PRINCIPAL

Investment Report Q3 2025

Promising market prospects amid rising uncertainty

In a rapidly evolving global environment, uncertainty has risen significantly in 2025. Market activity has been heavily influenced by geopolitical developments, particularly the resurgence of U.S. tariff policies and escalating tensions in the Middle East.

On the foreign exchange front, the U.S. dollar has lost over 12% against both the euro and the Swiss franc year-to-date. This depreciation has reinforced gold's status as a safe haven: the precious metal surged +25.9% in USD terms (+10.7% in EUR), and reaching an all-time high of USD 3,494 per troy ounce. Broad commodities and global bonds (hedged in EUR) also advanced, by +3.3% and +2.0%, respectively.

Equity markets initially fell by more than 10% early in Q2 amid the introduction of reciprocal U.S. tariffs but subsequently recovered fully. Year-to-date, global equities are up +9.1% in USD (+5.4% hedged in EUR).

Synchronised recovery, uneven momentum

While regional equity markets moved in tandem, performance varied widely. Japanese equities, which had previously lagged, outperformed with a +13.7% gain in Q2. European stocks increased slightly (+1.4% QoQ), while emerging markets have seen renewed investor interest.

U.S. tariffs open up opportunities

The 90-day moratorium on reciprocal U.S. tariffs expires on 9 July. Leading up to that date, headlines are likely to be dominated by trade negotiations. Tariff revenues are earmarked to finance a reduction in the U.S. corporate tax rate from 21% to as low as 15%, a move that would significantly benefit U.S. equities. We anticipate many indices will reach new all-time highs by year-end.

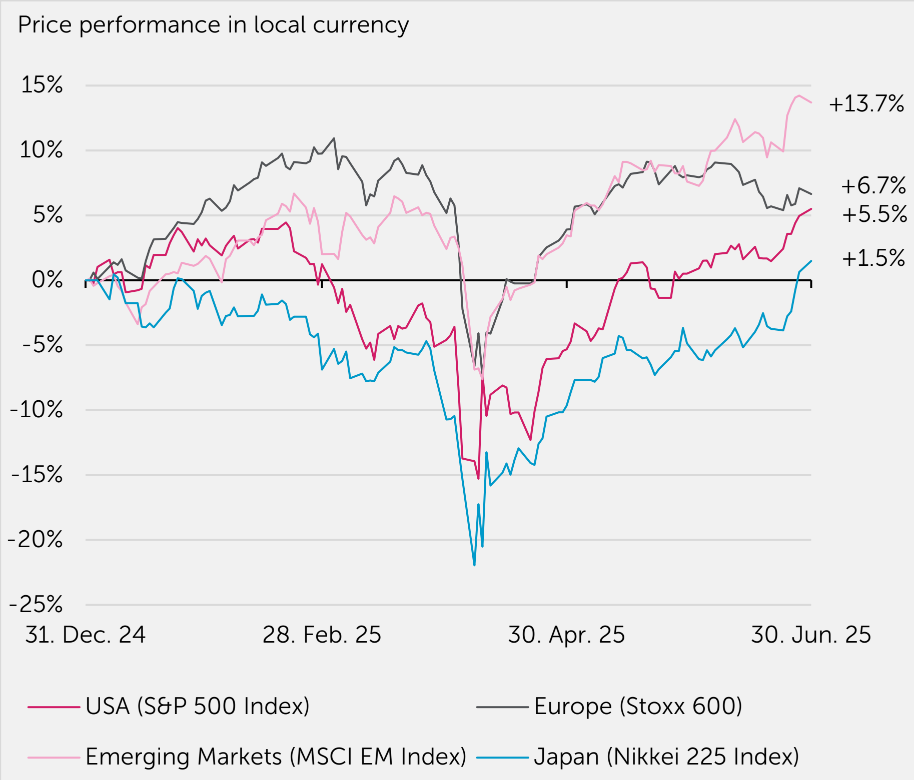
Inflation expectations out of sync with reality

Tariff announcements have pushed U.S. inflation expectations as high as +6.6% for the coming year. While the current forecast stands at +5.0%, our base case, given a moderate economic slowdown, anticipates actual inflation will come in lower.

Monetary policy outlook for H2 2025

Amid high uncertainty, the U.S. Federal Reserve is adopting a cautious stance. However, incoming economic data should support a policy shift. We expect two rate cuts each from the Fed and the ECB by year-end. The Swiss National Bank (SNB), meanwhile, announced a zero interest rate policy on 19 June. Given geopolitical risks, the Swiss franc is likely to strengthen, increasing the probability of negative interest rates. We believe the SNB will avoid intervening in currency markets to sidestep renewed accusations of manipulation from the U.S.

PERFORMANCE OF REGIONAL STOCK MARKETS YEAR-TO-DATE



Diminishing status of the U.S. Dollar

During Donald Trump's first term, the USD Index fell -10.2%. A similar pattern has emerged in the early months of his renewed presidency, with another double-digit decline. Eroding trust in U.S. leadership and policy communication is contributing to capital flight and a trend of 'de-dollarisation', especially among central banks. While the dollar will likely remain the world's primary reserve currency, its relative dominance is expected to diminish.

Conclusion

We anticipate heightened market volatility throughout the summer. Nevertheless, the combination of improving leading indicators alongside softening economic data is likely to provide support for equity markets in the latter part of the year. Our outlook on gold remains strongly bullish, driven by rising geopolitical tensions and sustained strategic demand from emerging Asian markets. We expect gold to reach new all-time highs.

Managed portfolios denominated in EUR and CHF posted negative returns in H1 due to sharp USD depreciation. Last year's strategic reduction of USD exposure helped mitigate losses. We will maintain a tactical USD underweight in both EUR and CHF portfolios.

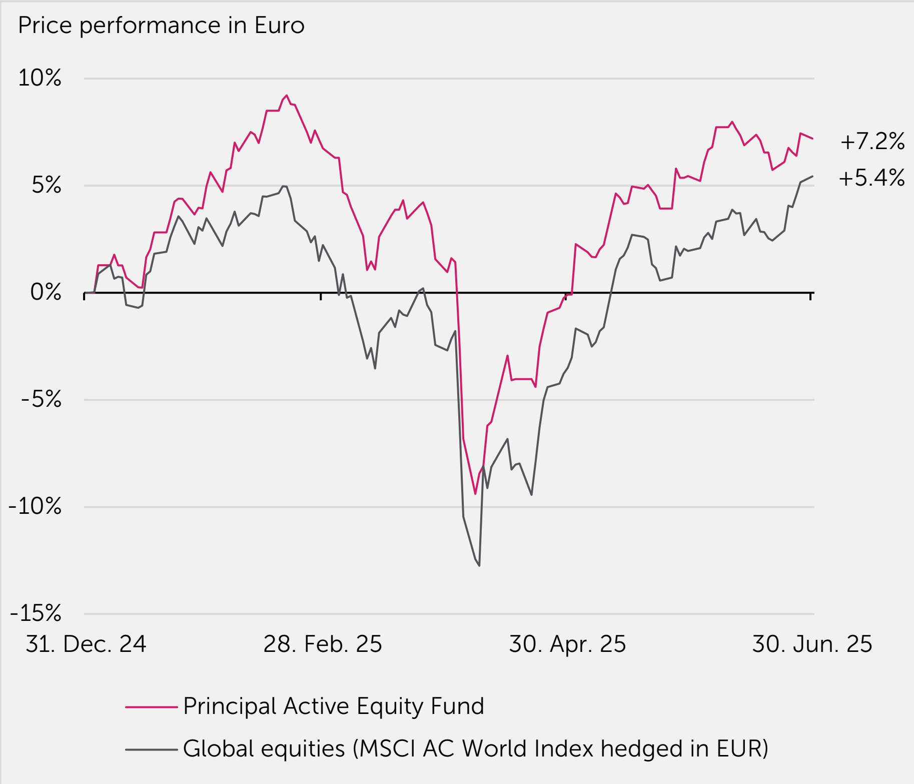
Despite zero rates from the SNB, we continue to hold Swiss francs in our EUR-denominated portfolios, reflecting its safe-haven appeal and fundamental strength.

Protective allocations in focus

In this environment of unresolved trade disputes and geopolitical risks, we are maintaining a slight underweight in equities. Our strategy prioritises portfolio stabilisers such as gold and commodity investments, energy sector equities, Swiss franc exposure, and alternative assets including CAT bonds and hedge funds.

The Principal Active Equity Fund, featured in our portfolios, has outperformed the global equity index due to its allocations in energy and commodities, AI and technology, as well as security and defence year-to-date.

SUCCESSFUL STOCK SELECTION DUE TO PROPRIETARY CRITERIA



In light of the EU's massive increase in defence spending, highlighted by Germany's €1 trillion special fund and the suspension of the debt brake, we expanded European equity exposure via DAX 40 and value stocks. We are also maintaining our overweight in Swiss equities.

Due to U.S. healthcare reform pressures and regulatory uncertainty, we exited our healthcare equity holdings for risk management purposes.

Japanese equities and large-cap U.S. tech names bounced back strongly in Q2, offsetting their underperformance in Q1. Chinese equities also saw a resurgence.

Gold loses a little of its shine

Central bank gold holdings now exceed their Euro-denominated foreign exchange reserves. As part of our strategic asset allocation, gold continues to serve as a stabiliser, insulating portfolios from equity and USD volatility. In Q2, however, the gold price lost -3% and -5% against the euro and the Swiss franc. Regarding the prevailing geopolitical crises and uncertainties, we maintain our high allocation to gold.

Fixed income strategy

We remain tactically underweight in bonds and prefer short durations (<4 years), given unattractive credit spreads and the steepening of both EUR and USD yield curves.

Special topic: Europe – A phoenix rising from the ashes?

Recent political uncertainty in the U.S. has led investors to reassess Europe. Valuations are attractive, and confidence in upcoming monetary and fiscal measures is rising. European equities have gained +6.7% YTD as measured by the STOXX 600.

Growth outlook: cautious optimism

Despite equity strength, growth forecasts for Europe, especially Germany, remain muted. The OECD cut its Eurozone GDP forecast to +1.0% for 2025. The European Commission echoes this with projections of +0.9% in 2025 and +1.4% in 2026.

Monetary stimulus in motion

The forecast of real growth implies the expectation of inflation. The forecasts of the OECD and the European Commission are almost identical at 2.2% and 2.3% respectively for this year, followed by 2.0% and 1.9% next year. A continuation of disinflation would give central banks the opportunity to lower key interest rates further. This year alone, the European Central Bank (ECB) has already cut the key interest rate four times in succession in order to stimulate the economy.

Fiscal expansion through new debt

Governments across Europe are embracing fiscal stimulus to modernise infrastructure and bolster defence. This is being financed through rising public debt. If spreads widen and credit ratings fall, the ECB may resume bond purchases via QE.

Migration: A social flashpoint

Immigration continues to be a divisive issue, as concerns over cultural integration intersect with the economic demand for skilled labor. Elevated migration levels are driving higher social costs and fuelling the rise of right-wing populism.

Europe's automotive industry in transition

Europe’s automotive industry faces a pivotal moment. As Asia dominates electric vehicle production, Europe’s path to maintaining global relevance lies in capitalizing on its strengths in combustion engine technology. Postponing or revising the 2035 ban on internal combustion engines may be crucial to sustaining the sector’s competitiveness.

The euro's outlook

Capital flows into Europe have strengthened the euro. However, monetary easing and debt accumulation could reverse this trend. We expect long-term depreciation of the euro against the Swiss franc. Nonetheless, we do not foresee an existential threat to the Eurozone.

Conclusion

Our outlook on Europe remains cautiously optimistic. Although valuations are attractive, the primary engines of future innovation are likely to be found in the U.S. and China. Only time will reveal whether Europe can defy expectations and rise again, like a phoenix from the ashes.

PRINCIPAL ASSET MANAGEMENT AG

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