Principal Islamic Asset Management (Ireland) (PLC)

Global Sukuk Fund

I Class August 2023

Market Review

Sentiment in the US Treasury (UST) market was weak in August, driving benchmark 10-year UST yields higher from 3.96% at end-July to touch 4.36% on 22nd August, after the US Treasury Department raised the size of its quarterly government bond auction for the first time in 2.5 years. The announcement came after Fitch downgraded the US' long-term rating by one notch from AAA to AA+ on 1st August, citing concerns over the government's fiscal health and growing debt burden. UST yields were also pressured higher by stronger-than-expected US retail sales data and hawkish minutes of the US Fed meeting in July, which indicated that more rate hikes may be necessary. 10-year UST recovered to end the month at 4.11% (m-o-m 15bps higher) on the back of softer US economic data, even though US Fed Chairman Jerome Powell maintained a hawkish tilt at the Jackson Hole Symposium. The UST yield curve bear steepened m-o-m, with shorter 2-year yields little changed, 5-year yields rose 8bps, while longer 7–30-year yields climbed by 13-20bps.

10-year UST yields initially rose in early August, from 3.96% at end-July to touch 4.20% on 4th August, after the US Treasury Department boosted the size of its quarterly government bond auction for the first time in 2.5 years. The Treasury Department said it will sell USD 103 billion of longer-term securities (more than the market expected), and plans to issue more government debt across the maturity spectrum. The announcement came just after Fitch downgraded the US' long-term rating by one notch from AAA to AA+ on 1st August, citing concerns over the government's fiscal health and growing debt burden. However, the timing of Fitch's announcement was heavily criticized by prominent economists, given signs of continued resilience in the world's largest economy. Janet Yellen, ex-chairman of the US Fed and current Treasury Secretary also commented, "Fitch's decision does not change what Americans, investors, and people all around the world already know: that Treasury securities remain the world's preeminent safe and liquid asset, and that the American economy is fundamentally strong". UST yields were also pressured higher by better-than-expected private ADP employment data, which added 324,000 new jobs in July, mainly in leisure and hospitality (consensus 190,000; June revised lower from 497,000 to 455,000).

10-year UST yields fell after US nonfarm payrolls came in weaker than expected. The US economy added 187,000 new jobs vs. consensus expectation of 200,000 in July, marking the second straight negative surprise after more than a year of beating expectations every month (June revised lower from 209,000 to 185,000). The unemployment rate ticked lower from 3.6% to 3.5%, while average hourly earnings stayed firm at 4.4% y-o-y (consensus 4.2%). US ISM data were also mixed, with ISM manufacturing improving from 46.0 in June to 46.4 in July (consensus 46.9), albeit marking its ninth consecutive contraction as demand remains weak; while ISM services dropped from 53.9 to 52.7 (consensus 53.1), mainly due to smaller growth in business production. 10-year UST yields briefly rose amid hawkish remarks from several US Fed members, before declining to around 4.00% after weak data from China heightened concerns over a softening global economic outlook. US headline CPI steadied at 0.2% m-o-m (consensus 0.2%, y-o-y up from 3.0% to 3.2% vs. consensus 3.3%). Core CPI was also flat at 0.2% m-o-m (consensus 0.2%, y-o-y down from 4.8% to 4.7% vs. consensus 4.7%), the smallest consecutive increase in two years, as inflationary pressures continue to subside.

10-year UST yields climbed to around 4.20%, triggered by poor demand at the 30-year UST bond auction. Yields continued to be pressured higher after US retail sales unexpectedly grew from 0.3% (revised higher from 0.2%) in June to 0.7% m-o-m in July (consensus 0.4%), signaling robust consumer spending despite the surge in borrowing costs over the past 18 months. 10-year UST yields continued to rise to touch 4.36% on 22nd August, the highest level since November 2007, after minutes of the US Fed meeting in July underlined the committee's concern over lingering inflation and tightness in the job market, thus opening the door to further rate hikes. Sentiment was also weak ahead of US Fed Chairman Jerome Powell's speech at the annual Jackson Hole Symposium from 24th to 26th August. 10-year UST subsequently recovered, with yields falling to around 4.20% after US economic data came in softer than expected. Preliminary S&P Global US Manufacturing PMI unexpectedly declined from 49.0 in July to 47.0 in August (consensus 49.0), weighed down by a renewed drop in output and steeper fall in new orders. S&P Global US Services PMI tumbled from 52.3 to 51.0 (consensus 52.2), its weakest reading since February, indicating that the services-led growth in 2Q23 may be softening.

Chairman Powell stated at the Jackson Hole Symposium, that the US central bank is prepared to hike rates further if necessary and intends to maintain monetary policy at a restrictive level until inflation is on a sustainable path towards its 2.0% target. However, Powell emphasized that policymakers will remain data dependent, and proceed carefully as they assess incoming data and the evolving outlook and risks. 10-year UST yields briefly ticked higher, following Chairman Powell's speech, but subsequently fell to close the month at 4.11% (m-o-m 15bps higher), as a series of weak US economic data reinforced investors' expectations of a potential pause in interest rates.

Brent crude oil prices fluctuated in August, after rebounding in July, but stayed within a narrow trading band of USD 82-88/bbl. M-o-m, Brent prices strengthened further from USD 85.56/bbl at end-July to close the month at USD 86.86/bbl (m-o-m 1.52% higher), largely driven by prospects of a tighter supply market due to production cuts by Saudi Arabia and Russia, as well as declining US crude oil stockpiles. Brent prices were also supported by expectations of improving oil demand from China, after Beijing announced various stimulus measures to revive the property sector and lift consumption.

Brent prices marched higher in early August, to touch USD 88/bbl, bolstered by Russia's announcement that it will extend production cuts until end-September, while tapering the size from 500,000 barrels per day (bpd) in August to 300,000 bpd. Russia's decision came after Saudi Arabia extended its unilateral oil production cut of 1 million bpd by another month until end-September, and said it could be prolonged further or even deepened. In addition to Saudi Arabia and Russia's voluntary cuts, under the existing agreement, OPEC+ members are also reducing production by 3.66 million bpd until end-2024, amounting to 3.6% of global demand. The committee said in a statement, it "will continue to closely assess market conditions", and noted that OPEC+ members are willing "to address market development and stand ready to take additional measures at any time".

Sentiment in the oil market was also bolstered by a report from the International Energy Agency (IEA), which highlighted that global oil demand hit an all-time high of 103 million bpd in June, driven by better-than-expected economic growth in OECD countries, strong summer air travel and surging oil consumption in China, particularly for petrochemical production. The IEA said demand could hit another peak in August, and was on track to rise by 2.2 million bpd in 2023 to 102.2 million bpd, the highest ever average annual level, with 70% of the growth coming from China. The demand outlook for oil was also boosted by news that China is set to buy around 40% more crude oil from Saudi Arabia in September compared to August, after China's mega-refiner Rongsheng Petrochemical brokered a new deal with Saudi Aramco. The oil supply market is getting tighter, with production from OPEC+ countries declining in July to the lowest level since October 2021. OPEC said in its monthly report, the global oil market is on track for a sharp supply deficit of more than 2 million bpd in 3Q23, the steepest inventory decline in two years, driven by Saudi Arabia's production cuts.

Brent prices subsequently pared gains to touch USD 82/bbl on 24th August, amid weak broad market sentiment given hawkish remarks from several US Fed members, and ahead of US Fed Chairman Jerome Powell's speech at the Jackson Hole Symposium. Brent prices recovered towards month-end, to settle at USD 86.86/bbl (m-o-m 1.52% higher), as investors shifted their focus back to prospects of a tighter oil supply market, coupled with optimism over China's economic outlook as the government ramped up efforts to spur growth. US crude oil inventories (excluding those in the Strategic Petroleum Reserve) plunged by 10.6 million barrels to 422.9 million barrels for the week ending 25th August, according to the Energy Information Administration (EIA), marking its lowest level since December 2022, mainly attributed by substantial declines in the Gulf Coast region. Meanwhile, Saudi Arabia and Russia are widely expected to extend their voluntary cuts of 1 million bpd and 300,000 bpd respectively beyond September, tightening the oil supply market further.

Fund Review

The Fund underperformed the Dow Jones Sukuk index return by 26bps in August, with returns of -0.81% compared to the index return of -0.55%. Year to date, the Fund outperformed the index by 78bps, with Fund's returns of 0.36% compared to index returns of -0.42%. The Fund maintained overall overweight position in GCC markets given the region's positive economic and rating outlook.

Portfolio Outlook and Strategy

The near term outlook for the fixed income market has somewhat moderated, hampered by short-term US Federal Reserve hawkishness despite inflation numbers coming off its peak. Meanwhile, oil supply is expected to tighten going forward, after Saudi Arabia and Russia announced an extension to oil production cuts, hence holding oil prices elevated.

We look to maintain our overweight position in GCC countries, in view of the region's solid economic outlook. At the same time, we continue to favor Asian sukuk issuers such as Malaysia and Indonesia sovereigns, supported by their resilient fundamentals and relatively benign inflation. Given the moderating economic outlook, we retain a more defensive investment strategy through 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.

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

This material covers general information only and does not take account of any investor's investment objectives or financial situation and should not be construed as specific investment advice, a recommendation, or be relied on in any way as a guarantee, promise, forecast or prediction of future events regarding an investment or the markets in general. The opinions and predictions expressed are subject to change without prior notice. The information presented has been derived from sources believed to be accurate; however, we do not independently verify or guarantee its accuracy or validity. Any reference to a specific investment or security does not constitute a recommendation to buy, sell, or hold such investment or security, nor an indication that the investment manager or its affiliates has recommended a specific security for any client account. Subject to any contrary provisions of applicable law, the investment manager and its affiliates, and their officers, directors, employees, agents, disclaim any express or implied warranty of reliability or accuracy and any responsibility arising in any way (including by reason of negligence) for errors or omissions in the information or data provided.

This material may contain 'forward-looking' information that is not purely historical in nature and may include, among other things, projections and forecasts. There is no guarantee that any forecasts made will come to pass. Reliance upon information in this material is at the sole discretion of the reader.

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.

Proprietary model output is based upon certain assumptions that may change, are not guaranteed and should not be relied upon as a significant basis for an investment decision. Forecasts for each asset class can be conditional on economic scenarios; in the event a scenario comes to pass, actual returns could be significantly higher or lower than forecasted. Because of the inherent limitations of all models, potential investors should not rely exclusively on the model when making an investment decision. Forecasts of financial market trends that are based on current market conditions constitute our judgment and are subject to change without notice.
Indices are unmanaged and do not consider fees, expenses and transaction costs are not available for direct investment. The information provided here is neither tax nor legal advice. Investors should speak to their tax professional for specific information regarding their tax situation.

This material is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

This document is intent for use in:

• **The United States** by Principal Global Investors, LLC, which is regulated by the U.S. Securities and Exchange Commission.

• **Germany, Austria and the Netherlands** by Principal Global Investors (EU) Limited, Sobo Works, Windmill Lane, Dublin D02 K156, Ireland. Principal Global Investors (EU) Limited is regulated by the Central Bank of Ireland. **For all other European countries**, this document is issued by Principal Global Investors (Europe) Limited, Level 1, 1 Wood Street, London, EC2V 7 JB, registered in England, No. 03819986, which is authorized and regulated by the Financial Conduct Authority ("FCA"). **In Europe**, this document is directed exclusively at Professional Clients and Eligible Counterparties and should not be relied upon by Retail Clients (all as defined by the MiFID). The contents of the document have been approved by the relevant entity. Clients that do not directly contract with Principal Global Investors (Europe) Limited ("PGIE") or Principal Global Investors (EU) Limited ("PGI EU") will not benefit from the protections offered by the rules and regulations of the Financial Conduct Authority or the Central Bank of Ireland, including those enacted under MiFID II. Further, where clients do contract with PGIE or PGI EU, PGIE or PGI EU may delegate management authority to affiliates that are not authorized and regulated within Europe and in any such case, the client may not benefit from all protections offered by the rules and regulations of the Financial Conduct Authority ,or the Central Bank of Ireland.

• **In Dubai** by Principal Global Investors LLC, a branch registered in the Dubai International Financial Centre and authorized by the Dubai Financial Services Authority as a representative office and is delivered on an individual basis to the recipient and should not be passed on or otherwise distributed by the recipient to any other person or organization. This document is intended for sophisticated institutional and professional investors only.

• **Singapore** by Principal Global Investors (Singapore)Limited (ACRAReg.No.199603735H), which is regulated by the Monetary Authority of Singapore and is directed exclusively at institutional investors as defined by the Securities and Futures Act (Chapter 289). This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.

• **Australia** by Principal Global Investors (Australia) Limited (ABN 45 102 488 068, AFS Licence No. 225385), which is regulated by the Australian Securities and Investments Commission. This document is intended for sophisticated institutional investors only.

• **Switzerland** by Principal Global Investors (Switzerland) GmbH.

• **Hong Kong SAR (China)** by Principal Global Investors (Hong Kong) Limited, which is regulated by the Securities and Futures Commission and is directed exclusively at professional investors as defined by the Securities and Futures Ordinance.

• **Other APAC Countries**, this material is issued for institutional investors only (or professional/sophisticated/qualified investors, as such term may apply in local jurisdictions) and is delivered on an individual basis to the recipient and should not be passed on, used by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation.

• **India** by Principal Asset Management Private Limited (PAMC). PAMC offers only the units of the schemes of Principal Mutual Fund, a mutual fund registered with SEBI.

Disclosures

The information in this document has been derived from sources believed to be accurate. It contains general information only on investment matters and should not be considered as a comprehensive statement on any matter and should not be relied upon as such. The information it contains does not take account of any investor's investment objectives, particular needs or financial situation. You should consider whether an investment fits your investment objectives, particular needs and financial situation before making any investment decision.

The data presented is for information purposes only and is not a recommendation to buy or sell any securities or adopt any investment strategy. This material is not intended to be relied upon as a forecast, research, or investment advice regarding a particular investment or the markets in general, nor is it intended to predict or depict performance of any investment.

All expressions of opinion and estimates in this report are subject to change without notice. This report is not intended to be, nor should it be relied upon in any way as a forecast or guarantee of future events or investment advice regarding a particular investment or the markets in general.

Persons wishing to rely upon this information should consult directly with the source of information or obtain professional advice.

All figures shown in this document are in US dollars unless otherwise noted. The information in this document has been derived from sources believed to be accurate as at 31 August 2023. This advertisement had not been reviewed by the Securities Commission Malaysia.