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Principal Global Investors Funds

Global Sukuk Fund

I Class March 2026

Market Review

The US and Israel launched coordinated military strikes against Iran on 28th February, citing the need to neutralize imminent threats, following weeks of military buildup despite ongoing nuclear negotiations. The large-scale attacks targeted Iranian military assets, infrastructure and senior leadership, with significant casualties across multiple provinces. Retaliation by Iran included missile and drone attacks on Israel and US bases across the Gulf, including Qatar, Kuwait, the UAE and Bahrain. The escalation has led to the closure of the Strait of Hormuz, a critical transit route for global seaborne crude oil, as well as LNG and refined products.

Even prior to this declaration of the closure by Iranian officials, tanker traffic through the Strait has largely halted as companies await clarity on the security situation along the waterway along with global insurers significantly hiking insurance coverage prices or outright canceled them. A sustained disruption was expected to impact major Asian importers such as China, India and South Korea, which receives approximately 80% of all crude oil and LNG passing through the Strait. In addition, approximately 13% of Europe's total LNG imports come from Qatar and the UAE, with Italy, Belgium and Poland obtaining around 40% of their LNG imports through the waterway. In response, the OPEC+ agreed to increase oil production by 206,000 bpd in April, resuming the unwinding of the 1.65 million bpd additional voluntary cuts that were paused in 1Q26. The International Energy Agency (IEA) also announced that it will release 400 million barrels of oil from its members' strategic reserves to counter soaring global energy prices, which is larger than the 182 million barrels of oil that IEA member countries released in 2022 after Russia launched its full-scale invasion of Ukraine.

Global financial markets reacted sharply to the escalation, with oil prices surging and equity markets declining. US Treasury (UST) weakened across the board in March, after staging a strong rally in February, driven by concerns that the ongoing US-Israel-Iran war that may heighten inflationary pressures. The war resulted in the closure of the Strait of Hormuz, disrupting the flow of energy and other commodities from the Middle East region to the rest of the world. Global energy prices have surged in response, with Brent crude rising close to USD120/bbl, exacerbating worries over the risk of rising inflation and prompting markets to reassess the likelihood of US rate cuts for 2026. During the month, the UST yield curve bear flattened as shorter 2–7-year yields jumped 42-44bps, while 20–30-year yields rose 36bps and 30bps respectively. The bellwether 10-year UST climbed 38bps to end the month at 4.32%.

Investor attention remained focused on the conflict, overshadowing US economic data. In February, US ISM Manufacturing eased slightly to 52.4 but exceeded expectations, while input prices surged to the highest level since 2022 and new orders declined. In contrast, ISM Services rose strongly to 56.1, supported by higher new orders and easing input prices. Labor data were mixed: ADP employment beat expectations by rising to 63,000, but non-farm payrolls unexpectedly fell by 92,000, reflecting temporary disruptions from strikes and adverse weather. The unemployment rate nudged 0.1% higher to 4.4%, while labor participation slipped to 62.0%. US inflation data were mixed, with headline CPI rising to 0.3% m-o-m in February, driven by higher gasoline and food prices, while core CPI eased to 0.2% on softer used cars, insurance and housing costs. Meanwhile, US 4Q25 GDP was revised sharply lower to 0.7% q-o-q due to weaker consumer, government and export spending. Consumer sentiment also deteriorated, with the University of Michigan index falling to a three-month low in March amid concerns over rising gasoline prices and cost-of-living pressures. Retail sales declined by 0.2% in January.

As expected, the US Fed voted 11-1 to keep rates unchanged at 3.50–3.75% and maintained its projection of one rate cut each in 2026 and 2027. The Fed upgraded its GDP forecasts for 2026–2028, while raising both headline and core PCE inflation projections for 2026, with inflation expected to moderate thereafter. Unemployment forecasts were broadly stable, though slightly higher for 2027. While the dot plot still showed a majority expecting at least one cut this year, several officials signaled fewer cuts, and one projected a hike next year. Chair Powell struck a mildly hawkish tone, noting that rate cuts would depend on renewed inflation cooling and that it was too early to assess the economic impact of higher oil prices.

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Fund Review

The Fund underperformed the Dow Jones Sukuk index by 98 bps in March, with returns of -3.55% compared to the index return of -2.57%. Year to date, the Fund underperformed the index by 18 bps, with returns of -2.45% versus index returns of -2.27%. Much of the underperformance was driven by weaker performance in long-duration positions and high-yield exposures such as the real estate sector.

Portfolio Outlook and Strategy

After nearly six weeks of elevated volatility, markets are expected to regain some composure as the United States and Iran begins its two-week ceasefire and the coming negotiations to end the conflict. The announcement eased fears of a prolonged global energy shock, triggering a decline in oil and gas prices and prompting a relief rally in US Treasuries. That said, Federal Reserve messaging remains uneven. While Chairman Powell and New York Fed President John Williams maintain that policy is appropriately positioned, despite some softening in growth expectations, other policymakers have signaled lingering unease over inflation persistence and labor-market fragility. This divergence underscores a Fed that is cautious, data-dependent, and far from committed to an imminent easing cycle.

In contrast, the macroeconomic outlook for the GCC remains broadly constructive, underpinned by formidable sovereign wealth buffers and strong institutional frameworks. Saudi Arabia, the UAE, Kuwait, and Qatar collectively hold external assets and reserves at levels sufficient to absorb significant external shocks. Recent affirmations by Moody's and S&P underscore this resilience, citing low sovereign leverage, robust fiscal positions, and effective policymaking. The UAE's growing role as a global trade hub, supported by record goods and services trade and continued momentum in high-end real estate, adds further stability. Notably, Dubai's property market has continued to display strength in the ultra-luxury segments, reflecting sustained capital inflows and confidence in the emirate's longer-term growth prospects.

Saudi Arabia's domestic financial indicators likewise point to underlying strength. Bank deposits have reached record highs, reflecting stronger private-sector activity, higher savings rates, and the continued impact of Vision 2030 reforms. The expansion of SAMA's foreign reserve assets further reinforces the Kingdom's external position. Importantly, both Saudi Arabia and the UAE benefit from infrastructure that allows oil exports to partially bypass the Strait of Hormuz, mitigating the economic impact of maritime disruptions. Oman, too, enjoys a geographic advantage, with its location outside the Persian Gulf helping to preserve trade flows; its improving fiscal position has been recognised by recent rating affirmations.

Looking ahead, the trajectory of global fixed income, particularly US rates and Global Sukuk, will remain closely tied to the evolution of the US-Israel-Iran conflict. A sustained energy shock risks feeding into US inflation and growth dynamics, potentially reshaping the Fed's policy path. In the GCC, however, the economic impact is expected to remain largely contained for now, supported by sizable sovereign wealth and FX reserves. While divergence within the region is likely, based on export exposure and non-oil sector sensitivity, overall resilience remains a defining feature. Given the fluid geopolitical backdrop, portfolio strategy will prioritise flexibility and capital preservation, maintaining a more defensive stance with elevated cash levels while remaining ready to redeploy as greater clarity emerges.

For the Fund's strategy, we intend to maintain a neutral duration with tactical allocation on longer tenures should the ceasefire and/or resolution become increasingly apparent. This also applies to credit allocation, with greater emphasis on sovereign or government related entities and selective exposures to unrated or sub-investment grade names which provides greater earnings visibility, capped reliance on consumer discretionary in its business operations and notable strong shareholder support.

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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