

Principal Global Investors Funds

Global Sukuk Fund

I Class July 2025

Market Review

US Treasury (UST) prices weakened across the board in July, after US economic data e.g. nonfarm payrolls and inflation surprised on the upside, denting expectations for a potential rate cut at the end of the month. Benchmark 10-year UST yields rose 26bps from 4.23% at end-June to hit 4.49% in mid-July, before rallying 12bps to end the month at 4.37% (m-o-m 14bps higher), buoyed by dovish comments by several US Fed members. Nevertheless, the US Fed kept rates unchanged at 4.25-4.50% for the fifth straight meeting at the FOMC meeting on 30th July, with Governors Chris Waller and Michelle Bowman dissenting. The FOMC statement noted that growth “moderated in the first half of the year”, while uncertainty about the economic outlook “remains elevated”. Chairman Powell in his press conference, adopted a slightly hawkish tone, stating that interest rates are in the right place to manage continued uncertainty around tariffs and inflation. The UST yield curve bear flattened m-o-m, with 2-5 year yields climbing by 18-24bps, while long 20-30 year yields were up by 12-13bps.

In early July, 10-year UST yields were pressured 20bps higher from 4.23% at end-June to hit 4.43% on 8th July, triggered by better-than-expected US economic data. In June, US ISM manufacturing improved more than expected from 48.5 in May to 49.0 (consensus 48.8), albeit remaining in contractionary territory for the fourth consecutive month. Similarly, JOLTS job openings rose sharply from 7.395 million in April to 7.769 million jobs in May, the highest in six months, and significantly beating consensus expectations of 7.300 million. Job openings increased the most in leisure and hospitality while layoffs declined, indicating a stable labor market despite increased economic uncertainty. UST yields spiked further after data showed that the US economy added 147,000 jobs in June, higher than consensus expectations of 106,000 jobs, pushing the unemployment rate lower from 4.2% in May to 4.1% (consensus 4.3%). The upside surprise was attributed to an unusual surge in state and local employment, particularly in public education. This masked a slowdown in hiring across the rest of the economy, where private payrolls rose only 74,000 in June, the least since October 2024. On the same note, the labor force participation rate eased from 62.4% to 62.3%, while average hourly earnings slowed from 0.4% to 0.2% m-o-m (consensus 0.3%, y-o-y down from 3.8% to 3.7% vs. consensus 3.8%). Meanwhile, US ISM services charged higher from 49.9 in May to 50.8 in June (consensus 50.5), driven by a rise in business activity and bookings.

Subsequently, 10-year UST took a breather, with yields falling briefly to around 4.32% on 10th July, following a successful new USD39 billion 10-year UST auction. This came despite minutes of the US Fed meeting in June highlighting growing division among policymakers. Most Fed members said they expect to resume cutting rates this year, while others favored keeping rates unchanged amid concerns that inflation would prove persistent. Nevertheless, 10-year UST came under pressure again amid renewed concerns over inflation, after President Trump announced that he will impose 30% tariffs on both Mexico and the EU starting 1st August, citing trade deficits and accusing Mexico of failing to adequately stop drug cartels. This escalation came after a week of widespread tariff threats, with the EU already facing existing levies of 25% on cars, 50% on steel and aluminum, and 10% baseline tariffs, while Mexico had previously secured exemptions for about 87% of its goods under the US-Mexico-Canada trade agreement. 10-year UST yields marched higher to 4.49% on 16th July, after US headline CPI jumped from 0.1% in May to 0.3% m-o-m in June (consensus 0.3%, y-o-y up from 2.4% to 2.7% vs. consensus 2.6%), while core CPI rose from 0.1% to 0.2% m-o-m (consensus 0.3%, y-o-y up from 2.8% to 2.9% vs. consensus 2.9%). Goods prices, excluding food and energy commodities, rose 0.2% after stalling in the prior month. Meanwhile, toy prices increased at the fastest pace since early 2021, cost of household furnishings and sports equipment climbed by the most since 2022, while prices of appliances jumped the most in nearly five years, as companies begin to more meaningfully pass some tariff-related costs to consumers.

Nevertheless, 10-year UST yields subsequently rallied 16bps to 4.33% on 22nd July, bolstered by Fed Governor Christopher Waller’s remarks that he would dissent if his colleagues vote to hold rates steady at the FOMC meeting on 30th July, stating “the private sector is not doing as well as everybody thinks it is”. Waller also said price pressures from tariffs are likely to be temporary and he sees no sign that inflation expectations are on the rise, which opens the door for the US central bank to resume cutting rates. Sentiment in the UST market was also lifted by concerns over a lack of real progress on tariff negotiations between the US and its trading partners, ahead of the 1st August deadline. Furthermore, investors breathed a sigh of relief after US Secretary Scott Bessent asserted that US Fed Chairman Jerome Powell does not need to resign and should continue serving his remaining term. This came after Bessent called for a review of the “entire Federal Reserve institution”, amid intensifying pressure from President Trump to replace Chairman Powell with someone who is more aligned to his interest rate views. Nevertheless, 10-year UST yields drifted upwards again to around 4.42%, as risk sentiment improved after President Trump announced a trade agreement with Japan, one of the US’ largest trading partners. According to the deal, Japan will invest USD550 billion in the US while its exports will be taxed 15%, lower than the 25% tariff President Trump had threatened earlier.

In the final trading days of the month, 10-year UST rallied 10bps from around 4.42% to 4.32% on 29th July, after US JOLTS job openings fell more than anticipated from 7.712 million jobs in May (revised lower from 7.769 million) to 7.437 million in June (consensus 7.500 million), reigniting concerns over a slowing labor market. The pullback in openings was broad, driven by accommodation and food services, health care as well as finance and insurance. In contrast, the Conference Board Consumer Confidence Index surprised on the upside, jumping from 95.2 in June to 97.2 in July (consensus 96.0), as Americans' concerns over the outlook for the broader economy and the labor market eased. Nevertheless, 10-year UST yields rose again to close the month at 4.37% (m-o-m 14bps higher), after US GDP posted strong growth in 2Q25 at 3.0%, higher than consensus expectations of 2.6% (1Q25: -0.5%). This was mainly driven by a large drop in imports, while personal consumption grew from 0.5% to 1.4% (consensus 1.5%). Meanwhile, PCE inflation jumped from 2.4% in May to 2.6% y-o-y in June (consensus 2.5%) while core PCE was flat at 2.8% (consensus 2.7%), indicating some pass-through of tariffs to consumers. UST yields were also pressured higher following a slightly hawkish US Fed meeting outcome on 30th July. As widely expected, policymakers voted to keep rates unchanged at 4.25-4.50% for the fifth straight meeting, with Governors Chris Waller and Michelle Bowman dissenting. The FOMC statement leaned a bit dovish, noting that growth "moderated in the first half of the year", while uncertainty about the economic outlook "remains elevated". However, Chairman Powell adopted a slightly hawkish tone during his press conference, stating that interest rates are in the right place to manage continued uncertainty around tariffs and inflation, therefore suggesting that a rate cut in September is not imminent.

Brent crude oil prices fluctuated around the USD 67-71/bbl range for most of the month in July, before ultimately rallying to settle at USD 72.53/bbl (m-o-m 7.3% higher). Gains were supported by concerns that US President Trump may impose new economic penalties on Russia if the latter does not reach a swift truce with Ukraine. This was despite OPEC+'s announcement that it will raise crude oil production by 548,000 barrels per day (bpd) in August, the fifth consecutive month of increases.

In the beginning of the month, Brent prices rose from USD 67.61/bbl at end-June to around USD 69/bbl, as sentiment was lifted by reports that the US had reached a trade deal with Vietnam, the third pact in addition to the UK and China, ahead of the 9th July trade deadline. This was despite US crude oil inventories increasing by 3.85 million barrels for the week ending 27th June, the most in three months, and much larger than the projected increase of 680,000 barrels. Subsequently, Brent prices initially dropped to touch USD 67.22/bbl on 7th July after OPEC+ announced that it will increase production by 548,000 bpd in August, higher than the 411,000 bpd increments it had implemented for May, June and July, sparking concern over supply overhang. With the latest oil supply increase, OPEC+ would be replenishing 1.918 million bpd out of the 2.2 million bpd cuts made in 2023, equivalent to around 4.6% of estimated OPEC+ supply of 41.64 million bpd (as of March 2025).

Nevertheless, Brent prices recovered back to around USD 70/bbl following news that Saudi Arabia has raised prices for its main crude oil grade, Arab Light, for Asian customers beginning August. This signals a vote of confidence in the market's ability to absorb additional oil supply, in light of OPEC+'s decision to raise production earlier. Subsequently, Brent prices continued to fluctuate around the USD 68-71/bbl range, as investors weighed the impact of a large gain in US crude stockpiles against fresh US efforts to curb Iranian oil exports. For the week ending 4th July, the Energy Information Administration (EIA) reported that US crude stockpiles sharply rose again for the second consecutive week by 7.1 million barrels (consensus: increase of 1.6 million barrels), the largest gain since January. At the same time, the US Treasury Department sanctioned 22 foreign entities for their roles in facilitating the sale of Iranian oil. This came as the US Treasury said Iran is using front companies abroad and offshore accounts to transfer hundreds of millions of dollars from Iranian oil sales, bypassing US sanctions. In addition, Brent prices were supported by talks that President Trump plans to impose new sanctions on Russia due to the Kremlin's continued attacks on Ukraine; as well as reports that OPEC+ was mulling a pause in further production increases after its next monthly hike in September.

Towards month-end, Brent prices soared to settle at USD 72.53/bbl at end-July (m-o-m 7.3% higher) after President Trump ratcheted up pressure on Russia to reach a truce with Ukraine, warning that the US will impose secondary sanctions if Moscow fails to reach a ceasefire with Kyiv in 10 days. Earlier on 14th July, President Trump had initially announced a 50-day truce deadline to Russia (until 2nd September), but has now moved up the new deadline to 8th August. In response, the Kremlin said it "took note" of President Trump's threat to curtail the deadline but made clear that the Russian government would not change course, with Russia ramping up its missile and drone attacks on Ukraine in recent weeks. Earlier, President Trump said he would impose 100% tariffs on Russia, while his advisers signaled that the penalties would likely take the form of secondary levies on countries that buy Russian exports such as oil. On 30th July, President Trump announced that he will impose a tariff of at least 25% on India's exports to the US starting 1st August, citing India's high tariffs and trade barriers, as well as India's purchase of sanctioned Russian energy and weapons. President Trump's announcement dashed New Delhi's hopes of preferential treatment over other Asian countries, who have secured tariff deals ranging from 15-20%. President Trump also threatened "secondary sanctions" on India for buying Russian crude oil, which further strain already tense diplomatic relations between the US and India.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 32bps in July, with returns of 0.59% compared to the index return of 0.27%. Year to date, the Fund outperformed the index by 184bps, with returns of 3.82% versus index returns of 1.98%.

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 rating 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.

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%).

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 USD42 bn, more than 77% of last year's total issuance of USD54.5 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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