Principal Global Investors Funds

Islamic Global Responsible Equity Fund

I Class October 2024

Market Review

MSCI ACWI Islamic Index declined by 4.5% in USD terms in October, mainly driven by Energy and Materials sectors. October was a volatile month for developed market equities. US 3Q GDP remained strong, +2.8% QoQ, led by consumer spending. US labour market data came in mixed in Oct, with only 12k jobs added which was likely skewed by hurricanes and industrial strikes, while core CPI rose +3.3% yoy in Sep vs +3.2% yoy in Aug. The U.S. Dollar strengthened by 3.2% as the U.S. economy demonstrated resilience, prompting markets to price in less aggressive future rate cuts by the Federal Reserve. Political uncertainty in Japan increased after the ruling coalition lost its simple majority in the lower house election, raising concerns that the Bank of Japan might delay rate hikes. Meanwhile, the 2024 US presidential race between Trump and Harris appears tightly contested. Market anticipation of a potential Trump presidency has pushed the 10-year Treasury yield up to 4.28% at end of October.

Fund Review

In October 2024, the Fund value decreased by 4.6% in USD terms. Stock selection in health care and consumer staples disappointed but positive contribution from communication services and real estate compensated partially. In terms of country, France and United Kingdom contributed negatively but was offset by good stock selection in the US.

Portfolio Outlook and Strategy

Outlook

The Fed is likely to continue to cut rates as the labour market is prioritized given that inflation is trending down. Our base case is for ~100bp of policy rate cuts from now till end 2025 but the range of scenarios could be wide. It is fluid depending on US trade, tax, immigration and fiscal policies.

Markets are taking strong encouragement from the clear and direct tone of the China Politburo's announcement, as well as the earlier-than-scheduled timing of the Politburo meeting. Ultimately, however, it is the exact size and design of the fiscal package that will be of the most significance. For example, tax or consumption subsidies may have a meaningfully smaller impact than policies that provide a clear fiscal injection to consumption or that directly address the root problem of the property market. We are of the opinion that the government needs to continue to roll out measures on both the fiscal and monetary front to improve business and household confidence.

Key themes for 2025: i) will the policy pivot help China's economy recover; ii) will US see a soft landing or no landing scenario and what are the implications for policy rates; iii) will geopolitical risks hit asset prices.

Regardless of the election result, we expect a continuation of protectionist policies, export controls on critical tech to China, reshoring to the US and supply chain diversification. There are mixed views as to how the US-China relationship would fare under a Trump administration. Trump could take a more transactional approach with China on tariffs and export controls.

Strategy

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.

Although the high level of crowding in Big Tech has led to selloff when markets were becoming increasingly concerned with Big Tech earnings not meeting expectations, we expect the market to reset expectations around the real growth potential of these companies. We believe that Artificial Intelligence (A.I.) is here to stay; and we believe that earnings growth will remain the key over the long run. The top 4 hyper-scalers, i.e., Alphabet, Meta, Microsoft and Amazon continue to guide for substantial capex growth in 2025 despite the high base this year, mostly driven by investment in AI infrastructure, lending confidence about AI spending sustainability. While productivity gains cannot yet be quantified, there will probably be a transformative impact.

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. Valuations for Japan market have become attractive after the correction. It is particularly important as we are at a crossroads where the country can withstand a stronger yen as well as the Bank of Japan's diverging monetary policies to the rest of the world amid rising inflation. 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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