Principal®

Principal Global Investors Funds

Global Sukuk Fund

I Class March 2025

Market Review

Benchmark 10-year US Treasury (UST) yields drifted 19bps higher in March, from 4.21% to touch 4.40% on 27th March, as the market took a breather following the strong rally in February, coupled with mixed US economic data. The US Fed kept rates unchanged at 4.25-4.50% on 20th March as widely expected, and maintained its forecast of two rate cuts this year. Policymakers also downgraded their growth expectations for 2025 and braced for higher inflation, while cautioning that "uncertainty around the economic outlook has increased". In addition, the US central bank announced that it will slow the pace of its balance sheet runoff beginning April, by lowering the cap on USTs allowed to mature without being reinvested from USD 25bil to USD 5bil. Nevertheless, 10-year UST rallied strongly in the final two trading days of 1Q25 to settle at 4.21% (m-o-m unchanged), driven by flight to safety as investors brace for US President Trump's scheduled retaliatory tariff announcement on 2nd April. The UST yield curve steepened m-o-m, with shorter 2-7 year yields declining by 4-11bps, while longer 20 and 30-year yields rose 7-8bps.

Nevertheless, 10-year UST yields rose again to 4.35% on 13th March, after JOLTS job openings surprised on the upside, increasing from 7.508 million in December to 7.740 million in January (consensus 7.600 million). Meanwhile, US headline CPI cooled more than expected from 0.5% in January to 0.2% m-o-m in February, the slowest pace in four months (consensus 0.3%, y-o-y down from 3.0% to 2.8%), driven in part by a drop in prices for cars and gas. Core CPI also eased from 0.4% to 0.2% m-o-m (consensus 0.3%, y-o-y down from 3.3% to 3.1%). However, the reprieve from higher prices is anticipated to be short-lived, as an escalating trade war may ratchet up prices on a variety of goods from food to clothing in the coming months. Subsequently, 10-year UST yields continued to fluctuate despite weaker-than-anticipated US economic data, as investors await the outcome of the US Fed meeting on 20th March. For example, the preliminary University of Michigan consumer sentiment index tumbled from 64.7 in February to 57.9 in March (consensus 63.0), the lowest in more than 2 years, with long-term inflation expectations soaring by the most since 1993 from 3.5% to 3.9%.

On 20th March as widely anticipated, the US Fed held rates unchanged at 4.25-4.50% for a second meeting in a row, and stuck to their December forecast for two rate reductions this year. However, the distribution of dots skewed more hawkish: for 2025, eight FOMC participants now expect zero or only one rate cut, compared to only four participants in December. The US Fed also revised down their US GDP projections from 2.1% in December to 1.7% for 2025, from 2.0% to 1.8% for 2026 and from 1.9% to 1.8% for 2027; citing increased uncertainty over the economic outlook as a result of President Trump's policies. Meanwhile, headline and core PCE inflation forecasts for 2025 were revised upwards, from 2.5% to 2.7% for the former and from 2.5% to 2.8% for the latter. Despite this, Fed Chairman Jerome Powell adopted a more neutral tone during his press conference, downplaying mounting growth concerns and inflationary pressures from President Trump's trade war. Powell even revived a once-abandoned term to say the inflationary impact of tariffs is likely to be "transitory." When asked about sagging business and consumer sentiment, Powell said "hard data" show the US economy remains on a solid footing, and expressed confidence that long-run inflation expectations remain well anchored.

Following the FOMC meeting, 10-year UST yields briefly dropped to 4.17%, but subsequently resumed its upward grind to touch 4.40% on 27th March, as risk appetite improved amid chatters that the Trump administration's eventual tariff structure may be less severe and widespread than previously feared. This comes ahead of "Liberation Day" on 2nd April, when President Trump is expected to announce reciprocal tariffs aimed to match levies that other countries charge on American exports, while also factoring in other penalties like taxes and currency manipulation. Sentiment was also dented by better-than-expected US data, e.g., the final reading of US 4Q24 GDP (revised upwards from 2.3% to 2.4%), as well as hawkish remarks from US Fed officials, who seemed to be at odds with Powell's "transitory inflation" view. Atlanta Fed president Raphael Bostic said while tariffs have historically had a one-time impact on prices, the recent Covid-related spike in inflation may cause consumers to be more price-sensitive this time around, affecting consumption. Reflecting this, Bostic said he now expects only one rate cut this year, rather than two, with tariff hikes impeding progress on disinflation. Meanwhile, headline PCE inflation was flat at 0.3% m-o-m in February (y-o-y unchanged at 2.5%), while core PCE ticked up from 0.3% to 0.4% m-o-m (y-o-y up from 2.7% to 2.8%). Nevertheless, 10-year UST rallied strongly on the final two trading days of the month to settle at 4.21% (m-o-m unchanged), as investors flocked to the safety of UST after President Trump said he plans to start his reciprocal tariff push with "all countries", curbing expectations that he may limit the initial scope of the levies.

Brent crude oil prices gained 2.1% in March, from USD 73.18/bbl at end-February to USD 74.74/bbl at end-March, supported by prospects of supply disruption caused by US President Trump's sanctions and levies. Nevertheless, the rise in Brent prices was tempered by ongoing concerns over softer global demand and rising supply, with OPEC+ scheduled to begin reviving idled production in April.

Brent crude oil initially started the month on a weaker note, with prices declining 6.6% to touch USD 68.33/bbl on 5th March, after OPEC+ announced that it will proceed to revive halted oil production, starting with 138,000 barrels per day (bpd) in April, and will gradually restore a total of 2.2 million bpd by 2026. The unexpected announcement came after three rounds of delays since OPEC first announced a supply roadmap in June 2024, catching investors by surprise. The increased production from OPEC+, coupled with the possibility of a change in Washington's stance toward tough sanctions on Russia raised concerns over a supply glut, sending Brent prices tumbling to the lowest level since September 2024. Sentiment was also dampened by news that the US was slapping 25% tariff on all imports from Mexico and Canada (except Canadian energy, at 10% tariff), as well as a 20% levy on Chinese goods.

Nevertheless, Brent prices subsequently drifted higher towards USD 72/bbl in mid-March, after Israel conducted military strikes across Gaza, shattering a ceasefire with Hamas that began in January. Furthermore, US attacks on Yemen's Iran-backed Houthi rebels revived concerns over a wider Middle East conflict, supporting Brent prices. China's plans to revive consumption by boosting people's incomes also lifted sentiment in the oil market. Other measures announced by the Chinese government include stabilizing the stock and real estate markets, and offering incentives to raise the country's birth rate, as the government tries to ease the deflationary pressures afflicting the economy. Brent prices briefly fell to USD 70/bbl on 19th March, after data released by the US Energy Information Administration (EIA) showed that US crude oil inventories rose by 1.7 million barrels to 437 million barrels for the week ending 14th March, significantly above analysts' expectations of 500,000 barrels.

However, in the final week of March, Brent prices rallied strongly to end the month at USD 74.74/bbl (m-o-m 2.1% higher), as signs of tighter near-term supply-and-demand balances overshadowed an intensifying global trade war that may crimp global energy consumption. According to the EIA, US crude oil inventories tumbled by 3.3 million barrels for the week ending 21st March, much sharper than expectations for a 956,000 barrel decline, pushing Brent prices higher. In addition, on 24th March, the Trump administration announced a new 25% secondary tariff on Venezuelan crude oil buyers, days after revealing sanctions targeting China's imports on Iran. The order authorizes the US State Department to issue 25% tariffs on all goods imported to the US from any country that imports Venezuelan oil, whether directly or indirectly, to take effect on 2nd April. The move is seen as a way to pressure China, a major purchaser of Venezuelan crude, and to deter other countries from buying Venezuela's oil exports. On the final trading day of the month, Brent prices jumped after President Trump threatened to impose 25-50% secondary tariff on all oil coming from Russia if a ceasefire with Ukraine cannot be reached. Russia is the third largest oil producer globally, therefore any attempts to punish purchases of Russian oil may have wide-reaching repercussions on the oil market, with India and China under pressure as key buyers of Russian barrels.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 36bps in March, with returns of 0.60% compared to the index return of 0.24%. Year to date, the Fund outperformed the index by 20bps, with returns of 1.39% versus index returns of 1.19%. At the end of March, as US Treasury yields went toppish ahead of Trump's "Liberation Day" tariff announcement, we took the opportunity to increase duration and exposure in Malaysia sovereigns and Saudi's mining company and ride 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.

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). Meanwhile, concerns over the impact of President Trump's tariffs to US and global growth have sent UST prices soaring, benefitting the Global Sukuk asset class as well. Nevertheless, 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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