PGIM

MID-YEAR 2026

FIXED INCOME VIEWS

All investments involve risk, including the possible loss of capital.

CONTENTS

BOND MARKET OUTLOOK

INVESTING THROUGH THE ARC OF THE CRISIS

Once again, geopolitics have come to the fore, creating a swirl of possibilities for the world's economies and shockwaves for the markets. The drama playing out in the Middle East is pushing energy prices higher, exacerbating what is now a widespread problem of perniciously above-target inflation.

As a result of the macro backdrop, traders rushed to price in central bank rate hikes, pushing yield curves higher and flatter. Equities and credit products have nonetheless proved resilient with stocks hitting new highs while, similarly, credit spreads have almost recovered from March's widening, taking them back toward historic lows.

Rates Selloff: Enough, or Not Until Oil Crests?

In the abstract, following the recent rise in rates, most economists and investors would probably see value in the bond market, with the hawkish rate paths now priced in appearing quite aggressive. Indeed, with markets now anticipating 75 basis points (bps) of hikes over the next year or so in both the UK and euro market, 100 bps of hikes in Japan, and nearly 50 bps of hikes in the U.S., it raises the question of whether yields overshot fair value on the high side.

But there is nothing abstract about the rising price of oil and supply chain shocks aggravated by the situation in the Middle East. As a result, while we're inclined to think the majority of the bad news is priced in and rates are near the top of their new range (Exhibit 1), a stabilization of yields may have to wait for a topping of energy prices and a cresting of inflation risks.

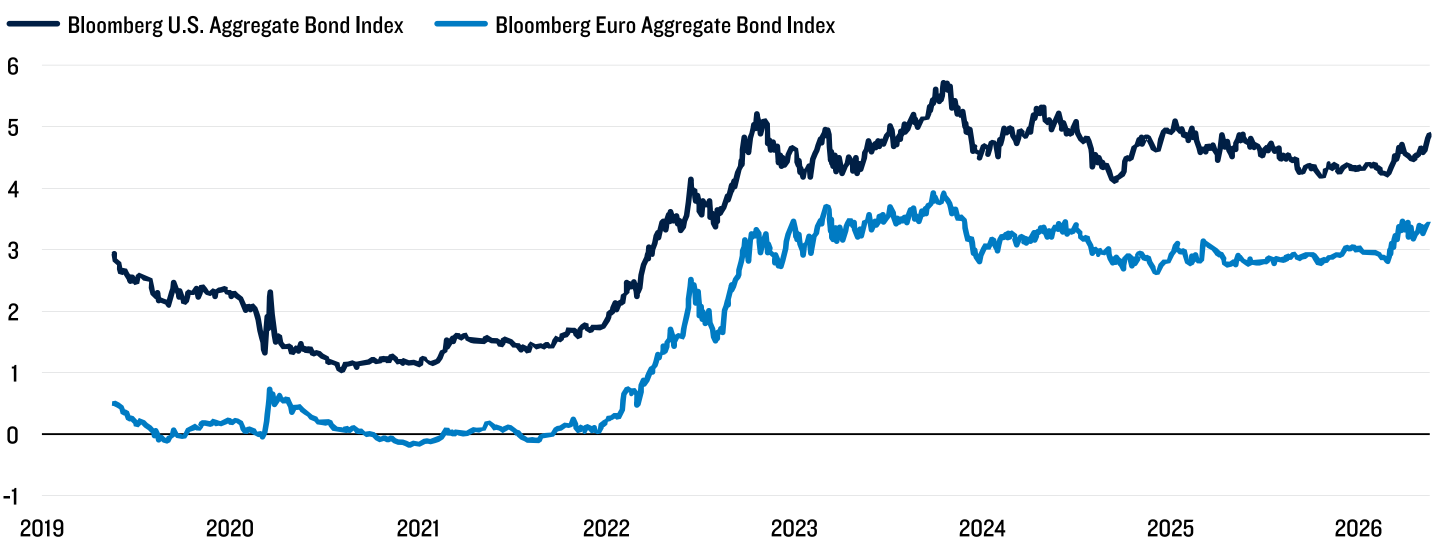
Credit and the Crisis

It's a bit surprising that after an initial widening in reaction to the outbreak of war, credit spreads have nearly fully recovered, and stocks have rallied to new highs. Are the markets pollyannish and underestimating the risks, or is there a message in the strong trading behavior to date?

Looking at the bigger picture, periods of risk-off trading since COVID—spread widenings in response to the 2022 rate hikes

Exhibit 1: The war pushed long-term government rates higher. More to come or opportunity knocking?

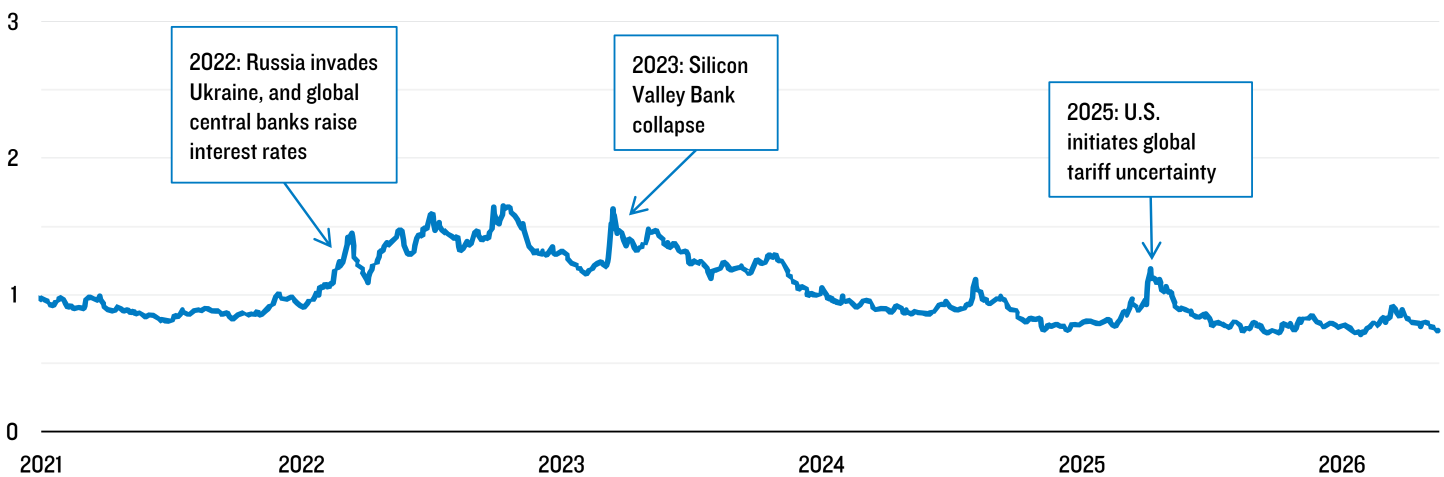
U.S. and European aggregate bond indices yield-to-worst; %



Source: Bloomberg. As of May 19, 2026.

Exhibit 2: Post-COVID spreads remain resilient—will fundamentals allow credit to come through relatively unscathed?

U.S. investment grade corporate spreads; percentage points



Source: Bloomberg. As of May 21, 2026.

and the Russia-Ukraine conflict, 2023's Silicon Valley Bank collapse, 2025's tariff developments—have been progressively mild, with each successive crisis having less of an adverse impact on the market than the last.

Our working assumption is that, in the wake of COVID, credit fundamentals are not only strong, but also fairly resilient to shocks. As investors catch on to this fact, each successive event experiences a shorter, shallower risk-off dip, followed by a speedier recovery (Exhibit 2), raising the possibility that credit markets may weather the unfolding Middle East crisis relatively unscathed.

Wait and See

If the Russia-Ukraine conflict is any indication of modern warfare, we could be in for an extended period of uncertainty surrounding the Middle East conflict as well as the economy and markets, leaving substantial upside and downside risks surrounding our outlook.

Yields in the Strategic Buy Zone

As we noted in late 2022—when yields first returned to their currently higher, but historically normal range—over the long run, yield is, more or less, destiny. On that point, the Middle East conflict has, in our view, pushed yields up to attractive levels. So, while it's difficult to know when we've passed the peak of the current crisis in terms of yields and volatility, we are guardedly optimistic that most of the increase in rates is likely behind us. In that event, the market is well poised from current respectable yield levels to deliver solid returns in the years ahead.

GLOBAL SECTOR VIEWS

DEVELOPED MARKET RATES

Outlook: We interpret the recent, abrupt repricing across developed market (DM) rates as part of a broader transition toward a structurally higher yield regime. While the proximate repricing catalysts differed by region, the underlying drivers—fiscal concerns, persistent inflation, and resilient growth—are global and increasingly synchronized.

The recent interest-rate selloff has been concentrated at the long end of yield curves, in contrast to the front-end led adjustment that followed the onset of the conflict in the Middle East, which reflected markets pricing in a more forceful central bank response to energy-driven inflation pressures. The combination of these dynamics has resulted in flatter yield curves across the U.S., Germany, Australia, and the UK.

In the U.S., the front-end repricing has been particularly notable, driven by a renewed upward shift in both Fed policy expectations and inflation compensation amid higher energy prices as well as continued economic strength. Market-based inflation measures point to a reacceleration in near-term price pressures: the one-year inflation swap has moved meaningfully higher, while the 1y1y forward rate—capturing expectations of more persistent inflation—now sits near the top of its post-2022 range. Consistent with this, the SOFR contract expiring at the end of the year is pricing in Fed hikes, a pronounced shift from the 2.5 cuts priced earlier this year.

UK rates have also moved sharply, reflecting a confluence of factors. First, the UK's reliance on imported energy leaves it directly exposed to geopolitical shocks. Second, inflation has remained stubbornly elevated despite weak underlying growth. Third, the gilt market has been unsettled by rising domestic political uncertainty. The leadership challenge to Prime Minister Starmer has gained momentum, with Birmingham Mayor Andy Burnham emerging as the market-implied front runner. A key risk is that a shift in leadership brings a departure from established fiscal rules, undermining policy credibility.

In Japan, recent developments point to a loss of inflation-fighting credibility at the margin. The pronounced steepening of the JGB curve—led by a sharp rise in 30-year yields to above 4%, a multi-decade high—suggests markets are questioning the Bank of Japan's policy stance. Inflation expectations have also surged, with 10-year breakevens reaching a record 2.23%, while the yen continues to weaken despite intervention by the Ministry of Finance.

The cross-market message is clear. First, fiscal credibility is once again a binding constraint, and markets are increasingly willing to penalize perceived profligacy—even across G10 sovereigns. Second, central bank credibility in anchoring inflation expectations remains critical, with markets acting decisively when that credibility is called into question.

Inflation expectations have been trending higher in Japan for some time and are now beginning to drift upward in the U.S. as well. In the near term, the most credible circuit breakers—such as a meaningful de-escalation in energy markets (e.g., a reopening of the Strait of Hormuz), strong anti-inflation signaling from major central banks, or a renewed commitment to fiscal discipline—appear unlikely. Given the BoJ's measured pace of adjustment, this suggests Japan may remain the softest of the major DM markets.

While supply chain inflation—most notably in energy—may very well persist for the foreseeable future, the adjustment in DM rates markets proceeded rapidly. As a result, the current lurch higher may not represent the first salvo in a further 50-100 bp bear move, but rather the final stages of a steep correction that stands to define the upper bound of the new long-term range for global rates for an extended period.

GLOBAL SECTOR VIEWS

AGENCY MBS

Outlook: Carry conditions. Mortgage-backed securities (MBS) carry remains intact versus intermediate U.S. Treasuries. We favor overweight in lower 30-year coupons with neutral positioning in the middle of the stack and underweights in higher coupons (5.5% and up) due to heightened convexity risks. We continue to prefer specified pools (pre-2022 vintages) over TBAs for better fundamental value and convexity.[1]

As we take stock of the first half of 2026, we see a market where mortgages generally benefitted from GSE purchases, optimism regarding a resolution to the conflict in the Middle East, constrained origination, benign prepayment speeds, and consistent yield-based demand. The market largely priced those factors in during the first half, and its focus will likely turn to higher risk premia for geopolitical risks over the longer run.

Furthermore, a few technical aspects may develop into headwinds going forward. GSEs continued to briskly add mortgage securities in the first half, yet we believe they may encounter limited capacity in September-October if preferred stock purchase agreement caps are not raised. Demand from deal structures and mortgage REITs may also moderate on valuation conditions. On the supply side, the recently introduced VantageScore 4.0 credit-scoring model will likely expand credit eligibility and boost origination volume.

As the end of the first half approached, the market backdrop provides context to our forward-looking views. Higher coupons outperformed within the 30-year, 20-year, and 15-year sectors. Lower interest-rate volatility, relatively muted gross originations, and slower-than-expected prepayment speeds supported performance. Lower-coupon 30-year securities benefitted from seasonality effects as well as bond fund inflows.

We continue to expect yield-based demand to support production coupon Ginnie Maes with Treasury yields at almost two-decade highs. This demand will likely to be offset by a pickup in origination due to seasonality in housing turnover.

In summary, we prefer to trim MBS exposure by fading potential strength in production and premium coupons (5% and above).[1] We expect better entry points where we can scale up basis exposure, which may emerge over the latter half of 2026.

[1] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

SECURITIZED CREDIT

Outlook: Carry conditions. Amid the tighter-than-average spread environment, we expect spreads to remain range-bound or widen and curves to steepen amid heavy new issuance, softening fundamentals, and macro volatility. However, senior securitized tranches continue to offer attractive relative value versus other fixed income instruments. Given this dynamic, we remain focused on tranches at or near the top of capital structures, while being highly selective among more credit-sensitive positions further down the capital stack.

Commercial Mortgage-Backed Securities (CMBS)

In CMBS, valuations for most property types have stabilized and we expect 2026 price appreciation to be marginally positive. Rent growth should improve in the near term as supply pressures ease in multifamily and industrial sectors, and we expect delinquency rates to plateau. Continued elevated single-asset, single-borrower (SASB) supply is likely to pressure spreads wider, and we see value in high-quality deals with structural protections against moderating commercial real estate (CRE) fundamentals. In conduit markets, we view AAA spreads as fair relative to corporates, and favor shorter spread duration given the flatness of the term curve.[2]

Residential Mortgage-Backed Securities (RMBS)

In RMBS, relatively tight inventories and strong demographic trends continue to support housing valuations despite historically high mortgage rates. Mortgage credit remains solid overall, despite rising delinquencies among lower-tier borrowers. Non-qualifying mortgages remain the most scalable opportunity for mortgage credit exposure, and we favor high-quality credit mortgages across favored document types—with investor loans featuring embedded prepayment penalty protections among the most attractive. Current T+130-140 basis point spreads are attractive compared to other fixed income sectors. We are seeking to add positions in AAA non-qualifying mortgage and second-lien home equity line of credit (HELOC) deals.

Collateralized Loan Obligations (CLOs)

In CLOs, while underlying leveraged loan fundamentals remain broadly positive, tail risks linger. CLOs have relatively low exposure to industries that have been most impacted by tariff-related volatility but may face pressure from those prone to AI-related disruption. Spreads remain inside long-term averages, but marginally wide of year-to-date tights and we do not expect spreads to move uniformly tighter amid persistent supply. As CLO credit curves steepen, we expect mixed near-term valuations to create opportunities. We see the most value in senior tranches, while selectively adding higher-quality mezzanine tranches. Benchmark to non-benchmark spreads remain compressed, so we slightly favor benchmark managers. We see select opportunities in European mezzanine tranches to extract additional economic terms relative to the U.S.

Asset-Backed Securities (ABS)

In ABS, the marginal U.S. consumer remains stretched, taking on more leverage to maintain spending, a trend across multiple income cohorts. Non-prime in particular is pressured. European and Australian consumers continue to be resilient. Commercial credit is stable. Globally, valuations appear fair relative to other securitized products sectors. Within ABS, our focus is towards higher quality issuers across the capital stack due to originator performance dispersion and compressed spreads. We are particularly constructive on select commercial (e.g., fiber, telecom, fleet lease, equipment, small business) offering diversification to consumer and favorable relative value within a global opportunity set.

[2] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

INVESTMENT GRADE CORPORATE BONDS

Outlook: Carry environment. Heavy AI- and M&A-related issuance, tight spreads, and geopolitical risk justify caution. That said, all-in yields are attractive and corporate earnings remain strong. In our global portfolios, we are agnostic between U.S. and European markets.

U.S. Investment Grade

Although U.S. IG corporate spreads are near historic tights, yields remain attractive and we expect yield-driven demand—particularly from overseas buyers and life insurers—and strong corporate earnings to continue to support the market.

As our base case, we expect spreads to end the year in the 85-95 bp range, driven by modest economic growth, easing inflation, and a U.S. Fed that begins to ease toward year-end. Under our more bullish scenario, we see spreads tightening from here amid stronger GDP and earnings growth, a resolution to the conflict in the Middle East, and easing hyperscaler issuance. In our bearish scenario, we could see spreads widening into the 110-130 bp range if the conflict drags on, oil prices remain high, inflation rises, and the Fed remains on hold or even raises rates.

Supply is up 25% year over year, with heavy issuance from hyperscalers and M&A-related volumes increasing. Issuance has accompanied a pickup in AI-related capital expenditures, rising levels of M&A activity, and debt-funded share buybacks as more companies look to support their equity valuations. While fundamentals remain strong, the upgrade-to-downgrade ratio slipped in the first quarter and negative outlooks now exceed positive outlooks. That said, aggregate leverage levels remain largely unchanged and corporate earnings growth is quite strong, with aggregate 2026 estimates recently revised higher.

We are underweight credit spread duration driven by an underweight in the long end of the IG curve.[3] If spreads widen, we may opportunistically increase our risk (e.g., by purchasing high-quality issuance with concessions in the primary market). We continue to favor moving up in quality in selective issuers in technology. We maintain overweights to banks, utilities, and energy. We are underweight life insurance, chemicals, and pharmaceuticals.

European Investment Grade

European IG spreads also tightened as the end of the first half of 2026 approached after widening in March on the back of AI- and private credit-related concerns, as well as the conflict in the Middle East. Despite the recent spread tightening, risks have increased as concerns around higher energy costs, supply chain disruptions, and private credit remain. Given Europe's vulnerability to an energy price shock, the duration and long-term outcomes of the conflict are critical factors to consider.

However, all-in yields are attractive with demand from fixed-maturity funds at the front end of the curve and insurance companies at the 10-12 year point of the curve supporting technicals. Meanwhile, the economy has held up, fundamentals are solid, and corporate earnings remain strong. Against that backdrop, new issuance versus inflows into the asset class is expected to stay net neutral. With full-year 2026 issuance expected to be only modestly higher than 2025, supply continues to be well-absorbed.

Despite recent volatility, performance dispersion between sectors has been muted. Energy is an obvious winner while property (e.g., REITs and other financials) has underperformed owing to its sensitivity to higher rates. We prefer utilities to industrials and have a modest overweight to financials.

In EUR portfolios, we are focusing on carry and are neutral spread duration. We have increased our exposure to U.S. issuers as reverse Yankee supply appears attractive. In our global portfolios, we are similarly positioned with a small underweight in spread duration. Whereas global portfolios were previously overweight EUR versus U.S., our positioning is now relatively agnostic between the two markets.

[3] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

LEVERAGED FINANCE

Outlook: Carry conditions. In our base case, elevated rates and range-bound spreads maintain a compelling carry environment. However, upside/downside risks remain negatively skewed given the complex macro and geopolitical backdrop. We maintain our close-to-home defensive positioning with a focus on relative-value opportunities.

U.S. High Yield Bonds

U.S. high yield bond spreads compressed in the second quarter to near post-global financial crisis (GFC) tights as strong earnings and bullish outlooks offset an uncertain macro outlook. As evidenced by the steady tightening, investors are focused on an economic outcome that more closely resembles PGIM's overheating economic base case than stagflation/recession conditions as a result of the global energy shock.

With spreads now back to year-to-date tights, we believe risks are skewed to the downside. However, elevated rate markets and range-bound high yield spreads create an attractive carry environment. While bouts of geopolitical-driven volatility are likely over the near term, the current fiscal and monetary outlooks are supportive for credit fundamentals and economic growth.

If our overheating scenario plays out, we expect excess returns will be flat and U.S. high yield will outperform other sectors on a risk-adjusted basis. Meanwhile, a quick resolution with Iran could cause spreads to compress through post-GFC tights, resulting in further upside.

Heading into the second half of 2026, the default rate remains well below long-term averages, and overall duration is relatively short. We're maintaining our overweight to short-duration bonds and continue to favor high-quality issues.

Sector positioning includes overweights to homebuilders, telecom, and finance companies, and underweights to technology (software), media and entertainment, and retailers and restaurants.[4] Recent adjustments include an overweight to chemicals and a reduction in our underweight to technology. We also increased our underweight to media and entertainment.

U.S. Leveraged Loans

In U.S. leveraged loans, we continue to expect total returns of 5% in 2026 as the demand dispersion between mid- to high-quality loans and those rated lower is likely to persist. We maintain our view that carry will be the primary driver of performance, but tempered by downward pressure from repricing transactions, elevated credit environment concerns, and potential technical pressures if net new issuance accelerates.

Notably, we do not expect broad-based deterioration in fundamentals, but defaults and liability management exercises (LMEs) could remain elevated at current levels. Software and technology issuers may face continued pressure on the back of AI-related disintermediation and terminal value concerns. In the primary market, net new issuance should remain manageable, but risks of higher supply include mounting data center-related financing, rising M&A activity due to a business-friendly policy environment, and more private-to-public transactions.

We continue to favor public BB and high-B loans over sponsor-owned, low-B and CCC loans as we expect those lower-quality loans to be challenged by the fundamental backdrop. We believe that deep, fundamental credit research and modeling are critical, with the avoidance of defaults likely the primary driver of alpha over the next 12-24 months.

European High Yield Bonds and Leveraged Loans

We expect the European high yield bond and leverage loan markets to remain resilient, supported by strong technicals. However, the upside/downside dynamic remains negatively skewed given the tight spread levels and complicated macro and geopolitical backdrop.

Looking ahead, we remain invested, but cautious—running risk slightly above market neutral, but generally defensive in our single-name positioning as well as underweight cyclicals. We continue to focus on relative value opportunities, maintaining a high threshold for high-beta names given the wide range of potential macro outcomes.

[4] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

EMERGING MARKET DEBT

Outlook: We continue to be risk leaning. Positioning reflects emerging market winners and losers given the performance dispersion across the sector. However, given valuations, tail risks, and the energy shock, we are modulating risk that was added after markets sold off.

Carry Conditions and Idiosyncratic Developments

A consistent reach for yield, dispersion of returns, and broadening investor appetite for the sector have characterized EM debt across segments this year. We continue to be risk leaning, and positioning reflects EM winners and losers. However, given valuations, tail risks and second-order effects of the energy shock, we are modulating risk that was added after markets sold off. In spreads, we still favor an overweight select EMHY (BB and CCC (distressed)), high-yielding EMFX, and EM rates where excessive rate hikes are priced in.[5] We are more cautious on our outlook for EM rates relative to other sectors.

EM Sovereigns and Spreads

The second quarter brought continued spread compression, inflows, and new issue supply to the sector. It also marked a reversal of the spread widening that occurred around the onset of the Iran war. We note that tight spreads do not mean rich spreads. Tight spreads, combined with unresolved risks, call for deliberate positioning, as well as a thorough examination of the current backdrop and potential downstream impacts from the war. As we near the mid-year mark, valuations—both across the market and within the countries most vulnerable—do not reflect potential downside scenarios. This warrants deliberate risk-taking and provides meaningful opportunities from a relative value standpoint.

Our base case is that global growth trends slightly lower, yet remains durable, which bodes well for spreads, especially given the high carry. Carry alone remains high enough to provide investors with attractive returns. Technicals should be supportive, while investors remain underweight the asset class and an increase in exposure could provide another tailwind.

In a negative scenario, we take some comfort in the level of a downside buffer—about 100 bps wider in spreads—where carry alone can support positive returns.

Country dynamics will likely be the main driver of performance for the rest of the year. While the last three years saw a strong beta market that benefited all countries, 2026 should be a year of dispersion amid the energy and broader supply disruption. Overall, we prefer BB issuers with stable-to-improving fundamentals and idiosyncratic issuers that are showing improvement through reforms or terms of trade. We generally have an overweight to oil exporters and are underweight importers. Turkey and Egypt might be the two best examples of potential dispersion between similar credits. Both are stressed issuers that were generally improving prior to the war in Iran. However, they have handled the crisis differently, with Turkey spending down reserves to defend the lira and Egypt preserving reserves while allowing the pound to float freely.

One factor illustrating the resilience in the EM hard currency market is the ability for issuers across the rating tiers to access the market. This includes debt buybacks, liability management exercises, taps (new debt under a previous issue), and "private" issuance that not only reduce funding risks for some issuers, but also underscore an expanding appetite for the asset class.

EM Corporates

The outlook for EM corporates is largely carry driven, with some bouts of volatility around geopolitical headlines and the trajectory of the global economy. Technicals are supportive amid strong demand for new issues, including crossover investor demand given the yield pick-up to developed markets. Industries like oil and gas, commodities, and chemicals generally reported good earnings results.

[5] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

Some issuers in consumer, pulp and paper, manufacturing, and retail are negatively impacted by higher input costs and logistical challenges, but these challenges appear manageable from a credit perspective given strong fundamentals. We think overall defaults will remain contained in the 3% range for EMHY, in line with developed markets, considering very manageable refinancing needs and resiliency in the underlying EM economies.

We favor sectors like LatAm financials and oil and gas, plus Asia metals and mining and infrastructure plays across energy and transportation. We have become more cautious on UAE high yield property and corporates in frontier countries. The risks to the carry thesis are that an extended Iran conflict impacts global growth and high yield spreads decompress.

EM Local Rates

The outlook for EM rates very much depends on how high crude prices may go and how long they might remain elevated. The pricing of monetary tightening in the future continues to swing as headlines surface. EM central banks' policy response function depends on the second-order inflation effects from supply-chain disruption caused by the war. Considering high volatility, we have a mix of paid and received rates reflecting idiosyncratic orthodoxy and relative value. More recently, we have seen more EM central banks willing to hike rates, or slow down cutting cycle, even as this potentially challenges the growth outlook.

We're structuring the portfolio around four concepts. We note that while we still have longs, we have reduced these positions and increased our underweights:

- **Structural tail wind from euro convergence:** overweight Hungary (5-10 year)
- **Relative rate pricing:** overweight Mexico (2-5-year) vs. underweight Chile (2-year)
- **Orthodox monetary and fiscal policy:** overweight South Africa (10-15-year)
- **Asia relative value:** overweight Korea and Philippines vs. underweight Thailand and Indonesia[6]

EMFX

Performance across currencies has been driven by the price of oil, and oil exporters have outperformed, by and large. However, even some oil importer currencies have nearly recovered their conflict losses (PLN, HUF, CZK, EUR). Observing this, we conclude that USD is trading rather poorly since it is an energy exporter and the impact to U.S. growth is less than many other parts of the world.

Going forward, with geopolitical uncertainty lingering, we are focused mainly on relative value with a skew towards longs in oil exporters (BRL, NGN, COP), some high-carry oil importers with attractive real rates where scope for rate hikes is on the rise (EGP, TRY) and idiosyncratic stories (HUF). We are underweight oil importers where growth downside is greatest (THB, INR, SGD, CZK).[6]

If the Strait is slowly normalized, we think USD will trend lower, but U.S. economic outperformance, and a repricing of U.S. Treasury risk, could keep the USD supported. EM central banks are going to be more hawkish than the Fed, and the global economy will be good enough from a cyclical standpoint.

[6] Positioning references reflect PGIM's current portfolio views and do not constitute investment recommendations.

GLOBAL SECTOR VIEWS

MUNICIPAL BONDS

Outlook: Carry conditions. We expect volatility to remain elevated with a new Fed regime, geopolitical risks, and midterms elections on the horizon. We continue to be agnostic on interest rates, expecting range-bound performance. While the 10/30s curve has flattened year-to-date, it remains historically steep, offering additional roll to investors.

Muni performance has been strong year-to-date, with the sector largely outperforming other fixed-income asset classes (mostly recapturing underperformance from last year). Supply continues to run 5-10% above record 2025 levels, though net supply of about $31 billion has been entirely offset by fund inflows of $33 billion year-to-date. Above-trend U.S. economic growth, as well as strong capital markets, should continue to support tax collections, benefiting state and local governments. Tax season only modestly impacted flows to short funds and was largely a non-event this year.

That said, idiosyncratic risk remains, with budget pressure coming from local governments like New York City and states like California (largely tied to new spending initiatives and changes associated with the One Big Beautiful Bill Act). States are contending with less federal support given a desire by the federal government to cut costs and shift costs down to the states, while rising income and wealth inequality are triggering calls for the wealthy in certain states to shoulder a burden of funding social programs. Municipal bonds will likely play a critical role in shielding the income of high-net worth individuals, depending on their tax situation, from higher state and federal taxes.

Additionally, declines in populations and wealth may also have negative implications for state budgets and could result in less future municipal bond issuance by negatively affected municipal borrowers. In the aggregate, these conditions are supportive of increased demand for municipal bonds as a tax shield among high-net-worth individuals.

On the upgrade/downgrade front, ratios are now running just under 1x, indicating that credit quality is off its peak from the post-COVID era, being driven down by education (charter schools, school districts, and higher education).

The technical backdrop looks positive. Supply should continue to be high, but landing within 10% of last year's annual amount, as taxable supply continues to shrink and refundings become less economical. At the same time, reinvestment will pick up in the summer months, with nearly $120 billion of bonds maturing or being called. As money moves out of money-market funds into longer-duration assets, municipal fund flows should continue to benefit. And, as mentioned, with many states passing (or proposing) higher income taxes this year, demand for municipal bonds should increase on the margin.

We are less optimistic on valuations. The Municipal-to-Treasury (M/T) ratio currently appears rich, with the 30-year M/T ratio at 87%, relatively rich versus both the 90-day and one-year averages. Valuations will have to leak wider to get crossover support. Spreads continue to be attractive relative to other fixed-income sectors, making taxable equivalent yields attractive relative to corporate bonds, for example.

On positioning, we are neutral on interest-rate duration, with a bias towards a flatter yield curve. From a sector perspective, we favor prepaid gas, housing, student loans, and IDB (waste management), while we're more cautious on transportation and hospitals (based mostly on valuations).

SUMMARY ASSET CLASS VIEWS

This summary consists of our short- and long-term (one-year) sector views. The latter is based on a scale of 1-5 with an accompanying description that indicates our expectation for the sector's total excess return.[1]

Sectors | Short-term outlook	Market Scores | Market rating: Carry Selloff · Correction · Carry · Modest tightening · Bull market	
Developed Market Rates: We interpret the recent, abrupt repricing across developed market rates as part of a broader transition toward a structurally higher yield regime. While the proximate catalysts in Q2 have differed by region, the underlying drivers—fiscal concerns, persistent inflation, and resilient growth—are global and increasingly synchronized.	U.S. (Modest tightening) Europe (Modest tightening)	UK (Modest tightening) Japan (Modest tightening)
Agency MBS: Carry conditions. MBS carry remains intact versus intermediate U.S. Treasuries. We favor overweights in lower 30-year coupons with neutral positioning in the middle of the stack and underweights in higher coupons (5.5% and up) due to heightened convexity risks. We continue to prefer specified pools (pre-2022 vintages) over TBAs for better fundamental value and convexity.	Agency MBS (Correction)	
Securitized Credit: Carry conditions. Securitized spreads have shown resilience despite macro volatility, but still remain attractive relative to spreads of other fixed income instruments. Credit curves continue to be relatively flat, so we remain focused on tranches at or near the top of capital structures, while being highly selective among more credit-sensitive positions further down the capital stack. Securitized sectors within residential housing, CRE and autos may offer an additional layer of resilience against AI-related disruption. Issuance has been robust overall, particularly within sectors such as non-QM RMBS, SASB CMBS, BSL CLOs, and digital infrastructure, creating potential opportunities for capital deployment.	CMBS (Carry) CLOs (Carry)	RMBS (Carry) ABS (Carry)
Investment Grade Corporates: Carry conditions. Heavy AI- and M&A-related issuance, tight spreads, and geopolitical risk justify caution. That said, all-in yields are attractive and corporate earnings remain strong. In our global portfolios, we are agnostic between U.S. and European markets.	U.S. corporates 1-10 (Carry) U.S. corporates 10+ (Carry)	European corporates 1-5 (Carry) European corporates 5+ (Carry)
Global Leveraged Finance: Carry conditions in the base case. Elevated rates and rangebound spreads have created an attractive carry environment. However, upside/downside risks remain negatively skewed given complex macro and geopolitical backdrop. We maintain our close-to-home defensive positioning with a focus on relative-value opportunities.	U.S. high yield 1-5 (Carry) U.S. high yield 5+ (Carry) U.S. leveraged loans (Carry)	Euro high yield BB (Carry) Euro high yield B & below (Carry) Euro leveraged loans (Carry)
Emerging Market Debt: We continue to be risk leaning. Positioning reflects EM winners and losers emerging amid a dispersion in performance across segments of the asset class. However, given valuations, tail risks, and the energy shock, we are modulating risk that was added after markets sold off.	Sovereign hard currency IG (Carry) Sovereign hard currency HY (Carry) Local rates[2] (Modest tightening)	EMFX[2] (Modest tightening) Corporates IG (Correction) Corporates HY (Correction)
Municipal Bonds: Carry conditions. We expect volatility to remain elevated with a new Fed regime, geopolitical risks, and mid-terms on the horizon. We continue to be agnostic on interest rates, expecting range-bound performance. While the 10/30s curve has flattened year to date, it remains historically steep, offering additional roll to investors.	Taxable (Carry)	

[1] The positioning in a respective portfolio may not be identical to the long-term ratings. The ratings and information herein are for comparison purposes only.
[2] The ratings on the indicated asset classes are based on expectations for total excess returns. Source: PGIM as of June 5, 2026.

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