Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class June 2024

Market Review

MSCI ACWI Islamic Index appreciated by 1.9% in USD terms in June, mainly driven by outperformance of Information Technology as the AI continued to move hardware technology sector higher. The US, Taiwan ROC and Korea markets were the main positive contributors to the market performance. The US 10-year bond yield fell 10 bps to 4.4% and the US Dollar appreciated by 1.1%.

Fund Review

In June 2024, the Fund value appreciated by 3.6% in USD terms. The outperformance was mainly attributed to good stock selection in Information Technology sector especially in the United States while the detractors were in Financials and Consumer Discretionary sectors.

Portfolio Outlook and Strategy

Outlook

The US labour market is gradually cooling, with the unemployment rate rising in June (4.1% vs 3.8% in March) and the pace of jobs growth in recent months being revised downward. In the US, Fed Chairman Powell said there were 2 conditions that would prompt rate cuts, i.e., more confidence in inflation coming down and an unexpected weakness in labour markets. Our base case is for Core PCE to gradually ease from the recent trend of +2.7% annualized rate over the last 3 months to May. In fact, the Core PCE of +2.6% yoy in May is below the Fed's year-end target of +2.8% yoy. The Fed will probably start a rate cut cycle in 4Q24.

June preliminary inflation in Europe came in line with market expectation. The manufacturing PMI is still deep in contraction. In early June, the European Central Bank (ECB) cut its key policy rates for the first time in five years. Market is looking at another two rate cuts by the ECB by the end of the year. Japan's manufacturing PMI stays above 50 but services PMI unexpectedly declined into contraction zone. Headline inflation advanced to 2.8% and inflation ex-food and energy moderated to 2.1%, but still above BOJ's inflation target. The latest BOJ Tankan Survey showed strong capex spending growth and improved manufacturing sector outlook. Wage growth came in higher than market expectation but household spending is still weak. The Yen fell through ¥160/US$ in late June due to expectations that the gap in real rates between Japan and the US could persist for longer. The Bank of Japan (BoJ) could delay rate hikes till Sep (vs previous expectations of an outright hike in July). This is because the BoJ has signalled for a substantial reduction in JGB purchases in July and there is a chance they would not do both simultaneously. Watching data to convincingly point to lower US rates is likely to be the main dynamic for the Yen.

China's recent economic data have been disappointing, e.g., manufacturing PMI, credit growth and primary property sales. Export growth has been better than expected. The 10-yr Chinese government bond yield has fallen below the levels seen in early 2020 reflecting concerns about growth and inflation. This is despite verbal guidance by the PBoC that it is prepared to directly intervene with the aim of discouraging a bond bubble and reducing financial risk. More effective measures are needed to address the weak confidence stemming from the property correction. Other parts of Asia are broadly fine with India seeing policy continuity and export-oriented Korea and Taiwan benefiting from the tech upswing.

There is heightened speculation of a Trump win in November which could lead to possible broad-based tariffs being imposed on China and/or the rest of the region. This could lead to volatility in the region.

Strategy

The strength of the broader US economy and improving earnings are feeding into investor optimism and, in turn, we are beginning to see breadth in equity returns. However, stubborn inflation levels are capping a further acceleration of this development while smaller companies have yet to play catch up. As we embark on the commencement of rate cuts at some point in 2024 and recently cooling global growth, this should create opportunities across the equity landscape, in particular given the concentration of select names in 2023.

Artificial Intelligence is here to stay; however, following a significant valuation re-rating for many companies known to be “intertwined” in the opportunity, 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. Despite the rally since 2023, Japan's equity valuation remains reasonable. The BOJ's removal of the reference amount for JGB purchases in the latest monetary policy meeting opens the possibility of future reductions of JGB purchases. However, any policy normalization is likely to be gradual to avoid sudden increases in JGB yields. The FX interventions by the Ministry of Finance will slow down any further depreciation of Japanese Yen. If the interventions fail to prevent further Yen weakening, the BOJ may need to increase interest rates or reduce JGB purchases to support the Yen, especially if US interest rates remain high. However, monetary policy would stay accommodative given that real interest rate will likely stay negative for Japan.

Following a period of valuation improvement, earnings remain a key catalyst to further upside. 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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