Principal℠ | RAKBANK ELITE

MARKET OUTLOOK
Q2 2021

The financial market outlook is based on current market conditions. There is no assurance that such events or projections will occur and actual conditions may be significantly different than that shown here. The current views and opinions of Principal Global Asset Allocation are expressed throughout and are subject to change without notice. This information is not intended to be, nor should they be relied upon in any way as a forecast or guarantee of future events regarding investments or the markets in general. Investing involves risk, including possible loss of principal.

INTRODUCTION

Get the investment intelligence you need

RAKBANK has tied up with Principal Global Asset Allocation to produce periodical investment publications to update its clients of current investment market conditions, asset class performance and investment outlook. The objective of these publications is not to serve as investment advice but as an independent view on investment markets.

Principal – your trusted investment partner

Principal Global Asset Allocation is a subsidiary of the Principal Global Investors, LLC - a wholly-owned, indirect subsidiary of Principal Financial Group, Inc. Listed on the Nasdaq Global Select Market under the ticker symbol PFG, Principal Financial Group, Inc. is a member of the Fortune 500 and a leading global financial institution offering a wide range of financial products and services through a diverse family of financial services companies.

Principal Global Asset Allocation provides you with access to multi-asset investment solutions spread across 4 centers of excellence, namely Investment Strategies & Research, Manager Research & Investment Support, Portfolio Management and Client Solutions. Using a proprietary process, Principal offers investors access to strategies with the benefits of cost effectiveness, customization and flexibility. They deploy the expertise of 31 investment professionals with an average of 17 years investment experience to achieve this.

Todd Jablonski, CFA
Chief Investment Officer
Principal Global Asset Allocation
23 years of industry experience
11 years of firm experience

Binay Chandgothia, CFA
MD, Portfolio Manager, Head of Asia
Principal Global Asset Allocation
27 years of industry experience
20 years of firm experience

Seema Shah
MD, Chief Strategist
Principal Global Investors
18 years of industry experience
11 years of firm experience

Greg Tornga, CFA
MD, Portfolio Manager
Principal Global Asset Allocation
19 years of industry experience
9 years of firm experience

MD=Managing Director.

Table of contents

31 March 2021
For RAKBANK Client use only.

Principal[SM] proprietary indicators

Economic recovery stayed on track in Q1'2021

Fundamentals

- Global COVID cases rose to 129 million by end-Mar'2021. The 7-day average of new cases jumped to 586k which was 197k higher than the number at the end of Feb'2021. Countries/regions with prominent increases were smaller countries (102k), India (44k and rising rapidly) and Euro-Area (38k of which France along contributed 26k). Mexico, UK, Indonesia, and Malaysia saw new cases decline. Our Global Stringency Index that uses Oxford data, improved to 60 from 69 (100=highest stringency) on increased re-openings in US, China, UK, Germany, and Malaysia. India went the other way as new cases spiked up. Global vaccinations gathered pace, with 350m new doses administered in Mar'2021 vs. 145m in Feb'2021.
- Economic recovery stayed on track. US fiscal spending is pushing growth estimates higher. Global manufacturing outlook remains strong. Our global Manufacturing PMI index reached an all-time high. Base effects helped global industrial output to grow 8.5% in Jan'2021 (had contracted -3% in Jan'2020). Global Macro-economic surprises were positive for an eleventh successive month and corporate earnings estimates ticked up further.

Valuations

- Equities stayed expensive on earnings-based measures. A few markets were cheap on P/B. Very low nominal and real rates, strong growth and continued policy support can sustain richness for some more time.
- IG and HY spreads remained expensive.

Technicals

- Equity inflows suggest animal spirits are back. Retail participation in markets is high, and risk positioning remains extended.

	INDICATOR	Mar. 2021	Feb. 2021	Jan. 2021	Dec. 2020	Dec. 2019	1 month
Fundamental	PGAA Global Manufacturing PMI Index	58.3	56.1	54.8	55.5	48.5	↑
	PGAA Leading Industrial Production Indicator2	53.2	53.4	53.3	53.0	49.1	=
	PGAA Global Inflation Index1	1.24%	1.1%	1.1%	1.2%	2.3%	=
	PGAA Global Financial Conditions Index	0.65	0.65	0.67	0.72	0.40	=
	PGAA Global Economic Surprise Index3	0.21	0.23	0.16	0.28	0.21	=
	PGAA Global 3-month Earnings Revision Ratio	0.60	0.60	0.60	0.59	0.41	=
	PGAA Global 3-month EPS change (in US$)	3%	4%	5%	5%	-1%	↓
	Global 2021 EPS growth expectation	27%	27%	27%	26%	10%	=
	Global Credit Rating Upgrade/Downgrade Ratio	49%	47%	46%	19%	43%	↑
Valuation	PGAA Equity Valuation Composite (MSCI AC World)	-3.0	-2.7	-2.6	-2.7	-0.7	↓
	PGAA High Yield Spread4	-1.3	-1.2	-0.9	-1.0	-1.2	↓
	PGAA Investment Grade Spread4	-1.3	-1.4	-1.2	-1.2	-1.4	↓
	PGAA 10-yr Treasury Valuation4	-0.6	-1.1	-1.6	-1.9	-0.8	↑
Technical	PGAA Cross Asset Implied Volatility Index	68	81	79	68	52	↑
	PGAA Cyclical Risk Environment Index	-0.7	-0.7	-0.9	-1.0	-0.7	=
	PGAA Cyclical Risk Positioning Indicator	0.4	0.5	0.4	0.3	-0.2	↓

As of 31 March 2021. Source: Bloomberg/FactSet/PGAA. See important information section for further details. Note: ↑ indicates positive for markets, ↓ indicates negative, = indicates stable momentum, **red** indicates -ve level; **green** +ve; direction of arrow shows if change is for better or worse; 1= 3-month average as of prior month, 2= 3m average, 3 = 3m time-weighted average, 4 = rolling 10-yr Z score

Q2 2021: Investing through the pandemic

The first quarter launched 2021 on a positive note. Risk markets ignored short-term economic setbacks and outperformed in anticipation of additional fiscal stimulus and widespread vaccine distribution. The equity market turnaround since COVID-19 lows has been astonishing, with the S&P 500 up 75%—the biggest 12-month increase since 1936.

While markets stayed broadly optimistic in the face of challenging conditions, bouts of volatility arose during the quarter as a stronger global growth outlook triggered inflation concerns, driving up bond yields and raising questions around future central bank policy.

The vaccine rollout and policy support continue to drive the global economic recovery.

- The vaccine rollout is proving successful in some developed markets, with the U.S., U.K. and Israel the standout performers. But low vaccination rates in other countries have enabled global COVID-19 infection rates to rise, with the spread of new variants once more strengthening the link between rising mobility and infections.
- Monetary and fiscal policy continue to support economies and drive risk market performance. The $1.9 trillion stimulus in the U.S. will likely supercharge consumer spending as households spend excess savings. Fiscal stimulus and re-openings are threatening inflationary pressure, raising concerns about Fed policies.
- The Fed's response to the crisis has been a vital factor in the market's impressive recovery over the last year. The central bank has strongly signaled an intention to keep rates on hold through the forecast period to 2024, thereby maintaining extremely easy accommodative conditions for the foreseeable future.

Economic data suggest a continuation of the strong rebound.

- Global GDP growth weakened in the first quarter, in line with renewed COVID-related restrictions. While services sectors have generally struggled, manufacturing has continued to thrive. As social restrictions are eased, pent-up demand should help drive a sharp recovery in economic growth.
- The re-opening of the U.S. economy is already helping leisure and hospitality—an area of the economy particularly hurt by the pandemic—bounce back. In Europe, government furlough schemes have diminished the impact of slower economic activity on the labor market, but extended lockdowns are taking their toll.
- Europe has fared worse than the U.S. overall, experiencing a double-dip recession and potentially first quarter contraction. Yet, most economic indicators suggest that European activity has likely troughed and should recover in the second quarter, especially as furlough schemes are lifted.

With inflation concerns looming, investors have questions about the outlook for 2021 and beyond:

- What's the base case for markets and economies going forward?
- How will central banks respond to the improving growth outlook?
- What is the lasting impact of the pandemic and where are the opportunities?

Macro insights: Global economies

Markets stayed broadly optimistic, despite challenging conditions.

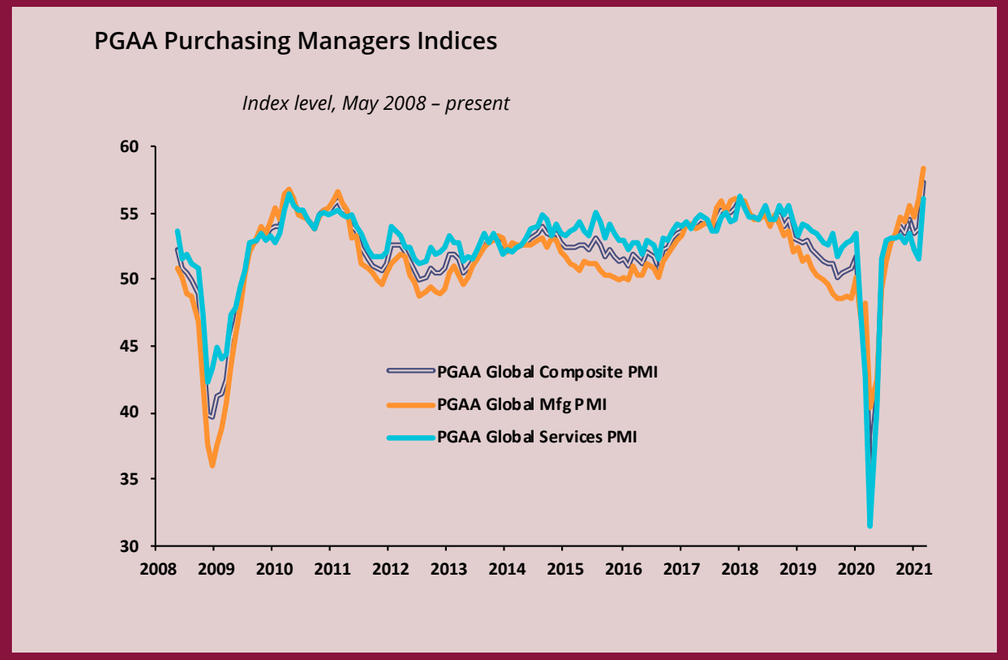
The S&P 500's 12-month gains are the largest in 85 years.

The performance of the equity markets over the last year has been astounding. Since the March 2020 trough, the S&P 500 has risen 75% over the rolling 12-month period, a return not seen since 1936. Unprecedented levels of fiscal stimulus and vaccine confidence helped to spur equity market performance, even as some indicators pointed to slowing economic momentum.

While global GDP growth weakened in the first quarter, current economic data signal a strong rebound and a favorable outlook for risk assets. Lockdowns have proved to be less disruptive on global economic activity than at the pandemic's start, reflecting the fact that current social restrictions have been both less stringent and more targeted. Manufacturing has continued to thrive with the global Purchasing Managers Indices hitting new highs in March.

Europe has fared worse than the U.S., experiencing a double-dip and potential GDP contraction in the first quarter. Nevertheless most economic indicators suggest that European activity should recover in the second quarter. While most emerging markets have had a slow start to the vaccine rollout due mostly to supply delays, as vaccine distribution improves in the second quarter emerging markets stand to benefit from a synchronized global economic upturn.

Source: Bloomberg, Principal Global Investors. Data as of March 31, 2021.



Source: Bloomberg, FactSet, Principal Global Asset Allocation. PGAA Purchasing Manager Index models start in May 2008. Data as of March 31, 2021.

Macro insights: Global economies

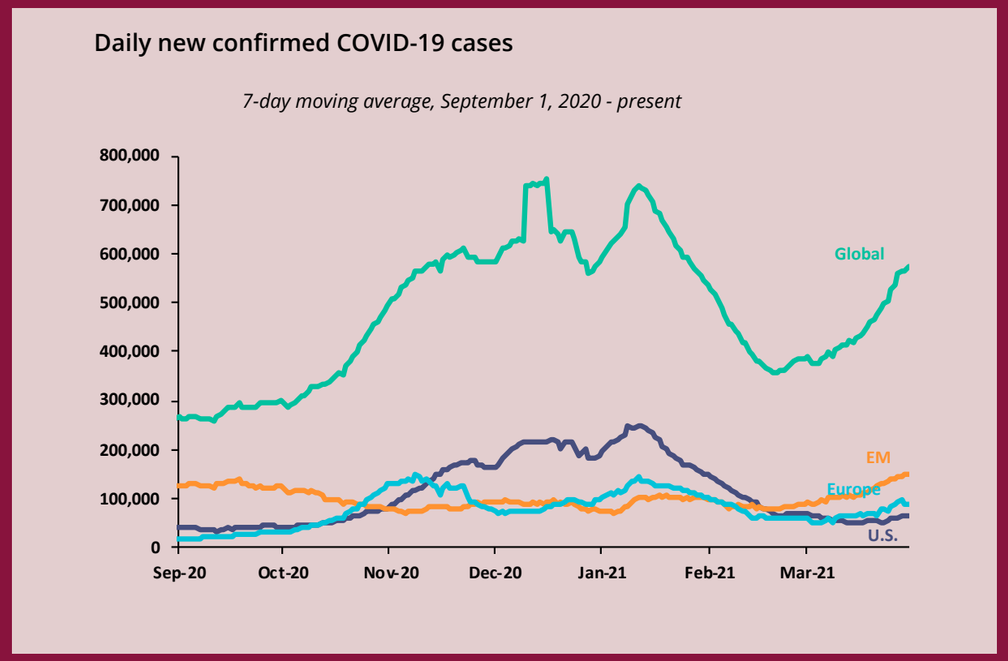
After peaking in January, COVID-19 is on the rise again. Success of the vaccine rollout varies significantly.

Social restrictions and the vaccine rollout are limiting the increase in COVID-19 cases but the virus has continued to be a key dynamic for both the economy and financial markets. After starting the year with several more infectious and deadlier virus variants spreading across the globe, the spread and mortality of COVID-19 was broadly positive but has started to increase again in parts of Europe, Brazil, and India amongst others. Total global cases rose to 129 million at the end of March and the 7-day average of daily new cases rose to 586,000—an increase from February but still significantly lower than the 806,000 peak reached in early January.

In countries where COVID-19 infection rates have continued to fall, the improvement is most likely primarily due to social restrictions, but the successful vaccine rollout in countries such as Israel, the U.K., and the U.S. is certainly stemming the spread, enabling these countries to begin to emerge from lockdown. Clearly, though, the success of the rollout varies significantly from country to country. While the U.S. and U.K. have vaccinated 45% and 30% of their populations respectively, Europe has only vaccinated around 10%. Safety concerns, bureaucracy, supply problems, and low vaccine take-up continue to plague Europe's rollout. As a result, infection rates remain elevated, prolonging restrictions.

The emerging markets have generally had a slow start to the vaccine rollout, largely due to delays in vaccine supply. Exceptions include Russia, India, and China, which have their own pipelines, as well as Chile, which ranks third globally for most doses administered per capita. Most other emerging markets are struggling to acquire vaccines. This stands in stark contrast to the U.S., where President Biden has announced his administration expects to have enough available vaccines to inoculate every adult by the end of May.

Notwithstanding the slow start in the emerging markets, the vaccine roll-out is likely to accelerate in the second quarter as manufacturers expand capacity, new vaccines are approved, and acceptancy rates rise in response to news of limited side effects.



Source: Bloomberg, Johns Hopkins CSSE, Principal Global Asset Allocation. Europe – France, Germany, Italy & Spain. Emerging Markets – Brazil, Chile, India, HK SAR, Mainland China, Malaysia, Mexico, Singapore. Global is cumulative of all reporting countries. Data as of March 31, 2021.

Macro insights: Global economies

The pace of the vaccine rollout will have a direct impact on mobility.

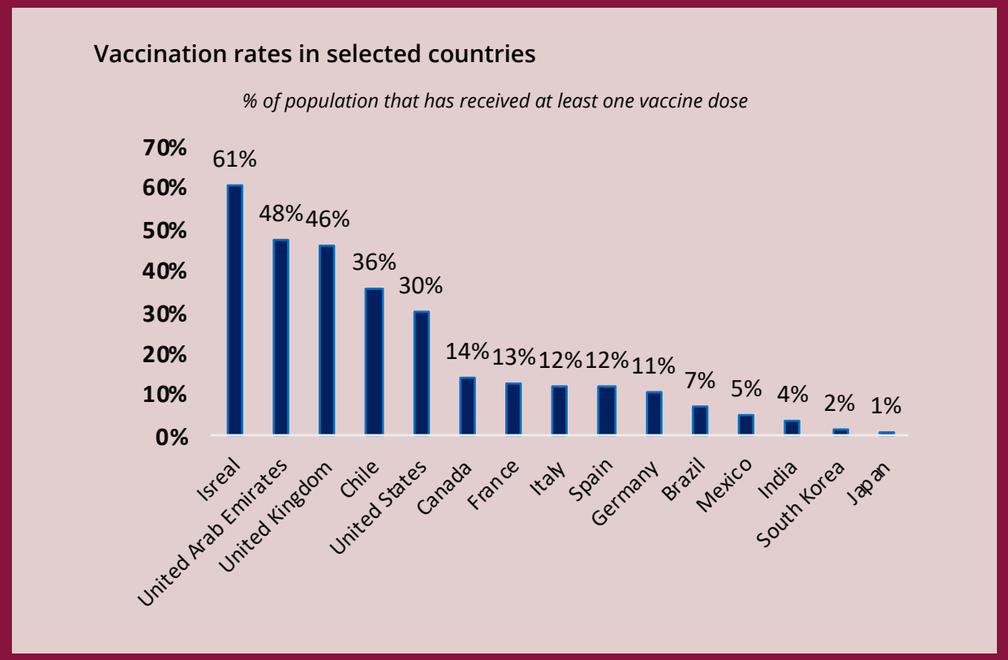
In developed markets, the increasing vaccine availability means that restrictions are likely to be eased early in the second quarter of 2021, while for some it will be earlier. In the U.S., certain states have already re-opened and mobility has trended higher, while in many European countries, re-openings will come later and will face a delayed recovery as the U.S. leaps ahead.

The million-dollar question is when, exactly, will normality return? Inevitably, capacity constraints will extend beyond economic re-openings, while masks, testing, and an increased reliance on technology at home and work may become a permanent feature in our lives. But in most of the developed world and in parts of the emerging markets, we anticipate economies settling into a "new normal" by the third quarter of 2021.

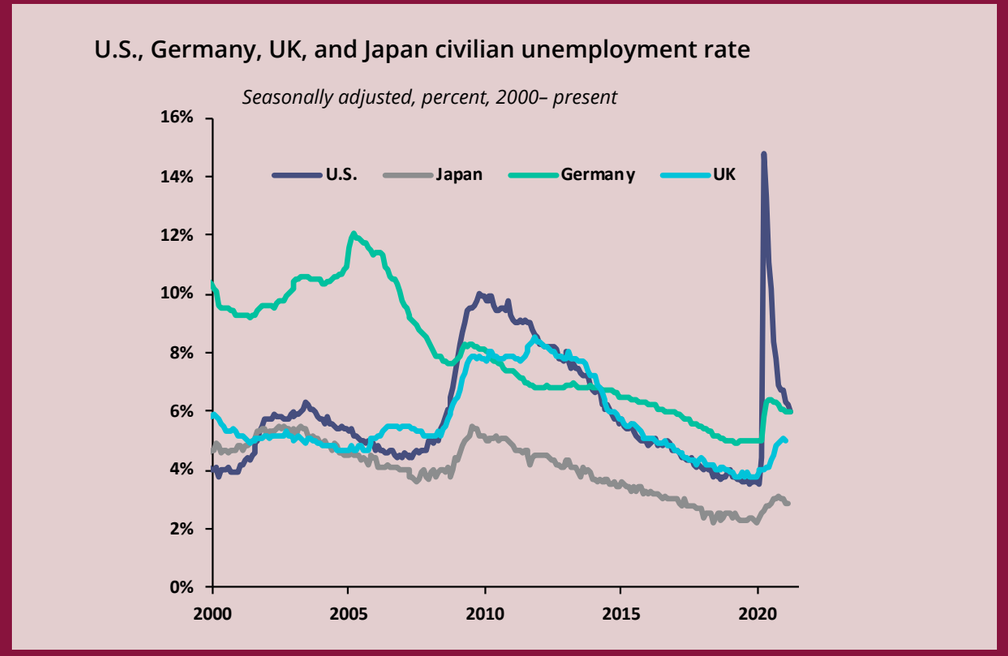
As re-openings enter full swing, jobs growth will gain momentum.

Ultimately, economies do not need to wait for a return to normality before experiencing the benefits of re-openings. The re-opening of the U.S. economy, underway across much of the country, is already helping spur a recovery in leisure and hospitality—an industry particularly crushed by the pandemic. Even as employment remains around 8.5 million below pre-pandemic levels, payroll growth will likely gain momentum as re-openings increase, likely leading to a further drop in the U.S. unemployment rate.

Despite the rapid turnaround in the U.S. labor market, the pandemic will have a lingering impact on the workforce as many unemployed find it difficult to find a new job in a permanently changed economy. In February, 13.3 million people reported they had been "unable to work because their employer closed or lost business due to the pandemic," while more than 40% of the total unemployed have been out of work for 27 weeks or more.



Source: Our World in Data, Principal Global Investors. Data as of April 1, 2021.



Source: Bureau of Labor Statistics, Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Macro insights: Global economies

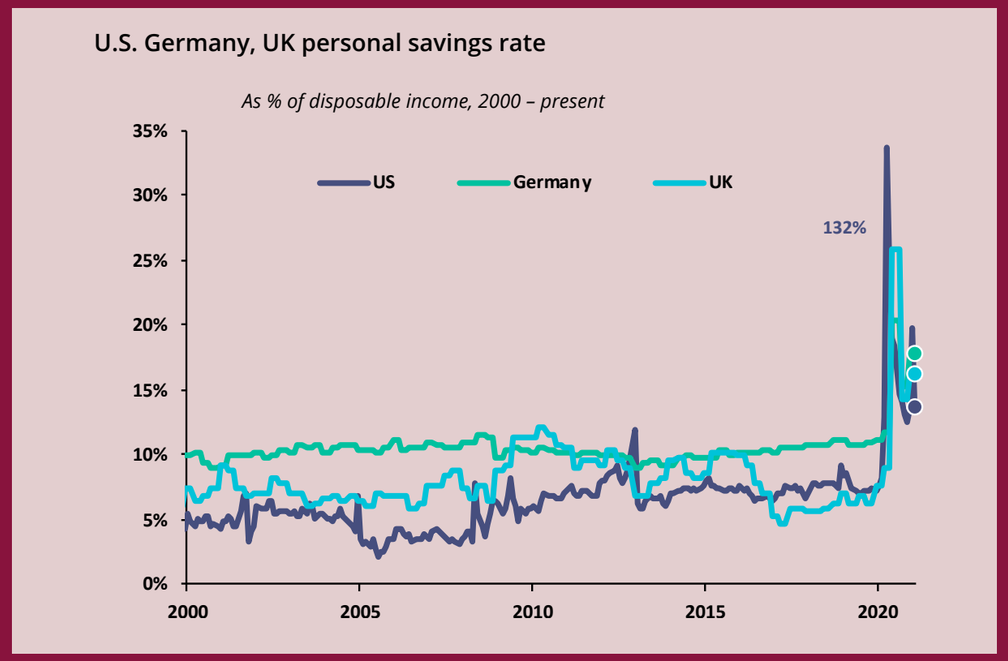
In Europe, government furlough schemes have clearly diminished the impact of slower economic activity on the labor market, but extended lockdowns are taking their toll. In Germany, unemployment rose in January for the first time in eight months, while in the U.K., unemployment has hit its highest rate in almost five years. The unemployment rate has fallen in France, but that reflects a worrying drop in the participation rate and suggests that a significant number of unemployed are feeling discouraged from looking for employment. Once furlough schemes are eventually terminated, likely this summer, labor market pain may become more evident in Europe, particularly if countries are lagging in re-openings.

Fiscal stimulus: A rising tide lifts all boats.

Savings rates have soared and may unleash a spending boom.

Inevitably, as restrictions are eased, pent-up demand will be unleashed and should drive a sharp recovery in economic growth. In the U.S., consumer demand will be further reinforced by an additional—and considerable—infusion of fiscal support. The passage of the $1.9 trillion American Rescue Plan Act of 2021, one of the largest U.S. government interventions in the post-World War II economy, will meaningfully raise households' spending power.

As individuals received stimulus checks last year and were restricted in their ability to spend, household savings rates in much of the developed world soared to record highs. In the U.S., the savings rate jumped to around 35%. While these rates stand at historical highs in Europe and parts of Asia as well, , the additional $1.9 trillion stimulus in the U.S. will likely supercharge U.S. consumer spending. In response to this, we have raised our U.S. growth estimates from 4.8% to 6% for 2021.



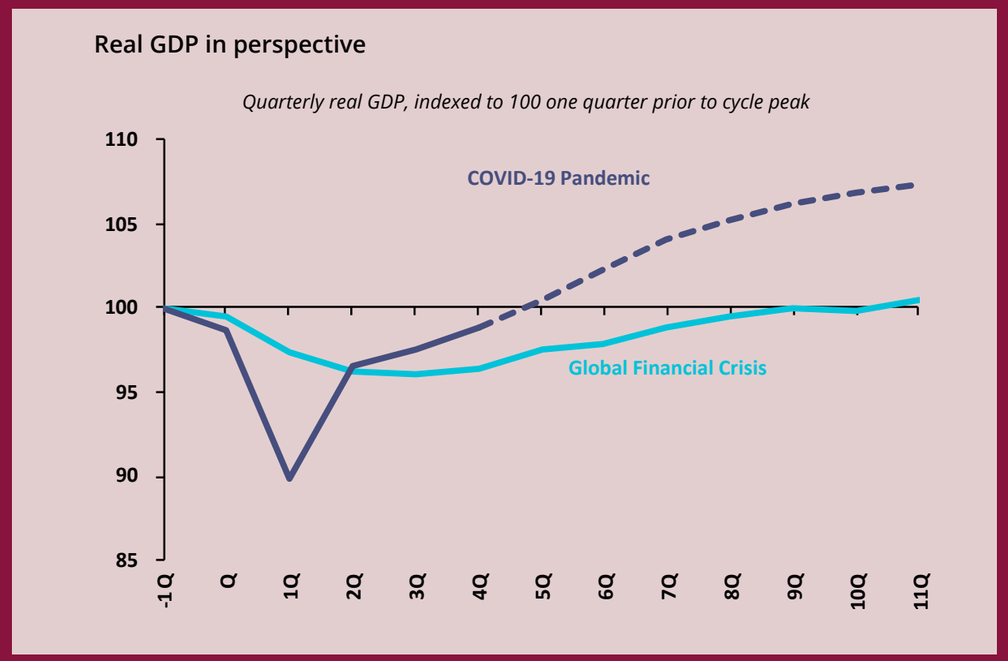
Source: Bureau of Labor Statistics, Deutsche Bundesbank, UK Office for National Statistics, Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Macro insights: Global economies

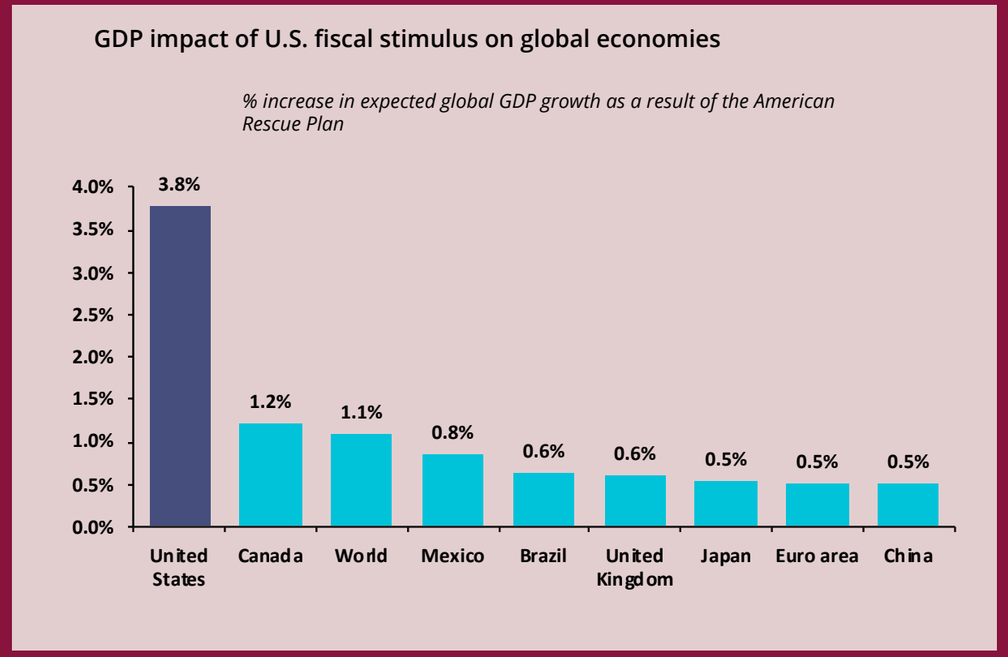
U.S. economy will reach pre-pandemic levels in the second quarter.

Our growth forecast for the U.S. implies that GDP will reach its pre-pandemic level in the second quarter, but also will exceed its pre-pandemic path in 2022. In other words, the pandemic will leave no lingering impact on the size of the U.S. economy and, if anything, GDP will actually be greater than we would have expected in the absence of the pandemic. Considering the disruption and economic upheaval of the last year, this is quite incredible. It is even more remarkable when you consider that after the Great Financial Crisis (GFC), largely due to the meagre immediate fiscal response, the U.S. economy never regained its pre-recession path.

The U.S. is not alone in adding fiscal stimulus this year. Meaningful discretionary fiscal measures in Japan, Germany, Canada, and India will add to overall global support this year. By contrast, Europe's total discretionary fiscal stimulus this year is likely to be relatively small, at just 1% of GDP. However, the extent of the U.S. fiscal support is so considerable that there will be meaningful demand spillovers in key trade partners that will lift global growth. According to the OECD, the American Rescue Plan adds 1.1% to global growth this year, raising global GDP growth to 5.6% and securing the global economic reflation narrative this year.



Source: Bloomberg, Principal Global Investors. Data as of March 25, 2021.



Source: OECD (2021), OECD Interim Economic Outlook, OECD Publishing, Principal Global Asset Allocation. Note: The chart shows the average percentage difference in GDP relative to baseline over the first full year of the package (20Q212-20Q221). Simulation of the planned fiscal stimulus in the United States, set out in the American Rescue Plan. The new measures are worth up to USD 1.9 trillion (around 8 ½ per cent of baseline GDP). Measures are assumed to take effect over 20Q212-20Q222. Data as of March 2021.

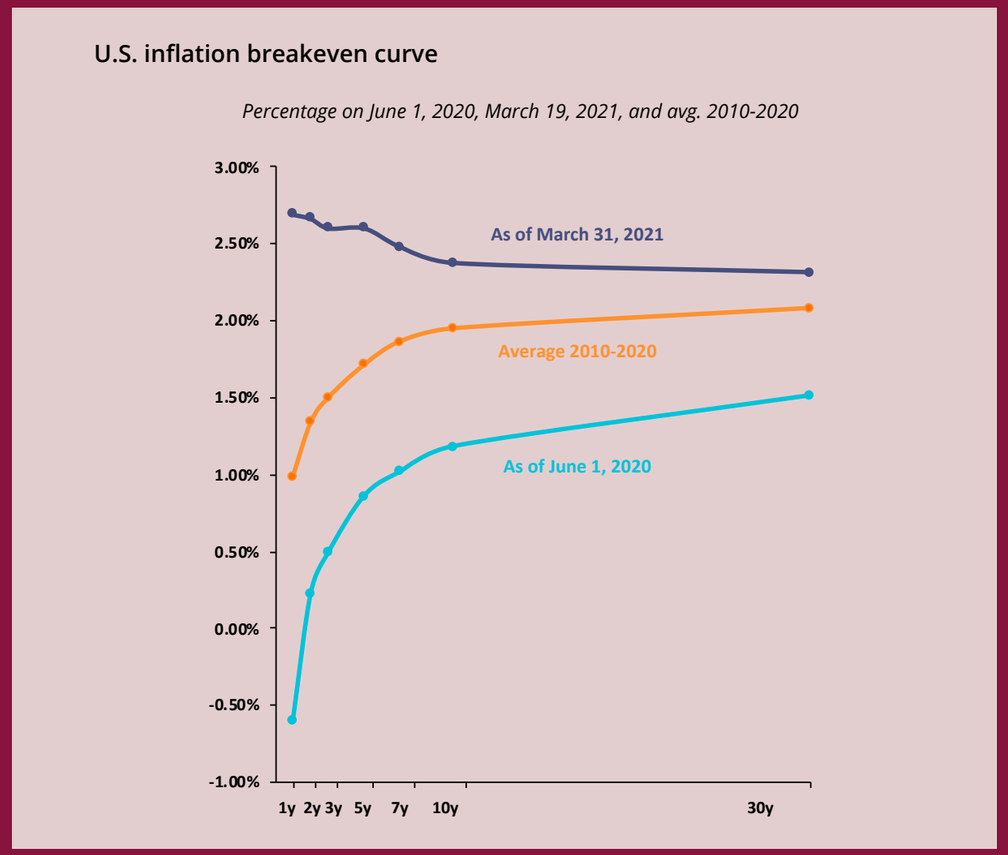
Macro insights: Global economies

Of course, running a high-pressure economy is not without risk.

As a result of the sheer speed and strength of the expected U.S. recovery, the market has become increasingly preoccupied with the risk that the U.S. spending package will overheat the economy, resulting in a significant run-up in inflation. For the first time in decades, inflationary concerns have become a major conversation for investors, and these concerns drove first quarter market volatility.

U.S. breakeven rates, a measure of future inflation expectations, had dropped meaningfully last year in reaction to the COVID disinflationary shock. Since late 2020, in unison with the market rally in response to positive vaccine news and hints of further U.S. fiscal stimulus, breakeven inflation rates have inverted. This is a signal the market expects an inflation surge in the immediate months ahead, but also that inflationary pressure will only be transitory.

Inflation is largely anticipated to stem from the supply side of the economy. Pandemic-related global supply chain disruptions have resulted in supply bottlenecks, driving up manufacturing input prices. As the U.S. economy re-opens over the coming months and pent-up demand is unleashed, there will not be sufficient capacity to satiate the surge in consumer demand and, as a result, supply constraints will intensify. However, these constraints will likely be short-lived. While it typically takes time to rebuild inventories, once the wheels start moving supply will rise sufficiently and price pressures will once again ease. Importantly, the transitory nature of this type of inflation is typically not a concern to the Fed and thus the central bank will likely not act as a result of this dynamic.



Source; Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

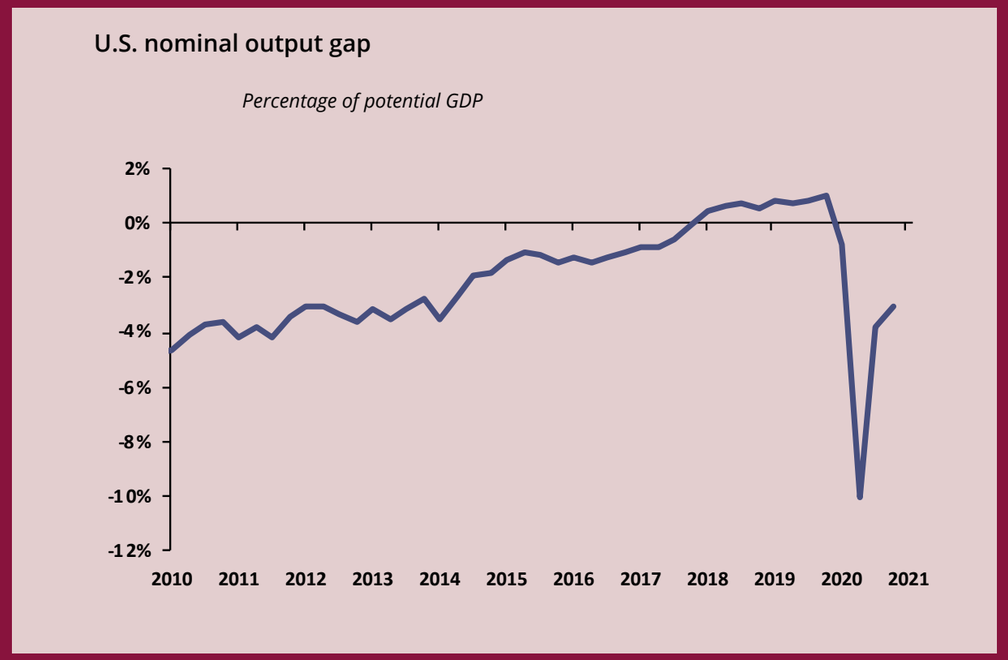
Macro insights: Global economies

However, the Fed would be more reactive to a rise in wage pressures passed onto consumers. Despite the impressive labor market recovery, there is still a considerable amount of slack, as measured by economic output. Employment remains some 8.5 million below the pre-crisis level, so even as fiscal stimulus surges through the economy and activity accelerates, there should be plenty of capacity for the labor market to absorb the ensuing jobs recovery without triggering economy-wide wage increases. Moreover, structural deflationary forces such as technology, globalization, and demographic trends have not been simply eradicated by the COVID-19 crisis and will continue to suppress inflation pressures. To that end, we foresee near-term U.S. inflation rising to about 3% before the rebuilding of inventory and other factors push inflation back towards the Fed's 2% target.

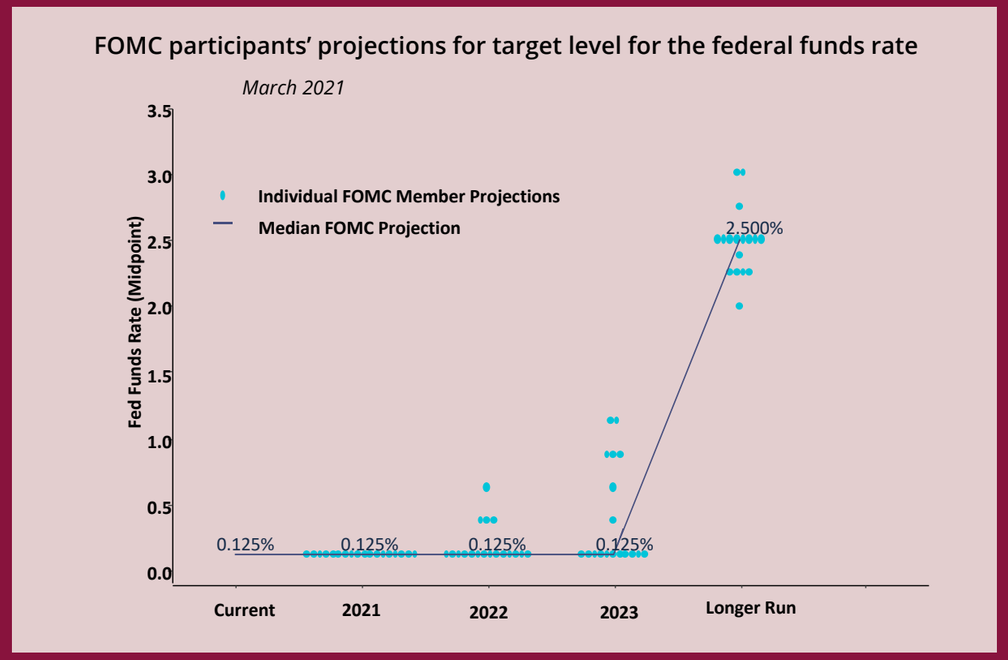
Even as it faces inflation, the Fed will remain patient. Fed tapering would still mean balance sheet expansion.

The Fed's response to the crisis has been a vital factor driving the market's impressive recovery over the last year. It's no wonder then that investors have become increasingly nervous a rise in inflation may trigger premature tightening in Fed policy.

Yet, as fiscal stimulus and re-openings create inflation pressure, the Fed has focused on the temporary nature of the inflation surge and has emphasized policy patience, waiting for inflation to overshoot its 2% target for a sustained period and the labor market to reach full employment before considering raising rates. As such, the central bank has strongly signaled an intention to keep rates on hold through the forecast period to 2024, thereby maintaining extremely accommodative monetary conditions for the foreseeable future. The Fed balance sheet will still be expanding, but at a slower pace. From a global central bank perspective, it is possible that the stronger U.S. economic performance and resulting rise in global bond yields encourages other central banks to increase asset purchases and even extend their programs.



Source; Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.



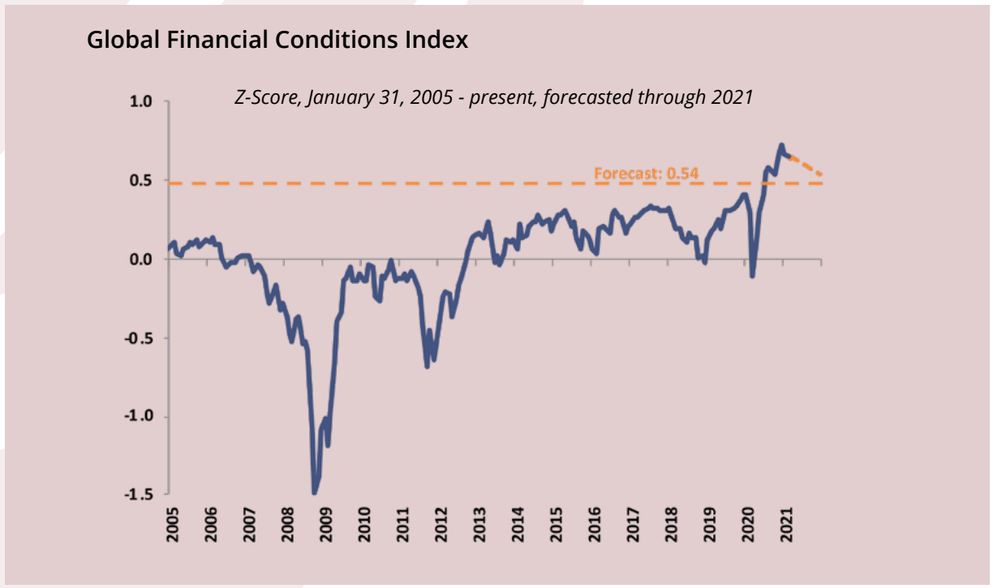
Source: Federal Reserve, Clearnomics, Principal Global Investors. Data as of March 17, 2021.

Macro insights: Equities

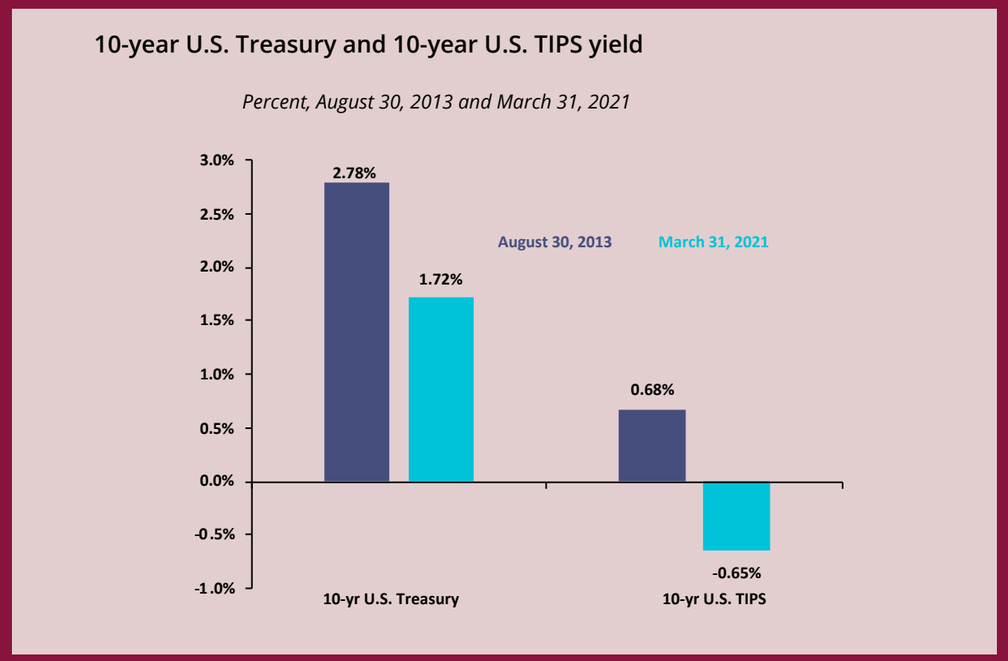
Economic recovery is driving a cyclical rally. Easy conditions and low rates will remain.

Real interest rates will remain low and global financial conditions easy throughout 2021. The combined balance sheets of the G4 central banks (Fed, ECB, BoE, BoJ) are forecast to grow by over $4 trillion in 2021 to well over 60% of their GDP by the end of 2021, as they continue to stimulate the economy through quantitative easing measures. Financial conditions, which broadly denote the ease of access to capital and have played a crucial role in shaping equity market performance, will tighten marginally due to higher nominal interest rates, but their level will remain accommodative and supportive of risk assets. .

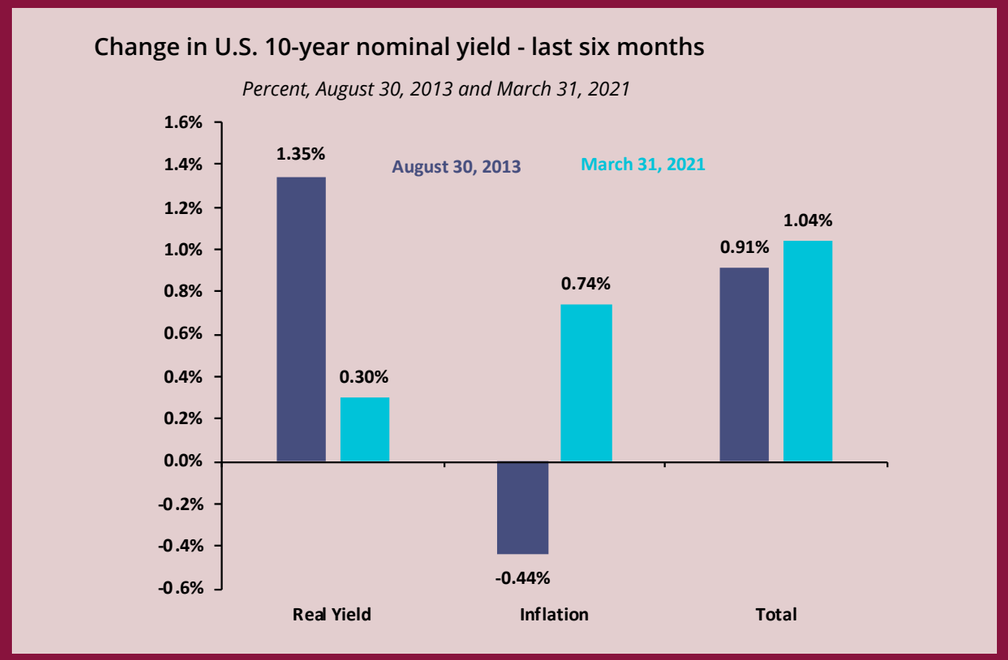
Reflecting improved growth dynamics, the nominal US 10-yr treasury yield has risen by 104 bps over the last six months, which is drawing comparisons with the 2013 taper tantrum, when Treasury yields surged after the Fed announced a tapering in its quantitative easing program. However, there are several significant differences worth noting. First, the recent rise in bond yields has been mainly driven by a rise in breakeven inflation expectations (a proxy for growth), whereas during the 2013 taper tantrum breakevens actually fell. Second, the rise in real yields during the current market turbulence is considerably smaller than during the taper. Finally, real yields remain deeply in negative territory and well below where they stood in 2013. So while financial conditions have tightened slightly, they do not pose a headwind to the economic recovery.



Source: Bloomberg, Principal Global Asset Allocation. Forecasted to year end 2021.Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.



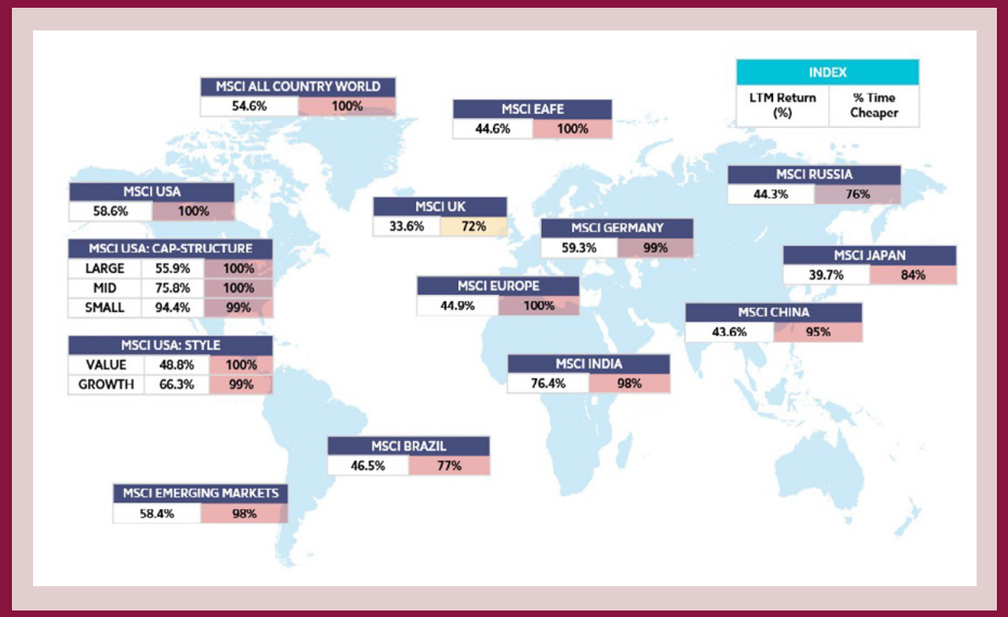
Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Macro insights: Equities

Valuations are high but fundamentals support positive equity returns.

After an extremely strong performance since the March 2020 lows, the entire equity universe looks expensive. Stocks are pricing robust economic recovery, elevating valuations to extraordinary levels in nearly every corner of the globe.

On the face of it, valuations might imply a difficulty in finding attractive investment opportunities, but the global earnings rebound gives us reasons to believe that there is upside left in equities. S&P 500 earnings are forecasted to grow 28% this year, with EPS exceeding the 2019 level by about 8%. Many emerging markets are also set to show positive EPS growth compared to 2019, but Europe is likely to just fall short of full recovery. Such impressive earnings performance is validating extended valuations, helping sustain a positive outlook on equity returns in an environment where core fixed income remains challenged due to rising bond yields and tight spreads.



Source: Bloomberg, MSCI, Principal Global Asset Allocation. Last twelve months returns are total return and in USD terms. % Time Cheaper is relative to PGAA Equity Composite Valuation history. PGAA 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. Data as of March 31, 2021.

Source: Factset, Principal Global Asset Allocation. Data is forecasted through year-end 2021. Data as of March 31, 2021.

Macro insights: Equities

Cyclical sectors dominate the equity landscape amidst rising interest rates.

The rebound in the economy has led to a rally for the most economically sensitive, or cyclical stocks. In the first quarter, the best performing sectors were the ones most often closely linked to economic cycles as measured by their long-term correlation to the change in 10-year U.S. Treasury yield. Energy, materials, and real estate stocks all outperformed while stocks in more defensive sectors like utilities and healthcare underperformed. Financials , which had a nearly zero long-term correlation, had some of the highest returns due to decreased default risk and the increase in the slope of the yield curve. Industrials too outperformed, riding recovering spending on capex and positive base effects from the expected reopening of travel-related and high contact segments of the economy.

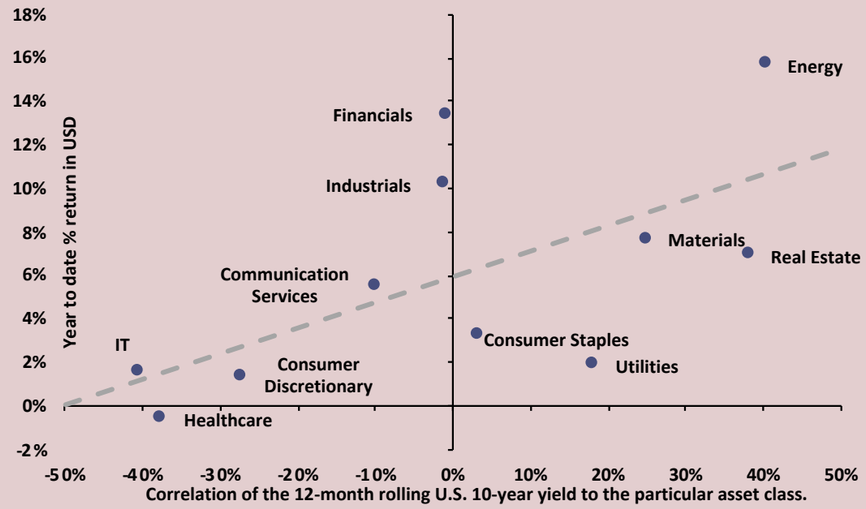
Low quality firms have surged to market leadership.

Another defining feature of the current equity market rally is the repricing of firms in the low-quality space. In many ways, the significant support from fiscal stimulus programs and ultra-accommodative monetary policy, and progress on vaccinations has boosted investor allocations away from Quality. Since the third quarter of 2020, low quality firms have outperformed high quality ones on renewed optimism not just about their survival, but also their ability to generate profits.

It is pertinent to note that a significant number of companies went bankrupt in the aftermath of the global financial crisis. Given the magnitude of the growth shock we got when COVID-related disruptions hit the global economy in the first half of 2020, it was natural for investors to fear a similar occurrence this time around, perhaps of even larger magnitude than in 2008-09. But that did not happen due to the size of the various stimulus programs, which provided a much-needed lifeline. And now, as global growth gathers steam, these firms are poised to do well on the earnings front, drawing investor allocations.

MSCI All Country World sector correlation to U.S. 10-year yield vs. YTD sector performance

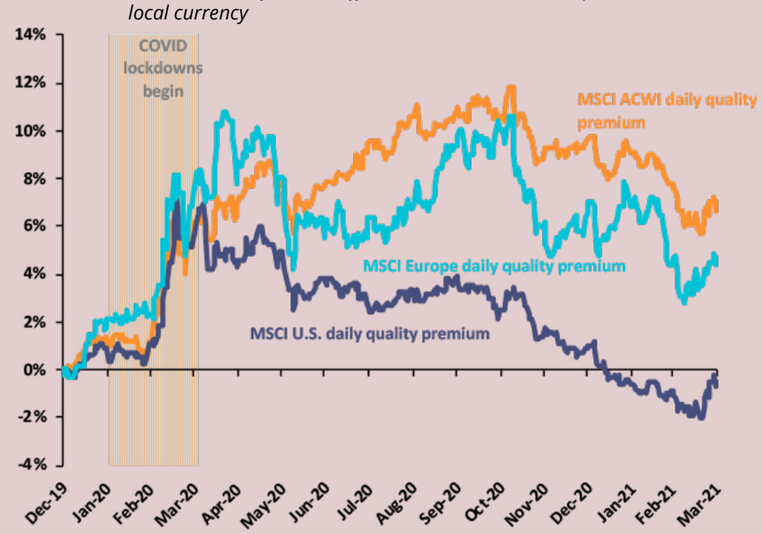
Year to date % return in USD; Correlation of the 12-month rolling U.S. 10-year yield to the particular asset class; January 2001 – present



Source: Bloomberg, Principal Global Asset Allocation. Real Estate calculated since inception August 2017 to March 2021. Data as of March 31, 2021.

Quality premium: Quality Index – Market Cap Index

Cumulative daily return difference, December 2019 – present, local currency



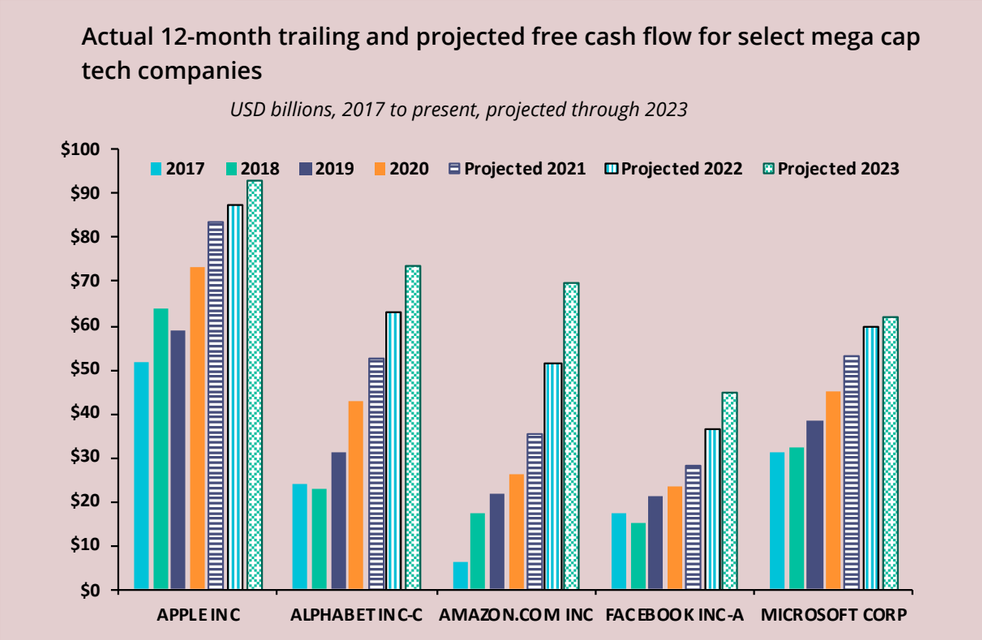
Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Macro insights: Equities

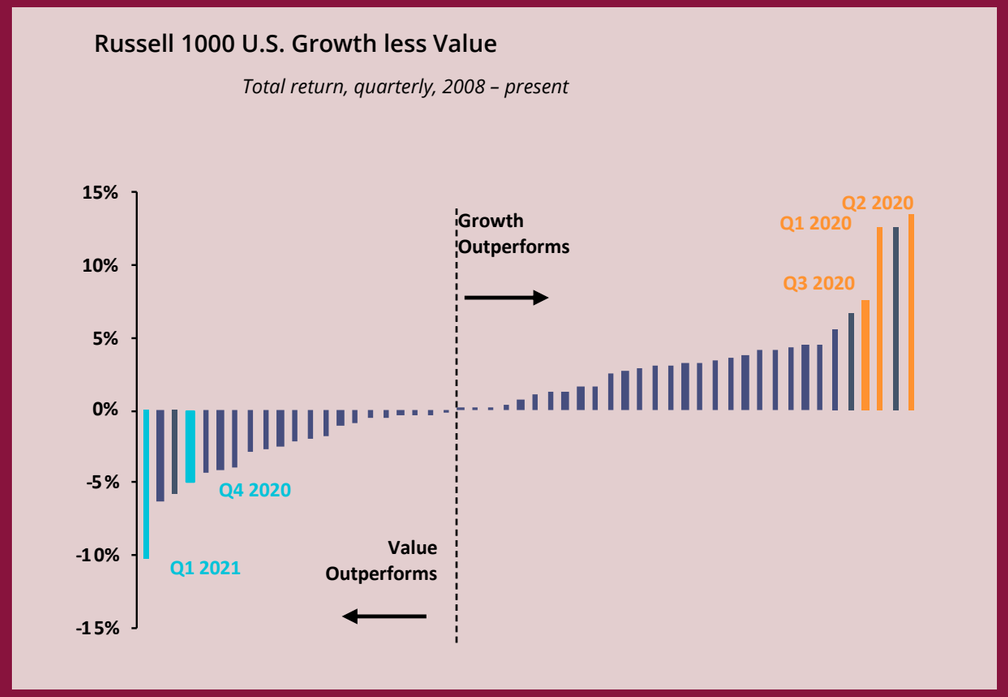
Polarized performance in global style distinctions continues.

From a style perspective, performance was highly polarized in the first quarter, driven by themes of higher growth and inflation. US Value outperformed Growth by the largest margin since 2008. Growth styles faced headwinds globally too, underperforming in Europe, Japan, and EMs.

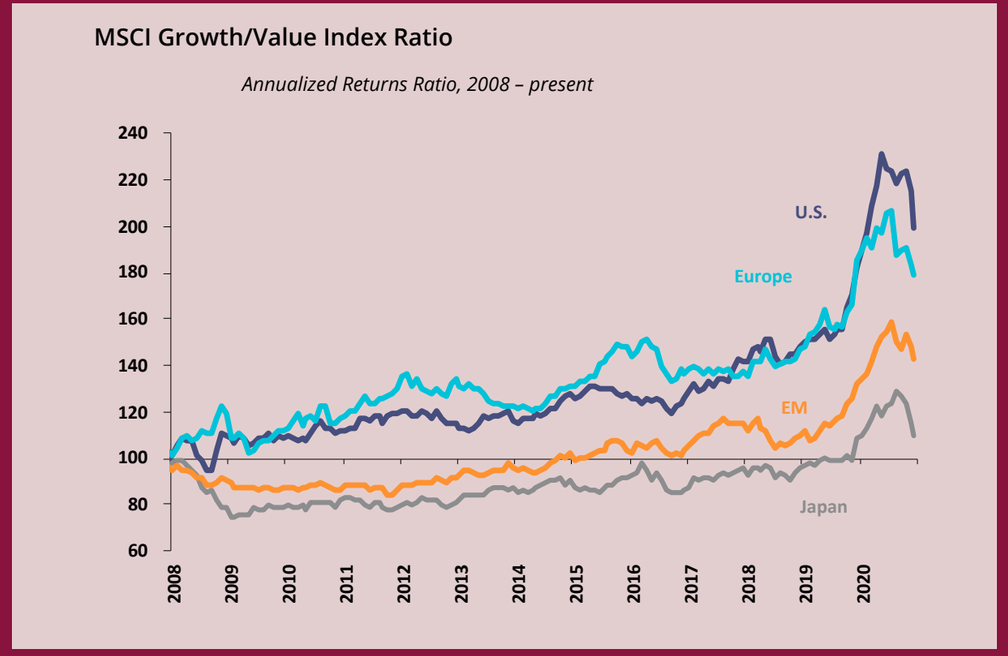
As Value surged, it is natural to evaluate if the decade-long secular earnings growth story that propelled mega-cap tech names in the U.S. is coming to an end. We believe these companies are still well-positioned for future growth and will continue to generate substantial free cash flows. Indeed, the projected free cash flows for the tech giants through 2023 shows extraordinary growth, giving us confidence that the secular theme remains in place. Additionally, owning these stocks can provide a potential hedge against deeply cyclical portfolio exposures.



Source: Bloomberg, Principal Global Asset Allocation. Data is projected by Bloomberg BEST through 2023. Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021.

Macro insights: Equities

Emerging markets stand to benefit from a synchronized global upturn.

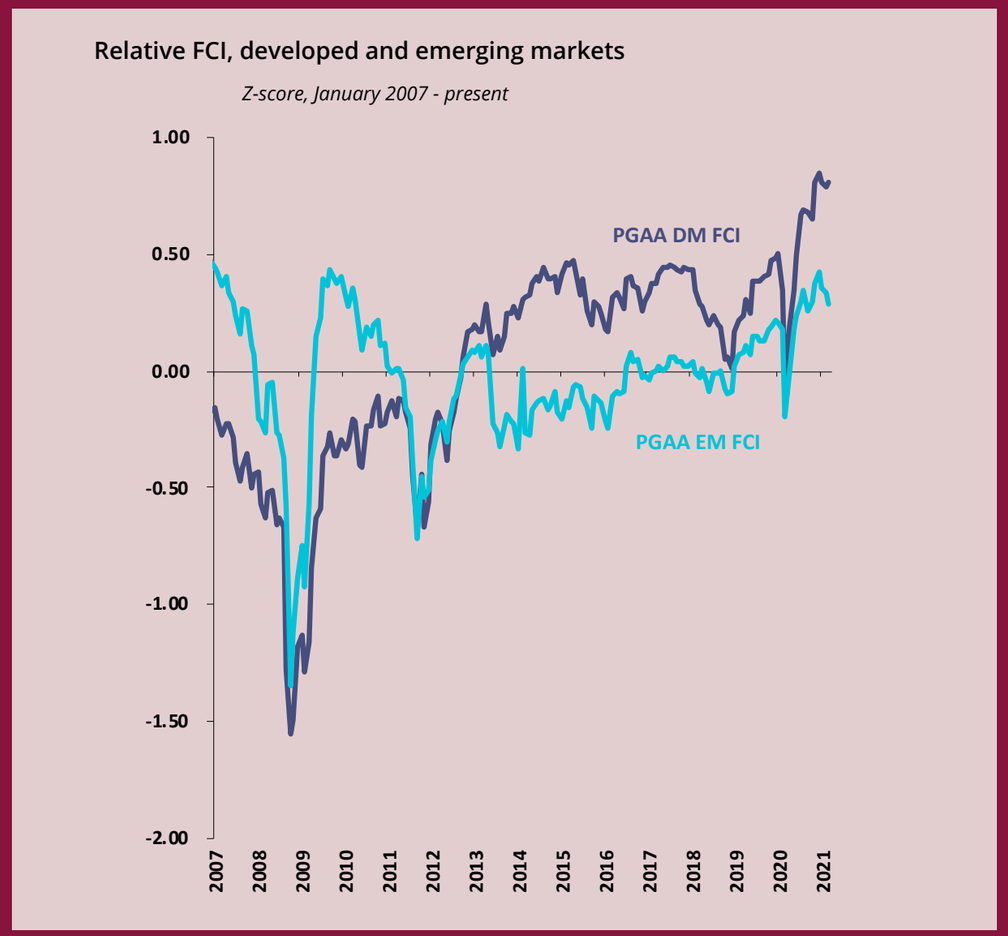
Generally speaking, emerging markets should benefit from an improving global economy given their strong historical correlation with global reflation trades. EMs like China, Taiwan, and Korea remain well-placed to ride the recovering global growth through exports. Brazil is benefitting from a significant improvement in its terms of trade brought about by higher metal prices.

However, EMs do face some headwinds. A resurgence of COVID-19 in several EMs (India, Brazil, and several smaller ones) is becoming a concern, and has the potential to dent growth recoveries in the near-term.

In addition, some emerging markets are also being challenged by the rise in U.S. treasury yields which has strengthened the US$. Recovering inflation amidst a setting of very low policy rates has already caused EMs like Turkey, Brazil, and Russia to hike rates, with more expected down the line. That has tightened financial conditions in EMs relative to Developed Markets, which could negatively impact the liquidity going into their risk assets. There are also rising political concerns in some countries like Turkey and Brazil where policy could turn at the expense of economic prudence. These variables make the emerging markets less of a broad strategic allocation for investors and more of an idiosyncratic, selective allocation. To that end, there are a number of emerging markets countries that stand out from an earnings growth perspective, including China, Korea, and Taiwan. Brazil, driven by significant improvement in its terms of trade (which is showing up in the pricing of iron ore and steel), is also presenting selective opportunities.

As monetary and fiscal policies remain supportive and vaccine distribution opens economies, we believe there is a strong case to be made for the continued outperformance of low quality and value-oriented stocks, as well as mega-cap tech and cyclical assets.

Source: Bloomberg, Principal Global Asset Allocation. Data is projected by Bloomberg BEST through 2023. Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. FCI = Financial conditions index. Data as of March 31, 2021.

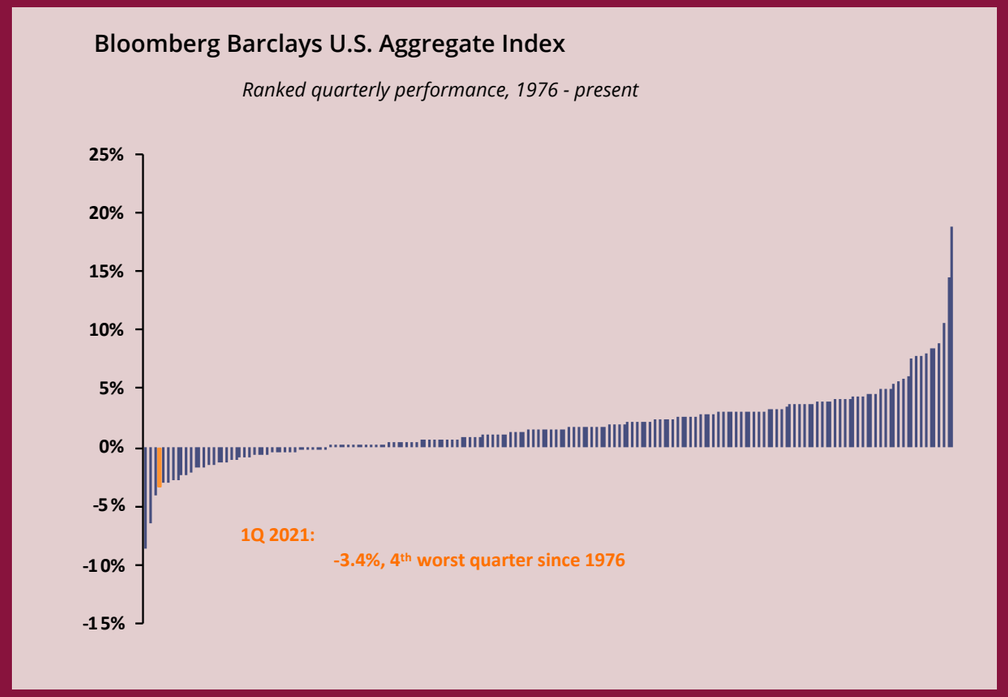
Macro insights: Fixed income

Core fixed income is challenged. The first quarter was the fourth worst quarter for bonds since 1976.

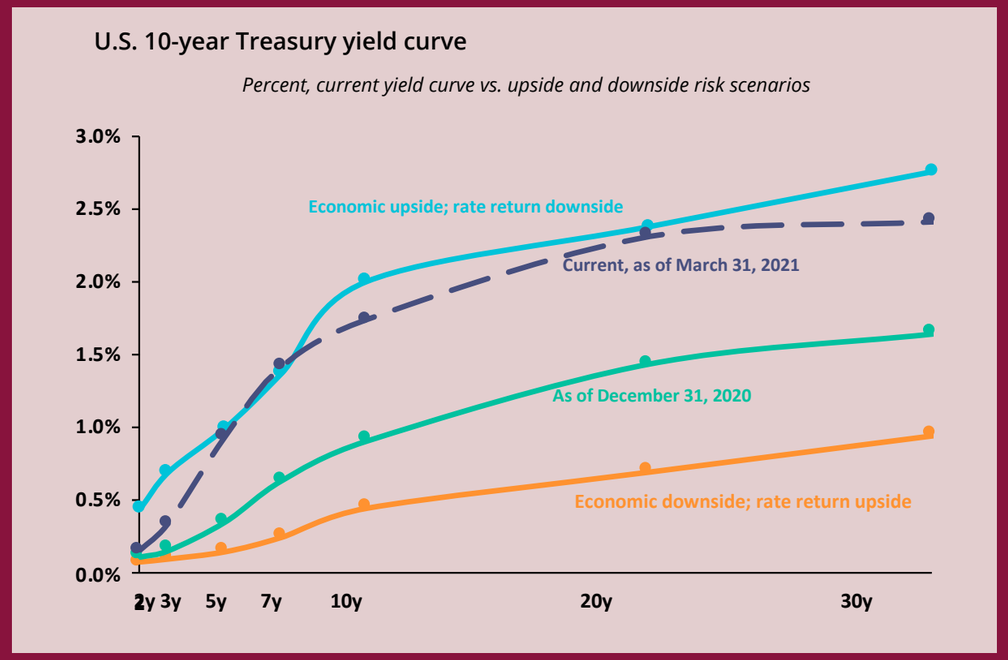
Rising long-term rates are certainly presenting challenges for bond investors. Core fixed income suffered its fourth worst quarterly performance since 1976. However, as bad as the first quarter was, bond investors were only down 3.4%. A key benefit of owning bonds is downside protection, and the limited loss in this environment is a good reminder for why bonds can be an attractive component of a balanced portfolio.

Inflation uncertainty: The long end of the curve moves higher.

Since the end of 2020, our forecast for long-term US nominal Treasury yields has shifted toward our economic upside scenario as inflation expectations, term premiums and, to a lesser extent, real rates have risen. While higher yields are inevitable given the current growth-monetary-fiscal setting, the speed of the normalization has caught investors by surprise.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021



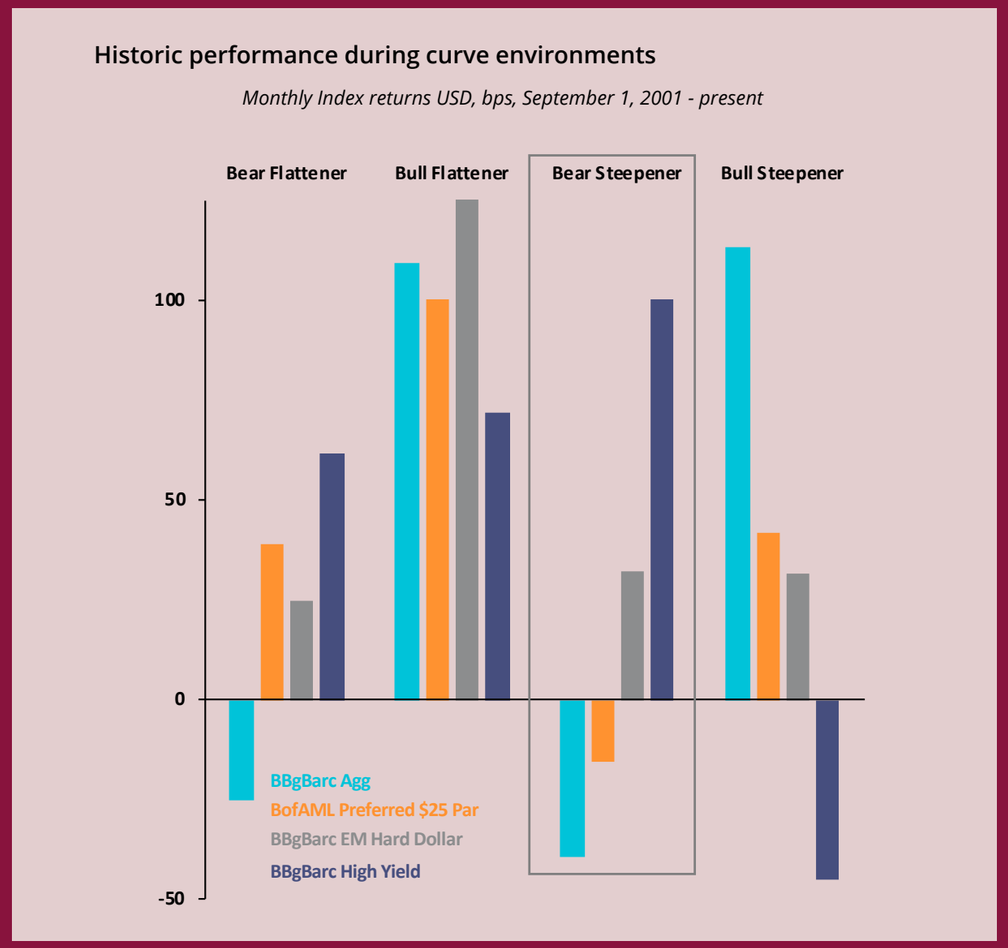
Source: Bloomberg, Principal Global Asset Allocation. Projected upside and downside ranges based on historical data from November 30, 1995. Data as of March 31, 2021.

Macro insights: Fixed income

As the current yield curve gets steeper, historic evidence suggests that certain parts of the fixed income universe will perform well, while others will struggle. During these "bear steepener" periods, the Bloomberg Barclays US Aggregate Bond Index—representing core bonds—suffers the most. Preferred securities also end up negative, but they are still better than core bond-like exposures while providing similar risk. While there are reasons to think preferred securities might not hold up as well as high yield or EM debt, its rate sensitivity gives preferreds the risk characteristics somewhat similar to core bonds while also providing positive carry.

EM debt also offers a distinct advantage to core bonds by offering the that the asset class offers the opportunity to harvest the carry.

Source: Bloomberg, Principal Global Asset Allocation. Data is projected by Bloomberg BEST through 2023. Data as of March 31, 2021.



Source: Bloomberg, Principal Global Asset Allocation. Data as of March 31, 2021. Bear Steepener: widening of yield curve caused by long-term rates increasing at a faster rate than short-term rates. This causes a larger spread between the two rates as the long-term rate moves further way from the short-term rate.

Our base-case economic scenario improves due to U.S. fiscal stimulus

Global capital markets will continue to respond favorably to policy stimulus, even as pandemic-related restrictions constrain economies. A successful vaccine rollout, along with continued monetary and fiscal stimulus, suggests improving earnings and a more rapid global recovery. In this cyclical environment, we maintain a preference for risk assets, including cyclicals, small cap, and real assets.

1. U.S. economy to lead global growth, expanding 6% (up from 4.8%) in 2021 with GDP reaching new high in Q2 2021.
2. By year-end, U.S. EPS will exceed the 2019 peak by 8%. EMs to also show positive EPS growth from 2019, while Europe just falls short.
3. Massive stimulus from developed-market central banks continues. Although, stimulus will come at a slower pace, it will provide support for risk assets through 2021.
4. Risk appetites will be less sensitive to virus activity and more sensitive to inflation fears. Even as they face inflation, central banks will keep rate rises on hold for the foreseeable future. U.S. PCE inflation will end 2021 between 2.25 - 2.50%

Key risks

At this stage, we see three key risks that could disrupt our base case:

1. A growth scare, triggered by virus activity and worsened by virus variants or vaccine missteps, leads to bankruptcies and job losses.
2. Inflationary pressures build up quicker than expected, raising questions around the Fed's dovish resolve.
3. The U.S. Congress accelerates sweeping regulatory, competition, and taxation reforms of the tech sector.

As of 31 March 2021.

Investment Outlook

A deeper dive for investors and their portfolios, both cyclical and secular.

We remain constructive on risk assets, staying overweight equities and underweight fixed income with a neutral alternatives position.

Key positioning changes over the quarter

Equities

- Strong growth, rising inflation and bond yields are nudging us to reduce allocation to U.S. large cap and technology towards neutral, with reallocation going towards the more cyclical side of markets (value-oriented styles within large caps).
- We continue to maintain our preference for small caps, U.S. and EMs. Europe remains our key underweight region.

Fixed income

- We remain biased towards higher volatility spread assets. While there are no changes in our fixed income asset allocations, the reduced duration risk in treasuries, given how much they have risen this year could make us revisit our stance towards the asset class through the course of the next few weeks.

Alternatives

- We prefer real assets as our preferred tactical call to participate in cyclical recovery. Cash is primarily for transactional purposes.

As of 31 March 2021. Alternatives asset classes include REITs, international real estate, MLPs, commodities, TIPS, multi-alternatives, and cash. Allocations across the investment outlook can be proportionately adjusted so magnitudes across categories do not have to net to neutral.

ASSET ALLOCATION	Investment Preference Less < < Neutral > > More				
Equities	○	○	○	●	○
Fixed Income	○	●	○	○	○
Alternatives	○	○	●	○	○
EQUITIES					
US	○	○	○	●	○
Developed ex-US	○	●	○	○	○
Emerging Markets	○	○	○	●	○
FIXED INCOME					
US	○	○	○	●	○
Government and Related	○	●	○	○	○
Corporates - IG and HY	○	○	○	●	○
Developed ex-US	○	●	○	○	○
Government and Related	●	○	○	○	○
Corporates – IG and HY	○	○	○	●	○
Emerging Markets	○	○	○	●	○
ALTERNATIVES					
Cash	○	○	●	○	○
Real Assets	○	○	●	○	○

Key: ○ → ● indicates a change in preference from the previous quarter (light) to the current quarter (darker).

BIOGRAPHIES

Todd Jablonski, CFA — Chief Investment Officer

Todd Jablonski is the chief investment officer and head of multi-asset investment strategies and solutions for Principal Global Investors. He is responsible for the business, research, and investment management of Principal Global Asset Allocation. Jablonski oversees specialized multi-asset investment strategies and solutions, including target date, dynamic risk, outcome-oriented solutions, and bespoke multi-asset investments on behalf of global clients. He leads portfolio management, product development, and research capabilities, which include macro insights, manager research, and investment risk & analytics. He also serves as a Portfolio Manager on U.S. dynamic risk asset allocation strategies. In addition, Jablonski is a member of Principal Global Investors' Operating Committee. In this capacity, he contributes to the overall vision and management of Principal Global Investors, including strategic planning and execution. He also serves on the board of directors of AFP Cuprum S.A. in Santiago, Chile. Jablonski joined Principal® in 2010. Previously, he was an Executive Director and Portfolio Manager at UBS, and prior to that, a Vice President and Portfolio Manager at Credit Suisse. He has an MBA with concentration in quantitative finance from New York University, a bachelor's degree in economics from the University of Virginia, and has earned the right to use the Chartered Financial Analyst designation.

Binay Chandgothia, CFA – Managing Director, Portfolio Manager and Head of Asia

Binay is a Hong-Kong based Managing Director, Portfolio Manager at Principal Global Asset Allocation (PGAA), a specialized investment boutique within Principal Global Investors that engages in the creation of asset allocation solutions. His entire career spanning 27 years has been in portfolio management, encompassing asset allocation, fixed income, and equities. Previously, Binay served as Chief Investment Officer for Principal Global Investors (Hong Kong) and Principal Asset Management (Asia) where he was responsible for overseeing investments in the Hong Kong region. He joined the Principal Financial Group in 2000 in India and has been in the investment industry since 1993. While in India he was the Deputy Chief Investment Officer of Principal's Indian Mutual Fund operations before relocating to Hong Kong in 2005. Prior to that, he spent 7 years in various portfolio management roles with India's largest banking group, State Bank of India. Binay has a post-graduate diploma in business management, equivalent to an M.B.A., from Xavier Institute of Management and a bachelor's degree in commerce from St. Xavier's College. He holds a Financial Risk Manager certification from the Global Association of Risk Professionals and has earned the right to use the Chartered Financial Analyst designation.

BIOGRAPHIES

Seema Shah— Managing Director, Chief Strategist

Seema is Chief Strategist at Principal Global Investors. Based in London, she is responsible for the creation of global economic macro and secular event research, closely monitoring global central bank policy and political developments, and providing broad asset allocation calls for use across the firm. She is a regular participant in seminars and forums, speaking about global macro market issues. Seema joined the firm in 2010, previously working as a strategist within Principal Global Fixed Income. Prior to joining Principal, Seema served as an economist at Capital Economics where she focused on macroeconomic analysis of the UK and the European economies. She also worked with the macro consulting group at PricewaterhouseCoopers, and as an economist at HM Treasury & Inland Revenue Service. She received a master's degree and bachelor's degree with honors in economics from the London School of Economics.

Greg Tornga, CFA — Managing Director, Portfolio Manager

Greg is a Managing Director and Portfolio Manager at Principal Global Asset Allocation (PGAA), a specialized investment boutique within Principal Global Investors that engages in the creation of asset allocation solutions. He is responsible for co-managing our dynamic risk asset allocation suite, our first active multi-asset high income ETF, and our dynamic risk model portfolios, including a digital advisor solution. He joined Principal in 2011 and has been in the investment industry since 2002. Greg has extensive expertise in the fixed income market and was previously Head of Fixed Income and a Portfolio Manager at Edge Asset Management, another investment boutique within Principal Global Investors. Prior to Principal, Greg was a Senior Vice President for Payden and Rygel Investment Management in Los Angeles, where he served as the Head of Investment Grade Credit Strategy. His background also includes corporate finance roles in the Technology and Communication industry with Texas Instruments and Covad Communications. He received an MBA from the Argyros School of Business and Economics at Chapman University and a bachelor's degree from the University of Michigan. Greg has earned the right to use the Chartered Financial Analyst designation.

IMPORTANT INFORMATION

From RAKBANK

This document has been prepared by Principal Global Investors for informational purposes only. The contents of the document should not be construed as an advice on legal, financial or regulatory issues. No person should rely on the contents of this document without first obtaining independent advice from qualified professionals. The National Bank of Ras Al Khaimah (P.S.C), its employees and consultants expressly disclaim all liability and responsibility to any person who reads this document in respect of anything done or omitted to be done by such person in reliance, whether wholly or partially, upon the contents of this document and shall not be responsible for the results of any actions taken on the basis of information provided in this document or for any error in or omission in this document.

Principal Global Investors

Index definitions

Bloomberg Barclays Global Aggregate Bond Index comprises global investment grade debt including treasuries, government-related, corporate, and securitized fixed-rate bonds from developed and emerging market issuers. There are four regional aggregate benchmarks that largely comprise the Global Aggregate Index: the US Aggregate, the Pan-European Aggregate, the Asian-Pacific Aggregate, and the Canadian Aggregate Indices. The Bloomberg Barclays Global Aggregate Bond Index also includes Eurodollar, Euro-Yen, and 144A Index-eligible securities and debt from other local currency markets not tracked by regional aggregate benchmarks. ©2020 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.

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

Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index.

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.

This document is intent for use in:

- **In Dubai** by Principal Global Investors LLC, a branch registered in the Dubai International Financial Centre and authorized by the Dubai Financial Services Authority as a representative office and is delivered on an individual basis to the recipient and should not be passed on or otherwise distributed by the recipient to any other person or organization. This document is intended for sophisticated institutional and professional investors only.

Insurance products and plan administrative services provided through Principal Life Insurance Co. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities are offered through Principal Securities, Inc., 800-547-7754, Member SIPC and/or independent broker/dealers. Principal Life, Principal Funds Distributor, Inc., and Principal Securities are members of the Principal Financial Group®, Des Moines, IA50392.

Principal℠ | RAKBANK ELITE