Multi-Asset Monitor: Views and Perspectives from PMA

PGIM MULTI-ASSET SOLUTIONS

Navigating Crosscurrents: Exploring Global Dynamics, Uncovering Opportunities and Risks

November 2024

Market Pulse: October in Review

As we navigate the final months of 2024, we will encounter a complex tapestry of market undercurrents that demand dynamic and strategic considerations. Recent developments have reinforced the delicate balance between resilience and volatility in global markets, offering valuable insights for institutional investors.

Across fixed income markets, Treasury yields have experienced notable upward pressure, driven by robust employment data that exceeded expectations. Strong ADP figures and September payroll numbers have prompted markets to reassess the Federal Reserve's rate cut trajectory, highlighting the persistent influence of labor market strength on monetary policy, in addition to inflation.

Remarkably, risk assets have demonstrated resilience despite the volatility in rates markets. Developed market equities generally maintained their positive momentum, riding the wave of sustained growth trends, although disappointing Tech earnings was a drag at October month-end. However, emerging market equities faced headwinds, primarily due to volatility in Chinese markets. Credit markets have also shown particular strength, with both investment-grade and high-yield spreads tightening modestly while maintaining their positive year-to-date performance. Even amid escalating tensions in the Middle East, emerging market credit has displayed notable stability, with few notable outliers (e.g., Israel) showing signs of stress. Commodities have also performed well with energy leading the upward trend.

Final Pulse: The key challenge for investors heading into 2025 lies in navigating a market environment where the following developments may pose a headwind to asset performance: 1) any delay in anticipated Fed easing driven by strong economic data, 2) geopolitical tensions, 3) outcome of US elections, and 4) stretched valuations. This will require tactical flexibility with a focus on quality assets that can weather potential volatility, while selectively pursuing opportunities in areas where volatility may create mispricing.

Market Snapshot (As of October 31, 2024)

		Benchmark	Current Levels Govt Bond = Current Yield(%) Credit Asset Classes = Spread (bps) Equity, Real Assets, Commod = Index Level	MTD Yield / Spread	YTD Yield / Spread	MTD Return	YTD Return
Fixed Income	2 Yr Treasury	US Government 2 Year Note	4.17%	57	(8)	-0.68%	3.17%
Fixed Income	10 Yr Treasury	US Government 10 Year Note	4.28%	55	41	-3.60%	-0.13%
Fixed Income	US Investment Grade Credit	Bloomberg US Credit Index	79	(5)	(13)	-2.41%	2.69%
Fixed Income	US Long Credit	Bloomberg US Long Credit Index	105	(4)	(11)	-4.18%	0.16%
Fixed Income	US High Yield	Bloomberg US HY 2%	283	(17)	(40)	-0.54%	7.42%
Fixed Income	Leveraged Loans	Credit Suisse Lev Loan Index	479	(8)	(49)	0.85%	7.51%
Fixed Income	CLO	JPM CLOIE Index	160	(4)	1	0.65%	6.84%
Fixed Income	Agency MBS	Bloomberg US MBS Index	48	7	2	-2.83%	1.54%
Fixed Income	CMBS (Investment Grade)	Bloomberg US CMBS Investment Grade Index	101	(2)	(36)	-1.82%	4.54%
Fixed Income	ABS	Bloomberg US Agg ABS Index	54	(10)	(14)	-0.70%	4.33%
Fixed Income	EM Debt (Local)	JP Morgan GBI-EM Global Diversified Index	6.38%	26	19	-4.61%	0.10%
Fixed Income	EM Debt (Hard)	JP Morgan EMBI Global Diversified Index	332	4	18	-1.72%	6.78%
Equities & Real Assets	US Large Cap Equity	S&P 500 Index	5,705	-	-	-0.92%	20.96%
Equities & Real Assets	US Small Cap Equity	Russell 2000 Index	2,197	-	-	-1.44%	9.56%
Equities & Real Assets	Global Developed Equity	MSCI World Index	3,647	-	-	-1.96%	16.95%
Equities & Real Assets	EM Equity	MSCI EM Equity Index	1,120	-	-	-4.32%	12.11%
Equities & Real Assets	Global Public Real Estate	FTSE / Nareit Developed Index	2,238	-	-	-5.02%	6.95%
Commodities	Energy	Bloomberg Energy Subindex	65	-	-	-4.42%	-8.34%
Commodities	Precious Metals	Bloomberg Precious Metals Subindex	684	-	-	4.00%	33.12%
Commodities	Industrial Metals	Bloomberg Industrial Metals Subindex	354	-	-	-3.71%	8.05%
Commodities	Agriculture	Bloomberg Agriculture Subindex	134	-		-4.16%	-6.83%

Source: Bloomberg, JP Morgan and PGIM. Data as of October 31, 2024.

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PGIM Multi-Asset Solutions Outlook and Views

The global economic landscape continues to demonstrate remarkable resilience, with the US maintaining its position as the primary engine of growth. This backdrop presents both compelling opportunities and notable challenges for institutional investors over the next 3-12 months.

Within developed markets, particularly in the US, we maintain a constructive outlook on equity markets, underpinned by robust earnings growth trajectories. However, elevated valuations warrant careful consideration, potentially tampering return expectations in the near term. The credit market environment remains supportive, benefiting from strong fundamentals and positive technicals, though current tight spread levels suggest heightened sensitivity to any deterioration in growth expectations. Private markets, particularly credit and real estate debt, offer attractive yield enhancement opportunities amide strong investor demand.

Our neutral positioning in rates, especially at the front end of the curve, reflects the complex interplay of forces affecting the interest rate environment. The path of Federal Reserve policy actions remains subject to considerable uncertainty, reinforcing the strategic importance of maintaining robust interest rate hedging protocols across the yield curve.

Within commodities, we anticipate differentiated performance across subsectors, including: the expectation that metals outperform driven by both rising demand for tail-risk hedging and accelerating AI adoption, while energy and agriculture likely remain range bound.

Given this landscape, we advocate for maintaining interest rate hedges across the curve, leaning higher credit quality, exploring private credit opportunities for enhanced yield, greater equity breadth and tactical metals allocation– all while emphasizing disciplined risk management across asset classes.

Short Term Views (3-12 Months)*

Risk Factor / Asset Class			UW	N	OW	Comments
Main Market Risk Factors		Rates		●		While we expect Fed's easing cycle to continue, Treasury yields can still see significant near-term volatility as the market continues to re-calibrate its expectation on the extent of Fed cut
		Credit			●	Strong fundamentals and technicals are supportive of credit assets. However, we are cautious of tight spread levels, which can widen should recession risk increase. We can look for relative value within credit sectors (see below)
		Equities			●	We expect continued earnings growth potential to be supportive of equities growth. However, high valuation presents headwind
Asset Class Views	Fixed Income	US Treasures		●		We expect US Treasuries to be range bound given near-term volatility from uncertainties around Fed's reaction function
		IG Corporate		●		Sound fundamentals and technicals are supportive of corporate credit but tight spreads present risk to the downside, which , particularly at any sign of economic slowdown
		High Yield		●		Reasonable leverage and relatively benign default environment are supportive of high yield, but spread levels remain very tight
		CLO			●	Spreads have compressed YTD but remain attractive relative to other fixed income sectors; in particular, we favor more senior CLO tranches given attractive risk/return tradeoff
		Agency MBS	●			Spreads have compressed but less so than other credit sectors. Near term may face challenges given technicals but medium-to-long term outlook is positive
		CMBS		●		Spreads relative to other fixed income sectors remain relatively attractive and we believe much of the negative impact from CRE has been priced in. However, more elevated cap rates and lower valuation can continue to be a headwind in the near term
		ABS		●		Consumer credit is generally healthy and spreads have not compressed significantly YTD. However, we remain cautious of impact from lower disposable income and elevated, albeit moderating, inflation
		EMD Local		●		Near term performance will be range bound and may be impacted by upcoming US election and resulting trade policy
		EM Corporate Debt		●		EM spreads have compressed, in line with positive credit performance more broadly, but we expect near term performance to be rangebound driven by impacts of US election and trade policy
	Equities	US Large Cap			●	Strong US corporate earnings and broadening of breadth in performance should be tailwind for the asset class, although significant upside will be muted given valuation
		US Small Cap			●	Rate cutting cycle should be supportive of small cap equities
		Japanese Equities			●	Corporate governance reform and focus on RoE should be supportive of equity returns, but appreciating Yen and mixed policy signals from BoJ can present headwind
		European Equities	●			Economic activities to remain relatively weak, and unlikely to see significant rebound in near term
		EM Equity	●			Broader EM equity heavily influenced by Chinese equity performance, which we expect to be a continued headwind
		Public Real Estate		●		Lower policy rates should be beneficial for real estate and REITs' relatively defensive equity beta can serve as hedge in tail risk scenarios, but CRE can continue to be a near term headwind

Underweight =UW, Neutral = N, Overweight = OW. Past performance is not an indicator of current or future results. Weightings represent an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be construed as investment advice or an offer or solicitation to buy or sell securities.

Risk Factor / Asset Class			UW	N	OW	Comments
Asset Class Views	Commodities	Energy		●		We expect near term performance to be range bound and tied to geopolitical developments and supply / demand dynamics
		Precious Metals			●	Often viewed as tail risk hedge and may benefit in flight-to-quality scenario amidst more elevated geopolitical risk
		Industrial Metals			●	Increasing AI and quantum computing adoption will be constructive for industrial metals such as Copper
		Agriculture		●		We expect near term performance to be range bound and tied to geopolitical developments and supply / demand dynamics

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Longer Term Views & Themes

Private Credit

The private credit landscape presents compelling secular opportunities, driven by several factors. Further, the growth and evolution of the asset class represents a transformative opportunity for institutional investors positioned to capture illiquidity premiums. Multiple secular trends are converging to reshape the landscape: traditional bank retrenchment driven by heightened regulation, an advantageous floating-rate return profile in the current rate environment, and robust market fundamentals marked by relatively contained default rates. These dynamics have created a compelling value proposition for investors seeking enhanced yield potential.

Additionally, innovation within private credit continues to accelerate, with strategies evolving beyond traditional direct lending. Private Asset-Backed Finance has emerged as a particularly dynamic segment, offering diversified exposure across sectors such as consumer, renewable energy, mortgages, and fund finance. The energy transition theme has also spawned specialized direct lending opportunities, while growing retail investor participation has catalyzed the development of more accessible vehicle structure, including perpetual and semi-liquid vehicles. Despite these promising developments, we emphasize that rigorous underwriting standards and comprehensive risk management frameworks remain critical success factors.

Real Estate Debt

Across real estate markets, we see emerging value opportunities as the market reaches a cyclical trough. This might suggest that valuations are reaching an inflection point. While the office sector continues to face structural headwinds, we maintain conviction in a broad-based rebound across other property types. This optimistic outlook is supported by anticipated Federal Reserve easing, moderating inflation trends, and stabilizing fundamentals in both operating income and capitalization rates. For institutional investors seeking to position for this recovery sentiment, real estate debt may offer an attractive risk-adjusted entry point, providing both spread premium and portfolio diversification benefits within fixed income allocations.

Bringing it All Together

As we traverse a landscape of resilient growth and heightened macro uncertainty, the investment environment demands a nuanced approach that balances traditional asset class constraints against emerging structural opportunities. Heading into the final months of the year and beyond, investors may want to explore the following:

- Maintain robust interest rate hedging protocols across the yield curve as potential protection against continued rate volatility
- Position higher in credit quality but be prepared to rotate into select opportunities, especially if credit spreads widen but fundamentals remain strong
- Increase breadth in equities to capture earnings growth potential while mitigating concentration risk
- Tactical commodity allocations, especially in metals as AI adoption and demand for tail-risk hedging accelerates
- Consider private credit opportunities across corporate and asset-backed strategies, with a focus on rigorous underwriting standards and comprehensive risk management frameworks
- Position for real estate recovery through debt opportunities, offering spread premium and portfolio diversification benefits

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