Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class February 2025

Market Review

MSCI ACWI Islamic Index depreciated by 2.8% in USD terms in February, mainly driven by Consumer Discretionary and Information Technology sectors, while Energy and Consumer Staples outperformed. From a country perspective, US was the main negative contributor to the global market returns. The USD depreciated slightly and the US 10 year bond yields fell 33bps to end the month at 4.208% with the uncertainties surrounding US tariffs.

Fund Review

In February 2025, the Fund value declined 0.82% in USD terms. The outperformance was mainly due to stock selection in the Consumer Discretionary and Information Technology sectors. On the other hand, the underweight in Materials and Energy sectors and stock selection in Communication Services sector detracted value. In particular, our underweight position in an electric vehicle company whose share price declined close to 27% during the month due to declining sales, potential impact of tariffs and negative sentiment against the founder added the most value. The stock selection in the US and Japan contributed positively too.

Portfolio Outlook and Strategy

Outlook

The likely onset of U.S. tariffs confronting numerous trade partners suggests that the divergence in global economic prospects is likely to persist through 2025. In addition, growth-supportive fiscal policies and deregulation only reinforce U.S. exceptionalism. The pace of global central bank rate cuts is also likely to diverge in early 2025. Not only does U.S. economic resilience imply a reduced need for policy stimulus, but with tariffs and restrictive immigration policies threatening a pick-up in price pressures in 2025, the Federal Reserve will be increasingly cautious about its policy path. By contrast, weak growth, or recession, in other developed economies means their central banks will need to cut rates meaningfully more than the Fed.

Earnings prospects for 2025 are fairly positive. Not only is the U.S. economic outlook constructive, but U.S. policy may spur additional economic growth as the new administration signals a push for deregulation and lower corporate and individual taxes. Yet, with valuation measures now showing that U.S. equities have never been as expensive, earnings must deliver against lofty expectations. A key challenge to the bull market is the rise in bond yields. If this persists, yields will exert pressure on equities, limiting potential gains. It may not take much of an increase in rate expectations to whipsaw the stock market. History suggests that the Federal Reserve tends to play an outsized role in determining the prevailing market regime based on its monetary policy stance. Indeed, most market sell-offs larger than 10% since 1965 were triggered by either the Fed pivoting aggressively to a hawkish stance and spooking markets or the Fed staying restrictive for too long, putting downward pressure on growth and earnings.

US headline inflation was higher than expected in January, rising by 0.5%MoM and core goods inflation re-accelerated to 0.3%MoM. With this print, it is possible that the Fed may prolong its pause into the second half of the year. Trump started the trade war with 25% tariffs on Mexico and Canada and 10% on China. It was estimated that the US growth is likely to be negatively impacted by an estimated 1.2% assuming these tariffs eventuate. Tariffs also lead to inflation risk and the US Fed needs to be mindful of the risk that inflation expectations start to drift higher.

The Euro Area economic growth stagnated on a QoQ basis in Q424 with Germany and France both in contraction. The ECB delivered another 25bps rate cut in the January meeting to support the economy. The troubling state of the Euro area economy suggests that the path forward is fairly clear: consecutive rate cuts through the first half of 2025, a far more aggressive pace of easing than the Federal Reserve. President Lagarde commented that any increase in trade barriers, such as tariffs, would pose additional downside economic pressures to Europe. In that scenario, it is possible that the ECB would need to continue cutting rates into the second half of 2025.

In Japan, the economy looked resilient and wage growth continued to be strong with the Japanese Trade Union Confederation (RENGO) targeting at least 5% wage hikes for the 2025 spring wage negotiation. The resilient economic situation and strong wage growth support BOJ's plan to continue increase interest rates. While the Chinese economy remains soft, there are some signs of improvement. Primary property sales of the top developers was flat on a yoy basis in the first 2 months of 2025. Beijing indicated the government would deregulate the economy and level the playing field for private enterprises. It is our assumption that the residential property sales may stabilize in 2025, potentially ending a 4-year downtrend.

Strategy

Uncertainty around future policy decisions poses a significant risk. The timing, scope, and duration of tariffs on Mexico, Canada, and China, as well as the path forward for additional tariffs remain unclear. Inflation remains a key concern, and the new Trump administration's fast-moving policy agenda could potentially impact the labor market and further complicate the inflationary picture. These will add challenges to Fed policymaking. Given this uncertainty, our investment strategy focuses on mitigating risks and capitalizing on opportunities amid ongoing policy uncertainties by maintaining a diversified portfolio.

Innovation is growth-stimulative and disinflationary due to its impact on productivity. AI is early in its usage but offers great promise across a wide scope of practical applications, including software development, agriculture, finance and healthcare. While DeepSeek's emergence challenges the dominance of U.S. chipmakers, it also presents an opportunity to democratize AI technology. By significantly lowering the cost of training advanced AI models, DeepSeek's innovation could accelerate widespread AI adoption and drive long-term global productivity gains. While certain chipmakers may face headwinds, the broader economy—and equity markets—are likely to benefit.

Although economic weakness in Europe and parts of Asia is ongoing, 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 investor's view companies domiciled in these markets with pessimism. Nevertheless, the 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.

Regardless of the region, sector, or general market conditions, our bottom-up focus on sustainable earnings trends and valuations relative to expectations remains a constant across the portfolio and helps rise above the fray of short-term "risk on/risk off" tendencies of many investors during bouts of volatility. As always, our analysts' search for underappreciated fundamental change at attractive valuations continues and, despite the macro noise, is highlighting profitable investment opportunities across sectors and regions.

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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