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Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class July 2025

Market Review

Global equity markets were largely higher over the period though a strengthening of the U.S. Dollar, after recent depreciation, did spur profit-taking in some regions that have led 2025 markets, including Europe. Tariff reprieve and better-than-expected earnings all contributed to healthy equity gains overall, extending equity strength year-to-date.

Despite all the tariff upheaval of the past few months, equity markets have hit new all-time highs and credit spreads are close to historic tights. This likely reflects the widespread view that the administration has been willing to soften its stance multiple times to prevent a lasting market sell-off. Moreover, with Trump's tariffs having a limited macro impact so far, markets may also be looking through trade policy and instead focusing on factors that can change economic fundamentals, such as corporate earnings.

The U.S. administration decided to delay its self-imposed deadline for implementing reciprocal tariffs until August 1. Reciprocal tariffs, originally announced on April 2, also known as "Liberation Day," saw U.S. import tariff rates rise significantly for over 50 trade partners before being temporarily lowered to 10% until July 9 to allow for negotiations.

Since then, tentative trade frameworks have been agreed upon, the U.K., Japan and Europe, as well as a truce with China. In an effort to accelerate talks, the administration has begun sending letters to various countries, informing them of their tariff rates if a deal cannot be secured. The move signaled the administration's willingness to move forward with significant country-specific punitive tariffs consistent with the initial announcement before the tariff delay. However, as these reciprocal tariffs exclude products subject to sectoral tariffs, they were not as meaningful as initially anticipated.

At its July meeting, the Federal Open Market Committee (FOMC) decided to keep its benchmark policy rate unchanged at 4.25%-4.50% as expected. However, this was not a unanimous decision. For the first time since 1993, there were two dissents, with Fed Governors Christopher Waller and Michelle Bowman voting to cut policy rates by 25 basis points.

Even so, the press conference provided no clear policy direction. Chair Powell did not offer any clues or guidance around the September FOMC meeting, although his broader comments leaned marginally more hawkish than the market had anticipated. With two employment reports and two inflation prints to be released ahead of the next meeting, the outlook for Fed cuts remains wide open.

To conclude, the July period was filled with volatility but once again largely ignored by equity investors. The S&P 500 was up by 2.2%, while the MSCI EM Index rose by 2.0%. The MSCI Europe Index did post a loss of 1.8%, while the MSCI Japan Index was lower by 1.4%.

Fund Review

The portfolio posted a loss of just of 1% in the month of July while underperforming its respective index. From a sector perspective, the consumer areas were sectors of strength while were more than offset by weakness in materials and health care. Ireland and South Korea were the top contributors from a country perspective while the United States and the Netherlands lagged overall.

Portfolio Outlook and Strategy

This year'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.

Tariff announcements initially triggered a sharp sell-off as investors worried that the trade levies would present significant headwinds for large and small businesses, and households by extension. The U.S./China trade truce and the 90-day reprieve reduced those concerns, but, perhaps more importantly, robust economic activity data reassured investors of the resilience of the U.S. economy, supporting a market recovery. Similarly, as geopolitical tensions permeated headlines in recent weeks, markets produced only a small wobble, quickly shaking off concerns amidst a strong economic backdrop.

The muted market response is valid. Periods of high uncertainty typically do not warrant dramatic portfolio changes unless events escalate to have a material and sustained impact on economic fundamentals. After all, the equity market reflects earnings, which remain healthy courtesy of solid household spending, a robust labor market, and strong corporate balance sheets. That said, given the uncertain policy backdrop, a broader hit to market sentiment cannot be ruled out. In this environment, it's essential for investors to maintain well-diversified portfolios designed to navigate periods of heightened uncertainty.

Late Thursday night (July 31), President 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 are due to take effect after August 7.

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 1930s Smoot-Hawley tariffs and meaningfully higher than the 2% at the start of 2025.

In the near term, 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.

As we dig into global equities, U.S. earnings growth and valuation multiples have reached extraordinary levels, largely fueled by innovation that has significantly favored mega-cap companies. In contrast, regions like Europe have struggled to secure a foothold in the digital economy, resulting in a stark earnings divergence. 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.

Risk Considerations

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