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Q2 2022 WEBINAR SUMMARY

WAR, ENERGY MARKETS, AND THE ROAD TO STAGFLATION?




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Financial markets are coming under pressure from multiple fronts. Soaring inflation has prompted central banks to unwind pandemic-era stimulus measures, and the war in Ukraine has fanned a surge in energy prices. As a result, the global economy may be entering a period of slower growth. PGIM gathered a panel of experts to discuss the outlook for the second quarter and how investors can build a portfolio that meets these challenges. The following are highlights from the discussion, which can be watched in its entirety here.

- **The investment outlook:** The war in Ukraine and COVID lockdowns in China have complicated the global economic outlook and increase the risk that policymakers will not be able to achieve a soft landing as rates rise (though the base case remains a soft landing). Monthly inflation readings will provide a gauge for how hawkish central banks will be this year. Consumers are in good shape, particularly with household balance sheets benefiting from healthy savings. The financial sector and corporate balance sheets are also well positioned, and there's much less systemic risk in the US economy compared with the lead-up to the Great Recession. As for the hawkish shift among central banks, investors have already priced in much of the impact, and equity markets are likely to gain ground between now and the end of 2022. Turmoil and volatility also present opportunities in the private credit market, especially in energy where companies are devoid of capital. Demand for private credit will continue to be strong, supported by business investment and onshoring trends.

- **The inflation playbook:** Real assets remain a hedge against inflation, and investors should have exposure to commodities, real estate, and Treasury inflation-protected securities (TIPS). Commodities, energy, and materials, which have historically been the best hedges against inflation, have the added benefit of cheaper valuations after a lengthy period of low inflation before the pandemic. The broader equity market has already begun to exhibit a rotation favoring value stocks. Non-US equities are cheaper and could outperform the US market over the next decade. Latin American equities are very attractive due to the outlook for higher commodity prices, although investors should keep in mind that less globalization and more automation are going to be difficult for emerging markets.

- **The balancing act for central banks:** Central banks have struggled to catch up after a surge in demand coming out of COVID shutdowns helped fuel a rapid rise in inflation. Some of that inflation may cure itself if, for instance, companies become more sensitive to higher wages, thus reducing consumers' purchasing power. Inflation has been lower in nations such as China and Japan that could export some of their low inflation to the rest of the globe. But the war in Ukraine, higher commodity prices and supply chain disruptions brought on by new lockdowns all pose risks to inflation.

- **The war's impact on energy:** Whether or not energy supplies from Russia are cut off further remains a wildcard. Such a scenario would cause an additional spike in prices, hampering economies' ability to achieve a soft landing. Another sharp rise in commodity prices could tip the global economy into a recession.

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