Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class March 2025

Market Review

The final month of the first quarter concluded with investor angst as March brought sharp bouts of volatility amid erratic tariff policies led by the Trump administration. U.S. equity markets faced the stiffest pressures as investors sought opportunities across the pond where there appears to be more valuation upside as well as a clearer monetary path amongst Central Banks indicating further rate cuts ahead. As the month closed, previous winners, in areas like IT and the U.S., all posted notable losses while previous laggards, energy, and more defensive areas held up better.

The U.S. economy has faced significant challenges recently, leading to downward revisions in growth forecasts and a spike in recession-related web searches. Investors anticipated a growth-friendly administration, but policy announcements, particularly on tariffs, have been harsher and more erratic than expected. The government's approach, immediately announcing tariffs and Federal job and spending cuts, has not included corresponding pro-growth policies, leaving markets and businesses grappling with disappointment, in addition to uncertainty. Thus far in 2025, this concern has translated to investors seeking equities in overseas markets.

At its March meeting, the Federal Open Market Committee decided to keep its benchmark policy rate unchanged at 4.25%-4.50% as expected. The new Summary of Economic Projections showed a meaningful downward revision to growth forecasts, coupled with an upward revision to the inflation forecasts. Still, the median dot plot remained unchanged at two rate cuts for this year—an important reassurance for markets as there have been concerns that the inflationary impact of tariffs may obstruct the Fed from delivering additional accommodation as the economy weakens. Fed Chair Jerome Powell immediately acknowledged the very uncertain economic outlook. Indeed, since the last Fed meeting in January, with the new administration in the process of putting through multiple significant policy changes, consumer and business sentiment has plummeted, inflation concerns have grown, and the broad economic outlook has become considerably murkier—a particularly challenging backdrop for Fed policymakers.

Overall, the Fed appears to be putting more weight on the downside economic risks than the upside inflation risks.

Outside the U.S. and, as expected, the European Central Bank (ECB) cut its policy rates today for the sixth time in this cycle, marking its fifth straight cut. The interest rate on the main refinancing operations, the marginal lending facility, and the deposit facility were each lowered by 25 basis points.

While European data have been fairly lackluster, showing only slight signs of improvement, the economic outlook could be significantly impacted by the events and announcements of recent days. In particular, the approved dramatic increase in Germany's public investment levels will likely have significant spillover effects on the entire Eurozone, driving stronger growth and reducing the need for additional monetary stimulus. On the other hand, however, there is the threat of U.S. import tariffs and the negative impact on investment and export growth.

ECB President Christine Lagarde acknowledged all these factors but also noted that their impact has not been measured. Indeed, there remains significant uncertainty as to whether the various measures will even be confirmed. As a result, the ECB's decision making will need to be based on how the economy and, specifically, how inflation evolves over the coming months. All that being said, green shoots are evident in the year ahead.

To conclude, U.S. equity markets were underwater overall amidst policy and tariff uncertainty while its global peers held up better. The S&P 500 was down by 5.6%, while the MSCI EM Index was up by 0.6%. The MSCI Europe Index was down slightly at 0.3%, while the MSCI Japan Index was slightly higher by 0.2%.

Fund Review

The portfolio posted a loss of 4.9% in the month of March while underperforming its respective index. From a sector perspective, consumer discretionary was one of the lone bright spots while was more than offset by weakness in information technology and health care. Belgium and South Korea were the top contributors from a country perspective while Denmark and Japan lagged overall.

Portfolio Outlook and Strategy

Heading into 2025, U.S. exceptionalism remained a dominant theme. But tech sector struggles, downward revisions to U.S. economic growth forecasts and tariff uncertainties have all culminated in U.S. equity weakness but a broadening into other parts of the world as well as better breadth. Protectionism remains a contentious point and likely to keep volatility prevalent on trade war concerns. This has become apparent in the first week of April following President Trump's coined "Liberation Day" and the sweeping tariff announcements.

The size and scope of the tariff announcement overwhelm the trade actions implemented during the 2018 Trade War, bringing average U.S. tariff rates even higher than those seen during the Smoot–Hawley Tariff Act of 1930. As a result, heightened worries about economic disruption have erupted.

The tariffs represent the largest U.S. tax hike in modern history, and the impact on consumers could be severe. We estimate the resulting hit to U.S. GDP growth at around 2.4%, with more considerable fallout if trade partners retaliate. The odds of a U.S. recession are higher as a result.

The dramatic nature of these tariffs and lack of ready softening measures implies equities will likely be in risk-off mode until something catalyses change. While markets priced in tariff risk, the actual measures announced are more severe than expected and future actions remain uncertain. This ambiguity, combined with the stagflationary nature of the shock, limits the Fed's ability to offset with policy support removing a pillar of potential market resilience.

We may be nearing peak uncertainty. There is an optimistic scenario where tariffs are a negotiating tactic intended to build credibility and pave the way for fiscal stimulus. This may be via tax cuts especially tied to onshoring or a market-driven reduction in rates. If paired with tighter immigration policy, this could support real wage gains at the lower-income cohort and incentivize pro-cyclical responses from foreign economies (e.g. China & Germany). But this outcome requires policy clarity, and we are not there yet.

Until a credible resolution emerges, either through de-escalation or fiscal offset, the market is likely to be defensive. Rising costs, limited visibility and uncertain policy path argues for caution in equity positioning. In this backdrop, companies with strong free cash flow generating capabilities remain attractive.

With that said, following the dramatic share price declines in a wide swath of equities, we view this as a great opportunity to add to positions where our financials models suggest significant upside over the long-term.

Risk Considerations

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