

## Principal Global Investors Funds

# Islamic Global Responsible Equity Fund

I Class August 2025

### Market Review

Global equity markets advanced further in the month amid tariff clarity, albeit modest, while rate cuts came into focus following Chair Jerome Powell's speech at Jackson Hole. Most regions advanced low-single-digits led by Japan though sectoral leadership reversed course. Previous lagging areas like health care and discretionary led returns while gold continued to rally on concerns over Federal Reserve (Fed) independence. Despite posting slightly higher returns, IT did lag as advancements in AI raised concerns for many cloud software vendors and other enterprise tech companies that the evolution of the technology could displace them.

To kick off the period, President Donald Trump signed an executive order announcing a new set of tariffs. Reciprocal tariffs have been set at a 10% global minimum, with levies sitting at 15% or higher for countries that hold trade surpluses with the U.S. Several key trade partners, including the EU, Japan, and South Korea, have negotiated a 15% tariff. In contrast, others, such as China, Mexico, and Canada, face higher rates. Notably, the EU, Japan, and South Korea have carve-outs reducing the levy on autos from 25% to 15%. The tariffs took effect after August 7th.

Overall, the newly announced rates are lower than those announced on Liberation Day, but higher than the 10% baseline that had been in motion since late April when the 90-day reprieve was announced. The average effective tariff rate now sits at 15%, the highest level since the 1930's Smoot-Hawley tariffs and meaningfully higher than the 2% at the start of 2025.

Markets are grappling with a complex and often contradictory economic landscape. As Chair Powell noted in his speech at the 2025 Jackson Hole Economic Symposium, growth indicators remain broadly resilient, but labor market data are beginning to show signs of strain and downside risks are rising. At the same time, while not surging, the effects of tariffs on inflation are now visible and could result in a more persistent inflation dynamic.

The July jobs report reignited concerns about the labor market's underlying health. While survey data had been signaling a slowdown in labor demand since late 2024, the modest 73,000 payroll gain—coupled with sharp downside revisions that pulled the three-month average to just 35,000—pushed slowdown fears to the fore. Historically, such levels have coincided with rising unemployment and heightened recession risk, prompting many investors today to reassess the labor market's strength. Still, the story is more complex than the headline figures suggest.

Recent inflation developments offer little reassurance. While July's inflation report wasn't alarmingly strong, the underlying signals point to building price pressures amid higher trade tariffs. Business surveys increasingly reflect rising cost dynamics, and producer price data suggest that inflation concerns could intensify in the months ahead.

In fact, producer price inflation in July rose at its fastest monthly pace since March 2022, signaling that businesses are already contending with higher tariff-driven input costs. While the relatively subdued CPI print suggests that firms are currently absorbing these pressures within their margins, that dynamic is unlikely to be sustainable. Eventually, companies may be forced to pass these costs on to consumers, pushing inflation higher and further away from the Fed's 2% target.

It is also important to note that the latest round of higher tariffs—35% on Canadian goods, 25% on Indian imports (which are set to climb to 50% on August 27), and 15% on products from the EU, Japan, and Korea—only took effect in August. As these measures filter through supply chains, they are likely to exert additional upward pressure on input costs.

Against this tense backdrop of worrisome labor market developments and sticky inflation concerns, Chair Powell has now all but confirmed a Federal Reserve rate cut in September. Yet, the macroeconomic case for aggressive monetary easing remains debatable. With both sides of the Fed's dual mandate drifting from target and political pressures

mounting, the size of the central bank's cut next month could prove pivotal—not just for the economy, but also for investor sentiment and asset valuations.

President Trump's continued criticism of Chair Powell—combined with the nearing end of Powell's term and speculation about his successor—has likely sharpened the focus of several current FOMC members (and potential future ones) on the case for rate cuts. Those seen as contenders for the Fed Chair role have a clear incentive to signal dovishness, effectively “auditioning” through their policy stance and public messaging.

To conclude, the August period was a reversal of leadership though the same trend of equity returns moving higher. The S&P 500 was up by 2.0%, while the MSCI EM Index rose modestly by 1.3%. The MSCI Europe Index was higher by 3.4%, while the MSCI Japan Index surged higher by 7.0%.

## Fund Review

The portfolio posted a positive absolute return of 1.5% in the month of August while performing inline with its respective index. From a sector perspective, the communication services and health care sectors were places of strength while were partially offset by weakness in materials and industrials. The United Kingdom and the United States were the top contributors from a country perspective while Switzerland and Canada lagged overall.

## Portfolio Outlook and Strategy

2025's investment landscape resembles a classic ‘buy the rumor; sell the news’ environment, making it difficult for investors to distinguish noise from trends amidst rapid change. Despite uncertainty encompassing Fed policy, fiscal policy, tariffs, and geopolitical tensions in the Middle East, the equity market has demonstrated remarkable resilience. Notably, investor interest has shifted to international opportunities as the once tailwind of U.S. exceptionalism has moved to a U.S. protectionism headwind.

Despite the continued excellence of certain U.S. companies, a more equitable economic landscape has emerged, where renewed growth outside the U.S. presents novel investment opportunities. As such, investors should adopt a global perspective, casting a wide net to identify potential opportunities. The old habit of ignoring most of the investable world could yield diminishing returns—as earnings growth converges, the gap between valuations will likely close, boosting equity prices outside the U.S.

Fortunes have begun to shift in 2025 led by Europe and the need to reignite growth through domestic initiatives, as global trade is threatened by global protectionism.

The “America First” policies have inadvertently prompted other nations to focus on internal development in pursuit of economic growth. This shift towards “anti-fragilism” could foster a more conducive environment for local businesses. A prime example is Germany's renewed commitment to invest in both physical and digital infrastructure, which is likely to stimulate short-term economic growth and enhance Berlin's long-term competitiveness.

Europe has always been prone to excessive regulations of businesses and consumers. However, European leaders are now reevaluating deregulation as protectionism becomes more heightened led by the United States. If concrete steps are taken in this direction, the current trade friction could become a long-term positive game-changer for Europe's economies.

Over the past decade, Japanese companies have made great strides in corporate governance and capital allocation. Former Prime Minister Shinzo Abe's push in 2012-13 to improve capital allocation in the corporate sector has had a lasting impact, driving more long-term, value-enhancing decisions by Japanese companies. Continued progress on these fronts is primed to release shareholder value in the coming years. As companies focus on higher profitability and improve balance sheet efficiency, return on assets (ROA) will likely continue to improve given the tailwinds of reshoring and improving governance. Recent conversations with Japanese companies indicate intentions to further use strong balance sheets for modest share buybacks.

The continuing pace of innovation is another reason for optimism, particularly in high-end computing and life-sciences. Innovation is growth-stimulative and disinflationary due to its impact on productivity. Artificial Intelligence is early in its usage but offers great promise across many practical applications, including software development, finance and healthcare. The investment needed for AI deployment is historically massive and shows no signs of abating. In healthcare, new weight loss treatments offer the ability to systematically address one of the greatest co-morbidities. This should improve lifespans and result in a net reduction in societal healthcare costs. Continued therapeutic customization also continues to grow, offering additional measures to improve the quality of life.

Finally, there are still numerous challenges and persisting risks. However, the depressed valuations in these regions create attractive entry points for long-term investors in firms generating resilient economic returns. Both China and the U.K. are examples of countries facing longstanding economic structural challenges. It is not surprising that investors' view companies domiciled in these markets with pessimism. Nevertheless, market pessimism seems extreme as many of these companies operate globally yet are beset with deeply discounted valuations relative to their own histories and global peers.

Within the U.S., risk-on sentiment may need to contend with an economic outlook of slowing growth, elevated inflation, and ongoing policy uncertainty. So far, companies have navigated the tariff noise without much visible strain, but pressures are likely to grow.

Yet, aggregate corporate sector balance sheets are well-positioned to absorb the headwinds. Overall cash holdings as a percentage of liabilities are elevated, particularly in comparison to historical levels, indicating ample buffers in the event of a revenue or cash flow squeeze. Moreover, profit margins remain high, and overall leverage remains manageable. While there may be some weakness ahead, this is a headwind that the U.S. economy can navigate.

Recent months have delivered a stream of noisy and sometimes contradictory economic signals. Stepping back, growth data remains broadly resilient, the labor market is cooling but not at a pace historically consistent with recession, and inflationary pressures threaten to build. Yet despite this backdrop, an interest rate cut at the next FOMC meeting is highly likely. In effect, the interest rate outlook has diverged from the macro fundamentals—creating a supportive environment for risk assets.

However, the Fed is walking a fine line. While the case for easing has strengthened, there is little economic justification for an emergency-sized 50 basis point cut. Should the Fed opt for such a move, markets may interpret it as a sign of political influence rather than data-driven decision-making. This could push inflation expectations and term premia higher, driving long-end yields up and undermining the very conditions that have supported risk assets. With valuations already stretched, the risk of a near-term market pullback would rise meaningfully. Markets may welcome a 25-basis point cut in September—but anything more could backfire.

## Risk Considerations

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