

Principal Global Investors
Morley Capital Management

Economic and market review

2Q 2021 | As of June 30, 2021



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

Key themes for 3Q 2021

Divergent experiences due to COVID-19 likely to drive de-synchronized global growth

- **Vaccinations aid re-openings and recovery in developed markets**
Yet, the global recovery is not yet synchronized, with slow vaccination rates weighing on the economic expansion in emerging markets.
- **Once policy support ends, consumer spending will sustain the recovery**
COVID-19 has created a war chest of excess savings—a strong foundation for satiating pent-up demand. The removal of fiscal supports should also improve employment status in the second half of 2021.
- **Supply constraints and bottlenecks temporarily inflating price pressures**
Markets are questioning the Fed's tolerance for inflation, however tapering and rate hikes are still likely some way off.
- **Easy financial conditions and strong earnings growth still support risk assets**
Strong fundamentals should continue driving cyclical and secular growth performance.
- **Fixed income continues to be challenged by low rates and tight spreads**
High valuations should produce muted returns.

What impact have we seen on global index returns?

Equity markets delivered their fifth consecutive quarter of positive performance

	3-months	YTD	1-year	3-year	5-year	10-year
Fixed Income						
B of A ML U.S. Treasury Bill 3-month Index	0.00%	0.02%	0.09%	1.34%	1.17%	0.63%
Bloomberg Barclays Aggregate Bond Index	1.83%	-1.60%	-0.33%	5.34%	3.03%	3.39%
Bloomberg Barclays U.S. Corp High Yld 2% Issuer Capped Index	2.74%	3.61%	15.34%	7.42%	7.47%	6.65%
Bloomberg Barclays Long-Term Govt/Credit Index	6.44%	-4.64%	-1.86%	9.92%	5.45%	7.30%
U.S. Equities						
Russell 1000 Value Index	5.21%	17.05%	43.68%	12.42%	11.87%	11.61%
S&P 500 Index	8.55%	15.25%	40.79%	18.67%	17.65%	14.84%
Russell 1000 Growth Index	11.93%	12.99%	42.50%	25.14%	23.66%	17.87%
Russell Midcap Index	7.50%	16.25%	49.80%	16.45%	15.62%	13.24%
Russell 2000 Index	4.29%	17.54%	62.03%	13.52%	16.47%	12.34%
Non-U.S. Equities						
MSCI EAFE NTR Index	5.17%	8.83%	32.35%	8.27%	10.28%	5.89%
MSCI ACWI ex-USA Index	5.48%	9.16%	35.72%	9.38%	11.08%	5.45%
MSCI Emerging Markets Index	5.05%	7.45%	40.90%	11.27%	13.03%	4.28%
Other						
MSCI U.S. REIT Index	11.74%	21.24%	36.57%	8.83%	5.02%	8.06%
S&P GSCI® Index	15.72%	31.40%	57.37%	-2.72%	1.73%	-6.48%
U.S. Dollar Index	-0.87%	1.90%	-6.37%	-1.11%	-0.74%	2.10%

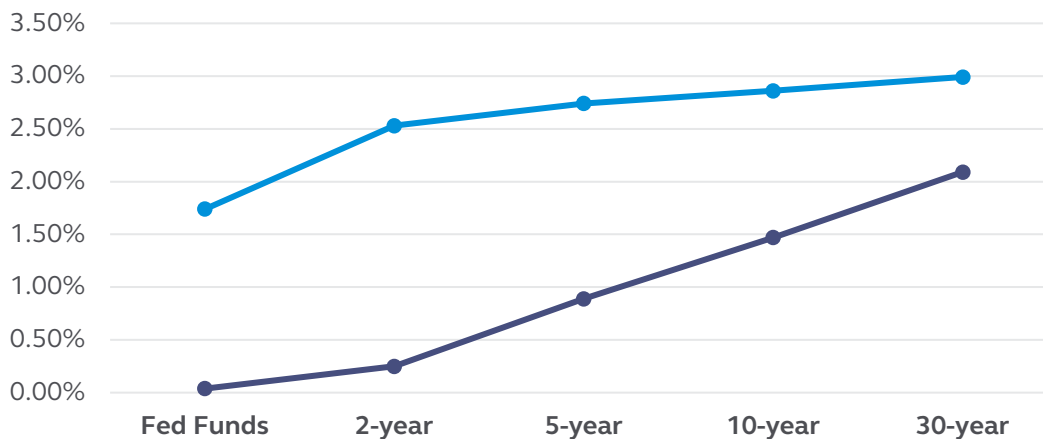
As of 6/30/2021.

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?

	June 30, 2018	June 30, 2019	June 30, 2020	June 30, 2021
2-year	2.53%	1.75%	0.15%	0.25%
5-year	2.74%	1.77%	0.29%	0.89%
10-year	2.86%	2.01%	0.66%	1.47%
2- to 10-year spread	0.33%	0.25%	0.51%	1.22%
30-year	2.99%	2.53%	1.41%	2.09%



June 30, 2021	0.04%	0.25%	0.89%	1.47%	2.09%
June 29, 2018	1.74%	2.53%	2.74%	2.86%	2.99%

Asset Class Returns as of June 30, 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 76.51%	Real Estate 26.60%	Government Treasury 25.93%	Emerging Markets 16.23%	Small Cap 38.62%	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 19.86%	Real Estate 22.76%
	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 22.74%	Intl Stocks 25.03%	Intermediate Bond 0.01%	Mid Cap 26.20%	Large Cap 18.40%	Commodities 21.15%
	Intl Bonds 11.30%	Intermediate Bond 5.24%	Mid Cap 37.38%	Mid Cap 26.64%	Intermediate Bond 7.64%	Real Estate 17.59%	Large Cap 32.39%	Large Cap 13.69%	Asset Allocation 1.26%	High Yield 17.34%	Large Cap 21.63%	Intl Bonds -1.56%	Real Estate 25.76%	Emerging Markets 18.31%	Mid Cap 17.59%
	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%	Government Treasury 17.70%	Small Cap 17.54%
	Government Treasury 9.61%	Asset Allocation -22.05%	Real Estate 26.60%	Commodities 16.83%	Asset Allocation 4.69%	Small Cap 16.35%	Asset Allocation 17.55%	Mid Cap 9.77%	Cash 0.03%	Commodities 11.77%	Small Cap 14.65%	High Yield -2.26%	Asset Allocation 22.16%	Asset Allocation 14.73%	Large Cap 15.25%
	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 8.83%
	Intermediate Bond 6.97%	Small Cap -33.79%	Large Cap 26.45%	Large Cap 15.05%	Large Cap 2.11%	High Yield 15.44%	Real Estate 1.66%	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 8.28%
	Asset Allocation 6.22%	Commodities 35.65%	Commodities 18.91%	Asset Allocation 12.13%	Cash 0.06%	Asset Allocation 11.21%	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 7.75%
	Large Cap 5.49%	Mid Cap -36.73%	Asset Allocation 18.40%	Government Treasury 3.38%	Mid Cap -1.73%	Intermediate Bond 4.21%	Intermediate Bond -2.02%	Cash 0.02%	Small Cap -7.41%	Intermediate Bond 2.85%	High Yield 7.48%	Small Cap -11.01%	High Yield 14.40%	Intermediate Bond 7.51%	High Yield 5.55%
	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 1.96%	Real Estate 4.16%	Mid Cap 11.08%	Intermediate Bond 8.72%	High Yield 6.20%	Cash 0.03%
	High Yield 2.17%	Real Estate -35.20%	Intl Bonds 3.54%	Intl Bonds 6.78%	Intl Stocks -12.14%	Intl Bonds 0.85%	Intl Bonds -5.06%	Intl Bonds -2.53%	Intl Bonds -7.84%	Government Treasury 1.33%	Intermediate Bond 3.54%	Commodities -11.25%	Commodities 7.65%	Cash 0.58%	Intermediate Bond -1.60%
	Small Cap 1.57%	Intl Stocks 43.38%	Cash 0.76%	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 6.40%
Worst	Real Estate -17.55%	Emerging Markets -51.33%	Government Treasury -12.92%	Cash 0.70%	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 -7.90%	Government Treasury -7.92%

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

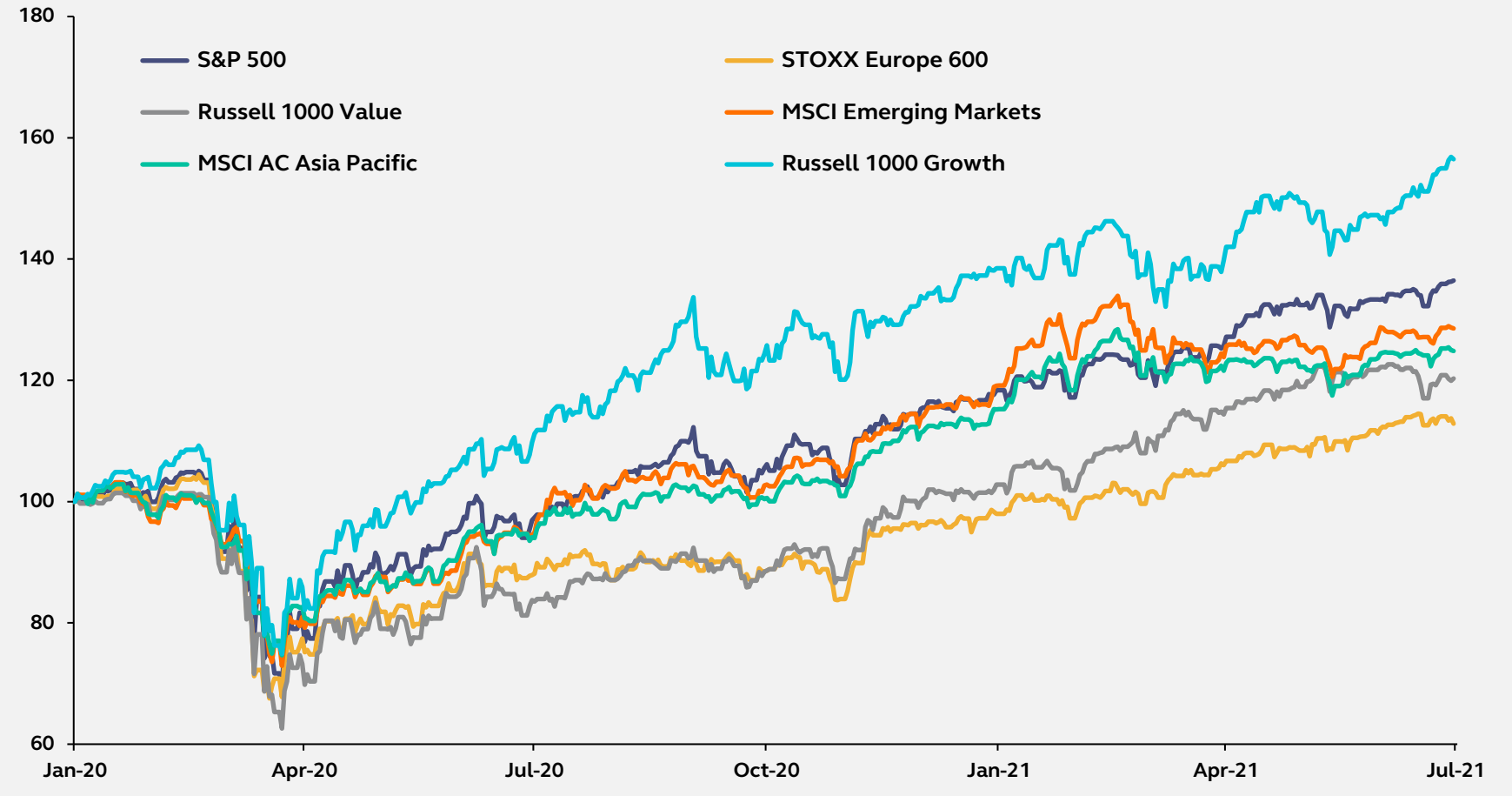


The global cyclical upturn has been spreading in staggered fashion

While Emerging Markets (EM) are struggling, European equities have been playing catchup

Global market performance

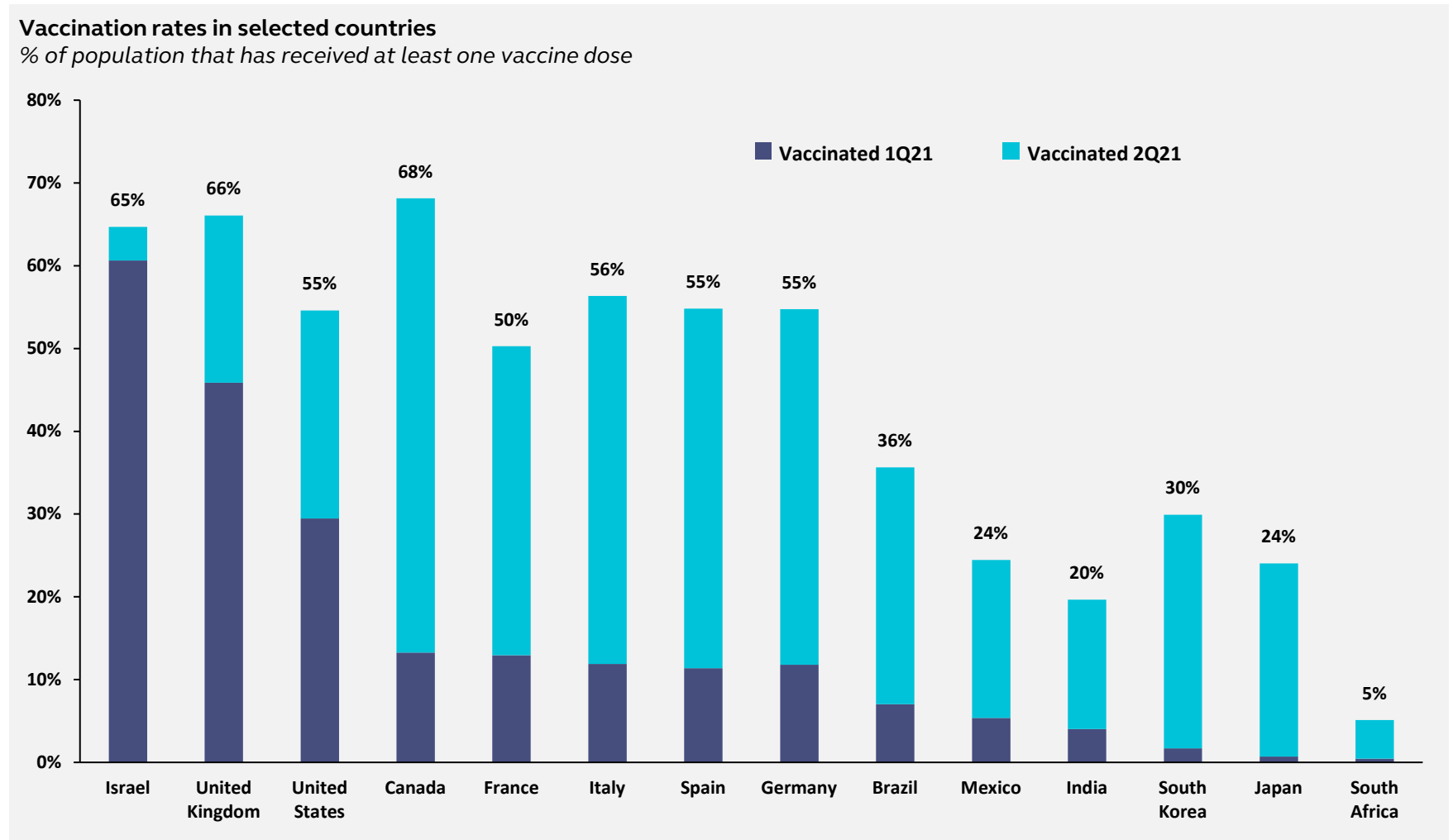
Index returns, local currencies, rebased to 100, January 1, 2020 - June 30, 2021



Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.

COVID-19 still plays a key role in global market performance

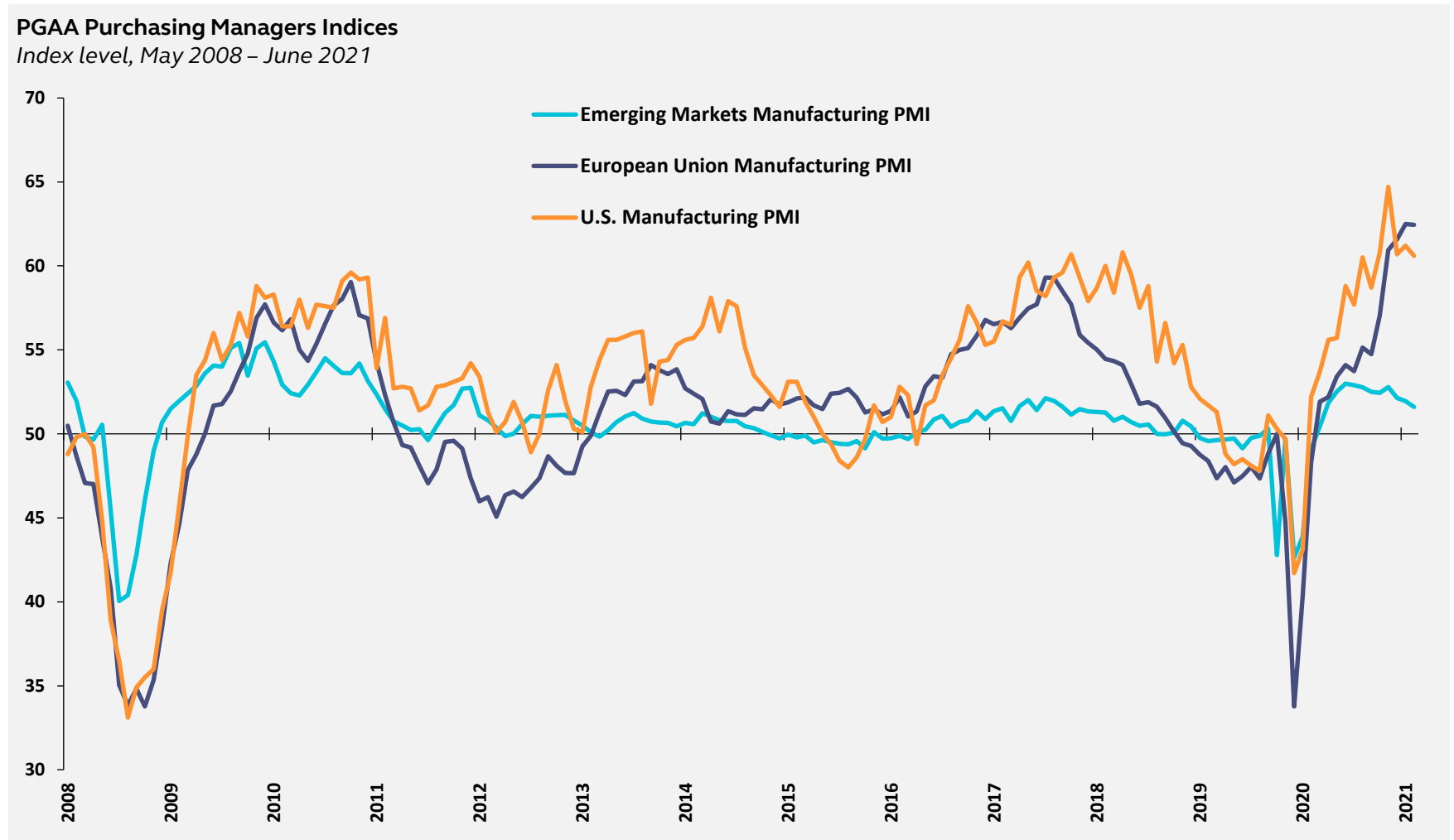
Vaccination progress is broadening, but EM continues to lag



Source: Our World in Data, Principal Global Asset Allocation. Data as of June 30, 2021.

Developed markets have been leading the growth rebound

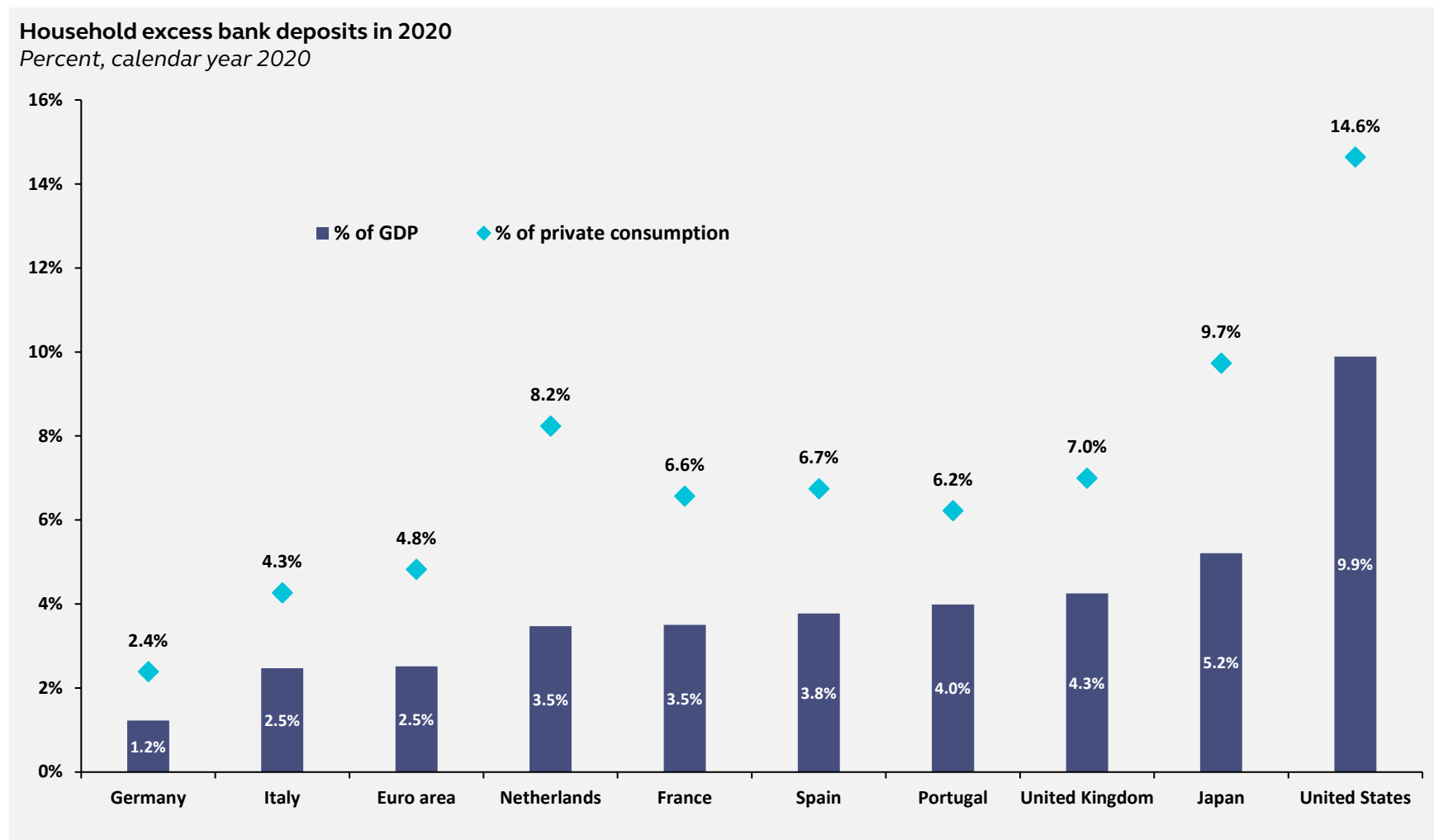
The U.S. economy may have hit peak recovery in 2Q



Source: Bloomberg, FactSet, Principal Global Asset Allocation. PGAA Purchasing Manager Index models start in May 2008. Data as of June 30, 2021.

Lining up the ingredients for a possible spending boom

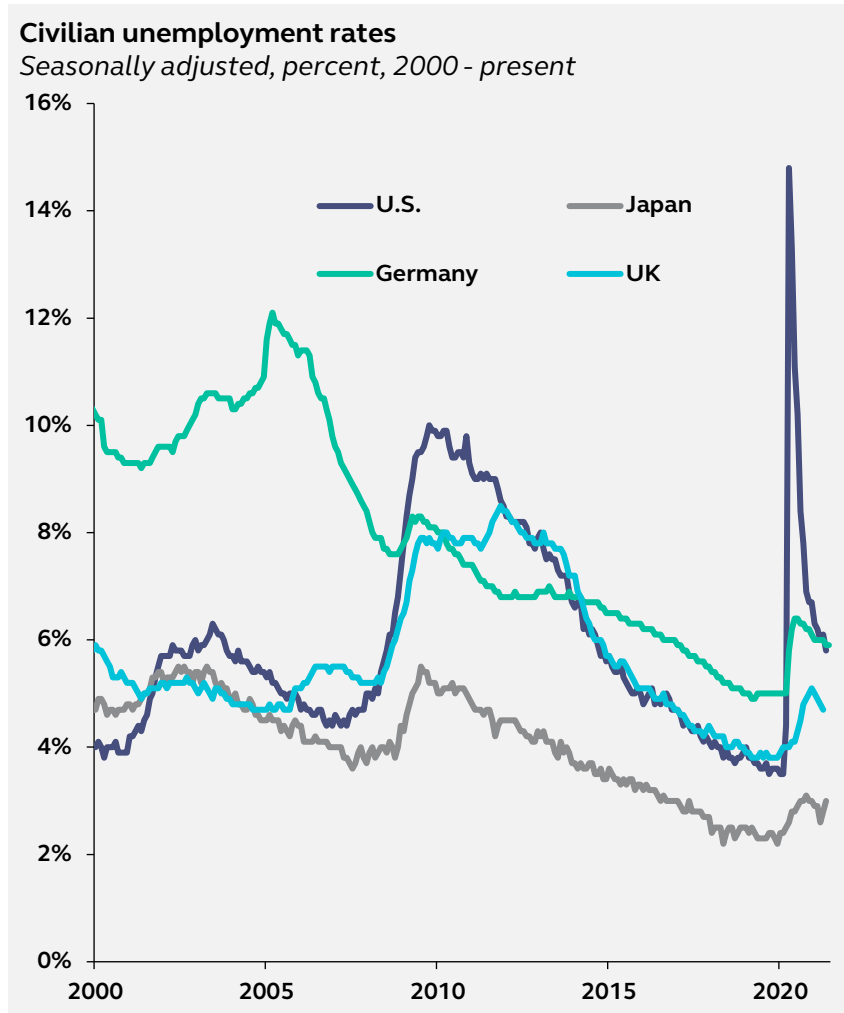
COVID-19 has created a war chest of excess savings



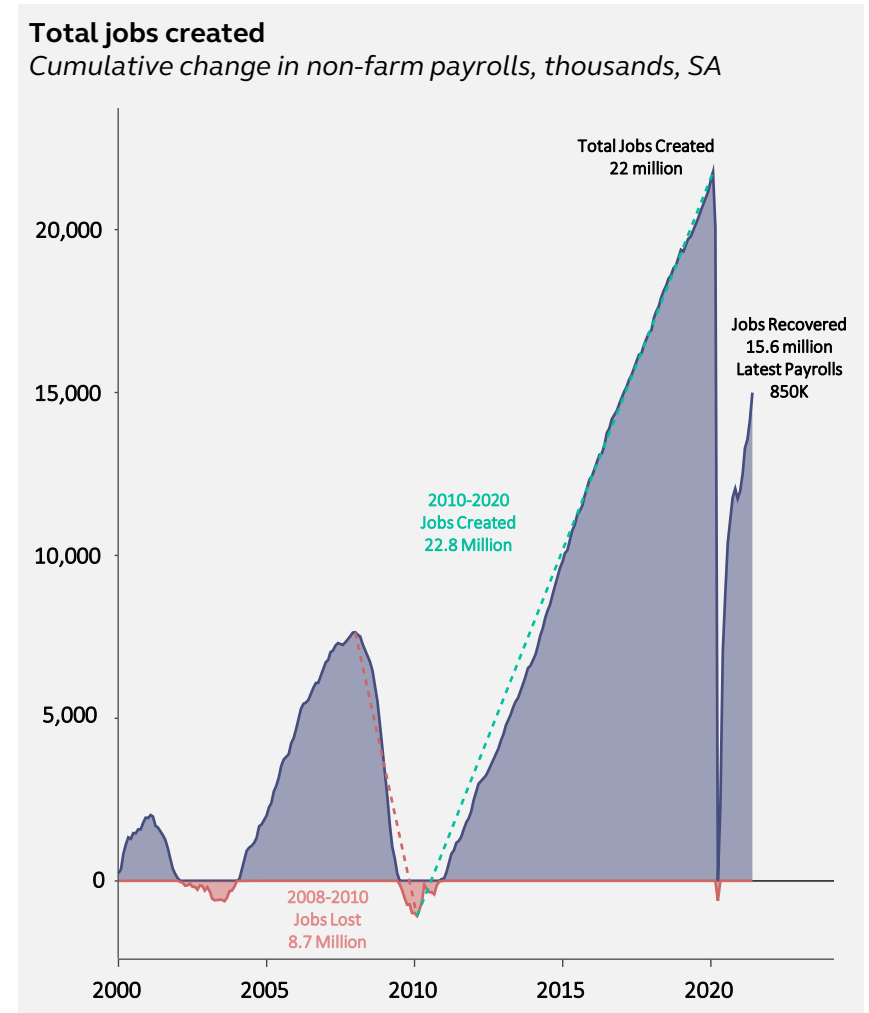
Source: OECD, Principal Global Asset Allocation. Data as of June 30, 2021.

U.S. jobs recovery struggling against labor supply constraints

European labor markets finally feeling a bit of pandemic heat



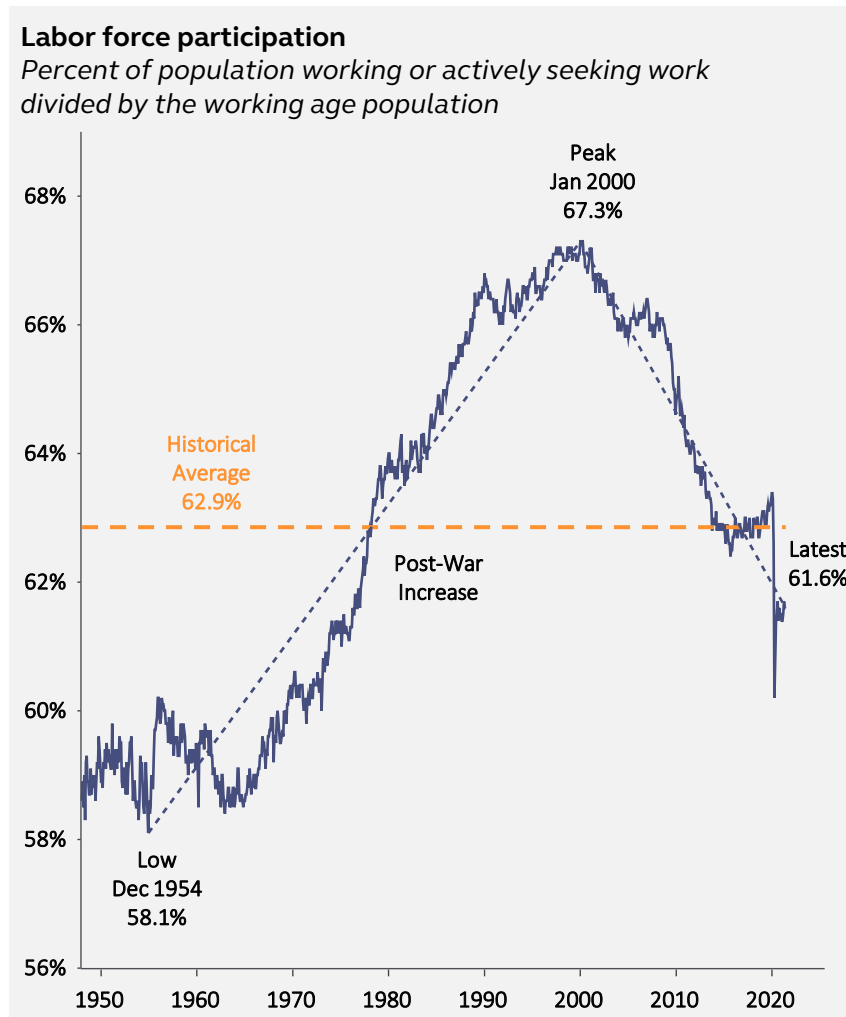
Source: Bureau of Labor Statistics, Bloomberg, Principal Global Asset Allocation.
Data as of June 30, 2021.



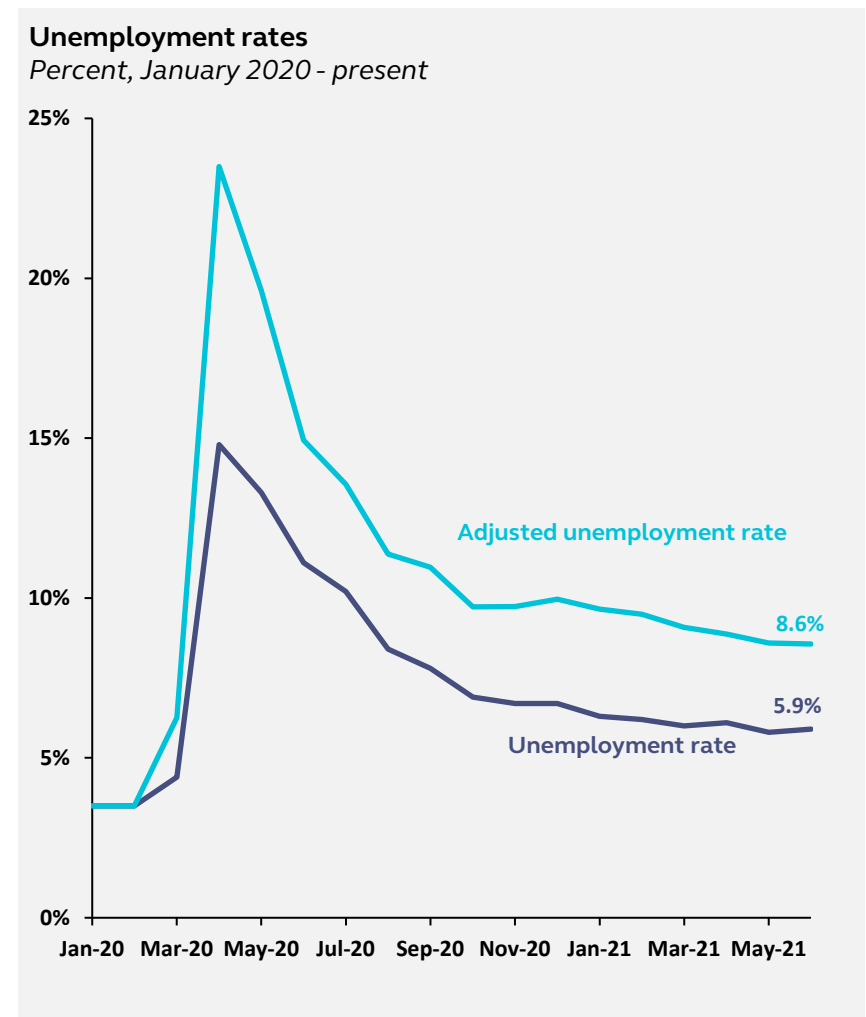
Source: Bureau of Labor Statistics, Clearnomics, Principal Global investors. Data as of June 30, 2021

Fiscal support has muted the incentive to return to work

Degree of economic distress is greater than headline unemployment suggests



Source: Bureau of Labor Statistics, Cleantomics, Principal Global Investors.
Data as of June 30, 2021.

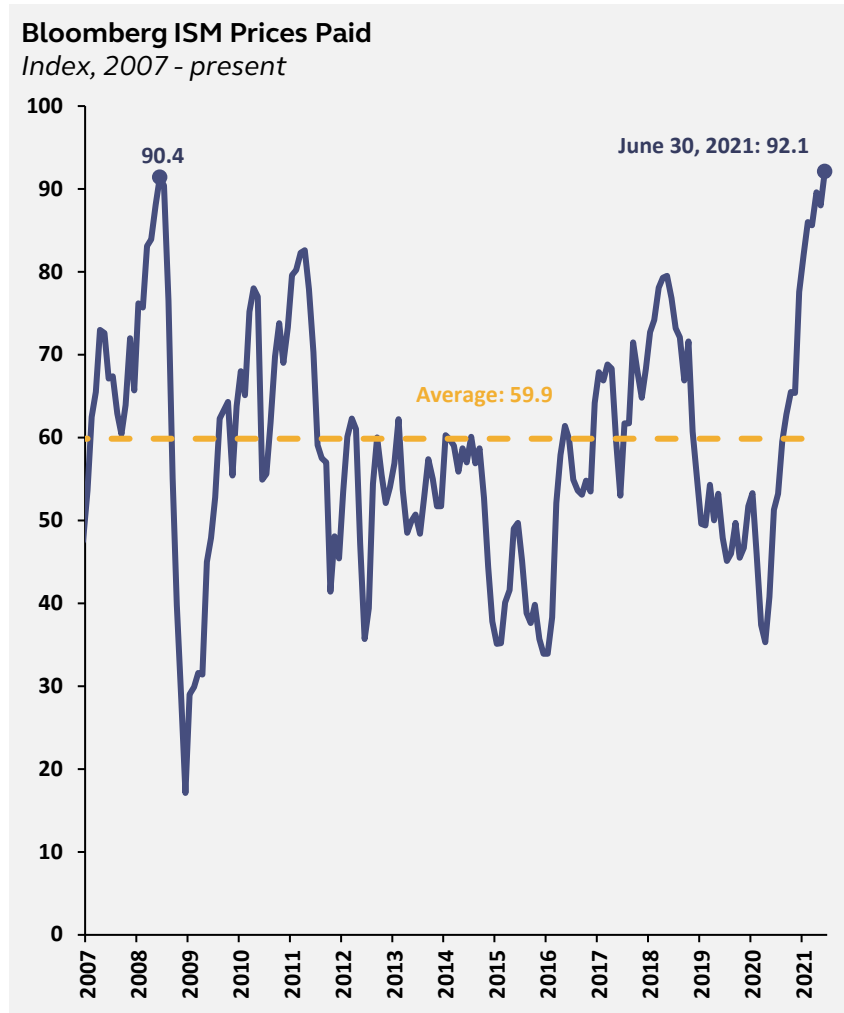


Source: Bureau of Labor Statistics, Principal Global Investors estimates. Adjusted unemployment holds the participation rate at February 2020 level of 63.3% and expands the classification of unemployed to include misclassified workers and the monthly change in labor force.
Data as of June 30, 2021.

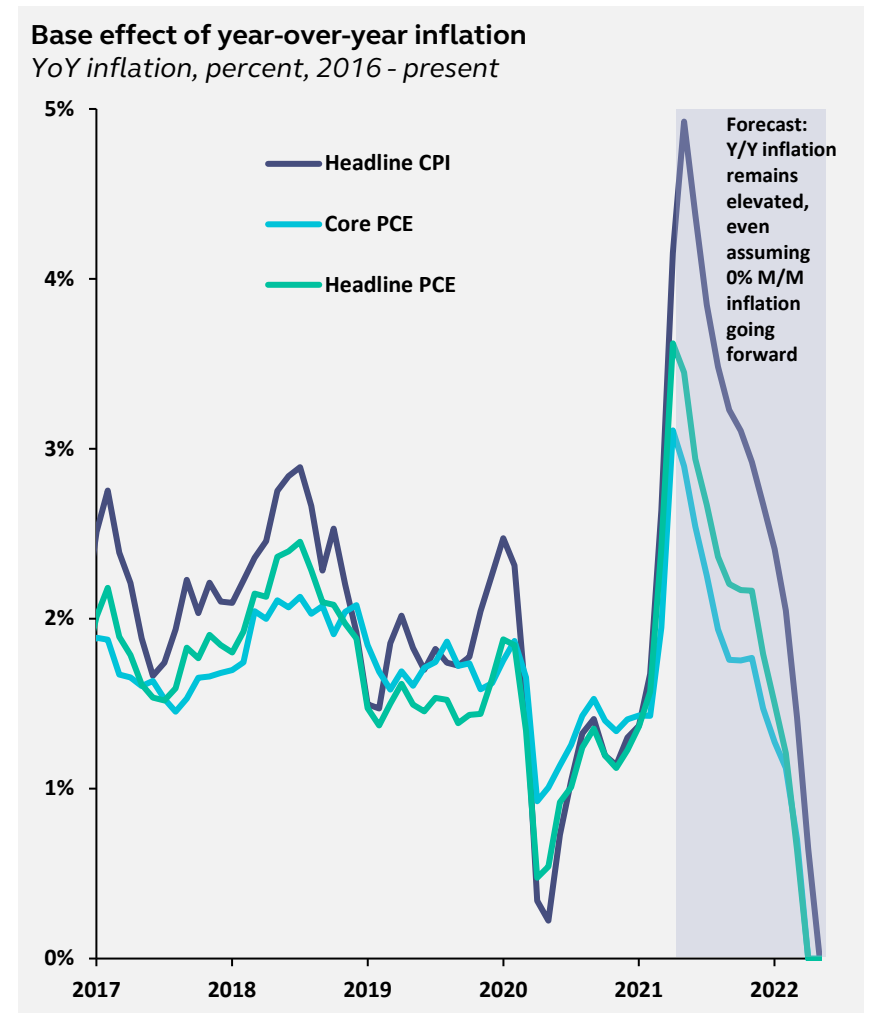
Past performance does not guarantee future results.

Supply pressures and base effects likely creating an inflation surge

Inflation may continue surprising to the upside for awhile longer



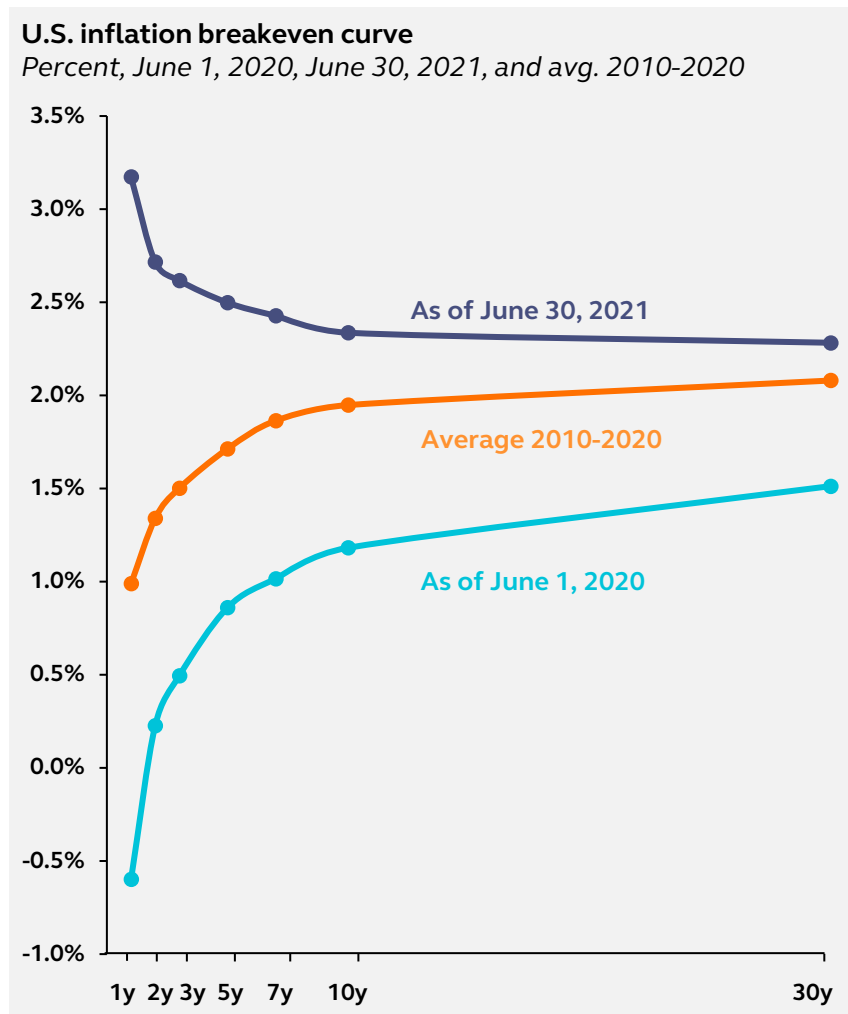
Source: Bloomberg, Institute for Supply Management, Principal Global Asset Allocation. Data as of June 30, 2021.



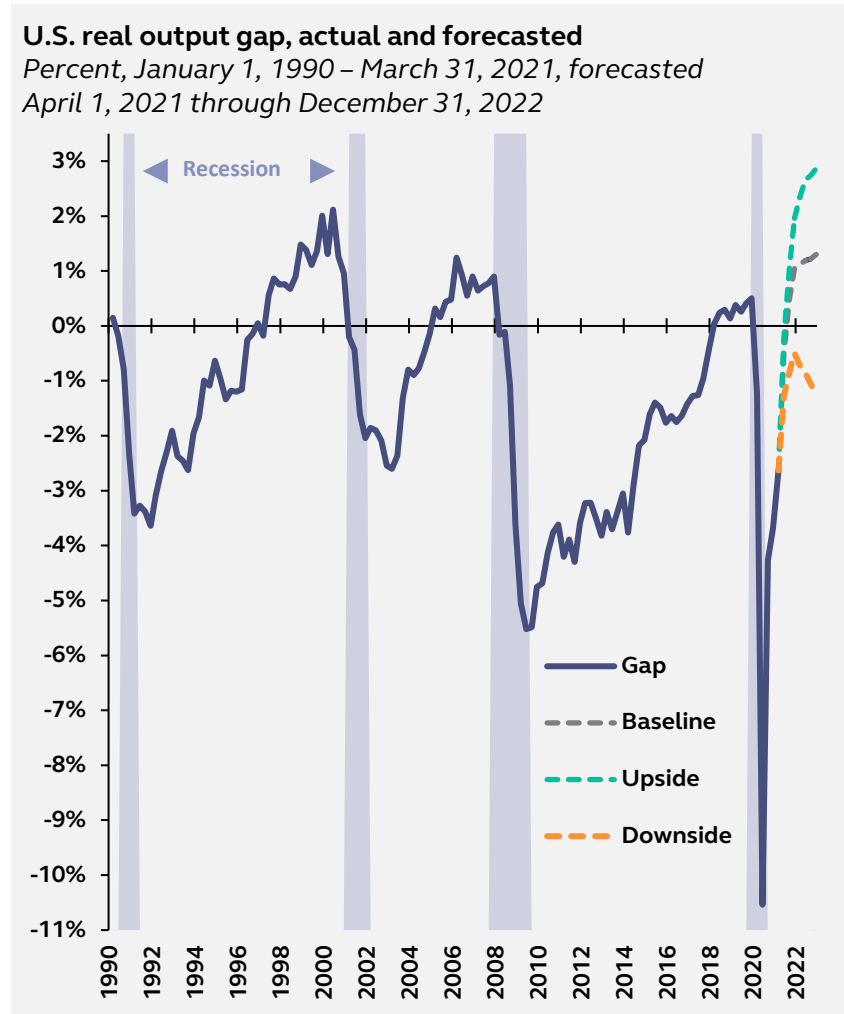
Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.

Markets increasingly see inflation less pronounced long term

PGAA forecasts see inflation settling around the 2% target



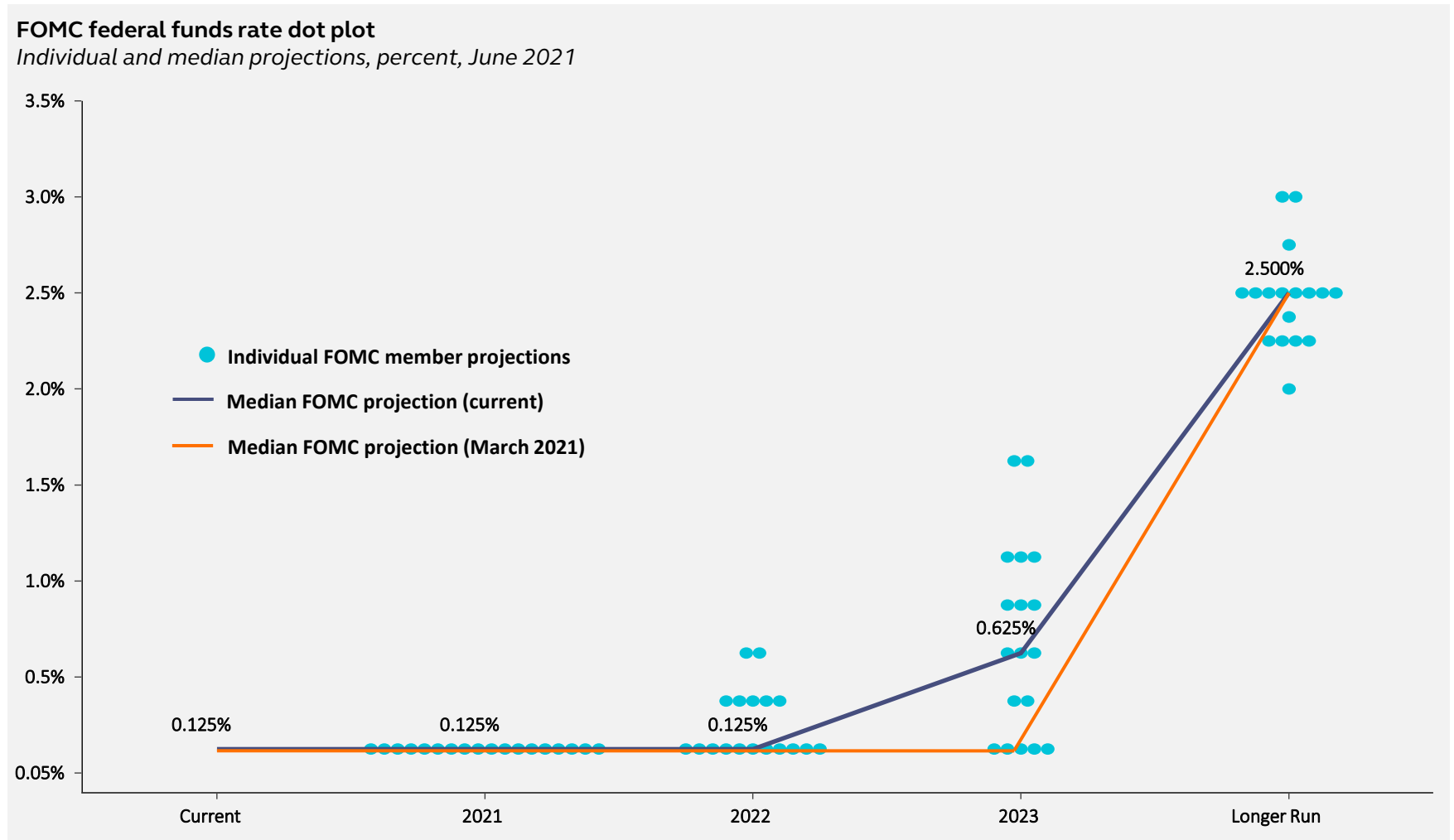
Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Forecasted scenarios from April 1, 2021 - December 31, 2022. Data as of June 30, 2021.

Fed has been extolling the virtues of inflation patience

Yet, actions speak louder than words – two rate hikes anticipated for 2023



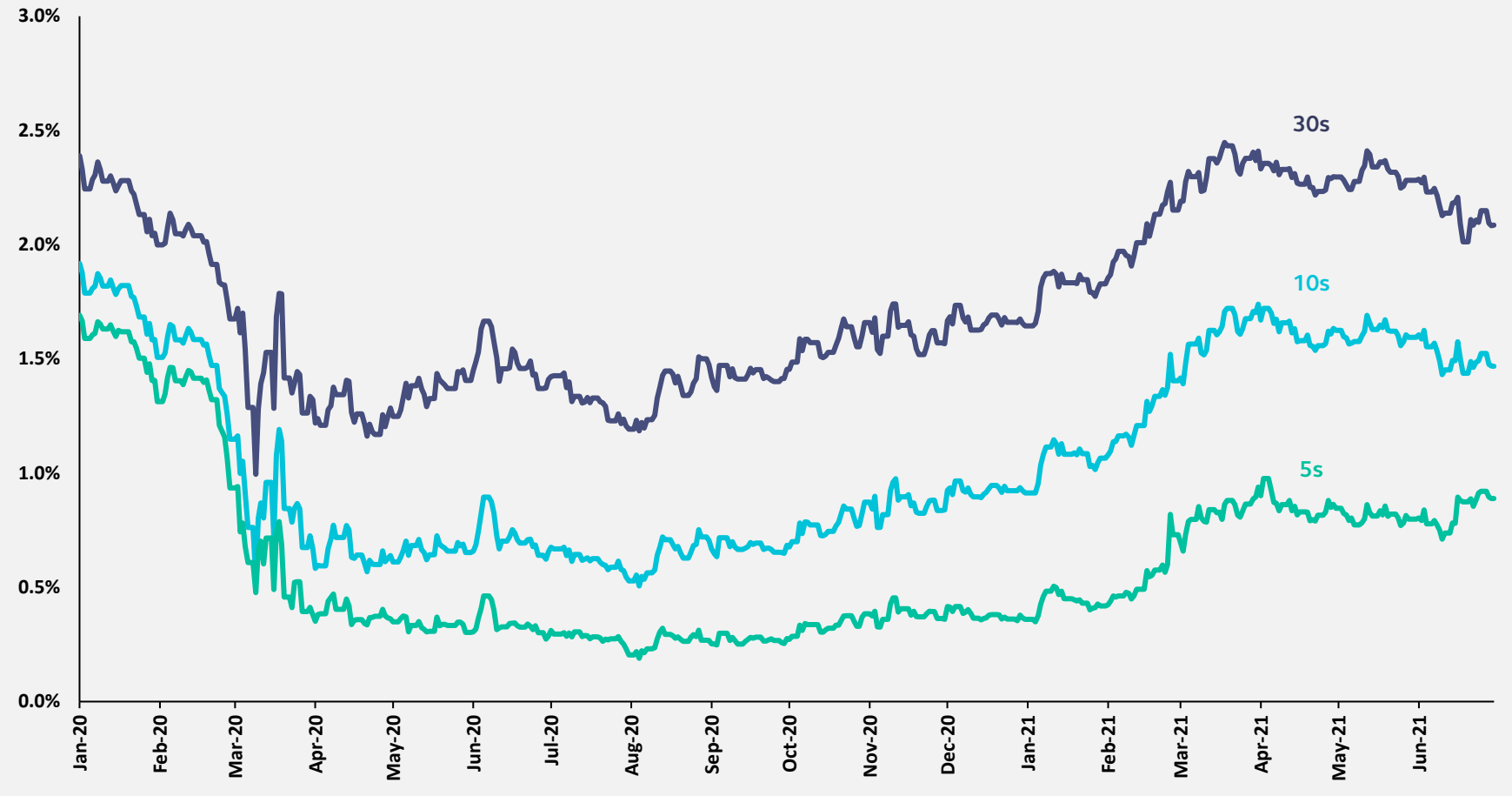
Source: Federal Reserve, Cleantomics, Principal Global Investors. Data as of June 30, 2021.

Markets are doubting the Fed's inflation tolerance

Question marks over central bank credibility don't appear positive for risk assets

U.S. Treasury yields

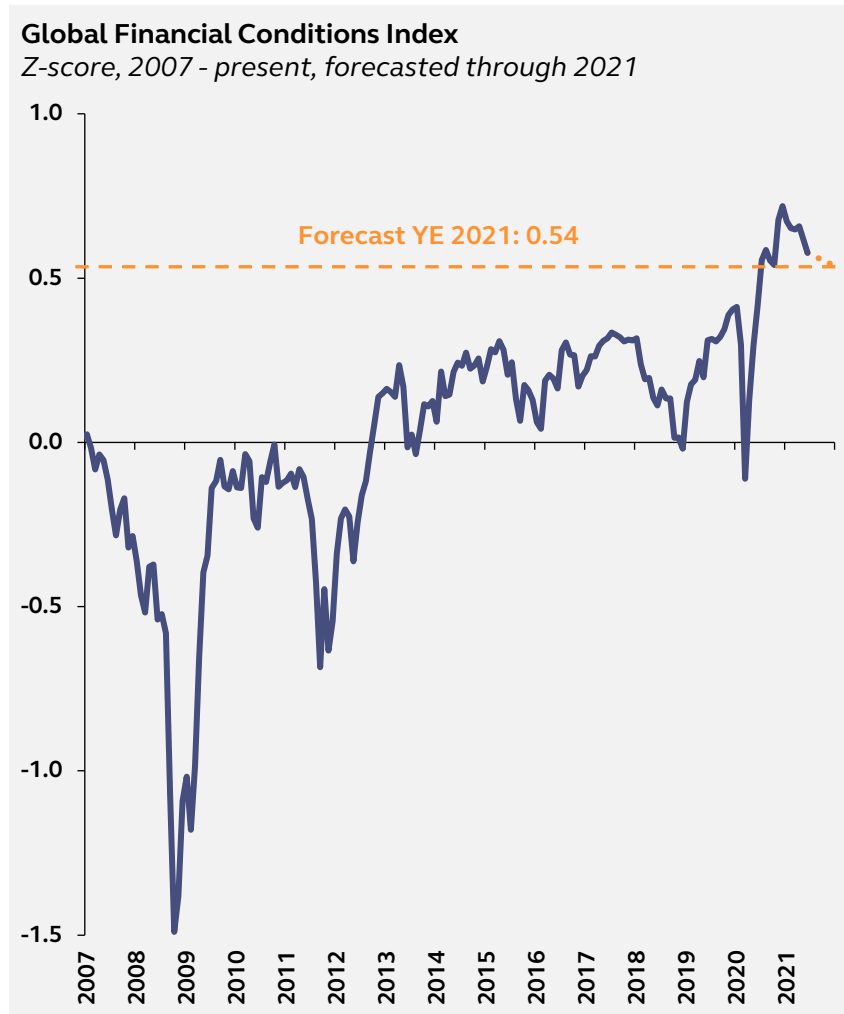
Percent, 5s, 10s, and 30s, January 1, 2020 - present



Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.

Easy financial conditions likely to remain in 2021

Global central banks will continue to be accommodative



Source: Bloomberg, Principal Global Asset Allocation. Forecasted to year end 2021.
Data as of June 30, 2021



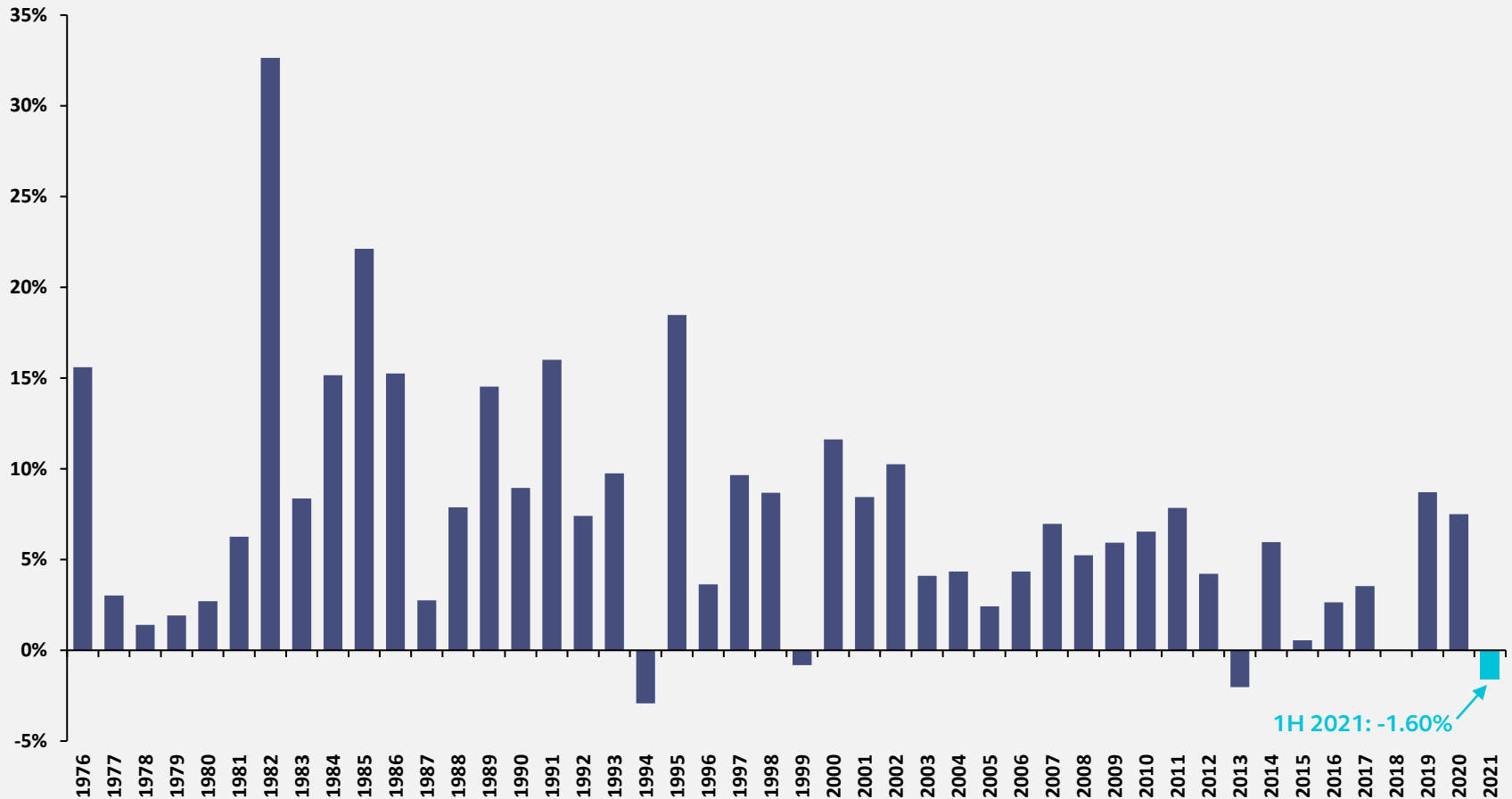
Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021

Past performance does not guarantee future results.

U.S. core bonds under duress

2021 could be the 4th negative annual return for the index in the past 45 years

Bloomberg Barclays U.S. Agg annual total return and 2021 return year-to-date
Percent, annual total return and 2021 total return year-to-date, 1976 – present

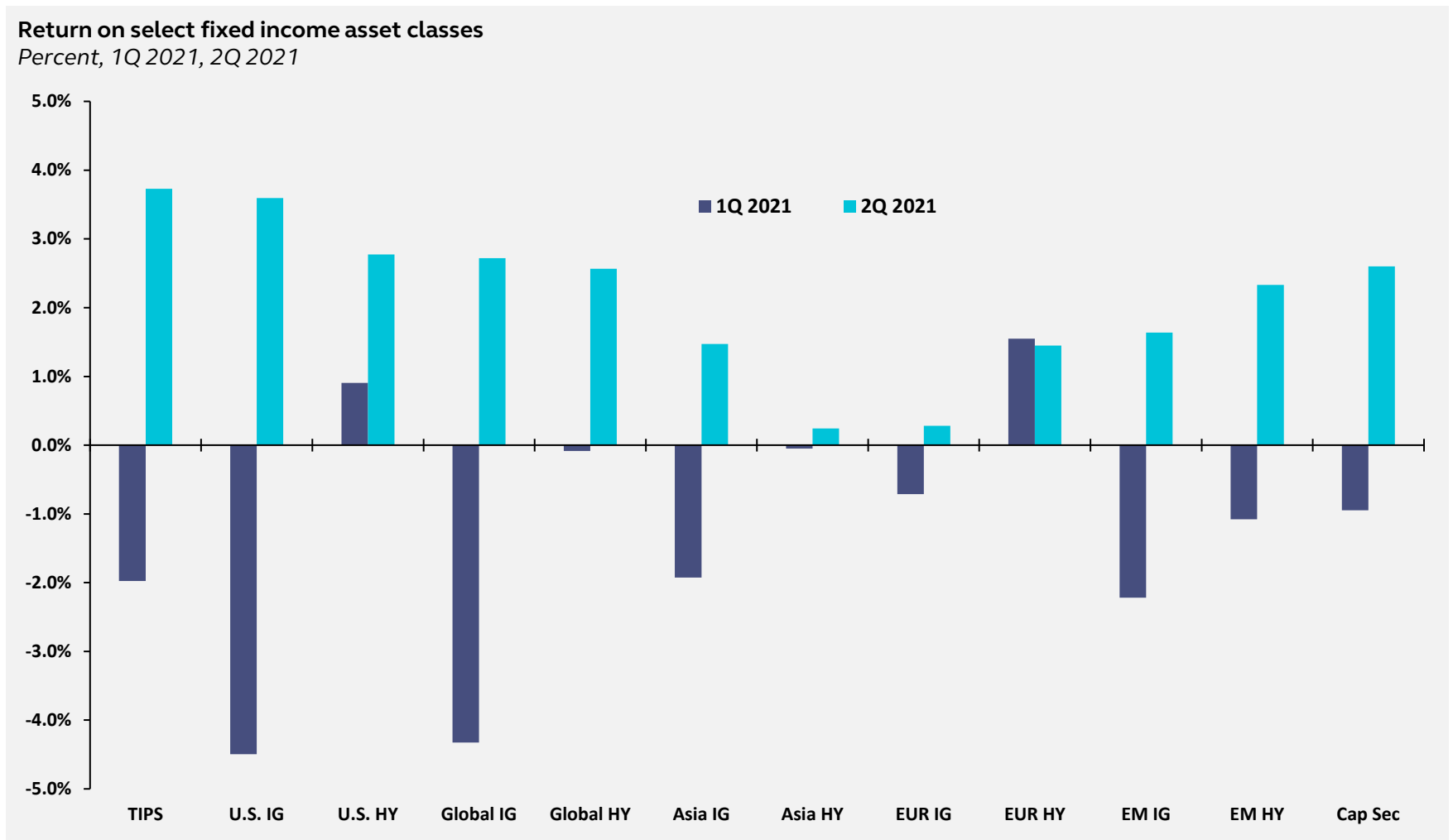


Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.

Past performance does not guarantee future results.

Bond market volatility on the rise: 1H21 was a tale of two halves

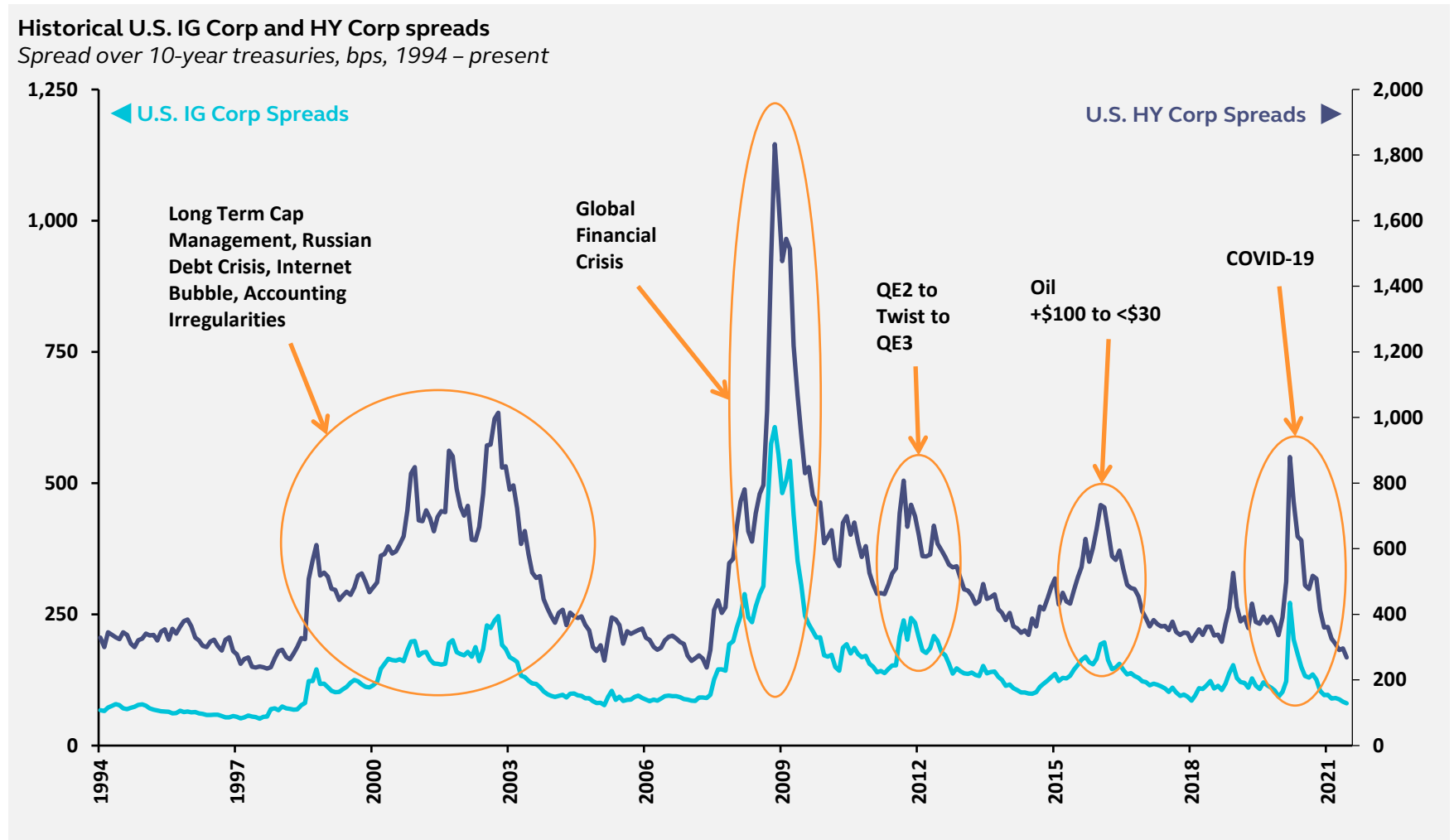
Rates generally rose in 1Q, but fell in 2Q



Source: Bloomberg, Principal Global Asset Allocation. See disclosure pages for index descriptions. Data as of June 30, 2021.

Past performance does not guarantee future results.

U.S. credit spreads are tighter than long-term averages



Source: Bloomberg, Principal Global Asset Allocation. Data as of June 30, 2021.

> Outlook



Growth/inflation trade-off at the investment forefront

Our base-case economic scenario

1 Global cyclical upturn spreading in a staggered fashion as vaccine progress broadens. U.S. economy to expand 6.8% in 2021.

2 Supply side dynamics drive inflation pressure globally. YoY U.S. CPI inflation will fade slightly to 4.8% by end-2021, before settling in the 2.00-2.25% range in 2022.

3 Fiscal policy still supportive but monetarily, central banks becoming less accommodative. Fed to begin tapering in 1Q22 and raising policy rates mid-2023.

4 Financial conditions still easy, providing support to risk assets, but inflation and central bank fears will be disruptive to market dynamics.

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

- **Runaway Inflation:** Inflation expectations become de-anchored as supply side issues extend and firms pass on higher costs to consumers. Growth slows as higher prices weigh on activity; central banks at a loss.
- **Hawkish policy error:** Fed tightens policy prematurely on transitory factors. Markets question the Fed's commitment to inflation overshooting and risk assets struggle with the sudden tightening in financial conditions.
- **Growth scare:** Triggered by additional significant waves of virus activity and worsened by virus variants. Bankruptcies and additional job losses would result.

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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