22%	-0.84%	6.25%	-0.97%	2.68%	4.55%
S&P GSCI® Index	0.65%	11.08%	15.01%	12.69%	8.28%	-3.12%
U.S. Dollar Index	1.26%	4.47%	2.87%	4.63%	1.95%	2.87%

As of June 30, 2024.
Source: Morningstar Direct. 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?

	June 30, 2021	June 30, 2022	June 30, 2023	March 31, 2024	June 30, 2024
Fed Funds	0.05	1.28	5.24	5.49	5.47
2-year	0.25	2.92	4.87	4.59	4.71
5-year	0.87	3.01	4.13	4.21	4.33
10-year	1.45	2.98	3.81	4.20	4.36
2- to 10-year spread	1.20	0.06	-1.06	-0.39	-0.35
30-year	2.06	3.14	3.85	4.34	4.51



June 30, 2024	5.47%	4.71%	4.33%	4.36%	4.51%
June 30, 2023	5.24%	4.87%	4.13%	3.81%	3.85%

Source: Morningstar Direct. **Past performance does not guarantee future results.**

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ASSET CLASS RETURNS AS OF JUNE 30, 2024

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	YTD
Best	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%	Small Cap 19.96%	Real Estate 46.18%	Commodities 16.09%	Large Cap 26.29%	Large Cap 15.29%
	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%	Large Cap 28.71%	Cash 1.50%	Intl Stocks 18.24%	Asset Allocation 8.70%
	Large Cap 32.39%	Large Cap 13.69%	Asset Allocation 1.28%	High Yield 17.34%	Large Cap 21.83%	Government Treasury -1.84%	Real Estate 25.76%	Emerging Markets 18.31%	Commodities 27.11%	High Yield -11.11%	Asset Allocation 17.67%	Emerging Markets 7.49%
	Intl Stocks 22.78%	Asset Allocation 10.62%	Intermediate Bond 0.55%	Large Cap 11.96%	Mid Cap 16.24%	Intl Bonds -2.15%	Small Cap 25.53%	Government Treasury 17.70%	Mid Cap 24.76%	Intermediate Bond -13.01%	Small Cap 16.93%	Mid Cap 6.17%
	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%	Asset Allocation 15.86%	Mid Cap -13.06%	Mid Cap 16.44%	Intl Stocks 5.34%
	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%	Small Cap 14.82%	Intl Stocks -14.45%	Real Estate 16.10%	Commodities 5.14%
	Real Estate 1.86%	Small Cap 4.89%	Government Treasury -1.21%	Asset Allocation 8.31%	Intl Bonds 10.51%	Large Cap -4.38%	Emerging Markets 18.44%	Intl Bonds 10.11%	Intl Stocks 11.26%	Asset Allocation -15.79%	High Yield 13.40%	Cash 2.76%
	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%	High Yield 5.29%	Large Cap -18.11%	Emerging Markets 9.83%	High Yield 2.50%
	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%	Cash 0.05%	Intl Bonds -18.70%	Intermediate Bond 5.53%	Small Cap 1.73%
	Emerging Markets -2.60%	Emerging Markets -2.19%	High Yield -4.55%	Intl Bonds 1.49%	Real Estate 4.18%	Mid Cap -11.08%	Intermediate Bond 8.72%	High Yield 6.20%	Intermediate Bond -1.54%	Emerging Markets -20.09%	Cash 5.26%	Real Estate -0.26%
	Intl Bonds -3.08%	Intl Bonds -3.08%	Intl Bonds -6.02%	Government Treasury 1.33%	Intermediate Bond 3.54%	Commodities -11.25%	Commodities 7.69%	Cash 0.58%	Emerging Markets -2.54%	Small Cap -20.44%	Intl Bonds 3.99%	Intermediate Bond -0.71%
	Commodities -9.52%	Intl Stocks -4.90%	Emerging Markets -14.92%	Intl Stocks 1.00%	Commodities 1.70%	Intl Stocks -13.79%	Intl Bonds 5.09%	Commodities -3.12%	Government Treasury -4.65%	Real Estate -26.81%	Government Treasury 3.06%	Government Treasury -5.01%
Worst	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 -7.90%	Intl Bonds -7.05%	Government Treasury -29.26%	Commodities -7.91%	Intl Bonds -8.16%

The returns 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-BBg Long Treasury, Commodities-Bloomberg Commodity Idx, Intermediate Bond-BBg US Agg Bond Idx, High Yield Bond-ICE BofA High Yield Idx, Intl Bonds-JPMorgan GBI Global ex U.S., Asset Allocation-portfolio assumes the following weights: 60% S&P 500 and 40% BBg 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.

Global economic growth broadens beyond the U.S.

After having weathered the post-COVID environment exceptionally well, the U.S. economy is now seeing a slight softening in growth. By contrast, while the Euro area, the UK, and several other developed nations experienced a meaningfully weaker growth outcome post-COVID, they have been enjoying a slight cyclical economic upturn.

Yet U.S. economic dominance generally still holds. Europe's recovery appears to have a limited upside, being held back by lackluster credit demand and signs that upside economic surprises are already losing momentum. Similarly, although China's growth has also improved, it is generally being upheld almost solely by net exports. With the property sector showing no clear signs of bottoming and credit growth still weak, China's recovery is unlikely to gain further traction. Meanwhile, the underlying resilience of the U.S. economy implies that any slowdown will likely be modest.

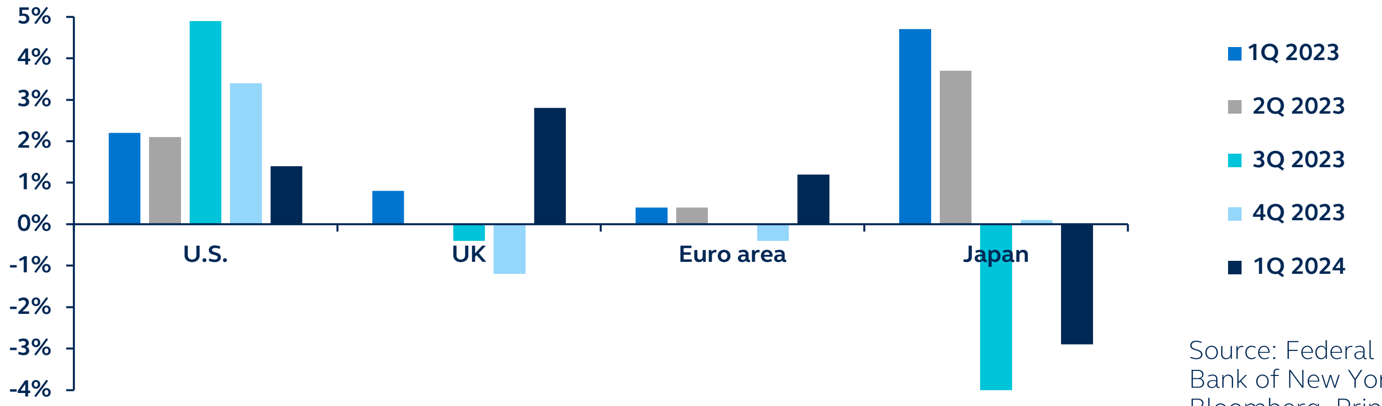
The upshot is that even as segments of the global economy enjoy upturns, the limited nature of their recoveries means that the U.S. will likely remain the strongest performer.

With so many elections taking place around the world this year, the global economy is vulnerable to the threat of increased trade tariffs and geopolitical tensions. Given the significant increase in government deficits, debates around fiscal discipline are also likely to dominate market focus.

Global growth has broadened beyond just the U.S. But the limited nature of the upturns implies U.S. dominance remains.

Global growth

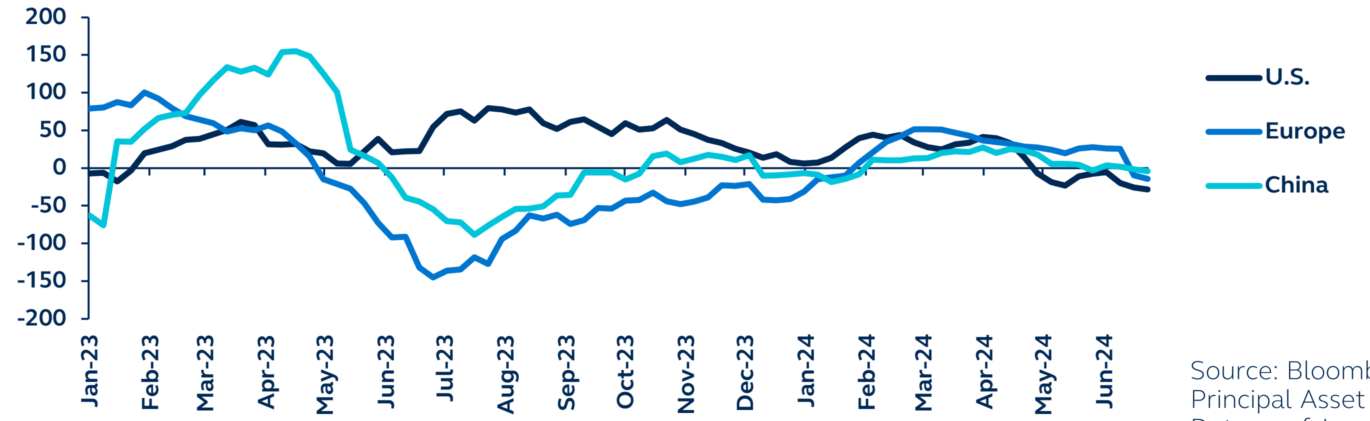
Quarterly, 1Q 2023–1Q 2024



Source: Federal Reserve Bank of New York, Bloomberg, Principal Asset Management. Data as of June 30, 2024.

U.S, Europe, and China economic surprises

Citi Economic Surprise Index level, weekly, 2023–present



Source: Bloomberg, Citi, Principal Asset Allocation. Data as of June 30, 2024.

U.S. lower income, levered consumers showing strains

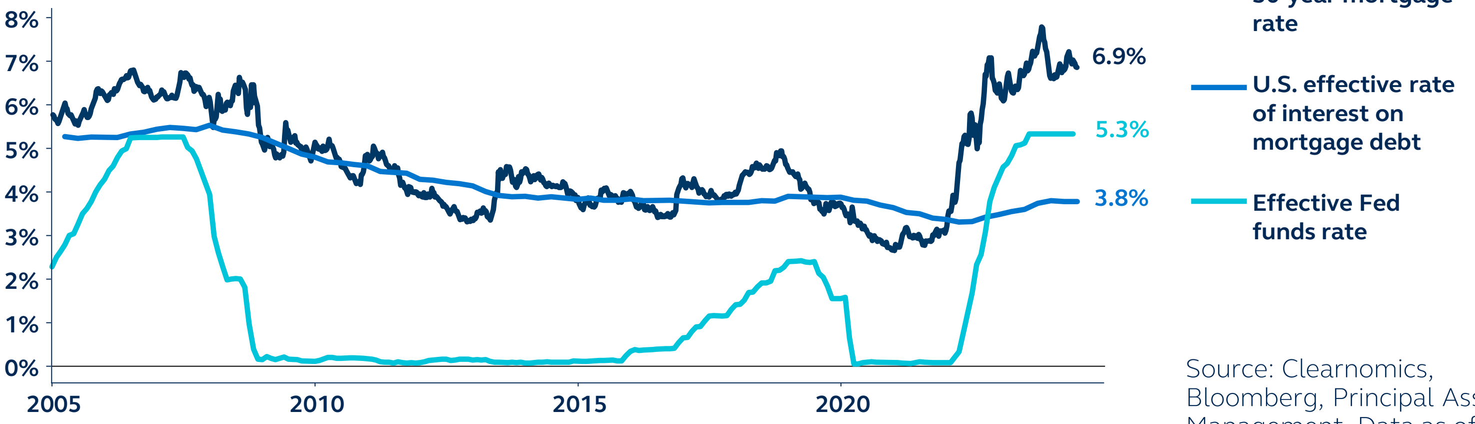
The recent downshift in U.S. growth is not unexpected—tighter Fed policy was inevitably going to weigh on the economy. In particular, lower-income households have been the most vulnerable. Not only have they borne the brunt of elevated prices, but many have missed out on the significant wealth gains stemming from higher stock prices and higher home prices, as well as the rise in passive income that higher interest rates on savings and deposit accounts bring. As such, many lower-income households have almost exhausted their excess savings, forcing them to become more leveraged.

As savings have dwindled, the inevitable increase in credit card spending has become a reality. Unlike mortgage rates, which most households locked in at extremely low levels in the years before inflation began to surge and Fed policy was tightened, soaring interest rates on credit cards and auto loans cannot be avoided. As a result, while mortgage debt payments as a percentage of disposable income has remained steady, consumer debt payments have increased sharply.

Credit card delinquency rates are rising, and at a faster pace than for mortgages. Recent corporate earnings guidance has also provided evidence of strains, with U.S. consumers extending their shift toward more deliberate value-focused spending and lower cost point retailers.

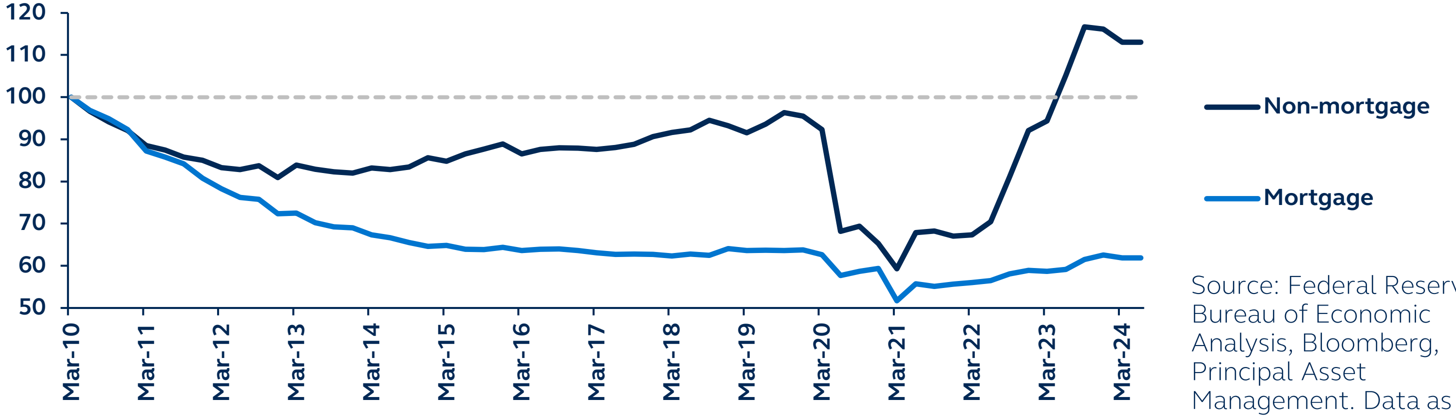
Many U.S. low income, highly-levered consumers are under pressure from higher rates and are adjusting their spending habits to reflect these strains.

U.S. 30yr fixed mortgage rate, effective mortgage rate, and effective Fed funds rate
2010–present



Source: Clearnomics, Bloomberg, Principal Asset Management. Data as of June 30, 2024.

Personal interest payments, mortgage and non-mortgage
Percent of disposable income, January 2010–present, Rebased to 100 at 1Q 2010



Source: Federal Reserve, Bureau of Economic Analysis, Bloomberg, Principal Asset Management. Data as of June 30, 2024.

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Yet sturdy balance sheets should promote resilience

It is important not to exaggerate the impact of pockets of U.S. economic weakness. While lower-income households are showing strains, middle- and higher-income households, who are responsible for most consumer spending, remain in good shape. Coupled with gains from property and equity market exposure, broad household balance sheets have remained strong. Total U.S. household net worth as a percentage of disposable income sits close to an all-time high.

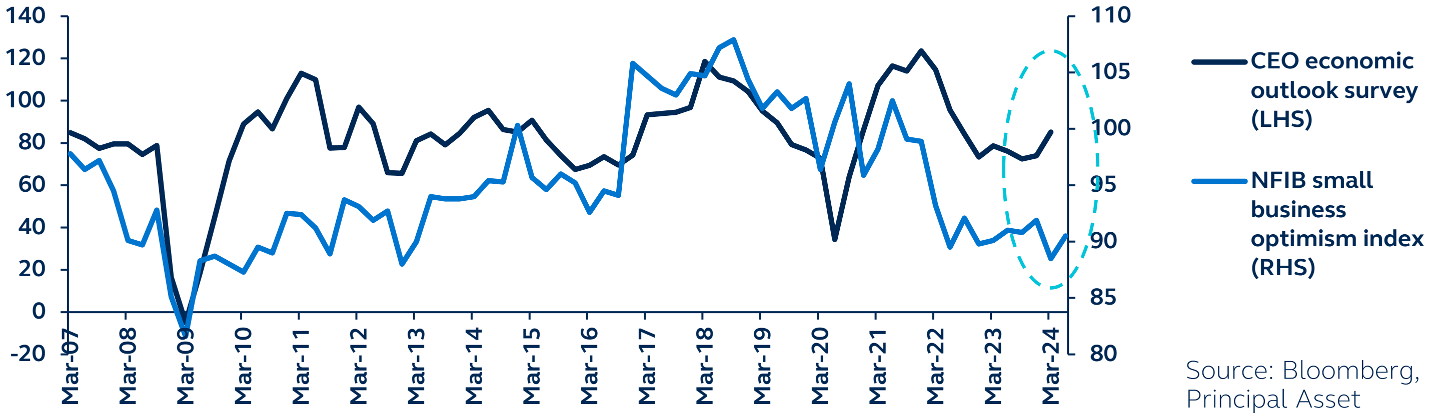
Similarly, there is a divergence within the corporate sector, with small business confidence struggling under the weight of their limited pricing power and shrinking margins, while large business confidence has remained very robust. Broad corporate balance sheets are generally in good shape, helped by the fact that a record number of companies chose to issue/refinance their debt when rates were low in 2020/21. Interest payments as a percentage of profits, are at the lowest levels since 1957.

But rising numbers of corporate bonds are now maturing, requiring refinancing at higher rates than their existing loans. The solid economic backdrop implies that most corporates should be able to climb the maturity wall relatively unscathed - but they will have to offset their higher refinancing costs by reducing expenses elsewhere. One key strategy is to reduce labor costs, in turn, contributing to a weaker labor market.

Strong household and corporate balance sheets should prevent the unfolding economic slowdown from mutating into a hard landing.

Small and large business confidence

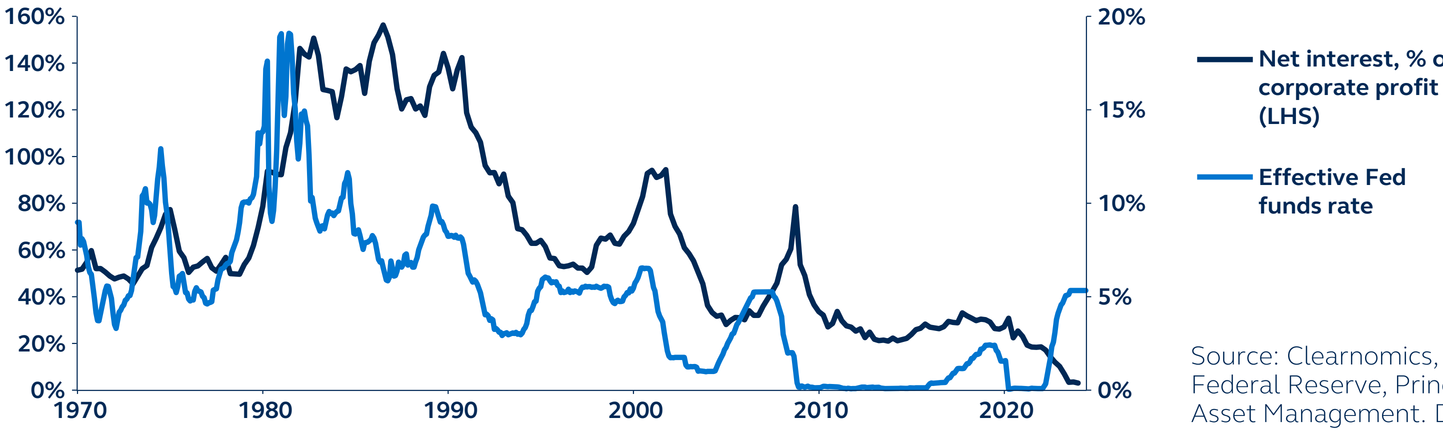
Level, March 2007–present



Source: Bloomberg, Principal Asset Management. Data as of June 30, 2024.

Corporate interest payments versus Federal funds rate

Quarterly, January 1970–March 2024



Source: Clearnomics, Federal Reserve, Principal Asset Management. Data as of June 30, 2024.

Labor market: Fissures under the surface

On the surface, the labor market appears to be in good health. Overall non-farm payrolls have averaged 177,000 in the past three months, meaningfully above the 150,000 level that would be considered consistent with a strong economy.

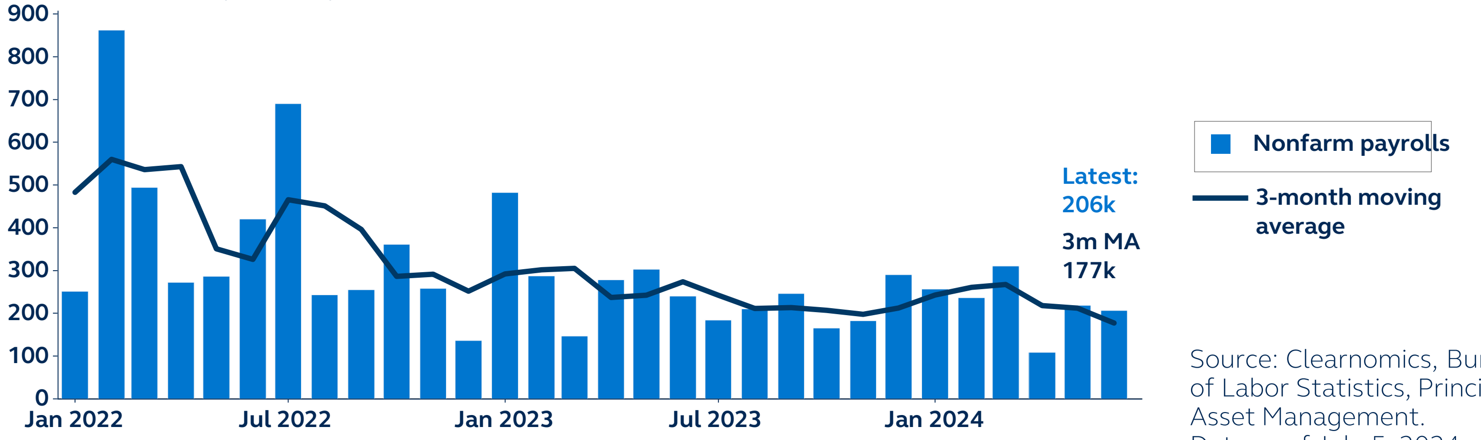
Yet, under the surface, companies are already re-evaluating labor costs. Job openings have declined meaningfully and hiring plans have been pulled back, particularly among smaller businesses where high input and wage costs have made it more difficult to expand headcount. Quits rates have fallen as employees' job security has deteriorated, with a recent New York Fed survey showing that, outside of the pandemic period—employees' perception of finding a new job within three months is the lowest in over decade.

Weekly jobless claims, typically a very timely labor market indicator, are low but trending higher. The U.S. unemployment rate also remains historically low but, at 4%, it too has been nudging higher. Labor market surveys suggest a further weakening in labor demand should soon show up in the data, likely pushing jobless claims and unemployment slightly higher. Yet, provided the underlying economy remains fundamentally robust and company profit margins remain healthy, mass job losses and an income decline spiral should be avoided. Yet, it is a pertinent risk that is on the Fed's radar.

Labor market resilience is set to remain a key theme for 2024. A healthy rebalancing of labor supply and demand should ensure unemployment does not spike.

U.S. nonfarm payrolls

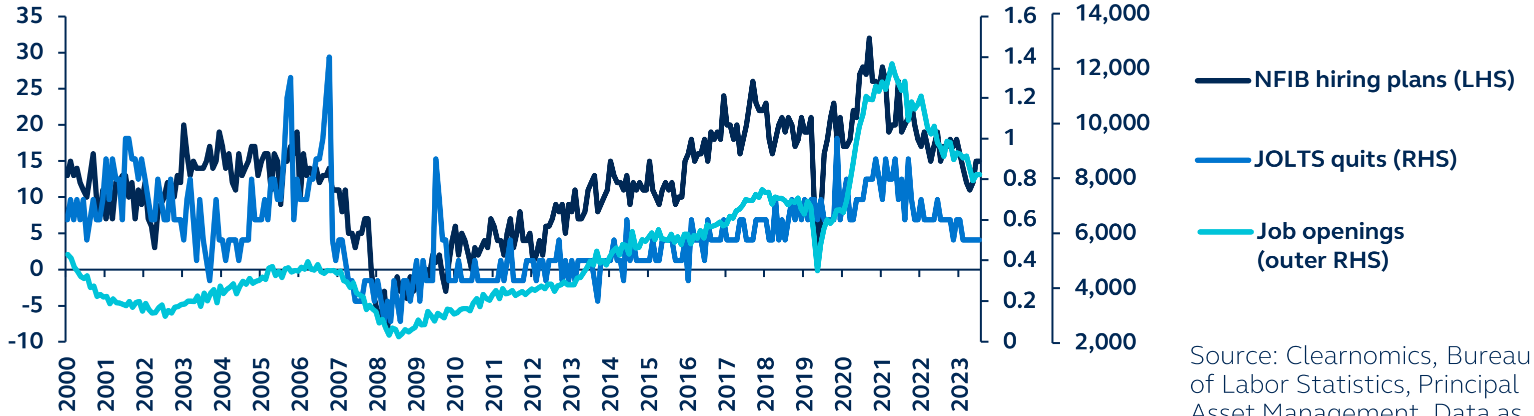
Thousands, monthly, January 2022–present



Source: Clearnomics, Bureau of Labor Statistics, Principal Asset Management. Data as of July 5, 2024.

Labor market tightness: various measures

NFIB hiring plans, JOLTS quits rate, job openings



Source: Clearnomics, Bureau of Labor Statistics, Principal Asset Management. Data as of June 30, 2024.

Global inflation: A frustratingly slow last mile

Global inflation progress continues to grab market attention. Although there has been significant improvement, the "last mile" in inflation is proving to be sticky and frustrating across most economies. Most central banks have responded by raising their 2024 inflation projections. Economic strength has not come without costs.

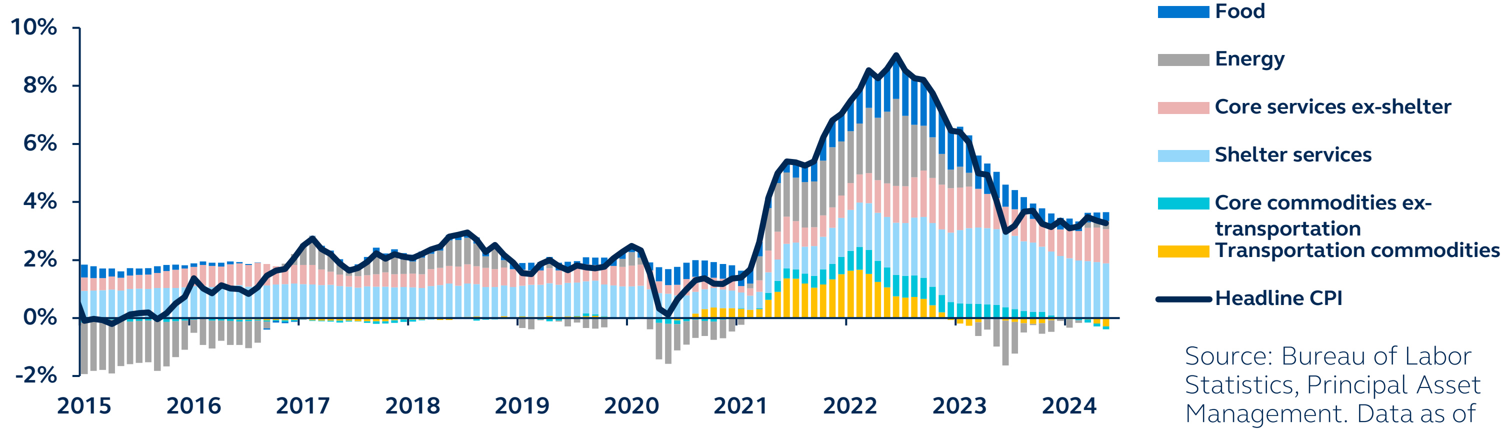
In the U.S., after a series of hotter than expected inflation prints, more recent data suggest U.S. inflation may have returned to its more disinflationary trend. The two key contributors to U.S. inflation remain shelter services, which various indicators including primary rents, new lease signings, median home prices, all indicate should see significant improvement over the coming year, and core services ex-housing—the segment of the consumer basket most closely related to wage growth. Provided the labor demand/supply balance continues to improve, a further softening in wage growth is likely and, therefore, core services ex-housing inflation should wane.

It is doubtful that, without further cracks in the labor market, there will be enough of a softening to bring inflation all the way down to the Fed's 2% target. But the improvement should be enough to assuage fears around renewed inflation pressures and a second inflation wave.

The last mile to central banks' inflation targets is proving tough and may require some (small) cracks in the labor markets to materialize.

Contribution to headline U.S. inflation

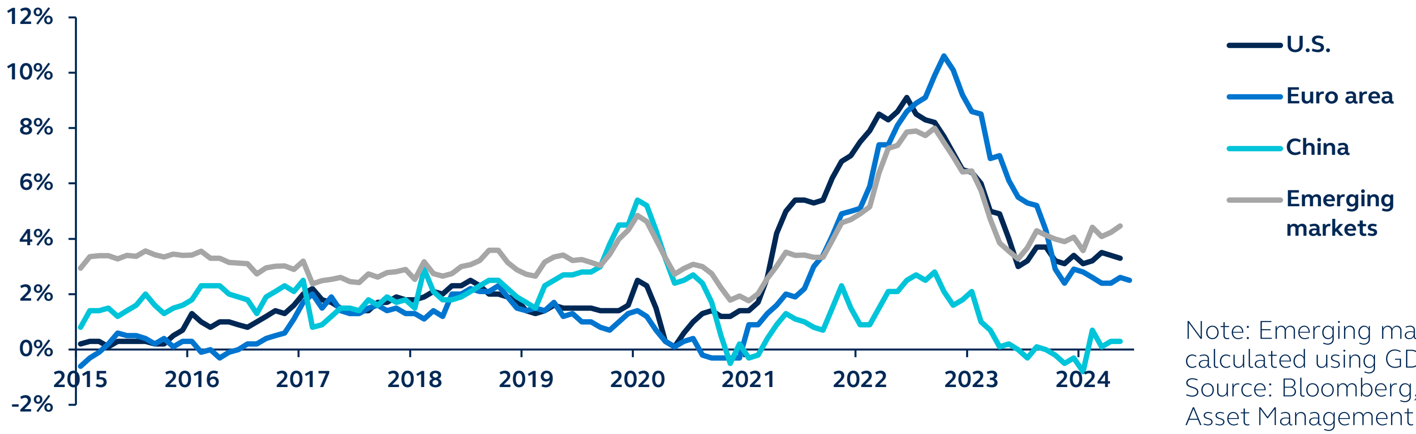
Year-over-year, January 2015–present



Source: Bureau of Labor Statistics, Principal Asset Management. Data as of June 12, 2024.

Global inflation rates

Principal Asset Allocation GDP-weighted inflation, 2015–present



Note: Emerging markets calculated using GDP weights. Source: Bloomberg, Principal Asset Management. Data as of June 30, 2024.

The Fed policy path: A fork in the road

Fed rate cut cycles typically play out against a backdrop of falling inflation, mass job layoffs and rising recession risk. Instead, in the current cycle, the Fed is playing a balancing act: perfectly time rate cuts to cultivate a soft landing without reigniting inflation pressures.

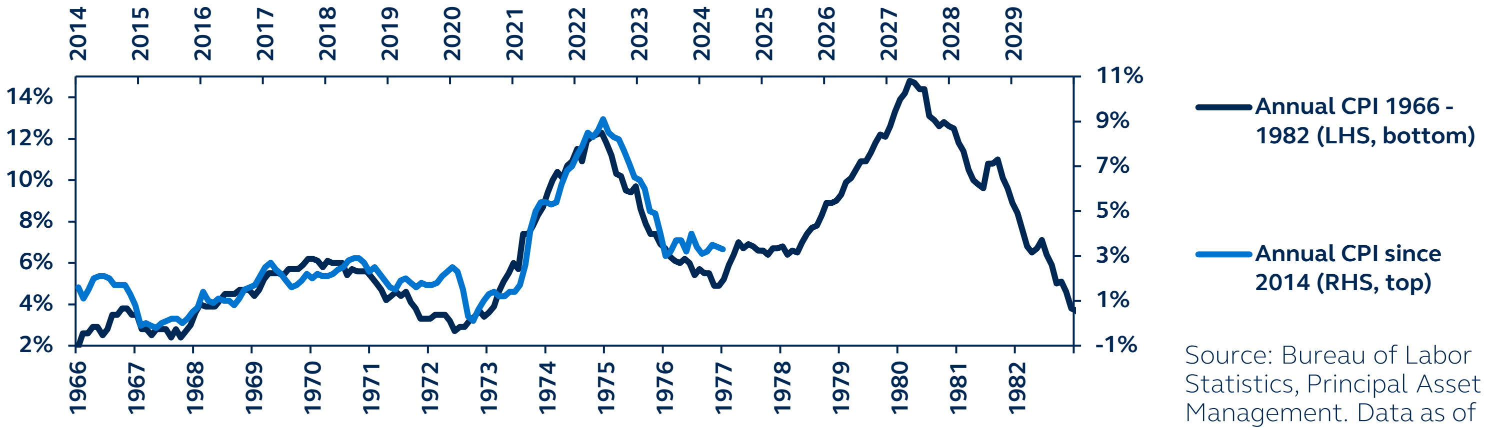
Indeed, the uncertainty around the last mile of progress for stubborn and sticky inflation undoubtedly complicates the Fed's decision making. History clearly warns against cutting rates before inflation is on a sustainable path to target. There are striking similarities between U.S. inflation developments today and those of the early 1970s. During that period, the Fed had also responded with steep interest rate hikes. After some time, it was anxious to ease monetary policy, cutting interest rates before inflation had fallen back to levels consistent with price stability. The result was a resurgence in price pressures.

While it is not obvious that the economy requires policy easing, the very limited number of successful soft landings following a Fed hiking cycle also demonstrates the dangers of waiting too long before cutting rates. Indeed, there are already signs that consumers are starting to show fatigue and that companies are considering labor costs, suggesting that the Fed risks throwing away prospects of achieving a soft landing if it waits too long.

The Fed is confronting the harsh reality that resilient economic activity cultivates sticky, stubborn inflation. Incoming data is pivotal to the near-term policy decisions.

Historical inflation comparison

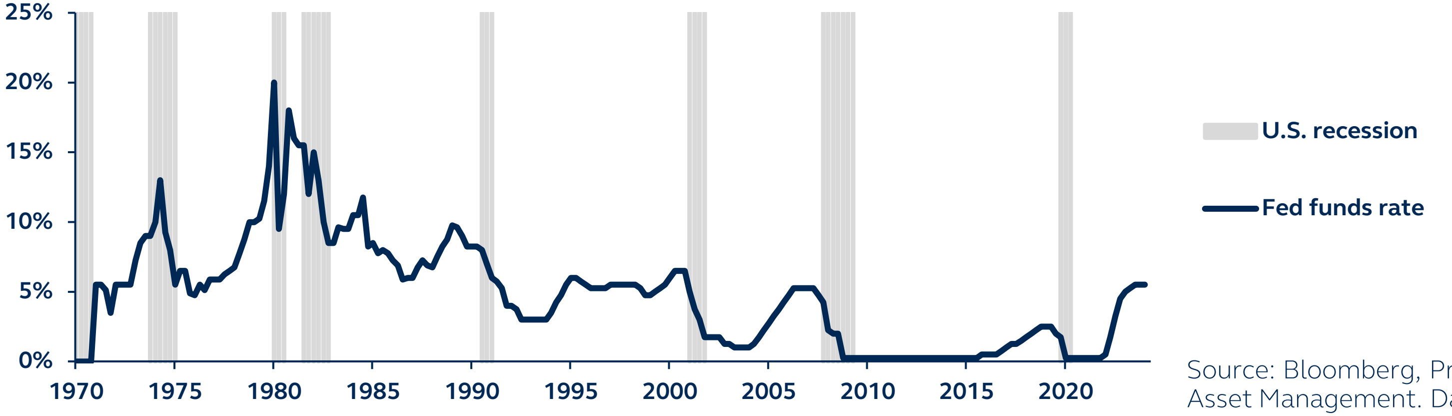
Consumer Price Index (CPI)



Source: Bureau of Labor Statistics, Principal Asset Management. Data as of June 12, 2024.

Fed funds rate and recessions

January 2009–present



Source: Bloomberg, Principal Asset Management. Data as June 30, 2024.

Federal Reserve: Closing in on rate cuts

Market rate expectations have shifted significantly over the past six months as inflation projections have risen. In fact, the timing of the first Fed rate cut remains a difficult question to answer given that the Fed's policy decision is highly dependent on incoming releases.

Evidence of moderating economic activity and a rebalanced labor market suggest that inflation pressures should subside over coming months. We expect the first cut to come in September, followed by December – but it will certainly take additional positive inflation readings to cement the timing.

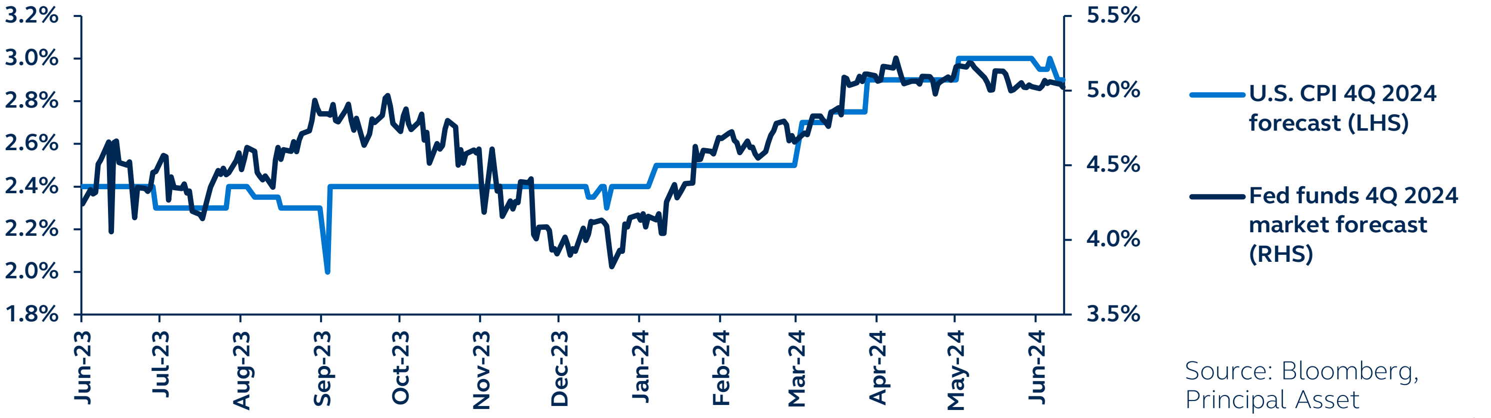
Investors can derive three key insights for the Fed's outlook:

1. Recent consumer and labor market survey data suggest that the next policy move will be a cut, not a hike.
2. With just four FOMC meetings remaining in 2024 and inflation still above the Fed's comfort zone, markets are unlikely to get more than two policy rate cuts this year.
3. While inflation is likely to decelerate, the economy's underlying strength, geopolitical tensions and several structural drivers argue against a meaningful drop in inflation. This is shaping up to be a short and shallow cutting cycle.

We anticipate cuts in September and December, but that requires convincing and consistent evidence of slowing economic activity, a weaker labor market, and softening inflation.

Evolution of market 4Q 2024 inflation and Fed rate forecasts

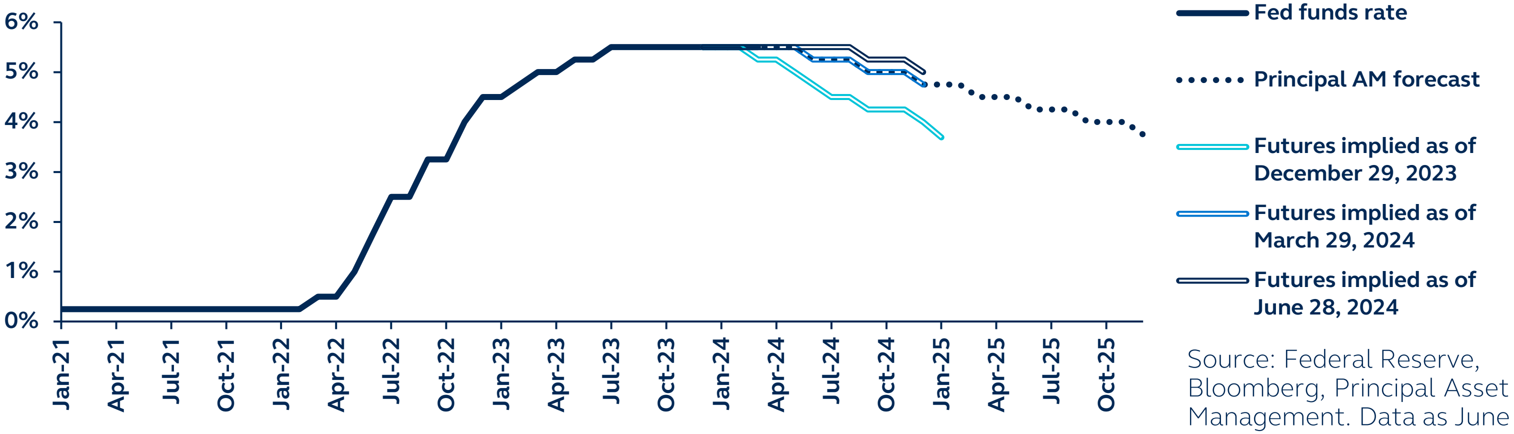
U.S. CPI 4Q 2024 and market implied Fed rate for December 2024, June 2023–present



Source: Bloomberg, Principal Asset Management. Data as of July 3, 2024.

Federal Reserve policy rate path

Fed funds rate and projections, 2021–present



Source: Federal Reserve, Bloomberg, Principal Asset Management. Data as June 30, 2024.

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Global central banks: Divergent, but not for long

Typically, central banks wait for the Fed to reduce rates before they move. In fact, until June, the ECB had never cut rates ahead of the Fed. But given the Euro area's lacklustre growth backdrop and headline inflation having plunged very sharply the ECB had strong reason to not wait for the Fed.

However, the ECB will be wary of its diverging policy path. A widening gap between U.S. and Euro area policy rates risks putting downward pressure on the euro, in turn adding to inflationary pressures. Although the Euro area's inflation has fallen, recent data have surprised to the upside, so the ECB cannot risk further significant euro depreciation.

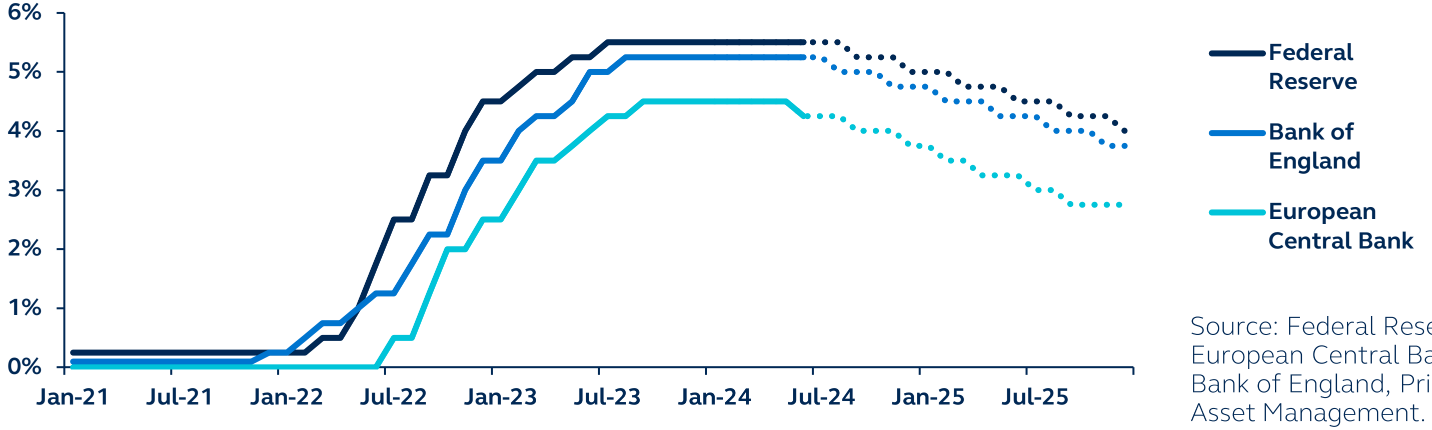
Some global policy coordination is required. The next ECB rate reductions are likely in September and December—the same months the Fed is likely to cut. However, if the Fed delays the start of its own easing cycle until early-2025, the ECB's next move may be equally delayed. The Bank of England (BoE) is likely to begin rate cuts in August and then move at a similar pace to the Fed.

For the Bank of Japan, a slow move towards hikes has weighed heavily on the yen. With the Fed's cutting cycle likely to be short and shallow, the Bank of Japan will likely need to embrace tighter policy if it is to avoid further yen weakness.

Given signs of sticky inflation, the ECB and BoE's policy paths are unlikely to be more dovish than the Fed's. The BoJ will likely need to move towards hikes to further avoid yen weakness.

Global central bank rates

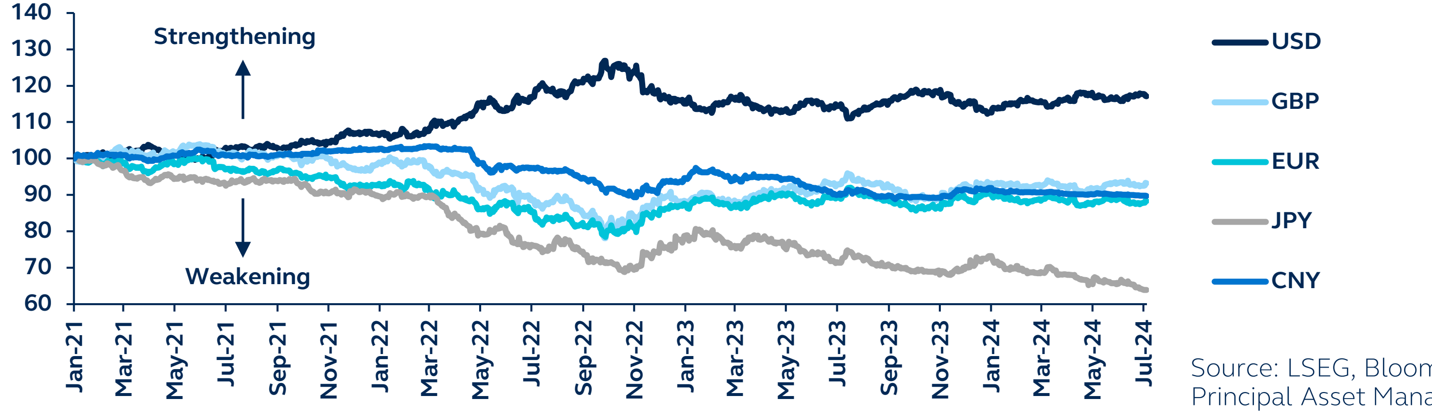
January 2021–present, forecasted through 2025



Source: Federal Reserve, European Central Bank, Bank of England, Principal Asset Management. Data as of June 30, 2024.

Major currencies

Rebased to 100 at January 2021



Source: LSEG, Bloomberg, Principal Asset Management. Data as of July 4, 2024.

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Yields to skew lower, but fewer rate cuts should limit the move

The second quarter of 2024 proved to be a volatile one for sovereign bonds as markets debated central bank policy paths. With investors pricing in a more gradual cycle of rate cuts in most economies, sovereign yields rose through 2Q, and 10-year U.S. Treasury yields ended the quarter 20 basis points higher than it started. Election risk has also played its part. Markets have focused on the risks of looser fiscal stances, putting upward pressure on longer-end bond yields, steepening the yield curve.

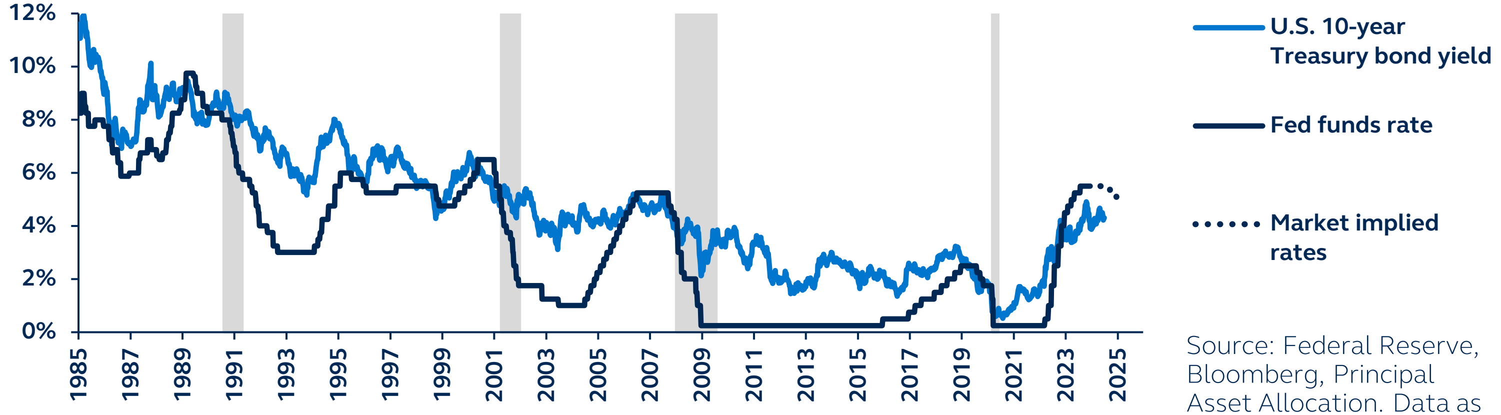
With the Fed likely to start cutting rates later this year, Treasury yields should skew lower. However, the likely short and shallow Fed cutting cycle, coupled with elevated market scrutiny on fiscal sustainability, suggests that yields are unlikely to revert to the ultra-low levels of recent years.

Despite the significant repricing in rate expectations so far in 2024, fixed income has continued to deliver positive performance, predominantly because the macro resilience narrative remains intact. More pertinently, the total yield generated from fixed income today is markedly higher than a few years ago, and credit is offering important additional carry to U.S. Treasurys.

Fed rate cuts could put downward pressure on U.S. Treasurys but the impact is likely to be limited by a shallow cutting cycle, as well as higher term premia as debt concerns persist.

Fed funds rate and U.S. 10y Treasury bond yield

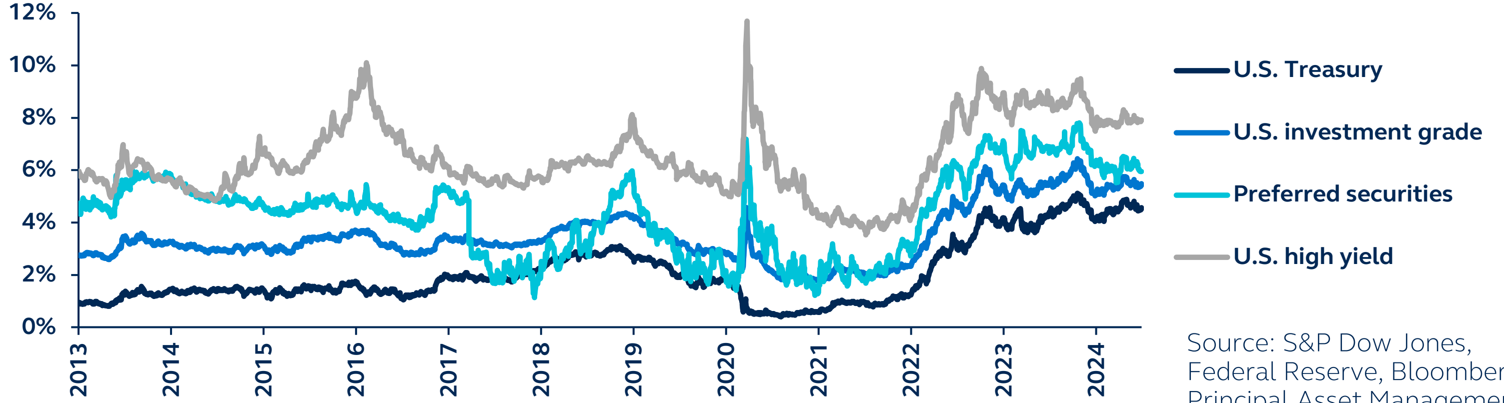
Recessions are shaded, 1985–present



Source: Federal Reserve, Bloomberg, Principal Asset Allocation. Data as of June 30, 2024.

Yield comparison

Yield-to-worst, 2013–present



Source: S&P Dow Jones, Federal Reserve, Bloomberg, Principal Asset Management. Data as of June 30, 2024.

A soft landing should maintain tight spreads

Credit spreads for both investment grade and high yield are currently near historic lows and are unlikely to narrow further. Yet attractive yields help offset unappealing credit spread entry points.

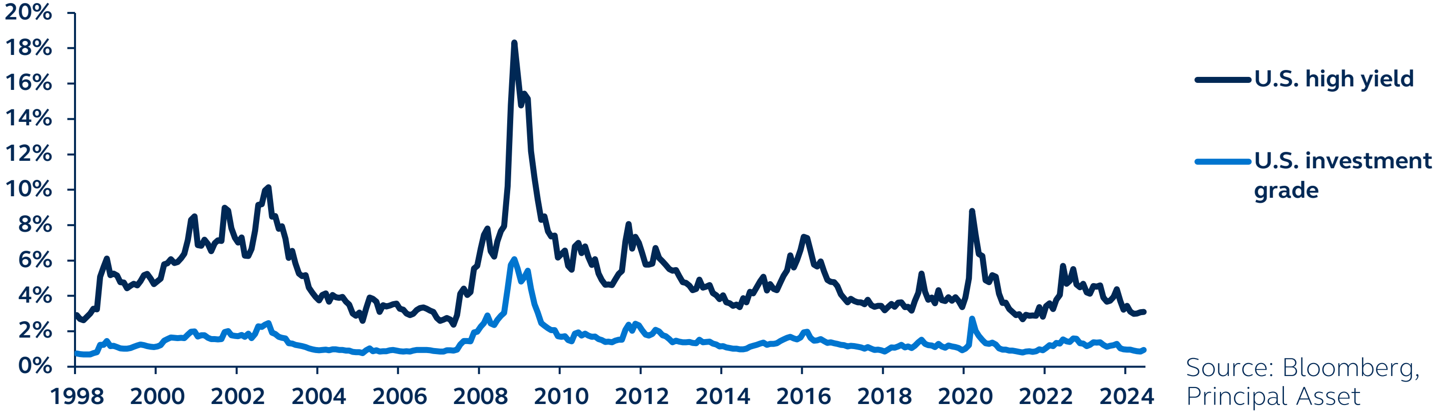
What's more, provided recession is avoided, a gradual rise in defaults is more probable than a sudden spike, meaning spreads are unlikely to widen significantly from their current levels. Additionally, it is noteworthy that despite recent macro volatility, spreads have remained within a relatively tight range. This suggests an attractive "stability" element to credit which should continue even amidst ongoing debates about interest rates.

In an environment of solid economic growth and higher for longer rates, the short duration and cyclical exposure of high yield is attractive. A much-flagged risk for high yield is that the wall of maturing debt will face significantly higher refinancing costs, potentially triggering a spike in defaults. However, the resilient, albeit slowing, macro backdrop and strong balance sheets suggest that companies should scale the wall relatively unscathed. In addition, the maturity wall leans towards high-quality, so most companies will likely be able to digest the interest rate costs without too much strain.

Although credit spreads remain tight, fixed income today offers important carry opportunities. Concerns around the high yield maturity wall are likely overblown.

U.S. high yield and investment grade spreads

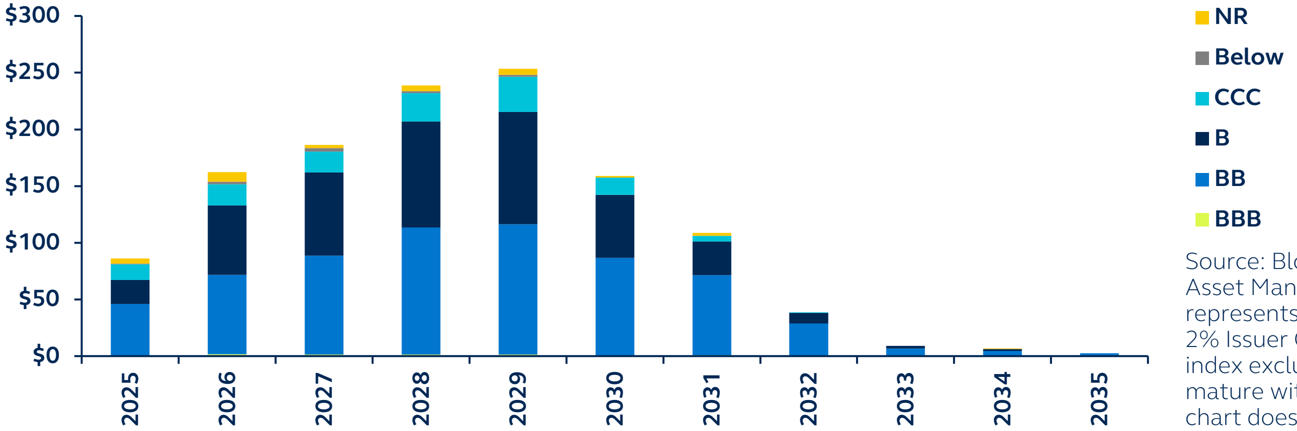
Option-adjusted-spread, 1998–present



Source: Bloomberg, Principal Asset Management. Data as of July 4, 2024.

High yield bond maturity schedule

Billions USD



Source: Bloomberg, Principal Asset Management. Data represents the U.S. High Yield 2% Issuer Cap index. As this index excludes bonds that mature within the next year, the chart does not include any bonds maturing in 2024. Data as of December 31, 2023.

A constructive backdrop for risk assets persists

As investors have pared back their expectations for the timing and pace of rate cuts, assets in money market funds have continued to increase. Yet, with the Fed set to reduce rates later this year, the attractiveness of cash is set to decline and reinvestment risk is elevated.

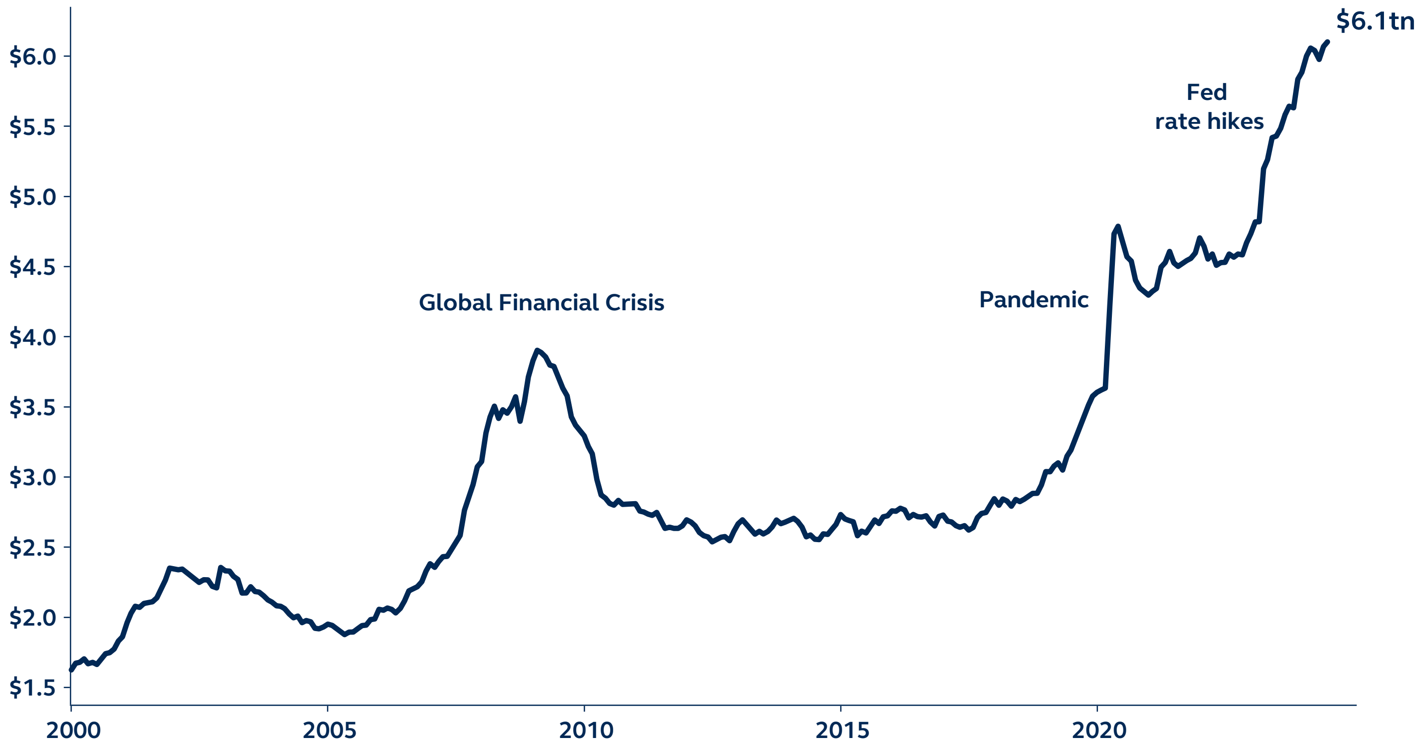
The U.S. economy is cooling, but is not heading for recession. Inflation is sticky, but we don't anticipate heading into a second wave. The Fed is cautious, but the next policy move will likely be a cut, not a hike. This backdrop, whilst not as convincingly positive as at the start of the year, is still constructive for risk assets—and a $6 trillion mountain of cash is ready to fuel risk assets.

Spread products such as investment grade credit and high quality ABS should continue to do well in this environment.

This year will likely be beset by election volatility and political risk. Investors will generally likely need to keep cool heads, focus on the fundamentals, and resist the temptation to revert to cash.

Rate cuts later this year will likely reduce the attractiveness of cash. Investors could already be considering how to optimize the constructive environment for risk assets.

U.S. total money market fund assets
Trillions, 2000–present



Source: Clearnomics, Federal Reserve, Investment Company Institute, Bloomberg, Principal Asset Allocation. Data as of June 30, 2024.

INDEX DESCRIPTIONS

Bloomberg U.S. High-Yield Corporate Bond Index is a rules-based, market-value-weighted index engineered to measure publicly issued non-investment grade USD fixed-rate, taxable and corporate bonds.

Bloomberg 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 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 U.S. and non-U.S. corporations.

Bloomberg 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 ACWI Index includes large and mid cap stocks across developed and emerging market countries.

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, Australasia, 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 Europe Banks Index is composed of large and mid cap stocks across 15 Developed Markets countries in Europe. All securities in the index are classified in the Banks industry group (within the Financials sector) according to the Global Industry Classification Standard (GICS®).

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 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 U.S. 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 U.S. market.

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

MSCI USA Quality Index aims to capture the performance of quality growth stocks by identifying stocks with high quality scores based on three main fundamental variables: high return on equity (ROE), stable year-over-year earnings growth and low financial leverage. The MSCI Quality Indexes complement existing MSCI Factor Indexes and can provide an effective diversification role in a portfolio of factor strategies.

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

MSCI USA Value Index captures large and mid cap U.S. 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.

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.

U.S. dollar index (USDX) is a measure of the value of the U.S. dollar relative to a basket of foreign 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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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. Non-investment grade securities offer a potentially higher yield but carry a greater degree of risk. Risks of preferred securities differ from risks inherent in other investments. In particular, in a bankruptcy preferred securities are senior to common stock but subordinate to other corporate debt. Emerging market debt may be subject to heightened default and liquidity risk. Risk is magnified in emerging markets, which may lack established legal, political, business, or social structures to support securities markets. Small and mid-cap stocks may have additional risks including greater price volatility. Treasury inflation-protected securities (TIPS) are a type of Treasury security issued by the U.S. government. TIPS are indexed to inflation in order to help investors from a decline in the purchasing power of their money. As inflation rises, rather than their yield increasing, TIPS instead adjust in price (principal amount) in order to maintain their real value. Inflation and other economic cycles and conditions are difficult to predict and there Is no guarantee that any inflation mitigation/protection strategy will be successful. Contingent Capitals Securities may have substantially greater risk than other securities in times of financial stress. An issuer or regulator's decision to write down, write off or convert a CoCo may result in complete loss on an investment. Real assets include but not limited to precious metals, commodities, real estate, land, equipment, infrastructure, and natural resources. Each real asset is subject to its own unique investment risk and should be independently evaluated before investing. As an asset class, real assets are less developed, more illiquid, and less transparent compared to traditional asset classes.

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