GLOBAL INSIGHTS • GLOBAL INSIGHTS • GLOBAL INSIGHTS • GLOBAL

1Q 2025

Global Market Perspectives

Diverging fortunes

PRINCIPAL GLOBAL INSIGHTS TEAM

Seema Shah
Chief Global Strategist

Brian Skocypec, CIMA
Director, Global Insights & Content Strategy

Christian Floro, CFA, CMT
Market Strategist

Jordan Rosner
Sr. Insights Strategist

Ben Brandsgard
Insights Strategist

Key themes for 1Q 2025

- **A complex global picture is emerging, with significant divergence in growth and policy actions.**
  While the U.S. continues to thrive, China and Europe are struggling. Proposed U.S. import tariffs threaten to intensify these diverging fortunes, reinforcing the U.S. exceptionalism theme. Policymakers will need to respond accordingly.
- **The U.S. economy remains resilient, but with pockets of weakness requiring careful watch.**
  Strong household and corporate balance sheets have created a very resilient economy. Nonetheless, low-income households and small businesses are struggling, highlighting the need for further interest rate relief to prevent weakness from spreading.
- **The Federal Reserve will likely adopt a slower, more cautious approach to policy.**
  Recent U.S. economic strength has combined with a rising threat of tariffs to increase upside inflation risks. The Fed is set to cut rates just a few times in 2025, likely hitting a floor of 3.75%. Interest rate relief will be shallow and restricted.
- **Equity market gains may be challenged by elevated bond yields and expensive valuations.**
  A strong economic backdrop will support continued solid earnings growth. Yet, expensive valuations imply elevated vulnerability to any earnings disappointment, while the recent rise in bond yields may exert pressure on gains.
- **Fixed income credit spreads to remain range bound, with a bias upwards.**
  The shallow Fed cutting cycle means that Treasury yields are unlikely to trend much lower. Credit spreads are near historic tights, but solid fundamentals and elevated starting yields imply credit could generate strong returns in 2025.
- **Flows into cash continue, but in this constructive environment, risk assets are more favorable.**
  While broad valuation concerns and policy uncertainty persist, the numerous pockets of value, coupled with inflation pressures and reinvestment risk, underscore the importance of investors optimizing opportunities in this favorable macro environment.

Investors should consider the divergent global picture

While U.S. outperformance is likely to persist in 2025, historically expensive valuations across U.S. equities should prompt investors to consider some global diversification in 2025.

Japan's valuations, although expensive, are not as stretched as those in the U.S. It also has positive prospects, driven by broad corporate reform and governmental commitment to end deflation. The UK's valuations are relatively cheap, and while it faces deep structural issues, pessimism is quite extreme, suggesting room for upside surprises. India's market has rarely been more expensive, almost comparable to the U.S. Yet, continued strong economic growth and relatively lower vulnerability to potential U.S. import tariffs suggest room for continued outperformance.

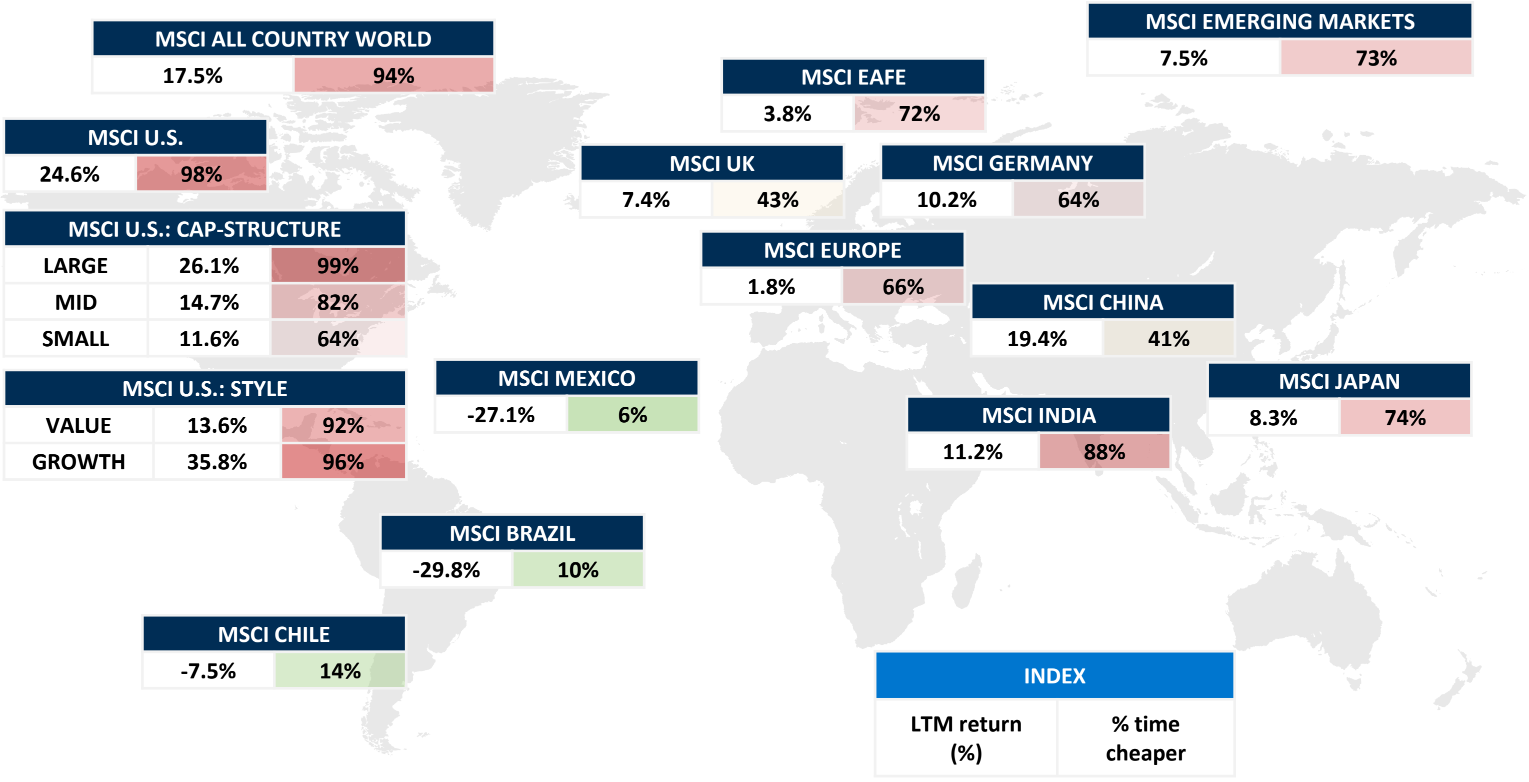
By contrast, Europe, Mexico, and China are very exposed to U.S. trade tariff policy. Their cheap valuations are likely insufficient to offset the negative fundamental outlooks.

Within the U.S., small-cap valuations are meaningfully more attractive than large-cap valuations. Although they have had a good run since the U.S. election, benefitting from a strong economy and deregulation, outperformance may be constrained by the Fed's shallow rate cutting cycle.

Expensive valuations across U.S. equities mean investors should consider other global regions, but still retaining a focus on strong fundamentals.

Global equity returns and valuations

Last twelve months returns and % of the time the Index been cheaper relative to its history since 2003, MSCI indices



Source: FactSet, Bloomberg, MSCI, Principal Asset Allocation. LTM (last twelve months) returns are total return and in USD terms. % Time Cheaper is relative to PAA Equity Composite Valuation history. PAA Equity Composite Valuation is a calculated measure, comprised of 60% price-to-earnings, 20% price-to-book and 20% to dividend yield. Composite started in 2003. EAFE is Europe, Australasia, Far East. See disclosures for index descriptions. Data as of December 31, 2024.

Bond yields: trending higher, counter to historic Fed cycles

Since the Fed's cutting cycle began in September, long end U.S. Treasury yields have been rising, ending 4Q at 4.57%, almost 80 bps higher than where they started. This is counter to historical trends, which show that yields tend to fall in cutting cycles and when economic activity is slowing.

Three factors appear to be at play:

- Pre-emptive Fed easing has reduced cut expectations
- Proposed policies, such as tariffs and immigration restrictions, have raised inflation risks
- Government policy uncertainty
- Fiscal sustainability concerns

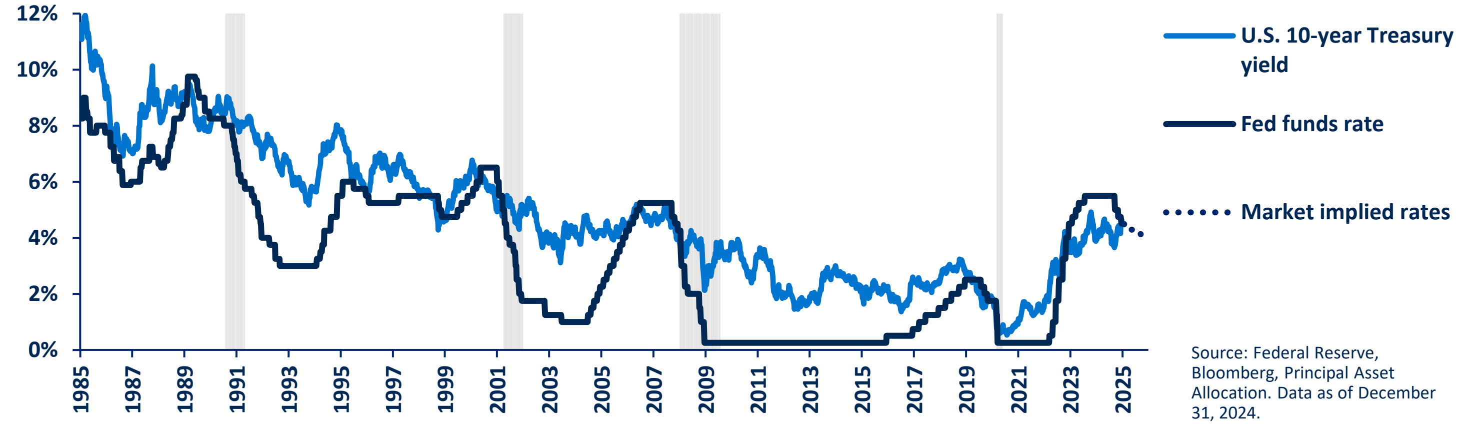
While the cutting cycle should ultimately limit the upside to yields, as the Fed easing cycle is likely to be only very short and shallow, longer-end bond yields are likely to remain relatively range-bound in coming months and unlikely to fall below 4% in 2025 (for a sustained period).

By contrast, with the market Fed funds rate expectations slightly more hawkish than our own, there is likely to be more downward pressure on the front end of the yield curve than the long end.

While history suggests Fed cuts and a slowing economy should push yields lower, bond yields have been trending higher in response to a multitude of factors.

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

Recessions are shaded, 1985–present



Source: Federal Reserve, Bloomberg, Principal Asset Allocation. Data as of December 31, 2024.

10-year Treasury yield and economic activity

November 2023–present

Source: Bloomberg, Principal Asset Management. Data as of December 31, 2024.

Despite tight spreads, credit may generate strong returns

Fixed income returns were quite volatile in 2024 as investor speculation about the size and pace of central bank cuts drove interest rate volatility.

However, overall, the total yield generated from fixed income today remains attractive relative to history, and credit continues to offer additional carry to U.S. Treasurys. As a result, yield buyers should continue to be attracted to credit.

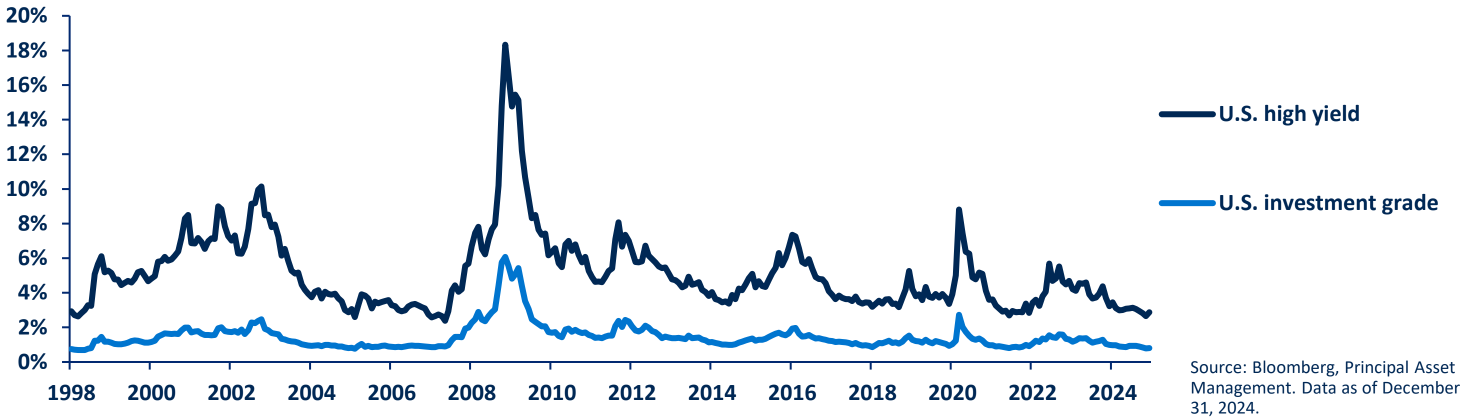
Credit spreads remain near historic lows. While this presents a slightly challenging valuation backdrop, the broad outlook remains positive. The economy is cooling slightly but remains in good health, and corporate balance sheets across both investment grade and high yield companies are also healthy. As such, while there may be only a modest widening bias, spreads are likely to remain broadly rangebound in 2025. The combination of supportive fundamentals and elevated starting yield should enable credit to generate strong returns for investors in 2025.

Ultimately, fixed income assets continue to provide a reliable source of income and yield, offer mitigation against widespread market volatility, and present opportunities to enhance returns within investment portfolios.

Credit spreads are near historic tights. But solid fundamentals and elevated starting yields imply credit could generate strong returns in 2025.

U.S. high yield and investment grade spreads

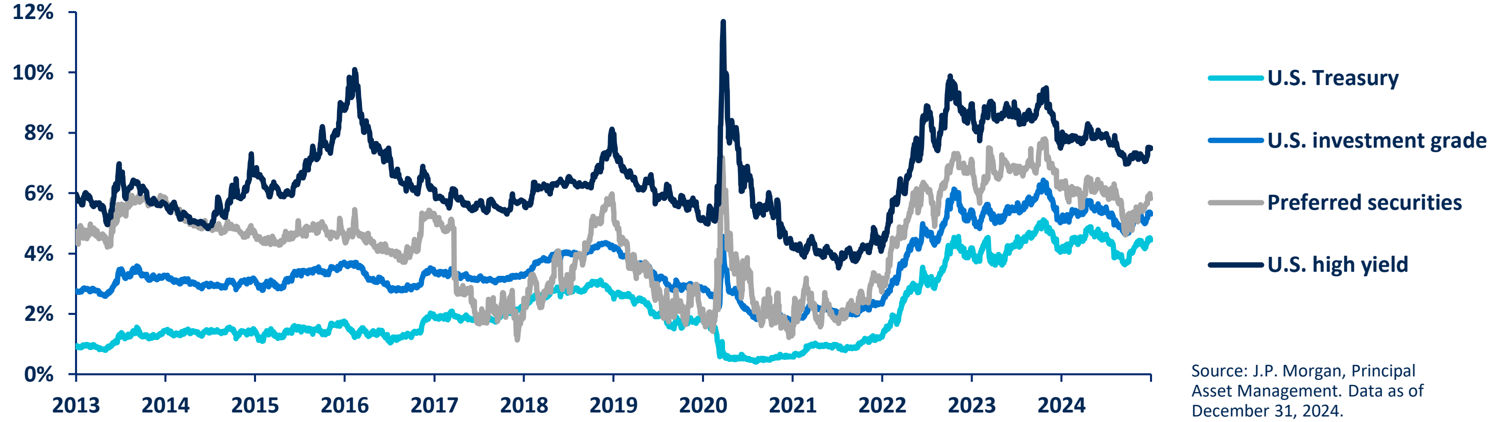
Option-adjusted-spread, 1998–present



Source: Bloomberg, Principal Asset Management. Data as of December 31, 2024.

Yield comparison

Yield-to-worst, 2013–present



Source: J.P. Morgan, Principal Asset Management. Data as of December 31, 2024.

Risk asset outlook: resisting the temptation of cash

Flows into money market funds have continued to increase. Valuation concerns and U.S. policy uncertainty have led investors to feel more comfortable in cash. Yet, these concerns are likely overdone.

While it is true that the change in government has raised policy uncertainty, the incoming administration's policy stance is for broad deregulation and lower corporate and individual taxes. It is not yet clear how these policies will be enacted, but they are unlikely to be damaging to U.S. economic growth—reinforcing the constructive macro environment, which provides a strong backdrop for risk assets.

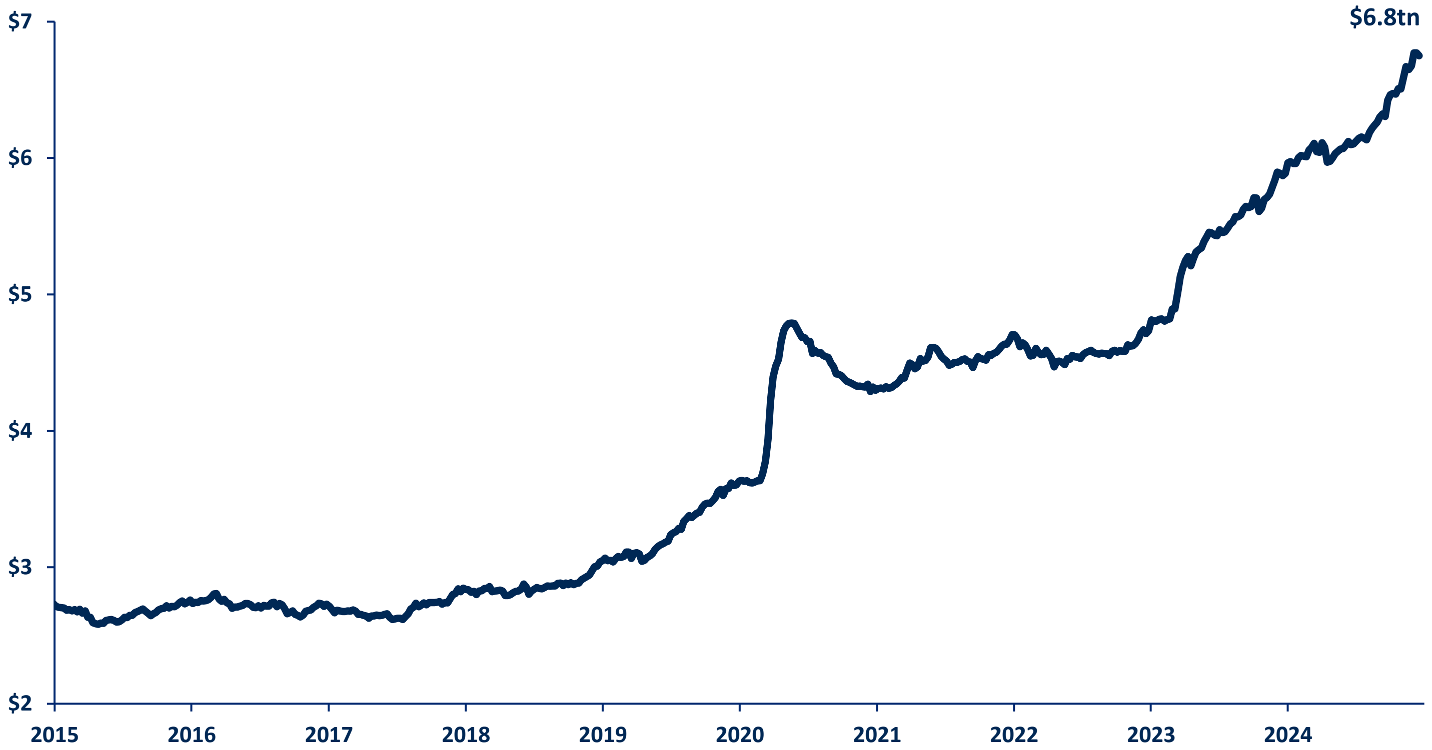
In addition, while the S&P 500 index is expensive, there are many segments of the market that are attractively valued and, therefore, less vulnerable to pullbacks.

A key concern for 2025 is the potential for a renewed increase in inflation—this makes it even more important for investors to consider real returns and to target risk assets that can deliver a higher return than cash.

Finally, with Fed policy rates still biased lower, investors face reinvestment risk and should lock in higher yields, suggesting some urgency for investors to put their cash to work.

The strong economic outlook and pockets of value in the market, as well as inflation concerns and reinvestment risk, mean that investors should resist the temptation of cash.

U.S. total money market fund assets
Trillions, 2015–present



Source: Investment Company Institute, Bloomberg, Principal Asset Management. Data as of December 31, 2024.

A cautiously risk-on environment for investors

Despite elevated policy uncertainty, a solid economic backdrop implies this is still a risk-on investing opportunity.

Equities *Retain U.S equity exposure but add diversification via global equities*

- Strong U.S. earnings growth can overcome valuations concerns and deliver solid equity market gains.
- Explore opportunities beyond the Mag 7, including tactical exposure to small- and mid-cap stocks.
- Pockets of attractive international valuations suggest opportunities outside the U.S

Fixed income *Increase exposure to high-quality credit and extend duration*

- Leverage core fixed income during a mild economic slowdown.
- Extend duration as a hedge against growth disappointment and reinvestment risks.
- Emerging market debt may offer total return potential during global central bank easing.
- High yield maintains a substantial carry advantage for income-seeking investors.

Alternatives *Pursue less correlated exposures*

- Real return-focused strategies gain attractiveness when nominal growth slows and inflation is sticky.
- Infrastructure offers resiliency and attractive valuations.
- REITs offer attractive valuations and constructive fundamentals as rates move lower.
- When valuations are expensive, reduce overall risk and focus on alpha capture.

Implementation

- Well-diversified, active international managers
- Quality-biased active managers
- Active mid- and small-cap strategies
- Large-cap U.S. strategies

- IG credit heavy core fixed income
- Flexible emerging market debt strategies
- Active high yield strategies
- Preferred & capital securities

- Real asset strategies (infrastructure, natural resources)
- Private real estate markets
- Proven REIT strategies
- Multi-strategy alternatives

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. 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.

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.

This material may contain 'forward-looking' information that is not purely historical in nature and may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader. This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

Ahli United Bank B.S.C.(c)

Bahrain: Licensed as an Islamic Retail Bank by the CBB. The views contained herein has been obtained from sources that Ahli United Bank B.S.C.(c) ("AUB") deems to be reliable but Ahli United Bank B.S.C.(c) makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of Ahli United Bank B.S.C.(c); however, Ahli United Bank B.S.C.(c) does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, Ahli United Bank B.S.C.(c) 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. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. AUB will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on AUB for advice or recommendations and/or solicitation of any sort. Ahli United Bank B.S.C.(c) is licensed as an Islamic retail bank by the Central Bank of Bahrain ("CBB"). For additional information about Ahli United Bank B.S.C.(c), please visit www.ahliunited.com/bh

Dubai International Financial Center: This material is for distribution by Ahli United Bank B.S.C (C) (DIFC Branch) which is regulated and authorized by the Dubai Financial Services Authority (DFSA). This presentation/document is for information purposes only and is not an offer to sell or a solicitation to buy any fund, units, shares, securities, or financial products. Reliance should not be placed on the views and information in these presentations when making individual investment and/or strategic decisions. It is only intended for Professional Clients and/or Market Counterparties as defined by the DFSA rulebook. No other person should act upon this material or publication. It is not intended for Retail Clients. In addition to the above, this material or publication and information within it are not directed at any person resident in the territory or any country or jurisdiction action where such distribution will be contrary to local law or regulation. Nothing herein constitutes investment, legal, accounting or tax advice, or a representation that any particular investment (if any) mentioned herein is suitable for or appropriate to your investment objectives, financial situation, and particular needs, or otherwise constitutes a personal recommendation to you. All investments carry varying levels of risk, and the value of your investment may go up or down depending on several factors, including market movements. Past performance is not an indicator of current or future returns. The recipient(s) before acting on any information herein should make his/their own investigation and seek appropriate professional advice prior to any investment decision or entering any financial obligation based on information, statement or opinion which is expressed herein.

Egypt: The views contained herein has been obtained from sources that Kuwait Finance House Bank (Egypt) S.A.E. ("KFH") deems to be reliable but KFHE makes no representation about the accuracy, completeness or timeliness of any information prepared by a third party and assumes no liability for the reliance thereon. The opinions and predictions expressed in the materials are subject to change without prior notice and has not been prepared by or with the involvement of KFHE; however, KFHE does not independently verify or guarantee its accuracy or validity. Subject to any contrary provisions of applicable law, KFHE 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. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only and derived from numerous sources, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. IMPORTANT – If you are in any doubt about the contents of this document you should seek independent professional advice. KFHE will not act and has not acted as your legal advisor to you in connection with this, and/or any related transaction and no reliance may be placed on KFHE for advice or recommendations and/or solicitation of any sort. Kuwait Finance House Bank (Egypt) S.A.E. . is licensed and regulated by the Central Bank of Egypt. For additional information about Kuwait Finance House Bank (Egypt) S.A.E., please visit www.eg.kfh.com.

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.