

Principal Global Investors Funds

Global Sukuk Fund

I Class September 2025

Market Review

Benchmark 10-year US Treasury (UST) rallied strongly in the first half of the month in September, with yields plunging 24bps from 4.23% at end-August to 3.99% on 11th September, after various US jobs data surprised on the downside. This gave a stronger signal that the US labor market may be slowing down, bolstering market expectations for multiple rate cuts this year. The US Fed voted 11-1 to lower the Fed Funds Rate by 25bps to 4.00-4.25% on 17th September,, with new governor Stephen Miran dissenting in favor of a larger 50bp reduction. Despite this, 10-year UST yields rose following the FOMC meeting, as the central bank characterized the rate cut as “risk management”, rather than attributing it to a weakening economy. Yields continued to drift upwards in the second half of September to settle at 4.15% (m-o-m 8bps lower), pressured by mixed US economic data. The UST yield curve bull flattened m-o-m, with shorter 2-year yields flat, 5-year yields up 5bps, while the longest 20 and 30-year yields fell by 17-20bps.

In early September, 10-year UST started the month on a cautious note, with yields edging higher from 4.23% at end-August to hit an intra-day high of 4.30% on 3rd September, amid mixed US ISM manufacturing data. In August, US factory activity improved from 48.0 in July to 48.7 but missed consensus expectation of 49.0 and remained in contraction for the sixth straight month, driven by a pullback in production due to higher import duties. On the other hand, new orders expanded for the first time since the start of the year while input prices declined to the lowest since February, offering some hopeful signs about the outlook. Meanwhile, US ISM Services jumped from 50.1 to 52.0 over the same period (consensus 51.0), the fastest pace in six months as orders accelerated. Nevertheless, 10-year UST started rallying sharply after data showed that JOLTS job openings plunged from 7.357 million in June (revised lower from 7.437 million) to 7.181 million in July, markedly below consensus expectations of 7.380 million. Similarly, private ADP employment slowed from 106,000 jobs in July to 54,000 jobs in August (consensus 68,000), supporting the view that the US labor market may be slowing down.

UST yields sank further to 4.04% on 8th September after nonfarm payrolls also materially surprised on the downside, cementing expectations for the US Fed to cut rates in September. In August, the US economy created only 22,000 jobs, significantly lower than consensus expectation of 75,000 jobs (July revised slightly higher from 73,000 to 79,000), and pushing the unemployment rate higher from 4.2% to 4.3%. Furthermore, a separate preliminary nonfarm payroll revision report indicates that the US economy likely created 911,000 fewer jobs in the 12 months period through March 2025, suggesting that job growth was already stalling before President Trump’s aggressive tariffs on imports was implemented. The revision estimate is equivalent to 76,000 fewer jobs per month, indicating that US job creation averaged about 71,000 per month, instead of 147,000. Subsequently, 10-year UST yields consolidated and briefly touched 3.99% on 11th September, supported by moderate US inflation reports. In August, producer price index (PPI) unexpectedly declined from 0.7% in July (revised down from 0.9%) to -0.1% m-o-m (consensus 0.3%), the first drop in four months, indicating that businesses are refraining from fully passing on the cost of higher tariffs to consumers. Meanwhile, headline US CPI rose from 0.2% to 0.4% m-o-m (consensus 0.3%, y-o-y up from 2.7% to 2.9%, matching consensus expectation), while core CPI was unchanged at 0.3% m-o-m (y-o-y unchanged at 3.1%, both in line with consensus expectation). While the CPI report pointed to increases in prices of new and used cars, apparel and appliances, as well as household expenses including groceries, gasoline, electricity and car repairs, the overall moderate report was not viewed as a deterrent for the US Fed to cut rates in September, therefore supporting UST yields. Sentiment was also bolstered after initial US jobless claims for the week ending 6th September jumped from 236,000 in the prior week to 263,000 (consensus 235,000), the highest since October 2021. Meanwhile, retail sales were flat in August at 0.6% m-o-m, albeit beating consensus expectations of 0.2%.

Meanwhile, the FOMC statement flagged growing downside employment risks, but the Fed’s updated projections showed a downward revision to the unemployment rate in 2026 and 2027, from 4.5% in June to 4.4% and from 4.4% to 4.3% respectively (2025: maintained at 4.5%). In response to this, Chairman Jerome Powell said most of the slowdown in the labor market was due to a reduction in immigration, which cannot be addressed by monetary policy. Powell also characterized the decision to cut rates as “risk management” to mitigate risks to the economy, stating that a “very different picture” of risks has emerged as the labor market has begun to cool, against a backdrop of sticky inflation. In addition, Powell said so far companies have been slow to pass costs from the higher tariffs to consumers, but expects the impact to build over the next few months and into 2026. Reflecting this, the central bank maintained its headline PCE and core inflation projections for 2025 at 3.0% and 3.1% respectively, but adjusted both forecasts upwards for 2026 from 2.4% to 2.6%. Nevertheless, both headline and core PCE inflation forecasts for 2027 are maintained at 2.1%. Notably, the US Fed also upgraded its GDP growth projections from 1.4% to 1.6% for 2025, from 1.6% to 1.8% for 2026 and from 1.8% to 1.9% for 2027.

Following the FOMC meeting, 10-year UST yields rose by around 15bps to hit 4.15% on 22nd September, as investors digested the US Fed's message, which was overall less dovish than expected. Furthermore, initial and continuing jobless claims for the week ending 13th and 6th September respectively came in much lower than consensus expectations, easing some concerns over a rapid slowdown in the labor market. Sentiment was also dampened by hawkish remarks from several policymakers. Meanwhile, Atlanta Fed President Raphael Bostic said he is not penciling in additional rate cuts this year and cautioned that "forecasting is really hard these days", while Cleveland Fed President Beth Hammack said she remains concerned over the US inflation outlook, and suggested that she does not agree with her colleagues that the impact of tariffs on inflation may be a one-off thing. 10-year UST yields continued to be pressured higher to touch 4.20% on 25th September, after the final revision of 2Q25 US GDP showed that the economy grew by 3.8% q-o-q, significantly stronger than the initial print of 3.0% and second reading of 3.3%. Personal consumption was also sharply revised up from the second reading of 1.6% to 2.5% (initial print: 1.4%), underscoring the resilience of the American consumer sector. Meanwhile, headline PCE inflation rose slightly from 0.2% in July to 0.3% m-o-m in August (consensus 0.3%, y-o-y up from 2.6% to 2.7% vs. consensus 2.7%), lifted by a 0.3% rise in services, reflecting airline fares, hotel and motel rooms as well as financial services and insurance, housing and utilities; while goods prices edged up 0.1%. Excluding the volatile food and energy components, core PCE inflation was flat at 0.2% m-o-m (consensus 0.2%, y-o-y flat at 2.9%, matching consensus). Nevertheless, 10-year UST pared some losses on final days of the month to settle at 4.15% (8bps lower m-o-m) amid growing risks of a US government shutdown, as Congress failed to pass a new spending bill ahead of the 30th September deadline.

Brent crude oil prices fluctuated between the USD 65-71/bbl trading band in September, as investors continued to weigh prospects of a supply glut due to OPEC+'s continued production hikes, against signals of a potential global supply disruption amid lingering geopolitical tensions. This came as President Trump intensified his rhetoric against Russia, and amid an Israeli attack targeting Hamas leaders in Qatar, who were meeting to discuss President Trump's ceasefire proposal. Brent prices weakened 4.5% from USD 68.12/bbl at end-August to hit USD 65.07/bbl on 5th September, before rallying to USD 70.76/bbl on 26th September and subsequently settling at USD 67.02/bbl (m-o-m -1.6% lower).

On the first two trading days of September, Brent prices rose 2.1% to hit USD 69.53/bbl, driven by rising concerns over oil supply, amid reports that Ukraine has carried out one of its biggest ever drone attacks on Russia, hitting power stations and oil refineries including in Moscow. At the same time, investors were also bracing for a disruption of Russian oil flows, as US President Trump said he is ready to move to a second phase of sanctioning Russia to hit Moscow's oil revenue and bring President Vladimir Putin to the negotiating table. However, Brent prices slumped to an intra-day low of USD 65.07/bbl on 5th September, amid reports that OPEC+ will consider a fresh round of supply increase when the group meets on 7th September. This is widely against market expectations for a pause, after OPEC+ returned 2.5 million barrels per day (bpd) of oil supply to the market since April (equivalent to around 2.4% of global demand). On 7th September, OPEC+ announced that it will increase oil production by a further 137,000 bpd in October, unwinding a second tranche of 1.65 million bpd supply cut that had been set to remain in place until the end of next year. The group also said the remaining barrels from the 1.65 million bpd tranche "may be returned in part or in full subject to evolving market conditions and in a gradual manner", while the third tranche of 2.0 million bpd cuts remain in place until end-2026. OPEC+'s decision to unwind its supply cuts earlier than scheduled sends a strong signal that the producers have shifted to a new approach after cautiously restraining production in recent years. Despite this, Brent prices rose to hit USD 67.78/bbl on 10th September, as the 137,000 bpd increase was much smaller than the market was expecting. Brent prices were also supported by rising geopolitical tensions following an unprecedented Israeli attack on Hamas leaders in Doha, Qatar, who were meeting to discuss President Trump's ceasefire proposal.

Subsequently, Brent prices briefly fell to around USD 65.85/bbl on 12th September, but marched higher to USD 68.50/bbl on 16th October after President Trump reiterated calls that Europe must stop buying oil from Russia. Earlier, President Trump also said he is prepared to move ahead with "major" sanctions on Russian oil if NATO countries do the same. While most European nations have cut back or stopped purchasing Russian oil, several NATO members, including Hungary and Turkey, continue to do so. Trump's increased pressure on the alliance comes as the US is set to urge G7 countries to impose tariffs as high as 100% on China and India for their purchases of Russian oil. The US also proposed for G7 countries to create a legal pathway to seize immobilized sovereign Russian assets and consider using those assets to fund Ukraine's defense. In response, European Commission President Ursula von der Leyen announced that the EU's next round of sanctions against Russia will focus on refineries, oil traders, petrochemical companies in third countries e.g. China and India, who purchase Russian oil in breach of the sanctions. Nevertheless, Brent prices retreated again to around USD 66/bbl on 22nd September, after the US Fed delivered a "hawkish cut" on 17th September. As widely expected, the US central bank cut interest rates by 25bps to 4.00-4.25%, but characterized it as "risk management", rather than attributing it to a weakening economy. Furthermore, the committee voted 11-1 to cut rates by 25bps, with the new Fed governor Stephen Miran dissenting in favor of a larger 50bp reduction. This was contrary to market expectations of a larger dissent, indicating some unity among US Fed members, and relieving some concerns over the central bank's independence from political pressure. Sentiment was also dampened after data showed that US jobless claims were smaller than expected, suggesting the job market may not be slowing as rapidly as initially thought. Brent prices were also pressured lower after President Trump implied that he favored low oil prices over sanctions to pressure Russia to end its war in Ukraine, telling reporters that "if we get oil down, the war ends".

Towards month-end, Brent prices were volatile, with prices initially soaring to USD 70.76/bbl on 26th September after President Trump ramped up his rhetoric against Russia. The US president said NATO nations should shoot down Russian aircrafts that violate their airspace, and struck a more sympathetic tone on Ukraine's chances of winning the war, while reiterating the need for Europe to halt

energy purchases from Moscow. At the same time, Russia was said to be mulling restrictions on diesel exports due to Ukrainian drone strikes on its oil refineries, igniting concerns over a potential supply shortage. Nevertheless, Brent prices fell sharply on the last two trading days of the month to settle at USD 67.02/bbl (-1.6% lower m-o-m), weighed by expectations that OPEC+ will hike production again in November, exacerbating concerns over a supply glut. Earlier, the International Energy Agency (IEA) said its projection for a record oil supply surplus in 2026 is looking even bigger as OPEC+ continues to revive oil production. While the IEA slightly boosted its forecast for global oil demand this year and next, it said world output will exceed consumption by an average of 3.3 million bpd in 2026, about 360,000 bpd higher than estimated in August. The agency said this may be a historic overhang in annual terms, though the surplus was briefly larger at the height of the pandemic. Nonetheless, despite announcing headline production increases, OPEC+ said the actual supply increase would be much lower as many members lack the ability to produce more oil.

Fund Review

The Fund outperformed the Dow Jones Sukuk index by 39bps in September, with returns of 0.83% compared to the index return of 0.44%. Year to date, the Fund outperformed the index by 258bps, with returns of 5.64% versus index returns of 3.06%.

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 re-rating actions by international rating agencies. 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. Moody's had earlier upgraded Saudi's credit rating from A1 to AA3 in November 2024.

The Saudi government expects GDP to strengthen from the projected 4.4% in 2025 to 4.6% in 2026, driven by growth of non-oil activities. The non-oil sector now contributes around USD 1.2tril to the economy, or 56% of GDP. Saudi's net FDI inflows climbed 14.5% y-o-y to SAR 22.8bil (USD 6.1bil) in 2Q25, signaling steady appetite for the Kingdom's reform-driven economy. Public Investment Fund's (PIF - Saudi's sovereign wealth fund) assets under management grew 18% y-o-y in 2024 to USD1.15 trillion, driven by strong performance from key portfolio companies including Ma'aden (Saudi Arabian Mining) and Saudi Telecom.

The UAE central bank upgraded its 2025 GDP forecast from 4.4% to 4.9% due to higher oil production and strong growth in the non-oil sector, which now accounts for 77.1% of GDP. The country is expected to host 27.6 million international visitors this year (up 4.6% y-o-y), with inbound travelers projected to spend USD 62.2bil, a 5.1% increase from USD 59.2bil last year. The UAE's travel and tourism sector is forecasted to contribute 12.9% of its GDP this year. Meanwhile, Dubai's status as a global property hotspot continues to solidify, with property sales surging 34% to AED 445bil (USD 121bil) by August.

Meanwhile, Oman will introduce 5% personal income tax for individuals earning more than OMR 42k p.a. (around USD 109k) in 2028, which S&P projects will generate OMR 80mil (USD 208mi) of revenues in the first year. This will supplement existing tax revenues including corporate income tax and VAT, which currently account for around 14% of total government revenue.

Activity in the primary Global Sukuk market picked up again in September as investors returned from the summer break. Notable issuances include Saudi Aramco, Almarai (Saudi's F&B company), as well as Egypt and Bahrain sovereign. 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 hard-currency offerings already surpassed USD67 bn, 24% higher than last year's all-time record total issuance of USD54 bn. The broad outlook for fixed income assets remains constructive, as the US Fed is poised to resume loosening monetary policy amidst slowing US economic momentum due to increased uncertainty over President Trump's policies. We will remain vigilant and adopt a nimble investment strategy to maneuver market fluctuations and capitalize on trading opportunities, with increased investments in sovereign and sovereign-related 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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