

Principal Global Investors Funds

Global Sukuk Fund

I Class August 2025

Market Review

The US Treasury (UST) yield curve bull steepened in August, with shorter 2-5 year yields rallying 28-34bps, as weaker US economic data strengthened expectations for a rate cut in September. Meanwhile, benchmark 10-year UST yields rallied by a smaller quantum of 14bps, while the longest 30-year yields closed the month 3bps higher. The rally was triggered by poor US nonfarm payroll data, which drove 10-year UST yields 19bps lower from 4.37% at end-July to 4.18%, before being pressured higher to hit 4.35% on 18th August amid rising inflationary pressures and mixed Fed speak. Nevertheless, 10-year UST recovered to close the month at 4.23%, after US Fed Chairman Jerome Powell adopted a more dovish tone than investors had anticipated at the Jackson Hole Economic Symposium on 22nd August. Powell said the balance of risks has shifted to the labor market even as worries over inflation remain, and opened the door to a potential rate cut in September. Powell also added that while tariffs are expected to drive prices higher, the inflationary impact may prove to be temporary.

On the first trading day of the month, 10-year UST yields sank 17bps lower from 4.37% at end-July to 4.20%, after a disappointing US jobs report strengthened the case for the US Fed to resume their rate cutting cycle in September. In July, the US economy added only 73,000 new jobs, much lower than consensus expectations of 105,000. Notably, May and June's nonfarm payrolls were collectively sharply revised down by 258,000, which means US employment growth has averaged a paltry 35,000 jobs in the last three months, the worst since the pandemic. The sluggish payrolls growth reflected declines in manufacturing, professional and business services as well as government. President Trump's efforts to pull back on government spending has resulted in the federal government shedding jobs for a sixth consecutive month in July, with layoffs spilling over to universities and nonprofit entities reliant on federal funding. The overall unemployment rate rose from 4.1% in June to 4.2% in July, while the labor participation rate dropped from 62.3% to 62.2%, the lowest in nearly three years. Sentiment in the UST market was further bolstered by a weak US ISM manufacturing report, where the index unexpectedly fell from 49.0 in June to 48.0 in July, defying consensus expectations for a recovery to 49.5.

The following day, 10-year UST yields initially pared some gains to 4.25%, but rallied again to 4.18% after a weak US factory orders report reinforced expectations for a rate cut in September. In June, new orders for US-manufactured goods slumped from 8.3% in May to -4.8%, as commercial aircraft orders plunged, reversing the surge in plane orders that had driven the overall upswing in orders in the prior month, highlighting the challenges brought on by President Trump's aggressive tariff policies. Nevertheless, 10-year UST yields drifted 14bps higher to 4.32% on 12th August, as investors reacted to mixed US economic data. In July, ISM Services unexpectedly fell from 50.8 in June to 50.1, much lower than consensus expectations of 51.5, as firms reduced headcount in response to tepid demand and rising costs. The employment index contracted further from 47.2 to 46.4, marking one of the lowest readings since the pandemic. Meanwhile, headline CPI dipped slightly from 0.3% in June to 0.2% in July m-o-m (consensus 0.2%, y-o-y unchanged at 2.7% vs. consensus 2.8%), while core CPI edged higher from 0.2% to 0.3% m-o-m (consensus 0.3%, y-o-y up from 2.9% to 3.1% vs. consensus 3.0%).

Despite the slightly higher inflation reading, 10-year UST yields rallied to 4.20% on 14th August, after US Treasury Secretary Scott Bessent called for a 50bp rate cut in September, and said Fed Funds rates should be 150-175bps lower than the current 4.25-4.50% level. Nevertheless, 10-year UST yields quickly reversed to 4.35% on 18th August, after data showed that US PPI accelerated from 0.0% in June to 0.9% m-o-m in July, much higher than consensus expectations of 0.2%. According to the report, services costs rose 1.1% (the most since March 2022) while goods prices excluding food and energy increased by 0.4%. The report also indicates that while businesses have absorbed the majority of tariff cost increases so far, their margins are being increasingly squeezed, which may prompt a stronger pass-through of levies into consumer prices in the coming months. Meanwhile, US retail sales slowed from 0.9% in June (revised upwards from 0.6%) to 0.5% m-o-m in July (consensus 0.6%). Subsequently, 10-year UST yields fluctuated ahead of US Fed Chairman Powell's highly anticipated speech at the annual Jackson Hole Economic Symposium, coupled with hawkish remarks from several Fed members. For example, Fed Bank of Cleveland President Beth Hammack said she would not support lowering rates if the meeting were tomorrow, citing inflation figures. Furthermore, minutes of the FOMC meeting in July highlight the division among Fed members over the appropriate path for interest rates, with "a number" of participants preferring to keep rates unchanged amid concerns that inflation may prove persistent, while "some" were open to cutting rates as soon as September.

Nevertheless, at the Jackson Hole event, Chairman Powell adopted a more dovish tone than market expected as he opened the door to a potential rate cut in September, stating that the balance of risks has shifted to the labor market even as worries over inflation remain. Powell noted that the labor market is in a "curious kind of balance" and that downside risks to employment are rising. On inflation, Powell asserted that the central bank needs to continue guarding against prospects of persistent inflation due to President

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Trump's tariff policies, but also acknowledged that it is reasonable to expect that the effects may be relatively short lived. Meanwhile, Powell remained mum over President Trump's increasing pressure on the US Fed to cut rates, as well as the president's call for Fed Governor Lisa Cook to resign over allegations that she provided false information in applying for two mortgages. Following Powell's speech, 10-year UST yields pared losses to around 4.25%, before rising again to hit 4.31% on 26th August after President Trump ordered Cook's removal as Fed Governor, indicating some concerns among investors over the US Fed's independence. Cook responded by filing a lawsuit against the president, claiming he does not have the authority to fire her.

Towards month-end, 10-year UST yields drifted lower to close the month at 4.23% (m-o-m 14bps lower) amid mixed US economic data. The US' second 2Q25 GDP reading was revised higher from 3.0% to 3.3% (consensus 3.1%), boosted by a pickup in business investment in intellectual property products such as artificial intelligence, which is estimated to have expanded by 12.8%, double the initial estimate of 6.4% and the fastest in four years. Personal consumption in 2Q25 was also revised up from 1.4% to 1.6%, underscoring the resilience of the US consumer sector. Meanwhile in July, personal spending rose from 0.4% in June to 0.5% m-o-m, the most in four months, supported by a slight uptick in personal income from 0.3% to 0.4% m-o-m. Nevertheless, the main engine of the US economy is widely expected to slow in the coming months, as companies pass on higher costs to consumers, against a backdrop of a cooling labor market. Meanwhile, headline PCE inflation eased slightly from 0.3% in June to 0.2% in July m-o-m (consensus 0.2%, y-o-y flat at 2.6%), while core PCE inflation was unchanged at 0.3% m-o-m (consensus 0.3%, y-o-y up from 2.8% to 2.9%). In August, the Conference Board Consumer Confidence index declined from 98.7 in July (revised up from 97.2) to 97.4 (consensus 96.5), as more Americans worried over the job market, with the share of consumers who said jobs were hard to get rose for the second month to the highest level since 2021.

Brent crude oil prices weakened in August, following the rally towards end-July, weighed by OPEC+'s latest supply increase, and amid President Trump's renewed warnings of increased tariffs on Russian oil and the countries that purchase it. Brent prices initially declined 10.4% from USD 72.53/bbl at end-July to touch USD 65.01/bbl on 13th August, before rebounding to close the month at USD 68.12/bbl (m-o-m 6.1% lower).

Brent prices sank 3.9% to USD 69.67/bbl on the first trading day of August, as the outlook for the world's largest economy weakened following the release of poor US economic data as well as tariff announcements, weighing on the prospects for oil demand. In July, US jobs growth cooled sharply over the past three months, while factory activity contracted at the fastest clip in nine months, signaling that the economy may be losing momentum, as the impact of President Trump's changing tariff rates has finally begun to weigh on economic growth. Sentiment in the oil market was further dampened after OPEC+ announced that it will increase oil production by 547,000 barrels per day (bpd) in September. This follows its gradual monthly cuts of 138,000 bpd in April, 411,000 bpd in May, June and July as well as 548,000 bpd cut in August, effectively completing the reversal of a 2.2 million bpd cutback made in 2023, which is equivalent to around 2.1% of global oil demand and around 5.2% of total OPEC+ supply. Following the increase in September, OPEC+ is said to be discussing a potential pause on production increases, as the alliance had previously indicated that its remaining 3.66 million supply cut will remain in place until end-2026. At the same time, investors were also closely monitoring statements from the White House, to see whether President Trump would impose more severe measures to restrict Russian energy flows, ahead of a planned meeting between President Trump and Russian President Vladimir Putin soon.

Brent prices continued to be pressured lower to touch USD 65.01/bbl on 13th August, after President Trump slapped additional 25% tariffs on goods from India on 6th August, over its ongoing purchases of Russian oil. This 25% tariff will stack on top of a 25% levy on Indian goods announced the week prior, making India subject to one of President Trump's highest tariff brackets, at a total of 50%. Washington's move will most likely impact India's labor intensive industries such as textiles, garments, gems and jewelry, marine exports as well as auto exports, which tend to be small and medium scale enterprises. A slowdown in India's economic activity may reduce its demand for oil and impact global oil demand, given India's position as the world's third largest oil consumer. Meanwhile, Presidents Trump and Putin's summit in Alaska on 15th August to discuss ending the war in Ukraine ended without a concrete deal, despite both sides touting the meeting as a productive one. President Trump said, "many points were agreed to", but conceded that there remain sticking points with Moscow before a ceasefire could be achieved. President Putin said Russia is committed to ending the war in Ukraine, but the conflict's "primary causes" must be eliminated for an agreement to be long-lasting. Despite the absence of a deal, President Trump signaled he would hold off on imposing more sanctions or other "severe consequences" against Russia, easing concerns over a reduction in global oil supply.

Nevertheless, sentiment in the oil market recovered in the second half of the month, driving Brent prices higher to hit USD 69.07/bbl on 25th August. This came after the US Energy Information Administration (EIA) reported that nationwide crude oil stockpiles fell by 6 million barrels for the week ending 15th August, the most since mid-June, while gasoline stockpiles also declined for a fifth straight week. Brent prices were also supported by US Fed Chairman Jerome Powell's more-dovish-than-expected remarks at the Jackson Hole Economic Symposium, where he signaled a possible resumption of US rate cuts in September. However, Brent prices pared gains to around USD 67/bbl on 27th August, as the US' additional 25% tariff on Indian goods kick in on the same day, before consolidating in the final trading days of the month to settle at USD 68.12/bbl (m-o-m 6.1% lower). This came after the EIA reported that US crude oil stockpiles at the Cushing, Oklahoma storage hub fell for the first time in eight weeks during the week ending 22nd August while national crude inventories declined by 2.4 million barrels, indicating resilient demand.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 30bps in August, with returns of 0.92% compared to the index return of 0.62%. Year to date, the Fund outperformed the index by 215bps, with returns of 4.77% versus index returns of 2.62%.

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 re-rating actions by international rating agencies. The non-oil economy now accounts for 56% of GDP in Saudi, and 75% of GDP in the UAE. 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. Moody's had earlier upgraded Saudi's credit rating from A1 to AA3 in November 2024.

Public Investment Fund's (PIF - Saudi's sovereign wealth fund) assets under management grew 18% y-o-y in 2024 to USD1.15 trillion, driven by strong performance from key portfolio companies including Ma'aden (Saudi Arabian Mining) and Saudi Telecom. Meanwhile, Saudi's net FDI inflows jumped 44% y-o-y in 1Q25 to US\$5.9 billion, reflecting a growing trend of multi-national companies establishing regional headquarters there. The IMF also revised up its 2025 GDP forecast for Saudi from 3.0% to 3.6% (2026: up from 3.7% to 3.9%), driven by expected gains in oil revenue and continued growth in non-oil sectors. The upgraded projection places Saudi among the world's fastest growing major economies for the year following India (6.4%) and China (4.8%). In 2Q25, Saudi's economy expanded from 3.4% in 1Q25 to 3.9% y-o-y, driven by non-oil activities (4.7% growth), oil activities (3.8%) and government (0.6%).

On a separate note, Fitch reaffirmed UAE's rating at AA- with a Stable outlook, citing its consolidated government debt, strong net external asset position, and high GDP per capita. In 1Q25, residential property values in Dubai rose 14% y-o-y with around 50,000 homes sold, boosting transaction values by nearly 40% y-o-y to roughly AED 144-147bil. Meanwhile, total value of real estate transactions in Sharjah's central and eastern regions hit AED 1.6bil, 143% higher y-o-y, attributed to government-led infrastructure projects and regulatory reforms.

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 hard-currency offerings already surpassed USD55 bn, more than last year's all-time record total issuance of USD54 bn. The broad outlook for fixed income assets remains constructive, as the US Fed is poised to resume loosening monetary policy amidst slowing US economic momentum due to increased uncertainty over President Trump's policies. We will remain vigilant and adopt a nimble investment strategy to maneuver market fluctuations and capitalize on trading opportunities, with increased investments in sovereign and sovereign-related 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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