Principal®

Principal Global Investors Funds

Global Sukuk Fund

I Class April 2025

Market Review

Benchmark 10-year US Treasury (UST) yields initially rallied in April, from 4.21% at end-March to 3.86% on April 4th, after President Trump's "Liberation Day" tariff announcement sent global markets into a tailspin, sparking a flight into safe haven assets. Market sentiment was also boosted by weakening US ISM manufacturing and ISM services data. Nevertheless, 10-year UST yields subsequently reversed course to touch 4.59% on April 11th, after President Trump announced a 90-day pause on all the reciprocal tariffs excluding China, coupled with market chatters that China may be dumping its UST holdings amid the "Sell America" theme. UST yields recovered to settle at 4.16% (m-o-m 5bps lower) in the second half of the month, supported by softer US economic data e.g. CPI and GDP, as well as dovish remarks from several US Fed officials. The UST yield curve bull steepened m-o-m, with shorter 2-5-year yields sinking by 22-28bps, 7-year yields falling by 14bps, while longer 20 and 30-year yields rose by 10-11bps.

Following the rally in late March, 10-year UST rallied further from 4.21% at end-March to 3.86% on April 4th, below the psychological 4.00% hurdle for the first time since October 2024, after President Trump unveiled the most sweeping tariff hikes in a century. In his "Liberation Day" announcement on 2nd April, President Trump imposed a universal baseline tariff of 10% on all imported goods effective 5th April, and steeper rates for major trading partners, including 34% on goods from China, 46% from Vietnam and 20% from the European Union, which will begin on April 9th. Canada and Mexico were largely exempted from this round of tariffs, while previously announced tariffs on steel, aluminum and autos, along with anticipated tariffs on semiconductors, pharmaceuticals, copper and lumber, will be assessed separately and not stacked onto the new tariffs. If implemented in full, President Trump's tariffs will increase the average US tariffs to above 20%, the highest in more than a century, and are harsher than most investors were expecting. The levies threaten to erase most of the progress made in reducing inflation in the US since the Covid-19 pandemic and push the economy into a recession, fueling a flight into safe haven assets. Sentiment in the UST market was further buoyed by weakening US economic data. In March, US ISM manufacturing data contracted from 50.3 in February to 49.0 (consensus 49.5), with input prices accelerating sharply while new orders and employment slowed, as the drumbeat of higher tariffs echoed throughout the economy. Similarly, US ISM services dipped from 53.5 to 50.8 (consensus 52.9) as orders growth fell and employment tumbled to the lowest level since 2023, reflecting increased caution among businesses as they await clarity on President Trump's policies.

On the labour market front, the US economy added 228,000 new jobs in March, beating consensus expectations of 140,000 (February revised lower from 151,000 to 117,000), with gains led by leisure and hospitality, as well as education and healthcare sectors. However, underlying details indicate that some one-off factors may have contributed to the jump in nonfarm payrolls. Meanwhile, federal government payrolls posted the first back-to-back decline since 2022 as the Department of Government Efficiency (DOGE) trimmed the federal workforce. However, the Bureau of Labour Statistics said federal employees who are on paid leave or receiving severance pay are still considered employed, therefore skewing the nonfarm payrolls data. Meanwhile, the unemployment rate ticked up from 4.1% in February to 4.2% in March, while average hourly earnings fell from 4.0% to 3.8% y-o-y (consensus 4.0%, m-o-m up from 0.2% to 0.3% vs consensus 0.3%), marking its slowest pace since July. Despite a less sanguine job market outlook, US Fed Chairman Jerome Powell emphasized that the central bank is not in a hurry to adjust rates as policymakers wait for more clarity on the Trump administration's policies and their impact to growth and inflation.

Subsequently, UST prices sharply reversed course, with 10-year yields spiking to touch 4.59% on 11th April after President Trump announced a 90-day pause on all reciprocal tariffs excluding China. The US' extensive tariffs on China will remain and were further increased from 104% to 125%, after the world's second largest economy announced new retaliatory tariffs of 84% on US goods, while other countries that were previously subjected to additional tariffs will see rates reduced to the universal 10%. Despite President Trump's stunning reversal from his hard stance earlier, UST and US Dollar continued to be sold down, as growing uncertainty over President Trump's policies fueled an exodus out of US assets. UST yields were also pressured higher by chatters that China may be dumping its UST holdings, amid the "Sell America" theme globally. Meanwhile, minutes of the FOMC meeting in March show a majority of participants expect the potential inflationary impact from President Trump's policies to be "more persistent" than originally projected, amplifying risks of stagflation. Some policymakers also warned of "difficult trade-offs" if inflation proved persistent and the outlook for growth and employment weakened. The minutes also reiterated the committee's wait-and-see approach in cutting rates. Meanwhile in March, US headline CPI fell from 0.2% in February to -0.1% m-o-m (consensus 0.1%, y-o-y down from 2.8% to 2.4% vs consensus 2.5%), while core CPI unexpectedly dipped from 0.2% to 0.1% m-o-m (consensus 0.3%, y-o-y down from 3.1% to 2.8% vs consensus 3.0%), reflecting a decline in energy costs, used vehicles, hotel stays and airfares. However, investors generally disregarded the positive CPI data, amid expectations that President Trump's tariffs may pressure inflationary pressures higher going forward.

In mid-April, sentiment in the UST market recovered, pushing 10-year UST yields lower to around 4.30%. This came after US Treasury Secretary Scott Bessent dismissed concerns over China weaponizing its massive UST holdings, ruled out a premature dismissal of Fed Chairman Powell, and reassured investors that all tools (including buybacks and potential intervention) are in place to address market dislocation if needed. Moreover, Bessent rejected concerns that the sharp simultaneous decline in UST and US Dollar in the prior week signifies that the US was losing its haven status, as the US is "still a global reserve currency" and there is still a "strong dollar policy". Regarding trade talks, Bessent said the US will gain first-mover advantage, and there may be an "agreement in principle" that allows the US and its trading partners to move forward, instead of having to finalize an actual trade "document" by the end of the 90-day pause period. Separately, US retail sales soared from 0.0% (revised lower from 0.2%) in February to 1.4% in March m-o-m, the biggest increase in two years, mainly attributed to a jump in car purchases and other goods such as electronics, as consumers rushed to buy goods before tariffs are implemented. Subsequently, during the later part of April, 10-year UST yields fluctuated around 4.30-4.43% in the absence of major catalysts.

Nevertheless towards month-end, buying momentum in UST picked up, driving 10-year yields lower to close the month at 4.16% (m-o-m 5bps lower), as investors received some respite from negative tariff headlines. On 22nd April, President Trump vowed to cut China's tariffs "substantially", amid reports that Vice President JD Vance and Indian Prime Minister Narendra Modi have also made "significant progress" towards a bilateral trade deal. Subsequently, President Trump also announced plans to reduce the impact of tariffs on the US automotive industry, as a result of intense lobbying from automakers, parts suppliers and dealers who warned that excessive duties could push up car prices, triggering plant shutdowns and job losses. Under the new measure, carmakers who produce and sell completed automobiles in the US can claim an offset worth up to 3.75% of the value of American-made vehicles. After one year, the offset will be reduced to up to 2.5% of the value of those cars, and then be removed the following year, in efforts to incentivize domestic manufacturing. President Trump also said he had no intention of firing Chairman Powell despite his frustrations over the central bank's policies, soothing investors' concerns. Sentiment in the UST market was also buoyed by dovish remarks from several US Fed members. Fed Governor Christopher Waller said firms may begin laying off more workers if aggressive tariff hikes are reinstated by the Trump administration, and said he would support rate cuts if there were a significant rise in unemployment. Similarly, Cleveland Fed President Beth Hammack said the central bank could move as early as June if it has clear and convincing evidence of the economy's direction in terms of growth and inflation. In April, the US Conference Board of Consumer Confidence index slumped from 93.9 in March (revised higher from 92.9) to 86.0 (consensus 88.0), almost a 5-year low, on growing pessimism surrounding prospects for the economy and labour market growth. Similarly, business surveys conducted by regional Federal Reserve banks show companies expect to rein in capital spending.

Brent crude oil prices weakened by 15.5% m-o-m in April, from USD 74.74/bbl to USD 63.12/bbl, driven by OPEC+'s surprise decision to increase production for the second consecutive month. Sentiment in the oil market was also dented by President Trump's Liberation Day announcement on 2nd April, amplifying concerns over slowing global economic growth.

In the beginning of the month, Brent oil prices plunged sharply from USD 74.74/bbl to touch USD 62.51/bbl on 7th April, after the OPEC+ alliance unexpectedly announced that it will increase oil supply by 411,000 barrels per day (bpd) beginning May. This followed its surprise decision on 3rd March to replenish 138,000 bpd of idle supply beginning April, and is equivalent to three monthly tranches of the amount announced in March. According to reports, the move was a deliberate effort by Saudi Arabia to push down prices as a warning signal to errant OPEC members, Kazakhstan and Iraq, for poor compliance with their production quotas. Brent prices sank further to USD 58.40/bbl on 9th April, hitting a four-year low, as President Trump's Liberation Day announcement sparked fears of a potential US recession. Trump's intensified tit-for-tat trade war with China also amplified concerns over slowing growth in the world's largest oil importer, amid the US administration's plans to implement 104% tariffs on many Chinese goods, and Beijing's pledge to "fight to the end".

Nevertheless, Brent prices recovered to around USD 66/bbl after President Trump announced a 90-day pause on reciprocal tariffs (excluding China) on 9th April. Brent prices continued to recover to around USD 68.60/bbl on 23rd April, supported by positive news on President Trump's tariff negotiations, especially with China and India. However, prices pared gains on the final three trading days of April to close the month at 63.12/bbl (m-o-m 15.5% lower), as investors braced for another potential supply hike by OPEC, when the alliance meets again in early May. Earlier on 14th April, OPEC slashed global demand growth forecasts for 2025 and 2026, citing strained consumption due to President Trump's tariffs. The alliance cut demand growth forecasts for 2025 and 2026 by 100,000 bpd, projecting an expansion of 1.3 million bpd for each year. Despite the downgrades, the estimates from OPEC remain considerably higher than others in the oil industry. Earlier, the US government's Energy Information Administration slashed its 2025 oil growth forecast by 30% to 900,000 bpd, while the International Energy Agency lowered their projections by 300,000 bpd for 2025, from 1.03 million bpd to 730,000 bpd, with half of the reduction accounting from US and China.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 30bps in April, with returns of 0.60% compared to the index return of 0.30%. Year to date, the Fund outperformed the index by 51bps, with returns of 2.00% versus index returns of 1.49%. During the month, we took profit on Malaysia sovereigns when 10-year US Treasury yields rallied to 3.86% on April 4th, and re-entered the market when yields rose 64bps higher to 4.50% on April 11th, effectively increasing duration and rode the bullish market momentum which follow suit.

Portfolio Outlook and Strategy

The economic outlook in GCC countries continues to be solid, anchored by the governments' ongoing efforts to diversify away from the hydrocarbon industry and strong growth in the non-oil sector, which have resulted in positive rerating actions by international rating agencies. The non-oil economy now accounts for 53% of GDP in Saudi, and 75% of GDP in the UAE.

President Trump's imposition of 10% tariffs on GCC countries is unlikely to have a significant direct economic impact to the region, as oil and gas imports are exempt from the new tariffs. Excluding energy, GCC countries have limited direct trade exposure to the US, with the US recording trade surpluses with all six GCC countries in 2024. In March, S&P upgraded Saudi's credit rating by one notch from A to A+ for the first time in two years, as the kingdom's efforts to diversify the economy from oil pays off.

In 2024, Saudi welcomed 30 million international visitors, up 9.5% from 2023, with non-religious tourism now accounting for the majority of international travel. Similarly, inbound spending surged to a record SAR153.6 bil in 2024, a 13.8% increase from 2023, and pushing Saudi's travel balance surplus to the highest annual level yet. Meanwhile, domestic travelers nearly doubled to 86 million, taking the total visitors figure to 116 million. Saudi has surpassed its 2030 target of 100 million visitors in 2023, seven years ahead of schedule.

On a related note, Dubai welcomed 18.72 million visitors in 2024, 9.2% higher than 2023 and posting a fresh record high. Visitors from Western Europe continued to account for the largest share of tourists (20%), followed by South Asia (17%), GCC and Russia. Dubai's average hotel occupancy increased from 77.4% in 2023 to 78.2% in 2024, while GDP grew 3.1% in 9M24. The government continues to invest heavily in developing the tourism sector, not only within the city, but also in rural areas e.g. the Saih al-Salam Scenic Route, which was recently approved with a USD106 mil budget. Dubai's neighbor, Abu Dhabi, also plans to boost its tourism sector's contribution to GDP from 5% in 2023 to 12% by 2030. In 2024, the emirate's GDP grew 3.8% (2023: 3.1%) to a record high value of AED1.2 tril, powered by the non-oil sector which expanded 6.2% y-o-y, contributing 54.7% to total GDP. The manufacturing sector was the biggest non-oil contributor to GDP (9.5%), followed by construction (9.1%) and financial services (6.6%).

Overall demand for Global Sukuk is expected to remain strong, anchored by the issuing countries' strong external credit ratings and credit profile. Year to date, primary Global Sukuk offerings continued to receive overwhelming demand from global investors, e.g. Saudi Arabian Mining Company's debut USD1.25 bil sukuk issuance, which was oversubscribed by 9.2 times (total orders USD11.5 bil). We will remain vigilant and adopt a nimble investment strategy to maneuver market fluctuations and capitalize on trading opportunities, with increased investments in sovereign sukuk. For corporate sukuk, we continue to prefer highly liquid, blue-chip government-related companies, utility companies, as well as those with strong financials and robust cash buffers, to enable a swift reaction to any changes in market sentiment or direction.

Risk Considerations

Investing involves risk, including possible loss of principal. Past Performance does not guarantee future return. All financial investments involve an element of risk. Therefore, the value of the investment and the income from it will vary and the initial investment amount cannot be guaranteed.

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