Principal Asset Management[SM]

Principal Global Credit Opportunities Fund

BENCHMARK
Bloomberg Global Aggregate Corporate Index (AUD hedged)[1]

OBJECTIVE
The Fund aims to achieve a total return above the benchmark before fees, over rolling three-year periods.

APIR	PGI0001AU	**ARSN**	108 685 927
INCEPTION DATE	31 May 2004	**FUND SIZE**	$188.7m
MANAGEMENT FEE	0.8000% p.a.	**EXIT PRICE**	$0.8014
BUY / SELL SPREAD	+0.15% / -0.30%		

Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.
Fund	**1.50**	**-0.41**	**1.73**	**-3.61**	**0.74**	**1.50**	**2.51**	**3.76**
Benchmark[1]	1.17	-0.23	4.15	-2.58	0.41	1.42	2.75	4.57
Active	*0.33*	*-0.18*	*-2.42*	*-1.03*	*0.33*	*0.08*	*-0.24*	*-0.81*

Fund investments (%)[2]

Asset class	Physical[3]	Effective[3,4,5]	Benchmark
Global Investment Grade Credit	68.41	68.41	96.82
Global High Yield	15.05	15.05	0.00
Emerging Market Debt	6.17	6.17	3.19
Securitised Assets	3.88	3.88	0.00
Government Debt	4.05	4.05	0.00
Other	-0.75	-0.75	0.00
Cash	3.20	3.20	0.00

Fund analysis (%)

Characteristics	Fund	Benchmark
No. of issuers	182	2169
Effective duration (years)	6.89	6.06
Spread duration (years)	5.09	6.20
Average credit quality	BBB+	A-
Yield to worst[6]	4.50	4.40
Yield to Maturity	4.54	4.46
Ex-Post VaR	7.61	6.20

Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.

[1]The Bloomberg Global Aggregate Corporate Index (hedged to AUD) was adopted as the Fund's performance benchmark on 27 December 2011. Benchmark calculations prior to this date are based on the UBS Bank Bill Index. Source: Bloomberg Index Services Limited. BLOOMBERG is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg").

[2]Totals may not equal due to rounding.

[3]Differences between physical and effective exposure reflect the impact of credit derivative hedges the Fund has in place. These hedges are using widely traded, liquid, credit market index derivatives.

[4]Effective breakdown includes hedging exposure.

[5]Effective breakdown includes the residual effect of hedging and is not representative of the actual cash level.

[6]Yield to worst is calculated as the lower of the yield to call or yield to maturity for each issue.

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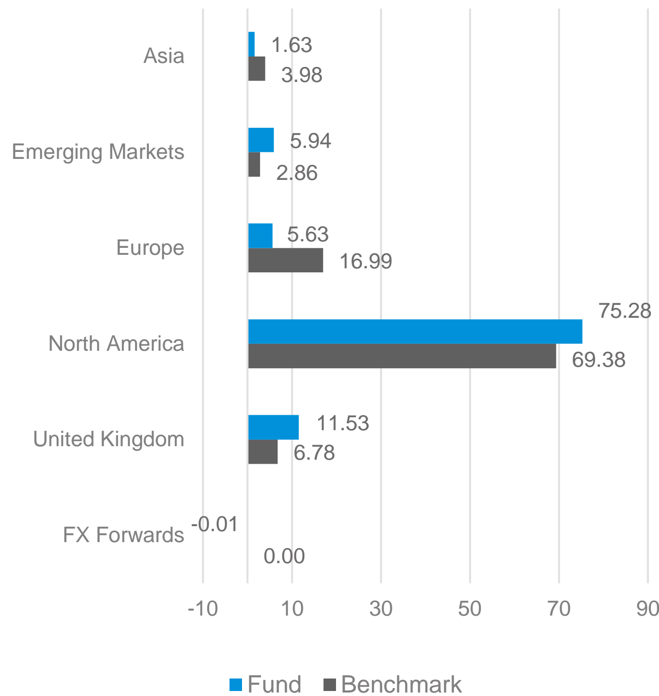
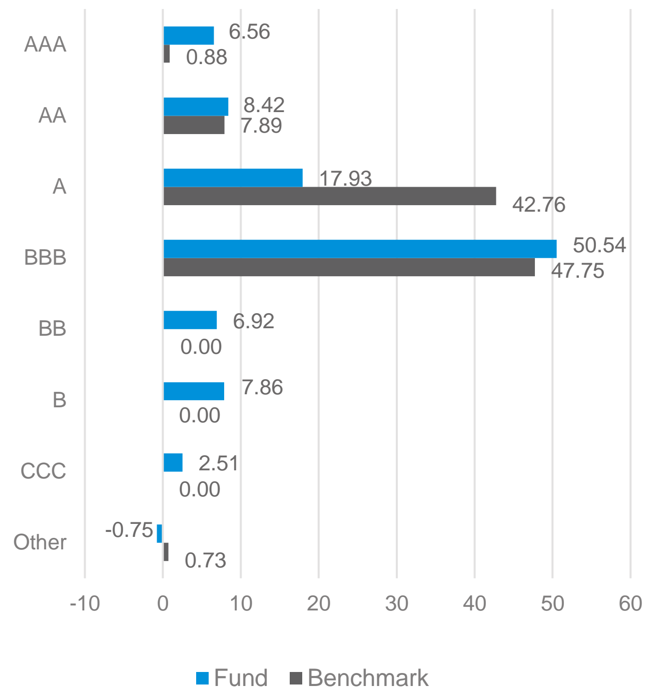
Regional asset allocation (%)[1,2]



Credit quality allocation (%)[1,3]



[1]Totals may not equal due to rounding.
[2]Certain analytics powered by Aladdin by BlackRock. BlackRock and Aladdin are trademarks and service marks of BlackRock, Inc. and its affiliates (collectively, "BlackRock"). BlackRock owns all proprietary rights in the marks and in the Aladdin by BlackRock services. BlackRock neither approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained there from. Investors should be aware that the allocation of the investments do not always add up to 100%.
[3]'Other' includes the currency forwards that are used for hedging and securities that are rated lower than CCC or are not rated.

Market review

After the sharp year-end rally, investors scaled back their expectations for interest rate cuts during the first quarter of 2024 in response to better-than-expected US economic data. The economy expanded at a robust 3.4% annualised rate in the fourth quarter of 2023, buoyed by strong consumer spending. Economic performance was also supported by the continued strength of the labour market, with the US adding an average of 265,000 jobs each of the past three months. In addition, inflation data contributed to the downward revision of rate cut expectations. The February CPI report indicated a modest increase in inflation as headline CPI rose 0.4% month over month and 3.2% year over year. However, core PCE, the Federal Reserve's preferred inflation measure, slowed to 0.3% month over month, and to 2.8% year over year, aligning with expectations and suggesting inflation remains on a gradually declining path. At its March meeting, the Federal Reserve announced its intention to wait for a few more months of data before changing policy, and left rates unchanged at a range of 5.25% to 5.50%. However, the Federal Reserve continued to signal three rate cuts of 0.25% each in 2024.

Both the unemployment rate and new jobless claims in the US remain near pre-Covid lows. Hiring remains resilient despite concerns about an economic slowdown. Strong growth in the US labour supply has enabled employers to steadily hire workers and narrow the gap between supply and demand, particularly due to manufacturing reshoring as companies seek to reduce their vulnerability to supply chain disruptions. In addition, US investments in chips and electric vehicle production continue to drive hiring. However, consumers are increasingly relying on credit card debt to maintain spending as savings built up during Covid becomes depleted. In addition, student loan borrowers face further headwinds as student loan payments have resumed.

Following surprisingly strong economic data, a slight increase in CPI inflation data, and the Federal Reserve's projections for the federal funds rate, market repriced its expectations for rate cuts from close to seven cuts at the end of 2023 to three cuts at the end of the first quarter. This caused an increase in US Treasury yields across the curve. During the quarter, the two-year and five-year US Treasury yield rose 0.37% to 4.62% and 4.21%, respectively. The ten-year yield increased 0.32% to 4.2% and the thirty-year yield increased 0.31% to 4.34%.

During the quarter, risk assets performed well as rate volatility declined to the lowest level in over two years. The Bloomberg Global Aggregate Corporate Index, the benchmark for this Fund, had an excess return of 1.09% for the quarter when compared to similar duration US Treasury securities. The Bloomberg US Aggregate index, a proxy for the overall fixed income market, outperformed similar duration US Treasury securities with an excess return of 0.23%.

Market review (continued)

The best performing sectors were emerging market debt, below investment grade corporate bonds, and commercial mortgage-backed securities (CMBS) with excess returns of 2.53%, 1.59%, and 1.45%, respectively. Investment grade corporate bonds and asset-backed securities (ABS) also outperformed similar duration US Treasury securities but underperformed the Bloomberg Global Aggregate Corporate Index with excess returns of 0.89% and 0.54%, respectively. Mortgage-backed securities (MBS) underperformed with an excess return of -0.14%.

Performance review

The Principal Global Credit Opportunities Fund (the 'Fund') returned -0.41% (net) for the quarter, underperforming the Bloomberg Global Aggregate Corporate Index's (AUD hedged) return of -0.23% by 0.18%.

Security selection contributed positively to performance while sector allocation, and duration and curve positioning detracted. Within sector allocation, underperformance was due to an underweight allocation to investment grade corporate bonds. This was partially offset by an out-of-index allocation to below investment grade corporate bonds. Positive security selection was primarily due to issuer specific performance within investment grade corporate bonds. Long duration positioning detracted from performance as rates increased during the quarter. Top performing issuers during the quarter included JBS USA, Arthur J Gallagher & Co and Cox Communication Inc. The investment manager is maintaining a more defensive stance on credit, given tight spreads and flat credit curves. Most of their positions are in short maturities, allowing them to capture most of the credit yield while minimising risk. This approach is particularly evident in defensive sectors such as defence, and non-cyclical industries such as food, beverage, water, and waste.

Market outlook

Year-over-year core PCE held a tight range around 5.0-5.5% from November 2021 to November 2022 but has since steadily declined to just 2.8%, compared to the Federal Reserve's Summary of Economic Projection expectation of 2.6% by the end of 2024. Further progress hinges on shelter inflation as good prices appear to have stabilised. Leading indicators of shelter inflation suggest additional improvement through the remainder of 2024, although precise timing is uncertain.

Federal Reserve Chair Jerome Powell has recently stated that the Federal Reserve is looking for "a little more" confidence in inflation measures before beginning the rate reduction process. With favourable base effects and improving shelter inflation, the Federal Reserve is anticipated to gain confidence by mid-year. However, if shelter inflation proves stickier than expected, market expectations for Federal Reserve cuts might be delayed further into the calendar year, posing a potential challenge for risk assets.

The US consumer has remained remarkably resilient, buoyed by excess savings, stock markets driving wealth gains, and a very tight labour market driving wage gains. However, a number of headwinds are building for the consumer, including depleted excess savings, resumption of student loan payments, tightening consumer credit and skyrocketing interest payments. Per capita credit card debt, already at a record high, continues to rise, and many consumer delinquency metrics have surpassed pre-Covid levels, potentially indicating difficulties for low-income consumers in sustaining post-Covid spending patterns.

The investment manager maintains their defensive positioning within investment grade credit due to economic headwinds. However, spreads are currently supported by strong technical as enticing yields have driven robust inflows into the market. Fundamentals have begun to weaken off peak levels with corporate leverage ticking up modestly, earnings growth slowing, and profit margins contracting from reduced pricing power. However, based on the overwhelming demand for yield, exposure to investment grade corporate bonds was increased during the quarter but remains underweight, comprised of the best opportunities within the sector.

Default rates within below investment grade corporate bonds continue to rise, with Moody's global 12-month trailing default rate currently at 5%. However, the investment manager expects default rates to gradually decrease to 3.5% over the next twelve months. Despite limited potential for spreads to tighten further, issuer fundamentals, including leverage ratios, and interest coverage are at strong points. Exposure to below investment grade corporate bond was increased during the quarter, focusing on opportunities at the front end of the yield curve that offer attractive yield while limiting exposure to spread duration risk. This reflects the investment manager's expectation of a supportive near-term environment for risk, though they remain cautious that the effect of restrictive central bank policy will cause economic data to deteriorate, resulting in additional volatility in risk assets.

Emerging market economic growth has been resilient despite the continued slowing of the Chinese economy and rising Middle Eastern tensions. Inflationary pressures are moderating as emerging market central banks are generally moving towards easing, albeit unevenly. The pivot towards US rate cuts will be a net positive for emerging markets, giving central banks greater flexibility on local rate cuts. A prolonged outflow stretch from emerging market debt funds continues but valuations are attractive relative to developed market alternatives. Exposure to emerging market debt remains overweight.

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