Principal Global Investors Funds

Global Sukuk Fund

I Class June 2026

Market Review

US Treasury(UST) weakened again in June as the sell-off was concentrated at the front end of the curve. During the month the 2-year UST yield rose from 4.00% at end-May to 4.17% at end-June, while the 5-year rose from 4.14% to 4.23%. The 10-year yield rose only around 3bps to 4.47%, and the 30-year yield was slightly lower at 4.95%, resulting in a bear-flattening of the yield curve. Investors scaled back expectations for near-term Federal Reserve rate cuts. The move reflected continued concerns over persistent inflation and a resilient labour market, which reinforced the view that interest rates may remain higher for longer. As geopolitical tensions eased and the Strait of Hormuz risk premium unwound, the improvement in energy prices was insufficient to drive a meaningful rally in government bonds, as major central banks remained focused on inflation risks.

US economic data in June reinforced the higher-for-longer interest rate narrative, as inflation remained elevated despite some moderation in goods prices. While economic growth was mixed, with first-quarter GDP revised up and manufacturing activity remaining in expansion territory, inflationary pressures in services continued to limit the scope for monetary easing. The labour market also remained relatively resilient, with ADP payrolls increasing by 98,000. Enough to keep the three-month average above 100k, and unemployment expected to stay around 4.3%, reducing the urgency for rate cuts. Reflecting on these conditions, the Federal Reserve maintained its policy rate at 3.50%–3.75% but adopted a more hawkish tone by removing forward guidance and reaffirming its commitment to price stability. The latest dot plot signaled that policymakers remain cautious on inflation and are increasingly open to keeping rates elevated for longer. As a result, expectations for Fed easing have been pushed back, with the balance of risks shifting towards a prolonged pause rather than a rate-cutting cycle.

Investment-grade global sukuk remained resilient in June, with the Dow Jones Sukuk Index posting a modest gain of approximately 0.20%, despite higher US Treasury yields and increased expectations that interest rates will remain elevated for longer. Performance was supported by carry income, continued demand for high-quality credits, and the easing of geopolitical and oil-related risk premiums. Market technicals also remained favorable, with new issuance of USD23.7 billion trailing maturities of USD29.9 billion, resulting in negative net issuance of approximately USD6.2 billion, which helped support prices and absorb market volatility. Nevertheless, investors should continue to remain selective given ongoing macroeconomic and interest rate uncertainties.

The GCC economy in June continued to navigate the aftermath of the US/Israel-Iran conflict, with growth, trade flows and investor confidence still affected by earlier disruptions. At the same time, signs of stabilization emerged as regional markets moved towards gradual reopening and geopolitical tensions eased. Brent crude fell sharply from USD92.05/bbl to USD72.92/bbl, helping to reduce inflationary pressures and support sentiment toward high-quality GCC credits, although ongoing geopolitical uncertainties and supply-side risks remain. Despite lower expectations of growth, GCC sovereigns continue to be underpinned by strong balance sheets and substantial financial buffers, providing resilience against near-term economic challenges. While GCC GDP is expected to contract in 2026 before recovering in 2027 as disruptions fade, the region's monetary policy remains closely linked to the US through currency pegs, suggesting that interest rates are likely to stay elevated for longer.

Primary market activity remained robust in June, with healthy issuance across sovereign, financial institution and corporate sukuk segments, reflecting sustained investor demand for both investment-grade and higher-yielding credits. Notable transactions included Dubai Islamic Bank’s USD1.0 billion perpetual AT1 sukuk and APICORP’s USD500 million senior sukuk, highlighting continued appetite for high-quality regional issuers. Investor interest also extended to higher-yielding offerings, including issuances from BAJ, Dukhan and Burjeel, demonstrating strong demand across the credit spectrum. The largest transaction of the month was Türkiye’s USD2.75 billion sovereign sukuk due 2032, further underscoring the depth of demand in the USD sukuk market. Overall, June issuance reflected resilient market liquidity and broad investor participation. There were no notable credit rating changes within the global sukuk asset class during the month.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 4bps in June, with returns of 0.24% compared to the benchmark return of 0.20%. As of Year to date, the Fund underperformed the benchmark by -46bps, with returns of 0.29% versus index returns of 0.75%. Similar to last month, the performance of the fund was driven by carry, resilient demand high-quality credit, and the unwinding of the most extreme oil and geopolitical risk premium.

Portfolio Outlook and Strategy

After a period of heightened geopolitical stress, market conditions improved in July as the US-Iran Memorandum of Understanding reduced concerns over a broader regional conflict and supported the gradual normalisation of activity around the Strait of Hormuz. Easing tail risks contributed to lower oil prices, firmer risk sentiment and a recovery in higher-quality fixed income assets. Nevertheless, investors remain cautious amid persistent US inflation, lingering disruptions across parts of the GCC and diverging economic trends within ASEAN.

In the United States, economic conditions continue to reflect a slow-growth yet resilient environment. Business activity remains expansionary, labour markets are holding up and consumer spending has not deteriorated materially. However, growth is becoming increasingly reliant on higher-income households, fiscal support and AI-related investment, while housing activity and consumer confidence remain subdued. More importantly, inflation remains inconsistent with an imminent easing cycle, reinforcing the Federal Reserve's higher-for-longer stance. While recession risks remain limited, the backdrop does not yet justify a more constructive duration position.

Within the GCC, the narrative has shifted from acute disruption towards gradual recovery. Although the US-Iran agreement has reduced immediate geopolitical risks, the earlier impact on shipping, exports, tourism and logistics continues to weigh on parts of the region. Saudi Arabia and the UAE remain best positioned given their stronger policy frameworks, sizeable buffers and resilient non-oil sectors. In contrast, Qatar and Kuwait remain more exposed to Hormuz-related export risks, while Bahrain continues to be constrained by weaker fiscal flexibility. Encouragingly, the region is facing temporary growth and confidence shock rather than a solvency challenge.

ASEAN remains increasingly bifurcated, with Malaysia standing out as the preferred exposure. Export growth, manufacturing activity and trade balances have remained resilient, supported by E&E exports, AI-related demand and petroleum products, while inflation remains contained. Indonesia presents a less favourable picture, with rising inflation, declining reserves and a weakening external position prompting a renewed focus on currency stability. As a result, Malaysia continues to offer a more attractive risk-adjusted profile, while Indonesia warrants a higher risk premium.

From a market perspective, technicals have improved following the June recovery, particularly among sovereign and government-related GCC sukuk. However, the normalisation process remains incomplete and upcoming GCC issuance could create supply pressure, especially within the intermediate segment of the curve. Valuations have largely normalised, although selective opportunities remain in longer-dated GCC sovereign and quasi-sovereign sukuk where curves continue to offer relative value.

Looking ahead, our investment approach remains centred on quality, selectivity and carry generation. We expect the Federal Reserve to remain on hold as inflation stays elevated, while additional GCC issuance may provide opportunities to add exposure at more attractive levels. Portfolio strategy will therefore continue to favour higher-quality sovereign, quasi-sovereign and government-related sukuk while remaining selective towards lower-rated credits. Malaysia remains the preferred ASEAN allocation, while exposure to Indonesia should remain measured until macroeconomic conditions improve further.

For the Fund's strategy, we intend to maintain a selective carry-and-quality approach with duration positioned broadly neutral to mildly short. While markets continue to price tighter monetary conditions into 2H26, the prevailing environment appears more consistent with an extended period of restrictive policy. We would therefore look to add duration opportunistically during yield spikes, particularly in high-quality longer-dated GCC sovereign and government-related sukuk. Within credit, preference remains skewed towards issuers with resilient balance sheets, strong liquidity and clear shareholder or government support, while exposure to sub-investment-grade names will remain highly selective.

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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