PRINCIPAL

Investment Report Q2 2025

New world order opens up investment opportunities

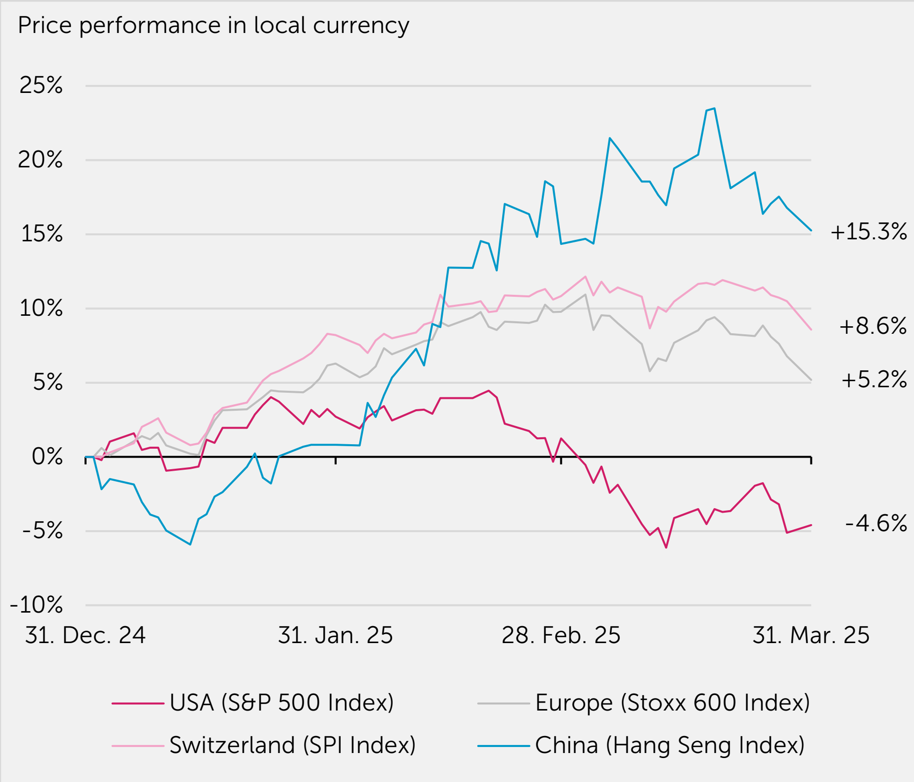
At the beginning of the new year, market prices surged across nearly all asset classes. However, the revision of U.S. foreign policy and the imposition of tariffs sparked concerns about inflationary pressures. Consequently, inflation and key interest rate expectations rose across global financial markets, leading to a decline in valuations of many asset classes by the end of the quarter.

Gold priced soared by +19.0% in Q1, reaching a new all-time high at 3,124 USD per troy ounce, while broader commodities gained +7.7%. At the same time, global bonds advanced by +0.8% (hedged Euro), while global equities lost -1.7%.

Diverging Market Trends

A closer look at global equities reveals stark divergences. While U.S. equities have dominated the markets in the last two years (S&P 500 Index +55.5% in 2023/24), they have declined by -4.6% since the beginning of the year due to high valuations. In contrast, Chinese equities surged by +15.3% in the same period which was underpinned by low valuations, the hope of a further economic stimulus package to revitalise domestic consumption in China and the euphoria surrounding the AI innovation ‘DeepSeek’. European equities advanced +5.2% while Swiss equities gained +8.6%, supported by improving sentiment indicators and strong capital inflows from the U.S.

PERFORMANCE OF REGIONAL STOCK MARKETS YEAR-TO-DATE



Shifting market dynamics

Since the beginning of the year, investors have favoured value stocks (MSCI ACW Value Index = +4.2%), while cyclical growth stocks have lagged (MSCI ACW Growth Index = -7.0%). This shift has also driven a sectoral reallocation, with capital moving away from highly valued sectors like information technology (-11.8%) toward undervalued sectors such as healthcare (+4.5%).

Temporary correction or pronounced bear market?

Since its all-time high on 19 February 2025, the broad-based U.S. equity index S&P 500 has declined by approximately 8%. Historically, only one in four market corrections since 1950 has evolved into a full-blown equity crisis.

In order to judge whether the current trend is a technical correction or the start of a full-blown bear market, it is necessary to assess the macroeconomic environment.

The U.S. economy remains resilient, with a tight labor market, strong consumer spending and ongoing disinflation. This supports our base case scenario of a 'soft landing' for the U.S. economy. However, leading economic indicators present a mixed picture. While purchasing manager sentiment is improving, consumer confidence has sharply declined. The latter involves considerable risk, as domestic consumption is the main pillar of the U.S. economy. Despite this divergence, the majority of key indicators we track remain positive, suggesting that a bear market is unlikely at this time.

Central banks remain cautious

Concerns over tariffs and inflation have limited the U.S. Federal Reserve's (Fed) flexibility to cut interest rates. Policymakers have signalled a willingness to lower rates only when uncertainty subsides. We anticipate two U.S. rate cuts, three in the Eurozone, and an additional 25-basis-point reduction in Switzerland by year-end.

Investment opportunities in uncertain times

The evolving investment landscape presents new opportunities. Increased European defense and infrastructure spending is bolstering the European defense industry and infrastructure providers. The associated rise in government debt issuance may lead to sovereign credit downgrades, higher bond yields and increased profitability for European banks. The German automotive industry appears undervalued as manufacturers shift strategies in response to declining EV profits, potentially reviving internal combustion engine production. This could trigger political debates around the EU’s planned 2035 ban on new petrol and diesel vehicles. China's AI ambitions continue to support Chinese technology stocks.

Conclusion

The emerging trade war, coupled with rising inflation and interest rate revisions, has predictably heightened market volatility. Given the strong resilience of the U.S. economy we expect this period of turbulence to be short-lived. If the correction continues, we plan to increase our equity exposure. We remain bullish on gold, expecting further all-time highs due to sustained geopolitical tensions and strong demand from emerging markets.

Tariffs put pressure on markets

As market breadth narrowed and valuation extremes in large-cap U.S. technology stocks signalled increased correction risks, we took decisive action in January, reducing equity exposure with a particular focus on capital-weighted large-cap U.S. stocks. This disciplined approach proved timely, as our actively managed and equally weighted U.S. equity investments delivered superior performance versus the cap-weighted S&P 500 in Q1, benefitting from a more balanced market environment.

Based on our current tactical positioning, our managed portfolios remain underweight in large-cap U.S. growth stocks in the technology sector amid geopolitical and trade-related uncertainties.

By investing in carefully selected secular sectors – healthcare and energy – we are capitalizing on the broad sector rotation in equity markets. Additionally, our managed portfolios are benefitting from the rally in the Chinese market through a passive investment in China, which made a significant contribution to the performance in the first quarter. Given Germany’s sweeping economic and defense policy realignment, marked by a planned additional expenditure of one trillion euros, we have increased our portfolios’ exposure to European equities. At the same time, we continue to overweight Swiss equities.

Gold advances to new all-time high

Gold emerged as the strongest-performing asset in the first quarter, driven by geopolitical tensions and strategic purchases by Asian central banks.

As a core stabilizer in our asset allocation strategy, gold plays a crucial role in mitigating portfolio risks. Given the prevailing uncertainties, we continue to maintain a high allocation to precious metals. Meanwhile, the euro outperformed both the U.S. dollar and the Swiss franc in the 1st quarter, supported by expectations of substantial European fiscal stimulus linked to increased defense spending and the easing of Germany's debt brake.

Increasing portfolio liquidity to navigate market volatility

In alignment with our risk management strategy, we increased portfolio liquidity by reducing U.S. equity holdings. This provides the flexibility to opportunistically expand European equity exposure should the market correction deepen.

Given the current economic environment, we remain tactically underweight in bonds with maturities under four years.

TACTICAL ASSET ALLOCATION (IN EUR)

	Underweight		Neutral		Overweight
Asset Classes					
Liquidity					◆
Bonds	◆				
Equities		◆			
Gold					◆
Alternatives			◆		
Equity Regions					
Eurozone			◆		
Switzerland					◆
USA	◆				
Emerging Markets				◆	

Conclusion

We are maintaining our tactical asset allocation with an underweight position in equities and bonds while preserving key stabilizers, such as gold and the Swiss franc for the time being.

Special topic: Swiss quality stocks - a distinctive opportunity

In an environment of rising uncertainty, the need for a reliable store of value has never been more critical. Switzerland stands as a proven safe haven, offering unparalleled stability and strength.

The Swiss advantage

Switzerland stands out for its exceptional economic and political stability. Its system of direct democracy and neutral foreign policy, where it remains outside the European Union and NATO, makes it a diplomatic powerhouse. The Swiss franc is one of the world's strongest currencies, providing further security. In addition, Switzerland is home to a wealth of globally active companies that are highly innovative and many of which are owner-managed.

The Swiss Market Index: a strong foundation

The Swiss Market Index (SMI) is the benchmark for Swiss equities, consisting of 20 major companies. It accounts for 75% of the market capitalization and 90% of the trading volume on the SIX Swiss Exchange. The index's defensive nature, with a substantial allocation to healthcare (37%) and consumer staples (17%), offers valuable diversification, especially during economic downturns. The global giants Nestlé, Roche, and Novartis together account for 46.7% of the index's market capitalization.

Active vs. passive investment strategy

Given the high concentration of major players in the SMI, the index is susceptible to sector-specific and factor-based risks. Exchange-traded funds (ETFs), which are gaining popularity, are particularly exposed to unsystematic risks because of this concentration. Thus, a passive approach to the SMI is not the most optimal strategy. To mitigate these unsystematic risks, a diversified equity index or an active investment strategy is necessary. At Principal Asset Management, we have developed a tailored, active investment strategy to navigate these complexities and deliver superior outcomes.

Extensive investment universe of Swiss equities

Our equity investment universe includes more than 250 companies listed on the Swiss stock exchange SIX, spanning a wide range of market capitalizations and sectors. Within this broad investment universe, the key to success lies in meticulous investment selection.

Quantitative and qualitative selection criteria

Our approach to selecting the best Swiss equities is driven by a comprehensive set of criteria that we have carefully defined. We apply both quantitative and qualitative factors to ensure a thorough evaluation.
In our quantitative screening, we focus on key metrics such as robust revenue and earnings growth, financial stability, a strong balance sheet, and healthy cash flow levels, all of which are critical to a company's long-term performance.
This quantitative stock selection model is complemented by a qualitative assessment, where we evaluate aspects such as the company's business model, ownership structure, competitive advantages, return on capital, and scalability, ensuring that the company is well-positioned for sustainable growth.

Result of the selection process

Our proprietary selection process identifies around 30 high-quality stocks that meet our investment criteria. These stocks are included in our Swiss equity portfolio, considering their respective risk/return profile. Risk management follows a disciplined approach, ensuring oversight at both the individual position level and within the broader portfolio context.

Conclusion

Swiss equities should be a core component of any portfolio. That said, an active strategy provides key advantages over passive investing. In a broad investment universe, the selection criteria are crucial to the success of an active investment strategy. Our investment center has developed and implemented a robust approach for identifying top-tier, high-quality Swiss companies, available to our clients through our Swiss equity mandate.

PRINCIPAL ASSET MANAGEMENT AG

Landstrasse 30
FL–9494 Schaan
Liechtenstein
Phone +423 235 04 40
info@principal.li