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Principal Global Investors Funds

Global Sukuk Fund

I Class May 2026

Market Review

In May, US Treasuries saw further weakening as the move was concentrated in the front end and belly than in the long end. The market sell-off was a combination of sticky US inflation, resilient labour data, fiscal and supply concerns, and a still-active oil shock. The 2-year and 5-year yields both rose by around 13.5bps, while the 10-year yield rose by around 6.5bps from 4.37% at end-April to 4.44% at end-May. The 20-year and 30-year yields were almost unchanged. The UST curve therefore bear-flattened, with the 2s10s spread narrowing from around 50bps to 43bps. The move reflected a shift as Investors were no longer debating whether the Fed could cut quickly, but whether inflation and oil-related supply risks could force a longer pause or even a limited tightening bias.

US data in May reinforced the higher-for-longer rates narrative, showing an economy that is moderating but not weakening enough to bring inflation under control. Inflation remained elevated across key measures: headline CPI rose 0.6% mom and 3.8% yoy, with core CPI at 0.4% mom and 2.8% yoy, while PPI was even stronger at 1.4% mom and 6.0% yoy. The Fed's preferred gauges also stayed sticky, with headline PCE at 3.8% yoy and core PCE at 3.3% yoy, alongside rising price pressures in surveys such as ISM manufacturing prices paid. Although growth indicators softened—Q1 GDP was revised down to 1.6%, retail sales and personal spending slowed to 0.5% mom, and income was flat—the slowdown appeared orderly, with industrial production, manufacturing output, and durable goods orders still showing resilience.

The labour market cooled but remained relatively firm, with non-farm payrolls slowing to 115k and unemployment steady at 4.3%, while wage growth held at 3.6% yoy and jobless claims stayed low. Business surveys continued to signal expansion, though unevenly, with manufacturing resilient but services showing signs of softer momentum, and consumer sentiment weakening alongside elevated inflation expectations. Overall, the data mix pointed to slowing but still stable growth, persistent inflation, and a resilient labour market—conditions that reduced the likelihood of near-term Fed easing and kept the focus on a prolonged pause with upside risks to interest rates.

In May, Performance dispersion was more important than headline index move, as Global Sukuk only delivered modest positive return. The Dow Jones Sukuk Index rose 0.31%. However, bucket performance showed May was not a broad rally and return remains uneven across sectors, ratings and regions. The long end outperformed the short end, Sukuk with more than 10 years of duration, returned an estimated 1.26% month to date. In contrast, all shorter duration buckets were laggard for the month, with performance ranging from around 0.18% to 0.45%. indicating gains were driven more by price recovery and spread support than front-end carry.

Performance was mixed across regions, sectors, and ratings. Malaysia, UAE, Kuwait, and Saudi Arabia led among countries, returning around 0.59%, 0.42%, 0.41% and 0.36% respectively. Qatar and Indonesia were also positive, while Supra, Oman, and USA lagging behind with only the Philippines were negative territory. Sector wise infrastructure, food & beverage, sovereigns, and utilities were the top sectors, and oil & gas, petrochemicals, and real estate lagged. Lower-rated sukuk BB and A outperformed higher-grade with returns around 0.39% and 0.35%, while BBB and AAA to AA were laggards. This suggests that selected carry and spread compression helped lower rated buckets outperform higher grade sukuk during the month. By region, Asia and GCC both performed positively in May, returning around 0.33% and 0.30% respectively, while other regions (i.e. USA) were flat

Brent crude fell sharply in May from above USD114/bbl to USD92.05/bbl, as markets begin to unwind part of the war and Strait of Hormuz risk premium. The decline also reflected concern that very high oil prices were beginning to hurt demand, while investors became more willing to assume that supply routes and inventories could absorb part of the shock. . While lower oil slightly eased inflation pressures, US rates still moved higher due to sticky inflation, reinforcing the higher-for-longer narrative. For GCC credit, oil at current levels remained supportive but reduced expectations of fiscal windfalls, resulting in stable yet selective sukuk performance. Primary market activity recovered with strong issuance across both high-grade and high-yield names, reflecting continued demand but with clear differentiation and required yield premiums.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 18 bps in May, with returns of 0.49% compared to the index return of 0.31%. The outperformance was mainly driven by long-tenured sovereign and quasi-sovereign sukuk, while detractors in performance were in the property sector.

Portfolio Outlook and Strategy

The US macro backdrop remains challenging, characterized by slow growth and persistently sticky inflation, which limits the case for aggressive Federal Reserve easing and keeps duration risk unattractive. While labour demand has softened, overall conditions—such as stable unemployment and wage growth—suggest that the economy is not weak enough to justify a meaningful policy pivot. As a result, the environment continues to be broadly negative for taking on additional interest rate exposure.

In the GCC, the region still had the strongest macro buffers in the sukuk universe. Oil revenue was still doing some of the heavy lifting. Saudi Arabia's oil exports rose sharply to SAR92.5 billion in March, while the trade surplus widened to SAR57.4 billion. That helped anchor the external story and kept investor confidence in high quality GCC sovereign and quasi sovereign sukuk intact. Furthermore, Saudi Arabia's PMI recovered back into expansion at 51.5, which was reassuring after the earlier conflict shock. The UAE and Dubai also stayed above 50, but both slowed from the previous month. Qatar improved sharply, but at 46.4, it was still in contraction. Inflation also added another layer of dispersion. Saudi, Qatar and Oman saw inflation ease, but Dubai and Kuwait moved the other way. Dubai inflation rose to 4.81%, a reminder that local price pressure can still build even when regional oil prices start to ease. Reserve buffers remained a major support. Saudi official reserve assets and SAMA net foreign assets edged lower, but levels remained large. Qatar's reserves were stable. This is why the GCC investment grade story remained intact. The region still had the balance sheet to absorb shocks.

In ASEAN, Malaysia and Indonesia gave two very different signals. Firstly, Malaysia's data were broadly supportive for sukuk sentiment. The economy was not booming as fast as 2025, but it remained stable. First quarter GDP was confirmed at 5.4% y-o-y, broadly in line with expectations, while the current account surplus widened sharply to MYR15.2 billion from a revised MYR2.7 billion. Manufacturing momentum also improved, with the S&P Global Malaysia Manufacturing PMI rising to 51.6 from 50.7 and manufacturing sales growth strengthening to 5.3% y-o-y. Industrial production rose 3.1% y-o-y, slightly below expectations but still positive.The inflation and policy mix also stayed benign. April CPI rose 1.9% y-o-y, up from 1.7%, but still low by regional standards. Bank Negara Malaysia kept the Overnight Policy Rate unchanged at 2.75%, reinforcing Malaysia's relatively stable policy backdrop. Foreign reserves were broadly steady, rising to USD129.7 billion at end April before easing slightly to USD129.5 billion by mid-May. Trade was strong in nominal terms, with exports rising 36.9% y-o-y and imports rising 20.0%, although the trade surplus narrowed to MYR28.75 billion from a revised MYR24.50 billion. Overall, Malaysia remained a low drama macro story, which is exactly why its sukuk market tends to behave defensively when global volatility rises.

Indonesia's picture was, however, more complicated. First quarter GDP growth was strong at 5.61% y-o-y, but the quarterly contraction of 0.77% showed weaker sequential momentum. Manufacturing also slipped back into contraction, with the S&P Global Indonesia Manufacturing PMI falling to 49.1 from 50.1. Trade data were mixed. The March trade surplus widened to USD3.32 billion from USD1.27 billion, but this was driven more by weak imports than strong exports. Imports rose only 1.5% y-o-y, well below expectations, while exports fell 3.1% y-o-y. Inflation pressure cooled but did not remove policy risk. April CPI slowed to 2.42% y-o-y from 3.48%, while core CPI eased slightly to 2.44%. However, Bank Indonesia still raised the BI Rate to 5.25% from 4.75, above the 5.00% market expectation. The signal was clear. BI was prioritising rupiah stability and inflation credibility over near-term growth support. Foreign reserves also fell to USD146.2 billion from USD148.2 billion, while the first quarter current account deficit widened to USD4.01 billion from a revised USD2.48 billion. These data explain why Indonesian assets remained more sensitive to global rates, oil and dollar conditions.

In the GCC, strong sovereign reserves and sovereign wealth fund buffers continue to underpin credit quality, particularly in Saudi Arabia, the UAE, Qatar, and Kuwait. However, May highlighted increasing divergence in economic momentum, inflation trends, and sectoral resilience, reinforcing the need for more selective credit positioning. High-quality sovereigns, banks, and quasi-sovereigns remain well supported, but credits exposed to tourism, logistics disruptions, higher funding costs, or weaker fiscal buffers warrant greater caution, and the market should not rely solely on elevated oil prices as the investment thesis. Market technicals remain supportive, with primary issuance activity rebounding and liquidity staying robust, as evidenced by strong demand for both high-quality and higher-yielding sukuk.

For the Fund's strategy, we intend to maintain a cautious stance on duration while remaining selectively constructive on credit. Credit positioning should focus on high-quality, short-to-intermediate GCC sukuk, particularly top-tier banks and quasi-sovereigns, while being more selective and demanding in higher-risk sectors such as real estate, tourism, aviation, and logistics.

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Risk Considerations

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