

Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class May 2026

Market Review

Global markets moved through May with limited headline volatility, but the underlying macro tone became more cautious. Earnings resilience remained supportive of equity performance, yet confidence weakened as inflation pressures proved harder to dismiss, bond yields moved materially higher, and policy flexibility narrowed. The month marked a transition away from markets simply absorbing geopolitical shocks toward a more uneasy assessment of how persistent those shocks may be.

A key signal of this shift was the deterioration in United States small business sentiment, with recession fears increasingly front of mind and confidence falling to the lowest levels since last year. While smaller firms typically have limited direct global exposure, rising energy costs, tariffs, supply chain disruptions, and elevated interest rates are increasingly shaping outcomes at the local level. This convergence highlights how macro pressures long concentrated among large, multinational firms are now filtering more broadly through the economy. Even firms without global footprints are paying closer attention to geopolitics, trade routes, and energy markets, reinforcing how interconnected local and global dynamics have become.

Pessimism itself does not drive downturns, but it does influence behavior at the margin. Heightened uncertainty tends to delay investment, slow hiring, and defer discretionary spending. These dynamics became more visible in May as firms of all sizes emphasized cost efficiency over expansion. Importantly, this shift reflects caution rather than distress. Corporate balance sheets remain generally strong, leverage is manageable, and cash flow generation remains healthy enough to absorb near-term volatility, reducing the risk that rising anxiety translates into an abrupt economic contraction.

Inflation remained the key macro constraint in May. Elevated energy prices continued to dominate the narrative, with higher input costs increasingly seen as a risk to core inflation. Although inflation expectations remain broadly anchored, the absence of clear disinflation progress has narrowed policy flexibility and reinforced the repricing seen across global bond markets.

This backdrop drove a sharp adjustment in rates. Global bond yields moved higher, with long-dated government yields reaching levels not seen in decades. The move reflected a reassessment of stickier inflation, expansionary fiscal policy, resilient U.S. growth, and elevated geopolitical risk tied to disruptions in the Middle East, as well as constrained energy flows. Importantly, this was a global repricing rather than a country-specific event, signaling broader skepticism around the timing and pace of future policy easing.

Against this backdrop, signs of potential de-escalation in the Middle East began to emerge late in the month. Reports that a U.S.–Iran agreement to reopen the Strait of Hormuz may be moving closer introduced the prospect of a gradual normalization in global energy markets. Even ahead of any formal agreement, markets began to reflect elements of a relief trade, with some moderation in oil prices, a stabilization in bond yields, and firmer equities in energy-sensitive regions.

However, markets are not pricing a full normalization. Oil futures remain elevated relative to pre-conflict levels, suggesting expectations for a slow and uneven adjustment process. Physical rebalancing in energy markets is unlikely to happen quickly, implying that inflation pressure linked to energy costs may ease only gradually rather than dissipate outright. This dynamic is important for policy. While easing energy prices could reduce near-term inflation concerns, they are unlikely on their own to justify policy easing. Resilient growth, supported by firm consumer spending, ongoing capital investment, and a stable labor market, continues to weaken the case for rate cuts. At the same time, the bar for renewed tightening remains high, requiring evidence of both sustained economic strength and renewed upside pressure on core inflation. The most likely outcome remains an extended policy pause, leaving markets sensitive to incremental changes in both inflation and growth data.

Strong earnings momentum remained a key stabilizer throughout May, with global earnings expectations revised higher even as rate pressures mounted. U.S. companies continued to benefit from relatively lower exposure to imported energy and ongoing investment tied to AI and infrastructure, helping offset higher discount rates. In Europe, earnings outcomes proved more resilient than initially feared, allowing equity markets to stabilize despite a more challenging macro backdrop.

Nevertheless, regional divergence remains important. Europe continues to face greater exposure to elevated energy costs, with less margin for error should inflation remain sticky or growth soften further. At the same time, any sustained easing in energy constraints could provide meaningful relief and create scope for relative catch-up. By contrast, the U.S. retains advantages through stronger earnings momentum and domestic energy exposure, though that resilience remains increasingly conditional on inflation dynamics and the Federal Reserve's reaction function.

More broadly, May reinforced several longer-term dynamics shaping markets: geopolitics is increasingly transmitting through commodities and inflation rather than equity volatility alone, affordability pressures are weighing on sentiment even as aggregate demand remains resilient, artificial intelligence (AI)-driven investment continues to support growth but is contributing to market concentration, and policy flexibility is more constrained than in prior cycles. At the same time, questions around U.S. exceptionalism are becoming more relevant as opportunities outside the U.S. broaden in a more fragmented global landscape.

May ultimately highlighted an environment in which headline stability masks growing underlying tension. Inflation persistence, elevated yields, and unresolved geopolitical risks have increased sensitivity to incremental changes in growth and policy expectations. As a result, markets are increasingly differentiating based on earnings durability, pricing power, and balance sheet strength rather than moving on broad risk sentiment alone.

Fund Review

The portfolio posted a positive net return of 7.19% in the month of May but underperformed its respective index. From a sector perspective, consumer staples and materials were places of strength, which were offset by weakness in consumer discretionary and IT. South Korea and Japan were top contributors from a country perspective, while the U.S. and Taiwan 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 as we enter 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

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