Insurance Quarterly:

Perspectives, challenges, and opportunities

Fourth Quarter | 2020

Highlights

- $14.3 billion in insurance company assets under management[1]
- Nearly three decades of insurance investment experience externally and five decades managing the general account for Principal Life
- 48 insurance company clients place their trust in our investment expertise
- An established global investment manager with $544.9 billion in AUM and more than 800 institutional clients worldwide[1]

Despite a global health catastrophe, 2020 brought record highs to many equity markets, while credit spreads narrowed close to pre-pandemic levels. With a U.S. Presidential election result that should maintain business-friendly policies and vaccine breakthroughs, the end of 2020 marked the beginning of the pandemic's aftermath.

As we move into 2021, global risk assets are on much more solid footing than they were at the beginning of the COVID-19 market crisis. However, the storm hasn't fully passed yet. Another wave of infections is still unfolding across the U.S., Europe, and certain emerging markets (EM). This will almost certainly continue to dampen economic activity, postponing a full recovery until mass vaccination is achieved. Still, expectations of an upcoming end to the pandemic have helped raise investor spirits. Plus, massive policy stimulus continues to lessen the worst of what could have been a major collapse of the world economic order, while also contributing to a developed-market (DM) recovery.

Market Insights

Strong market performance continued through the 4th quarter

Contributor: Seema Shah, Chief Strategist, Principal Global Investors

The United States was a clear outperformer for much of the year, as the mega-cap technology sector benefitted meaningfully from both the "stay-at-home" trade and record low bond yields. A partial role reversal in the winners and losers of 2020 in the fourth quarter was driven by positive vaccine news, alleviating fears that society would have to learn to live with the virus on a more permanent basis and offering the hope of a much quicker return to normal than had been anticipated.

2021: Navigating uncertainty on the path to recovery

- **Vaccine:** There are still many questions surrounding vaccine distribution logistics, from storage to the ability to mass manufacture, to regulatory approval. Thus, the unavoidable link between mobility and virus will linger well into this year, and sectors with high human-to-human contact such as restaurants, hospitality and travel, will continue facing capacity constraints, weighing on the performance of these battered sectors through the first half of 2021.

[1] As of December 31, 2020.

- **Global growth:** While global economic data shows continuing recovery from the COVID-19 shock, and PMIs signalling continued strength, high-frequency indicators suggest that the recovery will likely stall modestly in Q1 2021.
- **Labor market:** Around 60% of jobs lost during the pandemic-driven shutdown in March and April have now been recovered. However, the pace of job growth has slowed significantly, perhaps reflecting the additional negative pressure already inflicted on the U.S. economy by the winter virus wave. On a clear positive note, however, bankruptcies and loan delinquency rates have remained supressed. While they will likely rise slightly in Q1, bankruptcies will remain considerably lower than in previous economic downturns when they have followed unemployment rates higher.
- **Central bank policy and fiscal stimulus:** So far in this crisis, central banks have responded very aggressively, cutting interest rates, introducing forward guidance, balance sheet expansion, and direct funding of corporate assets. While the direct impact of such actions to invigorate economic reflation has been somewhat questionable, central banks have cleared the path for governments to introduce massive fiscal support packages. Quantitative easing has absorbed expansion of government issuance and supressed bond yields, thereby permitting the government to aggressively increase crisis spending without worrying about spiralling debt costs. In both developed and emerging markets, government debt has now doubled since 2008. For developed markets, government debt has hit its highest level since WWII, and in EM it is the highest it has ever been. These extraordinarily easy financial conditions created by central banks have also facilitated and encouraged a build-up of corporate debt.
- **Inflation and continued policy support:** In 2021, while inflation will likely recover, it will not prompt a U-turn from central banks. We expect central banks to remain committed to limiting spill overs, and we do not see a move away from accommodative monetary policy. As a result, the Federal Reserve (Fed), European Central Bank (ECB), the Bank of Japan, and other central banks will continue absorbing significant amounts of sovereign and private debt to mitigate future market stress. While this may not match the atmospheric pace of balance sheet expansion of 2020, continued stimulus will supress borrowing rates and cushion high debt levels.
- **Borrowing rates:** While the build-up of debt leaves the corporate sector more vulnerable to shocks, the continuation of abundant liquidity and low borrowing rates mean that companies that issued substantial amounts of debt in 2020 will remain well-funded through 2021, suggesting diminished risk of a corporate credit-driven meltdown.

Industry Insight

2021…the barbell continues

Contributor: Jack Bishop, Portfolio Manager, General Account, Principal Financial Group

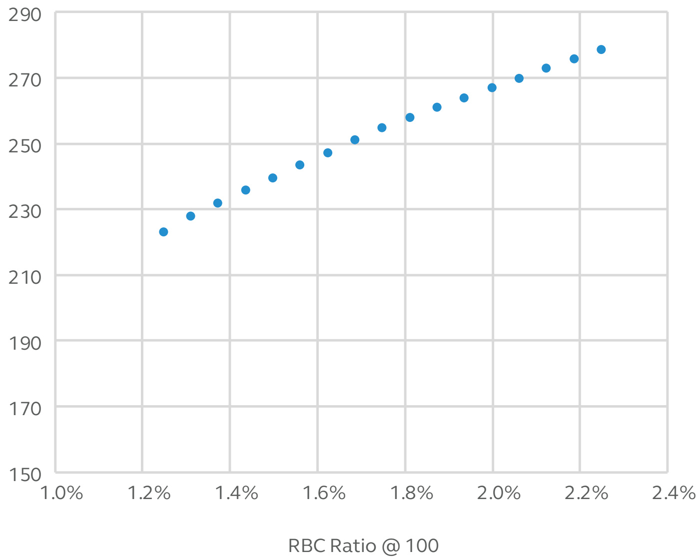
The General Account 2020 can be summarized as a 360° year. What do I mean by that? We started the year worried about late-stage credit concerns and the potential for elevated idiosyncratic risk. Anticipated drift and losses were slightly elevated. Those expectations quickly shifted to a more systemic analysis in February/March, with expectations of 2002-2004 or 2007-2009 scenario comparisons given the potential pandemic impact.

Government program intervention allowed for more aggressive investment aspirations and value hunting in April/May, but large-scale opportunities were primarily found in investment grade (IG) credit. In June/July the portfolio recognized that the opportunity set experienced in the first half of the year (primarily IG corporates) was likely too skewed to overcome in the second half to achieve full year allocation targets. This more than likely is impacting insurers 2021 playbook.

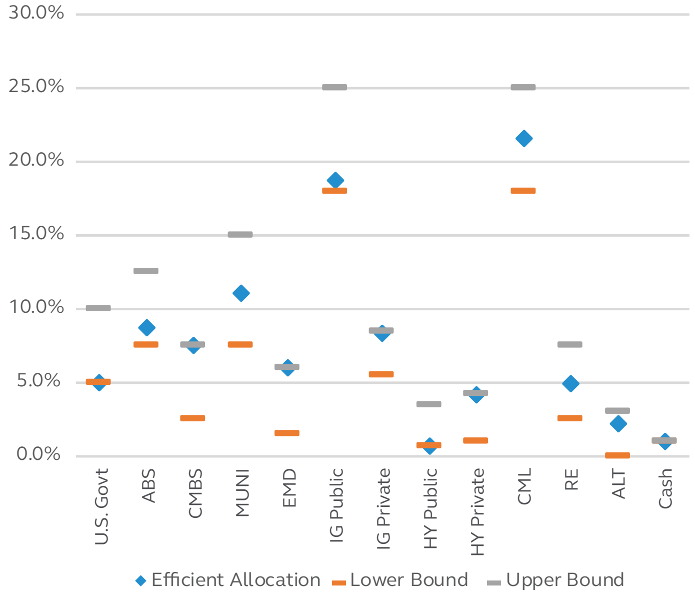
So, what does 2021 look like for us? We think the barbell continues. High quality asset-backed securities and municipal bonds will continue to play a significant role in the strategy and tax-exempts could finally be back on the radar as a possible option, coupled with continued execution of BBB thru B private IG and private high yield (HY). We believe the barbell still makes sense from an economic perspective while, on the margin, finding ways to get equity upside-exposure into the portfolio.

As shown in the chart below, the portfolio construction team continues to update their models with updated correlation, drift and loss data that is applied to the risk-based capital (RBC) construct enabling the portfolio managers to make more informed decisions about risk and return.

Asset Allocation Frontier



1.8% RBC Efficient Portfolio



Source: Principal Financial Group. The data that is being shown utilizes long-run assumptions for returns based upon internal experience and capital is a regulatory specified level.

The barbell strategy is maximized in the middle of the frontier in the 1.6% – 1.9% RBC baseline factor. This baseline factor has little meaning by itself without incorporating the other diversifiable risks in an insurance company portfolio (C0 thru C4). Once those other risks are included, the portfolio is optimized based upon the various underlying assumptions.

Spotlight on Portfolio Allocation Strategies

2020 EM fixed income review

Contributor: Damien Buchet, CIO-Total Return Strategy, Finisterre Capital

Emerging market (EM) countries engineered their own steady recovery from the COVID-19 March shock, initially attempting to emulate the drastic lockdowns and sanitary measures of developed markets (DM), but with more limited means and policy constraints. To be sure, EM countries experienced their share of hardships, being less equipped than their DM counterparts in terms of monetary tools and more constrained in terms of fiscal flexibility.

- Some countries suffered from inadequate pandemic management (Brazil) or felt the pain of harsh or misplaced lockdowns (India, Indonesia); others experienced both (Peru, Argentina).
- Turkey and South Africa were more exposed to the virus's economic impact, largely due to pre-existing policy credibility/flexibility issues.
- Frontier countries saw the most salient event risks: Lebanon, Zambia, and Suriname have already officially defaulted, while many others retain precarious debt dynamics.
- A notable exception was China, due to its more solid finances and quick response efforts.

However, most significant EM country-level risks are well identified, and investors are not overly exposed, precluding the risk of systemic crisis.

What we're keeping an eye on in 2021

- **Chinese growth and currency -** Although China's superior growth may plateau in 2021 (putting the brakes on the renminbi), we expect Chinese government bonds will remain an attractive structural opportunity.
- **Normalization trades -** The timing of monetary and fiscal "exit" policies will be prominent focal points in 2021, as limited policy headroom pressures some EM economies to straighten their fiscal balances earlier than their DM counterparts.
- **Peak oil -** Although we aren't expecting any major oil-price collapses, there's limited upside to current levels. We envision a range of US$45–55 per barrel, given pent-up supply and renewed potential for U.S. shale production.
- **The new U.S. administration -** A containment approach to China should remain a strategic objective, and a Biden presidency will very likely appeal to European allies for a more concerted approach. Overall, we expect a more predictable approach to geopolitical challenges should mean lower potential event risks for global markets.
- **A chance to prioritize ESG -** 2020 has already seen something of a revolution in ESG thinking across the emerging market debt (EMD) investment community. EM portfolio managers are realizing their collective power in driving more sustainable policy choices from both EM governments and issuers with large carbon footprints.

Looking ahead

These valuations are supported by the balanced policy outcome of the U.S. elections, lingering effects of the massive DM policy stimulus, and concrete expectations of a decisive cure for COVID-19 in 2021.

- **Positive short-term EM-DM growth differential:**
  As EM policymakers have allowed most economies to reopen despite a lingering virus risk, growth has recovered more steadily across the EM universe than in Europe or the U.S.
- **EM currencies:**
  While the U.S. economy would likely lead any sustained DM growth rally later in 2021, the more consistent rebound of EM economies should help EM currencies perform on their own growth and valuations merits over the next three to six months.
- **EM local-bond exposure:**
  Despite record-low average yield, opportunities do exist in the steeper curves of Brazil and South Africa, as well as in higher-yielding countries with policy flexibility.
- **EMD technicals:**
  With 2021 U.S. credit expected to hit 12-year lows, technicals should remain biased towards emerging market debt (EMD) inflows, as global "crossover" investors and balanced "60/40" funds struggle to find DM sources of yield with some degree of liquidity.
- **EM hard currency:**
  Credit spreads in the high 300 basis point range with a BB+ rating continue to trade near the wide end of their 12-year trading range, remaining attractive compared to their DM high-yield and investment-grade peers.
- **EM corporates:**
  EM corporate credits remain a relative laggard in terms of inflows but retain solid fundamentals across various sectors—particularly telecom, Latin mining and metals, and Chinese property.

Asset Class Perspectives

Real Estate Equity

To "D" or not to "D"

Contributor: John N. Urban, Managing Director, Portfolio Manager, Principal Real Estate Investors

With multiple COVID-19 vaccine solutions being administered in the U.S. and the expectation of stronger economic growth in 2021, now is the time to plant some total return seeds to help your bottom line in this low-yield environment.

> Value-Add and Development investing are the most compelling strategy options to consider in this sector.

Mention was made last quarter that a core property investment program will likely not be attractive to life insurance company investors after considering risk based capital (RBC) requirements and the GAAP depreciation drag on income. If you view equity real estate as a total return strategy that should provide yields comparable to alternative asset investments, then Value-Add and Development—the "D" word—investing are the most compelling strategy options to consider in this sector.

It is largely because many investors and consultants are unable to get over the "D word" that returns are attractive in this space, with expected yields in the high single- to double-digits, depending upon the holding period. Principal has been investing in the development space for 50 years and seeks to mitigate as much of the typical risk as possible so that the main risk investor clients are taking is getting a shiny new, high quality property leased up as construction gets completed. We focus on limiting pre-development and construction cost risk as best we can for every new investment in this space and would welcome the opportunity to talk through this with you in more detail.

Around this general approach, an investor can choose a **build-to-core** strategy of holding completed and leased assets at a favorable basis for as long as they like. This strategy generally leads to GAAP income returns that exceed investment grade bonds, the benefit of economic appreciation over time, and a historical cost accounting profile that limits downside income statement volatility. Alternatively, investors can elect a **merchant build** strategy to sell once a property has been developed and leased in order to capture the highest holding period returns. Or, even better, a mix of these two development strategies to realize the benefits of both.

Since 2001, Principal has completed more than $9 billion in development investments on behalf of clients. We think that you would like the results and invite you to learn more about this track record in greater detail.

Real Estate Private Debt

Commercial mortgages provide upside in a squeezed yield market

Contributor: Christopher Duey, Senior Managing Director, Portfolio Manager, Principal Real Estate Investors

Although Q4 2020 volume numbers have not yet been published, the American Council of Life Insurers (ACLI) did report a material increase in commercial mortgage volumes in Q3 relative to Q2 when the industry hit the pause button on account of COVID-19. Given our own activity, I would expect Q4 to show another increase in activity on behalf of life insurance companies. With positive progress on the vaccine front and a stronger economic environment looking forward, I would expect life insurance companies to steadily increase their commercial mortgage volumes as we move through 2021. In addition, it is expected that commercial real estate investment sales activity should pick up in 2021 as well, thus providing additional financing opportunities for life companies and investors across the risk spectrum.

Many life companies are using core commercial mortgages to support their asset and liability matching needs. These mortgages are primarily fixed rate, call-protected loans, with terms between 3-30 years (with 10 years being the most popular) and secured primarily by the four main commercial property types (multifamily rentals, industrial, office, and retail). Although overall yields remain

Commercial mortgages continue to provide 80-100+ bps over comparably rated corporate bonds

compressed post-COVID, from a relative value perspective commercial mortgages continue to potentially provide 80-100+ bps over comparably rated corporate bonds, depending on credit quality and tenor.

Since COVID, we have witnessed a material bias by both investors and lenders to favor the industrial and multifamily property types given positive sector-specific market fundamentals and a general view that these asset classes are more defensive. Lenders are being much more cautious in the office and retail sectors given the structural headwinds both currently face. We have also seen lenders branch out to top secondary markets as employers and employees move to less dense, lower cost-of-living markets that offer a high quality of life.

We continue to view construction lending and investment-grade subordinate debt as strategies that offer attractive risk-adjusted returns and yield premiums relative to core commercial mortgages and comparably rated corporate bonds. These higher risk, higher return strategies offer lenders a means to incorporate a barbell approach for commercial real estate private debt to achieve higher overall returns.

Real Estate

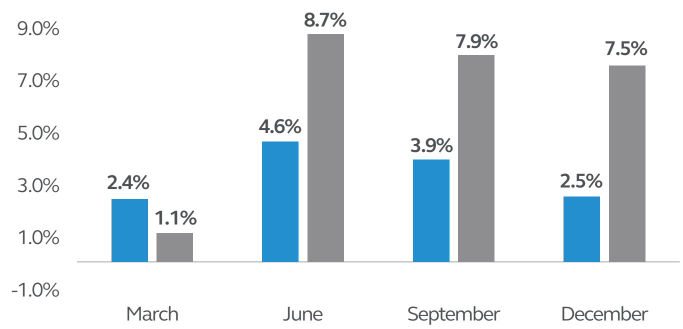
CMBS: Outlook improves and spreads tighten despite higher NAIC capital requirements

Contributor: Marc Peterson, CFA, Chief Investment Officer-CMBS, Principal Global Fixed Income

Demand for CMBS credit grows

Stability and spread tightening continued for CMBS in the fourth quarter as demand for yield overwhelmed supply, supported by an improved fundamental outlook for commercial real estate after positive vaccine announcements in November and the encouraging trend in delinquencies. The spread performance is especially notable considering weekly trading volumes that more than doubled in December from insurance company selling in response to preliminary changes in risk-based capital requirements issued by the NAIC in November. There was an estimated $2 billion of insurance company sales in the secondary market. The fact that spreads tightened through that supply demonstrates how broad the demand for CMBS credit was during the quarter outside of insurance company investors.

Delinquency transition—total conduit



Source: JPMorgan, Trepp. For the time period 3/1/2020-12/31/2020.

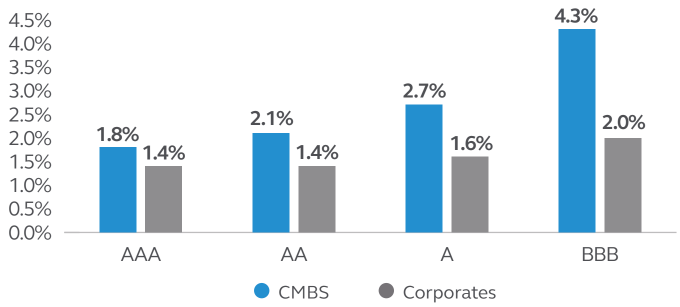
After spiking with the onset of the pandemic, delinquency rates, especially those less than 30 days, trended lower in the second half of 2020.

Outlook improves as spreads tighten and delinquency rates trend lower

During the quarter, spreads on AAA- rated bonds tightened 16 bps, AA- rated bonds 13 bps, A- rated bonds 40 bps and BBB-rated bonds 187 bps. Even at these tighter levels, CMBS spreads continue to offer an attractive spread premium to similarly rated corporate bonds which continues to help drive demand for CMBS as investors look for attractive yield opportunities. This yield advantage also comes during a period where the outlook for the fundamental recovery of commercial real estate improved, and delinquency rates trended lower as investors looked past the second wave of Covid-19 into a post-vaccine environment in late 2021 and 2022.

CMBS spreads continue to offer an attractive spread premium to similarly rated corporate bonds.

CMBS vs. corporate bond yields

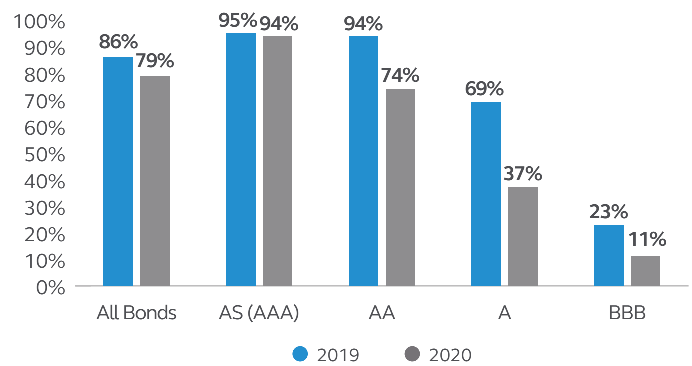


Source: JPMorgan. As of 12/31/2020.

Changes likely in 2021 for NAIC risk-based capital requirements

The changes in risk-based capital requirements from the NAIC at the end of the year reflected a COVID-19 driven increase in stress across the scenarios that were selected to run in Blackrock's CMBS model. This was especially the case in the most conservative scenario which appeared to assume a materially higher level of stress that resulted in losses being projected much higher in the CMBS structure than what the market expected. The consequence of bonds being projected to take a loss in any of the scenarios versus being considered a "no-loss" bond and automatically a NAIC 1 is the intrinsic price calculated by the NAIC and has to be compared to the book price to determine the NAIC rating. This process especially put bonds being carried at a premium book price at risk of material downgrades which resulted in bonds that were NAIC 1 at the end of 2019 being moved to NAIC 3 or 4 at the end of 2020 and capital charges moving 11 and 25 times higher respectively. The number of bonds impacted, and the magnitude of the downgrades is what took investors by surprise and prompted discussions on changes that could be made in 2021 to make capital charges more reasonable.

Zero loss share



Source: Citigroup. As of 12/31/2020.

Preferred Securities

Preferred Securities – A sweet spot for insurance company portfolios

Contributors: Matthew R. Byer, Executive Director, Chief Operating Officer and Steven Solmonson, Senior Vice President, Marketing, Spectrum Asset Management

Insurance companies and other institutions typically maintain a substantial allocation to sovereign and high-grade senior debt; which performed exceptionally well in 2020. "A" rated fixed income not only averted the sharp credit spread hike in March, but also benefited the most from the dive in rates.

In late 2020, high-grade fixed income investors turned their attention to reallocation—looking to take some of their "unexpected windfall" unrealized gains in high-grade off-the-table and redeploy to other higher yielding segments of the fixed-income market; including capital securities (i.e. preferreds, junior subordinated and AT1 CoCos) which are primarily issued by regulated banks, insurance companies and utilities. In part, the rationale takes account of the fact that there is little upside left in high grade and current yield is inadequate. Capital securities presently provide attractive relative value, and even if the yield curve moderately steepens (as Spectrum expects) and rates eventually nudge upward, the impact on banks and insurance company earnings should be positive; allowing credit spreads to further tighten; especially in the bank sector.

In that regard—the table on the next page provides a general performance overview comparing High Grade (C0C0) and Capital Securities (I0CS) as well as High Yield (H0A0). The table also includes a simple example showing the results when blending all three based on an equal allocation of 33.3% each.

ICE B0fA Indices	US Corp	US All Capital Securities	US High Yield	HG – CS - HY
Segment of Corp FI	**Sr. Debt / High Grade**	**Preferred & Capital Securities**	**Sr. Debt / Below IG**	**33.3% BLENDED**
Index Ticker	**C0A0**	**I0CS**	**H0A0**	
	Cumulative Total Returns			**Cumulative**
Apr 2012 - Dec 2020	56.91%	86.73%	73.02%	72.22%
	Annual Returns			**Annual**
2020	9.81%	7.63%	6.17%	7.87%
2019	14.23%	18.39%	14.41%	15.68%
2018	-2.25%	-4.45%	-2.26%	-2.99%
2017	6.48%	10.55%	7.48%	8.17%
2016	5.96%	3.81%	17.49%	9.09%
2015	-0.63%	5.43%	-4.64%	0.05%
2014	7.51%	11.95%	2.50%	7.32%
2013	-1.46%	2.67%	7.42%	2.88%
April-Dec 2012	7.74%	10.27%	9.92%	9.31%

As of 12/31/2020. Past performance is no guarantee of future results. Note: The I0CS inception date is 4-1-2012. It is a roll; thereby including both $25 par and $1000 par securities. Source: ICE BofA Index Platform www.theice.com.

Aside from performance, the rationale for considering an allocation to Capital Securities becomes even more evident when comparing Credit Quality and Industry Weighting as shown below:

ICE B0fA Indices	US Corp	US All Capital Securities	US High Yield	HG – CS - HY
Segment of Corp FI	**Sr. Debt / High Grade**	**Preferred & Capital Securities**	**Sr. Debt / Below IG**	**33.3% BLENDED**
Index Ticker	**C0A0**	**I0CS**	**H0A0**	
	Credit Quality Weighting %			**Credit**
AAA	1.4	0	0.0	0.5
AA	7.6	0	0.0	2.5
A	40.3	7.1	0.0	15.8
BBB	50.7	64.3	0.0	38.3
BB	0	27.1	55.4	27.5
B	0	1.5	32.5	11.3
CCC	0	0	11.3	3.8
CC	0	0	0.7	0.2
Total	100	100	100	100
Avg Credit	A-	BBB-	B+	BBB-
	Industry Weighting %			**Industry**
Banks	16.3	38.6	1.3	18.74
Utilities	8.9	6.1	3.2	6.05
Insurance	4.3	21.4	1.1	8.96
Other Financials	7.2	12.2	4.2	7.84
Industrials	38.7	2.2	51.8	30.91
REITs	3.2	4.5	4.3	3.99
Retail	3.6	0.8	4.8	3.08
Energy	9.7	6.7	13.4	9.92
Media	3.9	0.4	9.2	4.48
TelCom	4.2	3.7	6.8	4.86

Source: ICE BofA Index Platform www.indices.theice.com. As of 12/31/2020.

The Spectrum team has had a long history providing sub-advisory portfolio management to the insurance industry. Most notably, when customizing guidelines for an insurance company's managed portfolio, it is important to factor-in two additional considerations: 1) NAIC Regulatory Capital Treatment and 2) DRD Tax Treatment.

The decision to allocate to capital securities may be prompted by the goal to achieve higher returns. That said, it is important to consider the allocation as complementary addition; mindful that the allocation can be blended at various levels based upon target returns as well as evaluating credit quality and industry weighting objectives.

It is important to know that Spectrum can design a portfolio where all or most holdings are rated at or above BBB- in order to minimize NAIC capital charges.

Similarly, it is possible to set guidelines to where all or most holdings quality for DRD (Dividend Received Deduction) tax treatment in order to maximize after-tax returns.

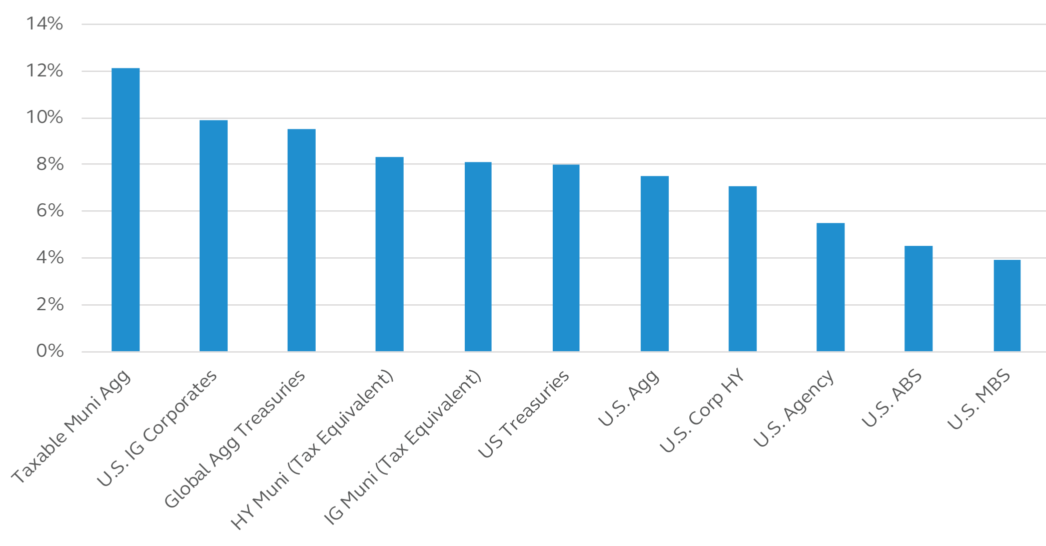
Municipal Debt
A banner year behind us and opportunities ahead

Contributors: Nick Pierce, CIPM, Managing Director-Product Specialist; Andrew Dion, Managing Director and Chief Operating Officer; Garrett Schmid, Product Specialist, Principal Global Fixed Income

Performance: The asset class performed extremely well and issuance was met with excess demand as the institutional investor base continued to expand due to increased foreign ownership. The AGG-eligible component of the asset class was up over 12% and the index as whole was up 10.5%. Transportation, health care and higher education sectors, in particular, experienced outsized performance. These are noteworthy figures for 2020 returns in fixed income.

U.S. Fixed Income Performance

2020 calendar year returns



Source: Bloomberg. As of 12/31/20.

Record issuance: Municipal bond issuance in 2018 was $37 billion; volume more than doubled in 2019 to $85 billion; and more than doubled again in 2020 to $180 billion. 2020 issuance surpassed 2010, which had been the highest year on record, which was principally due to the Build America Bond (BAB) program. While issuance in the space has had its ebbs and flows in previous years, we believe what we are witnessing is not cyclical – this is a structural change. The record issuance was consistently oversubscribed through domestic and international demand, as the weakness of the dollar continues to attract foreign investors.

The asset class also has the enviable trait of being largely ESG / SRI compliant

Increasing demand: In addition to spread advantages, diversification benefits, and lower default rates over similarly rated corporate credits—the asset class also has the enviable trait of being largely ESG / SRI compliant. Adherence to ESG and SRI guidelines is increasingly common in mandate language, and taxable municipal bonds are a natural fit.

Looking ahead

The new administration, likely emboldened by the Georgia Senate runoff election results, is poised to increase supply and demand as infrastructure spending likely becomes a priority. What is more, the Democratic control of Congress heightens the likelihood of increased regulation and higher corporate taxes, which would be a headwind for corporate credit, but would act as a tailwind for municipal bonds.

2020 was a wakeup call for the industry - taxable municipal bonds are the fastest growing fixed income sector and, as stated, we believe this is a structural shift that warrants attention. Increased capital commitment from dealers, coupled with overall market growth, has aided in creating deep and narrow bid-ask spreads and allowed for greater maneuverability in the asset class. Momentum in the sector continues to build and as it gains the attraction it rightly deserves, we believe we will continue to see opportunity in 2021 and beyond.

High Yield Debt

Record-low coupons stoke debt financing appetite

Contributors: Jeffrey Stroll, Chief Investment Officer, Post Advisory Group Board member; Hugh Costello, Managing Director, Marketing, Post Advisory Group

2020 ended on a strong note for the high yield market in spite of numerous macro headline challenges, including a surge in COVID-19 cases, a disputed election result, and halting progress on extending stimulus benefits. The Bloomberg Barclays US Corporate High Yield Index generated gains of 6.45% during the quarter, bringing the total return for the year to 7.11%.

Record new issue volume

The strong momentum in primary issuance volumes during the third quarter cooled only slightly in 4Q 2020. For the quarter, volume was $99.6 billion, driven largely by refinancings, as net volume was only $31.6 billion. Full-year new issue volume of $450 billion topped the prior record set in 2013 by $51 billion. Central bank activity in response to the pandemic drove rates lower and, when combined with spread compression back to pre-pandemic levels, resulted in record-low coupons in the new issue market that stoked the appetite for debt financing. Adding to that, the primary market continues to be supported by strong technicals as high yield bond funds continued to see inflows, totalling $8.4 billion in 4Q20 and $44.3 billion for the full year.

Spreads tighten

Spread compression was once again a primary factor in high yield returns during 4Q20. While treasury yields actually rose during the quarter—the yield on the 10-year rose 23 bps to 0.91%--spreads tightened by 157 bps to 360 bps. In the latter half of the year, high yield spreads tightened by almost 270 bps in total. In 4Q 2020, BB spreads tightened 118 bps to 264 bps, B spreads tightened 161 bps to 379 bps, and CCC spreads tightened 293 bps to 658 bps.

Sector leaders

After lagging the index for most of the year, the energy sector posted notably strong returns in 4Q 2020 as oil prices staged a steady rally over the last two months of the quarter. Transportation and aerospace were also outperformers, due to an improved outlook for airlines and a significant rally in the bonds of a large, stressed aerospace issuer. Higher quality sectors such as technology and communications were laggards.

Uncertain outlook

The ongoing challenge of dealing with COVID-19 creates certain headwinds for the market, though one could also point to many supporting factors in the market—ongoing development and distribution of vaccines, an accommodative Fed joined now by new leadership in the Treasury Department, the likelihood of further stimulus (tempered somewhat by concerns about fiscal responsibility), and the general health of the American consumer, thanks to

> Opportunities remain for spread tightening in well positioned, healthy companies, as well as in floating rate bank debt that benefits both from the lower credit risk afforded by senior secured status.

improvements in personal incomes and the savings rate over the last year. Prudent credit selection remains paramount, as always, but opportunities remain for spread tightening in well positioned, healthy companies, as well as in floating rate bank debt that benefits both from the lower credit risk afforded by senior secured status and the ability to capture with rising rates.

Partnering with insurance investors is a key strength of Principal Global Investors. From our own insurance company heritage, Principal Global Investors has grown into a global investment manager with more than $544.9 billion in assets under management, and more than 800 institutional clients globally (as of December 31, 2020). Forty-eight of those clients are external insurance companies. They trust Principal Global Investors to manage more than $14.3 billion in assets, ranging from private real estate debt and equity, to specialized debt and equity strategies.

Contact your Principal representative for more information on these and other product solutions.

Risk considerations

Investing involves risk, including possible loss of principal. Past performance is no guarantee of future results. Equity markets are subject to many factors, including economic conditions, government regulations, market sentiment, local and international political events, and environmental and technological issues that may impact return and volatility. International and global investing involves greater risks such as currency fluctuations, political/social instability and differing accounting standards. Risk is magnified in emerging markets, which may lack established legal, political, business, or social structures to support securities markets. Emerging market debt may be subject to heightened default and liquidity risk. Fixed-income investment options are subject to interest rate risk, and their value will decline as interest rates rise. Risks of preferred securities differ from risks inherent in other investments. In a bankruptcy preferred security are senior to common stock but subordinate to other corporate debt. 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

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