PRINCIPAL EDGE MIDCAP FUND

# Quarterly commentary

**SECOND QUARTER 2024**

**TICKER:**

**Class I: PEDGX**

Class A: PEMCX

## Market review

The Federal Reserve last increased rates on July 26, 2023, to 5.25-5.50% and ever since, investors have debated at length when the first rate cut might occur. Six months into the year, investors are still debating and waiting. Despite this uncertainty, markets have charged ahead with the S&P 500 hitting more than 30 record highs led by U.S. mega-caps.

Performance was mixed across U.S. equities during the second quarter with the Russell 1000 Index increasing +3.57% while both mid- and small-cap indexes fell as measured by the Russell Midcap (-3.35%) and Russell 2000 (-3.28%) Indexes. From a sector standpoint, only 4 out of 11 sectors in the Russell Midcap Index posted a positive return, with the utilities sector leading the way with a return of +3.80%. Communication services (+2.69%) and information technology (+1.17%) rounded out the top 3 sectors. The bottom 3 sectors were all down more than -8.00% with the materials sector returning -8.06%, health care -8.45%, and consumer staples -9.06% in the quarter.

As the economy has started to show signs of slowing with Q1 GDP coming in notably lighter than projected, we expect mixed macroeconomic data and political noise to make forecasting sector-level outperformance extremely challenging in the near-term. While the start of 2024 brought double digit returns across U.S. equities, we believe that investors will become more discerning by refocusing on fundamentals and higher-quality companies in 2024.

## PRINCIPAL EDGE MIDCAP FUND

The Principal Edge MidCap Fund seeks long-term growth of capital by investing primarily in common stocks of mid-capitalization U.S. companies.

# Top five contributors

**Teradyne, Inc. (TER)** develops and sells automatic test systems for semiconductors, systems, and wireless segments. The company also has a robotics division that designs, manufactures, and markets robotic arms, autonomous mobile robots, and advanced robotic control software. During the quarter, TER outperformed as investors were enthusiastic about the company's increasing total addressable market (TAM) and share gains from artificial intelligence-oriented products.

**Fair Isaac Corporation (FICO)** provides decision management solutions through its software and scores businesses (including FICO scores). The company continues to see strong pricing in its scores segment and good growth opportunities in its software business. During the quarter, FICO beat expectations with higher-than-expected revenues and margins.

**Tyler Technologies, Inc. (TYL)** provides integrated technology and management solutions and services for the public sector with a focus on local governments. Tyler aided relative results during the quarter as the company continued to win state and local government contracts and its payments business continued to drive customer acquisition and existing customer growth.

**Lennox International Inc. (LII)** designs, manufactures, and markets products for heating, ventilation, air conditioning (HVAC), and refrigeration. During the quarter, LII aided relative performance as the company's earnings beat expectations due to better margins in its commercial segment.

**Casey's General Stores (CASY)** is a best-in-class convenience store operator with locations through 16 states, primarily in Iowa, Missouri, and Illinois. We believe CASY is in the early stages of consolidating the industry with strong geographic growth opportunities over our five-year investment horizon. During the quarter, CASY added to results as earnings exceeded expectations, driven by higher-than-expected profits in its stores and fuel business.

# Top five detractors

**Lincoln Electric Holdings, Inc. (LECO)** designs and manufactures welding and cutting products. The company's products include arc welding power sources, wire feeding systems, robotic welding packages, fume extraction equipment, consumable electrodes, fluxes, and regulators and torches used in oxy-fuel welding and cutting. LECO lagged during the period as investors worried about the company's opportunity in electric vehicle charging stations. Additionally, although earnings beat expectations, sales were lighter than expected with weakness in equipment, automation, and consumables. We continue to believe LECO is well-positioned given the shortage of skilled welders, labor inflation, reshoring, civil and energy infrastructure investments in electrification.

**Brunswick Corporation (BC)** designs, manufactures, and markets recreational marine products, including marine engines, boats, and parts and accessories for those products. The propulsion segment manufactures boat engines mostly under the Mercury brand. We believe BC is a leading marine pureplay with a durable and growing engine franchise as well as a stable recurring revenue parts and services business. During the quarter, although the company met expectations and maintained full year guidance, investor sentiment weakened as the marine industry is in the midst of an inventory correction driven by higher interest rates and softening boat demand.

**Nordson Corporation (NDSN)** is a manufacturer of high-end capital equipment utilized in the precision dispensing and processing of fluids such as adhesives, polymers, coatings, sealants, lubricants, quality control/test systems, and equipment used to treat/cure surfaces. During the quarter, NDSN lagged after lowering guidance due to weaker than expected end markets, particularly in electronics and agriculture.

**Kinsale Capital Group, Inc. (KNSL)** is a property and casualty insurance company that operates in the excess and surplus lines business. We believe that the company has an advantaged business model including core competencies in underwriting and claim handling. During the quarter, KNSL detracted from results as investors worried about slower growth and the potential for a tough comp in Q2.

**Snap-on Incorporated (SNA)** manufactures and markets tools, equipment, diagnostics, repair information, and system solutions for professional auto repair shops. SNA lagged during the quarter as slower growth within its tools segment continued with technicians and franchisees remaining cautious on spending given macroeconomic uncertainty.

# Outlook

U.S. equity performance in the second quarter of 2024 was once again dominated by the mega-cap technology leaders, pushing the S&P 500 close to all-time highs despite only 26% of index constituents outperforming the index itself. Artificial Intelligence and its effect on future power needs was top of mind as investors contemplated its tangible applications as well as the resulting implications for the viability and profitability of companies. Investors also continued to agonize over the outlook for interest rates and inflation as economic signals remained mixed and once again pushed out the timing of a much-anticipated Fed rate cut.

While we don't believe that the tremendous relative outperformance of the magnificent seven will continue unchecked, we do believe their strong outperformance illustrates an important point that best-of-breed businesses can capitalize on new technologies and secular trends to become increasingly valuable over time. And we don't think this phenomenon is limited to just seven large companies. We believe there are competitively advantaged businesses across sectors and the market cap spectrum that are positioned to expand margins, gain market share, and become increasingly valuable investments. From a valuation standpoint, reversion to the mean is not a foregone conclusion as best-of-breed companies can compound their advantages over time. This is the power of fundamental research and a long-term approach. Money can be made trading around momentum and technical indicators in the short run, but the most lucrative investments tend to be structurally advantaged compounders that can grow into increasingly valuable companies over time. We know firsthand that fundamental research isn't easy and best-of-breed companies can be out of favor or face operational challenges for sustained periods, but we have also seen firsthand that consistently applying a disciplined fundamental approach focused on quality cash generating business and holding for the long-term greatly increases the odds of success.

As we move into the back half of 2024, we expect mixed macroeconomic data and political noise to make forecasting sector-level outperformance extremely challenging. But regardless of the near-term dynamics, we expect bottom-up identification of quality businesses to endure the test of time.

## Top 10 holdings

| | % of net assets |
|---|---|
| Fair Isaac Corp | 3.4 |
| Teradyne Inc | 3.4 |
| Lennox International Inc | 3.3 |
| Avery Dennison Corp | 3.2 |
| Tractor Supply Co | 3.2 |
| Tyler Technologies | 3.0 |
| Hamilton Lane Inc | 3.0 |
| STERIS PLC | 3.0 |
| Expeditors International of Washington Inc | 2.9 |
| MSA Safety Inc | 2.8 |
| **Total** | **31.2** |

The holdings listed do not constitute a recommendation to purchase or sell a particular security. Cash and/or derivative positions that are not part of the core investment strategy will not be reflected in the top holdings list.

## Performance, rankings, & ratings

| Average annual total returns (%) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 3-month | YTD | 1-year | 3-year | 5-year | 10-year | Since inception (09/28/2015) | Expense ratio[1] (gross/net) | Expense limit expiration date |
| Class I[2] | -2.72 | 0.88 | 9.86 | 2.56 | 8.54 | — | 10.73 | 0.83/0.77 | 12/30/2024 |
| Russell MidCap Index[3,4] | -3.35 | 4.96 | 12.88 | 2.37 | 9.46 | 9.04 | — | — | — |
| Morningstar category average | -3.32 | 5.57 | 13.23 | 3.41 | 9.43 | 8.19 | — | — | — |
| **Morningstar rankings and ratings** | 3-month | YTD | 1-year | 3-year | 5-year | 10-year | Overall | | |
| Category and number of funds in category: Mid Cap Blend | 438 | 438 | 425 | 397 | 364 | 251 | 397 | — | — |
| Class I percentile rankings[5] | — | — | 78 | 64 | 74 | — | — | — | — |
| Class I ratings[6] | — | — | — | ★★★ | ★★ | — | ★★ | — | — |

| Calendar year returns | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|---|
| Class I[2] | 24.44 | 14.00 | -6.00 | 33.88 | 10.44 | 21.42 | -15.89 | 18.14 |
| Russell Midcap® Index[3,4] | 13.80 | 18.52 | -9.06 | 30.54 | 17.10 | 22.58 | -17.32 | 17.23 |
| Morningstar category average | 14.14 | 15.93 | -11.15 | 26.21 | 12.39 | 23.40 | -14.01 | 16.00 |

Morningstar percentile rankings are based on total returns. Morningstar ratings are based on risk-adjusted returns.

**Returns represent past performance and do not guarantee future results. Share price, principal value, and return will vary and you may have a gain or loss when shares are sold. Current performance may be lower or higher than quoted. For the most recent month-end performance, visit PrincipalAM.com.**

[1] The net expense ratio reflects contractual expense limits, if any, which may lower net expenses and cause the gross and net expense ratios to differ. In such cases a date is listed through which expense limits are expected to apply; however, Principal Funds and the investment adviser may mutually agree to terminate the expense limits prior to the end of the period. Returns displayed are based on net total investment expense.

[2] Performance assumes reinvestment of all dividends and capital gains.

[3] The Russell Midcap® Index is a market capitalization weighted index that represents the smallest 800 companies in the Russell 1000® Index (Companies 201-1000). nformation regarding the comparison to the Russell Midcap® Index is available upon request. Russell Investment Group is the source and owner of the trademarks, service marks and copyrights related to the Russell Indexes. Russell® is a trademark of Russell Investment Group.

[4] Index performance information reflects no deduction for fees, expenses, or taxes. Indices are unmanaged and individuals cannot invest directly in an index.

[5] Morningstar percentile rankings are based on total returns and do not reflect the inclusion of sales charges. If sales charges were reflected, rankings could be lower.

[6] The Morningstar Rating™ for funds, or "star rating," is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36–59 months of total returns, 60% five-year rating/40% three-year rating for 60–119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. Morningstar ratings do not reflect the inclusion of sales charges. If sales charges were reflected, ratings could be lower.  Part of the mutual fund data contained herein: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

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