Principal Global Investors Funds

Global Sukuk Fund

I Class May 2025

Market Review

US Treasury (UST) prices weakened in May, with benchmark 10-year yields pressured higher from 4.16% at end-April to 4.54% in mid-May, as investors pared expectations of US rate cuts amid growing optimism over trade deals between the US and its major trading partners, as well as stronger-than-expected US economic data. Sentiment was further hampered by rising ultra-long Japanese government bond yields and growing concerns over the US' ballooning fiscal deficits after House Republicans passed President Trump's "One Big Beautiful Bill", pushing 10-year UST yields higher to touch 4.62% on 22nd May. The US lost its remaining AAA credit rating earlier on 16th May, when Moody's downgraded it by one notch to AA1, citing large deficits and rising interest costs. Nevertheless, 10-year UST subsequently rallied 22bps to close the month at 4.40% (m-o-m 24bps higher), bolstered by mixed US economic data, stabilization of Japan's debt market, and some setbacks in trade talks. The UST yield curve shifted upwards m-o-m, with 2-year yields rising by 30bps, while 5-30 year yields climbed by 24-25bps.

In early May, 10-year UST yields trended higher from 4.16% at end-April to touch 4.40% on 9th May, as most US economic data surprised on the upside. In April, US ISM services unexpectedly rose from 50.8 in March to 51.6 (consensus 50.2), with eleven industries recording growth, led by accommodation and food services, wholesale trade, mining and real estate. On the other hand, US ISM manufacturing index dipped from 49.0 to 48.7 over the same period, albeit higher than consensus expectations of 47.9. The decline was caused by thinning orders and higher material costs from tariffs, which drove the steepest output contraction since 2020. Furthermore, the US employment report for April was solid, indicating that tariff uncertainty has yet to meaningfully impact the job market, prompting investors to dial back expectations of US rate cuts this year. Nonfarm payrolls added 177,000 jobs in April, significantly exceeding consensus expectations of 138,000 (March: revised lower from 228,000 to 185,000), with job gains seen in healthcare, transportation and warehousing, financial activities and social assistance, while federal government employment fell. Moreover, the unemployment rate held steady at 4.2% (consensus 4.2%), while average hourly earnings ticked lower from 0.3% in March to 0.2% m-o-m in April (consensus 0.3%, y-o-y unchanged at 3.8% vs consensus 3.9%).

On 7th May, the US Fed unanimously agreed to maintain rates at 4.25-4.50% for the third consecutive meeting. In the policy statement, the committee said, "risks of higher unemployment and higher inflation have risen", highlighting growing risks of a stagflationary environment. Fed Chairman Jerome Powell and his colleagues indicated that they are determined to keep tariffs from triggering a lasting increase in inflation, with several officials signaling that they would not support preemptive rate cuts to protect against a slowing economy. Chairman Powell also noted that trade negotiations could have a material impact on the economic outlook, thus the committee will have to take a "wait and see" approach. Meanwhile, UST yields continued to be under pressure after President Trump announced a trade framework with the UK on 8th May, the first agreement the White House has reached since launching steep new global tariffs in April, igniting hopes of less aggressive trade policies going forward. Separately, US Treasury Secretary Scott Bessent informed US lawmakers that federal debt limit measures may run out in August, and urged Congress to "increase or suspend the debt limit by mid-July, before its scheduled break, to protect the full faith and credit of the United States". The timeline puts pressure on Republicans to agree on a huge tax and spending package in the coming weeks, which includes a USD5 trillion boost in the debt ceiling, further dampening demand for UST.

In mid-May, 10-year UST yields continued to march higher to 4.54% on 15th May, as risk sentiment improved amid more promising trade talks, before easing to 4.39% on the back of softer US economic data. Earlier on 11th May, the US and China agreed to temporarily lower tariffs on each other's goods in efforts to de-escalate trade tensions, buying the world's two largest economies three months to work toward a broader agreement. Meanwhile, US headline CPI eased from 2.4% in March to 2.3% y-o-y in April (consensus 2.4%, m-o-m up from -0.1% to 0.2% vs consensus 0.3%), amid softer prices for clothing and new cars, suggesting little urgency so far by companies to pass along the cost of higher tariffs to consumers. At the same time, weakness in service categories such as travel and recreation indicate that consumers are cutting down on leisure and other discretionary spending. Core CPI remained sticky at 2.8% y-o-y (consensus 2.8%, m-o-m up from 0.1% to 0.2% vs consensus 0.3%). Nevertheless, 10-year UST yields subsequently tumbled to around 4.40%, following a slew of weaker-than-expected US economic data. In April, US retail sales declined from 1.7% in March (revised higher from 1.4%) to 0.1% m-o-m (consensus 0.0%), as consumers cut back on spending on cars, sporting goods and other categories of imported goods due to concerns over rising prices from tariffs. Furthermore, US PPI unexpectedly contracted from 0.0% in March (revised higher from -0.4%) to -0.5% in April (consensus 0.2%), the steepest decline in five years, and largely attributed to a slump in margins, suggesting companies are absorbing some of the hit from higher tariffs.

Nonetheless, 10-year UST yields rose again to touch 4.62% on 22nd May, as investors shifted their focus back to the US' rising deficits after Moody's downgraded the US' credit rating by one notch from AAA to Aa1 on 16th May. Moody's was the last of the three main international rating agencies to remove the US' top-tier rating, as S&P and Fitch had downgraded it from AAA to AA+ in 2011 and 2023 respectively. Moody's cited deepening concerns that the US' swelling debt and deficit (running near USD2 trillion a year; more than 6% of GDP) will damage its standing as the preeminent destination for global capital and increase the government's borrowing costs. The downgrade reinforced investors' growing concerns over the US' fiscal outlook, pressuring the longest 30-year UST yields higher to touch 5.15% on 22nd May, the highest since October 2023, after the US House of Representatives passed the "One Big Beautiful Bill Act" by a narrow 215-214 margin (the bill has now moved for voting at the Senate). Sentiment was further dented by a similar situation in Japan, where ultra-long Japanese bond yields rose to record highs amid worries over a new fiscal stimulus programme. Furthermore, two US Fed officials, i.e. New York Fed Chief John Williams (voter) suggested that policymakers may not be ready to cut rates before September as they confront a gloomy economic outlook, while Atlanta Fed President Raphael Bostic (non-voter) signaled unwillingness to lower rates for some time.

Nevertheless, 10-year UST yields subsequently rallied to close the month at 4.40% (m-o-m 24bps higher), buoyed by mixed US economic data, stabilization of Japan's debt market, as well as some setbacks in President Trump's tariff enactment. While the US' second reading of 1Q25 GDP was revised higher from -0.3% to -0.2% q-o-q (consensus 0.3%), it was still significantly lower than the 2.4% growth recorded in 4Q24, curbed by leaner consumer spending and an even larger impact from trade than initially reported. Personal consumption in 1Q25 was sharply revised lower from 1.8% to 1.2% (consensus 1.7%; 4Q24: 4.0%), its weakest level in two years. Meanwhile, the Fed's preferred gauge of inflation, core PCE inflation, stayed firm at 0.1% m-o-m in April (y-o-y down from 2.7% to 2.5%), while headline PCE inflation rose from 0.0% to 0.1% m-o-m (consensus 0.1%, y-o-y down from 2.3% to 2.1% vs consensus 2.2%). Minutes of the FOMC meeting on 7th May also highlighted the committee's concerns over facing "difficult tradeoffs" over potentially rising inflation and unemployment in the coming months, in addition to increased financial market volatility. Separately on 28th May, a New-York based trade court ruled that President Trump overstepped his authority by imposing hefty levies on all American trading partners in April and the fentanyl-related duties on China, Mexico and Canada; although this has been temporarily halted by the US federal appeal court. Nevertheless, increased uncertainty over trade policies continues to erode business and investor confidence.

Brent crude oil prices recovered in May, from USD 63.12/bbl to touch USD 66.81/bbl on 13th May, following a trade truce between the world's two largest economies, US and China, as well as other positive developments around President Trump's trade negotiations with other major trading partners. Subsequently, Brent prices took a breather to trade around the USD 63.50-66.50/bbl range, before closing the month at USD 63.90/bbl (m-o-m 1.2% higher), amid talks that OPEC+ was considering hiking output by more than 411,000 barrels per day (bpd) for July.

Brent prices initially fell in early May, from USD 63.12/bbl at end-April to touch USD 58.50/bbl, after OPEC+ agreed to increase output again for June, as the group's leaders continue an accelerated revival of production, as a warning to over-producing members that have sent crude prices plummeting. Key OPEC+ members, led by Saudi Arabia and Russia, agreed to add production by 411,000 bpd in June, a similar increase announced in April when the alliance made a surprise decision to produce triple the planned volume for May. In response, Kazakhstan, the largest OPEC over-producer in recent months, agreed to lower its oil production from 1.85 million bpd in March to 1.5 million bpd in June, while reaffirming that it always was and is committed to the OPEC+ agreement. In addition, US Fed Chairman Powell reiterated that the central bank is not in a hurry to lower rates, further weighing on Brent prices.

Nevertheless, Brent prices rebounded sharply to touch USD 66.81/bbl on 13th May, following a 90-day trade truce between the world's two largest economies, US and China, bringing some relief to commodity markets. China announced that it will reduce tariffs on US goods from 125% to 10%, while the US will cut its levies on China from 145% to 30%, as talks for a more comprehensive trade agreement continue before the truce expires on 12th August. In addition, US Treasury Secretary Scott Bessent said neither nation wanted their economies to decouple, and both countries said they would set the means to continue discussions on economic and trade relations. Brent prices were also supported by the trade framework between the US and UK, spurring optimism over more deals to come. President Trump said the UK would fast-track US items through its customs process and decrease barriers on billions of dollars of agricultural, chemical, energy and industrial exports, including ethanol. Nevertheless, the terms of the deal are narrow in scope, while the 10% baseline tariff on UK goods remains in place.

For the remainder of the month, Brent prices traded sideways within the USD 63.50-66.50/bbl range, as investors continue to grapple with a softer outlook for oil demand. Towards month-end, Brent prices strengthened to around USD 66/bbl on 29th May, amid heightened prospects of more US sanctions against Russian oil after President Trump warned that Russian President Vladimir Putin was "playing with fire" by escalating attacks on Ukraine. The US' aggressive measures against Russia's oil industry earlier this year had sent crude prices soaring past USD 80/bbl. Meanwhile, according to the International Energy Agency ("IEA"), global oil demand growth may taper throughout the rest of the year after a robust first quarter, due to "economic headwinds". After growing by 990,000 bpd y-o-y between January and March, the IEA projects the rate of oil consumption growth to decline to a "subdued" 650,000 bpd for the rest of the year. However, Brent prices fell to settle at USD 63.90/bbl (m-o-m 1.2% higher) on the last trading day of the month, amid talks that OPEC+ was mulling an even larger production increase for July. The alliance has made a radical policy shift in the past two months, from defending crude oil prices to driving them lower, which may reflect Saudi Arabia's plans to warn over-producing members like Kazakhstan and Iraq, and recoup market share lost to US shale drillers and other rivals. Nevertheless on 31st May, OPEC+ announced that it will raise oil production by 411,000 bpd for July (similar to the quantum for June), with more than half of the output hike to be split among its big three members, i.e. Saudi, Russia and the UAE.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 48bps in May, with returns of 0.09% compared to the index return of -0.39%. Year to date, the Fund outperformed the index by 99bps, with returns of 2.08% versus index returns of 1.09%. Towards end-May, we added some duration in sovereign and sovereign-related names when 10-year US Treasury yields peaked at 4.62% on May 22nd, and rode 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. Meanwhile, domestic travelers nearly doubled to 86 million, taking the total visitors figure to 116 million. Saudi has surpassed its 2030 target of 100 million visitors in 2023, seven years ahead of schedule. In 1Q 2025, Saudi's non-oil exports rose 13.4% y-o-y to SAR 80.7 bn, led by chemical products.

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). 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.

Important Information

The interest rate used is a general economic indicator that will have an impact on the management of the Fund regardless whether it is a Shariah-compliant Fund or otherwise. It does not in any way suggest that the Fund will invest in conventional financial instruments. All the investments carried out for the Fund are in accordance with Shariah requirements.

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