Principal Global Investors Funds

Global Sukuk Fund

I Class June 2025

Market Review

Benchmark 10-year US Treasury (UST) prices continued to rally in June, with yields sinking 17bps lower from 4.40% at end-May to 4.23% m-o-m, as softer US economic data and dovish Fedspeak bolstered expectations for a potential rate cut in July. The US Fed unanimously voted at the June FOMC meeting to maintain rates at 4.25%-4.50% but maintained their projections for two cuts this year, as Chairman Jerome Powell reiterated his wait-and-see stance. However, Fed Vice Chair Michelle Bowman and Fed Governor Christopher Waller voiced out their support for a rate cut as early as July, citing transitory inflationary impact from tariffs, driving UST yields lower. Market sentiment was further boosted after the final 1Q25 US GDP reading was unexpectedly revised lower from -0.2% to -0.5% q-o-q (first reading: -0.3%, 4Q24: 2.4%), as personal consumption came in much weaker than initially estimated. The UST yield curve shifted lower and bull steepened slightly m-o-m, with yields falling 16-18bps across all tenures (2-30-year).

In early June, 10-year UST yields initially dipped from 4.40% at end-May to 4.31% on 5th June, amid weaker-than-expected US economic data. In May, US ISM services unexpectedly slipped into contractionary territory for the first time in almost a year from 51.6 in April to 49.9 (consensus 52.0) due to an abrupt pullback in demand, while prices accelerated as higher tariffs seeped through the economy. Similarly, US ISM manufacturing slid further from 48.7 to 48.5 (consensus 49.5), with ISM's import measure falling to a 16-year low and the gauge of exports declining to the lowest level in five years, possibly reflecting retaliatory tariffs from other countries on US producers. Furthermore, ADP private payrolls plunged from 60,000 in April (revised lower from 62,000) to 37,000 in May (consensus 114,000), marking its slowest pace in two years, as business services, education and healthcare sectors s ed jobs. On the other hand, JOLTS job openings unexpectedly picked up from 7.20 million in March to 7.39 million in April (consensus 7.10 million), suggesting that demand for workers remains healthy despite heightened economic uncertainty. The increase in openings was driven by private-sector industries such as professional and business services, as well as health care and social assistance. Nevertheless, 10-year UST yields subsequently jumped to an intra-day high of 4.51% on 9th June, as investors moderated rate cut expectations this year following a stronger-than-expected US jobs report. In May, nonfarm payrolls added 139,000 jobs, exceeding consensus expectations of 126,000 (April: revised lower from 177,000 to 147,000), where job gains accelerated in trade, transportation and utilities, information, financial, other services, as well as leisure and hospitality. Moreover, the unemployment rate stayed firm at 4.2% (consensus 4.2%), while average hourly earnings grew more than expected from 0.2% to 0.4% m-o-m in May (consensus 0.3%, y-o-y unchanged at 3.9% vs. consensus 3.7%).

In mid-June, 10-year UST recovered, with yields falling to 4.31% on 13th May, amid a softer-than-expected inflation report and strong demand for primary UST auctions. In May, US headline CPI fell from 0.2% in April to 0.1% m-o-m (consensus 0.2%, y-o-y up from 2.3% to 2.4% vs. consensus 2.4%). Core CPI also fell from 0.2% to 0.1% m-o-m (consensus 0.3%, y-o-y flat at 2.8% vs. consensus 2.9%), suggesting that companies are largely holding back from passing higher tariff costs to consumers. Furthermore, US PPI ticked up from -0.2% in April to 0.1% m-o-m in May (consensus 0.2%), indicating muted inflation across the board, another sign that tariffs have yet to result in higher prices for consumers and businesses. Gains in UST were further boosted by strong demand at the USD39 billion 10-year primary UST auction, with non-dealers taking more than 90% of the offering. However, 10-year UST yields subsequently rose 15bps to 4.46% on 16th June, following news that Israel launched military strikes on Iran on 13th June, prompting a broad selloff in global financial markets and a surge in oil prices, before recovering to around 4.38% ahead of the US Fed meeting on 18th June.

At the FOMC meeting, the US Fed unanimously voted to keep rates unchanged at 4.25%-4.50%, as Chairman Powell reiterated that the central bank was "well-positioned to wait and learn more about the likely course of the economy before considering any adjustments to our policy stance". Meanwhile, the US central bank also downgraded their GDP projection for 2025 from 1.7% to 1.4% (2026: down from 1.8% to 1.6%), and revised up their PCE inflation forecast from 2.7% to 3.0% (2026: up from 2.2 to 2.4%). The projected unemployment rate was also revised higher from 4.4% to 4.5% for 2025, as the committee acknowledged some recent softening in the labor market. In its statement, the Fed said uncertainty over the economic outlook "has diminished but remains elevated", with Chairman Powell reiterating that there is time to wait for more clarity on the likely course of the economy.

10-year UST yields traded sideways following the US Fed meeting, given the lack of new information. Nevertheless, market sentiment subsequently turned bullish amid weakening US economic data and dovish comments from several Fed members, prompting yields to rally from around 4.40% to close the month at 4.23% (m-o-m 17bps lower). On 23rd June, Fed Vice Chair Michelle Bowman said she would support cutting rates as soon as their next meeting in July, as she expects President Trump's trade war to have a smaller effect on inflation than anticipated. Bowman also said recent data had "not shown clear signs of material impact from tariffs and other policies", and that the inflationary effect of the trade war "may take longer, be more delayed and have a smaller effect than initially expected". Bowman's remarks echoed Fed Governor Christopher Waller's view that the US central bank should begin easing monetary policy in July to avoid a potential slowdown in the labor market, and as inflation is not posing a major economic threat. These dovish remarks were vindicated by the weak Conference Board Consumer Confidence index for June, which plummeted from 98.4 in May to 93.0 (consensus 99.8), amid growing nervousness over the labor market outlook.

Meanwhile, US retail sales slumped from -0.1% in April (revised lower from 0.1%) to -0.9% m-o-m in May (consensus -0.6%), as anxiety over tariffs and personal finance prompted consumers to cut back on spending after a shopping spree in the beginning of the year. According to the retail sales report, seven out of thirteen categories posted declines, mainly dragged by building materials, gasoline and motor vehicles; while spending at restaurants and bars, the only service-sector category in the retail report, fell by the most since early 2023. Furthermore, the final 1Q25 GDP print was revised lower from -0.2% to -0.5% q-o-q (first reading: -0.3%; 4Q24: 2.4%) amid a large downward revision to personal consumption from 1.2% to 0.5%. Meanwhile, PCE inflation, the US Fed's preferred inflation gauge, was flat at 0.1% m-o-m in May (consensus 0.1%, y-o-y up from 2.2% to 2.3% vs. consensus 2.3%). Core PCE ticked up from 0.1% to 0.2% m-o-m (consensus 0.1%, y-o-y up from 2.6% to 2.7% vs. consensus 2.6%). Towards month-end, sentiment in the UST market was also lifted by talks that President Trump may announce Fed Chairman Powell's replacement earlier than anticipated, "by September or October", way ahead of the expiry of Powell's term in May 2026. This comes as President Trump seeks to replace Powell with a Fed Chair who is more aligned to his economic agenda, amid the president's public frustration with Powell for maintaining his cautious wait-and-see stance.

Global oil markets were taken on a bumpy ride during the month, with Brent crude oil prices initially trading at a range of USD 63-69/bbl, before spiking to a high of USD 81.40/bbl on 23rd June, after Israel's attack on Iran's nuclear facilities, missile sites and military leadership stoked fears of an oil supply disruption. However, Brent prices subsequently normalized and ended the month at USD 67.61/bbl (m-o-m 5.8% higher), as concerns over a wider conflict in the Middle East region (and its dire consequences to the global economy) dissipated after President Trump brokered a ceasefire between Israel and Iran.

In early June, Brent prices steadily rose from USD 63.90/bbl at end-May to around USD 69/bbl on 12th June, amid optimism over ongoing trade talks between the US and China. Prices were also buoyed by OPEC+'s earlier decision on 31st May to raise oil production by 411,000 barrels per day (bpd) for July (May and June: 411,000 bpd each, April: 138,000 bpd), which came as a relief after talks emerged that the alliance was mulling an even larger production increase. With the latest oil supply hike, OPEC+ will have replenished 1.371 million bpd out of its 2.2 million bpd voluntary cuts, while the remaining 3.66 million bpd supply cuts will remain in place until end-2026. In addition, Brent prices were supported by simmering geopolitical tensions after Ukraine struck military infrastructures in Russia, while Iran criticized a report showing its growing stockpiles of enriched uranium, in escalations that reduce the chances of more supply entering the market from these two sanctioned OPEC+ members. President Trump said the US will not allow any uranium enrichment as part of a potential nuclear deal with Iran, countering an earlier report that some enrichment could be allowed. Furthermore, concerns over increased oil supply from OPEC+ were moderated by production disruptions due to Canada's wildfires. The blazes in Canada's energy heartland of Alberta have shut down almost 350,000 bpd of heavy crude production, more than three quarters the amount of oil production OPEC and its alliance agreed to resume in July.

On 13th June, news broke that Israel had launched waves of airstrikes against Iran's nuclear facilities and ballistic-missile sites, as well as carried out assassinations of top Iranian military officials and nuclear scientists. Israeli Prime Minister Benjamin Netanyahu said the attacks targeted Tehran's nuclear program and military, and would last until the threat was removed. Brent prices jumped more than 10% to touch USD 78.50/bbl on the same day, amid panic that a major escalation between the two adversaries may spark a severe crisis with far-reaching economic and geopolitical consequences. While OPEC+'s spare oil production capacity may be able to cover the loss in Iranian oil production, investors were also worried that Iran may try to shut down the Strait of Hormuz, a narrow waterway which handles about a quarter of the world's oil trade. In addition, the Red Sea, flanked by Suez Canal and Bab-el-Mandeb strait on either side, is another crucial area for container ships that has been under attack by Yemen's Houthi rebels, financed by Tehran. After briefly consolidating, Brent prices continued to march higher to USD 79.04/bbl on 19th June, amid little signs that the conflict would be resolved soon.

On 23rd June, the US carried out airstrikes on three nuclear sites in Iran overnight, directly entering Israel's war with Tehran despite President Trump's longtime promises to stay away from new foreign conflicts. President Trump announced that Iran's key nuclear enrichment facilities had been "totally obliterated" and warned of "far greater" attacks unless the Islamic Republic agreed to make peace, increasing the prospects of deeper US involvement in a Middle East war sparked by Israel. Brent prices spiked to USD 81.40/bbl, as the US' attack drastically raised the stakes in the confrontation, stoking already deep concerns over a potential disruption in energy supplies. However, Brent prices quickly plummeted to around USD 70/bbl on the same day, after President Trump announced that Israel and Iran have agreed to a "complete and total" ceasefire, despite neither country confirming the agreement. Subsequently, Brent prices consolidated and ended the month at USD 67.61/bbl (m-o-m 5.8% higher), amid positive signals that the ceasefire would hold, therefore alleviating fears of further escalation in the 12-day conflict. Moreover, the oil demand outlook for China, the world's largest crude oil importer, turned slightly less bearish after the nation's factory activity improved for a second straight month in June, albeit remaining in contraction.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 49bps in June, with returns of 1.11% compared to the index return of 0.62%. Year to date, the Fund outperformed the index by 150bps, with returns of 3.21% versus index returns of 1.71%.

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.

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 US5.9 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 3.5% (2026: up from 3.7% to 3.9%), bolstered by OPEC+'s unwinding of oil production cuts.

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. The rating also benefits from Abu Dhabi's sovereign net foreign assets amounting to 157% of UAE GDP in 2024. According to a report by Henley & Partners, the UAE is ranked as the world's most popular wealth haven, and is expected to attract a record 9,800 wealthy migrants to the country this year.

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 USD34 bn, more than 63% 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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