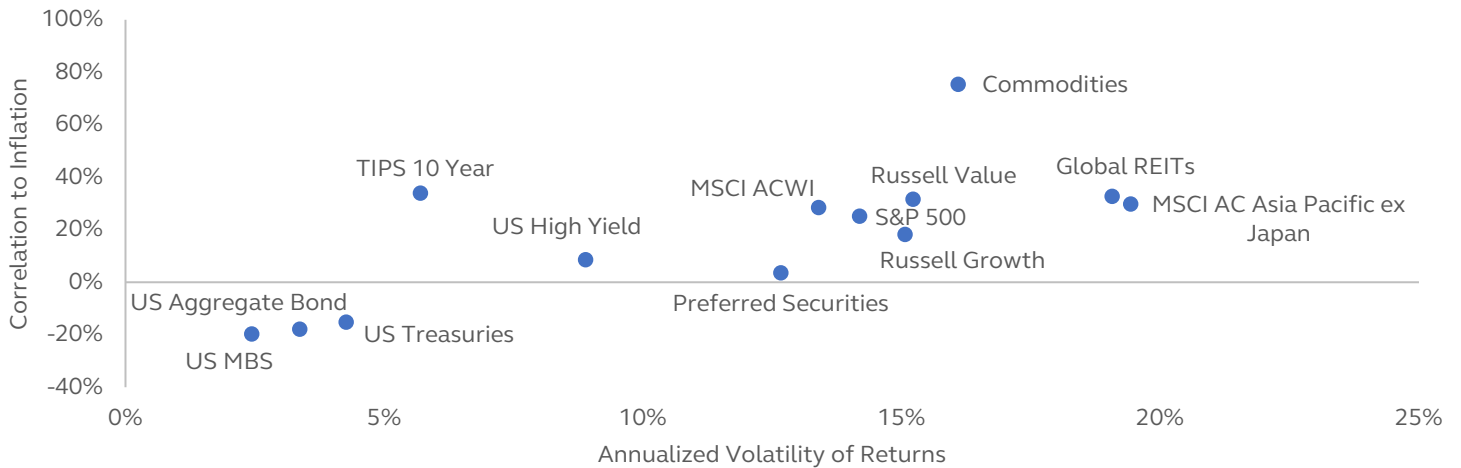


Investment Strategy as Inflation Edges

Figure 1: Asset Classes Correlation To 12 Month Rolling CPI¹



Post-COVID economic recovery drives inflation higher

- After softening during the late summer COVID wave from July through September, prices for items most associated with reopening demand and supply shortages have come roaring back. At the same time, prices for items not associated with either reopening or supply shortages have steadily risen. Core inflation in the U.S. reaches a 30-year high in October.
- With both real yields and inflation expectations surging once again, the U.S. 10-year Treasury bond yield rose in 3Q, reaching over the 1.7% level before falling slightly. The yield curve continued to steepen.
- While we still believe inflation pressures can lessen during 2022 and approach 2% by the end of next year, the latest CPI report shows that inflation will likely get worse before it gets better, with price increases broadening out across every major sectors – all signs of underlying price pressures.
- Although market participants expect a seamless transition between the Federal Reserve ending asset purchases in June 2022 and the start of Fed Funds rate hikes, we think the timing of the hikes is too soon. The Fed still needs to focus on the maximum employment side of its dual mandate, and we expect further labor market progress before beginning to tighten policy.

Figure 2: US Treasury Yield Curve²

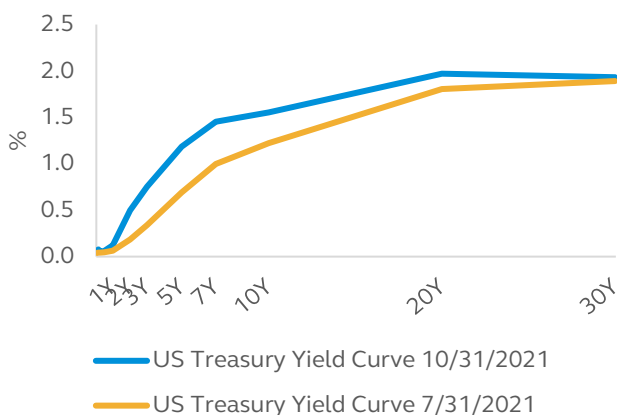
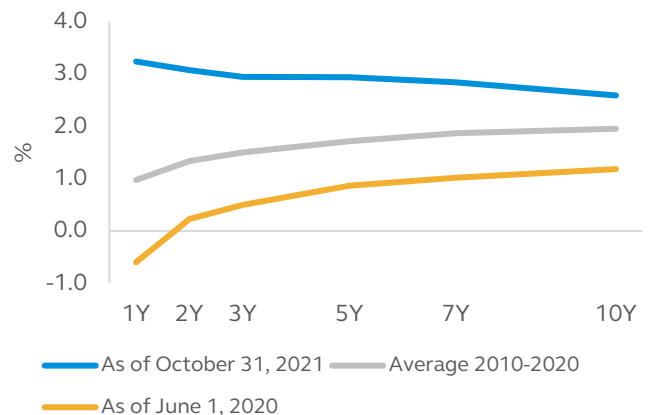


Figure 3: US Breakeven Inflation Curve²



Investment Strategy

- **Equities:** As bond yields and inflation expectations rise with the Fed's policy tightening, the market may undergo a short-term adjustment. However, it will be difficult to reverse the upward trend of the stock market as long as economic directions remain unchanged. Asia-Pacific markets, which have relatively reasonable valuations, are likely to attract continuous inflows. **As shown in Figure 1, Asia-Pacific stock markets have a higher correlation with inflation than global or U.S. stock markets, which means the stock market may rise with inflation.** Similarly, value stocks generally have a higher correlation with inflation than growth stocks. Traditional sectors such as energy, financial and industrial are likely to continue to benefit from a relatively positive earnings outlook.
- **Bonds:** The bond market is more susceptible to inflation than equities. Although real interest rates remain negative, long-term bond yields may stay elevated in the short-term as inflation expectations heat up. This would be unfavorable to traditional bond investments, such as sovereign debt, which are negatively correlated with inflation. **Benefiting from spreads and the high correlation to an economic recovery, high-yield bonds may outperform as a result of rising inflation, especially low duration high-yield bonds.** Meanwhile, investors may also consider other assets that provide stable potential returns e.g., preferred securities.
- **Alternative investments:** In addition to the stock and bond markets, the performance of assets such as commodities and real estate investment trusts (REITs) can track the inflation rate relatively closely. **REITs can offset the impact of inflation by passing on price increases to leasing agreements and property prices.**

¹ Source: Bloomberg, Principal Asset Management Company (Asia) Limited, as of 31 October 2021. Data goes from 1/2003 – 10/2021. US CPI Urban Consumers MoM NSA represents for US CPI; Bloomberg US High Yield TR Index Value Unhedged USD represents for US High Yield; Bloomberg US Agg Total Return Value Unhedged USD represents for US Aggregate Bond; Bloomberg Commodity Index Total Return represents for Commodities; Bloomberg US MBS Index Total Return Value Unhedged USD represents for US MBS; Bloomberg Global Inflation-Linked US TIPS 10 Year Total Return Unhedged represents for TIPS 10 Year; ICE BofA Fixed Rate Preferred Securities Index represents for Preferred Securities; S&P Global REIT USD TR represents for Global REITs; Bloomberg US Treasury Total Return Unhedged USD represents for US Treasuries. Correlation is a statistic that measures the degree to which two securities move in relation to each other. A zero correlation implies no linear relationship.

² Source: Bloomberg, Principal Asset Management Company (Asia) Limited, as of 31 October 2021.

Disclosures:

Investment involves risks. Past performance of any particular fund or product mentioned in this document is not indicative of future performance of the relevant fund or product, and the value of each fund or product mentioned in this document may go down as well as up. You should not invest solely in reliance on this document. There is no assurance on investment returns and you may not get back the amount originally invested.

You should consider your own risk tolerance level and financial circumstances before making any investment choices. If you are in doubt as to whether a certain fund or product mentioned in this document is suitable for you (including whether it is consistent with your investment objectives), you should seek legal, financial, tax, accounting and other professional advice to ensure that any decision made is suitable with regards to that your circumstances and financial position and choose the fund(s)/product(s) suitable for you accordingly.

The information contained in this document has been derived from sources believed to be accurate and reliable as of the date of publishing of this document, and may no longer be true, accurate or complete when viewed by you. The content is for informational purpose only and does not constitute an offer, a solicitation of an offer or invitation, advertisement, inducement, representation of any kind or form whatsoever or any advice or recommendation to enter into any transactions in respect of the funds/products referred to in this document. This document is not intended to be relied upon as a forecast, research, or investment advice regarding a particular investment or the markets in general, nor is it intended to predict or guarantee the performance of any investment. The information does not take account of any investor's investment objectives, particular needs or financial situation. You should not consider the information as a comprehensive statement to be relied upon. All expressions of opinion and predictions in this document are subject to change without notice.

Subject to any contrary provisions of applicable law, neither the companies, nor any of their affiliates, nor any of the employees or directors of the companies and their affiliates, warrants or guarantees the accuracy of the information contained in this document, nor accepts any responsibility arising out of or in connection with any errors or omissions of the contents set out in this document.

Dividend is not guaranteed.

This document is the property of Principal Asset Management Company (Asia) Limited that no part of this document may be modified, reproduced, transmitted, stored or distributed to any other person or incorporation in any format for any purposes without Principal Asset Management Company (Asia) Limited's prior written consent.

Source of this document is from Principal Asset Management Company (Asia) Limited.

This document has not been reviewed by the Securities and Futures Commission.

This document is issued by Principal Asset Management Company (Asia) Limited.