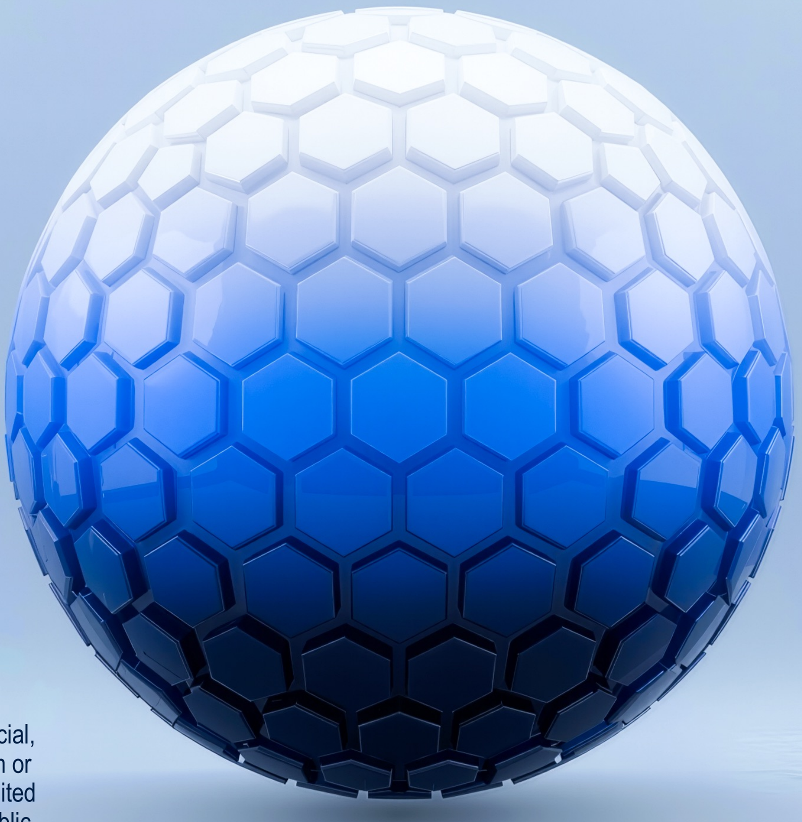
PGIM

MULTI-ASSET OUTLOOK

Q1 2026



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MULTI ASSET TEAM

MULTI-ASSET OUTLOOK

KEY CONSIDERATIONS

- **Macro Environment:** Risk assets continue to benefit from a supportive macro backdrop, with themes from 2025—rising fiscal spending, technology-driven investment, and ample liquidity—expected to persist.
- **Global Growth:** Signs of resilience and gradual acceleration are emerging, supported by cumulative interest rate cuts since 2024, even as global activity remains below trend.
- **Central Banks:** Diverging policies dominate, with the U.S. Federal Reserve maintaining a cautious stance on rate cuts, the European Central Bank pausing as inflation nears target, and the Bank of Japan gradually raising rates amid fiscal concerns.
- **Currency:** The U.S. dollar saw its steepest decline since 2017, driven by shifting interest rate differentials, while the yen remained flat despite significant rate moves in Japan.
- **Corporate Earnings:** Earnings remain robust globally, with U.S. productivity gains driving growth and emerging markets projected to deliver 18% earnings growth in 2026.
- **Emerging Markets:** Positioned to benefit from resilient global growth and trade dynamics, though political risks and tariff uncertainties remain key considerations.
- **Commodities:** Strong returns in 2025 are expected to broaden in 2026, supported by elevated inflation, fiscal-driven demand, and favorable momentum.
- **Asset Allocation:** Diversification across asset classes remains critical, with stock-bond correlation anchoring portfolios and commodities providing stability during inflationary or geopolitical stress.

MACRO ENVIRONMENT & GLOBAL GROWTH

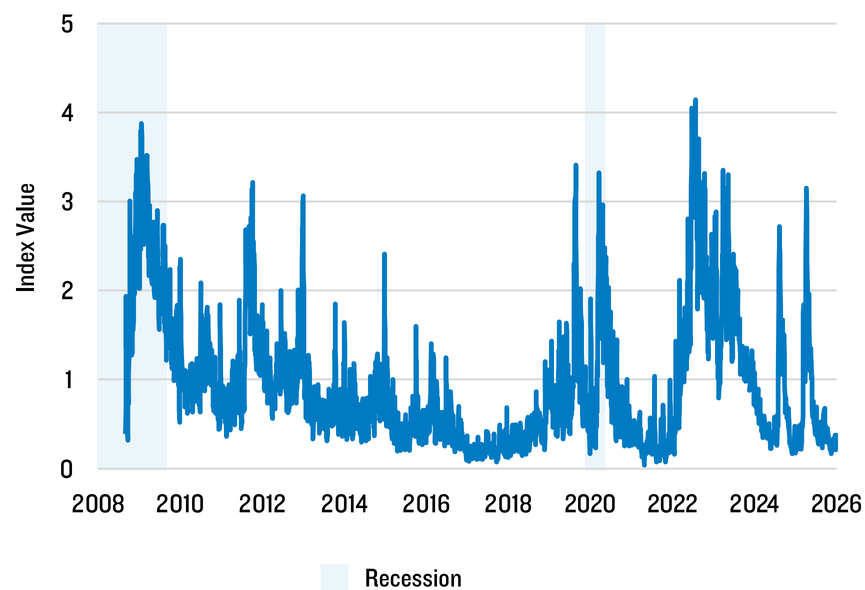
Risk assets continue to benefit from a benign macro environment

The prevailing themes of 2025 —rising fiscal spending and widening deficits across major economies, a technology-driven investment boom in the U.S. and China, and a supportive liquidity backdrop that underpins major asset classes — are expected to carry forward into the new year.

Although global activity remained below trend in late 2025, signs of resilience and gradual acceleration are emerging, supported by cumulative interest rate cuts since 2024. Tariff concerns are gradually fading, and the cyclical improvement in growth momentum, while not robust in absolute terms, is broad-based. In the U.S., economic growth remains supported by AI-related capital expenditures and consumer spending. However, consumption has been sharply bifurcated, with higher-income spenders driving the majority of expenditures, while trends among other segments have been more subdued.[1]

Investments in AI, still in their early stages, have yet to reveal their full impact on productivity and employment. Amid lingering tariff uncertainty, companies are adopting a measured approach to payrolls, resulting in a "low-hire, low-fire" labor market. Households, too, remain cautious about employment prospects. Despite these uncertainties, hard data remain encouraging. Notably, our high-frequency U.S. recession sentiment indicator (Exhibit 1) is near its lowest level in several years and well below the peaks seen in 2024 and 2025.[2]

Exhibit 1: U.S. Recession Sentiment Remains at Multi-Year Low



Source: PGIM, Bloomberg as of 12/31/2025.

[1] https://www.bostonfed.org/publications/current-policy-perspectives/2025/why-has-consumer-spending-remained-resilient.aspx

[2] https://www.pgim.com/us/en/institutional/insights/asset-class/multi-asset/quantitative-solutions/running-an-nlp-model-during-the-shutdown-data-void

CENTRAL BANK DIVERGENCE

Global central bank policies diverged over 2025. Following two years of monetary easing, expectations for Federal Reserve (Fed) rate cuts in early 2026 are low. While the labor market is gradually softening, it has not deteriorated meaningfully, and inflation remains elevated. This has left the Fed divided between proponents of proactive cuts and advocates of a more cautious stance. Proprietary indicators from our investment team suggest the Fed's stance on inflation is slightly hawkish, while its tone on growth is largely neutral. Another indicator, which tracks attentiveness to unemployment and inflation (Exhibit 2), reveals a sharp decline in focus on inflation from its 2025 highs, while attention to unemployment remains elevated.[3]

The anticipated appointment of a new Fed Chair introduces additional uncertainty around the pace of future rate cuts. Nevertheless, our base case assumes the Fed will gradually move the fed funds rate toward a neutral level near 3%, keeping U.S. short rates well anchored. Meanwhile, long rates have remained range-bound for some time. Over 2025, 10-year Treasury yields were roughly unchanged (Exhibit 3) despite Fed cuts, resulting in a steepening of the yield curve — a dynamic likely to persist in the near term.

Euro area government bond curves — notably in Germany and France — also steepened through 2025. Although the European Central Bank has signaled a pause in its rate-cutting cycle as inflation reaches its target, there remains a risk that inflation undershoots, which could potentially prompt rate cuts. In contrast, the Bank of Japan (BoJ) continued raising policy rates in 2025, driven by an increased likelihood of achieving its inflation target. However, real policy rates remain extremely low, making further hikes likely to be gradual, given this rate hike cycle is Japan's first in several decades. Consequently, short-term rates are likely to stay relatively stable, while longer-term yields face continued upward pressure from fiscal concerns.

Exhibit 2: Attentiveness to Inflation & Unemployment

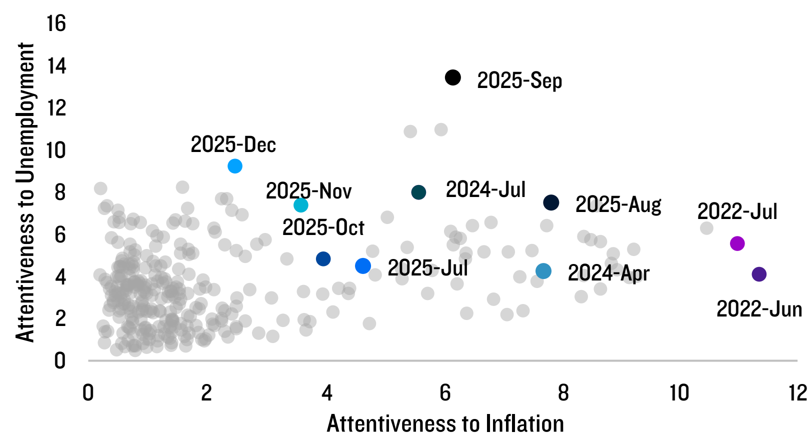
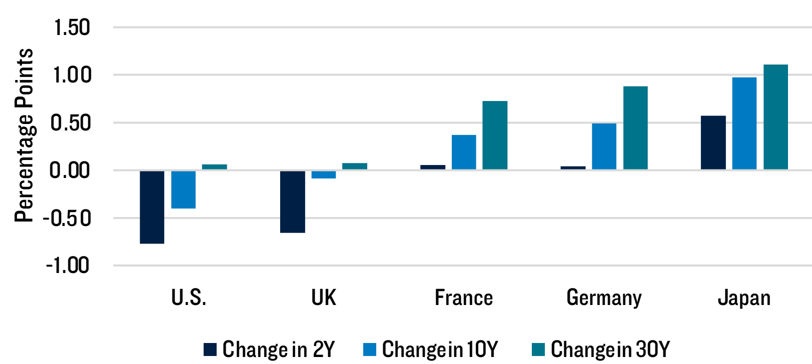


Exhibit 3: Global Yield Curve Shifts



Source: PGIM, Bloomberg as of 12/31/2025.

[3] https://www.pgim.com/us/en/institutional/insights/asset-class/multi-asset/quantitative-solutions/from-data-void-to-data-point-tracking-media-attention-after-cpi

CURRENCY & GLOBAL EQUITIES

Currency

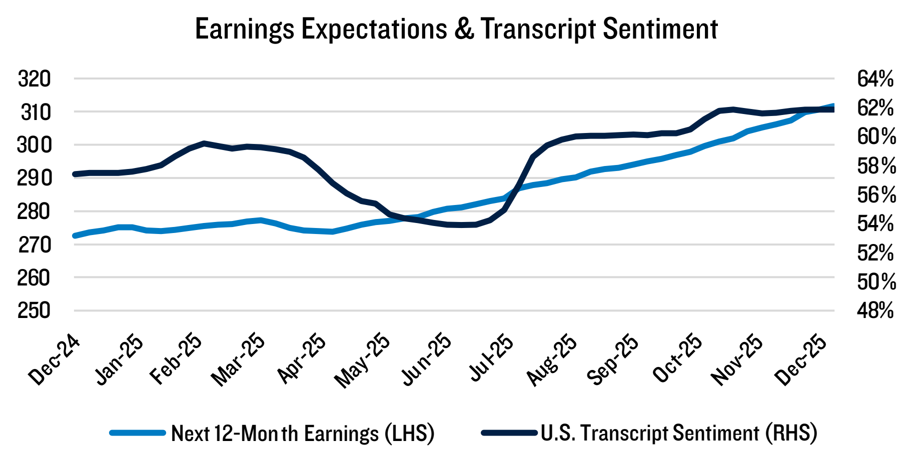
The U.S. dollar index (-9.4%) recorded its steepest annual decline since 2017 during 2025, weakening against every other G10 currency. The strong performance of U.S.-based assets in dollar terms still translated to relatively weaker returns in local currency outside the U.S., with dollar weakness reflecting interest rate differentials as U.S. rates edged lower while most other regions saw rates rise. The exception was Japan: the yen remained essentially flat against the USD despite a significant move in Japanese rates and narrowing of the U.S.-Japan short-term rate differential. Uncertainty around the BoJ's neutral rate guidance has made it difficult for currency markets to price in higher rates beyond the next meeting or two.

Global Equities

Global equities remain supported by a solid earnings outlook. Corporate earnings showed remarkable resilience in 2025 despite tariff-related uncertainty. While U.S. earnings expectations were revised lower in Q2 as tariff concerns spiked, firms quickly reaffirmed guidance, leading to a rebound in expectations by mid-year. Third quarter earnings growth exceeded forecasts, coming in at 15% versus mid-year expectations of 8%, signaling a healthy earnings environment even amid tariff announcements. A key driver of the current expansion has been rising productivity, which continues to support earnings growth. U.S. non-farm productivity rose at an annualized rate of 4.9% in Q3, following an upwardly revised 4.1% in Q2. Even if the Atlanta Fed's Q4 GDP tracking estimate of 5.1% falls short, muted job growth would still suggest another quarter of significant productivity gains. Our corporate sentiment indicator (Exhibit 4) dipped following the Liberation Day tariffs announcement but stabilized and improved well above 2024 highs. Current earnings expectations for the S&P 500 hover near 15% growth over the next twelve months.

The resilience in earnings extends beyond the U.S. EAFE earnings growth is expected to reach approximately 10% over the next 12 months, while emerging markets are projected to deliver robust growth near 18%. European equities offer a more attractive valuation backdrop compared to the U.S., but face headwinds from subdued economic momentum. Tariffs and global trade remain wildcards. Japanese earnings expectations point to double-digit profit growth next year, supported by the Takaichi administration's fiscal expansion and corporate governance reforms aimed at reducing excessive cash reserves, which are expected to boost shareholder returns.

Exhibit 4: Corporate Earnings Sentiment



Source: PGIM, Bloomberg as of 12/31/2025.

EMERGING MARKETS & COMMODITIES

Emerging Markets

Emerging market assets are positioned to benefit from resilient global growth and trade dynamics despite headwinds from higher U.S. tariffs. China's pivot toward export diversification is supportive of growth, even as domestic demand remains subdued. Productivity gains, policy easing, and potential spillovers from U.S. growth could present upside surprises. Across emerging markets, inflation has largely stabilized near target levels, and central banks have concluded their easing cycles, creating a stable monetary backdrop for equity valuations. However, political risk remains a consideration in 2026, with elections in several countries and lingering tariff threats.

Commodities

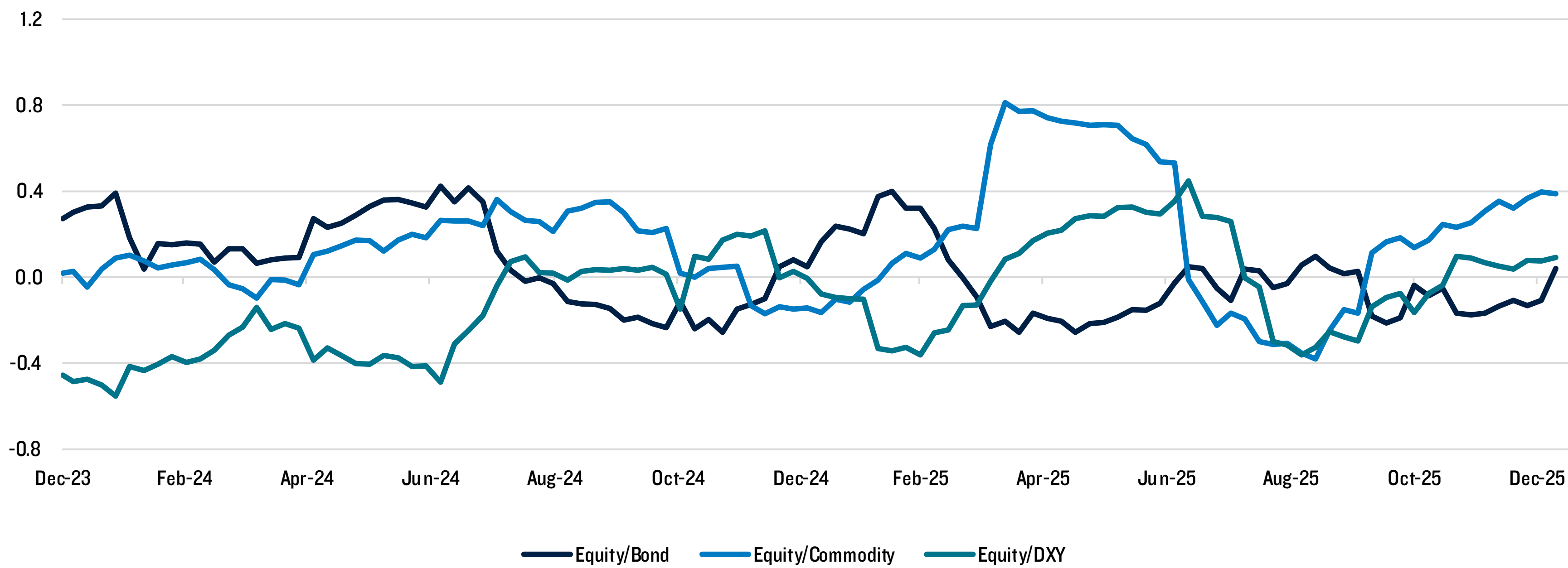
Commodities delivered strong returns in 2025, largely matching equity gains and outperforming during periods marked by heightened inflation concerns and geopolitical tensions. Our 2026 outlook for commodities remains positive, supported by elevated inflation and potential demand pressures from fiscal initiatives. While commodity carry remains moderate relative to other asset classes, favorable momentum, risk, and liquidity dynamics provide support. After spectacular gains in precious metals in 2025, returns across the broader commodity complex are likely to be more evenly distributed in 2026.

ASSET ALLOCATION

Monitoring cross-asset correlation pattern (Exhibit 5) provides valuable insights for portfolio management. Stock-bond correlation is expected to remain the cornerstone of portfolio construction. Following mixed trends in recent years, when inflation worries disrupted markets, stock-bond correlation was modestly negative for most of 2025. Barring a resurgence of extreme inflation concerns, which does not appear highly likely, diversification across major asset classes should continue to enhance portfolio returns in the coming year.

Commodities can provide ballast during periods of heightened inflation concerns or geopolitical stress, as they did in 2025. Finally, the dollar-equity correlation fluctuated between significant positives (post-Liberation Day) and negatives through 2025, recently settling into mildly positive territory. If this trend persists, hedging by non-U.S. investors is likely to be driven primarily by volatility control considerations, whereas a return to negative correlation would likely prompt hedging of U.S. asset exposures to protect returns.

Exhibit 5: Cross-Asset Correlations



Source: PGIM, Bloomberg as of 12/31/2025.

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