

## Principal Global Investors Funds

# Islamic Global Responsible Equity Fund

I Class August 2024

## Market Review

MSCI ACWI Islamic Index appreciated by 0.9% in USD terms in August, mainly driven by outperformance of Health Care which more than offset the negative contribution from Consumer Discretionary and Energy. By country, Europe and Taiwan contributed positively while Korea was a major detractor for the month. The Dollar Index declined by 2.3%, and the US 10-year bond yield fell to 3.9% as market expect more than 2 rate cuts in coming months. Oil price trended down to US\$79 on macroeconomic concerns.

## Fund Review

In August 2024, the Fund value appreciated by 1.6% in USD terms. The outperformance was mainly attributed to stock selection in Information Technology and Health Care sectors. Within Information Technology, the absence of a major US chip company that faced challenges to remain relevant into the future in the portfolio and our value added stock selection in US and Taiwan were the key factors of outperformance. The performance of Health Care sector was mainly contributed by strong stock performance of a US pharma company that continued to rally on earnings beat. We continue to hold on to these stock as they are expected to have good long-term growth over the next few years. On the other hand, our stock selection in communication services, consumer staples and energy detracted value with the global economy trending weaker.

## Portfolio Outlook and Strategy

### Outlook

August was another volatile month for developed market equities, with the S&P 500 and MSCI Europe rising by 2.4% and 1.6% respectively, while MSCI Japan declined by 2.7%, all in local currency terms. In early August, jobs data from the US suggested a cooling labor market, triggering concerns about the US economic outlook. Meanwhile, the expectation of more hawkish rate hikes by the Bank of Japan triggered the unwinding of Yen carry trades and a sharp sell-off in Japan and global equity markets.

US headline inflation moderated to 2.9% in July, with core inflation slowing to 3.2%. Notably, shelter inflation, a main contributor to persistent inflation, continued to ease YoY. The US GDP came in at 2.8% for 2Q24. The US labour market is clearly cooling as the nonfarm payroll numbers in August came in softer than expected, the second month in a row. But overall economic growth is forecast to remain healthy with the Atlanta FedGDP Now estimates at +2.1% thanks mainly to strong consumption. More recent US data (retail sales, initial claims, services ISM) has pointed to relative strength in the US, dispelling the fear of a hard landing. The US Fed is likely to ease rates gradually starting with a 25bp cut in Sep given it is now confident that inflation risks have subsided. The debate is now on the pace and magnitude of the rate cuts.

As recent market volatility subsides, investors are shifting their attention back to fundamental factors such as corporate earnings. While there are concerns in areas such as consumer spending, the overall growth rate for S&P 500 profits remains healthy. In fact, the current earnings rebound, which began one year ago, has led to a trailing 12-month growth rate of 7.4%— just around the historical average. Consensus estimates suggest that the S&P 500's earnings-per-share could continue to grow 10% in 2024, and 14% over the next twelve months. While there is still significant macro uncertainty, continued earnings growth should help ease valuation concerns and support markets over the next phase of the cycle.

The Euro Area economic growth expanded by 0.3% QoQ in 2Q24, though there were discrepancies among different economies: the German economy contracted by 0.1% while the French economy expanded by 0.2% QoQ. Euro Area inflation continued to moderate to 2.2% in July. Policymakers expect a return to 2% inflation before year end 2025. Bank of England cut interest rate for the first time in four years in August. Japan's Manufacturing PMI increased slightly from last month, although still in contraction zone. The services PMI remained in expansion zone. Inflation remained high at 2.8%, above BOJ's 2% target. Wage growth also continued to be strong. The resilient economic situation and strong wage growth support BOJ's plan to continue increase interest rates. This is inline with our belief in a reflation story in Japan.

The change in the Democratic Presidential candidate has shifted the dynamic of the US election. Volatility is likely to persist until the US Fed cuts in September. Meanwhile, outstanding issues like geopolitical tensions, US elections and the unwinding of the Yen carry trade (given divergent monetary policies of the US and Japan) remain. The outcome of the elections could have profound implications for Asian economies in terms of trade dynamics and geopolitical relations. Protectionist policies against China and supply chain diversification are expected to continue, regardless of election results.

China's economic expansion remains uneven, with export-led manufacturing growth compensating for weak consumption. Policy stimulus has been muted. China's economy remains soft and meeting the 2024 GDP growth target of 5% will be a challenge. However, no large-scale stimulus program is in sight. Policymakers are mulling new efforts to support the housing market such as allowing local governments to sell bonds to buy homes and allowing mortgage refinancing at lower rates. To be more positive, we need to see the government implement a larger fiscal stimulus to boost demand, funded by new issuances of central government bonds or policies to improve business confidence.

### Strategy

After a sharp selloff beginning of the month triggered by a much softer than expected jobs data, the recent volatility eased. Adequate growth of the broader economy and improving earnings growth are feeding into investor optimism and, in turn, we are beginning to see breadth in equity returns. As we move closer to a rate cut cycle in the US and with the start of Europe's rate cut cycle, this should create opportunities across the equity landscape. We expect volatility in the months ahead as recent economic tea leaves point to slowing global growth and a normalizing job market. A soft-landing scenario remains in place, but the environment remains fluid and the looming U.S. election is likely to bring ongoing angst. In the event of any sharp correction, we would be looking to take advantage of the sell off where we believe price movements have gone too far and finding attractive entry points based upon our fundamental analysis.

Artificial Intelligence is here to stay; and we believe that earnings growth will remain the key over the long run. As the technology improves and additional features / functionalities are developed, generative A.I. will be embedded across wide swaths of the economy. The total addressable market remains very large domestically and internationally with sizable monetization potential. Generative A.I. is highly computer-intensive from both an algorithm training and content creation perspective. This level of data creation necessitates the need for significantly more GPUs relative to other computational / training workloads. The long-term structural change remains relevant, but the key will be picking the winners from the losers as so many have significant aspirations.

The fundamental themes of reflation and ongoing corporate governance reforms in Japan remain intact. Corporate earnings growth continues to be revised higher. Valuations for Japan market have become very attractive after a sharp sell-off exacerbated by technical dynamics and margin calls. We maintain the view that policy normalization in Japan will be gradual, with monetary policy remaining accommodative as real interest rates stay negative, barring a hard landing in US economy.

Bottom-up stock selection will be key amidst uneven global economy recoveries and fluid Central Bank policies. Regardless of the region, sector, or general market conditions, our bottom-up focus on sustainable earnings trends and valuations relative to expectations remains a constant across the portfolio.

## 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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