Market Outlook – Asset Class 2Q 2022

Equities

Neutral

- Due to key uncertainties, global growth projections were adjusted downwards. With the swings in commodity prices, inflation may stay high for a few more months before it starts to subside. The risk of a stagflation is rising
- The surge in energy prices in response to the Russia/Ukraine conflict comes at a time of existing tension in energy supplies. If commodity prices stay elevated, it may hit consumption and impact growth more extensively
- Global central banks are pursuing a tightening stance despite rising uncertainties. Financial conditions might tighten further as policy rates head higher globally
- Equities fundamentals have improved in the past quarter. Except for the U.S., the valuation of global equity has receded to a level closer to 10-year average.
- Negative real yields are likely to support equity performance as well

Fixed Income

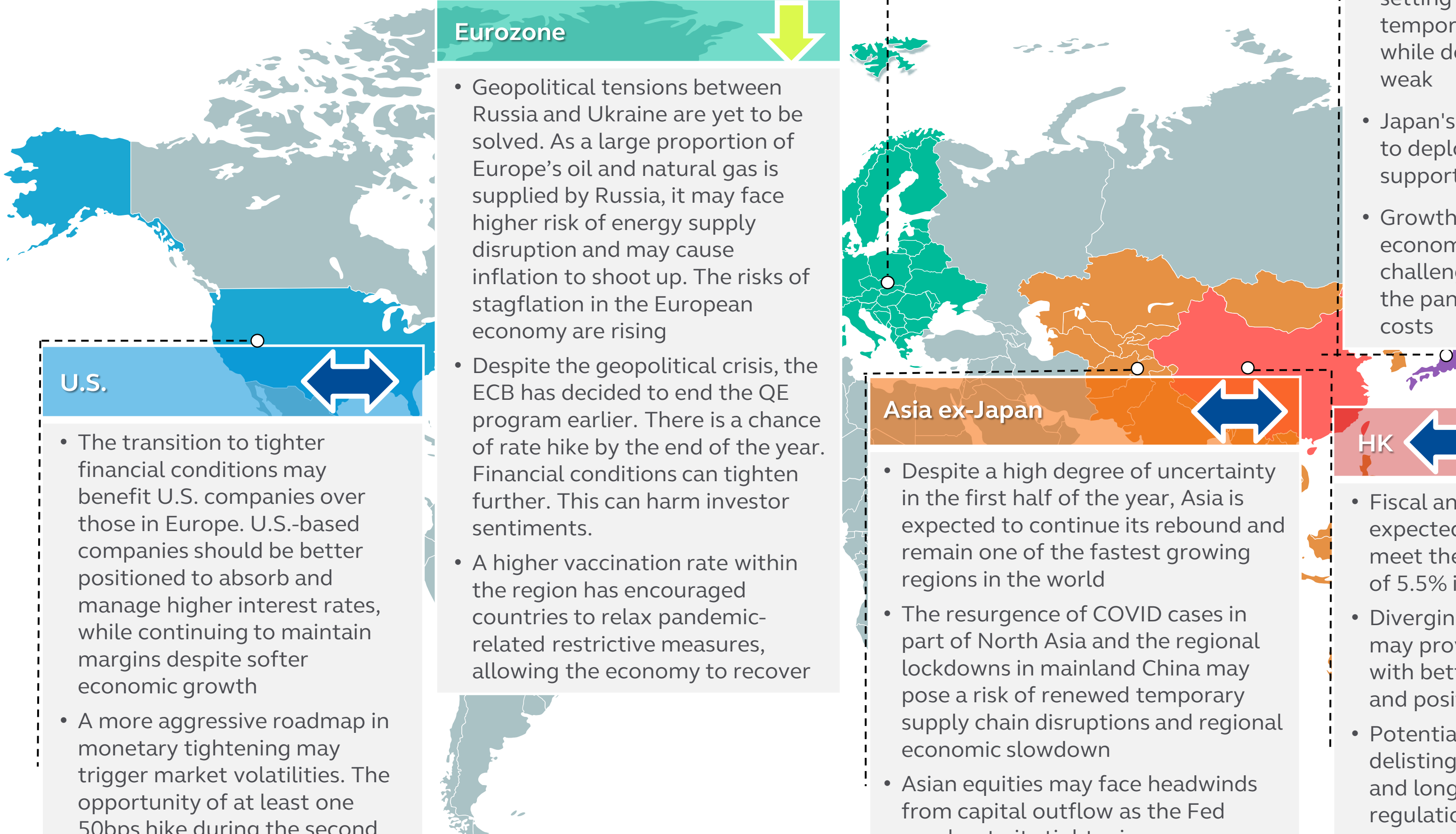
Neutral

- Government yields may rise further boosted by inflationary pressures and central banks tightening expectations
- Yield curve is likely to flatten. Short-term rates may rise further due to the hawkish tilt of the Fed, while slower economic growth may somewhat limit the rise of long-term yields, causing continuous flattening
- Given the relatively strong health of the corporate sector, there might be limited room for spreads to widen further from the current fair value zone

Overweight **Slightly Overweight** **Neutral** **Slightly Underweight** **Underweight**

Source: Principal Asset Management Company (Asia) Ltd.

Market Outlook – Equities 2Q 2022



U.S.

- The transition to tighter financial conditions may benefit U.S. companies over those in Europe. U.S.-based companies should be better positioned to absorb and manage higher interest rates, while continuing to maintain margins despite softer economic growth
- A more aggressive roadmap in monetary tightening may trigger market volatilities. The opportunity of at least one 50bps hike during the second quarter is on the table
- Valuations of US equities remain high among global markets

Eurozone

- Geopolitical tensions between Russia and Ukraine are yet to be solved. As a large proportion of Europe's oil and natural gas is supplied by Russia, it may face higher risk of energy supply disruption and may cause inflation to shoot up. The risks of stagflation in the European economy are rising
- Despite the geopolitical crisis, the ECB has decided to end the QE program earlier. There is a chance of rate hike by the end of the year. Financial conditions can tighten further. This can harm investor sentiments.
- A higher vaccination rate within the region has encouraged countries to relax pandemic-related restrictive measures, allowing the economy to recover

Asia ex-Japan

- Despite a high degree of uncertainty in the first half of the year, Asia is expected to continue its rebound and remain one of the fastest growing regions in the world
- The resurgence of COVID cases in part of North Asia and the regional lockdowns in mainland China may pose a risk of renewed temporary supply chain disruptions and regional economic slowdown
- Asian equities may face headwinds from capital outflow as the Fed accelerate its tightening process

Japan

- The Bank of Japan is likely to stick with its accommodative policy setting even if headline inflation temporarily reaches the 2% target while domestic demand remains weak
- Japan's government stands ready to deploy more fiscal stimulus to support economic recovery
- Growth potential of Japan economy may be fragile, challenged by the resurgence of the pandemic and higher energy costs

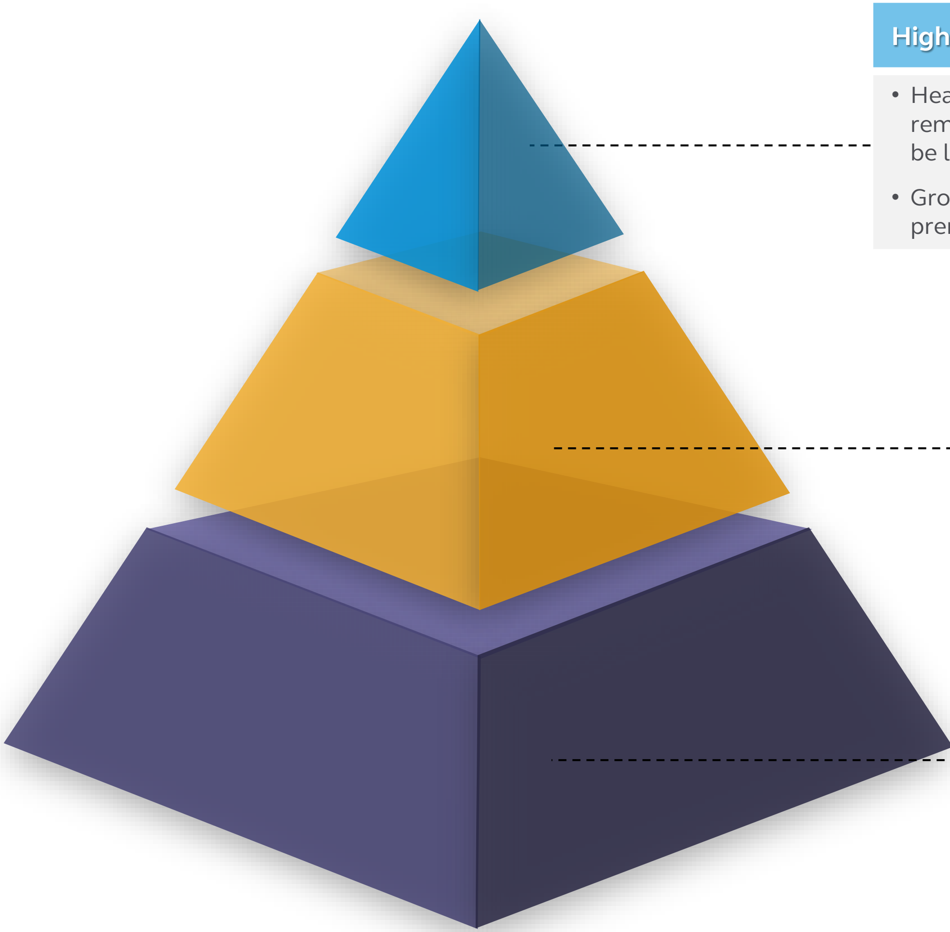
HK China

- Fiscal and monetary policies are expected to stay supportive to meet the full year growth target of 5.5% in China
- Diverging PBOC and Fed policies may provide China-related equities with better financial conditions and positive fund flows
- Potential risks of widespread US delisting of Chinese companies and long-running domestic regulations on tech companies still exist and may further dampen investors' sentiments

Overweight | Slightly Overweight | Neutral | Slightly Underweight | Underweight

Source: Principal Asset Management Company (Asia) Ltd.
The geographical classification of above listed equity markets is based on MSCI 2021 annual market classification review. For more information, please refer to https://www.msci.com/market-classification

Market Outlook – Fixed Income 2Q 2022



High Yield

- Healthy corporate fundamentals and earnings growth remain supportive to high yield bonds. Defaults should be limited
- Growth headwinds are growing and increases in risk premia could pose threats to the high yield market

Investment Grade

- Total returns for investment grade corporate bonds may face headwinds with higher government yields
- Corporate spreads widened towards fair value as risk-off gripped markets. IG spread is close to its 10-yr median
- The hunt for yield in corporate bonds from investors remains strong

Sovereign

- Although geo-political risks and other uncertainties may cause a flight towards safety, treasury yields are expected to go higher with aggressive Fed move and lingering inflation
- Real yields are likely to remain in the negative territory. The current level of government bond yields may not be attractive relative to credits, from asset allocation perspective

Overweight | Slightly Overweight | Neutral | Slightly Underweight | Underweight

Source: Principal Asset Management Company (Asia) Ltd.

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