Principal Islamic Asset Management (Ireland) (PLC)

Islamic Global Responsible Equity Fund

I Class March 2024

Market Review

MSCI ACWI Islamic Index appreciated by 2.86% in USD terms in March, mainly driven by outperformance of Energy, Information Technology and Material sectors while Consumer Discretionary sector detracted value. The US 10-year bond yield declined 5bps to 4.20%. The US Dollar appreciated by 0.32% while Brent oil price rose 4.6% to US$87.48/barrel due to tension between Iran and Israel.

Fund Review

In March 2024, the Fund value appreciated by 2.40% in USD terms. On relative basis, the Fund detracted value from Materials and Energy sectors on the back of disappointing sector allocation and stock selection decisions. On the other hand, the good stock selection in Real Estate and Communication sectors added value. From a country perspective, investments in Australia and Japan contributed positively while France and South Korea subtracted value.

Portfolio Outlook and Strategy

Outlook

The US economy keeps defying pessimists. GDP growth, the labour market and financial health of household and business are all in good shape. Immigration has helped boost labour supply in recent times, which partly explains the strong output growth. No surprise that inflation remains sticky with headline CPI in Feb running at +3.2% y-o-y. Hence, the Fed has been careful in guiding the pace of rate cuts. Markets currently expect ~75bp of cuts this year and there is a chance of this being reduced to 50 bps.

In Europe, earnings expectation was muted for 2023 as the economies in general stagnated. We begun to see modest improvements in regard to both earnings and growth in 2024. As widely expected, the European Central Bank (ECB) kept its key policy rates on hold. The interest rate on the main refinancing operations, the marginal lending facility, and the deposit facility remain at 4.5%, 4.75%, and 4.0%, respectively. Since the last ECB meeting in January, markets had adjusted their rate expectations, pushing out the date of the first rate cut from March to June. At its meeting, ECB President Christine Lagarde essentially affirmed market timing, noting that while they are confident that inflation is progressing towards the ECB's 2% target, they are not yet "sufficiently confident." The ECB needs more evidence that inflation is trending back to 2%, but, as Lagarde noted, they will "know a little more in April," but they will "know a lot more in June." There is now a view that ECB may be first to cut rates, before the US Fed.

Most Asian central banks (except China) are waiting for the US Fed to start cutting rates before embarking on any monetary easing. Inflation is generally easing, and consumer confidence is recovering. Exports are recovering and could surprise on the upside in 2024. China's economy is stabilizing. Exports rose +7% y-o-y in Jan & Feb, and manufacturing PMIs printed above 50 in March, the first time since Oct 2023. The domestic oriented economy is mixed with property sales remaining weak, retail sales +5.5% y-o-y in Jan & Feb, and aggregate credit growth +9% y-o-y in Feb 2024. The PBoC is also expanding its balance sheet. 1Q24 GDP growth could reach +4.5-5% y-o-y which would be in-line with the full year target of +5%. Policy action is a key determinant of how the macro evolves. China has started drafting a Private Enterprise Law to improve confidence, promote development, motivate businesses to be innovative and enforce rules so that state-owned enterprises and private companies are treated equally.

Strategy

As we look to 2024, we expect to see increasing divergence in performance between companies as they contend with the tension between growth and interest rates. With a playbook that is no more certain this year than last, our dominant eye remains on company-level fundamentals and investing in advantaged businesses that can:- maintain a strong balance sheet, grow their sales, generate ample free cash flow, out manoeuvre the competition, invest in long term growth, and/or consistently return capital to shareholders.

Despite Japan experiencing some economic slowdown, there are increasing signs that inflation and wage increases may be sustainable in 2024. Sustainable nominal wage growth is expected to lift household real income and support a virtuous cycle between wage and price increases. The 2024 Spring Wage Negotiation (Shunto) showed optimistic results with strong wage growth of 5.28% for headline and 3.7% for base pay for the first release, a 33-year high. In response, the BOJ exited its Negative Interest Rate Policy and Yield Curve Control. Any future policy change is likely to be gradual. Although short-term volatility in currency markets is likely, Japan remains attractive with corporate governance reforms and a virtuous cycle between wage and price increases as the key drivers.

In our opinion, artificial intelligence (AI) is a structural trend but following a significant valuation re-rating for many 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 AI will be embedded across wide swaths of the economy. The total addressable market remains very large globally with sizable monetization potential. Generative AI 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.

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.

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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