Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class September 2025

Market Review

Global equity markets closed out the quarter on a positive note as the Federal Reserve (Fed) implemented its expected rate cut while business cycle indicators remained buoyant. The labor market softened further but inflation remained tame despite ongoing tariff concerns. Emerging markets led the strength as commodity-related companies linked to gold and copper benefitted from the United States dollar, which is having its worst year since 1973, while a forced majeure at a Freeport mine sent copper prices higher.

As widely expected, at its September meeting the Federal Open Market Committee (FOMC) decided to lower its benchmark policy rate by 25 basis points (bps). The decision was characterized as a "risk management cut," an acknowledgement of the labor market risks but also the elevated uncertainty around inflation and government policy. Expectation is for two more 25 bps cuts this year as the Fed gradually reduces rates to below most measures of neutrality.

The August jobs report showed a 22,000 gain in payrolls, missing consensus expectations, and revised the past two months' releases, including a contraction in June's jobs. The unemployment rate edged up to 4.3%, likely reinforcing the notion that the decline in labor supply is keeping the labor market somewhat in balance. The increasing weakness in jobs since May, however, could revive recessionary concerns if the labor market deteriorates further in the coming months. Behind challenged labor market headlines, underlying consumer and capex resilience remains a backbone of this year's earnings strength. Additionally, business cycle leading indicators—ISM Services and regional manufacturing Fed surveys—have surprised to the upside in recent months. The broader picture of economic robustness, further supported by tight credit spreads, continues to underpin the strength in the equity market.

Across the pond, the European Central Bank (ECB) kept its policy rates steady, the second consecutive meeting without rate action. ECB President Lagarde struck a balanced tone, offsetting downgrades to the new staff forecasts with more positive comments about the labor market outlook and reiterating that the central bank is in a very good place to respond to the evolving economic developments.

To conclude, the September period was a reversal of leadership though the same trend of equity returns moving higher. The S&P 500 was up by 3.7%, while the MSCI EM Index rose sharply by 7.2%. The MSCI Europe Index was higher by 2.0%, while the MSCI Japan Index posted similar absolute returns of 2.4%.

Fund Review

The portfolio posted a gain of more than 3.5% in the month of September while underperforming its respective index. From a sector perspective, the communication services and consumer staples sectors were areas of strength while was more than offset by weakness in IT and health care. China and South Korea were the top contributors from a country perspective while the United States and the United Kingdom lagged overall.

Portfolio Outlook and Strategy

The adage "stocks follow earnings" 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 this period, 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 closed the gap in 2025.

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.

As for the second point, U.S. earnings growth may slow if the Magnificent Seven mean-revert to their long-term averages in their fundamentals. Looking at the earnings growth of the bottom 490 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 valuation gap should close.

Yet, thanks to the trade war launched by the Trump Administration, European leaders are taking steps to bolster their economies. Leading this effort is Germany, which unveiled a 500-billion-euro stimulus package, signaling an end to decades of budget austerity as it focuses on military and infrastructure investment. If pronouncements translate into concrete steps, the current trade friction could become a long-term positive gamechanger 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.

Within the U.S., Despite labor demand eroding for much of the year, and following April's Liberation Day selloff, the S&P 500 has reached record highs. The divergence between market strength and labor weakness has raised questions about the true underpinnings and sustainability of the market rally.

Behind challenged labor market headlines, underlying consumer and capex resilience remains a backbone of this year's earnings strength. Additionally, business cycle leading indicators—ISM Services and regional manufacturing Fed surveys—have surprised to the upside in recent months. The broader picture of economic robustness, further supported by tight credit spreads, continues to underpin the strength in the equity market.

Looking ahead, the combination of monetary easing alongside fiscal and regulatory stimulus could bolster an economy that has proven resilient to this year's headwinds. A policy-driven recovery may help revive the more sluggish segments of the economy, including housing, manufacturing, and employment, suggesting that equities, beyond the large tech leaders, could be poised for further modest gains.

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.

Risk Considerations

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