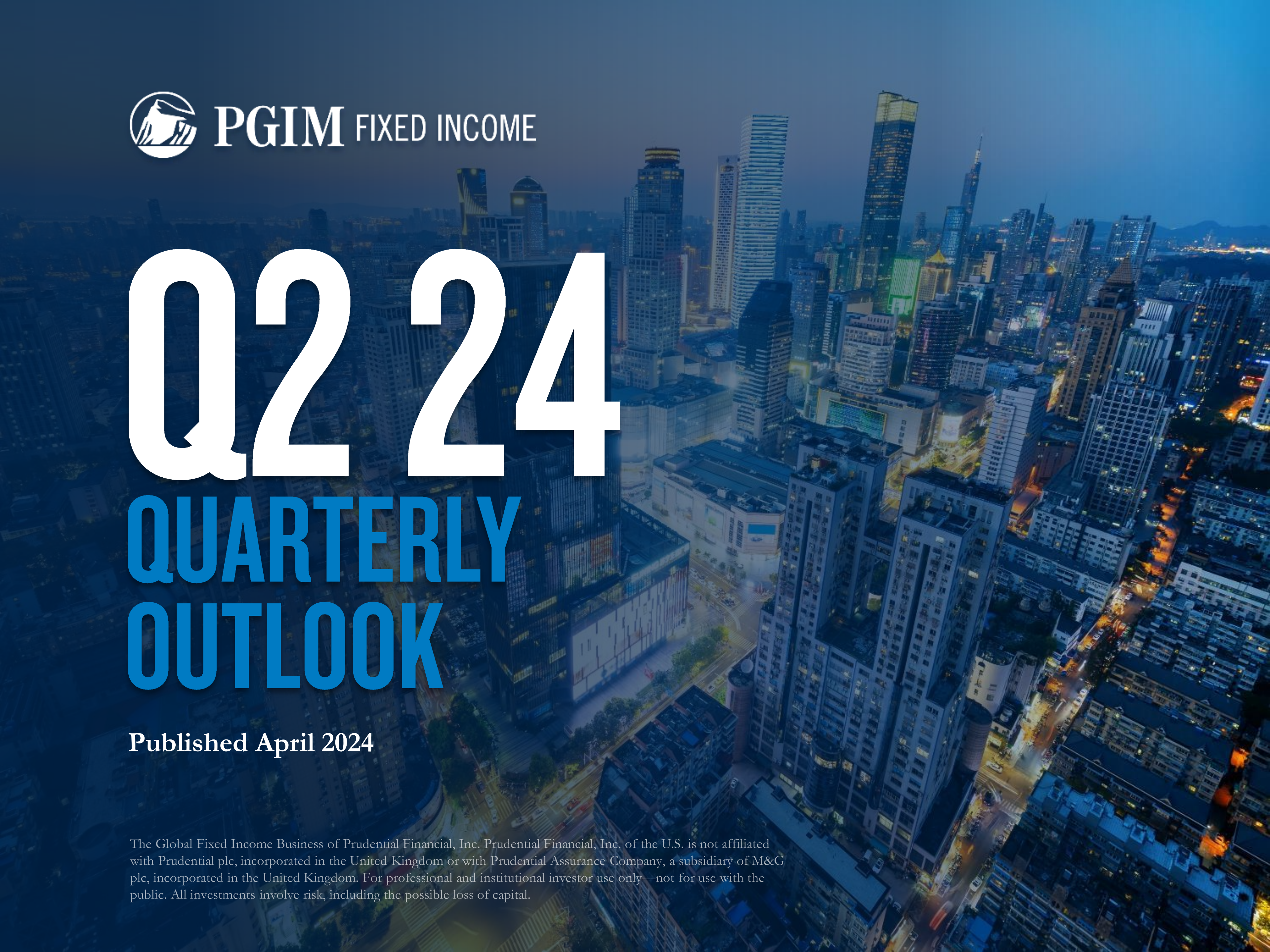


PGIM FIXED INCOME

Q2 24 QUARTERLY OUTLOOK

Published April 2024

WHATS INSIDE?

Select a section to jump ahead.

	Total Returns (%)				
Individual FI Sectors	Q1 '24	2023	2022	2021	2020
European Leveraged Loans	2.53	13.53	-3.36	4.87	2.4
U.S. Leveraged Loans	2.52	13.04	-1.06	5.40	2.8
EM Debt Hard Currency	2.04	11.09	-17.78	-1.80	5.3
European High Yield Bonds	1.81	12.78	-11.13	3.32	2.9
U.S. High Yield Bonds	1.47	13.45	-11.19	5.36	6.2
CMBS	0.84	5.42	-10.91	-0.64	8.1
European IG Corporate	0.47	8.19	-13.65	-0.97	2.8
EM Local (Hedged)	0.20	7.60	-8.85	-5.52	6.1
Municipal Bonds	-0.39	6.40	-8.53	1.52	5.21
U.S. IG Corporate Bonds	-0.40	8.52	-15.76	-1.04	9.9
U.S. Treasuries	-0.96	4.05	-12.46	-2.32	8.0
Mortgage-Backed (Agency)	-1.04	5.05	-11.81	-1.04	3.9
EM Currencies	-1.12	8.44	-7.14	-3.09	1.7
U.S. Long IG Corporates	-1.69	10.93	-25.62	-4.65	13.9
Long U.S. Treasuries	-3.26	3.06	-29.26	-1.13	17.7
Multi-Sector					
Global Agg. Hedged	0.02	7.15	-11.22	-0.15	5.58
Euro Aggregate (Unhedged)	-0.33	7.19	-17.18	-4.71	4.05
Yen Aggregate	-0.38	0.51	-5.30	-2.85	-0.8
U.S. Aggregate	-0.78	5.53	-13.01	-1.39	7.51
Global Agg. (Unhedged)	-2.07	5.72	-16.25	-1.54	9.2
Other Sectors					
S&P 500 Index	10.56	26.29	-18.11	28.71	18.4
U.S. Dollar (DXY Index)	10.39	-2.11	8.21	6.37	-6.69
SOFR	1.35	5.18	1.66	0.03	0.38

Past performance is not a guarantee or a reliable indicator of future results. See Notice for important disclosures and full index names. All investments involve risk, including possible loss of capital. Sources: Bloomberg except EMD (J.P. Morgan), HY (ICE BofA), Bank Loans (Credit Suisse). European returns are unhedged in euros unless indicated. Performance is for representative indices as of March 31, 2024. An investment cannot be made directly in an index.

PGIM FIXED INCOME

SECTION 1

KEY CONVICTIONS & INVESTMENT THEMES

01

KEY CONVICTIONS & INVESTMENT THEMES

1. **After pivot, some pause, while others party on.** Central bankers signaled their policy pivots, and while we await movement, mini cycles continue playing out within the market's higher yield ranges. The first quarter was a pause for the investment grade segment of the bond market, but the party went on for high yield and emerging markets.

2. **Traversing ranges across the strategic buy zone for bonds.** True, credit spreads are tighter. But from the perspective of the last 20 years, yields remain in rarefied air, central banks appear done raising rates, and long-term rates are also probably past their peaks for the cycle. As a result, as yields drift in this new higher range, the bull market where returns derive from yield itself, is poised to continue.

3. **The best offense is a better defense**. While geopolitical risks fester, they have yet to result in major macroeconomic or market impacts. In an environment of tight credit spreads, these risks—amongst others—underscore the importance of issue selection to keep portfolios resilient to potential shocks.

4. **Alpha opportunities as yield becomes destiny.** Ongoing uncertainty continues to create a deep opportunity set for adding value through issue, sector, term structure, and currency positioning. Hence, our bond market outlook is still generally positive over the balance of 2024 as high yields boost the odds of favorable market returns (Yield is Destiny after all) and the potential for ample alpha generation remains favorable.

SECTION 2

BOND MARKET OUTLOOK

By Robert Tipp, CFA, Chief Investment Strategist & Head of Global Bonds

02

A New Quarter, Similar Positive Outlook

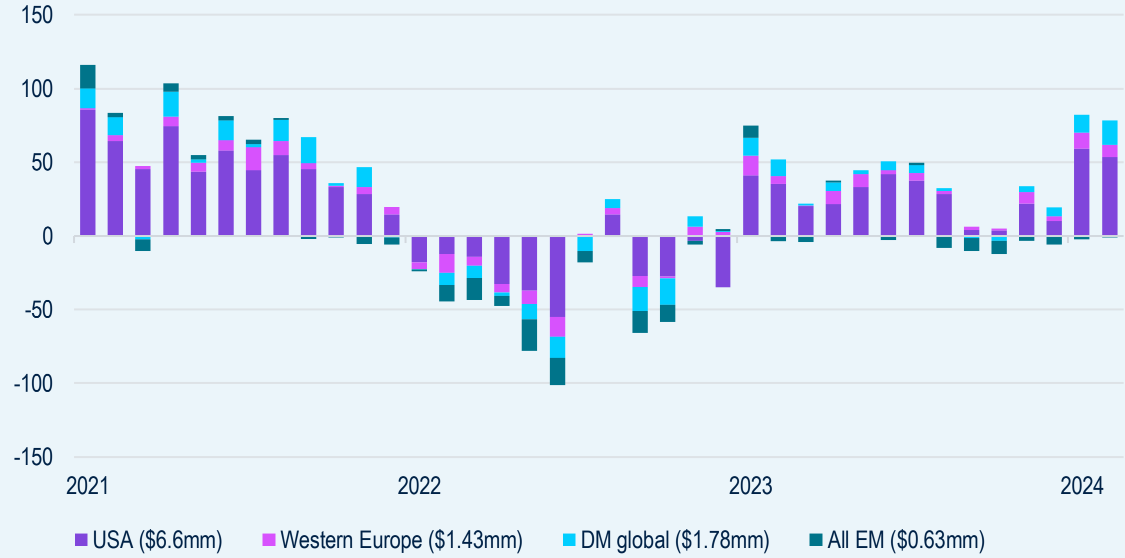
As expected, after the strong interest-rate rally in the fourth quarter of 2023, the market was due for a rest. Indeed, the longer-duration and higher-quality segments of the bond market registered negative returns in Q1. However, the rally in credit products powered ahead thanks to stable fundamentals and strong demand from retail, pension, financial, and overseas investors (Figure 1). In fact, the demand for yield was so strong that the higher risk segments of the market, such as high yield corporates and hard currency emerging markets, posted strong positive returns despite the increase in government yields (click here for Q1 returns). Although the tightening in investment grade spreads was far more modest, it was impressive nonetheless as it occurred in the face of record supply.

Rate cut expectations halved… Long rate movement comparatively muted…

Short rates increased dramatically in Q1 as investors significantly scaled back expectations for rate cuts (Figure 2)–by a third in Europe and by one half in the U.S. Despite this aggressive re-rating at the front end of DM yield curves, the increase in long-term rates was comparatively mild, giving back just a fraction of the Q4 2023 rally. **The muted reaction in longer yields (+30-40 bps) suggests investors remain committed to the idea of locking in yield**

Figure 1

Fund inflows indicate the breadth of fixed income demand (EPFR monthly bond flows; USD billions)



Source: EPFR.

Figure 2

The front end sobers up to more realistic rate-cut expectations (2024 rate cut expectations; bps)

Central bank	As of Dec. 31, 2023	As of March 31, 2024	Q-o-Q change
Federal Reserve	-165	-80	+85
ECB	-194	-123	+71
BoE	-190	-111	+79

Source: PGIM Fixed Income and Bloomberg.

for the long term, and inverted yield curves show that they are willing to give up a bit of yield in order to do so.

A further testament to the bid for yield… Spreads cut in half since 2022

Investors' enthusiasm for locking in yields is most evident in spread product. Despite the dramatic reassessment of potential rate cuts, end-users' strong demand for yield broadly drove spreads 10% tighter this year, bringing the cumulative drop in spreads since the post-invasion wides to as much as 50% (Figure 3).

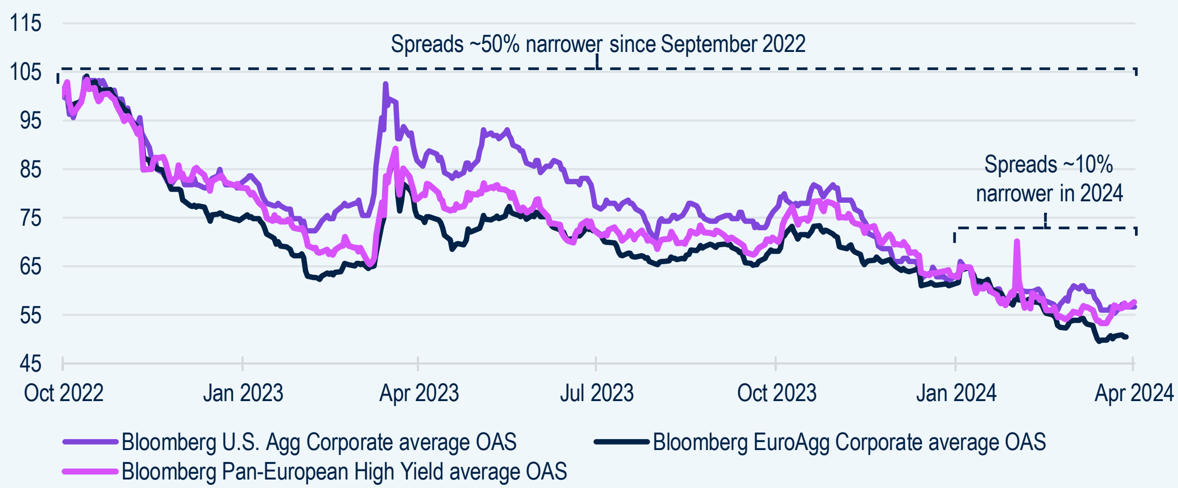
Is there too much cash?

In general, the strong bond inflows and the **sharp rally** in higher-risk fixed income hasn't happened in a vacuum, but rather against a backdrop of rallying prices for **a range of asset classes** from gold to crypto currency to AI stocks (see box on Rocketing Prices). While one can make the case for any of these bullish stories, perhaps there is **a powerful contributing factor: investors have too much cash** (Figure 4)**.**

In absolute terms, money fund assets soared during COVID. They surged again as savers at first sought safety and then higher yields in money funds following the SVB blowup. **Compared to the roughly 15% of nominal GDP invested in money funds during more placid times, the current level of 21% is more akin to the highs of the 2002 and 2008 recessions—both of which were followed by**

Figure 3

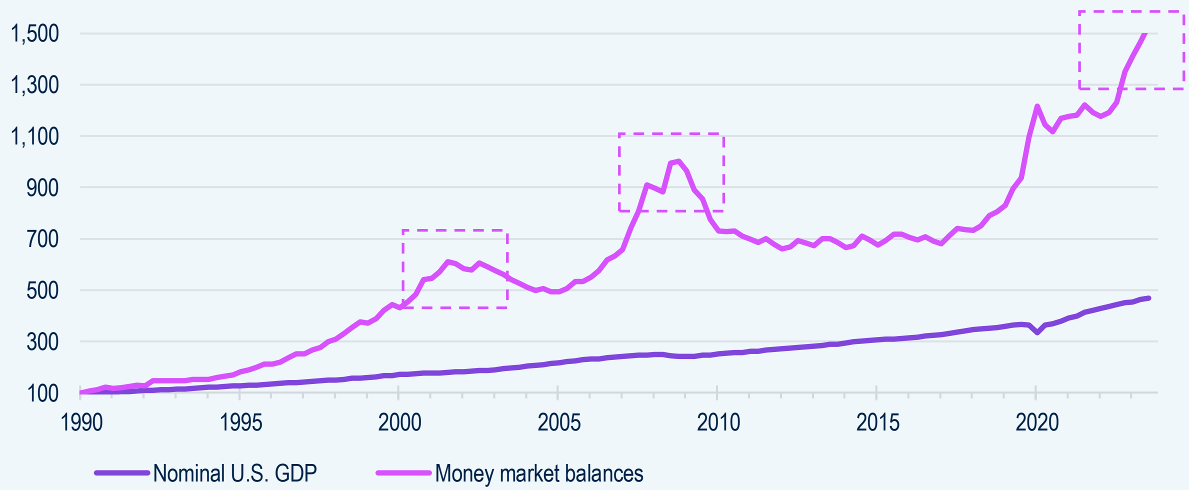
The expanding search for yield continues to compress spreads (indexed to 100).



Source: Bloomberg.

Figure 4

Perhaps some of the buoyance across asset ranging from stocks, bonds, gold, and crypto currency is the result of investors paring back uncomfortably high levels of cash (indexed to 100).



Source: Bloomberg

strong, multi-year rallies in stocks and a generally favorable environment for credit product as well.[1]

Mother of all asset allocation trades yet to come?

While investor allocations to equities and real estate may have increased via appreciation and cash allocations increased through flows, bond allocations may have been depressed by the rate increases over the last few years. This seeming imbalance in allocations—running counter to an aging demographic—suggests, all else equal, that **bonds could remain well supported if and as investors try to rebalance towards more normal/higher fixed-income allocations.**

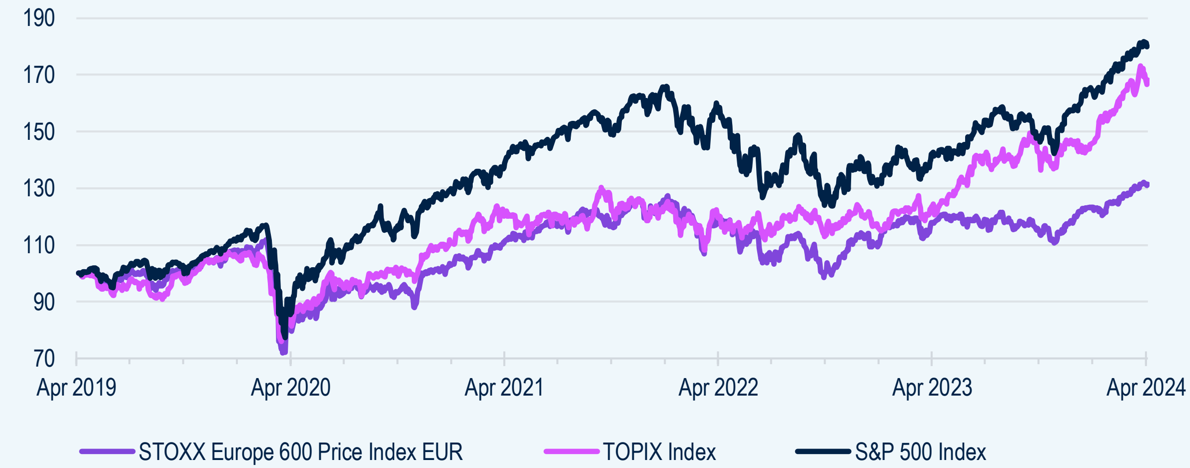
ROCKETING PRICES—A RATIONALE FOR EVERY MARKET, OR JUST TOO MUCH CASH LOOKING FOR A STORY, OR A BIT OF BOTH?

In the "lower interest rates are coming, a soft landing is in the bag, AI will save the world, and don't bother me about geopolitical risk" category, stocks have (in very rough terms) nearly doubled from their COVID lows with half the rise occurring in practically a straight line over the last handful of months. Alternatively, in the "hedge against geopolitical risk" category, gold has catapulted to new highs, up 25% since early October as tensions have risen in the Middle East. Lastly,

[1] A fraction of the increase is the result of low interest bank deposits moving into market rate mutual funds. But even allowing for this adjustment, cash balances are well above pre-COVID levels.

Figure 5

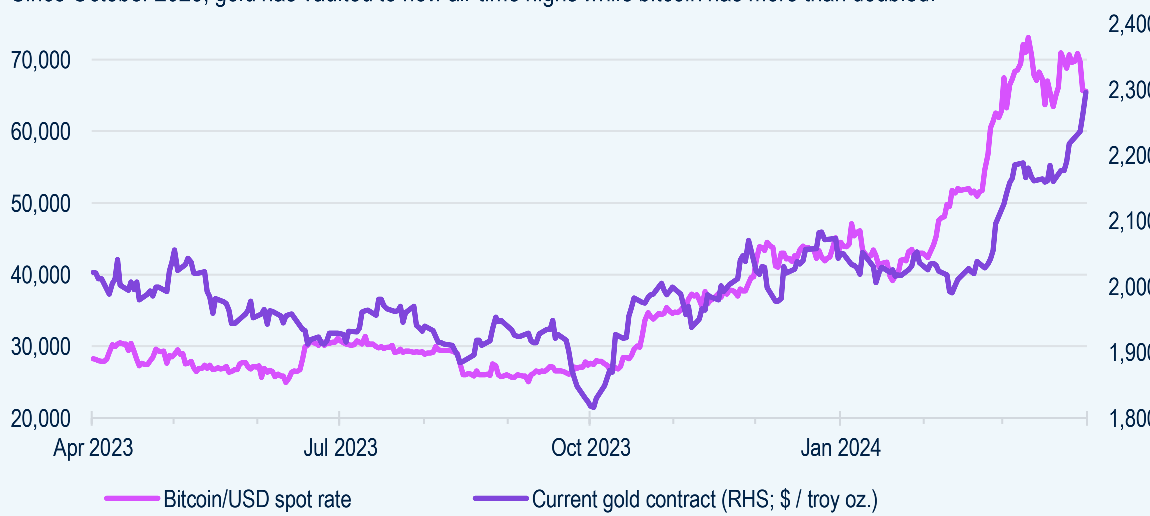
Stocks—some have doubled since the COVID lows, with more than half of the rise occurring since the invasion lows of 2022 (indexed to 100).



Source: Bloomberg

Figure 6

Since October 2023, gold has vaulted to new all-time highs while bitcoin has more than doubled.



Source: Bloomberg

the SEC has unleashed a new pool of investor capital on the crypto currency market by enabling crypto ETFs. Over the last six months, the pre-hype and kick-off of the ETFs has driven a doubling of bitcoin.

Inverted yield curves: investors want to lock in yields for the long term

Ever since the fall of 2022 when 10-year yields broke above 2% for the German bund and 4% for the U.S. Treasury, investor demand has suppressed long yields, causing an inversion of the yield curve as cash rates continued to rise. While many assumed this was a sign of a looming recession, alternatively, it may simply reflect investors' recognition that yields are back at generational highs (Figures 7 and 8). And as the markets have progressed since the fall of 2022, central bank rate cycles have peaked, adding a sense of urgency on the part of aging investors, pension funds, and financial institutions to get into the bond market at the peak of the rate cycle.

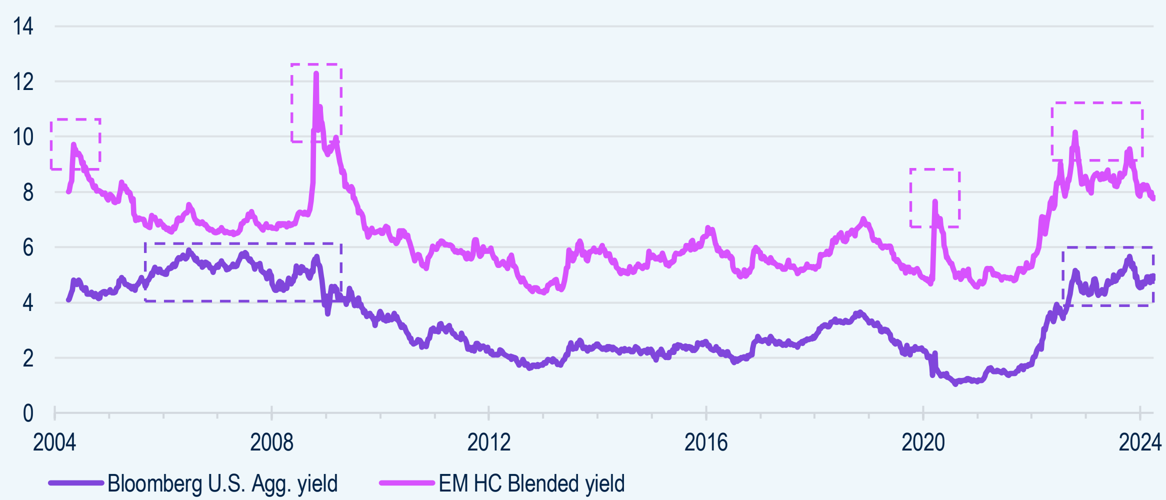
Where to from here? High yields generate return; rinse, repeat.

Looking ahead, the outlook for bond market returns over the long run remains strong. While we do not expect a decline in long-term yields, today's still generous yield levels will nonetheless continue to accrue. Similarly, although wholesale spread tightening from current levels is unlikely, spread sectors can add incremental income and return as well as offering opportunities to add value through sector rotation and issue selection. One possibility is that the rally's laggards catch up, potentially resulting in spread compression across the quality spectrum.

OPPORTUNITIES FOR CCCs TO BRING UP THE REAR

In the higher risk markets, such as high yield and emerging markets, investors have finally turned their attention to the laggards: the lower credit quality realms. In particular, EM HY has trailed IG, while in U.S. high yield, CCCs have trailed BBs. As discussed in the sections that follow, that leaves room to add value by playing for narrower spreads by quality (i.e., CCC spreads compressing to BBs), through tactics like a credit barbell (see EM section), or issue selection in stressed/distressed credits.

Figure 7
The peak in central bank rate cycles and generationally high yields are drawing strong investor flows and contributing to curve inversions (%).



Source: Bloomberg.

The Bottom Line

This unusual bull market is set to continue. Long-term rates and credit spreads are likely to remain relatively range bound, with some potential for narrowing of credit spreads and favorable avenues for adding value through active management as the highest yields in a generation transform over time into realized returns.

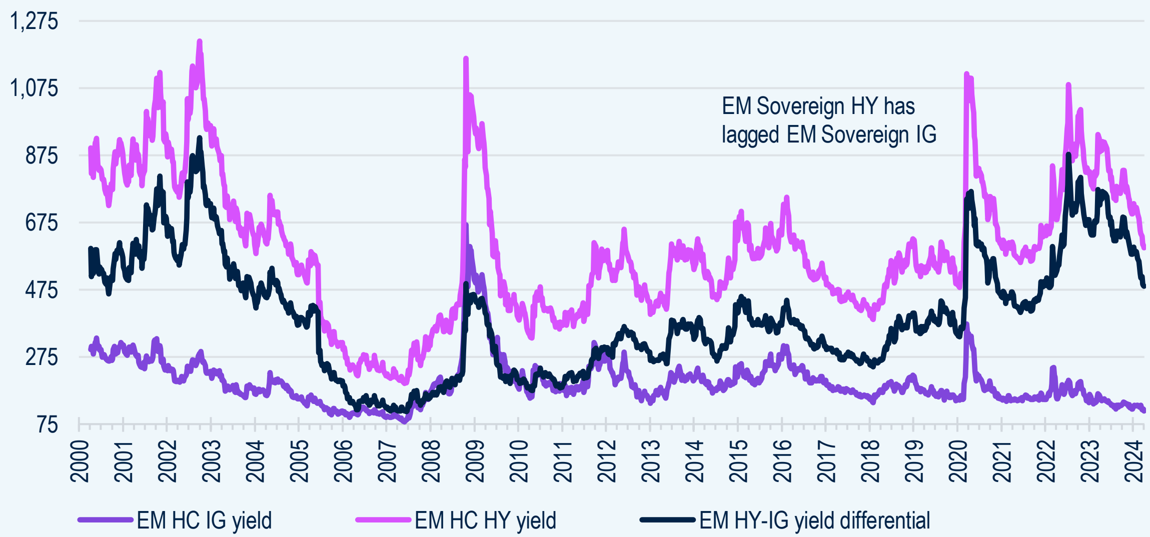
THE BENEFIT OF BONDS, DESPITE AN INVERTED YIELD CURVE

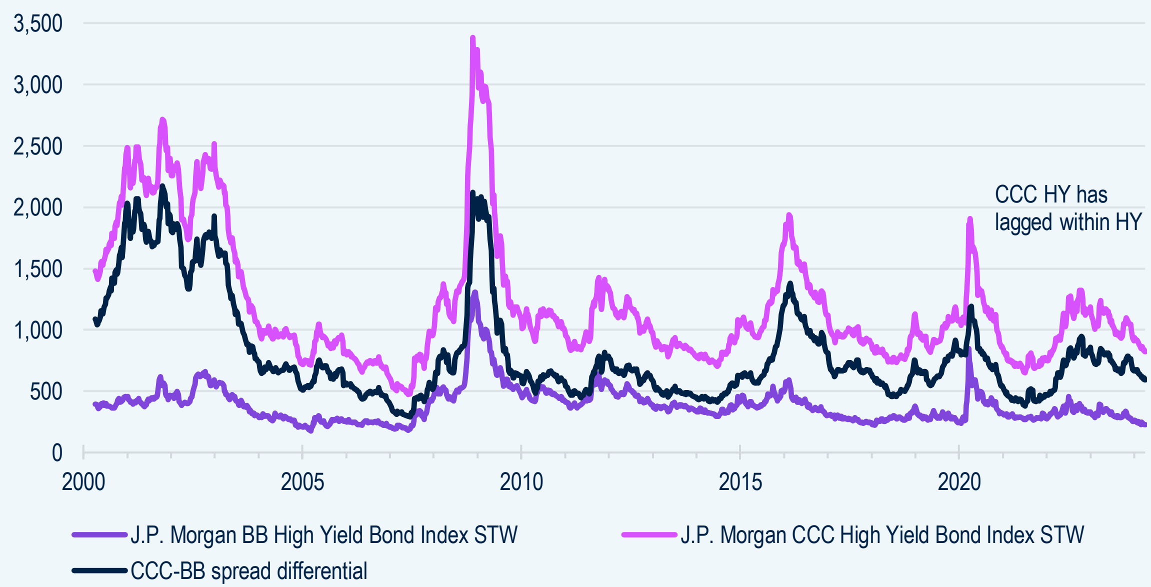
With cash rates remaining elevated, it's worth revisiting some of the benefits of boosting fixed-income allocations:

- Considering that rate hike cycles are over, we remain "in the buy zone" with long-term rates near their secular peaks;
- alpha generating opportunities;
- exposure to credit beta;
- long-term income hedge—lock-in generational highs in yield;
- potential risk hedge;
- and favorable relative valuations versus other asset classes.

Figure 8 and Figure 9

Opportunities to capture spread compression in laggard credit sectors (yields in %; spreads in bps)





Source: Bloomberg

RESEARCH HUB

WHAT LIES BENEATH GLOBAL ECONOMIC RESILIENCE?

The question above continues to confound the market consensus. While we can point to the resiliency in recent data, the proper context is needed to help extrapolate these economic conditions into strategic investment views.

We have collected insights covering three themes that we believe shed light on the main factors driving resiliency: the U.S. economy's evolving interest-rate sensitivity, the future of global inflation, and our expectations for interest rates and fixed income performance.

[Learn more at PGIMFixedIncome.com →](PGIMFixedIncome.com)

SECTION 3

GLOBAL MACROECONOMIC OUTLOOK

By the Global Macroeconomic Research Team

03

An Improved Balance of Risks and its Policy Implications

While the global economy's resilience continues to surprise many, it also remains aligned with our expectations from the beginning of the year. The minor adjustments that we've made to our economic scenarios are largely indicative of the two-sided growth and inflation risks that appear more prominent as we look ahead. Yet, there is more that is feeding into the tail risks with geopolitics and global fiscal stimulus each contributing to the elevated left and right tails.

That said, the ramifications from the U.S. presidential election, the EU parliamentary elections, and two wars with the potential to expand into wider conflagrations—while the great-power competition between the U.S. and China continues to unfold—pose risks that are more difficult to quantify, thus also keeping tail risks wider going forward.

All the while, most major global economies continue to chug along. In **the U.S.**, stronger-than-expected readings on inflation and labor market conditions—the latter due in part to immigration effects—have flowed to the right side of the tail, delaying or curtailing rate cuts by the Federal Reserve relative to prior market expectations. Indeed, the median projection for the Fed funds rate from the March FOMC meeting still indicated three cuts in 2024, which remains consistent with our view for cuts to start in June. Notably, the Fed's summary of economic projections' (SEP) core PCE forecast for year-end 2024 increased from 2.4% to 2.6%.

Furthermore, the latest SEP indicated one fewer rate cut in 2025, reducing the forecast to three 25 bps cuts. We forecast YE '24 core PCE at 2.8% as inflation struggles to move towards the Fed's 2% target.

In addition, the FOMC's long-run dot inched up from 2.5% to 2.6%. While the adjustment was minor, it may be an initial sign that the Fed is willing to implicitly accept a higher Fed funds level over the long run if it feels that the economy can tolerate higher policy rates even with inflation at target over the long run. Additional adjustments in the long-run projection towards the 3.0% area will likely follow.

That said, when looking through the headline figures, we see signs that the labor market continues to moderate, albeit not as quickly as many anticipated. As one forward-looking signpost, we look at average weekly earnings (it includes wages and hours worked) to assess how employers may manage their labor costs going forward. Historically, employers first adjust hours worked, then they adjust wages, and then they reduce positions as necessary. To that end, the consistent increase in continuing unemployment claims underscores the gradual easing in labor market conditions.

The labor market's support for U.S. consumer spending also appears to be moderating (also at a slower pace than many anticipated) and nearing some points of exhaustion. Indeed, for all but the top 1% of consumers by income, savings have dropped below the pre-COVID trend, increasing their reliance on credit, which also has its limits (Figure 1).

While our base case in the U.S. continues to call for "weakflation," the reduced probability from 35% in Q4 to 30% leads to a relatively wide distribution of the remaining scenarios. For example, the right side of the distribution includes a 10 percentage point improvement in our soft-landing scenario at the cost of the weakflation and recession scenarios (see the scenarios summary page for comparisons across global regions and to prior quarters).

Much will be said as the Trump and Biden campaigns march towards November, and investment implications loom in either outcome. A Trump win could result in a negative supply shock given the expectations for increased tariffs on China and potential reductions on immigration, thus reduced labor supply. It may also feature a positive demand shock from looser fiscal and monetary policies coupled with regulatory relief. A Biden win could be more positive from the supply side amidst continuation of various initiatives, such as the IRA and CHIPS acts, but less so from the demand side, e.g., no tax cuts. In the event the Senate flips to Republican and the House, which is more of a toss up, flips to Democrats, the government will remain deeply divided, likely propagating the political polarization that continues to assert itself globally.

After **the Euro Area** avoided recession in 2023, we see growth continuing at 0.6% in 2024—slightly better than the consensus—amidst rising real incomes, continued fiscal support, resilience in the U.S. economy, and looming ECB rate cuts. That said, growth of less than 1% is very weak for the EA when compared to its pre-pandemic average of 1.4% per year. Developments on a regional basis also warrant consideration as recent data confirm the "flip" in the EA narrative with much of the periphery, e.g., Greece, Spain, and Portugal, outperforming the core of France and Germany (Figure 2). Although Italy remains the periphery's weak link as of late, we see further upside risks emanating from the peripherals reflecting unspent NGEU funds (where the multiplier could now be even larger), domestic fiscal support, reduced fiscal uncertainty from revised Stability and Growth Pact rules, and the benefits of rate cuts.

From a monetary policy perspective, recent indications from the ECB that it could start cutting rates in June, as opposed to April, aligns with our expectation for a total of 75 bps in rate cuts in 2024, which would bring its policy rate to 3.25% by year end. The ECB's recent comments on a capital markets union could also manifest into another structural boost to growth across the EU over the medium term. In **the UK**, the Bank of England's recent statement that "the stance of monetary policy could remain restrictive even if Bank Rate were to be reduced," points to a scenario where it cuts

Figure 1

Rising credit card balances and delinquencies point to a slightly U.S. stretched consumer

U.S. Credit card balances as % of limits vs. debt per capita (30 days late) Federal Reserve Bank of New York

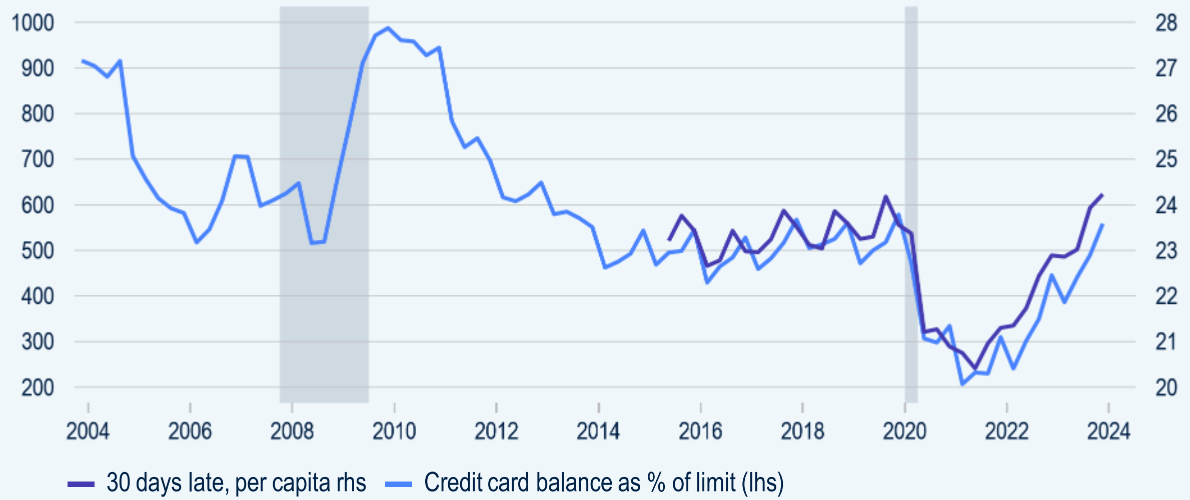
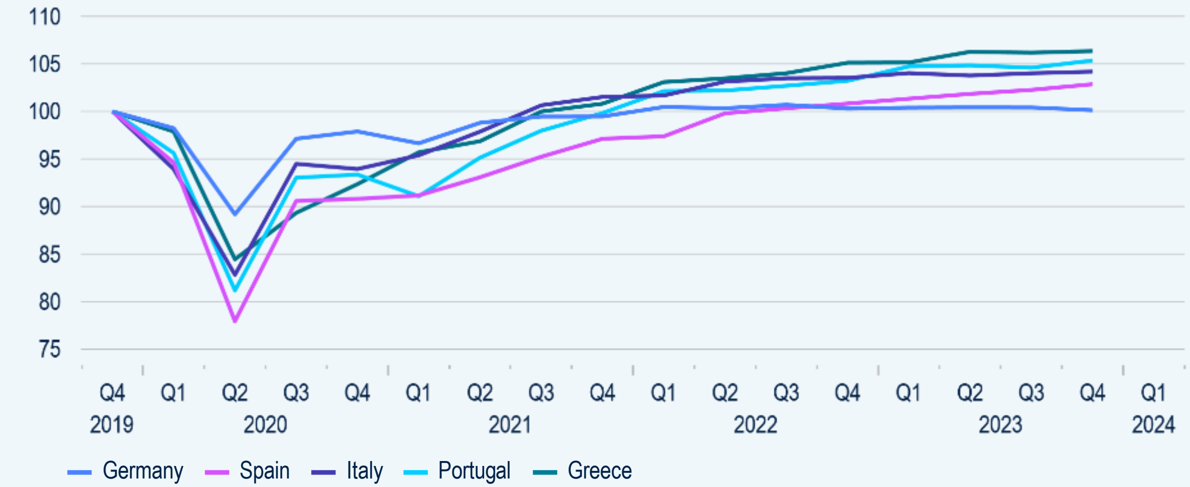


Figure 2

Growth in the periphery exceeding Germany's relative stagnation

Euro Area by GDP by country: Index, 2019Q4 =100



Source: Macrobond as of March 2024.

rates over the near-term horizon, while telegraphing that its policy rate will nonetheless remain relatively elevated for the foreseeable future.

While our base case (40%) for Europe also calls for weakflation, the increased probability to the right side of the distribution is reflected by the 10 percentage point increase in the soft landing scenario, which now matches the recession scenario at 25% and reflects a more balanced picture of risks going forward.

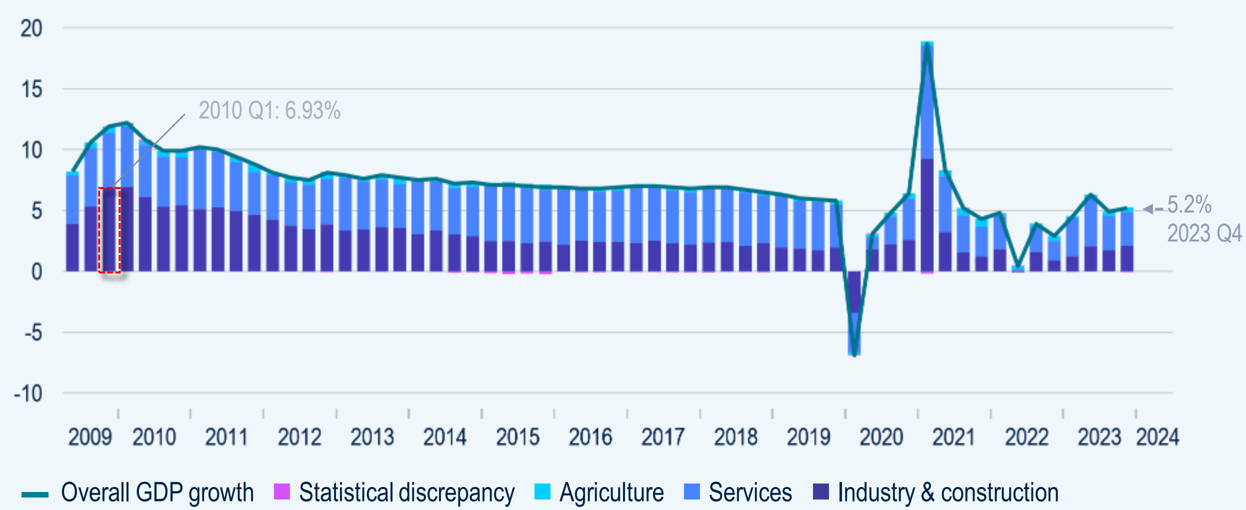
As the great-power competition between the U.S. and **China** continues to play out, the latter's growth prospects remain one of the more prominent global macro uncertainties. Yet, a forward-looking view requires context regarding nominal vs. real conditions in the world's second-largest economy. Indeed, when adjusting for inflation, China's growth and the contribution from consumption appear relatively healthy in the 4-5% range, while the contribution from investment, inventories, and net exports lags. China's relative stability on an inflation-adjusted basis may be one reason why authorities are taking a gradual approach to stimulus in China.

While more stimulus measures will likely emerge in China, they're unlikely to match the actions from 2008 or 2015 when China's policymakers benefitted from more fiscal space and the real estate sector was regarded as a cyclical factor (rather than its current status as a structural situation). Our view for additional, but not massive, stimulus—which should keep growth expectations positive, but muted, at 4.5% in '24—is indicative of policymakers' multiple objectives, including national security, structural transformation, and financial regulation. This view flows through to our base case with the probability for a soft landing rising from 55% to 70%, while the recession scenario on the left side of the distribution gained 5 percentage points to 20% (see the Economics Scenarios for additional detail, including the remainder of the Emerging Markets sector).

Finally, in **Japan**, the BoJ's decision to lift its policy rate into positive territory ends the era on negative policy rates. The BoJ also concluded its yield curve control program with the pledge to buy long-term JGBs as needed. As for the BoJ's next moves, it likely sees a fragile, but stable, economy that warrants an accommodative stance keeping rates close to zero. However, the U.S. economy's continued resilience and buoyant growth in China could prompt the BoJ to tighten policy further.

Figure 3

When adjusted for inflation, growth in China should progress and add some global support (China: contribution to real quarterly GDP growth, by sector: YoY % change)



Source: China National Bureau of Statistics (NBS)

Indeed, we viewed the BoJ's statement that additional policy accommodation remains needed "for the time being" as somewhat hawkish. We're also cognizant that the BoJ could announce an early start to a QT process that could have spillover effects across the global bond markets.

That said, if the yen continues to trade weaker vs. the U.S. dollar, as it did after the decision to lift policy rates out of negative territory, its risk markets could benefit from ongoing tailwinds. It's an apt picture for a global economy increasingly bracketed by prominent probabilities on either side of the distribution.

Figure 4

With no shortage of geopolitical hotspots, the following summary page provides our scenario analysis of the respective situations along with signposts to watch over the coming months and quarters.

Key geopolitical risks (base case and assumptions)	**Signposts**	**Benign Case**	**Adverse Case**	**Direction and impact**
Escalation of Russia's War vs Ukraine Attritional war with risk of escalation (80%) **Assumptions:** Positional warfare persists, with no major changes to frontlines.	Continued support from West. Battlefield breakthroughs (lack thereof). Next U.S. President.	Mutual understanding that victory is impossible. Fragile ceasefire with external participation. West - Russia security talks	Faced w/ defeat Russia responds via WMDs, risking escalation with NATO (5%)	↓ Medium/ high
Expansion of Israel - Hamas War Conflict remains limited to Gaza (65%) **Assumptions:** Major regional players against expanded conflict. KSA & Iran truce holds up.	Diplomatic progress; Israeli and U.S. politics. Iran's actions and China's engagement.	Hostage diplomacy succeeds. PA-led admin takes over. Israel accepts discussion of two-state solution - Gaza reconstruction.	Wider ME conflict in Gulf region, including the U.S. and Iran KSA-Iran truce breaks down (30%)	↔ Medium/ high
Escalating Military Tensions on the Korean Peninsula NK's nuclear and diplomatic coercion (80%) **Assumptions:** Build up of conventional/ nuclear capability to undermine security status quo and coerce diplomatic recognition as nuclear state	Advance of nuclear program. Perceived strength of U.S./allies' deterrence. China and Russia's relationship with NK.	Return to status quo. Denuclearization talks resume in exchange for sanctions relief.	War with SK, including potential use of nuclear weapons. Nightmare scenario - attack coincides with China's invasion of Taiwan (15%)	↓ High
Escalating Dispute Between China and Philippines Uneasy status quo with risks of accidental military confrontation (65%) **Assumptions:** Philippines strengthening military ties with U.S.; challenging China's presence in disputed islands	Continuation of China's coercive actions against Manila; re-launch of bilateral, regional treaty talks.	Pre-Marcos status quo: Philippines and China launch negotiations resulting in cooperation to address disputes.	Military conflict. Fear of wider credibility gap forces US to act (25%)	↓ High
China's Military Invasion of Taiwan China continues to erode status quo in preparation for takeover short of war (85%) **Assumptions:** China prepares ground for reunification using coercive tools / deterrence against U.S.' involvement.	Continued U.S. support and its "strategic ambiguity" policy. Whether Taiwan's Lai signals drive for independence.	Current status quo broadly persists.	War over Taiwan: Taipei pushes for & US supports independence. Misunderstandings lead to Chinese invasion (5%)	↔ High

Source: PGIM Fixed Income.

PGIM FIXED INCOME

SECTION 4

GLOBAL SECTOR OUTLOOKS

04

DEVELOPED MARKET RATES

Outlook: Maintaining a tactical approach to range-bound Western markets, while the BoJ's end of the negative-policy rate era highlights the potential for higher JGB yields.

- The unexpected economic resiliency in many DM economies provided a reality check for the markets' exuberant monetary policy expectations. As noted in our introduction, the increase of about 30 bps in long-term rates was a fraction of the 90-120 bps increase in short-dated forward rates as participants pared their expectations for monetary policy easing.

- Despite quite different fundamental backdrops in the Western markets, yield changes were quite comparable across countries in Q1 (e.g., UST/UKT/DBR/JGB +36/+54/+36/+21 bps, respectively), with the increases amounting to a mere fraction of the yield declines of Q4 2023.

- Given the potential for fewer and/or slower rate cuts as well as the heavy government issuance expected across DM markets, one might expect rates to be even higher.

- However, these bearish factors have been nearly offset by demand from end users who are anxious to lock-in yields at their cycle highs. All said, between the peak in yields and pessimism of September 2023 and the trough in yields seen at the turn of the year, we believe the violent moves of the last six months have more or less defined the yield ranges we are likely to see in the quarters ahead (i.e., 3.8%-5.0% in the U.S.; 1.9%-3.0% in Germany (see accompanying chart)).

- Away from the amazing likeness of market movements across DM markets, two outliers emerged in Q1. First, the Swiss National Bank became the first DM central bank to cut rates in what is likely to become a series of rate cuts. While others are likely to follow, the SNB situation is unusual in that the Swiss inflation rate has actually dropped below target, and the franc has been quite strong. For such an open economy, that combination afforded the SNB the latitude to cut rates in order to support growth.

- However, the Bank of Japan's situation is clearly the most dynamic as Q2 commences. For several months, the expectation was that NIRP would end—as it did—following the Spring wage negotiations. But the market's subsequent expectations for a glacially slow normalization of rates with very few, if any, follow-on rate hikes and a very slow reduction in bond purchases has come into question as a result of the yen's dramatic weakening following the end of the NIRP era.

Recent market swings have defined the yield ranges likely to persist in the U.S. and Europe going forward (%).

Source: PGIM Fixed Income

- With the yen relatively stable versus the dollar in 2023, the general assumption by the market and policy makers was that the BoJ would patiently implement policy normalization to ensure that a 2% inflation rate had been sustainably achieved. Yet, since ending NIRP, the yen has scratched new cycle lows, raising the threat that the multi-year trend of yen weakness could resume. In that event, a renewed bout of yen weakness could easily create another rise in import price inflation that could in turn create an unacceptably high, above-target rate of inflation. This has opened up the prospect of a more rapid policy normalization in Japan–i.e., more of a series of rate hikes with a greater reduction in bond purchases—than previously envisioned.

AGENCY MBS

Outlook: Positive expectations on eventual rate cuts and on excess returns vs. Treasuries. We continue to express this view in specified pools amid better prepayment speeds vs. TBAs. Intermediate coupons appear attractive due to yield and carry as well as better convexity profiles than higher coupons.

- Our positive outlook on the sector is due to a combination of factors, several of which pertain to the Federal Reserve's anticipated rate-cutting cycle. From a general perspective, MBS should benefit from further reductions in implied volatility once the timing and implementation of the rate cuts become clearer.

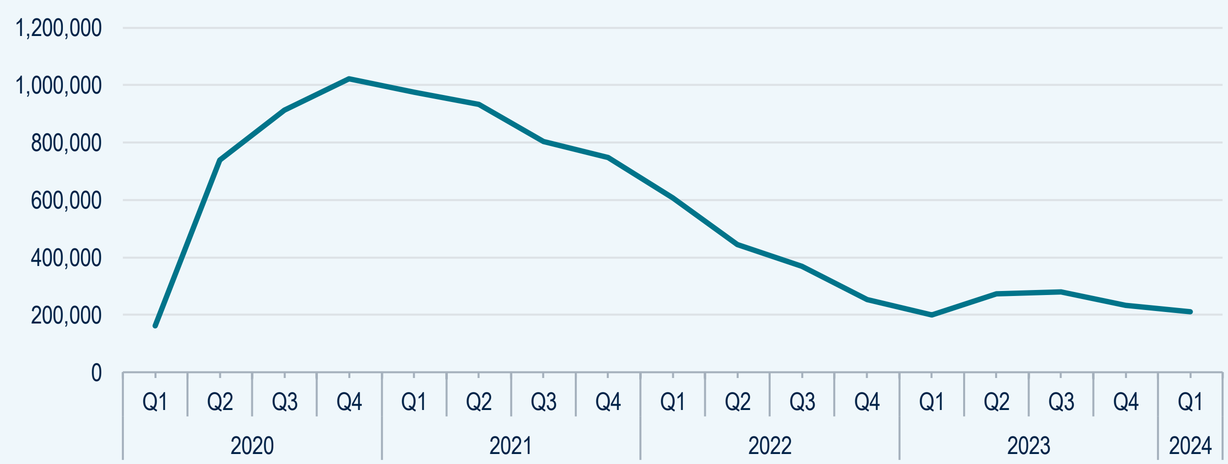
- From a technical perspective, although seasonal origination activity could increase with a moderation in primary rates, the lack of affordable housing units remains a headwind for purchase loan activity. Primary rates have also restrained prepayment activity, but we expect higher coupons will display faster speeds when borrowers in higher, newer-production coupons can take advantage of lower primary rates.

- On the demand side, buying from banks could increase if deposit pressures ease amid the rate cutting cycle. Fed Chair Powell has also indicated final Basel 3 capital rules will be less restrictive.

- In terms of market conditions, Fed rate cuts would also improve dollar roll performance, thus reducing the rationale for short positioning in MBS TBAs. The recent Treasury selloff led to some pressure on MBS durations, which subsequently stabilized. Looking ahead, most coupons in the MBS Index should behave more in line with expectations at these rate levels.

- The potential risks to our outlook also pertain to the Fed, particularly if it doesn't deliver the policy easing anticipated by markets. Furthermore, if the Fed adjusts its quantitative tightening initiative, its unlikely to stop MBS from rolling off the balance sheet, and it's also unlikely to add them again in the instance of another quantitative easing program. Finally, expectations of rate cuts have also limited the opportunity set in the sector as convexity risk continues building in production coupons, narrowing investment choices to more positively convex opportunities down in the coupon stack.

Quarterly MBS issuance
(USD millions)



Source: PGIM Fixed Income

The Ingrained Income Bias in Sovereign ESG Ratings

In 2020, the World Bank released a paper entitled "Demystifying Sovereign ESG," which analyzed the methodologies and outputs of the major sovereign ESG rating providers. The paper highlighted a structural issue prevalent in sovereign ESG scores, termed "the ingrained income bias." This is the phenomenon that richer countries tend to perform better on sovereign ESG indicators while those of poorer economies tend to perform worse. Thus, sovereign ESG indicators are often highly correlated with a country's income. Additionally, ESG risk ratings tend to be highly correlated to general risk ratings on sovereigns, which in turn tend to be correlated with income, meaning that most ESG risk ratings likely add little new information.

After initial testing, we found that the prior version of our sovereign ESG Impact Ratings also suffered from the same ingrained income bias. The concern is that this systematic bias could be driving an inefficient allocation of capital, as money is being allocated to richer countries where the incremental impact may be lower than if it went to lower income countries that are effectively developing. Further analysis found that in our framework, some Emerging Markets (EMs) had a lower ESG Impact Rating compared to Developed Markets (DMs) but were outperforming relative to what was expected given their level of wealth.

Dynamic peer-grouping

When updating our sovereign ESG Impact Rating framework, we decided to address this challenge through the creation of peer groups. Benchmarking against peers in each group can reduce the ingrained income bias as we compare countries to those with a similar capacity to spend on relevant environmental and social issues, allowing for meaningful performance measurements relative to the peer group average instead of the entire universe of countries.

Our approach to peer grouping differs from that of much of the industry in several ways. Firstly, we do not construct peers based on closest ranked GNI per capita, but rather use the actual value for GNI per capita. Secondly, common practice is to have static peer groups (i.e. breaking the universe down into distinct quartiles or quintiles). Instead, we created dynamic peer groups, meaning that every country has its own unique peer group comprised of whichever countries have the most similar GNIs per capita. As a country's GNI per capita changes, so does the composition of its peer group.

We believe that, although more complex, this method allows us to overcome certain challenges arising from static peer groups. Namely, when grouping countries based on defined thresholds (e.g. quintiles, quartiles, etc.), we found that some countries were subject to hard boundary effects.

PODCAST

THE ELEPHANT IN THE ROOM: OVERCOMING BIODIVERSITY DATA CHALLENGES

A review of the vital role of biodiversity across social and economic dependencies has captured the attention of ESG investors

WHITE PAPER

DECARBONISATION: THEORY VS. REALITY

We explore why carbon footprint alone will not suffice for investors that want to support decarbonization and begin to offer outlines of an alternative.

Check out more ESG thought leadership and media spotlights at www.PGIMFixedIncome.com

For example, a country at the top of its static peer group in terms of GNI per capita could be performing better than the rest of its peer group. But if its GNI per capita increased slightly, it could move up to the next peer group and suddenly become that group's worst performer, even though there was no change in their actual ESG performance.

For example, Turkey and Bulgaria have a similar performance on the maternal mortality indicator. The absolute difference in the two countries' GNI per capita is also fairly small, but Turkey is currently near the top of the third quartile while Bulgaria is around the bottom of the second. Despite their similar performance on maternal mortality and incomes, Turkey ranks eighth in its quartile whereas Bulgaria ranks twentieth. Hypothetically, if Turkey became richer and moved into the second quartile or were Bulgaria to become poorer and fall into the third quartile, their ranking on this metric within their new quartiles would shift dramatically from their current ranking despite a maternal mortality performance that remains unchanged.

Is everything eer-grouped?

It's important to note that we do not apply peer grouping to every indicator in our framework. Instead, we analyze each data point to decide whether we need to adjust for the income levels of a country. In cases where a particular data point is highly influenced by the country's capacity to allocate resources to the theme, assessing performance relative to its peer group might be warranted to account for the ingrained income bias. For example, the life expectancy of a country is highly correlated with income. The country's number of doctors, hospital infrastructure, access to medicines, and quality of treatments are key drivers of life expectancy and are highly dependent on the country's available resources for healthcare. In these cases, it makes sense to compare countries against others with a similar capacity to spend to see which countries are better or worse at effectively deploying their available resources (i.e. which countries are "punching above / below their weight"). However, there are some indicators where peer grouping may not be appropriate given that they should not be driven mainly by income levels. For such indicators, there may still be some empirical correlation with income, but we do not believe in these cases that correlation implies causation (and/or the causation may be reversed, i.e. poor performance on the indicator explains lower incomes). For example, indicators under the Freedom and Rights theme will not be peer grouped in our updated framework despite some empirical correlation with income.

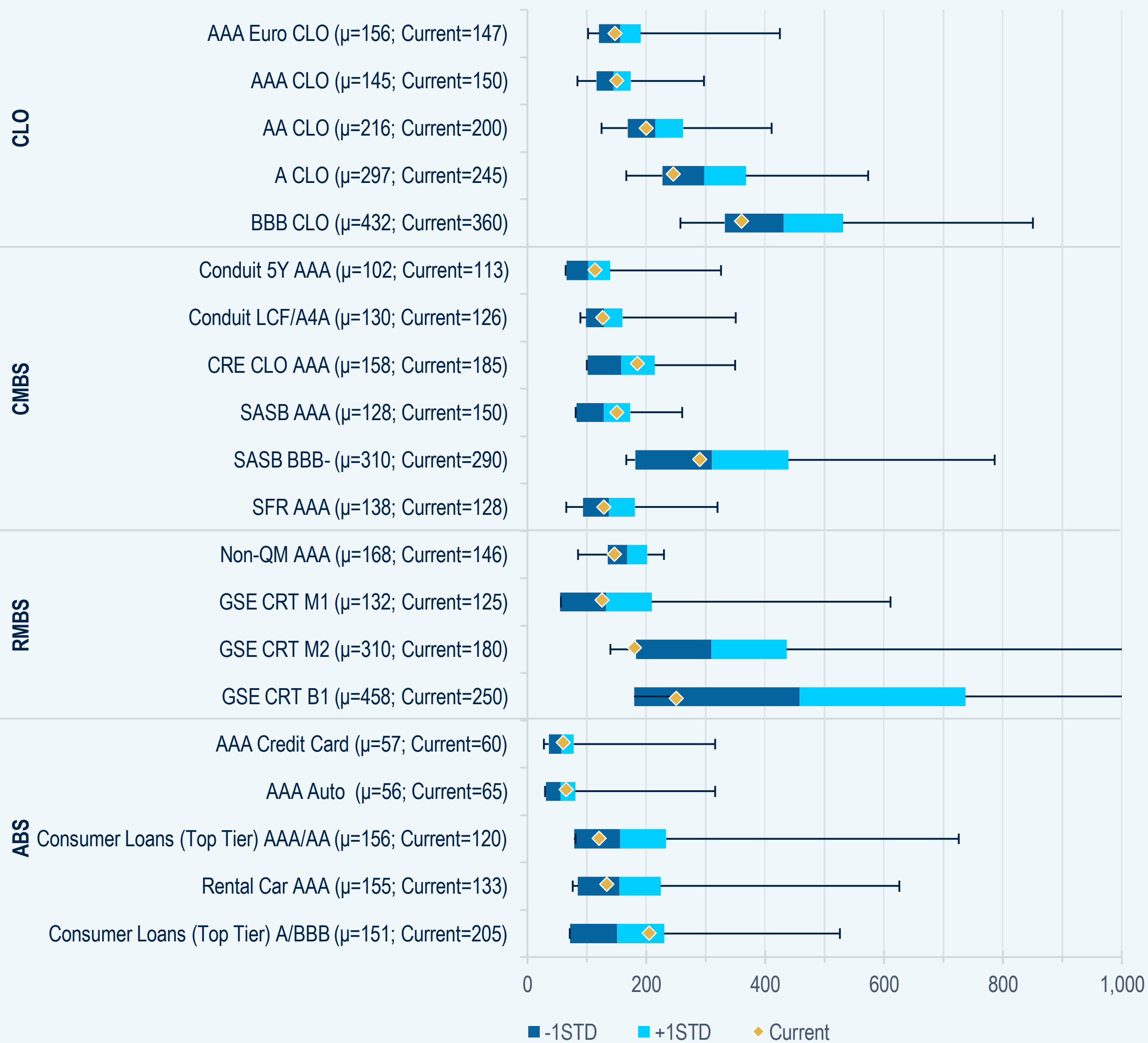
Overall, our approach to peer grouping has achieved what we intended: The correlation between our sovereign ESG Impact Ratings and GNI per capita is less than before but has not been eliminated completely. Instead, the best performing Emerging Markets are scoring higher than previously, thus getting the credit they deserve, and the worst performing Developed Markets have lower impact ratings than before.

SECURITIZED CREDIT

Outlook: We continue to favor tranches at or near the top-of-capital structure given their attractive relative and absolute risk-adjusted return potential. We expect spreads will remain rangebound, making "carry" the dominant theme in 2024. Down the capital structure, we have observed material credit curve flattening as spreads have rapidly tightened despite deteriorating credit performance in underlying assets. We attribute this spread compression to be driven largely by strong technicals as other risk markets have meaningfully rallied this year on the back of strong fixed income flows and a return of the need for yield. However, we do believe that the negative skew of returns in mezzanine tranches is not reflected in current spreads and are being much more selective in this environment. Notwithstanding this caution, we acknowledge that the current strong market technicals for fixed income assets could lead to further spread and further credit curve compression.

- In **CMBS**, higher interest rates have led to softness in capitalization rates, which will continue to pressure valuations in 2024. However, current CRE valuations better reflect the higher interest rate environment, and we are now closer to the trough in valuations. Our expectation is that property values will generally decline by about 20% peak to trough, but dispersion will abound with office likely to do the worst. AAA conduit bonds now trade fair to

Valuation perspective in securitized credit
(spreads in bps; μ refers to the set mean)



Source: PGIM Fixed Income

comparable corporate bonds, and we prefer seasoned AAA front pay securities over AAA last cashflows given their priority in the super-senior waterfall. We continue to see value in select single-asset single-borrower securities. While we expect 2024 issuance to rebound compared to last year, higher interest rates and a challenging financing environment are expected to keep activity suppressed.

- Home prices continue to benefit from strong technicals as existing homeowners with low mortgage rates stay in their homes. We remain constructive on **RMBS** performance, particularly credit risk transfer bonds backed by higher-quality, GSE seasoned collateral. However, we acknowledge mortgage delinquencies have ticked up slightly in FHA and non-qualifying mortgage pools—two of the lowest credit-quality segments of the mortgage market. We currently see value in RPL and second-lien bonds, which offer wider spreads than corporates and other non-agency securitized products.

- While bank loan spreads have been supported by low loan supply and strong demand, we expect to see some credit deterioration in the underlying **CLO** collateral via downgrades to CCC, increased default rates, and lower recovery rates. We expect higher interest costs to pressure loan issuers' free cash flows, leading to negative credit migration and more price volatility. Thus, we continue to broadly favor senior CLO tranches in the U.S. and in Europe but are also seeing total return opportunities in discount mezzanine bonds of seasoned deals in secondary market.

- In **ABS**, prime consumer credit remains resilient, while the effects of inflation and lower disposable income continue to weigh on the weakest consumer segments and is starting to weigh on the near-prime segment. Moreover, some specialty ABS originators were caught off guard by rapidly rising rates and higher-than-expected defaults, underscoring the importance of originator/servicer due diligence. We remain positive on spreads in the near term but are mindful of heavy supply headwinds into Q2. Looking forward, we expect increased banking regulation to lead to more opportunities via asset sales or regulatory transactions (i.e., significant risk transfer).

INVESTMENT GRADE CORPORATES

Outlook: Positive—although U.S. IG corporate spreads are tight, yields still appear attractive. Fundamentals are firm, demand is strong, and the pace of new issue supply is set to slow. U.S. spreads will be generally range-bound between +85 and +115 bps through the end of the year. Risk in global portfolios leans towards euro spreads given their wider levels.

■ While overall EBITDA declined in Q4'23, that was driven largely by the commodities sector; ex-commodities, EBITDA grew. Margins have stabilized, and leverage was up slightly with divergence among ratings categories as leverage improved for the Baa3/BBB- cohort even as it worsened for higher quality issuers. For 2024, estimates are for 11% earnings growth.

■ Currently, demand for **U.S. IG** from a breadth of investors remains strong. Pension plans are overfunded at ~105% of target, and their assets are expected to shift into fixed income as part of an overall de-risking strategy. Fixed annuity sales are on pace for over $250 billion per year (as of Q3 2023), and mutual fund inflows are tracking near the fastest pace we have seen over the last decade.

■ New issue supply is expected to slow from over $150 billion per month in the first quarter to less than $100 billion per month on average for the rest of the year, according to J.P. Morgan.

■ Currently, we prefer to position in shorter-maturity BBBs. We find the carry there to be attractive, and front-end spreads have lagged the broader market, adding to their relative attractiveness. We are cautious on longer maturities as credit curves have flattened significantly. The Long Corporate Index is in the tightest percentile of the last ten- and twenty-year periods. As such, positions in the long end tend to be focused on taxable-municipals, utilities, and credits that have specific catalysts—e.g., deleveraging commitments and/or potential ratings upside. In addition, we continue to favor banks and the more defensive electric utilities sector as both have lagged industrials, and we see room for those relationships to compress.

■ Potential risks to the IG market include tight valuations, geopolitical risks, above-target inflation, monetary policy uncertainty, interest-rate volatility, elevated equity market valuations, and mounting shareholder-friendly actions and M&A.

■ With the Q4 reporting season completed, European corporates maintained good fundamentals despite limited economic growth. EBITDA fell by 2.7% (q/q), driven by the healthcare and oil & gas sectors, while cash on balance sheets has been approaching pre-pandemic levels (on an inflation-adjusted basis). Conservative management has made the risk of significant downside economic misses in the future more of a tail risk than base case. Furthermore, the likelihood of energy price shocks stemming from the Russia/Ukraine war has been moving further into the tail, reflecting less of a need for a risk premium.

■ **European IG** spreads sit ~23 bps back from U.S., reflective of fair value. Spreads recently traded at the tightest levels since early 2023. which has helped bring opportunistic U.S. issuers back into the market. For the U.S./European dispersion to fully compress, additional clarity on the tail risks mentioned above would be needed.

■ To date, issuance has been ample and enthusiastically received by the market. In the primary markets, the technical backdrop is expected to remain supportive, with moderately higher issuance expected in 2024 than in 2023, resulting in a subtle increase in net supply.

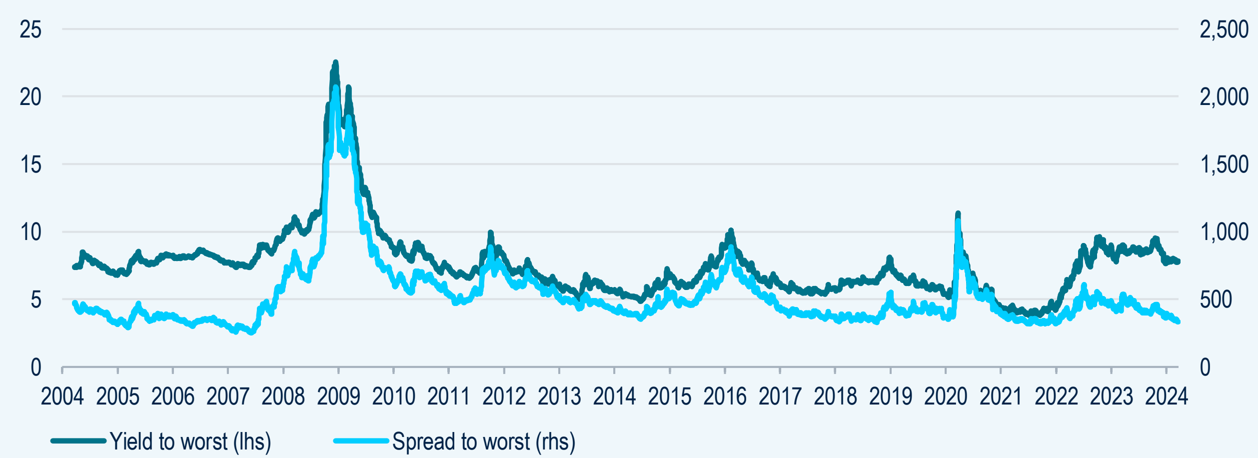
■ In terms of positioning, we are long market risk and neutral spread duration in the Euro funds, but notably have cut risk as spreads have rallied. In global corporates, we have a similar risk position with a minor underweight in spread duration and a moderate skew to having more risk in the Euro portion of our portfolio(s).

GLOBAL LEVERAGED FINANCE

Outlook: Constructive on a total return basis, more cautious on excess returns as economic headwinds and geopolitical risks are not adequately priced by the market. Technicals remain supportive over the shorter term. Credit dispersion should lead to more alpha-generating opportunities.

- The market's belief in an economic soft landing and a Fed pivot has pushed **U.S. high yield** spreads close to their post-GFC tights, and the positive technical backdrop may push spreads even tighter still. Nevertheless, we believe the market is currently underpricing global geopolitical risk, and, therefore, we maintain a slightly cautious outlook. That said, any geopolitical flare-up will likely provide an opportunity to add risk, as most recent events have caused only temporary spread widening.
- With BB and B rated spreads sitting at multi-year tights and fundamentals no longer on an improving trajectory, we believe there is limited upside to the higher-quality portion of the market at current valuations. We see more value in the CCC-and-below portion of the market where fundamentals appear to be improving, and, due to the idiosyncratic nature of the market, it is possible to generate alpha through careful credit selection.
- While the credit ratings profile of the high yield market is very strong by historical standards and balance sheets for high yield issuers remain solid (with leverage levels remaining well below the long-term average), higher costs are leading to some margin deterioration in certain sectors (e.g., media, transportation, chemicals).
- The lagged effects of higher policy rates and tighter lending standards remain headwinds to economic growth, and shrinking savings and slowing job growth will likely impact consumer confidence and spending. Should consumers pull back, downward pressures on corporate earnings and profit margins will increase. Higher interest expense has already led to some modest deterioration in coverage ratios—albeit from very high levels—and we expect that to continue in the coming quarters.
- Due to the strength of most issuer's balance sheets, the absence of a significant maturity wall through 2024, manageable (but higher) maturities in 2025, and the declining probability of a recession, we don't anticipate a sharp increase in default rates over the next 12 months. That said, the pace of credit ratings downgrades continues to increase, with downgrades outpacing upgrades so far in 2024.

While U.S. HY spreads hover near historical lows, yields generally remain near 8% (lhs: YTW %; rhs: STW)



Source: Bloomberg. ICE BofA U.S. High Yield Index..

- Meanwhile, the technical backdrop remains supportive due to a variety of factors, including muted new supply, a sizeable group of rising stars, and a growing share of below-investment grade companies opting to issue in the private credit markets. With positive technicals showing no signs of abating, our short-term outlook is modestly positive, and we are looking to take advantage of any market pullbacks to opportunistically add risk in the secondary market.

- We are maintaining overweights to home construction as well as the electric and independent energy sector names, while maintaining underweights in technology, retailers, consumer cyclical services, media & entertainment, wirelines, and property & casualty.

- Following the strong returns of Q1, we expect **U.S. leveraged loans** to post total returns of 7.5%-8.0% in 2024, supported by high all-in current coupons and yields, strong CLO formation, increased inflows into bank loan ETFs, and modest net new supply. Our return forecast includes an expected 1-2 point price depreciation either due to defaults and/or negative credit migration or continued repricing activity that leads to tighter spreads. As a result, there's upside risk to our forecast should the current market momentum continue for longer than expected and loan prices hold steady or rise further.

- Loan defaults rose above their long-term average in recent months amid rising corporate headwinds and higher interest rates. We expect the higher cost of capital to continue to pressure free cash flows in 2024—particularly for lower-quality, sponsor-owned companies with loan-only capital structures. Given that these types of issuers currently comprise a larger portion of the overall market than in prior cycles, we expect loan default rates (including distressed exchanges) to rise to 4-4.5% by year-end 2024 and cumulative defaults of 9-10% over the next 24 months.

- We continue to favor public, BB and high single-B loans over sponsor-owned, low single-B and CCC loans as we expect those lower-quality loans to be most impacted by the challenging fundamental backdrop. We believe that credit selection and deep, fundamental credit research/modeling is becoming increasingly important, and that the avoidance of defaults will be the biggest driver of alpha over the next 12–24 months.

- Spreads for **European high yield** and **European loans** tightened significantly in Q1 as markets priced in a lower probability of recession. While we expect spreads to remain rangebound in Q2 amid a lack of supply, we believe spreads are more at risk of widening as European economies continue to slow.

- An earnings recession and/or increased interest costs will erode fundamentals, and we expect to see a pickup in defaults over the next 12 months, but this should be relatively modest given the lack of near-term maturities, issuers' strong liquidity profiles, and the generally high credit quality within the market. Given this context, we are confident that excess returns will remain positive for the asset class in 2024 in most scenarios, save for a very severe recession (we assign a low probability to a severe recession).

- In terms of positioning, we are running market neutral levels of risk with reduced levels of risk in cyclical sectors, lower conviction credits, and credits that are sensitive to higher interest costs. We are also opportunistically adding carefully selected credits that have dislocated from fair value and present compelling relative-value opportunities. Ultimately, we think active management and accurate credit selection will be rewarded amid increased credit dispersion.

EMERGING MARKET DEBT

Outlook: Constructive on EM hard currency—particularly in a mix of BBB/BB issuers across EMD credit sectors and in select sovereign distressed issuers—against a backdrop of moderating growth and inflation. Given its high carry, EM debt looks attractive on a relative basis versus comparable asset classes, and mild spread tightening and/or declining core yields could raise total returns to double digits. Local market performance may be challenged unless the Fed begins cutting rates in either May or June and EM inflation data improves materially. We remain neutral on the U.S. dollar with a relative-value focus in currencies.

EM Hard-Currency Government Bonds

- As emerging markets economies remain resilient amidst a multi-year shock and markets continue to price in a soft landing, hard currency spreads have posted strong performance over the past two quarters. Generally attractive fundamentals, relative value, and positive technicals helped spreads tighten in spite of continued retail outflows. With spreads near their long-term average, we remain constructive given the macro backdrop of moderating growth and inflation and the increased likelihood of a soft landing (see our global economic scenarios). In this environment, high-carry opportunities should be in demand and EM debt looks attractive on a relative basis versus other comparable asset classes.

- Current yields (not yield-to-worst) alone are enough to generate attractive returns even if spreads or risk-free rates do not decline further, and even mild spread tightening and/or declining core yields could raise total returns to double digits. This return prospect, in the context of the current macro environment, underscores our investment thesis.

- We are seeing improvement in many sovereign fundamentals, particularly in the stressed and distressed portion of the market. While some of this has already been reflected in valuations, there is still plenty of room for these issuers to perform given the degree of spread widening that took place in EM high yield over the course of 2021 and 2022, and we believe the EM HY/IG spread compression can continue to play out in Q2.

- Within EM investment grade sovereigns, we have seen domestic buyers, as well as interest from U.S. investors after the asset class recently lagged U.S. IG corporates. This demand was instrumental to absorbing the $150 billion of EM HC issuance so far this year.

1-year Hard Currency expected return analysis

UST yield change	Spread change (bps): Widening ← 150	100	75	50	25	Unchanged 0	-25	-50	-75	Tightening → -100
100	-10.7%	-7.4%	-5.7%	-4.0%	-2.4%	-0.7%	1.0%	2.6%	4.3%	5.9%
50	-7.4%	-4.0%	-2.4%	-0.7%	1.0%	2.6%	4.3%	5.9%	7.6%	9.3%
0	-4.0%	-0.7%	1.0%	2.6%	4.3%	5.9%	7.6%	9.3%	10.9%	12.6%
-50	-0.7%	2.6%	4.3%	5.9%	7.6%	9.3%	10.9%	12.6%	14.2%	15.9%
-100	2.6%	5.9%	7.6%	9.3%	10.9%	12.6%	14.2%	15.9%	17.6%	19.2%
-150	5.9%	9.3%	10.9%	12.6%	14.2%	15.9%	17.6%	19.2%	20.9%	22.5%
-200	9.3%	12.6%	14.2%	15.9%	17.6%	19.2%	20.9%	22.5%	24.2%	25.9%

Nominal GDP Boom **9%**
Weakflation **25%**
Roaring 2020s **5%**
Soft landing **39%**
Recession **24%**

Source: PGIM Fixed Income

■ Our highest conviction positions are in a credit barbell: a mix of BBB/BB sovereigns, quasi-sovereigns and corporates, along with diversified idiosyncratic distressed sovereign issuers. The names we prefer in this crossover-ratings space are likely to be more resilient in a risk-off scenario. At one end of the barbell, we continue to prefer a mix of BB and BBB issuers, mainly in the belly of their respective curves. This exposure is supplemented with the elevated yields on the other, higher-beta end of the barbell, which consists of B and distressed issuers, mainly at the front of their respective curves.

■ Our largest single-country exposures in spreads continue to be Mexican quasi-sovereigns (Mexico City Airport and PEMEX), Middle Eastern Sovereign and Quasi-sovereign debt, Indonesia (both sovereigns and a mix of quasi-sovereigns), and Romania. This cohort is fundamentally solid, offers high yields, and should benefit from the tailwinds from infrastructure investment and nearshoring—particularly Mexico. We acknowledge that the U.S. election outcome could raise uncertainties related to Mexico, but we do not believe a second Trump presidency would have lasting negative consequences for the country. We don't foresee policy surprises as result of Mexico's presidential election in May.

■ Within the BB cohort, we continue to see strong relative value from a mix of solid and improving fundamentals and attractive absolute spreads in the Dominican Republic, Serbia, Ivory Coast, Colombia, and Brazil. We believe these issuers offer good value even if they are trading at the tighter end of their recent range.

■ Our exposure to B issuers is limited with a preference for Angola, Gabon, Egypt, and Senegal. We note that many issuers—particularly Egypt and Pakistan—rallied significantly following news of bilateral and multilateral inflows, along with market-friendly policy announcements. Our distressed exposure (CCC and defaulted) is primarily in front-end Pakistan, Zambia (defaulted), Ukraine (defaulted), Mozambique, and Ecuador. Within the defaulted issuers, we believe recoveries will be higher than what the market is currently pricing. For other distressed issuers, we believe downside risks have already been priced in, regardless of the macro context. Some issuers, such as Argentina, still face considerable challenges and are likely going to have to face a debt reckoning.

■ Our underweights are in issuers that we consider rich given our credit assessment (e.g., Malaysia, Philippines, Uruguay, Chile) or have geopolitical downside risk, such as China. Some issuers have credit rating downside risk due to credit deterioration, in particular Panama, but this seems to already have been reflected in prices and, as a result, we have covered most of our underweight in the name. We are watching elections in South Africa amid uncertainty about the post-election policy mix.

EM Hard-Currency Corporate Bonds

■ Although EM corporate spreads are well through their historical average and they have been outperforming developed markets, the spread pick-up versus developed markets and versus their own sovereigns is still relatively elevated.

■ The overall EM corporate yield of 7.0% for an average investment grade rated asset class will likely continue to drive healthy total returns for the sector

■ Meanwhile, EM corporate high yield has been a strong outperformer but is still attractive given resilient fundamentals. The maturity wall of 2025-2026 has been pushed out amid a strong new issue market and looser local financial conditions, and we expect EM corporate high yield defaults to remain within the historical range of 3-4% and in-line with developed markets. Non-dedicated EM investors remain under-invested in the asset class, and net financing will remain deeply negative, which is supportive of technicals.

■ With average spreads of +320 bps and +200 bps, respectively, we believe EM corporate BBs and select longer-dated BBBs currently offer the best value. EM corporate top performers this year have been from lower-rated countries such as Argentina, Ghana, and Ukraine but we believe this has mostly played out. There are several higher-yielding issuers in the chemicals, telecom, and metals & mining sectors that have recovered strongly from the lows, but we believe there could be some further upside given stabilizing fundamentals. Risks to the asset class include credit stress related to higher funding costs and/or a broader economic slowdown.

EM Local-Currency Government Bonds

■ After a strong start to the year, the rally in local rates faded as the market shifted its expectations from six rate cuts by the Fed to three. In addition, the latest core inflation prints in many EM countries either surprised to the upside or remain sticky, which has caused many EM central banks to turn more cautious.

- After being constructive on EM duration in Q1, we have recently downgraded our outlook. Unless the Fed begins its rate cutting cycle in either May or June and we see a material improvement in the EM inflation data, it will be challenging for the spot yields to beat the forwards.

- Our main overweights are in Mexico, Brazil, Poland, Hungary, China, and Thailand. We are underweight Chile and Czechia. The high real yields of Mexico and Brazil are attractive. For Mexico, as expected, the central bank recently cut rates by 25 bps to 11% to begin an easing cycle after raising the base rate to 11.25% and remaining on hold since February 2023. For Brazil, we believe the terminal rate currently priced into the curve is 50-75 bps too high. We also expect the National Bank of Poland to resume its easing.

- We have a small overweight in Hungarian local bonds to benefit from their relative cheapness to swaps. The economies of China and Thailand have yet to come out of their disinflationary trap as a result of the COVID lockdowns, and their local bonds offer very attractive FX hedged carry opportunities. On the underweight side, we believe too many cuts are priced in for Chile and Czechia and that navigating across the belly of the curve can help us partially mitigate the negative carry and roll down of our overweights.

- With respect to curve positioning, due to negative roll and carry considerations and elevated issuance, we expect the belly of the EM swap curves (5- to 7-year) to outperform both the front end and the long end. We have a steepening bias beyond seven years.

EM Currencies

- Going into Q2 we remain relative-value focused as our conviction in the direction of the U.S. dollar remains muted. We introduced a slight long U.S. dollar bias into the portfolios in mid-February on the back of a higher-than-expected U.S. CPI print, but the dollar failed to maintain its momentum, and our positioning is now back to being fully relative-value driven.

- This relative-value focus is structured as being regionally long in the Middle East and Africa, as well as Latin America, and short Europe and, to a lesser extent, Asia. In individual currencies, we favor longs in the Mexican peso (carry/vol, growth), the Philippine peso (carry/vol), the Indonesian rupiah (carry/vol), and the Brazilian real (carry, BoP). We favor shorts in Hungarian forint (aggressive cuts, political interference w/NBH), Czech koruna (aggressive cuts), Chinese yuan (low carry), and Taiwan dollar (low carry).

- As long as the low volatility environment and soft landing narrative persists, we believe select high carry currencies will continue to outperform select low carry currencies. Our conviction in the direction of the U.S. dollar may increase if 1) developments in Q2 (lower inflation) cause the Fed to cut earlier than expected (USD weaker), 2) growth in Europe and China starts to outperform (USD weaker), 3) U.S. inflation proves sticky, causing the Fed to become more cautious and the market prices out the remaining three cuts in 2024 (USD stronger), or 4) there is an abrupt and meaningful deterioration in the U.S. labor market (USD stronger).

MUNICIPAL BONDS

Outlook: Positive positioning. Our view is based on the economy's resilience regarding state and local government tax receipts as well as expectations for capital gains tax receipts due to the strong performance of the stock market in 2023. This is balanced against a likely slowdown in reinvestment activity and potential uncertainty in supply.

- In Q1, munis outperformed Treasuries, leaving relative values stretched. While spreads in the municipal bond market have tightened ~15-20 bps, they have not returned to pre-lift off levels, which is the case in U.S. IG corporate spreads.

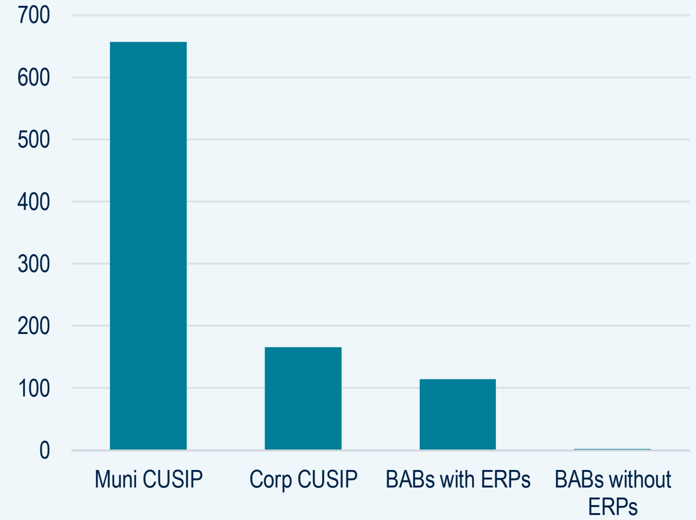
- We believe the rangebound rates market (see DM rates section) should help maintain retail asset flows into municipal fund complexes, thereby keeping spreads and relative value on the richer side. However, we believe this will also bring issuers back to the market after years of underinvestment (e.g., healthcare issuers).

- Tax-exempt supply surprised to the upside with issuance in January and February reaching ~$64 billion, the highest since 2007. Although taxable muni supply continues to be light, the asset class still offers value relative vs. traditional corporates and tax-exempt munis.

- **Supply uncertainty:** Taxable muni bonds issues under the Build-America-Bond (BABs) program may have significant ramifications in terms of supply in both the taxable and tax-exempt muni markets. These bonds were issued with call provisions triggered by reductions to their associated government subsidies. Bondholders have attempted, unsuccessfully, to contest these calls (e.g., a nearly $1 billion UCal deal). Supply expectations at the start of the year did not account for the call activity that may convert this taxable paper into tax-exempt paper. Estimates for additional tax-exempt issuance based on these calls may be more than $30-$60 billion (+15%).

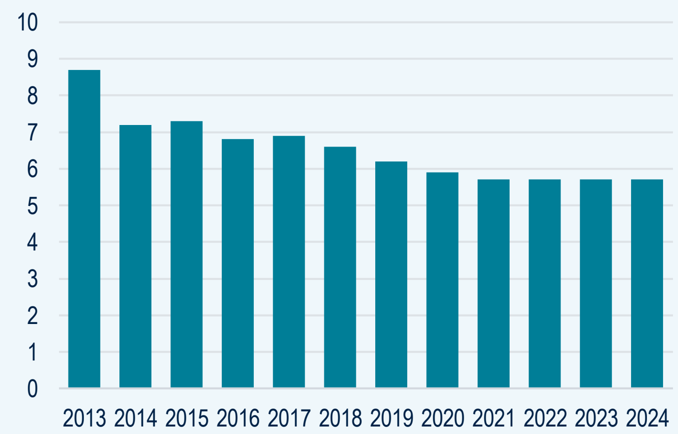
- Should market weakness materialize over the coming months, we will seek to opportunistically increase credit and/or interest rate risk, depending on where the "cracks form." We continue to like sectors where both credit and demand have been resilient—i.e., airports, charter schools, prepay gas, and Puerto Rico (PREPA will be entering the index at 1.7%). We are more cautious on healthcare, private higher education, and development sectors.

Taxable muni market
(by type, USD billions)



Source: Barclays Research, Bloomberg.

ERP subsidy cuts
(% by year)



Source: Barclays Research and IRS as of March 2024.

SECTION 5

SUMMARIES

05

SUMMARY OF OUTLOOKS & ASSET CLASS VIEWS

This summary consists of our short- and long-term (1-yr) sector outlooks. The latter is based on a scale of 1-10 and indicates our expectation for the sector's excess return relative to its broader, regional fixed income market (which is assigned its own 1-10 market score in the box to the right). A sector score of 1 represents an expectation for it to vastly underperform the market, and 10 indicates an expectation for the sector to vastly outperform the market.[1]

NEGATIVE VIEW POSITIVE VIEW

Market Scores

U.S.

Europe

EM

Sector	Short-term Outlook	Long-term (1-yr) Outlook[1]
DM Rates	Maintaining a tactical approach to range-bound Western markets, while the BoJ's end of the negative-policy rate era highlights the potential for higher JGB yields.	U.S. UK Europe Japan
Agency MBS	Positive expectations on eventual rate cuts and on excess returns vs. Treasuries. We continue to express this view in specified pools amid better prepayment speeds vs. TBAs. Intermediate coupons appear attractive due to yield and carry as well as better convexity profiles than higher coupons.	Agency MBS
Securitized Credit	We continue to favor tranches at or near the top-of-capital structure given their attractive relative and absolute risk-adjusted return potential. We expect spreads will remain rangebound, making "carry" the dominant theme in 2024. Down the capital structure, we have observed material credit curve flattening as spreads have rapidly tightened despite deteriorating credit performance in underlying assets. We attribute this spread compression to be driven largely by strong technicals as other risk markets have meaningfully rallied this year on the back of strong fixed income flows and a return of the need for yield. However, we do believe that the negative skew of returns in mezzanine tranches is not reflected in current spreads and are being much more selective in this environment. Notwithstanding this caution, we acknowledge that the current strong market technicals for fixed income assets could lead to further spread and further credit curve compression.	CMBS ABS CLOs
Global IG Corporates	Positive—although U.S. IG corporate spreads are tight, yields still appear attractive. Fundamentals are firm, demand is strong, and the pace of new issue supply is set to slow. U.S. spreads will be generally range-bound between +85 and +115 bps through the end of the year. Risk in global portfolios leans towards euro spreads given their wider levels.	U.S. Corps. 1-10 European Corps. 1-5 U.S. Corps. 10+ European Corps. 5+
Global Leveraged Finance	Constructive on a total return basis, more cautious on excess returns as economic headwinds and geopolitical risks are not adequately priced by the market. Technicals remain supportive over the shorter term. Credit dispersion should lead to more alpha-generating opportunities.	U.S. High Yield 1-5 Euro High Yield BB U.S. High Yield 5+ Euro High Yield B and below U.S. Leveraged Loans Euro Leveraged Loans
EM Debt	Constructive on EM hard currency against a backdrop of moderating growth and inflation. Given its high carry, EM debt looks attractive on a relative basis versus comparable asset classes, and mild spread tightening and/or declining core yields could raise total returns to double digits. Local market performance may be challenged unless the Fed begins cutting rates in either May or June and EM inflation data improves materially. We remain neutral on the U.S. dollar with a relative-value focus in currencies.	Sov. Hard Currency IG EMFX[2] Sov. Hard Currency HY Corps. IG Local rates[2] Corps. HY
Municipal Bonds	Positive positioning. Our view is based on the economy's resilience regarding state and local government tax receipts as well as expectations for capital gains tax receipts due to the strong performance of the stock market in 2023. This is balanced against a likely slowdown in reinvestment activity and potential uncertainty in supply.	Taxable

[1] The positioning in a respective portfolio may not be identical to the long-term ratings. The ratings and information herein is for comparison purposes.
[2] The scores on the indicated asset classes are on an absolute basis; i.e., the expectations for risk-adjusted market returns are embedded within the asset class specific returns.

SUMMARY OF MARKET PERFORMANCE

Sector		Subsector	Spread change (bps) Q1	SOFR OAS 3/31/24
CMBS	CMBS: Conduit AAA	First-pay 10-year	-31	126
	CMBS: Conduit BBB-	BBB-	-132	785
	CMBS: SASB – Senior	AAA	-50	150
	CMBS: SASB – Mezz	BBB-	-150	290
	CMBS: Agency Multifamily	Senior	-10	86
Non-Agency RMBS	Legacy	RPL Senior	-26	147
	Legacy	'06/'07 Alt-A	-25	235
	GSE Risk-Sharing	M2	-30	180
CLOs	CLO 2.0	AAA	-13	150
	CLO 2.0	AA	-30	200
	CLO 2.0	BBB	-65	360
ABS	Unsecured Consumer Loan ABS	Seniors	-62	120
	Unsecured Consumer Loan ABS	Class B	-67	170
	Refi Private Student Loan	Seniors	-52	135
	Credit Card ABS	AAA	-32	60

Source: PGIM Fixed Income.

	Total Return (%)		Spread Change (bps)		OAS (bps)
	Q1	YTD	Q1	YTD	3/31/24
U.S. Corps.	-0.40	-0.40	-9	-9	90
European Corps.	0.47	0.47	-24	-24	114

Source: Bloomberg. Represents data for the Bloomberg U.S. Corporate Bond Index and the Bloomberg European Corporate Bond Index (unhedged).

	Total return (%)		Spread / yield change (bps)		OAS (bps)/ yield %
	Q1	YTD	Q1	YTD	3/31/24
EM Hard Currency	2.04	2.04	-42	-42	342
EM Local (Hedged)	0.20	0.20	8	8	6.27
EMFX	-1.12	-1.12	-87	-87	8.06
EM Corps.	2.32	2.32	-36	-36	276

Source: J.P. Morgan.

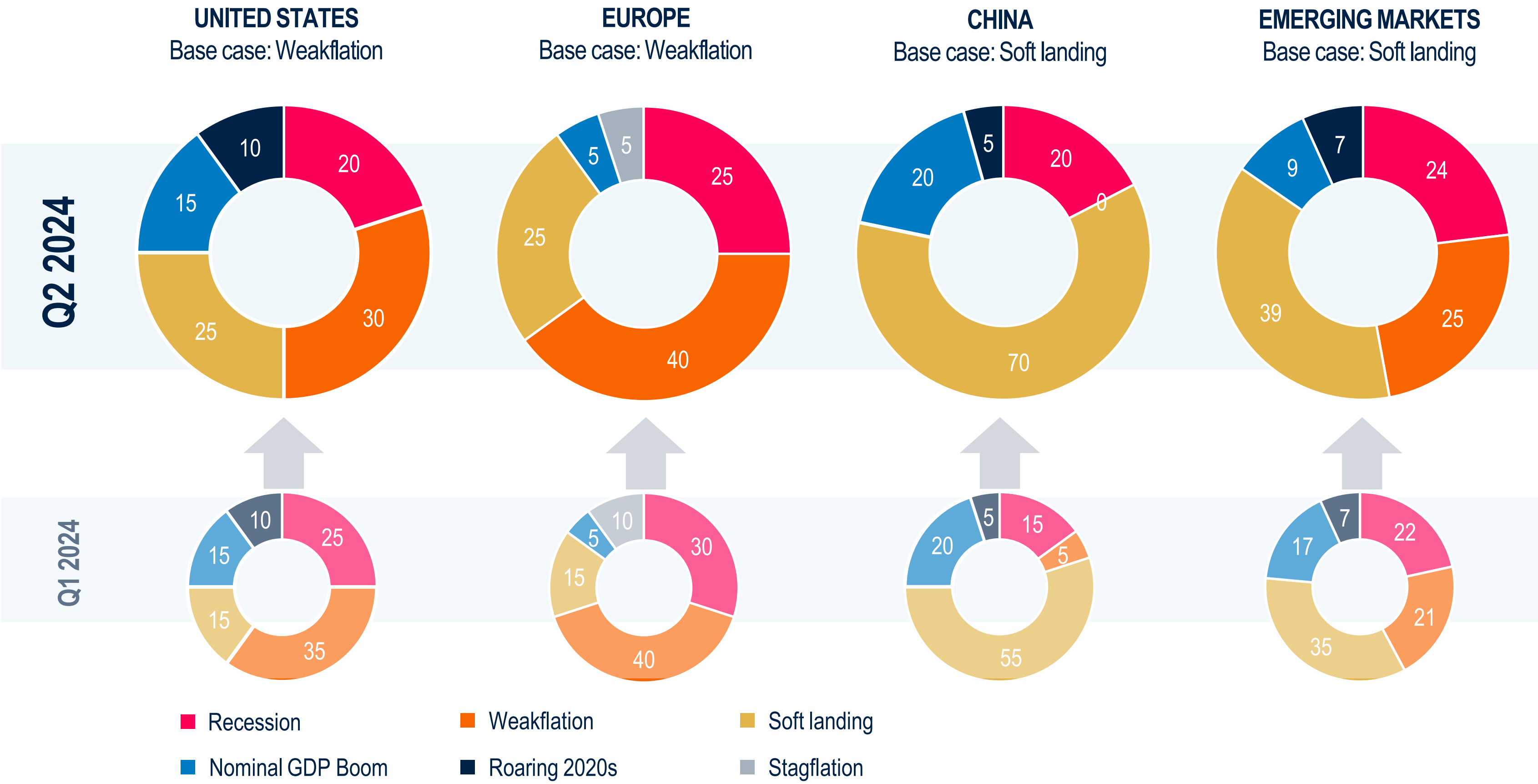
	Total return (%)		Spread change (bps)		OAS/ DM (bps)
	Q1	YTD	Q1	YTD	3/31/24
U.S. High Yield	1.47	1.47	-24	-24	323
Euro High Yield	1.81	1.81	-41	-41	399
U.S. Leveraged Loans	2.52	2.52	-18	-18	520
Euro Leveraged Loans	2.53	2.53	-20	-20	514

Source: ICE BofAML and Credit Suisse.

	Total return (%)	
	Q1	YTD
High Grade Tax-exempt	-0.39	-0.39
High Yield Tax-exempt	1.51	1.51
Long Taxable Munis Agg. Eligible	-0.26	-0.26

Source: Bloomberg. Represents the Bloomberg Municipal Bond Indices.

FORECASTED ECONOMIC SCENARIOS
BY REGION (%)



Source: PGIM Fixed Income forecasts. Note: Probabilities for emerging markets may not sum to 100% due to rounding. For emerging markets, we assume a 'global growth' scenario by taking a weighted average of the U.S., Europe, and China using the following weights: U.S. (40%), Europe (10%) and China (50%).

IMPORTANT INFORMATION

Source(s) of data (unless otherwise noted): PGIM Fixed Income, as of **April 2024**.

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INDEX DESCRIPTIONS

U.S. INVESTMENT GRADE CORPORATE BONDS

Bloomberg U.S. Corporate Bond Index: The Bloomberg U.S. Investment Grade Corporate Bond Index covers U.S.D-denominated, investment-grade, fixed-rate or step up, taxable securities sold by industrial, utility and financial issuers. It includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. Securities included in the index must have at least 1 year until final maturity and be rated investment-grade (Baa3/ BBB-/BBB-) or better using the middle rating of Moody's, S&P, and Fitch.

EUROPEAN INVESTMENT GRADE CORPORATE BONDS

Bloomberg European Corporate Bond Index (unhedged): The Bloomberg Euro-Aggregate: Corporates bond Index is a rules-based benchmark measuring investment grade, EUR denominated, fixed rate, and corporate only. Only bonds with a maturity of 1 year and above are eligible.

U.S. HIGH YIELD BONDS

ICE BofAML U.S. High Yield Index: The ICE BofAML U.S. High Yield Index covers US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, and at least one year remaining term to final maturity as of the rebalancing date.

EUROPEAN HIGH YIELD BONDS

ICE BofA European Currency High Yield Index: This data represents the ICE BofA Euro High Yield Index value, which tracks the performance of Euro denominated below investment grade corporate debt publicly issued in the euro domestic or eurobond markets. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P, and Fitch). Qualifying securities must have at least one year remaining term to maturity, a fixed coupon schedule, and a minimum amount outstanding of €100 M. ICE Data Indices, LLC, used with permission.

U.S. SENIOR SECURED LOANS

Credit Suisse Leveraged Loan Index: The Credit Suisse Leveraged Loan Index is a representative, unmanaged index of tradable, U.S. dollar denominated floating rate senior secured loans and is designed to mirror the investable universe of the U.S. dollar denominated leveraged loan market. The Index return does not reflect the impact of principal repayments in the current month.

EUROPEAN SENIOR SECURED LOANS

Credit Suisse Western European Leveraged Loan Index: All Denominations EUR hedged. The Index is a representative, unmanaged index of tradable, floating rate senior secured loans designed to mirror the investable universe of the European leveraged loan market. The Index return does not reflect the impact of principal repayments in the current month.

EMERGING MARKETS U.S.D SOVEREIGN DEBT:

J.P. Morgan Emerging Markets Bond Index Global Diversified: The Emerging Markets Bond Index Global Diversified (EMBI Global) tracks total returns for U.S.D-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. To be deemed an emerging market by the EMBI Global Diversified Index, a country must be rated Baa1/BBB+ or below by Moody's/S&P rating agencies. Information has been obtained from sources believed to be reliable, but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval.

EMERGING MARKETS LOCAL DEBT (UNHEDGED)

J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index: The Government Bond Index-Emerging Markets Global Diversified Index (GBI-EM Global) tracks total returns for local currency bonds issued by emerging market governments.

EMERGING MARKETS CORPORATE BONDS

J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified: The CEMBI tracks total returns of U.S. dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries.

EMERGING MARKETS CURRENCIES

J.P. Morgan Emerging Local Markets Index Plus: The JP Morgan Emerging Local Markets Index Plus (JPM ELMI+) tracks total returns for local currency–denominated money market instruments.

MUNICIPAL BONDS

Bloomberg Municipal Bond Indices: The index covers the U.S.D-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. The bonds must be fixed-rate or step ups, have a dated date after Dec. 13, 1990, and must be at least 1 year from their maturity date. Non-credit enhanced bonds (municipal debt without a guarantee) must be rated investment grade (Baa3/BBB-/BBB- or better) by the middle rating of Moody's, S&P, and Fitch.

U.S. TREASURY BONDS

Bloomberg U.S. Treasury Bond Index: The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index.

MORTGAGE BACKED SECURITIES

Bloomberg U.S. MBS—Agency Fixed Rate Index: The Bloomberg U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

COMMERCIAL MORTGAGE-BACKED SECURITIES

Bloomberg CMBS: ERISA Eligible Index: The index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974, which will deem ERISA eligible the certificates with the first priority of principal repayment, as long as certain conditions are met, including the requirement that the certificates be rated in one of the three highest rating categories by Fitch, Inc., Moody's Investors Services or Standard & Poor's.

U.S. AGGREGATE BOND INDEX

Bloomberg U.S. Aggregate Bond Index: The Bloomberg U.S. Aggregate Index covers the U.S.D-denominated, investment-grade, fixed-rate or step up, taxable bond market of SEC-registered securities and includes bonds from the Treasury, Government-Related, Corporate, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS sectors. Securities included in the index must have at least 1 year until final maturity and be rated investment-grade (Baa3/ BBB-/BBB-) or better using the middle rating of Moody's, S&P, and Fitch.

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