

## Principal Global Investors Funds

# Islamic Global Responsible Equity Fund

I Class May 2025

### Market Review

Equity markets were sharply higher in May as a trade truce, albeit temporary, between the U.S. and China engineered hopes that common ground on tariffs could potentially be found. Volatility, identified through the VIX, eased on the reports, while Treasury Yields did remain elevated on deficit concerns and uncertainty surrounding next steps by the Federal Reserve. Sectoral performance was cyclically led while all global regions posted gains in the mid-single digits.

The 90-day tariff truce between the U.S. and China marks a significant, if temporary, easing of tensions that have weighed heavily on global markets since the start of the year. As both countries scale back punitive tariffs—U.S. tariff rates dropping from 145% to 30%, and China's from 125% to 10%—investors have responded with relief, sending risk assets higher as recession fears subside.

By averting a scenario that could have slashed U.S. GDP growth by over 2%, the rollback lowers the effective U.S. tariff rate to around 12%, reducing the drag on the U.S. economy to just over 1%. Importantly, it also mitigates the risk of widespread supply shortages. China, too, benefits—its projected GDP impact narrows to under 1%, offering breathing room to policymakers and exporters alike.

But this reprieve is not a resolution. While peak trade policy pessimism has likely passed, the direction of travel implies more, rather than less, trade barriers compared to a year ago. The path beyond the 90-day window also remains unclear. Business investment and hiring decisions may remain cautious amid lingering uncertainty, while elevated tariff levels continue to pressure margins and consumer prices.

As expected, the Federal Open Market Committee decided to keep its benchmark policy rate unchanged at 4.25%–4.50% at its May meeting.

The Fed continues to see the U.S. economy as resilient and is waiting to see if the weakness in soft data translates into weakness in hard data. With risks to their dual mandate rising, the Fed prefers to wait for additional clarity before adjusting policy, especially as the outlook remains extremely uncertain.

To conclude, the May period was filled with investor optimism on the tariff front leading to a risk-on period. The S&P 500 was up by 6.3%, while the MSCI EM Index rose by 4.3%. The MSCI Europe Index posted gains - rising by 4.6%, while the MSCI Japan Index was higher by 4.1%.

### Fund Review

The portfolio posted a strong gain of more than 6% in the month of May though did slightly underperform its respective index. From a sector perspective, energy (no exposure) and industrials were areas of strength while partially offset by weakness in health care and IT. The United States and the Netherlands were the top contributors from a country perspective while Ireland and Germany lagged overall.

### Portfolio Outlook and Strategy

Heading into 2025, U.S. exceptionalism remained a dominant theme. But previous tech sector struggles, downward revisions to U.S. economic growth forecasts and tariff uncertainties have all culminated in U.S. equity going from a leader to laggard as investors seek growth and valuation opportunities in international markets. Protectionism remains a contentious point and likely to keep volatility prevalent on trade war concerns.

Following multi-year leadership, U.S. equities have taken a back seat to international markets thus far in 2025. President Trump and his administration are looking to restructure international trade through tariffs and by extension has increased concern about the economic outlook. Odds for a recession in the States have ticked higher and there is the increased likelihood for growth boosting policies, deregulation and tax cuts, to avoid this scenario.

However, the announced U.S.-China tariff truce marks a significant, albeit temporary, de-escalation in trade tensions—one that meaningfully reduces recession risks and helps stabilize near-term investor sentiment. Still, the policy path ahead remains highly uncertain. While the worst-case scenario may be off the table, the long-term implications for global trade and portfolio positioning are far from settled, especially considering tariffs are still higher compared to where they were at the start of the year.

Turning to the Federal Reserve, they have emphasized the need to wait and see if the weakness in soft data translates into weakness in hard data. They are beholden to trade policy—itsself incredibly uncertain—and are now likely to delay further rate cuts until late Q3. Also complicating matters is the ongoing challenges to their independence, which has the potential to undermine monetary policy credibility. In the meantime, investors should prepare for a higher-volatility environment marked by fragile rate expectations, increased market sensitivity to Fed signals, and renewed pressure on the U.S. dollar.

Given this environment, opportunities are likely to arise in companies residing in economically sensitive industries and overlooked sectors. There are many examples of companies generating resilient free cash flows and trading at attractive valuations across a variety of economically sensitive industries, including materials, capital goods, consumer cyclical and financials.

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. Cool stuff is happening and fast. A.I. is early in its usage but offers great promise across a wide scope of practical applications, including software development, agriculture, finance and healthcare. The investment needed for A.I. deployment is historically massive and shows no signs of abating.

In recent months, European markets have staged an impressive run of outperformance relative to the United States. What began as a tactical move by investors to capitalize on valuation asymmetries has evolved into something more structural: a valuation story increasingly underpinned by fundamentals. The policy tone across Europe has become more constructive, with a shift toward a more expansionary fiscal mindset raising hopes that the continent might finally unlock a stronger and more sustainable set of investment opportunities—something that has eluded investors over the past decade.

Germany's announced massive fiscal shift is a notable and structural development as the winds are seemingly changing across the globe. President Trump's decision to suspend military aid to Ukraine in early March, plus his evolving approach to global security, has prompted a significant re-think on defense spending in Europe and accelerated a long-awaited fiscal shift in Germany.

Taken at face value, Germany is set to embark on a major fiscal expansion—over 1 trillion euro—far exceeding expectations. While a policy shift wasn't a surprise, the scale marks the biggest change in Germany's fiscal approach since reunification 35 years ago. The reforms could raise allowable structural net borrowing by more than 2% of GDP annually, though questions remain about how quickly the funds can be deployed.

Germany, which makes up about a third of Euro area GDP, is poised to lift broader European growth through its fiscal expansion. At the same time, the E.U. has proposed a modest but supportive fiscal shift, including looser budget rules to enable more defense spending, a “national escape clause” for member states, and a new 150 billion euro loan facility (SAFE) to support investment. While the EU-wide impact will be smaller than Germany's, it should still provide a 0.1–0.2% boost to Euro-area GDP in the coming years.

From a global perspective, 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 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.

In times like these, the adage of staying invested with a diversified portfolio is more important than ever. Global diversification remains essential, especially given the asymmetric implementation of tariffs across countries, while cross-asset class exposure provides valuable resilience in periods of heightened volatility. Volatility is a normal feature of investing, not a flaw—those who remain disciplined and invested through the noise are often rewarded over time.

## Risk Considerations

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