Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class June 2026

Market Review

Global markets entered June with greater resilience than many anticipated earlier in the quarter. While the Middle East conflict continued to influence inflation, energy prices, and policy expectations, the broader economic impact remained relatively contained. Rather than reacting to geopolitical headlines alone, markets are increasingly focused on how structural forces, including artificial intelligence (AI) investment and energy security, are shaping both economic resilience and portfolio construction.

A key theme emerging during June was the growing challenge of achieving diversification in an increasingly interconnected global economy. Traditionally, investors have relied on geographic allocations to manage risk, benefiting from differing regional growth drivers and policy environments. However, the ongoing expansion of AI ecosystems and the global nature of energy supply chains are reducing those distinctions. As a result, many regions are becoming increasingly exposed to similar underlying forces, limiting the diversification benefits investors have historically relied upon.

This dynamic is particularly evident across parts of Asia. South Korea and Taiwan continued to benefit from their central roles in global semiconductor production and the accelerating AI investment cycle. Multi-year spending commitments from U.S. hyperscalers remain a powerful earnings driver, with capital expenditures projected to reach approximately $700 billion in 2026 and exceed $1 trillion in 2027. These trends have supported strong equity performance despite elevated geopolitical risks and higher energy costs.

Europe presents a different challenge. The region continues to benefit from structural support through defense spending, infrastructure investment, and a gradual shift toward more expansionary fiscal policy. However, its categorization as a net energy importer leaves it particularly exposed to persistent disruptions in global energy markets. Elevated energy costs continue to pressure household incomes and business margins, contributing to weaker relative equity performance since the onset of the Middle East conflict. Any sustained easing of geopolitical tensions could provide meaningful relief, particularly given Europe’s longer-term investment tailwinds, but for now energy remains the dominant factor shaping the region’s outlook.

Against this backdrop, China has emerged as one of the few major markets offering a more differentiated source of diversification. Long-running efforts to strengthen domestic technology capabilities and diversify energy supply have reduced reliance on both U.S. semiconductor ecosystems and global energy trends. The country’s push toward a more self-sufficient technology sector, alongside investments in renewable energy and strategic energy reserves, has helped insulate domestic markets from some of the dominant forces driving global asset performance. As a result, Chinese equities have exhibited lower correlations with broader global markets in recent years, enhancing their diversification appeal despite persistent structural challenges.

Inflation remains a central macroeconomic consideration. In the United States, headline inflation rose 0.5% in May, lifting the annual inflation rate to 4.2%, its highest level in more than three years. Energy prices increased 3.9% during the month and accounted for roughly 60% of the headline gain, underscoring the continued influence of the Middle East conflict on global price pressures. However, underlying inflation trends were somewhat more encouraging. Core inflation rose only 0.2%, below expectations, while goods prices registered modest declines, suggesting that elevated energy costs have not yet translated into broad-based second-round inflation effects. Although inflation remains above central bank targets, the data reinforced the view that the economic impact of higher energy prices remains manageable for now.

Central banks nevertheless maintained a cautious stance. In Europe, the European Central Bank implemented its first rate increase since 2023, raising its deposit rate by 25 basis points to 2.25%. Policymakers cited the inflationary effects of higher energy costs and the need to prevent broader price pressures from becoming entrenched. While growth projections were revised only modestly lower, inflation forecasts were increased meaningfully, reinforcing the ECB's willingness to prioritize inflation control even at the expense of some near-term economic growth.

In the United States, the Federal Reserve (Fed) left policy unchanged but delivered a notable shift in tone under new Chair Kevin Warsh. The June meeting highlighted greater emphasis on price stability, less reliance on forward guidance, and more hawkish economic projections. Fed officials raised their 2026 core inflation forecast from 2.7% to 3.3%, while projecting that inflation may not fully return to its 2% target until 2028. At the same time, economic growth expectations remained relatively healthy and labor market forecasts showed little deterioration.

Despite these policy developments, economic fundamentals continued to provide support for risk assets. Corporate earnings expectations remained constructive, particularly among firms benefiting from AI-related capital spending. Ongoing investment in data centers, semiconductor capacity, and digital infrastructure continued to provide an important source of growth, offsetting some of the headwinds created by higher interest rates and geopolitical uncertainty. Labor markets also remained stable, while consumer spending continued to demonstrate resilience despite ongoing affordability pressures.

More broadly, the end of the second quarter reinforced several themes that are likely to remain influential over the coming quarters. AI investment continues to reshape market leadership and regional growth prospects while simultaneously reducing traditional diversification opportunities. Geopolitical developments are increasingly transmitted through energy markets and inflation expectations rather than equity volatility alone. Policymakers remain constrained by inflation risks even as growth moderates, increasing the importance of incoming economic data and policy communication. At the same time, regional differentiation is evolving, with markets increasingly distinguished not only by economic growth trajectories but also by their degree of exposure to shared global drivers such as energy and technology.

This quarter ultimately highlighted an investment environment where resilience remains intact, but diversification has become more difficult to achieve. As AI-related investment and global energy dynamics increasingly influence outcomes across regions, investors are being forced to look beyond traditional geographic allocations to identify genuinely distinct sources of return. In this environment, earnings durability, pricing power, and exposure to differentiated structural growth drivers remain critical considerations as markets navigate an increasingly interconnected global landscape.

Fund Review

The portfolio posted a negative net return of -0.05% in the month of June and underperformed its respective index. From a sector perspective, materials and industrials were places of strength while IT and health care contributed to weakness. The Netherlands and South Korea were top contributors from a country perspective, while the United States and China lagged overall.

Portfolio Outlook and Strategy

Stocks follow earnings and free cash flow growth has never been truer than in recent years, particularly during a decade characterized by American exceptionalism. U.S. stocks have outperformed global counterparts, buoyed by superior free cash flow, earnings growth, and higher valuation multiples. Yet presently, driven by innovation and supportive policies, now raises the question: Is it time for this exceptionalism to normalize? The answer appears to be yes, as U.S. valuations have declined while ex-U.S. valuations have begun to close the gap.

Following 2025 strength, this again rung true in 2026 as international equities had their best start versus U.S. peers since 1995 until February 28th when the U.S and Israel launched coordinated military operations against Iran, citing the need to neutralize "imminent threats from the Iranian regime." More on this below. The gap closed but leadership remained in May.

U.S. earnings growth and valuation multiples 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—U.S. earnings per share (EPS) have doubled those of developed markets over the past decade.

Two key developments are necessary for Europe and emerging markets to sustain this shift in fortunes. First, both regions must reignite growth through domestic initiatives, as protectionism threatens global trade. Second, U.S. earnings growth must slow to align more closely with international trends.

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

Japan is also following suit following the 2026 snap election won by PM Sanae Takaichi. She is promoting aggressive fiscal policies, investments in technology sectors like semiconductors as well as the increase in defense spending. This will build upon the already in place catalyst with Japanese companies which are further leverage the use of strong balance sheets as they unwind longstanding cross shareholdings.

As for the second point, U.S. earnings and free cash flow growth looks to be slowing for Magnificent Seven amid significant capex investments without apparent ROI upside thus far. Looking at the earnings growth of the bottom 493 stocks, they are far more pedestrian. That is, without the top S&P 500 names, the earnings growth of the U.S. would look quite like the rest of the world. In fact, earnings estimates globally show a similar expected growth rate in 2026 in every region. Should that come to pass, the approximate 30% discount valuation gap should close.

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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