Q4 2022 OUTLOOKS

PLOTTING A COURSE THROUGH MARKET VOLATILITY

Recession fears caused financial markets to whipsaw in the third quarter. Equity indices fell to fresh lows on the year, interest rates rose to multi-year highs and major global currencies weakened further against the US dollar. Central banks' hawkish posture, coupled with persistently high inflation, remained the dominant force directing investor sentiment.

With signs emerging that economic activity has decelerated around the world, investors continue to face an uncertain macro and geopolitical environment. To help guide investors through this period of market volatility, PGIM brings the following perspectives from its affiliates to examine the opportunities and challenges present across asset classes.

- **Fixed Income:** While most of this cycle's rise in yields is almost certainly behind us, the hard landing question – and the outlook on spread products – remains clouded with risks to the downside. This bears close watching, however, as there are at least some signs of a moderation in the economic data. We think about the complex interplay of macroeconomics, geopolitics and policy with a humble mindset, and have come away with a growing conviction that the global economy will fare much worse in the fourth quarter and into next year – culminating in a global recessionary environment – before things can possibly get better. While it's still too early to fully embrace risk, fixed income will offer ample value when it's time. The renaissance of higher yields restores the balance to the asset allocation galaxy and will be warmly welcomed by investors and savers.

- **Multi-Asset Class:** Following the bloodletting in the first half of 2022, global equity markets tried to rebound in Q3 but have generally given back most of their gains. As of late in the third quarter, inflation has not declined as expected and central banks have become increasingly hawkish. Monetary tightening works in part by tightening financial conditions, and the Fed has indicated that tight financial conditions (i.e., risk-off markets and higher rates) are a feature, not a bug, of their current policy stance.

  Given this environment, we are maintaining cautious tactical positioning on asset allocation relative to policy benchmarks. While equities have already experienced the type of declines one might expect from a mild recession, still-larger declines are a real possibility given the odds of monetary policy over-tightening (and thus more significant economic contraction) in the current inflationary environment.

- **Active Equities:** Share price declines year to date reflect a combination of an increase in risk aversion and lower price/earnings ratios in the face of higher interest rates. The presumption of slowing growth and possible recession is now challenging revenue estimates and profit margin assumptions. Our continued focus on the fundamental growth prospects for companies requires an understanding of the difficulties and uncertainty created by the macroeconomic environment. We have reduced earnings forecasts for a number securities in the past few months, largely due to US dollar strength. Most economic slowdowns and recessions in the modern era occurred under circumstances that differed from those confronting investors today. But their aftermaths have generally seen large-cap growth companies generating fundamental outperformance for reasons of innovation, leadership in large and growing addressable markets, and financial stability. We see much to be optimistic about from this perspective and in the context of our multi-year investment horizon. Greater clarity on some of the macroeconomic and geopolitical challenges investors face may be required before superior fundamentals reassert themselves and share price leadership is reestablished.

Explore more at pgim.com/outlooks