

Principal Fixed Income

Off Quarter Outlook

NOVEMBER 2025

A note from the CIO

In our fixed income era



Michael Goosay

CIO & Global Head of Fixed Income

Markets don't wait for quarter-end, and neither should we. This intra-quarter outlook is designed to provide timely insights helping investors position portfolios between traditional reporting milestones.

Late 2025 brings complexity: inflation remains sticky, growth is slowing, and geopolitical shifts are reshaping capital flows. Fed rate cuts anchor the near-term, but this cycle looks different – labor markets are softening without collapsing, and lower-quality credit hasn't seen typical late-cycle stress. Selectivity is critical.

Our current outlook is shaped by the intersection of cyclical challenges and structural change: rate cuts, inflation, labor market transitions, and de-globalization. At **Principal Fixed Income**, we see complexity as a catalyst for differentiation, leveraging global reach and sector expertise to uncover value where others see only risk. As we move toward year-end, staying proactive, not reactive, will be key to capturing opportunity in a market that rewards discipline and foresight.

Key themes across fixed income

Global Macro: Asia credit remains relatively constructive versus U.S. Investment Grade (IG), while emerging market (EM) flows are choppy; geopolitical risks and fiscal policy shifts (Japan, UK) add uncertainty.

U.S. Macro: Fed remains divided; December cut is no longer a foregone conclusion. Inflation elevated, labor market softening but not collapsing.

Investment Grade: Strong fundamentals and technicals – record issuance, robust earnings, and pro-growth policy support IG spreads despite tight valuations.

High Yield: Credit metrics stable, refinancing risk minimal; issuance strong and mostly refinancing-driven. Spreads and yields have widened modestly amid risk-off tone.

Securitized Debt: Fundamentals broadly solid with pockets of stress (subprime ABS, office CMBS). Technicals strong, spreads flat to tighter, demand for yield persists. Lower net supply of MBS and seasonal slowdown in speeds support valuations; near-term screens rich, longer-term modestly cheap versus IG.

Emerging Markets: Fundamentals intact but spreads near post-GFC tights; selectivity critical amid uneven flows and dollar strength.

Municipals: Municipal bonds lagged early in 2025 due to policy uncertainty and heavy issuance but have since rebounded, with strong demand and attractive valuations, especially at the long end, leaving room for further gains.

Global Macro

Navigating global shifts



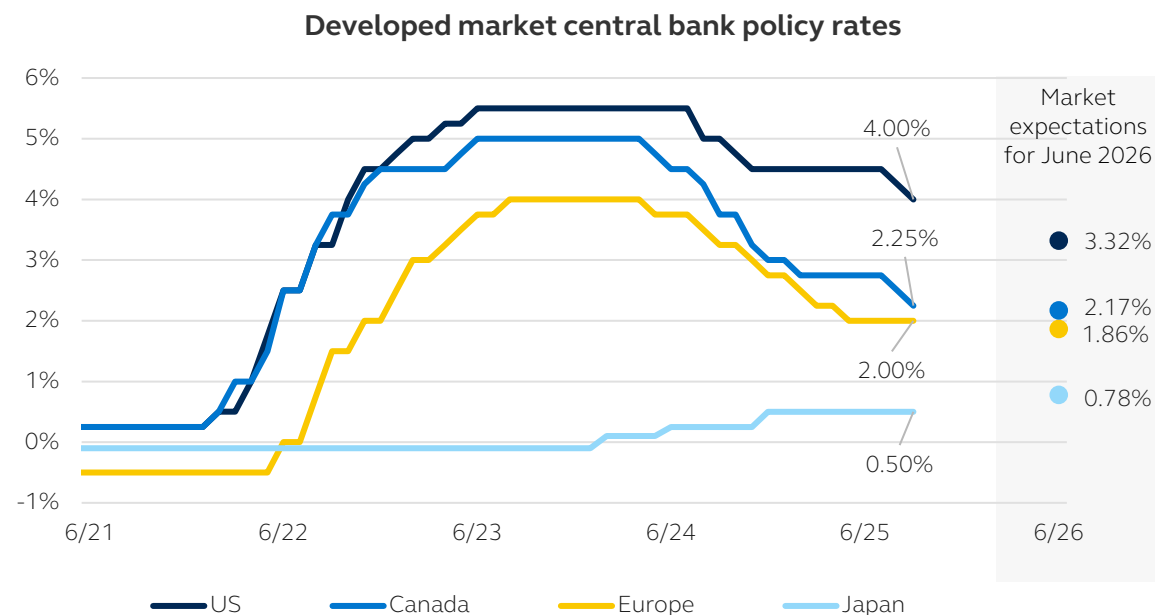
Chee Sin Koh

Global Multi-Sector Portfolio Manager

Near-term dedollarization momentum is constrained by France's political uncertainty and Japan's policy recalibration, though U.S. labor market data may take over as the dominant macro driver ahead. In rates, our strategy has pivoted from duration to curve steepeners, anticipating backloaded Fed easing as official labor market data converges with private sector sourced data, and supportive fiscal measures ahead of the 2026 mid-terms to mitigate cost-of-living pressures. Globally, fiscal stance turning more pro-active, reflecting domestic political realities and geopolitics in the case of defense and securing supply chains.

Monetary policy divergence ahead

- Although the Fed has tempered its dovish tone, markets still anticipate more U.S. rate cuts versus the rest of the world



U.S. Macro

A blind landing



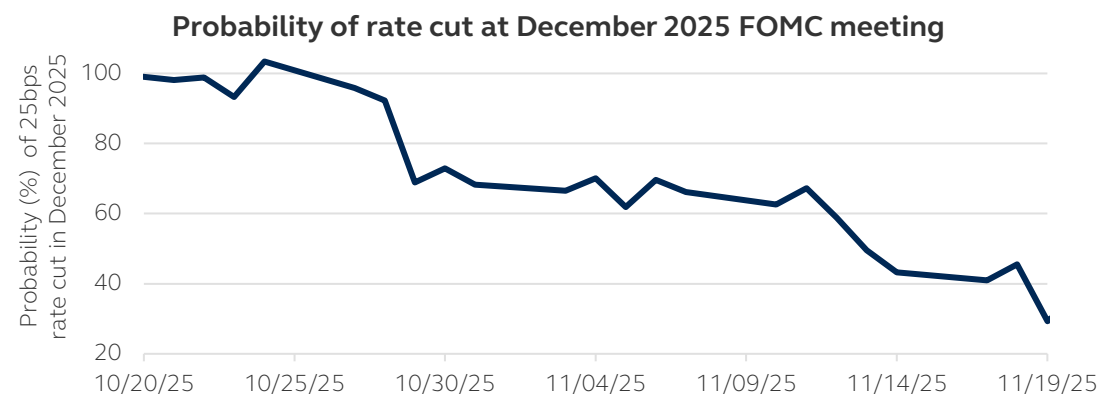
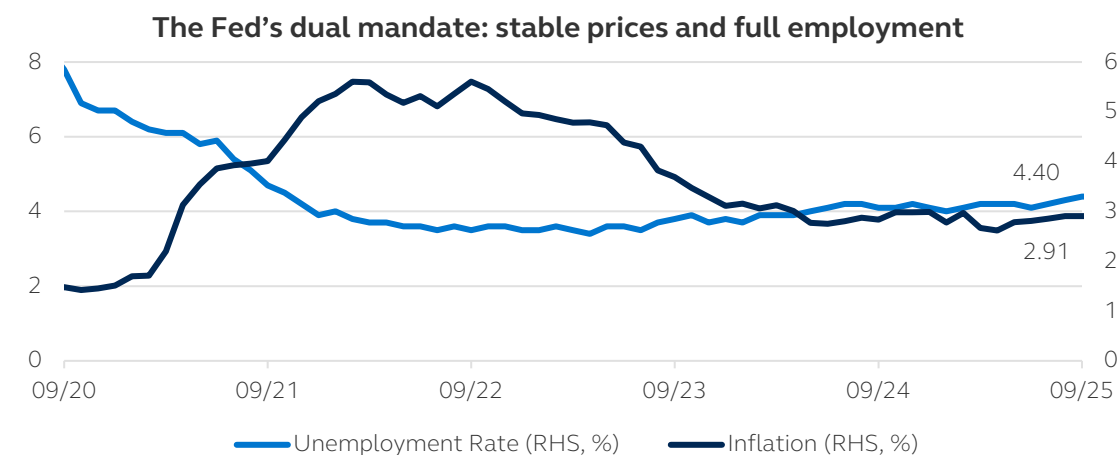
Bryan Davis, CFA

Multi-Sector Portfolio Manager

The Federal Reserve remains divided following its recent rate cut, with markets pricing in a probability of less than 40% of another cut in December – down from 90% just prior to their October meeting. Chair Powell has emphasized optionality, signaling that a December cut is “not a foregone conclusion.” Inflation remains elevated around 3% and the downtrend has stalled, though the Fed continues to downplay the risk of a resurgence. Labor market indicators suggest a gradual slowdown rather than a sharp deterioration: job openings (JOLTS) and Indeed postings are declining, ISM employment sub-indices remain in contraction, and Challenger layoffs hit their highest October level since 2000. These trends point to a continuation of the gradual slowdown in the labor market which should support additional Fed cuts. Our base case – the Fed pauses near the neutral rate after cumulative cuts totaling -100 bps, with the policy rate ending 2026 near 3%.

Focus remains on available economic data to decipher the Fed's next move

- Inflation progress has stalled as labor market softening continues, creating a more challenging situation for the Fed
- In late October, markets were pricing in close to a 100% chance of another 25bps cut at the final FOMC meeting in December. That probability is now below 40%.



Investment Grade Credit

Fundamentals + Technicals > Valuations



Jon Curran, CFA

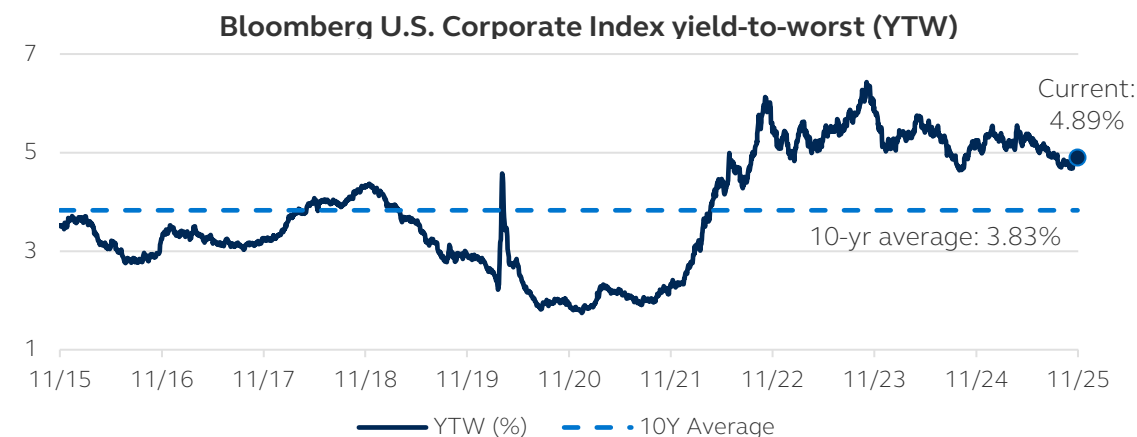
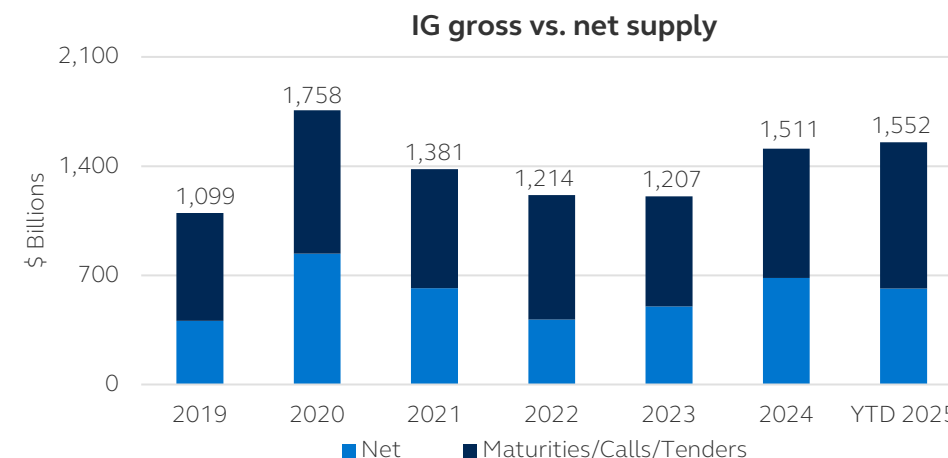
Head of Investment Grade Credit

Investment grade corporates entered Q4 2025 with strong technicals and fundamentals. October's record \$158 billion issuance pushed year-to-date volumes to roughly \$1.54 trillion, underscoring investor demand and issuers' ability to capitalize on favorable conditions. Corporate health remains solid, with over 90% of S&P 500 companies reporting Q3 earnings growth of about 13%. If that rate holds through the remainder of earnings season, it will mark the fourth straight quarter of double-digit gains.

Policy tailwinds, including deregulation and tax cuts, should continue to support IG bonds, while additional Fed rate cuts aimed at cushioning labor market softness provide further upside. Spreads remain tight but yields are still compelling. We expect modest tightening into year-end, followed by some widening mid-2026 as issuance and AI-driven capex needs increase. Overall, the outlook for IG credit remains constructive.

Technical support remains a key tailwind for IG corporates

- Despite a record \$158B of new supply in October and robust issuance over \$1.6T YTD, net supply has been very manageable due to slew of maturities this year
- While credit spreads remain tight, yields are compelling and solid inflows into the asset class have effectively taken down the sizable issuance



High Yield Credit

Resiliency and selectivity



Mark Denkinger, CFA
Head of High Yield Credit

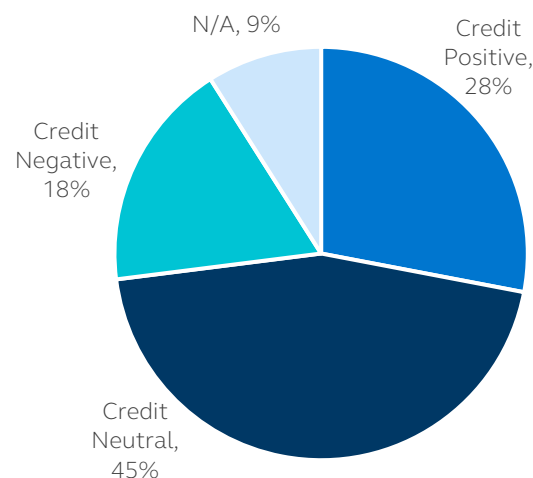
High yield fundamentals remain resilient, with credit metrics broadly stable despite a slight uptick in leverage from incremental debt. Interest coverage ratios are healthy, and while Q3 earnings season has moderated after a strong start, sector divergence is evident. Importantly, refinancing risk is minimal in the near term – less than 1% of outstanding HY debt matures in 2025–2026, and only 8% comes due in 2027. These factors, combined with strong corporate liquidity, underpin a constructive outlook for credit quality.

Technicals and valuations reflect a more nuanced picture. While recent weekly fund flows have shown modest outflows, year-to-date flows remain strong, and 2025 issuance has already surpassed last year's total, expected to close between \$300–325 billion, with 70% allocated to refinancings. Dealer inventories are steady around \$3.8 billion. Spreads are in line with their one-year average at 300 bps (+24 bps since the start of the quarter), and yields have risen to 6.96% (+30 bps), largely driven by a 16 bp increase in the 5-year Treasury yield to 3.72%. November performance reflects this risk-off tone, with HY posting -0.24% MTD, while the Morningstar LSTA Leveraged Loan 100 index is modestly positive at +0.24%.

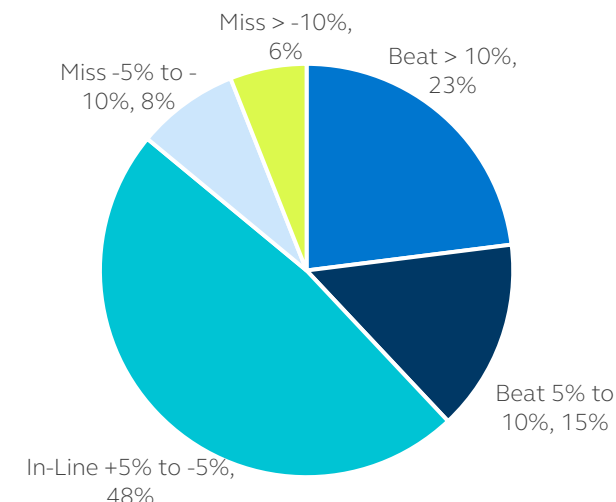
3Q 2025 high yield earnings season – an early read

- 2.7 times as many high yield companies beat expectations versus missed
- 1.5 times as many high yield companies provided guidance interpreted as positive versus negative

Adjusted EBITDA vs. consensus estimates
(% of companies reporting)



Outlook / guidance trend
(% of companies reporting)



Securitized Debt

Demand abounds



Laura Rank, CFA
Head of Securitized Credit

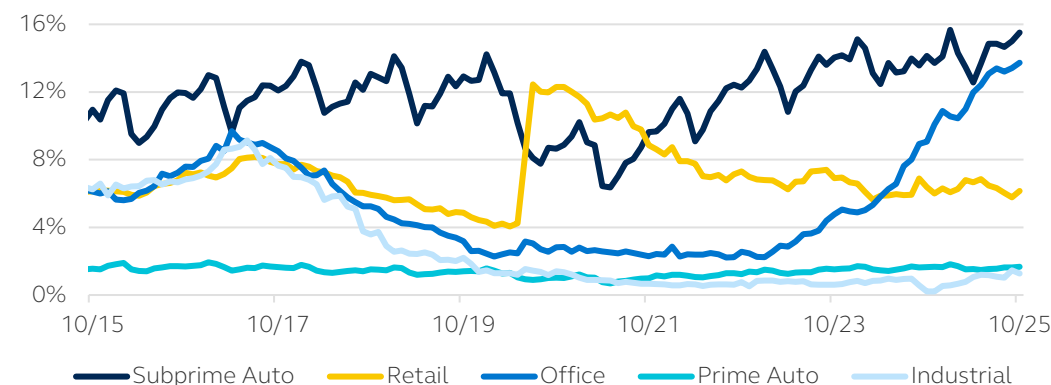
Fundamentals are stable overall, though stress persists in subprime ABS and parts of Commercial Real Estate. ABS shows a K-shaped pattern with subprime auto delinquencies rising while higher-income consumers remain strong. CLO credit quality is improving, defaults have plateaued, and loan prices are firm. CMBS weakness is primarily concentrated in office loans (delinquencies above 13%), while RMBS remains solid but bifurcated between Prime Jumbo and Non-Qualified Mortgage. Agency MBS benefits from lower net supply and muted demand, though near-term valuations screen rich.

Technicals and valuations remain supportive. Spreads appear to fair to cheap relative to fixed income alternatives across sectors, demand for longer duration is strong, and markets continue to look through macro uncertainty. While pockets of weakness warrant caution, overall consumer and business health should help securitized credit navigate a slowdown. The backdrop for 2026 looks constructive, supported by persistent demand and a Fed focused on stability.

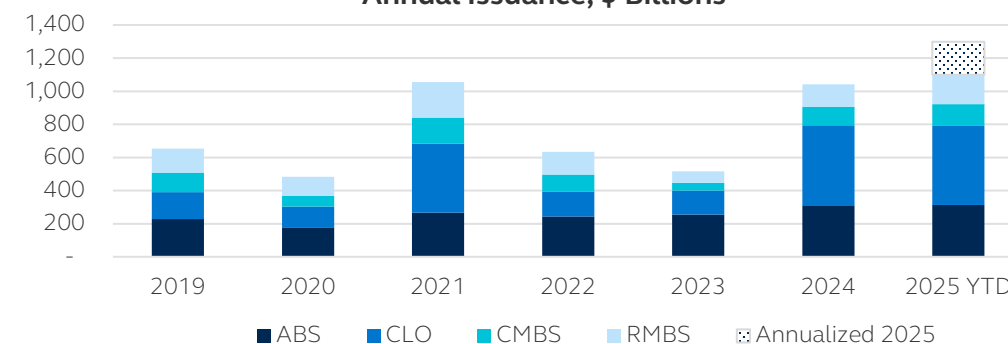
Robust issuance has been met with strong demand, but selectivity remains key as fundamentals are mixed

- Delinquencies have been rising in subprime auto ABS and office CMBS, but higher income borrowers and other property types are exhibiting more stability
- While pockets of weakness warrant diligent underwriting, investor demand is strong, easily absorbing record new issuance

Delinquency rates – CMBS (60+ day) and ABS (30+ day)



Annual Issuance, \$ Billions



Emerging Market Debt

Relative value endures



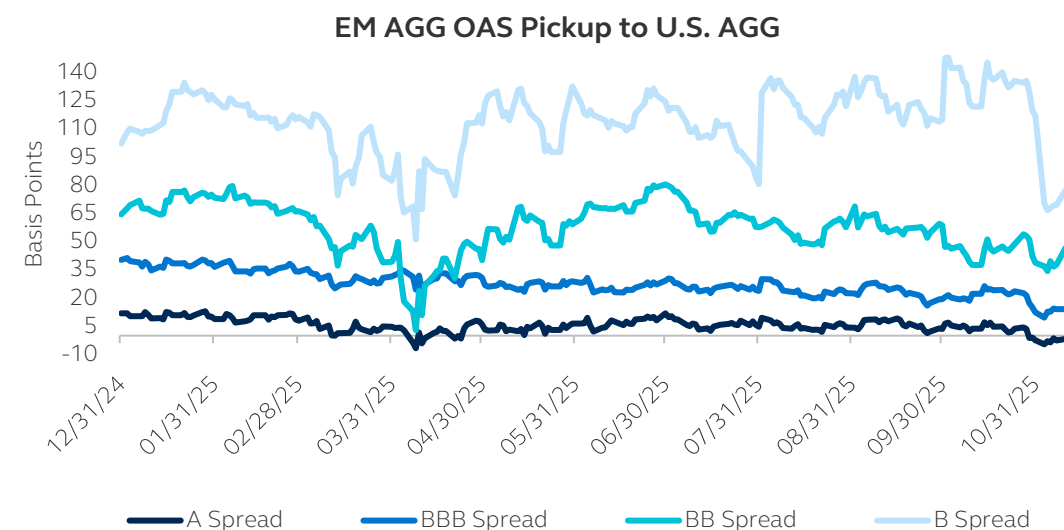
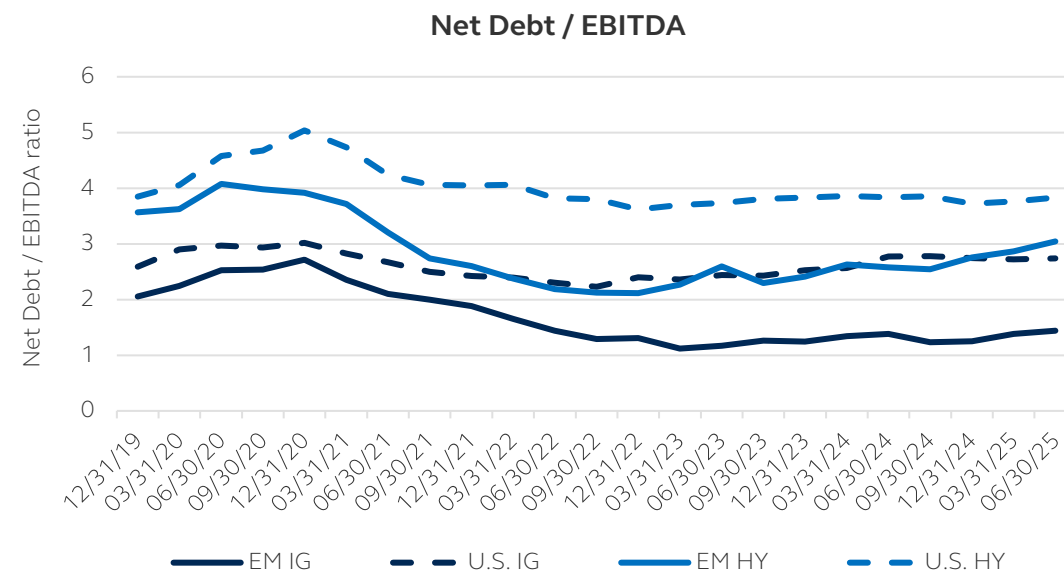
Howe Chung Wan

Head of Asian Fixed Income

Fundamentals remain solid, with manageable amortization schedules and resilient macro profiles across EM. Technicals are mixed – new issue performance has varied, but flows remain positive into year-end, and local currency continues to attract more demand than hard currency credit. Supply has been strong, supporting liquidity.

Valuations have tightened, with EM spreads down 27 bps month-over-month to +181 bps (near post-GFC tight). We forecast spreads widening to +200 bps by YE 2025 and +225 bps by mid-2026, though sentiment shifts could reinforce risk aversion near term. Despite this, EM still offers a meaningful pickup versus U.S. credit, warranting selective positioning.

In Asia credit, fundamentals for investment grade (IG) remain constructive despite tight valuations, supported by technicals—negative net supply for the fourth consecutive year and China's issuance share falling from 60% to 30%. Positioning favors buying on spread widening given attractive all-in yields, prioritizing IG duration with a quality bias over high-yield (HY) beta. Curve preference is ≤ 10 years, with sector allocation skewed toward financials and technology.



Municipals

Reversion to the mean is underway



James Welch

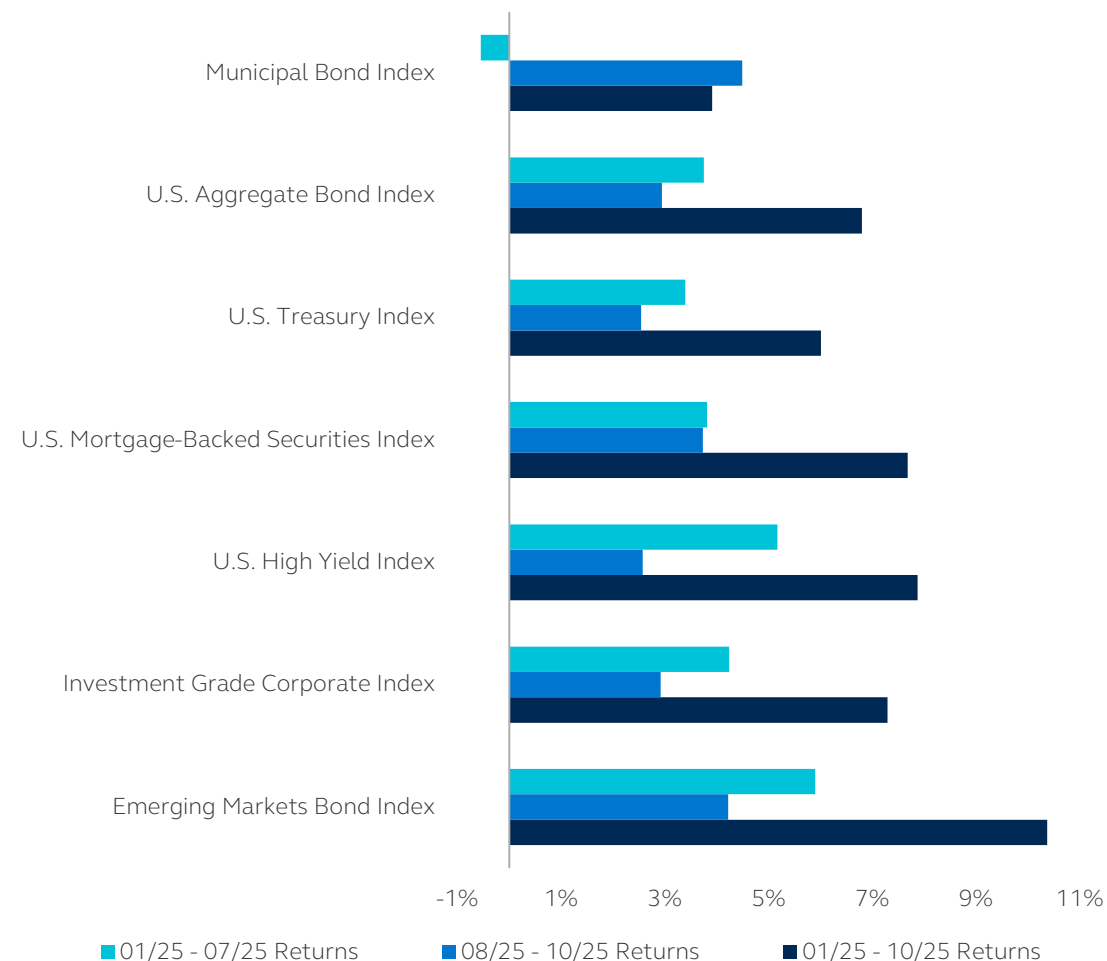
Municipal Bond Portfolio Manager

The first seven months of 2025 were not kind to the municipal bond market – Munis were the only major fixed income asset class with negative total return through the end of July. The incoming administration brought with them a host of policy concerns that had yet to be addressed, which left investors questioning the future status of tax exemption. On top of this, issuance at record levels was flooding an already stressed market. Fortunately, tax risk concerns have been laid to rest and investor appetite for municipal bonds has reemerged.

Since July, the dislocation in returns has reversed as the relative value municipal bonds presented could no longer be overlooked. Muni to treasury ratios remain attractive across the curve, but especially at the long end where they're currently hovering around 89%.

The underperformance of the first seven months of the year has now been followed by outperformance, but there's still plenty of room for continued gains.

Municipal bond returns have yet to catch up to the broader fixed income market – but they'll get there



Principal Fixed Income: A leading global fixed income platform

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Investment Strategy Group

The creation of the fixed income outlook is a collaborative effort led by the Principal Fixed Income Investment Strategy Group. The Investment Strategy Group comprises the senior-most investment professionals across the platform. It is responsible for identifying the key macroeconomic factors that are most likely to drive investment performance across global fixed income markets. Output from the Investment Strategy Group is formalized through Principal's proprietary Macro Risk Outlook framework and informs investment processes across the platform, acting as a top-down complement to the platform's bottom-up fundamental research capability.

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Investment Grade Credit Portfolio Manager



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