Principal Fixed Income

Principal Asset Management℠

FOURTH QUARTER 2025

Fixed income perspectives

Identifying opportunities in a shifting policy landscape

Introduction

As we enter the final quarter of 2025, the fixed income landscape is shaped by slowing economic growth and the Federal Reserve's anticipated rate cuts. With inflation running above target, the Fed faces a delicate balance between price pressures and a weakening labor market, which is expected to lead to additional measured rate cuts. This macroeconomic backdrop suggests that returns could more closely align with the asset class's long-term averages, particularly for higher-quality segments like investment grade and securitized credit, which are more sensitive to interest rate shifts.

Policy volatility: Navigating geopolitical and economic challenges

Markets are contending with persistent inflation and a slowing U.S. labor market. The resumption of the Fed's easing cycle amid elevated inflation rooted in tariff impacts and geopolitical tensions will likely introduce volatility as investors seek clarity. The ongoing potential for a one-off, or possibly extended, inflation shock tied to tariffs adds another layer of complexity. At the same time, the stagflationary tilt persists, contributing to a steepening yield curve.

What's inside

Credit fundamentals: Resilience amidst market dynamics

Investor focus should remain on the underlying economic conditions, but also on strong technicals and robust credit fundamentals within the fixed-income market. While slow growth may not equate to recession and stubborn inflation may yet be contained, the impact of headline risks and trade sensitivities could lead to significant sector dispersion. In this context, active issuer selection and credit discipline become increasingly vital for navigating the complexities of the current environment.

Valuations: Further compression may be limited, but opportunities exist

Given the tightening of spreads following spring's volatility, further compression may be limited. Nevertheless, emerging markets, securitized assets, and private credit continue to offer compelling risk-adjusted opportunities for long-term investors. In this dynamic market, active management will be essential for uncovering value and successfully navigating the ongoing volatility.

Perspectives from the CIO

MICHAEL GOOSAY
Chief Investment Officer,
Fixed Income

The fixed income market in late 2025 is at a crossroads: economic conditions are shifting, inflation remains stubbornly elevated, and geopolitics are redrawing the map for capital flows. For investors, these dynamics create challenges, but also distinctive opportunities for those with the breadth, discipline, and research depth to navigate them.

Economic uncertainty and late-cycle divergence

Federal Reserve rate cuts continue to anchor the near-term outlook, but this late-cycle environment does not resemble past playbooks. Historically, deteriorating growth pushes investors toward the highest-quality bonds. This time, however, the labor market remains resilient, and lower-quality sectors have yet to suffer the typical late-cycle fallout. This divergence underscores the value of rigorous security selection: finding mispriced opportunities in credit while maintaining discipline on risk.

Inflation and labor market dynamics

Inflation remains central to the investment debate. Years of unprecedented stimulus from COVID-era relief to the Inflation Reduction Act have reshaped leverage and capital allocation in ways that make inflation stickier than in prior cycles.

Against that backdrop, with the labor market softening but not collapsing, investors face an environment in which long-term yields may adjust as growth moderates. This supports extending duration in select areas that offer compelling yields. Our approach is not simply to lengthen portfolios, but to align duration with sectors where we see durable fundamentals and supportive technicals.

De-globalization and capital flows

Perhaps the most underappreciated force shaping markets is de-globalization. As supply chains localize and trade barriers rise, capital is being redirected inward. This has profound implications for fixed income markets: liquidity patterns are shifting, and the cost of capital is being redefined.

Principal's global platform is uniquely positioned to evaluate these changes. Drawing on expertise across developed and emerging markets, we can identify where localized capital flows create dislocations and turn them into opportunities. Whether in corporates, securitized assets, or sovereign debt, our ability to navigate these structural shifts is a key differentiator.

Looking ahead

The outlook is not defined by a single theme, but by the intersection of cyclical challenges and structural change—rate cuts, inflation, labor market transitions, and de-globalization. At Principal Fixed Income, we see this complexity as an opportunity to differentiate: leveraging our global reach, sector expertise, and disciplined research process to uncover value where others see only risk.

As always, our goal with Fixed Income Perspectives is to share our outlook for the quarter ahead and foster a dialogue. We welcome feedback, questions, and engagement as we navigate this environment together.

Summary of investment implications

INVESTMENT GRADE CREDIT

Investment grade (IG) credit is well-positioned, supported by solid fundamentals, healthy demand, and a favorable macro environment despite slower growth. Lower net issuance has created scarcity, bolstering demand for spread products. While financials remain a high-conviction overweight due to favorable valuations and strong capital, consumer-linked credits face challenges. The steepening U.S. Treasury curve has shifted focus to the 5–10-year segment, offering attractive risk-adjusted opportunities. Overall, IG credit remains resilient, allowing active managers to leverage bottom-up credit selection and sector differentiation effectively.

HIGH YIELD CREDIT

Strong technicals and stable issuer fundamentals continue to underpin high yield markets. Since mid-April, $14.8 billion in inflows have met limited new issuance, as companies extend maturities and reinforce balance sheets. Although leverage is elevated, interest coverage ratios remain stable. Opportunities remain in rate-sensitive sectors such as capital goods and building materials, though consumer-focused sectors warrant caution. Interestingly, spreads have tracked equities more closely than usual, and valuations are no longer cheap. As such, selective credit analysis remains critical to identifying value and sustaining returns heading into Q4.

STRUCTURED CREDIT

Securitized markets remain solid ground. U.S. MBS markets face rising prepayments and potential GSE demand, while credit segments like ABS, CMBS, and RMBS show mixed fundamentals. Fed rate cuts are accelerating prepayments, with roughly a quarter of the mortgage index poised to refinance. Consumer credit shows divergence, with middle- and upper-income households remaining resilient while lower-income borrowers begin to struggle. CMBS refinancing challenges are keeping valuations subdued. Quality in the sector remains key: AAA-rated CMBS and non-consumer ABS offer compelling relative value. Despite heavy issuance, demand continues to outpace supply, reinforcing the importance of active management.

MUNICIPALS

Municipal bonds enter late 2025 from a stronger position, supported by improved technicals, normalized valuations, and steady demand from both institutional and retail investors. Earlier headwinds, including tax exemption concerns and record issuance, have eased, allowing valuations to reset attractively. Elevated absolute yields, especially on a tax-equivalent basis, have attracted nontraditional buyers. The steeper municipal yield curve offers opportunities in intermediate- and long-maturities bonds for both income and total return. With stable credit fundamentals and solid liquidity, municipals are well-positioned to deliver tax-advantaged income and stability heading into 2026.

EMERGING MARKET DEBT

Emerging market debt continues to build momentum, supported by resilient fundamentals, easing inflation, and policy divergence from developed markets. Capital flows remain steady across both local- and hard-currency debt, though tighter valuations and geopolitical risks underscore the need for selectivity. Many EM economies have weathered trade tensions well, enabling central banks to ease ahead of the Fed. Hard-currency spreads are near post-GFC lows, and upcoming political shifts in Latin America may improve credit quality. However, delayed Fed easing or renewed geopolitical stress remain risks, reinforcing the value of careful credit selection and diversification.

PRIVATE CREDIT

Private credit ends the year with strong momentum, supported by resilient fundamentals, attractive yields, and expanding roles for nonbank lenders. Borrower and investor demand remains robust, particularly in direct lending and investment-grade private placements. Middle-market borrowers continue to rely on private financing as banks tighten standards, creating opportunities in essential businesses, digitization and infrastructure. Investment-grade private placements offer yield and covenant protections, with activity resuming across issuers. As nonbank lenders gain market share, private credit is poised for sustained growth, making it a valuable addition to diversified fixed income portfolios.

Macro

U.S. outlook

It's been forty-plus years since the Fed's dual mandate components, labor and inflation, have been at odds. Today, however, the Fed is forced to choose between above-target inflation and the weakening labor market. With the shift in the balance of risks, the Fed delivered the first of what we believe will be a series of measured rate cuts at its September meeting.

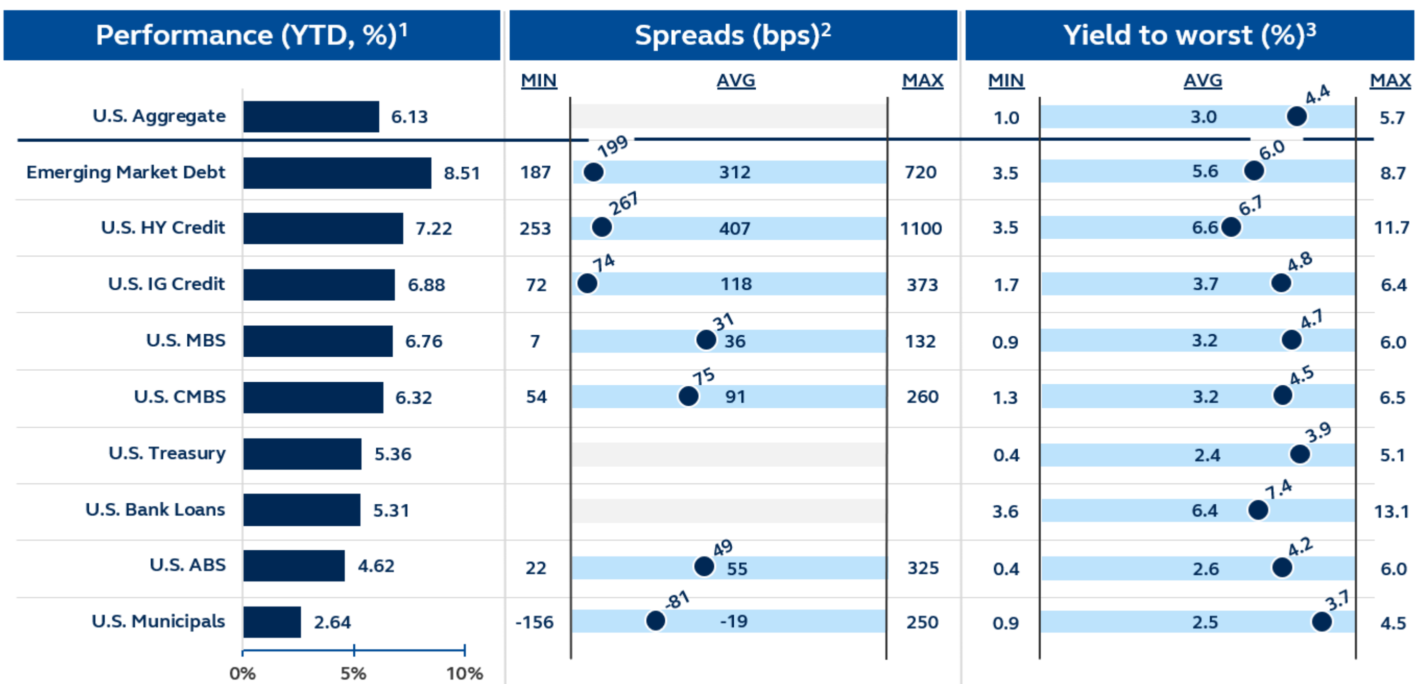
The labor market has suffered a sharp slowdown in demand/hiring. The three-month average of nonfarm payrolls entered the year above +200k workers per month but has slowed to just +29k in the three months through August. Concurrently, the labor supply is also declining precipitously due to tighter immigration policy. The simultaneous decline in supply and demand has led to a labor market that we categorize as being in a delicate balance. Thanks to slowing supply, the unemployment rate is only creeping higher. However, the other implication of slow job growth is slow potential growth for the overall economy, absent a productivity boom.

Regarding inflation, progress in core PCE has stalled, and the full impact of tariffs has yet to be seen. The Fed believes importers intend to pass more of the tariff burden to consumers over time, suggesting that core PCE will continue to march higher. We expect that the Fed's preferred metric, year-on-year core PCE, will peak around 3.25-3.50% in the first half of 2026 before receding.

As long as an increase in inflation appears to be limited to the goods sector due to tariffs, and inflation expectations remain relatively anchored, the Fed will likely look through discomforting price pressures and provide stimulus if the jobs data remains weak. There is also the possibility that the recent lull in the jobs market proves temporary, and that the data will be more sanguine in the coming months/quarters. However, our base case is that a soft labor market keeps the Fed on a gradual path of lower rates through early 2026.

Market environment

Year-to-date performance, spread, and yield for various fixed income indices



[1] Total returns for representative indices. [2] Spread to Treasury. Min, max, and average based on last 10 years. [3] Index yield to worst. Min, max, and average based on last 10 years. Weighted average yield-to-maturity reflected for U.S. Bank Loans. Indices are unmanaged and do not take into account fees, expenses, and transaction costs, and it is not possible to invest in an index.

Source: Bloomberg, Principal Asset Management. Data are as of September 30, 2025.

U.S. outlook continued

Consumer spending has held on remarkably well to date, even as the labor market has slowed, and the overall consumer balance sheet appears to be on solid ground. However, there is significant bifurcation—the higher-end consumer has benefited significantly from the wealth effect of ever-higher stock prices. Wage growth continues to outpace inflation, leading to real wage gains across the income spectrum.

Resilient consumer spending has powered solid growth across the economy. Final sales to private domestic purchasers are down a bit, at +1.9% quarter-over-quarter in June, but still respectable and show no significant sign of recession risk. Profit margins are near an all-time high, driven in part by the Magnificent 7. Corporate fundamentals, while arguably past peak, remain strong.

While valuations are challenging across almost every asset class, fixed income yields are extremely attractive relative to equity dividend yields. The tailwind of Fed rate cuts combined with solid fundamentals and strong technicals supports tight valuations, and we continue to embrace a risk-on posture.

Global outlook

The global macroeconomic landscape is undergoing significant changes as we approach the final quarter of 2025. A shift in monetary policy, emerging geopolitical risks, and an underappreciated recovery in Europe are reshaping investment strategies. While the outlook for risk assets is generally positive, complacency about geopolitical risks could expose investors to vulnerabilities.

Divergent monetary policies

This quarter's key development is the reversal of global monetary policy dynamics. Over the next two to three quarters, the Federal Reserve is anticipated to cut interest rates by 100 basis points, contrasting sharply with the rest of the world, where easing may be limited to about 20 basis points.

This divergence will impact interest rate differentials, yield curves, and capital flows. While U.S. rate cuts may support global risk assets, the slower pace of easing in other developed markets could result in a varied steepness of global yield curves versus the U.S. Additionally, this policy divergence is expected to exert downward pressure on the U.S. dollar.

Europe's fiscal expansion versus U.S. fiscal restraint

Some trends continue to exert considerable influence on the global landscape. One is the eurozone's increasing resilience. Germany's fiscal expansion, particularly in defense-related infrastructure, yields a higher-than-expected growth multiplier, supporting broader momentum—even in politically fragile markets like France. Conversely, the U.S. is entering a phase of relative fiscal restraint. Although hardly contractionary, U.S. policy is bounded by high base effects and appears more redistributionary than outright expansionary. The U.S. government shutdown adds uncertainty and likely downside risks to growth.

Underappreciated geopolitical risks

Another significant factor is rising geopolitical tensions, particularly in the Middle East. While attention is focused on immediate headlines, the implications for capital markets are profound. Gulf nations are evolving from energy exporters to influential financial centers. Beyond the traditional impact from energy markets, the Middle East will seek new security partners to diversify reliance on the U.S. This would have longer-term implications that may not be immediately apparent.

Emerging markets may benefit from ongoing portfolio allocations amidst Fed easing, but idiosyncratic risks are emerging for specific countries, such as Indonesia. China is seeing signs of stabilization, particularly in manufacturing, as it gradually emerges from real estate-led doldrums.

The path ahead

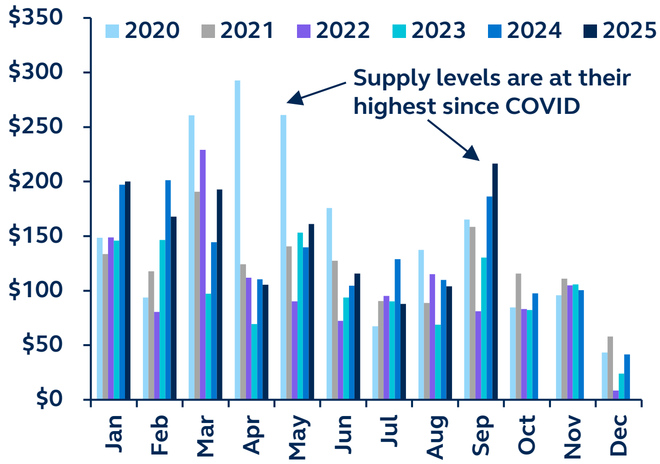
The global outlook remains broadly supportive, but the path forward is increasingly complex and less synchronized than in recent years. As monetary policy, growth, and geopolitical risks diverge, maintaining agility across regions and asset classes will be crucial to improving risk-adjusted returns.

Investment grade credit

Supportive technicals, strong fundamentals, and a favorable macro backdrop keep IG well-positioned

Investment grade (IG) credit continues to show constructive momentum. Technical conditions remain supportive, fundamentals are solid, and the macro environment, although characterized by slower growth, is historically favorable to high-quality credit. Net issuance remains slightly lower despite nearly $1.4 trillion in gross supply year-to-date. Coupon income and maturities are generating reinvestment needs that exceed new issuance, creating a rare environment of scarcity. This imbalance has provided a durable bid for spread products. As issuers secure long-term funding at attractive yields, strong investor demand has squarely met that supply, keeping spreads hovering in a tighter range.

Investment grade monthly supply
$Billions, 2020–2025 YTD



Source: Bloomberg, Principal Asset Management. Data as of September 30, 2025.

The Fed's resumption of its easing cycle aligns with a moderating growth trajectory. Importantly, this slowdown is not recessionary. Historically, such periods have been constructive for IG, as investors are rewarded for carry and quality while avoiding the downside risks typically associated with contraction. The decline in policy rates reinforces the asset class's role as a portfolio ballast.

Sector trends favor financials; caution warranted in consumer-linked credits

Financials remain a high conviction overweight. U.S. banks trade at wider spreads than their industrial peers and, beyond good valuations, they boast strong capital, liquidity, and asset quality. Incremental regulatory relief, particularly adjustments to supplementary leverage ratio requirements, is helping to reduce issuance needs and onerous costs without compromising bondholder protections, adding to the banking sector's appeal.

Not all sectors have the same tailwinds as financials. In contrast, consumer-linked credits confront headwinds. Retailers pursuing debt-financed M&A face deteriorating credit metrics, while food and beverage companies continue to contend with tariff-related margin compression. Both sectors exhibit higher event risk and, as such, warrant underweight positioning in portfolios.

Curve dynamics create opportunity in the belly

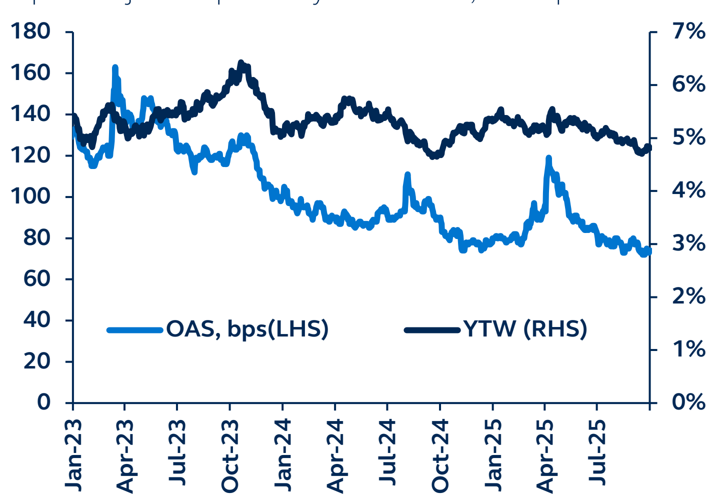
The steepening of the U.S. Treasury curve has catalyzed a shift in investor behavior, with many buyers extending duration and moving from short-dated positions into the 5–10-year part of the curve. With the 10s–30s portion of the curve unusually flat, the belly currently offers the most favorable risk-adjusted opportunities.

Potential long-end opportunities may arise from anticipated M&A activity, estimated at $73 billion for 2026, which could lead to increased supply. For now, however, credit selection in the belly of the curve clearly remains the most attractive position for investors seeking yield and roll-down potential.

Navigating with conviction and selectivity

Investment grade credit continues to deliver through resilience and remains a compelling asset class and portfolio anchor. With strong technicals, sound fundamentals, and a supportive macro backdrop that rewards quality, the market offers opportunities for active managers to differentiate through bottom-up credit selection. In an environment of moderate growth and declining policy rates, active investors can add value through sector differentiation, selective curve positioning, and disciplined, bottom-up credit selection.

U.S. Corporate Investment-grade Index spread and yield
Option adjusted spread & yield to worst, 2023–present



Source: Bloomberg, Principal Asset Management. Data as of September 30, 2025.

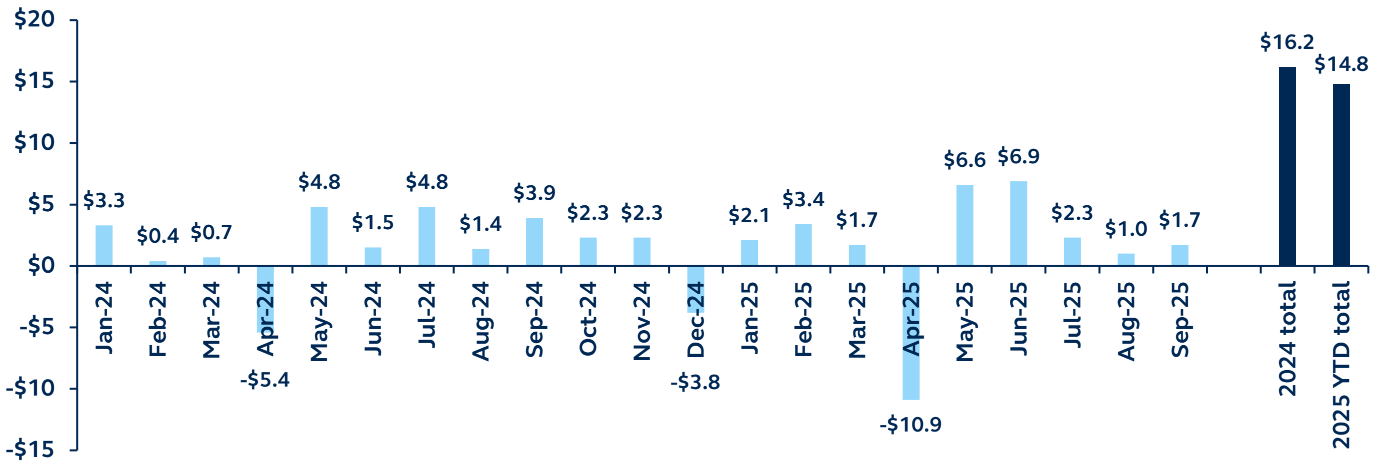
High yield

Strong technicals and refinancing-led issuance support a constructive outlook

Robust technicals, strong demand, and solid issuer fundamentals underpin the high yield credit market. Inflows have accelerated since mid-April, with mutual fund flows totaling $14.8 billion entering the fourth quarter, following $16.2 billion in total during 2024. While institutional interest is also rising alongside gross issuance, refinancings have driven limited net new issuance. That supply dynamic has kept the market tight, with investors competing for fewer bonds as companies use the opportunity to strengthen their balance sheets.

High yield monthly fund flows

$Billions, January 2024–present



Source: J. P. Morgan, Lipper FMI, Principal Fixed Income. Data as of September 30, 2025.

Overall, issuers have capitalized on the Fed's renewed easing cycle to extend maturities into 2030 and beyond and reduce near-term refinancing risk. Despite somewhat elevated leverage, this is a more supportive environment than in past cycles, as interest coverage ratios remain stable. The dip in index yields below the psychologically important 7% yield threshold underscores both market appetite and fundamental resilience heading into 2026.

Sector positioning: Balance opportunity and risk

Opportunities in high yield are most compelling in rate-sensitive sectors that benefit from lower rates and resilient consumer spending. Capital goods and building materials, particularly those tied to home construction, are well-positioned, with some issuers also seeing upside from M&A activity.

At the same time, pockets of caution remain. Retail and consumer products issuers face margin pressures from elevated input costs, i.e., tariffs, and uneven pricing power. Big-box retailers have struggled to pass through higher tariff-related costs, raising concerns about credit quality. Within energy, preferences have rotated up in quality: exiting higher-beta exploration and oil field services credits in favor of more stable midstream credits as oil prices stabilize.

Macro sensitivity remains elevated, but spreads reflect a stronger footing

High yield has historically shown limited correlation with interest rates, but 2025 has been different. Spreads have tracked more closely with equities and Treasurys as investors price further Fed cuts. Compared with the 2002–2008 period, when spreads remained tight despite weaker credit profiles, today's HY market is on a stronger footing. Companies have adapted to tariff pressures and adjusted cost structures, leaving the sector better prepared for a slower, but still expanding, economy.

Disciplined positioning amid tight spreads

High-yield valuations are no longer cheap, but value exists through idiosyncratic credit selection. With spread levels likely to remain contained and refinancing trends dominant, future returns will likely be driven more by issuer differentiation than by broader market trends, all favoring active management. Investors should be prepared for incremental duration extension in new issuance but should continue to anchor exposure to shorter- to intermediate-duration and higher-quality credits. Looking ahead, high yield continues to offer a favorable risk-adjusted premium, but taking advantage of that will require managers willing and able to do the fundamental work.

Structured credit

A firm footing with divergent narratives

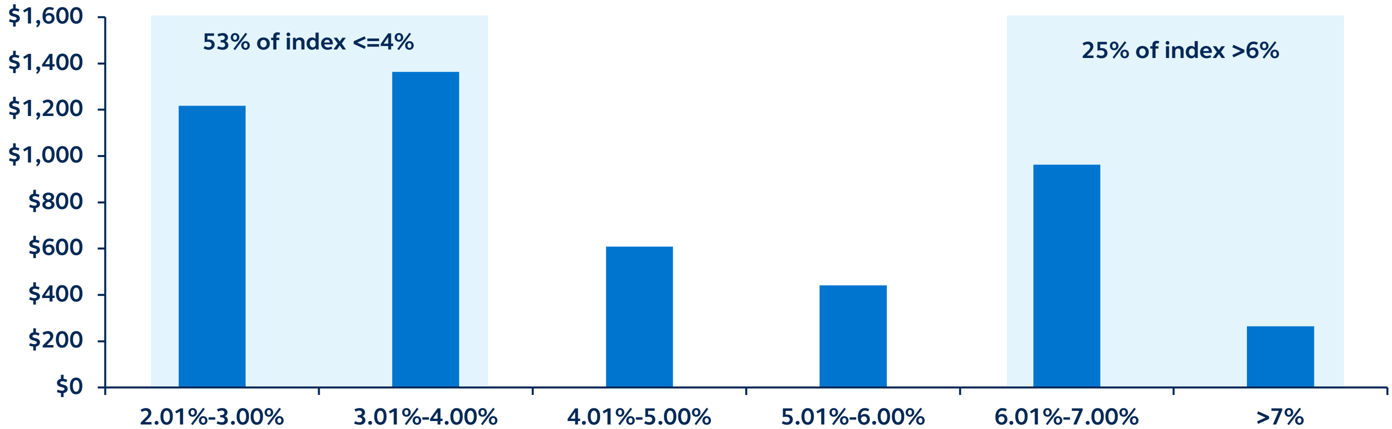
Securitized markets remain on solid ground, though narratives diverge across subsectors. U.S. Agency MBS markets are defined by rising prepayments and the potential return of demand from Government-Sponsored Enterprises (GSE), while credit segments, including asset-backed securities (ABS), commercial mortgage-backed securities (CMBS), and residential mortgage-backed securities (RMBS), face mixed fundamentals but remain supported by technicals and selective value.

Agency dynamics: Prepayments and GSE demand

With the Fed's rate-cutting cycle underway, prepayments are accelerating as more mortgages become "in the money." If rates decline further, roughly a quarter of the mortgage index—primarily 2023–2025 vintages—could refinance. That refinancing wave would reshape cash flows and valuations across agency pools.

Conventional 30-year Mortgage Index by borrower rate

$Millions, Bloomberg U.S. MBS Index



Source: Bloomberg, Principal Fixed Income. Data as of September 15, 2025.

Meanwhile, GSE reforms could bring Fannie and Freddie back as portfolio buyers, adding demand to a market with low net supply. Asset managers and REITs have absorbed issuance so far, but renewed bank or GSE participation would be a meaningful tailwind for the sector.

Consumer fundamentals: Divergence by income tier

Consumer credit remains bifurcated. While middle- and upper-income households show resilience, lower-income borrowers face mounting strain from higher prices and a softer labor market. Additionally, subprime auto delinquencies are near pandemic and GFC peaks, signaling a growing strain among vulnerable borrowers.

Refinancing in CMBS remains challenging. Loan modifications and maturity extensions are common as borrowers contend with elevated capital costs. While lower rates provide some relief, organic net operating income growth has been insufficient to address capital challenges, keeping valuations under pressure.

Positioning favors quality and relative value

Curve dynamics are playing a key role in sector positioning. A modest steepening bias supports near-par agency coupons and short-dated ABS. At the same time, RMBS and jumbo mortgage pools—particularly recent vintages with larger balances—are more sensitive to refinancing and thus offer selective upside.

On the credit side, higher quality is preferred. AAA-rated single-asset, single-borrower CMBS and certain CLOs can deliver attractive carry relative to similarly-rated IG corporates. In ABS, non-consumer sectors, like equipment or commercial deals, stand out as defensive positions.

Technical support remains intact despite record issuance

Securitized markets, including ABS, CLOs, and CMBS, have seen heavy issuance in 2025, yet demand has consistently outpaced supply. New deals have been consistently oversubscribed, supported by inflows into total return strategies and dedicated securitized mandates. While agency MBS technicals are more balanced, they could strengthen further if GSE or bank demand materializes.

Securitized products across agencies and credit segments remain well supported by technicals and selective opportunities. The asset class offers relative value, particularly in less index-represented areas where collateral and structural features create yield premiums. Active management, focused on quality and curve-aware positioning, is essential to navigating today's crosscurrents.

Municipal bonds

Normalized valuations, improving technicals, and healthy demand

Municipal bonds are in a much stronger position than they were earlier in the year. Policy uncertainty has receded, supply pressures are easing, and demand has broadened across both institutional and retail channels. The asset class now benefits from healthier technicals, normalized valuations, and a renewed role as an income-rich, defensive allocation heading into 2026.

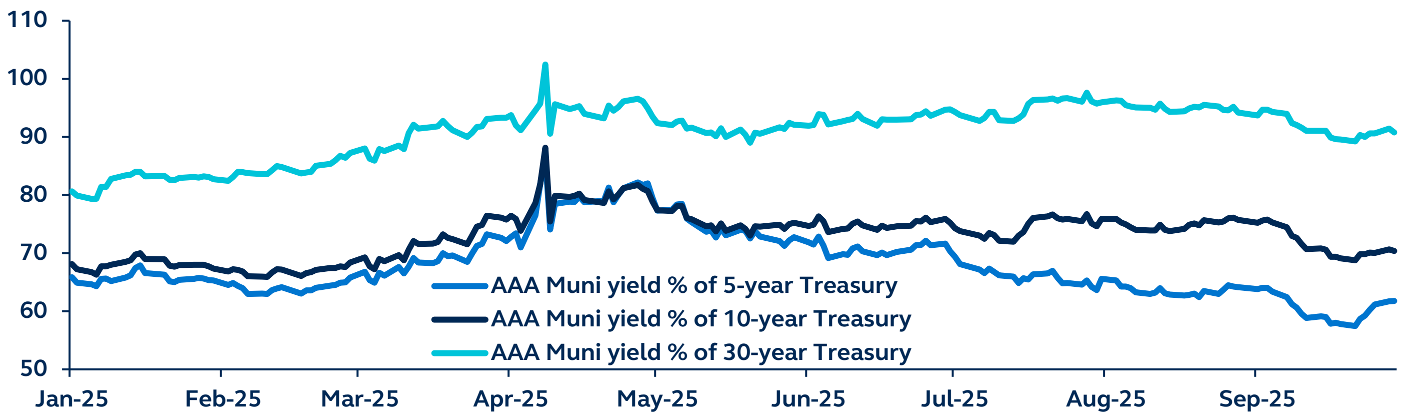
From headwinds to tailwinds

Earlier headwinds—concerns over the loss of tax exemption, record issuance, and delayed Fed cuts—have subsided. While supply remains elevated, it is moderating, and with policy risk off the table, valuations have reset to more attractive levels. Overall, the market's technical position has meaningfully improved, and demand has increased across investor types.

Absolute yields remain elevated, and on a tax-equivalent basis, municipals offer some of the most attractive income opportunities across fixed income. These yields have drawn nontraditional buyers back into the market, including insurance companies and LDI-driven investors, adding to the retail base already searching for tax-advantaged income.

Municipal to Treasury ratios

AAA municipal bond yields relative to Treasurys, year-to-date



Source: Bloomberg, Principal Asset Management. Data as of September 30, 2025.

Curve steepness: Roll-down and total return potential

The municipal yield curve has steepened significantly, particularly versus the flatter taxable curve. Front-end yields have declined with Fed cuts, while long-term rates remain elevated following heavy issuance. This dynamic creates opportunities for both income and roll-down-driven total return, making intermediate- and long-maturities especially attractive.

Credit fundamentals are broadly stable

Municipal credit remains on a solid footing. Many states are operating with tax revenues above forecasts, rainy day funds are well capitalized, and sector-level risks are limited. Infrastructure-related issuance, including airports, toll roads, and transportation, has increased supply and created attractive entry points for long-term investors. Selectivity remains key: transparency gaps and speculative projects, such as those reliant on now-defunct tax incentives, warrant caution. A growing subset of corporate-style municipal issuance, such as bonds tied to hospitals, airports, or utilities, is also attracting attention. These securities combine higher yields and familiar revenue-backed structures with the tax advantages of traditional munis. Their corporate-like credit profiles broaden the investor base to include crossover buyers, while covenants and revenue pledges often provide stronger protections than more opaque municipal structures.

Technicals and liquidity also improved

Liquidity remains robust, with elevated trade counts and volumes supporting efficient execution across the quality spectrum. The technical backdrop has improved significantly, and with demand strong from both retail and institutions, supply is being absorbed without significant spread pressure.

Tailwinds from both ends of the buyer base

Municipals are transitioning from a market defined by policy and supply risk to one offering a more balanced, income-rich environment. With valuations normalized, technicals improving, and demand broadening, the asset class is well positioned to deliver tax-advantaged income and stable total return into 2026. Risks remain, particularly the possibility of stickier inflation delaying Fed easing, but municipals now present one of the most constructive setups in recent years.

Emerging market debt

A constructive view that demands selectivity

Although it's been a year of surprises in emerging market (EM) debt, primarily Liberation Day and the post-Liberation Day rebound, EM heads into Q4 with solid momentum, supported by resilient macro fundamentals, easing inflation, and a growing policy divergence from developed markets. While capital continues to flow into both local and hard currency debt, tighter valuations and geopolitical uncertainty underscore the importance of selectivity.

Inflation relief and policy flexibility

Despite trade tensions, EM economies have generally held up well. For many, the limited impact of U.S. tariffs, local currency strength, and disinflationary pressures in food and energy prices allowed EM central banks to ease ahead of the Fed. Capital has followed, particularly into local-currency markets, where nominal and real yields remain attractive relative to developed-market peers.

Tight spreads, favorable fundamentals, and lingering tariff uncertainty underscore selectivity

Hard currency spreads have compressed to near post-GFC lows, reflecting benign fundamentals and manageable new supply. While yields remain compelling, the easy gains are largely in the rearview mirror.

A likely swing to the right in upcoming Latin American elections should improve credit quality across the region. In Asia, large domestic markets such as India and Indonesia offer insulation from external shocks, while Korea and Taiwan benefit from a stabilizing tech cycle. The weaker U.S. dollar also supports local currency debt in Taiwan, Malaysia, Hong Kong, and Singapore.

Sector and country opportunities

With tighter valuations, credit selection is increasingly important in corporate opportunities and domestic cyclicals, where lower rates and firmer currencies improve credit profiles. More broadly, improving fundamentals and rate convergence may prompt global investors to reduce underweights and move toward neutral EM allocations.

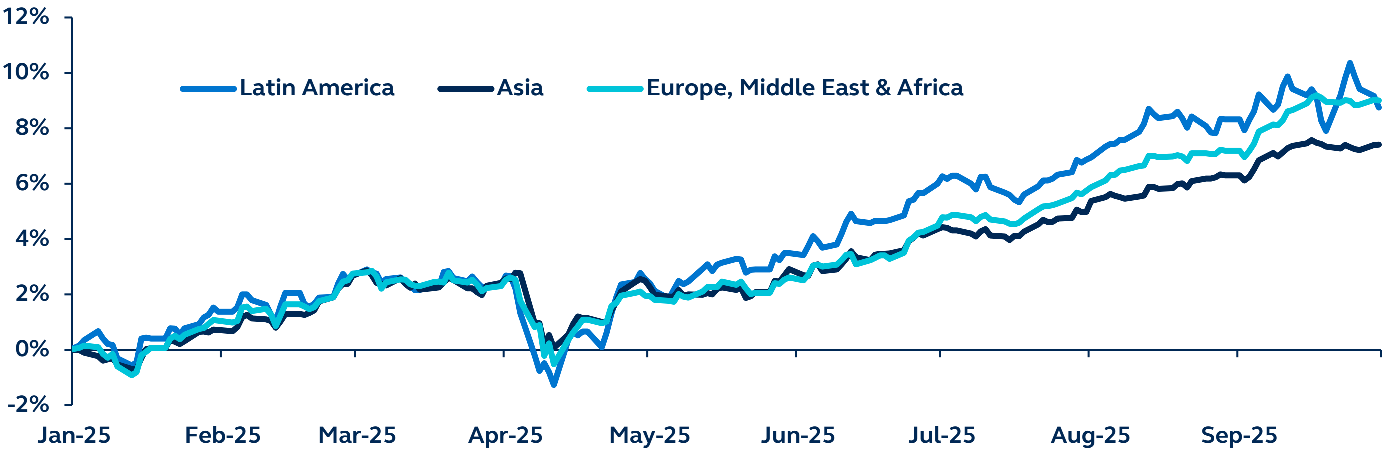
Geopolitics and the U.S. policy trajectory are risks

While the outlook is constructive, risks remain. A delay in additional Fed easing, an upward surprise in U.S. inflation, or further deterioration in U.S.–China relations could undermine the current tailwinds. Additionally, political volatility in select EM countries and external shocks—such as sharp commodity price swings—may challenge recent stability.

Still, fundamentals across much of the EM universe are stronger than in previous cycles, and institutional credibility continues to improve. With greater monetary autonomy, stronger current accounts, and increasing domestic demand, EM debt offers compelling relative value—especially for active managers able to differentiate across countries, sectors, and capital structures.

Year-to-date performance for select emerging markets

Rebased to 0 at December 31, 2024



Source: Bloomberg, Principal Fixed Income. Data as of September 30, 2025.

Private credit

Middle market resilience and broad demand support private credit's momentum into 2026

Steady tailwinds, anchored by resilient fundamentals, attractive yields, and the growing role of nonbank lenders in global credit markets, all provide tailwinds in the private credit space. Demand remains robust from both borrowers and investors, with direct lending and investment-grade private placements each offering compelling opportunities as disintermediation and structural change reshape the landscape.

Direct lending: Durable borrowers in essential sectors

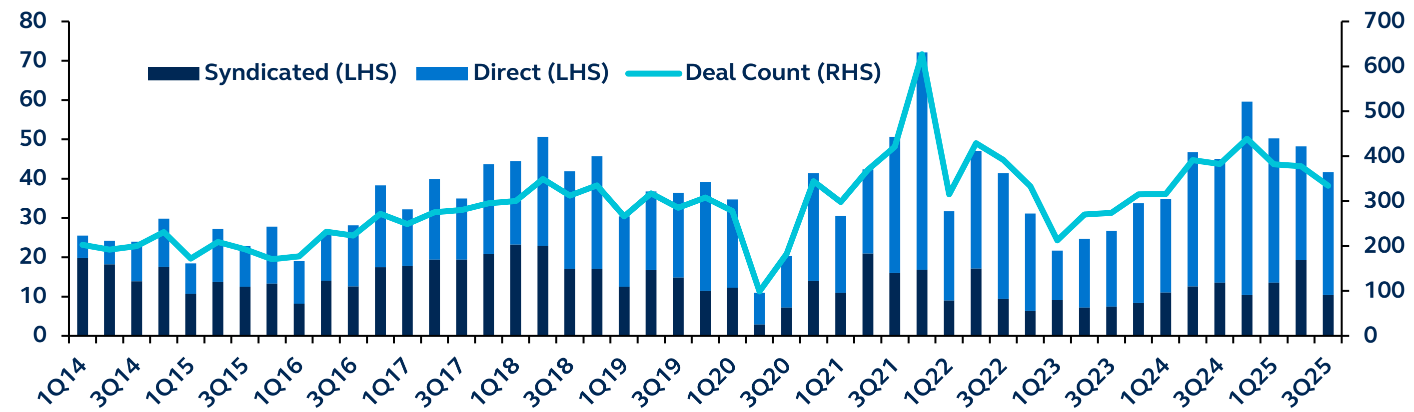
The middle market continues to be a powerful engine for private credit, with direct lending strategies benefiting from a favorable demand-supply dynamic. Many borrowers still face tight lending conditions from traditional banks, leading them to rely more on private lenders to finance growth, recapitalizations, and ownership transitions.

Credit selection remains critical, and the focus is on companies with stable cash flows, strong service footprints, and low sensitivity to economic cycles. "Everyday essential" businesses, such as HVAC, healthcare services, auto repair, and legal/accounting firms, are favored, where customer stickiness and recurring demand support long-term credit stability.

Secular themes are widening the opportunity set. Private lenders increasingly finance businesses tied to digitization, electrification, and infrastructure optimization. Loans to software providers, grid management firms, and 5G infrastructure operators are smaller and targeted, but often deliver compelling risk-adjusted returns. Most structures remain floating rate, which has bolstered income in a higher-rate environment. As policy rates move lower, debt service burdens should ease further, supporting credit stability and new issuance.

Sponsored middle market loan volume and deal count

$ billions, 1Q14–present



Source: LSEG, Principal Asset Management. Data as of September 30, 2025.

Investment-grade private placements: Yield, covenants, and customization

On the higher-quality end of the spectrum, investment-grade (IG) private placements remain a core allocation for institutions seeking incremental return and covenant protections. Although deal flow slowed slightly earlier this year, activity has resumed across both traditional and asset-backed issuers, with strong investor appetite for bespoke, long-dated capital solutions.

We continue to find value in transactions backed by real assets or operating cash flows, particularly in sectors like structured finance, digital infrastructure, and asset management. Opportunities in NAV-based lending and fiber build-outs are especially attractive, offering above-market spreads with downside protections.

Despite common concerns about illiquidity, IG private credit has historically delivered better downside protection and lower volatility than comparable public bonds. With continued demand from issuers seeking customized capital and from investors pursuing stable, excess yield, private placements should remain a strategic allocation in diversified fixed income portfolios.

Positioned for persistent growth

Private credit continues to benefit from both cyclical tailwinds and structural shifts. As capital markets evolve and nonbank lenders take a greater share of traditional financing channels, direct lending and IG private placements will likely remain key pillars of investor portfolios. Selectivity remains paramount, but the combination of yield, structure, and access continues to make private credit a compelling complement to public markets today.

Forward-looking sector views

	Underweight		Neutral	Overweight	
	——	—	=	+	++
Investment grade					
U.S. agency MBS	○	○	○	●	○
CMBS	○	○	○	●	○
ABS	○	○	●	○	○
Mortgage credit	○	○	●	○	○
U.S. credit	○	○	○	●	○
European credit	○	○	● ←	○	○
Asia credit	○	○	●	○	○
Municipals	○	○	●	○	○
High yield					
U.S. credit	○	○	○ →	●	○
U.S. bank loans	○	○	●	○	○
European credit	○	○	●	○	○
Asia credit	○	○	●	○	○
Emerging market debt					
Hard currency	○	○	○ →	●	○
Local currency	○	○	●	○	○
Corporates	○	○	○ →	●	○
Alternatives					
Direct lending	○	○	○	●	○
Investment grade private credit	○	○	○	●	○

As of September 30, 2025. The above views reflect the relative value of the sectors shown based on forward-looking return expectations over the next 12 months. Arrows represent the quarter-over-quarter change in forward-looking views.

Conclusion

The fixed income landscape continues to evolve amid shifting monetary policy, persistent geopolitical risks, and an increasingly bifurcated global economy. While valuations have adjusted and central banks begin to ease, dispersion remains a defining feature across regions, sectors, and credit tiers. Against this backdrop, elevated all-in yields, improving technicals, and durable fundamentals continue to offer attractive opportunities for long-term investors. In our view, active management and disciplined sector allocation will remain critical to identifying relative value, managing risk, and positioning portfolios for a more normalized—but still uncertain—investment environment in Q4 and beyond.

Principal Fixed Income: A leading global fixed income platform

Principal Fixed Income is the fixed income investment management platform of Principal Asset Management and manages U.S. $150.7 billion in assets under management as of June 30, 2025. Principal Fixed Income has capabilities that span all major fixed income sectors. Our globally integrated platform, with investment centers worldwide and over 80 investment professionals, helps investors directly access global fixed income markets and delivers a diversity of investment perspectives. Our structure and proprietary investment tools foster collaboration across sector-specialty teams, whether the sector is explicitly integrated into a portfolio or not. In our view, this diversity of insight helps each sector-specialty team formulate richer investment theses and make better-informed investment decisions on behalf of our clients.

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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