4Q22 Market Review and 1Q23 Outlook

Market Backdrop

Equity markets finished out a challenging year, with major indices closing at or near their year lows. Uncertainty and volatility were enduring constants throughout 2022.

An evolving economic slowdown, around the world and across industries, saw a broad swath of companies that had benefited most from the pandemic commence headcount reductions and take operational steps to mitigate expected weakness. Commodity prices continued their retreat, despite the lingering impact of the Ukrainian war. China took steps to ease its stifling "COVID Zero" policy, resulting in a wave of infections, hospitalizations, and further economic dislocation as the year ended.

Economic data intra-quarter continued to reflect the mix of contrasting trends, with strength in employment, wages, and savings largely offsetting the effects of consumer price inflation, falling house prices, and waning spending by lower income households. The persistence of labor market tightness kept the Federal Reserve on a tightening path, with the federal funds rate closing the year in the range of 4.25% to 4.50%, levels last seen in 2007. Inflation has been a global phenomenon, and central banks in many countries have followed a path similar to that of the Fed, leading to a partial retracement of the US dollar's significant rise since the end of 2021.

Market Index Performance

As of December 31, 2022. Source: Jennison, FactSet, MSCI.

Style Performance

- All investment styles finished a volatile year with gains in the fourth quarter.
- For the quarter and calendar year, value outperformed growth across capitalizations. Large-cap growth was the weakest market segment.
- In longer time periods, large-cap growth still leads.

Style Index Performance

4Q22

	Value	Core	Growth
Large	12.4	7.2	2.2
Mid	10.5	9.2	6.9
Small	8.4	6.2	4.1

Trailing 1-year

	Value	Core	Growth
Large	-7.5	-19.1	-29.1
Mid	-12.0	-17.3	-26.7
Small	-14.5	-20.4	-26.4

Trailing 3-Year

	Value	Core	Growth
Large	6.0	7.3	7.8
Mid	5.8	5.9	3.9
Small	4.7	3.1	0.6

Trailing 10-Years

	Value	Core	Growth
Large	10.3	12.4	14.1
Mid	10.1	11.0	11.4
Small	8.5	9.0	9.2

As of December 31, 2022. Source: Jennison, FactSet, MSCI.

Sector Performance

- In the fourth quarter, energy, industrials, and materials were the best performing sectors. Consumer discretionary was the weakest sector, while communication services was also negative.
- For the trailing one year, energy was the only positive sector. Communication services, consumer discretionary, and information technology were the worst performing sectors.
- Energy now leads on a three-year basis; however, information technology maintained its lead position for the trailing five- and ten-years.

GICS Sector Performance - S&P® 500 Index

	4Q	One Year	Three Years	Five Years	Ten Years
Energy	23	66	19	9	6
Industrials	19	-5	8	7	12
Materials	15	-12	10	7	10
Financials	14	-11	6	6	12
Health Care	13	-2	12	13	15
Consumer Staples	13	-1	9	9	11
Utilities	9	2	6	10	11
Information Technology	5	-28	12	16	18
Real Estate	4	-26	2	6	8
Communication Services	-1	-40	-3	1	4
Consumer Discretionary	-10	-37	1	6	12
Total	8	-18	8	9	13

As of December 31, 2022. Source: Jennison, FactSet, MSCI.

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There is no guarantee our objectives will be met. All investments contain risk, including possible loss of principal. The strategy may vary significantly from the benchmark in several ways including, but not limited to, sector and issuer weightings, portfolio characteristics, and security types.

Earnings Results

- Third-quarter earnings results overall were weaker than last quarter with 75% of the S&P 500's constituents meeting or beating consensus expectations versus 80% last quarter.
- Information technology and energy had the best results with 87% and 86% of companies meeting or beating consensus estimates. Consumer staples and industrials also continue to post strong earnings, with only 20% or less of companies missing expectations.
- Communication services and real estate turned in the weakest results with less than 60% of companies beating or meeting expectations.

Sector Name	% of Companies Beating/Meeting	% of Companies Missing
S&P 500	75%	25%
Information Technology	87%	13%
Energy	86%	14%
Consumer Staples	82%	18%
Industrials	80%	20%
Utilities	76%	24%
Health Care	75%	25%
Financials	75%	25%
Consumer Discretionary	68%	32%
Materials	61%	39%
Real Estate	58%	42%
Communication Services	50%	50%

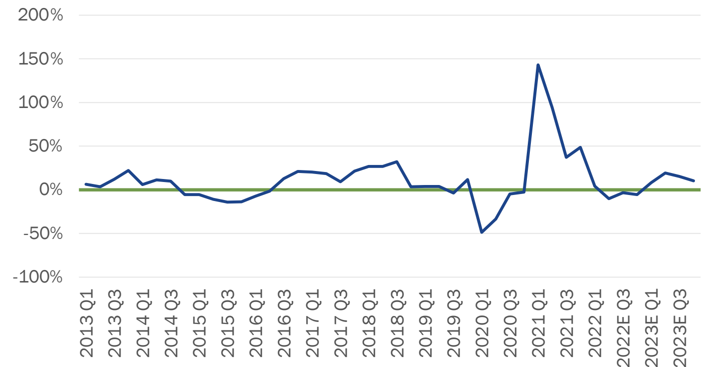
As of December 30, 2022 (most recent available) reflecting the end of the third quarter 2022 reporting season. Source: Standard & Poors.

Sector Weights

	S&P 500	MSCI ACWI ex US	Russell 1000 Growth	Russell 10000 Value
Communication Services	7	6	7	7
Consumer Discretionary	10	11	14	6
Consumer Staples	7	9	6	7
Energy	5	6	2	8
Financials	12	21	3	20
Health Care	16	10	13	17
Industrials	9	12	8	11
Information Technology	26	11	43	8
Materials	3	8	1	4
Real Estate	3	2	2	4
Utilities	3	3	0	6

As of December 31, 2022. Source: Jennison, FactSet, MSCI.

S&P 500® Index - YoY EPS Growth



As of December 31, 2022. YoY = Year over Year. Source: FactSet. Forecasts may not be achieved and are not a guarantee or reliable indicator of future results.

S&P 500® Index - NTM P/E

As of December 31, 2022. Source: Jennison, FactSet, MSCI.

Outlook from Jennison's Growth Teams

Investors are grappling with the likelihood of recession in the United States and around the world. The ongoing war in Ukraine and frequently changing COVID policies in China remain unquantifiable risks. Persistent high inflation, resulting from the accommodative policies of the pandemic, has brought about a sharp reversal in monetary policy globally and an unusually abrupt tightening of financial conditions. In response, growth equities have gone through a grinding period of adjustment over the past fifteen months. The starting point for the correction also coincided with high levels of absolute and relative valuations for growth stocks, resulting in significant underperformance.

The biggest retrenchment has occurred in companies that are not yet GAAP profitable or where the pull-forward effects of the pandemic proved greater than we had modeled. The deceleration in revenue and earnings growth proceeded at a pace and scope beyond our forecasts. This trend was exacerbated by the strength of the dollar over the previous year and a half, leading to more negative translation effects than originally expected for our global holdings. Moreover, our growth holdings were subjected to greater price and valuation adjustments than was the case for the market overall.

In the short term, we expect that fewer companies will generate earnings growth. We believe profit resiliency is likely to be as much a proxy for outperformance as expected growth under current conditions. We continue to focus on companies that have the products and services that meet today's needs, while also investing for tomorrow's opportunities. These businesses are well capitalized, against a backdrop of higher interest rates, and, we believe, are likely to grow profitably at above-average rates over the balance of the cycle.

It has been nearly 15 months since the Fed announced its policy-tightening plans, and the market has adjusted to the new reality through sharply higher interest rates, lower growth expectations, and significantly lower stock prices and valuations. We expect greater clarity around the path of inflation, growth, and interest rates to emerge in the first half of 2023, accompanied by a bottoming in earnings expectations and sentiment. Our positive multi-year view on our holdings incorporates the challenges that may continue to pressure the market in the short term.

Sector Views

Information Technology

The S&P 500 Index's information technology sector was up 5% in the fourth quarter of 2022, trailing the broader market S&P 500, which returned 8% in the quarter. For the full year 2022, technology was down approximately -28% (the third worse sector after communication services and consumer discretionary), significantly behind the -18% return for the S&P 500.

The near-term difficult macro environment along with negative global economic sentiment expected through 2023 continued to drive stock prices. Multiple compression and lowered earnings revisions also affected the technology sector's price return. Nevertheless, driven by the digital transformation of the consumer and businesses, the longer-term underlying strength in these business models and their secular revenue trends remain solid.

Rising rates (occurring quickly), persistent inflation, the hawkish Fed, energy supply, China turbulence, and the war in Ukraine have resulted in market expectations coalescing around a possible hard economic landing in 2023. These factors are responsible for the elevation of the discounting mechanism for equities. Accordingly, it is not surprising that the longest duration and highest valuation equities (areas such as secular growth and especially technology stocks) had the worst full year performance and the highest levels of multiple compression. It does not look like the current environment is expected to change in the short-run (risk levels will remain elevated), so on a go-forward basis we can expect continued volatility and consolidation for the technology sector, both relative and absolute.

Longer term we believe the market over will continue to favor companies with asset-light business models, high incremental gross profit margins, subscription model revenue streams, disruptive products, large total addressable markets (TAM), and faster organic growth with long runways of opportunity. This is especially true as the overall real economic growth is expected to slow back to its post global financial crisis average. If this occurs, growth will become scarce again and we expect the market to pivot towards the select few companies that can produce it organically.

It is important to recognize that technology is no longer a distinct sector. Rather, it is woven through every industry in which we invest, a backdrop that creates an attractive environment for long-term champions of innovation. For example, we expect continued accelerated long-term CAPEX spend on tech, software, and R&D, especially since these expenditures have now become a "necessity for survival" for businesses instead of a way to reduce costs and a "nice to have." This can be seen across multiple fronts, including technology-heavy capital expenditures, artificial intelligence/deep-learning, ecommerce strategies, health care and medical technology, the enterprise transition to the cloud, direct-to-consumer business models, and software applications that extend across businesses. The long-term implications of this change in CAPEX spend will likely be profound.

We also see continued acceleration and long duration technology demand from the massive global millennial and Gen-Z population, given their early uptake of so many digital economy related products (many of which are driven through the smartphone) that are solving their real-world problems. We believe these large, global-oriented total addressable markets provide an ample runway for long-duration top-and bottom-line growth, with many disruptive trends expected to double over the next four to five years. Historically, earlier stages of mass adoption have spurred more innovation, greater ease of use, and an expansion of the ecosystem, which in turn has kept the virtuous cycle spinning with yet greater adoption.

Strong earnings growth isn't limited to "tech" companies grouped in the index's information technology sector. It extends to other businesses with technologically driven advantages in other sectors. This includes social media companies (classified as communication services); internet retailers and electric vehicles (consumer discretionary); communication tower companies (real estate); and medical technology and biopharmaceutical companies (health care).

Investment Themes & Areas of Focus

- The use of digital technologies to create new (or alter existing) business processes, cultures, and customer experiences has become a strategic imperative as enterprises seek to meet changing business and market needs. This digital transformation has been driven by technologies such as social media, mobile devices, artificial intelligence, and cloud computing.
- We look for companies positioned to benefit from increased business CAPEX spending on technology. This includes investing in industries such as 5G, SaaS, business intelligence (AI), semiconductors, cloud storage and software, and life sciences tools.
- We think the continued ramping-up of data/information/entertainment usage across a broad range of devices and applications, along with digital payments, are among the areas that offer long-duration opportunities and huge addressable markets for companies with the right technologies. Business and consumer behaviors have clearly changed, with adoption and uptake rates inflecting higher.

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Health Care

In 2022's fourth quarter, the health care sector of the S&P 500 Index gained 13%, outperforming the 8% return of the broader S&P 500 Index. Additionally, the Nasdaq Biotechnology Index rose 12%. Over the trailing 12-months, the health care sector fared much better than the broad market returning -3% compared to the S&P 500 Index's -18% decline.

We exited the fourth quarter of 2022 with stickier inflation, elevated wage growth and a higher cost of capital as the factors that placed downward pressure on profit margins. A strong US dollar and a trend away from globalization are additional pressures for large multinational companies that have high shares of revenues from abroad and highly globalized supply chains. In an attempt to reduce inflation the Fed raised the Federal Funds Rate seven times in 2022, including two rate hikes in the fourth quarter, and indicated a commitment to tighten policy until inflation returns to the target range. The yield on the 10-year US Treasury note finished the year at 3.87%, up approximately 230 basis points (bps) from year-end 2021, however 37 bps below the highs for the year. Similar to the 10-year US Treasury, the US dollar continued to strengthen against most major currencies, but ended the quarter off the highs for the year. US equities and government bonds stabilized somewhat in Q4, but ended 2022 with negative returns as investors remained concerned about high inflation, slowing growth and the potential for an aggressive Fed to cause a recession.

While the healthcare sector has broadly outperformed year to date, it has largely been driven by larger market cap pharmaceutical, medical device and managed care companies that are able to fund their businesses with cash generated from operations. With that being said, the first half of the year was truly unprecedented for development stage companies as January and April of 2022 were two of the worst months for the S&P Biotechnology Select Index in the past ten years. In Q4, trends began to reverse, as receding US Dollar headwinds and attractive growth prospects for select pharmaceutical, health care equipment & supplies, and biotech companies drove returns.

We believe the sector has begun to show signs of leadership again as investors place more emphasis on stable company fundamentals and the significant alpha generating opportunities that broad health care innovation can provide. Furthermore, with the Inflation Reduction Act now in place, for the first time, the Act brings the prospect of government mandated drug price controls, albeit for only a handful of the largest-selling products as they near patent expiry beginning in 2026. We believe the impact to the sector will be manageable as it only impacts the highest spending drugs covered under Medicare and does not impact the initial pricing of a new drug. Furthermore, with the Inflation Reduction Act being passed, we ultimately believe that clarity on drug pricing removes a seven-year overhang and can be a long-term positive for the sector, in particular, biotech. More specifically, now that some "action" is being taken on drug pricing, we believe any draconian changes that were potentially negative for the industry are off the table.

Investment Themes & Areas of Focus

Healthcare is one of the fastest growing sectors in the global economy, which is driving rapid scientific and technological advancements. The convergence of technology and consumerization is fueling an unprecedented flow of innovation to address unmet medical needs and reduce costs. This evolution will have a lasting impact on the patient experience as healthcare is switching to more preventive medicine and an outcome-based economic model. This backdrop presents unique opportunities to allocate capital to multiple healthcare industries.

- We expect that productive research and development activity will yield effective disease treatments that improve the quality of patients' lives. These characteristics historically have been the source of longer-term outperformance in the sector.
- We believe many bio-therapeutic companies have compelling fundamentals and innovative products and pipeline drugs.
- The number of drug candidates in biopharma pipelines continues to be high. Increased research and development investment by large global pharma companies, as well as advancements in drug screening and discovery, are driving the increase in drug candidates.
- Larger multinational pharmaceutical companies, especially those with patent-expiration pressures, are expected to continue to make acquisitions of smaller cap companies with single products or promising pipeline assets.
- Many tools and diagnostic companies are engaged in improving the physician decision making process, accelerating the drug development and approval process, and integrating biology faster.
- Medical device companies are improving quality of life, offering less invasive procedures, and increasing the ease of use for both doctor and patient, all of which reduces facility stays.
- The healthcare service companies we focus on are leading sources to improve access to care, increase patient engagement, improve disease management, shift treatments to lower cost, more convenient sites of care, and lower overall cost of care.

Utilities

Utilities remained under pressure at the start of the period following a rapid rise 10-year Treasury yields at the tail end of the third quarter, but gradually recovered once rates stabilized. Despite fluctuations caused by short-term rate movements, utilities had a solid quarter, outperforming the S&P 500 Index for the period and outperforming all other sectors in December's sell-off. The utilities sector of the S&P 500 Index finished 4Q22 up 9% versus the 8% return of the S&P 500 Index. Periodic rate-induced volatility aside, utilities largely benefitted from being a "safe haven" sector in 2022, which helped drive relative outperformance. Utilities were the second best-performing sector of the S&P 500 Index for the year after energy, and the only other sector to finish in positive territory.

Utilities saw a meaningful recovery in 2022. The group had been the worst-performing sector in the S&P 500 Index on a trailing two-year basis prior to 2Q22, despite strong fundamentals. Even during this period of economic volatility, utilities companies have continued to execute operationally and deliver strong earnings while also de-risking their portfolios. The gap in performance closed this year, and utilities have now outperformed the S&P 500 Index by more than 14% over the past 24 months. Continued solid execution, along with the potential growth opportunities from renewable energy investments, should help to drive the sector's earnings going forward. In addition, geopolitical concerns as well as a flattening yield curve, remain macro tailwinds. Strong fundamentals and macro tailwinds underscore the opportunity in the sector, especially given what remains a lower-than-average interest rate environment.

Utilities are a compelling defensive growth proposition for investors for several reasons, both sector-specific and macro-related:

- The Renewables Opportunity: improving economics in wind and solar power continue to remain a growth driver for the overall sector. Companies are only now beginning to incorporate renewables into their capex plans, allowing them to earn a regulated rate of return on their renewable investments.
- Predictable cash flow and earnings: Utilities are by nature a defensive sector and those companies with regulated or quasi-regulated (renewables) businesses generate long-duration cash flows and predictable rate base earnings. In addition to providing stable dividends even in periods of uncertainty, growth in renewables should help drive earnings above the sector's historical 3%-5% growth rate.
- Continued low interest rate environment: even with recent Fed moves, rates remain low from a historical perspective. In a "lower for longer" interest rate environment, utilities should continue to benefit from the lower cost of capital – savings that eventually should flow directly to the bottom-line.
- Policy tailwinds: the Inflation Reduction Act (IRA) contains many provisions that are supportive of renewables development over the next decade as the US aims to lower carbon emissions, and should help to sustain dividend growth.

Investment Themes & Areas of Focus

- Regulated Utilities - companies operating in favorable regulatory environments and geographies, with above-average projected earnings and/or dividend growth driven by regulatory rate-base investment.
- Renewable Electricity – the energy transition is driving ongoing investment and usage of renewables and should continue to provide unique investment opportunities over the long-term.
- Water Utilities – a focus on improving water quality, as well as pipeline replacement and maintenance, provides ten years of transparency into spending and income plans.
- Midstream Energy - specifically companies with exposure to natural gas, a critical bridge fuel.
- Communications Infrastructure - tower operators provide critical infrastructure and strong free cash-flow generation due to multi-year contracts.

Midstream Energy Infrastructure

Midstream energy continues to be a strong performer in the two years since the COVID vaccine announcement. The Alerian MLP Index – and energy broadly – outperformed the S&P 500 Index once again in the fourth quarter, though that was in large part due to outsized relative outperformance in October. While energy lagged almost all other sectors in what was a strong market in November, the group held up better than most other non-defensives in December's weakness. Despite the fact that fundamentals and cyclical tailwinds remain intact, over the course of 2022 broader macro concerns periodically heightened and weighed on the group, and 4Q was no different. Midstream lagged all other energy sub-sectors during the quarter despite strong absolute performance. For the full three-month period, the Alerian MLP Index gained just over 10%, outperforming the S&P 500 Index by 248 bps.

Midstream energy has been a sector in transition for several years. Most of the larger companies took decisive measures to conserve cash and "right-the-ship" during the pandemic, and we believe this disciplined behavior will continue. Cash-flow metrics have improved across the board after companies reduced capex and growth spending over the past two years. Many larger companies are now free cash flow positive for the first time, an important inflection point reached in 2021. Added cost reductions and increased asset optimization should continue to fortify balance sheets, while offering management teams further opportunities to reduce debt levels as well as return cash to shareholders.

While it is likely that we have seen the last of severe global economic shocks due to the pandemic, the world has not completely moved past COVID and China's impending re-opening only creates more uncertainties. Add an ongoing war in Eastern Europe and recessionary concerns to the mix and continued hiccups along the road to recovery should be expected. However, as economic activity normalizes, stocks should increasingly price in the long-term positive benefits from the significant transformational corporate reform that has occurred over the past few years. Accordingly, we believe the group is well-positioned for performance beyond the cyclical recovery.

The global energy transition will require multiple sources of energy to be successful. Hydrocarbons will continue to have a role, driving future demand not just for commodities but for the essential logistical systems that move them. With physical steel in the ground, midstream energy infrastructure companies have difficult-to-replicate asset networks with high barriers to entry, and whose adaptability to transport other energy sources is underappreciated. Management teams are increasingly aware of the role they will play in our energy future, focusing not just on the environmental impact of their operations but also on how their asset bases can and will be part of a greener future.

Investment Themes & Areas of Focus

- "Reformed" companies – those companies exhibiting greater capital discipline, and healthier, more conservative balance sheets that can withstand a downturn, along with improving ESG metrics such as solid corporate governance.
- Integrated business models – the larger, more integrated companies with multiple touch points along the energy value chain, higher barriers-to-entry, and steady cash-flows.
- Firms with exposure to the natural gas liquid (NGL), liquefied natural gas (LNG), and natural gas demand export themes.
- Companies with liquids exposure that should benefit from the re-opening of the economy.

Financials

Equities advanced in the fourth quarter with most sectors posting solid returns. The energy, industrials, materials, and financials sectors produced the highest quarterly results. Ongoing Fed tightening and geopolitical and inflationary concerns continue to impact market returns and volatility, specifically resulting in increased expectations that we may be headed toward a hard-landing recession. The financial sector would be negatively impacted if this would occur, specifically around higher credit losses and slowing consumer/business lending activity. This dynamic has showed up across all risk assets. For example, high yield spreads remained at elevated levels throughout the quarter. The financials sector of the S&P 500 Index returned 14% for 4Q22 versus the 8% return of the S&P 500 Index.

Fundamentally, the sector continues to experience labor cost pressures, but this is being offset by improved tech-driven efficiencies and generally better overall operation of businesses (especially credit risk) by management. Nevertheless, the market is less concerned with these dynamics and is solely focused on the expectation of a future economic slowdown and the course of Fed tightening. For the quarter within the sector, mortgage REITs did the best (bouncing back in price return after a very difficult first three quarters), followed by insurance which has, by far, been the top performing industry group all year.

Recently, equity returns have been hampered by the evolving difficult forward macro environment. The drivers behind this are tightening financial conditions and higher rates beyond expectations (occurring quickly), persistent inflation, the hawkish Fed, energy supply, China turbulence, and the Ukraine invasion. We continue to have increased uncertainty, resulting in a sharply higher discounting mechanism for equities. With market expectations coalescing around a future recession, we should expect continued volatility and the potential for more negative forward earnings revisions.

Despite the gathering storm clouds, from a relative basis the current environment is supportive of banks and capital markets companies given modest loan growth, improving interest income from rising rates, ample loan loss reserves, and credit conditions that remain solid enough to absorb some expected deterioration. Property and casualty insurance remains a safe haven given its defensive nature and strong pricing dynamics. Additionally, both of these industries have attractive valuations and reasonable earnings floors to support the stocks under a more difficult macro environment.

Investment Themes & Areas of Focus

- Overall, banks are significantly better-positioned today than they were in 2008-2009 financial crisis across a broad range of balance sheet, capital, and risk management metrics.
- With the rapid rise in rates since the summer of 2021, valuations in the sector have normalized. We expect tailwinds for future bank earnings growth will be primarily driven by solid revenue trends and credit controls, stabilizing net interest margins, ongoing expansion of their fee based business opportunities, and continued efficiency improvements through better use of technology.
- Fundamentals for P&C insurance companies are solid (driven by favorable pricing dynamics) and valuations remain attractive.
- As a return to normalized growth plays out over the long-term, secular growth companies with defensive attributes (low leverage rates, asset light models, sustainable, high margin, and high free cash flow businesses) should fare better. Several digital payment and financial technology companies meet these criteria.

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PGIMJ96385