PGIM INVESTMENTS

ACTIVELY CAPITALISING ON A NEW MARKET REGIME

Investment implications and opportunities amid new macro realities

Markets rebounded in 2023 as central banks signaled an impending conclusion to the interest-rate hiking cycle. While resilience and moderating inflation have been prominent economic themes, heightened geopolitical risks and softening consumer trends add uncertainty to the outlook. Against a backdrop that warrants selectivity and the flexibility to act as conditions evolve, PGIM asset managers highlight key trends set to shape 2024 and identify opportunities that they believe show significant promise.

EXPLORE 2024 INVESTMENT THEMES

1 FIXED INCOME	2 EQUITIES	3 EQUITIES
Fixed income enters golden age →	New secular growth cycle accelerates →	Decarbonisation efforts intensify →
4 EQUITIES	**5 ALTERNATIVES**	**6 ALTERNATIVES**
Consolidation drives REIT rebound →	Private real estate benefits from deep discounts →	Private credit profits as banks retreat →

ATTRACTIVE INVESTMENT IDEAS

	THEME	RATIONALE	ASSET CLASSES TO CONSIDER
FIXED INCOME	EXTEND DURATION	With the Fed hike cycle nearing an end and markets pricing in rate cuts in 2024, investors may benefit from extending duration now and locking in higher rates.	• Multi-sector bonds • Intermediate bonds
	SEEK HIGH-QUALITY RELATIVE VALUE OPPORTUNITIES	Extreme volatility since 2022 has compressed valuations across fixed income sectors, creating attractive relative value opportunities in key spread sectors.	• High yield bonds • Emerging market debt
EQUITIES	FOCUS ON STRUCTURAL TRENDS WITH RESILIENT DEMAND	Major transformative changes are afoot globally in areas with resilient demand and growth that do not rely on the economic environment. Structural changes, including digitalisation, demographic, and decarbonisation trends, are changing the investment landscape across industries.	• U.S growth stocks • Global equities • Emerging market equities • Thematic equities • Public REITs
ALTERNATIVES	DIVERSIFY WITH ALTERNATIVE RETURN SOURCES	Public markets are vulnerable to short-term market noise with prices often overshooting to the downside based on shifting investor sentiment. Private markets benefit from a longer-term view and less frequent mark to market, often providing investors a smoother ride.	• Private real estate • Private credit

FIXED INCOME ENTERS GOLDEN AGE

Bullish on bonds as new paradigm emerges

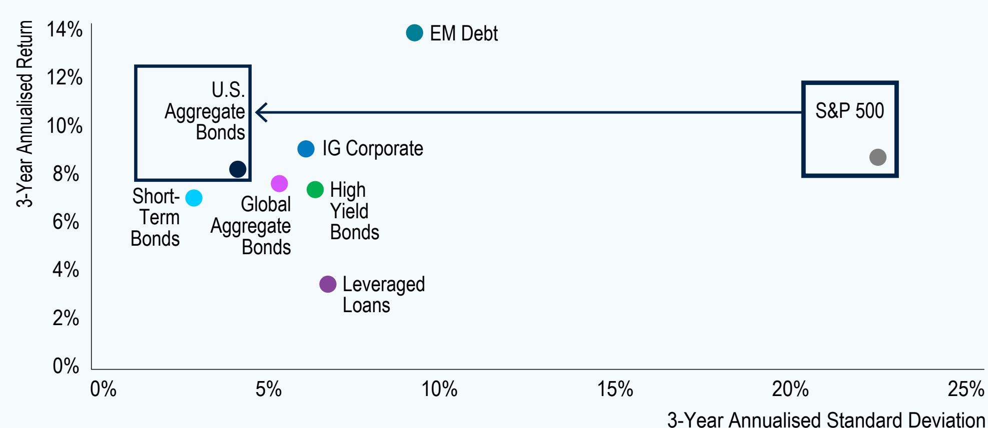
GREGORY PETERS
Co-Chief Investment Officer
PGIM Fixed Income

The end of the Great Moderation is introducing an era of volatility in growth and inflation. Investors are adjusting to the contours of the new global paradigm, but ultimately, a new regime of higher bond yields makes fixed income assets attractive for long-term investors.

Global economy: Despite mounting macro challenges, the global economy has managed to remain resilient. In the U.S., weakflation—the combination of weak growth and elevated but falling inflation—remains our base case. We expect real GDP growth of between 1.0-1.5% and inflation to descend to 2.5-3% in 2024.

In the euro economy, we see headwinds from higher global interest rates, high energy prices, and persistent inflation as ongoing challenges and expect a mild contraction before some improvement in 2024. In China, our expectations of increasing fiscal stimulus are now materialising, supporting our still-above consensus GDP forecast.

Bonds provide better risk-adjusted returns vs. stocks after rate hike cycles



Source: Morningstar. Average returns following the end of each of the past four Fed rate hike cycles (end dates used: 1/2/1995, 16/5/2000, 29/6/2006, 19/12/2018). U.S. Aggregate Bonds = Bloomberg U.S. Aggregate Bond Index, Short-term Bonds = Bloomberg Credit 1-5 Year Index, Global Aggregate Bonds = Bloomberg Global Aggregate Index, Leveraged Loans = Credit Suisse Leveraged Loan Index, High Yield Bonds = Bloomberg U.S. Corporate High Yield Index, U.S. Treasury = Bloomberg U.S. Treasury Index, IG Corporate = Bloomberg U.S. Credit Index, EM Debt = JP Morgan EMBI Diversified Index. **Past performance does not guarantee future results.**

Interest rates: With interest rates now near multi-year highs and economic growth and inflation finally moderating, we're likely near the end of central bank rate-hiking cycles. While we expect the Fed to implement ~50 basis points of "fine-tuning" rate cuts in 2024, the economy's neutral long-run interest rate may gravitate to the 3.0% area (up from previous estimates of 2.5%).

Fixed income outlook: Despite a challenging macro environment, we believe we're entering a golden age in fixed income investing. The traditional characteristics of fixed income investing—roll, carry, and income—are moving to the fore. Bonds play a key role in long-term portfolio allocations, and higher yields allow them to reassert their roles as critical income provider and equity market diversifier. These aspects can generate performance that meets or exceeds investors' objectives. Furthermore, if economies hit a surprise air pocket, ample room now exists for yields to decline and provide an additional boost to returns.

Broadening dispersion brings alpha opportunities

Increased credit dispersion adds to alpha-generating opportunities. A broad range of fixed income sectors appear well positioned for solid risk-adjusted returns over the long term, creating a constructive outlook for adding value through active management. But as elevated macro uncertainty remains, we prefer to stay up in quality and to avoid leveraged structures that are vulnerable to high interest rates. Key investment ideas for 2024 include:

Step out of cash: Many investors spent most of 2023 on the sidelines given rising interest rates and mounting macro uncertainty. An unexpected shock or a continuation of rate normalisation in 2024 could push short-term yields downward. Shorter duration assets may provide more attractive income with a cushion against further volatility.

Extend duration: Yields have retreated from recent highs in the aftermath of recent geopolitical events. While too early to know for sure, we could be entering a protracted normalisation period, offering investors a short window of opportunity to lock in higher rates for the long term.

Seek high-quality relative value opportunities: Extreme volatility since 2022 has compressed valuations across fixed income sectors, creating attractive relative value opportunities in key spread sectors such as high yield bonds and emerging market debt. After central banks abandoned their outsized rate hikes, credit sectors have seen improved performance—a trend we generally expect to continue to benefit diversified fixed income portfolios.

NEW SECULAR GROWTH CYCLE ACCELERATES

Fundamentals come back in focus for global equities

MARK BARIBEAU, CFA
Head of Global Equities
Jennison Associates

Moderating market expectations: Moderating inflation should ease rate hike pressure from central banks. Bouts of volatility are expected as markets adjust to "higher-for-longer" realities, but a large part of repricing should be behind us if no big surprises unfold. The global economy has shown resilience thus far, but is pointing to a slowdown in 2024. If a recession can be avoided, we believe equities should fare well, albeit with more modest returns than 2023.

Balanced setup for 2024: Investors should shift their focus to fundamental drivers of equity returns as rates appear to have peaked and tightening policy nears its end. Although equity markets have largely priced in the new rate realities, valuations still remain below historical averages, creating a balanced setup of valuations going forward. Earnings growth appears to have troughed and is signaling a recovery in 2024. The recent artificial intelligence (AI) boom seems to have lifted the tech sector out of its recession as well. Historically, growth stocks (which tend to have more organic growth sources that are less vulnerable to economic conditions) have outpaced value stocks (which tend to be more sensitive to the business cycle) during periods of subpar economic growth. Stocks with durable earnings growth become more attractive as the broader economy slows, which should bode well for growth stocks as the economy slows.

Actively embrace disruptive innovation: Today's innovative secular themes are both disruptive and resilient to macro conditions, with AI driving revolutionary change across most industries. Finding the right balance between emerging growers and stable growers is critical, as well as the ability to look past market volatility to the top beneficiaries of secular disruption.

Biggest secular growth themes for 2024 and beyond

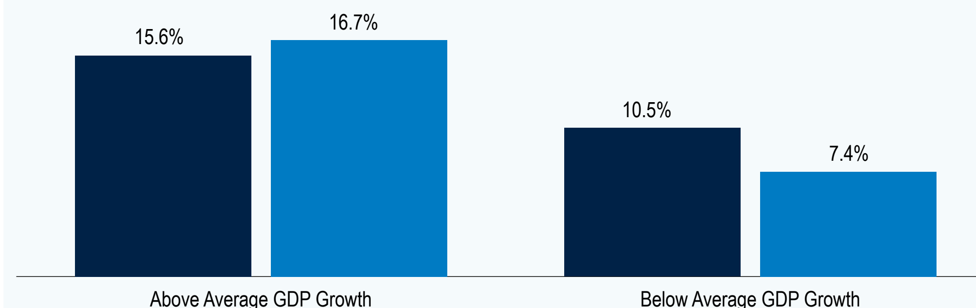
Advanced technologies: AI and cloud computing continue to revolutionise industries, amplifying demand for increasingly intelligent software and infrastructure.

Global consumer: Large, younger demographic populations with healthy disposable incomes are reshaping consumption patterns and generating persistent demand for luxury goods.

Industrial automation: A boom in manufacturing and high-tech facilities leveraging AI is driving revolutionary automation of industrial processes to enhance efficiencies.

Transformative mobility: Evolving structural trends in electric vehicles, autonomy, and mobility-on-demand are creating new mobility ecosystems to transport people and goods more efficiently.

Growth beats value in below-average economic growth environments



Source: FRED, Morningstar. Based on average annual data for real GDP from 1979-2022. Growth represented by Russell 1000 Growth Index. Value represented by Russell 1000 Value Index. **Past performance does not guarantee future results.**

Fintech platforms: Consumers are rapidly embracing powerful financial technology platforms, particularly in areas where sophisticated financial systems are limited.

Healthcare innovation: An innovation cycle marked by advanced research capabilities, game-changing therapies, and digital supply chains is fostering demand for more integrated healthcare ecosystems.

DECARBONISATION EFFORTS INTENSIFY

Broad opportunities in an evolving journey to a low carbon economy

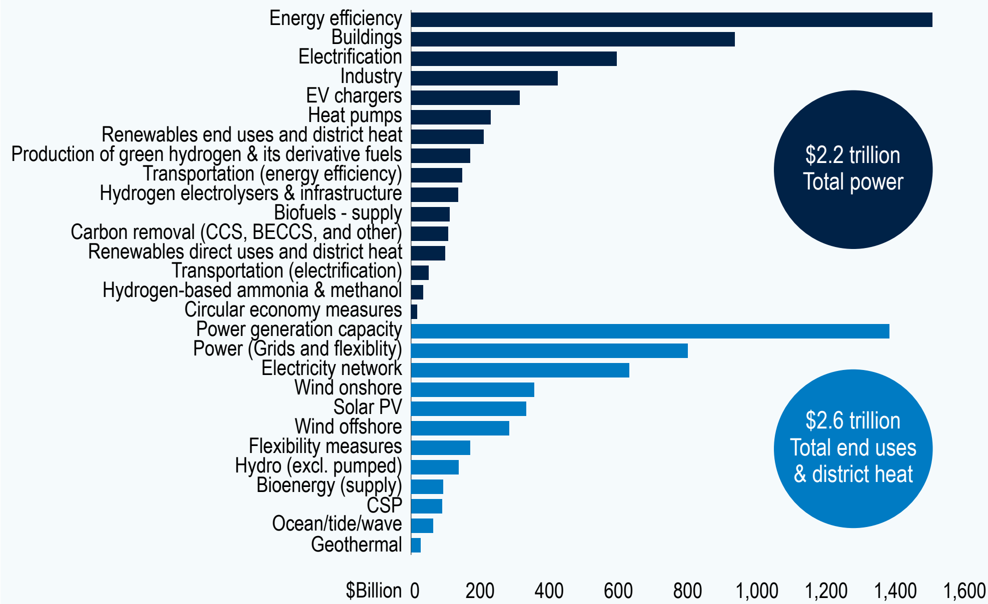
JAY SAUNDERS
Carbon Solutions Strategy
Portfolio Manager
Jennison Associates

The magnitude of the mission

The transition to a lower-carbon global economy is a mammoth undertaking requiring massive spending over an extended period to redefine humankind's relationship with energy. As megatrends go, decarbonisation is virtually without peer in terms of the magnitude of the related investment opportunity given the far-reaching effort needed to accomplish the carbon-reduction revolution's goals.

In 2022, there was a record $1.1 trillion spent in global energy transition investments towards decarbonisation. Global investments across all transition technologies need to average $5.3 trillion annually from 2023 to 2050 to remain on the pathway that limits global warming to 1.5ºC. The large gap showcases the need to accelerate the mission by quadrupling investments—a massive undertaking that countries around the world are starting to plan for.

For instance, the Inflation Reduction Act (IRA) in the U.S. plans to fund triple its investment toward climate technologies and energy infrastructure over the next decade. In Europe, the "Fit for 55" initiative targets reducing net greenhouse gas emissions by at least 55% by 2030, an effort that will also require significant capital expenditure. China, the largest greenhouse gas emitter, is also the world leader in global energy transition investments.



Source: Statista, Bloomberg NEF as of June 2023.

A comprehensive commitment is required

The energy transition represents a tectonic shift in supply and demand that goes far beyond power and transportation. Given the transformation's massive scope, a full pivot is expected to take a very long time. For example, meeting carbon-reduction goals will require overhauling existing infrastructure and modernising buildings and factories across the global supply chain. As renewable energy use rises, demand will grow for a different set of commodities, including lithium, copper, cobalt, and nickel, due to their status as key inputs for the transition to cleaner technologies. In addition, technology required to improve efficiencies, reduce costs, and store energy from alternative sources, such as wind, solar, and hydrogen, will need to evolve over time.

Early stages of a multi-decade megatrend

The transition to a low-carbon global economy will be a multi-decade, multi-trillion dollar endeavour. The magnitude of the opportunity for investors is huge and the scale of the changes required to move from where we are today to a low-carbon economy is going to require every sector and every part of the world to re-engineer themselves. From rethinking basic materials to cutting-edge technology, ongoing carbon-reduction efforts are poised to upend industries and inspire motivation on a level that remains largely underappreciated.

The recent drastic shift in commodity market supply and demand dynamics will undoubtedly pave the way for new winners to emerge in the renewable energy space. At the same time, the opportunity set among oil and gas companies will also evolve as more mature companies race to keep up with sustainability trends and changes in the supply chain.

As the energy transition evolves, so will the opportunity set, and this should provide fertile ground for fundamental investors. We expect the pursuit of carbon-reduction goals to drastically alter a wide range of industries, including electricity generation and transmission, building infrastructure, vehicles, industrial users, forestry, and agriculture. At the same time, we do not expect fossil fuels to be fully replaced. In these early innings of the energy transition, we believe the opportunity is most compelling among companies that are positioned to help drive this transition and keep up with changes in the supply chain.

CONSOLIDATION DRIVES REIT REBOUND

Divergence across regions and sectors creates opportunities

RICK J. ROMANO, CFA
Head of Global Real Estate Securities
PGIM Real Estate

As the real estate market has been adjusting to elevated interest rates, valuations have significantly compressed, although the magnitude varies widely by region.

Americas: We believe we are nearing the end of the current rate cycle and the recent headwind will shift into a tailwind throughout 2024. The U.S. REIT market has a demonstrated record of outperformance after the conclusions of past tightening cycles. Moreover, given today's low supply risk and strong secular demand trends, fundamentals are likely to remain resilient even if economic growth softens.

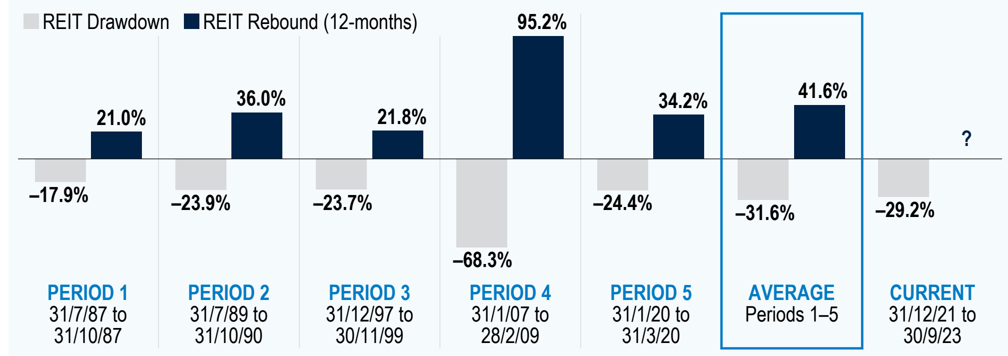
Europe: Companies with weak balance sheets remain on near-record discounts to net and gross asset values, as they are still exposed to refinancing risk and falling cash flows. Cap rates moved up since late 2022 in response to major upward moves in bond yields, but share prices are still implying further moves in private market-cap rates. Our focus remains on companies better equipped to withstand the risks of further corrections because macroeconomic and geopolitical risks remain prevalent in the region.

Asia Pacific: In Asia, managing higher costs of living while ensuring economic growth remains the predominant challenge. Attention will center on how the Fed, the Bank of Japan (BOJ), and the Chinese government move in the coming months. The path by which China manages its fiscal and monetary policies to boost economic growth, as well as the country's housing market policies, presents an uncertain economic outlook. For the rest of Asia, economic growth and monetary policy outlook remains largely dependent on Fed policy and global growth. Across individual sectors, a sharper rise in long-term real interest rates could negatively affect regional REIT valuations. On the bright side, continued volatility presents an interesting dilemma wherein bad macroeconomic news could benefit real estate equities as long as interest rate hikes slow while net operating income (NOI) is maintained.

Continued consolidation creates attractive entry point for REITs

The recent sell-off in the real estate market has depressed asset prices and raised capitalisation (cap) rates. Public REIT cap rates, which measure the potential rate of return for properties based on their market value, are near the highest levels seen in recent years. We believe we're in the early stages of a Great Consolidation in the real estate market. Well-capitalised firms have a long shopping list of attractive properties, which they can now buy for steep discounts. While consolidation has already started in many areas, we expect to see increased M&A activity and strong privatisation trends in the REIT sector as the macro environment stabilises and credit markets open up, which should raise REIT asset prices and fuel a strong rebound.

Strong REIT rebounds historically followed large drawdowns



Source: Morningstar Direct as of 30/9/2023. Public REITs represents the FTSE NAREIT All Equity REITs Index.
Past performance does not guarantee future results.

Structural and cyclical trends boost rebound potential

Investment opportunities will be driven by a combination of better entry prices and rental growth prospects underpinned by structural shifts in occupier trends, including digitalisation, demographics, and decarbonisation. Attractive areas include:

Data centers: AI is rapidly accelerating data proliferation, which is driving immense demand for data centers in a supply-constrained market, contributing to low vacancy rates and higher rent growth.

Industrial: Demand easing from record pace as supply delivers in less constrained markets. Dense, coastal markets remain best positioned.

Retail: Necessity formats offer the best risk-adjusted return potential as rent growth slows (but remains positive) and retail sales decelerate.

Senior housing: Revenue growth is heading higher as rent and occupancy gains offset operating expense growth.

Student housing: Occupancies are at historical highs with the best outlook near the most competitive schools.

PRIVATE REAL ESTATE BENEFITS FROM DEEP DISCOUNTS

DARIN BRIGHT
Head of U.S. Core Plus Investment Platform
PGIM Real Estate

A compelling entry point for long-term real estate investors

Commercial real estate is the third-largest asset class after fixed income and equities. Private investments dominate the market, comprising approximately 95% of the $35+ trillion global real estate market.[1] While less liquid than the public market, private real estate benefits from being less affected by capital market dynamics, often offering investors less volatility over the long term.

Real estate has historically provided attractive income, capital appreciation, diversification from traditional allocations, and inflation protection. Despite the benefits, most investors are underexposed to the asset class. But, with interest rate stability on the horizon, now may be a compelling entry point for long-term investors.

Income remains resilient as repricing continues

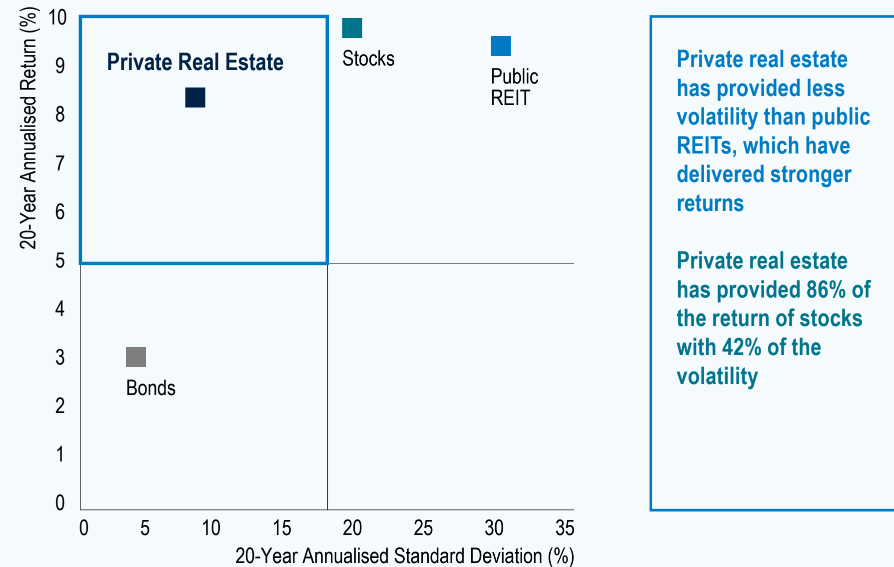
The inflation rate has slowed substantially amid tighter monetary policy and fading fiscal stimulus. Increasing labor force participation makes a soft landing a plausible base case, though downside risks are prevalent. Affordability is the main constraint to tenant demand across property types. Housing costs have risen faster than incomes, setting the stage for lower rent growth. Commercial tenants are similarly looking for cost savings as profits decline. Further value declines would likely be due to pressure on cap rates from higher interest rates, not falling property incomes.

Near-term headwinds to convert into long-term tailwinds

Currently depressed commercial real estate prices offer well-capitalised private real estate companies a historic opportunity to buy properties at deep discounts. Investment opportunities presented during a recessionary environment include equity repricing, which provides attractive cost-basis opportunities and select tactical opportunities at the bottom of the cycle. We see significant upside potential over the long term in broadly diversified real estate assets with strong and sustainable income with compelling growth potential tied to exposure to rapidly evolving societal trends.

Demographics: Aging baby boomers and millennials are the two largest demographic segments creating significant and growing demand for senior living, affordable housing, necessity-based retail, self storage, and life sciences.

Digitalisation: Continued digital transformation is materially changing the real estate landscape in areas such as logistics (distribution and last mile), office with knowledge-based tenancy, and life sciences. As e-commerce grows, industrial and retail play complementary roles, with e-commerce driving industrial demand while bricks and clicks support well-located retail that offers daily use and services.



Source: Morningstar Direct as of 31/12/2022. Private Real Estate represented by NCREIF Fund OCDE, Public REIT represented by FTSE NAREIT All Equity Index, Bonds represented by Bloomberg U.S. Aggregate Bond Index, Stocks represented by S&P 500. **Past performance does not guarantee future results.**

Decarbonisation: Growing focus on ESG (Environmental, Social and Governance) is transforming both occupational demands and the real estate regulatory environment, creating demand for office with green certifications and transit-oriented real estate.

PRIVATE CREDIT PROFITS AS BANKS RETREAT

MATTHEW HARVEY
Head of Direct Lending
PGIM Private Capital

Credit contraction boosts appeal for private credit

The brutal year in bonds in 2022 and the aggressive rate hikes that followed in 2023 are stressing balance sheets in banking. Major banks are still dealing with billions in fixed income losses. With continued uncertainty about monetary policy and the economy, banks are tightening their belts. The situation is likely to translate into reduced bank lending in 2024, especially to midsized businesses as banks focus their exposure to larger companies. Fortunately, middle-market companies now have a compelling alternative in private credit, or non-bank institutional lending.

Since the Global Financial Crisis (GFC), the private credit market has quietly grown to a size on par with public leveraged loans and high yield bonds. It now accounts for more than 75% of total global leveraged loan volume and is estimated to grow.[2] The market is expected to reach $2.8 trillion by 2028, up from $1.6 trillion in 2022.[3] Reminiscent of what happened during the GFC, the financial gap created by decreased bank lending to midsized businesses will increasingly be filled by private credit lenders. We currently see attractive opportunities due to the following:

Refinancing: We expect to see issuers increasingly turning to the private credit market for refinancing solutions as the upcoming "maturity wall" of leveraged loans and high yield bonds issued around the same time approach their repayment dates.

Private equity dry powder deployment: As M&A activity has dipped recently amid capital market volatility, there is a significant amount of undeployed capital currently held by private equity sponsors (who are the primary drivers of private credit loans). We expect to see strong demand from this area as the macro environment stabilises, transaction volume improves, and sponsors look to high-quality managers who can deliver execution certainty.

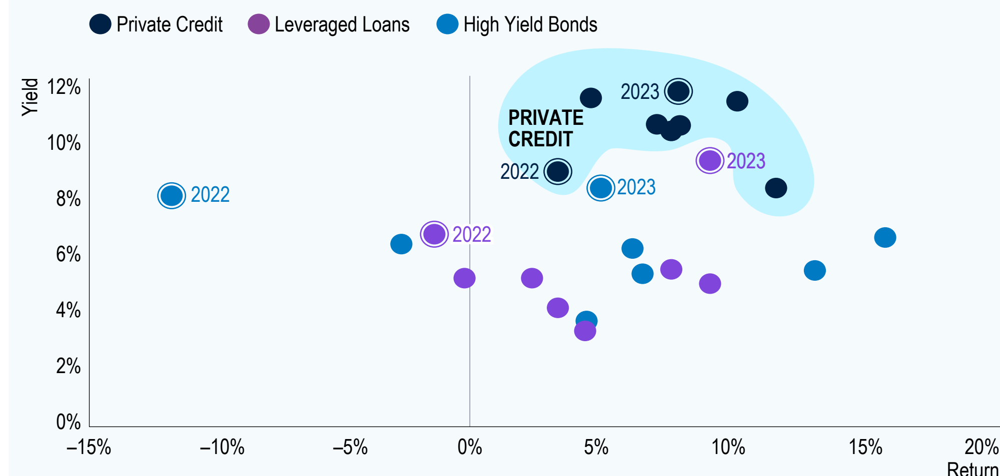
A compelling case for private credit investors

Private credit can be a powerful complement to traditional portfolio allocations, offering diversification, resilience, and enhanced income and return potential. Most private credit lending is in the form of floating-rate investments that change as rates change, providing better interest rate and inflation risk mitigation compared with investments such as fixed-rate bonds. Private credit has historically outpaced other more liquid forms of corporate credit, providing stronger returns and lower volatility than leveraged loans, high yield bonds, U.S. aggregate bonds, and the standard 60/40 portfolio. Whereas performance for both suffered during 2022 and 2023, private credit returns remained positive, suggesting it may also offer better protection against losses in an economic downturn.

Profound alpha opportunities for conservative lenders

With notional yields near the highest levels seen in 20+ years and expected to remain elevated for the foreseeable future, there is a strong opportunity to generate alpha through private credit investments. We're seeing lower entry leverage and better covenants and terms which should continue as bank lending tightens. Investors need to be careful as ultra-accommodative monetary policy since the GFC has led to some liberal underwriting standards. As we move back into a higher interest rate environment amid a tenuous economic backdrop, this could translate into bigger risks for investors in funds run by less conservative managers. Investors can better reap the benefits of the asset class by investing in experienced active managers with conservative credit postures to minimise the risks while capitalising on the opportunities.

Private credit has delivered consistently stronger yields and returns versus related public markets



Source: Cliffwater Direct Lending Index as of 30/9/2023. Return is annual returns from 2016-2022 and YTD returns as of 30/9/2023. Yield calculated by averaging quarterly yields for year. Bloomberg High Yield Corporate Index (High Yield Bonds), Morningstar LSTA U.S. Leveraged Loan Index (Leveraged Loans), Cliffwater Direct Lending Index (Private Credit). Private Credit yield represented by Cliffwater Direct Lending Index 3-year takeout yield, Leveraged Loans and High represented by yield to maturity. **Past performance does not guarantee future results.**

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[1]Source: Statista, EPRA as of December 2022.

[2]Source: S&P LCD Leveraged Lending Review as of 31/3/2023. Share percent based on annual volume of USD-denominated new-issue global leveraged loans.

[3]Source: Preqin Special Report: The Future of Alternatives in 2028 published October 2023.

[4]While all investors potentially can benefit from a direct indexing strategy, the value of tax losses and after-tax returns decrease as an investor's tax rate decreases.

Definitions and Indices—Bloomberg Commodity Index represents performance of exchange-traded futures on physical commodities. **Bloomberg Credit 1-5 Year Index** measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets with maturities between one and five years. **Bloomberg U.S. Aggregate Index** represents securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade, fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. **Bloomberg Global Aggregate Bond Index** is an unmanaged index of global investment-grade fixed income markets. **Bloomberg U.S. Credit Index** measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets. **Bloomberg U.S. Corporate High Yield Index** covers the USD-denominated, non-investment grade, fixed rate, taxable corporate bond market. **Bloomberg U.S. Treasury Bond Index** measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. **Cliffwater Direct Lending Index** measures the unlevered, gross of fee performance of U.S. middle market corporate loans, as represented by the asset-weighted performance of the underlying assets of business development companies. **Credit Suisse Leveraged Loan Index** represents the investable universe of the USD-denominated leveraged loan market. **FTSE NAREIT All Equity REITs Index** is designed to track REIT performance in the commercial real estate space across the U.S. economy. **ICE BofA U.S. 3-month Treasury Bill** measures the performance of a single issue of outstanding Treasury bill, maturing closest to, but not beyond, three months from the rebalancing date. **JP Morgan EMBI Global Diversified Index** is an unmanaged index of emerging market debt, including USD-denominated Brady bonds, eurobonds, and traded loans issued by sovereign and quasi-sovereign entities. It limits the weights of those index countries with larger debt stocks by including only a specified portion of these countries' eligible current face amounts of debt outstanding. **Morningstar LSTA U.S. Leveraged Loan Index** measures the performance of the U.S. leveraged loan market. **MSCI All Country World Index (ACWI)** is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world and is comprised of stocks from both developed and emerging markets. **Russell 1000 Growth Index** measures the performance of Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. **Russell 1000 Value Index** measures the performance of Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. **Russell 3000 Index** measures the performance of the largest 3,000 U.S. companies representing approximately 96% of the investable U.S. equity market. **S&P 500 Index** is an unmanaged index of 500 common stocks of large U.S. companies, weighted by market capitalization.

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