PGIM FIXED INCOME

Q2 25 QUARTERLY OUTLOOK

Published April 2025

WHATS INSIDE?

Select a section to jump ahead.

	Total Returns (%)				
Individual FI Sectors	Q1 '25	2024	2023	2022	2021
Long U.S. Treasuries	4.67	-6.41	3.06	-29.26	-1.13
EM Currencies	3.13	-1.08	8.44	-7.14	-3.09
Mortgage-Backed (Agency)	3.06	1.20	5.05	-11.81	-1.04
U.S. Treasuries	2.92	0.58	4.05	-12.46	-2.32
CMBS	2.56	4.68	5.42	-10.91	-0.64
U.S. Long IG Corporates	2.38	-1.95	10.93	-25.62	-4.65
U.S. IG Corporate Bonds	2.31	2.13	8.52	-15.76	-1.04
EM Hard Currency Sovs.	2.24	6.53	11.09	-17.78	-1.80
EM Local (Hedged)	1.62	3.77	7.60	-8.85	-5.52
U.S. High Yield Bonds	1.00	8.19	13.45	-11.19	5.36
European Leveraged Loans	0.99	9.17	13.53	-3.36	4.87
U.S. Leveraged Loans	0.61	9.05	13.04	-1.06	5.40
European High Yield Bonds	0.54	9.14	12.78	-11.13	3.32
European IG Corporate	-0.01	4.74	8.19	-13.65	-0.97
Municipal Bonds	-0.22	1.05	6.40	-8.53	1.52
Multi-Sector					
U.S. Aggregate	2.78	1.25	5.53	-13.01	-1.39
Global Agg. (Unhedged)	2.64	-1.69	5.72	-16.25	-1.54
Global Agg. Hedged	1.17	3.40	7.15	-11.22	-0.15
Euro Aggregate (Unhedged)	-0.90	2.63	7.19	-17.18	-4.71
Yen Aggregate	-2.38	-3.07	0.51	-5.30	-2.85
Other Sectors					
SOFR	1.08	5.40	5.18	1.66	0.03
U.S. Dollar (DXY Index)	-3.94	7.10	-2.11	8.21	6.37
S&P 500 Index	-4.27	25.00	26.29	-18.11	28.71

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, 2025. An investment cannot be made directly in an index.

PGIM FIXED INCOME

SECTION 1

KEY CONVICTIONS & INVESTMENT THEMES

01

KEY CONVICTIONS & INVESTMENT THEMES

1 **Strategic Buy Zone for Bonds:** As we referenced in Q1, the 2022 bear market hoisted yields to levels not seen in more than a decade, positioning fixed income markets—particularly the higher yielding sectors—for an extended period of solid returns. That backdrop remains in Q2 as do the uncertainties that will rattle markets over the near term. **Bottom line: Bonds are positioned for solid returns, and they should outperform cash and equities if serious downside risks materialize.**

2 **Market Dislocations, Divergence, and Dispersion:** Divergent markets can create value for those moving across regions, sectors, and issuers. In Q1, "American Exceptionalism" paused, boosting U.S. bond returns. Simultaneously, European credit outperformed on an excess return basis amidst expectations for accelerating European growth. **Ongoing policy confusion seems destined to continue to prompt bouts of market turbulence that precipitate relative value opportunities.**

3 **Let Fundamentals be your Guide:** The post-COVID bond market has been prone to dramatic overreactions and course corrections as participants struggle to understand the post-pandemic paradigm. **The lesson for investors is clear: don't confuse extreme market movements with changes in fundamental market trends.** Rely on research and analysis to distinguish the market spasms from true changes in value and capitalize on reversions back to fundamentals.

PGIM FIXED INCOME

SECTION 2

BOND MARKET OUTLOOK

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

02

TACTICAL TURNS IN THE SLOW-GO BULL MARKET

After a pause in Q4 2024, the bond bull market resumed in Q1, but with wide variations by sector and region (see Figure 1 and the accompanying page on the contours of the recent market divergence). While our favorable outlook for the bond market dating back to the end of 2022 stands—especially for the higher yielding sectors—stark risks remain given the rapidly evolving investment environment. Early Q2 could be one of the more fraught periods of the Trump presidency with bouts of volatility likely to create both risks and opportunities.

We remain optimistic on the market's longer-term return prospects. From a more contemporary perspective, **bonds may be far better positioned than equities and cash to weather—or even benefit from—serious market downdrafts that would push rates lower and consequently boost bond returns** (click here for more on moving out of cash).

Where to from Here?

Since the beginning of the current bull market in Q4 2022, variable economic data and events, such as the SVB crisis, have kept the markets subject to bouts of volatility. At this juncture, we expect more of the same as we pass through what may represent the high-water mark for anxiety stemming from the Trump administration's rapidly evolving policies.

In terms of underlying fundamentals, we expect to see the highly volatile policy backdrop contribute to a further moderation of what was already a gradual growth backdrop. **Further moderation should support central banks' pre-existing bias to cut rates** and cushion downside risks. It should also make the potential for rate hikes even more remote despite the potential for tariff-driven increases in inflation.

As a result, **we expect that long-term returns will likely mirror current elevated yield levels. Furthermore, there may be an upside bias to returns** as a result of three factors we also highlighted in our Q1 outlook:

1. Investors may be awash in cash and under-allocated to bonds. Money fund balances have risen to successive records and may represent a liquidity pool eager to lock in long-term yields, especially if and as cash rates fall (Figure 2).

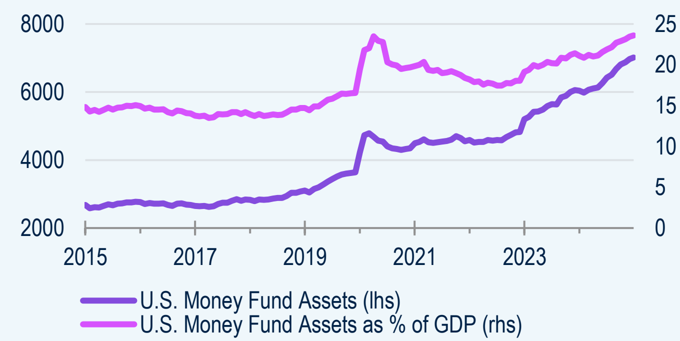
2. With Western central banks past their peak policy rates**, investors may increasingly shift from short-term investments and into bonds as they lock in yields for the long term.** The net result: long-term yields may be capped around current levels (Figure 3).

3. Despite bouts of volatility, credit spreads may remain rangebound. Moderating growth and heightened anxiety may translate into a "good enough" environment as fundamentals allow for **modest credit outperformance over the long term.** (Figure 4).

Figure 1: The bull market resumed in Q1 with higher-yielding sectors continuing to outperform. It's worth noting a phenomenon during this period: hedged global indices tended to outperform domestic indices in risk-adjusted terms, but not necessarily in absolute terms (see The Case for Going Global for more). In Q1, the hedged global agg. delivered roughly the same cumulative return as the U.S. agg., but with about one-third less volatility, i.e., providing much higher risk-adjusted returns (indexed to 100).

Source: Bloomberg

Figure 2: At this point, investors over-allocated to cash may be anxious to lock in a steady income stream for the long term. This may cap yields around current levels (lhs: $ billions; rhs: % of GDP).

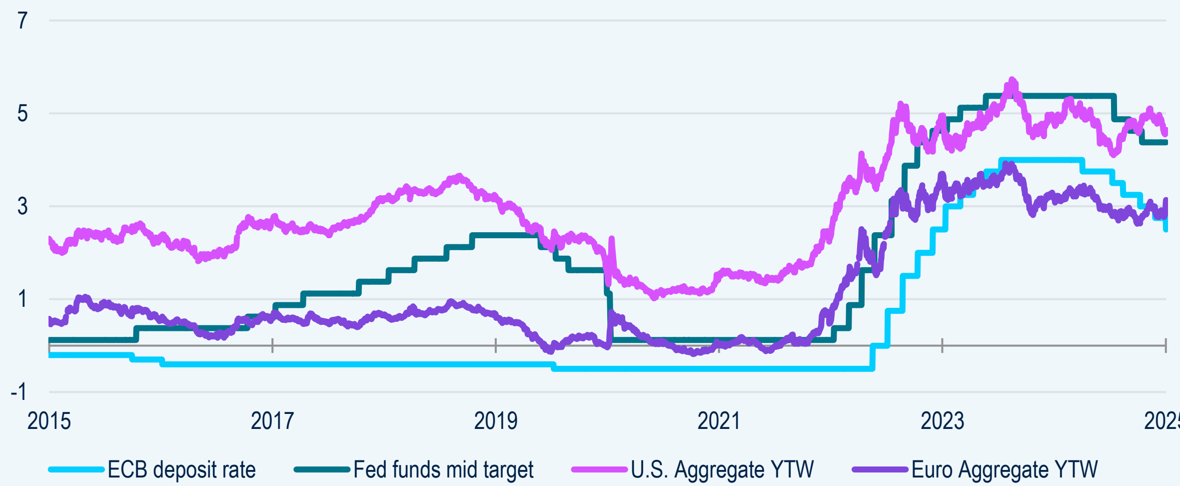


Source: Bloomberg

Despite heightened geopolitical volatility, we not only remain constructive on fixed income in absolute terms, but also relative to cash and equities given the downside risks looming in the investment backdrop. The combination of high absolute yields and supportive central banks creates an environment where long-term bonds should outperform cash over the long run. Furthermore, moderate economic growth remains sufficiently supportive of credit fundamentals and should support a steady bid for yield. This is likely to lead to a relatively flat yield curve (notwithstanding potential declines at the front of yield curves in the event policy rates decline) and allow spreads to remain in the bottom quartile of their historical ranges. In sum, this will create an environment where investors can continue to "earn the yield"—and maybe then some—in this slow-moving bull market.

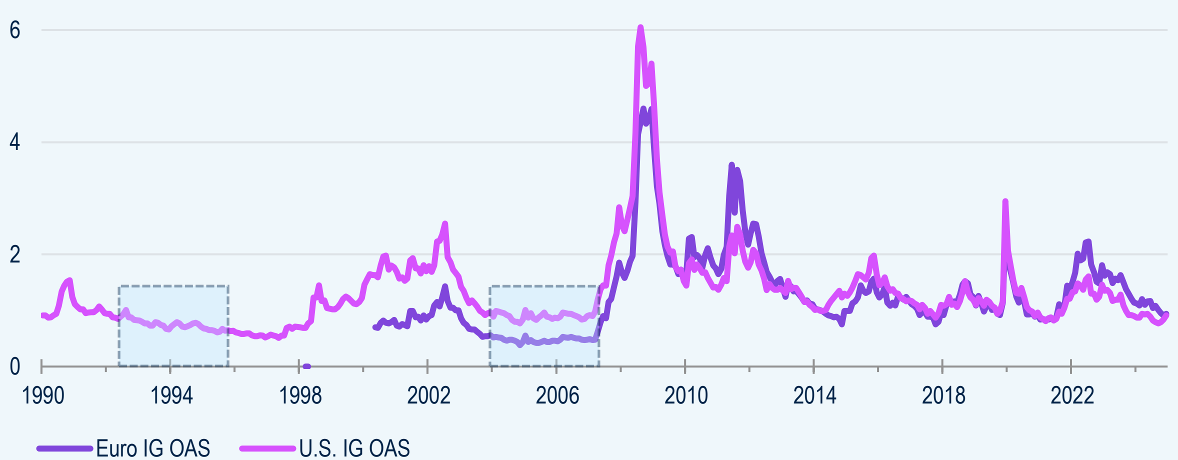
Bottom line: The moderate economic backdrop with downside risks is likely to attract ongoing flows into fixed income as investors seek to lock in yields for the long term. From current yield levels, bonds—especially those in the higher-yielding sectors—should generate respectable returns and provide ballast to investors' portfolios while intermittent volatility may continue to create opportunities to add value through active management.

Figure 3: With Western central banks past their peaks in policy rates, investors may increasingly shift from short-term investments and into bonds as they lock in yields for the long term (%).



Source: Blomberg

Figure 4: Despite bouts of volatility, credit spreads may remain rangebound (percentage points).



Source: Bloomberg

The convergence of G3 economies towards moderate growth trajectories (see Economics section)—the U.S. from the topside with Europe and Japan from below—drove divergent behavior across interest-rate, equity, and credit markets in Q1.

U.S.-Europe Role Reversal

As expected, the increase in U.S. rates in Q4 was indeed a pause, after which the bull market resumed in Q1 as U.S. rates declined (Figure 1) and European credit spreads tightened. While trajectories for the major economies appear to be converging (see Economics section), the dynamic across markets is, perhaps ironically, one of divergence.

In the case of the U.S., anxiety regarding rapidly shifting government policies—e.g., DOGE layoffs, tariffs, and the immigration crackdown—broke, or, at a minimum, interrupted the mystique of "American Exceptionalism." In the U.S., rates and the dollar fell, equities underperformed, and spreads widened (Figure 2).

Meanwhile, European markets were stunned with rates rising, spreads tightening, and equities outperforming (Figure 3). The surprise moves were driven by expectations that **the sudden drive for military self-sufficiency would result in looser fiscal policy, higher defense spending, and, ultimately, stronger growth.**

An Area of Temporary Alignment

In other noteworthy breaks from the U.S. markets, Chinese rates rose as their roaring bull market (entering its third year) took a break. In Japan's case, the increase in yields was just another quarter of JGBs continuing their multi-year trek higher. The Q1 impetus for higher rates arose from the ongoing economic recovery and a strong Spring wage round, all of which adds up to a rising probability of more rate hikes by the Bank of Japan.

Figure 1: After Q4's substantial increase, U.S. rates fell back in Q1 on mounting policy anxiety. European rates rose on fears that defense spending would drive a surge in deficit spending and lead to stronger growth. In terms of the yield differential between German bunds and U.S. Treasuries, the last few months has seen a marked swing of ~75 bps, fulling traversing the recent range (% and pp).

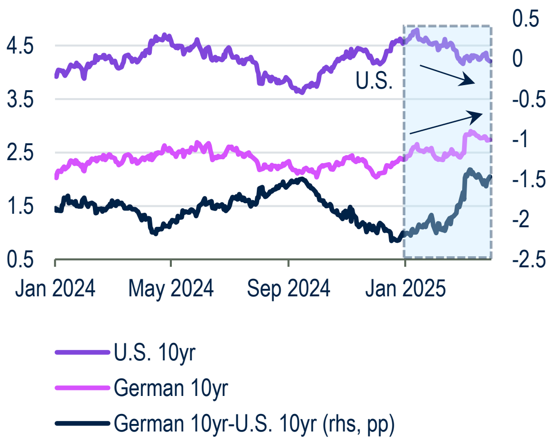


Figure 2: A break from American Exceptionalism—at least for now—surfaced in relative credit spread performance as European spreads narrowly declined over the quarter as U.S. credit spreads widened markedly (indexed to 100).

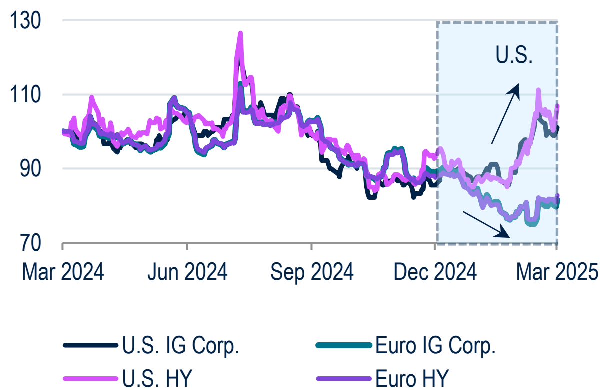
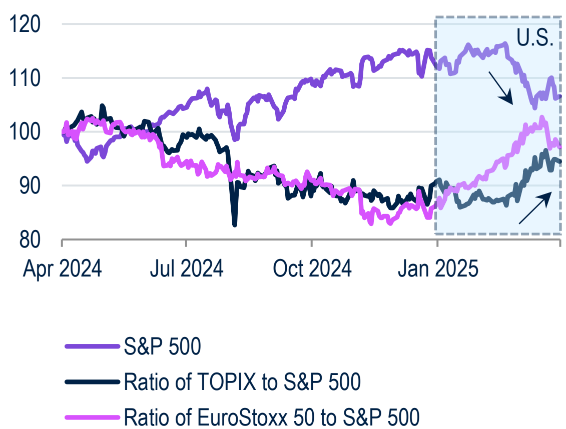


Figure 3: The role reversal between the U.S. and Europe was perhaps most visible in equities where the S&P 500 floundered, and EuroStoxx finished near the highs of the quarter (1st futures contract indexed to 100).



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PODCAST

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BLOG POST

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PODCAST

CHINA: PROJECTIONS FOR 2025

Amid global complexities, China's economic outlook presents both challenges and opportunities that are crucial to investment considerations. In this episode we weigh possible growth scenarios for China, the impacts of tariffs, private sector confidence, and property sector challenges.

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SECTION 3

GLOBAL MACROECONOMIC OUTLOOK

By Katharine Neiss, PhD, Deputy Head of Global Economics & Chief European Economist

03

CONVERGENCE IN A WORLD OF THICK TAILS

As we distill the first quarter's volatility and confusion, we see further economic moderation ahead with sizable risks to the downside. Not surprisingly, the tails of our distribution have thickened as the global trading order gets turned on its head.

In the U.S., the delta pertains to the tail scenario of rising recession risks. In the euro area, the latest tariff developments potentially offset some of Germany's bold fiscal announcements, leaving our base case firmly in sluggish growth territory (watch our webinar series on tariffs here).

U.S.

There were always going to be challenges with maintaining—not to mention boosting—the exceptional growth rate of the U.S. economy in 2024. The 2.7% annual GDP growth figure was underpinned by significant improvement in labor market participation, investment, and energy production. Of course, fiscal support has also been exceptional.

But it is unlikely this trick can be repeated.

Indeed, the relentless uncertainty due to major policy shifts, particularly with tariffs (see Figure 1 for a summary), increases the probability on the left tail of our distribution for the U.S.

Figure 1: A Summary Status of Trump 2.0

Tariff related	By country	By sector
In Force	• **China**: Additional 20% on all products • **Canada:** Additional 25% on non-USMCA-compliant products (10% on energy and related) • **Mexico:** Additional 25% on non-USMCA-compliant products	• **Steel & Aluminum:** 25%, prior exemptions/exclusions revoked and additional derivative products added • **Autos:** 25% on imported vehicles and parts
Formally Announced		• **Shipbuilding:** Fees on Chinese-built ships docking in U.S. ports open for public comment through March 24
Apr. 2 Announcements	• **10% baseline universal tariffs** (April 5) • Higher, reciprocal rates for "worst offenders" due to non-tariff barriers: China 34%, Japan 24%, and EU 20% as largest trade partners.	
Under Development / Threatened	• **Canada / Mexico**: USMCA updates to address Chinese-owned subsidiaries and trade deficits	• **Copper, Lumber, Pharma, Semiconductors:** 232 Investigations launched, due in November
Later	• **China / Semiconductors:** Ongoing 301 investigation • **Canada / Dairy & Lumber:** 250% tariffs in response to retaliatory • **EU / Spirits:** Additional tariffs in response to retaliatory	

Upcoming event dates to monitor
April 15—EU retaliatory tariffs against US steel and aluminum duties
April 15—U.S. Treasury to submit to Congress its semiannual report on currency practices of trading partners
April 30—USTR to release its annual Special 301 report on IP practices (around this date)
May 2—End of U.S. "de minimis" rule on lower-value imports from China
Mid-May—EU to announce additional tariffs on additional set of goods
May-June—Expectations for legislation extending TCJA tax cuts, exhaustion of extraordinary measures under debt ceiling.
June 24-26, 27-28—NATO and EU summits, respectively
July 1—Deadline for the US ITC to submit biennial report to Congress on the effects of USMCA auto rules of origin
Oct 4—Deadline for USTR to submit notice for public comment on the USMCA's six-year review
Late Nov—U.S. Dept. of Commerce to conclude Section 232 and 2032 investigations into copper and lumber imports

Source: PGIM Fixed Income, Evercore ISI as of April 3, 2025

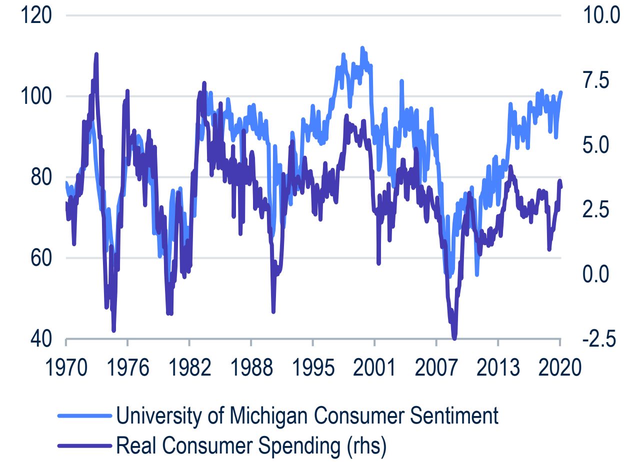
Following the reciprocal tariff announcement in early April, the aggregate effect across countries and industries lifted the effective tariff rate from about 2.5% at the beginning of the year to more than 20%, potentially exceeding the level from the era of the Smoot-Hawley Act in 1930. Significant uncertainty regarding further tariff increases remains amidst ongoing negotiations and the potential for a retaliatory cycle. At this point, our general assessment assigns a 0.1 percentage point hit to growth for every 1 percentage point increase in effective tariff rates.

Uncertainty is consequently driving U.S. sentiment weaker. Weak sentiment, even in the absence of tails risks around the crystallization of negative policy outcomes, can weigh on growth via delayed investment. This was a phenomenon observed in the UK in the intervening years between the Brexit referendum and the eventual trade agreement between the UK and EU. That experience offers a classic case study of what economists call "the Bernanke bad news principle."[1] That is, given the high cost of reversal, the decision to invest depends only on the severity of the bad news that may arrive. Delayed investment weighs on growth in the here and now, and worse, it reduces the future productive capacity of the economy, other things being equal. Policy uncertainty, particularly around tariffs, also poses a risk to U.S. household sentiment. History has shown that when sentiment weakens, consumption closely follows.

Weak sentiment can be reflected by a range of indicators, such as the inflation outlook on the back of higher tariffs as well as the fear of unemployment. The latter could be linked with DOGE-related job cuts (where it is estimated that every public sector job is associated with 0.7 in the private sector). So, while the headline impact on overall employment is likely quite limited, its indirect effect via sentiment could be more impactful. The key point is that even in the absence of a material weakening in the labor market, rising concerns about the labor market can, in itself, lead to a retrenchment in household consumption. That said, the prospect of Fed rate cuts is a key potential mitigant to recession risks, and ample space to provide policy accommodation remains. This space has been reflected in the market pricing for more than three rate cuts through the remainer of the year (up from two prior to the reciprocal announcement), which would bring the Fed funds rate closer to 3.5% by year end.

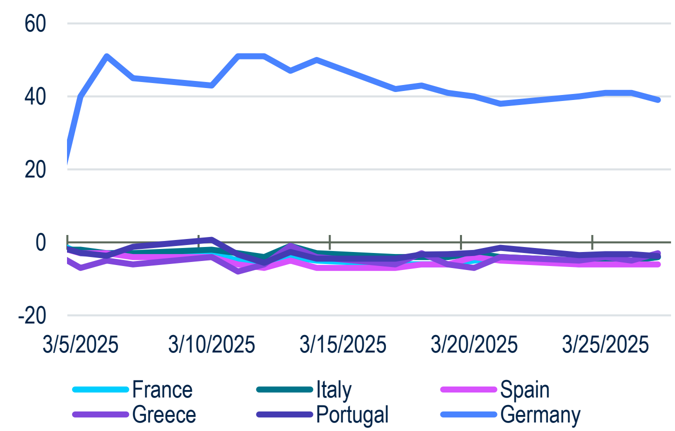
Of course, the Fed will remain acutely focused on labor market conditions, which have also undergone notable change. The labor market's resilience was supported by a sharp rise in participation, which driven by a post-pandemic catch-up and a reversion to the pre-pandemic trend. The positive effect that the participation increase had on the labor market was magnified by an immigration-led population boost. As a result, more people working provided a significant punch to U.S. real economic growth.

Figure 2: U.S. consumer sentiment and expenditures historically move in tandem (lhs Q1-66=100, rhs % change year to year).



Source: University of Michigan, BEA / Haver

Figure 3: Change in 10-year Bunds and Sovereign Spreads to Bunds since March (basis points)



Source: Macrobond

[1] Bernanke, Ben, "Irreversibility, Uncertainty, and Cyclical Investment," The Quarterly Journal of Economics, February 1983.

Going forward, we expect a more gradual pace of labor market participation, and labor market conditions will be a key aspect of avoiding outcomes from the thicker left tail of the distribution.

EA

Tariff uncertainty has global spillover effects. Europe is a very open economic region and is particularly vulnerable to renewed trade tensions given its weak growth. The threat of renewed trade tensions against a sharply shifting security situation has ushered in a sea change within Europe—and Germany in particular—to open the fiscal taps.

To secure the necessary votes, a substantial fiscal package was agreed in the final days of the outgoing German government. The package significantly increases the amount of German fiscal space for defence and infrastructure, while also adding greater flexibility and discretion around ramping up defence spending. Both ingredients had hitherto been missing, and, as such, these reforms mark a major departure from Germany's previous strict debt rules.

Alongside these changes, the EU announced additional support measures, such as discretion to flex the EU fiscal rules to exclude defence spending and an EU defence fund (ReARM EU). As substantive as these changes are, they are unlikely to be sufficient to meet Europe's security needs. Nor are they likely to materially boost investment and, hence, productivity in the region. Consequently, barring any further major announcements, we see the macro impact at the euro area level as likely being muted and delayed, which is an outcome that feeds into our base case.

Although the sharp repricing in bunds was likely overdone, it appeared orderly in that it was not accompanied by increased fragmentation in financial conditions across the euro area and was accompanied by a stronger euro (Figure 3).

The market reaction was consistent with an expectation of increased deficits in other euro area countries, prompting worries around fiscal sustainability in already stretched countries, such as Italy and France. While France has been given a bit of a reprieve post the eventual passage of its 2025 budget, the UK and France still appear vulnerable to shifts in market sentiment.

That said, while the spreads of European peripheral debt to bunds have compressed, we still see factors supporting that compression. First, as indicated above, we see the likelihood of higher deficits for defense at the country level as limited: we see Germany as the exception here rather than the rule. Second, the periphery—particularly Italy and other central and eastern European economies—will benefit from positive spillovers from increased fiscal spending in Europe. So, other things being equal, peripheral growth prospects should be marginally higher than under previous conditions, which would be credit positive. Third, the starting point for debt ratios in the periphery continues to go from strength to strength, with Italy being the only G7 country to post a primary budget surplus in 2024. Finally, we continue to expect significant Next Generation EU funds to be deployed in the next two years. These funds could now be completed by looser conditions around the use of EU cohesion funds. All in all, we remain constructive on the periphery against a backdrop of an ECB backstop in the form of the Transmission Protection Instrument.

The major fly in the ointment is from U.S.–EU trade relations. This remains a wild card for the outlook. We assume that the outcome will lead to an equalisation of the average tariff rate between the two regions–so yet another aspect of convergence. Our assessment of the reciprocal tariffs—if they stay at the announced levels—is that they may reduce growth by 50 bps per year. While European growth was previously middling, but expected to accelerate slightly, the trade situation underscores our base case expectation.

There remains a risk, however, that as the EU is more prepared, negotiations with the U.S. could become more confrontational. In particular, the recent Germany fiscal announcements alongside new EU tools to address imbalances between the U.S. and the EU on services (where the U.S. has a large trade surplus with the EU) puts Europe on a stronger footing.

As a result, we could see trade tensions spillover beyond goods and into services. Such an escalation would pose a significant downside risk to our euro area outlook. Bottom line is that even in the absence of a major deterioration and in light of substantive fiscal announcements, we continue to see weakly improving growth and the ECB as on track to deliver a few more rate cuts to put the policy rate firmly in neutral territory of around 2%.

China

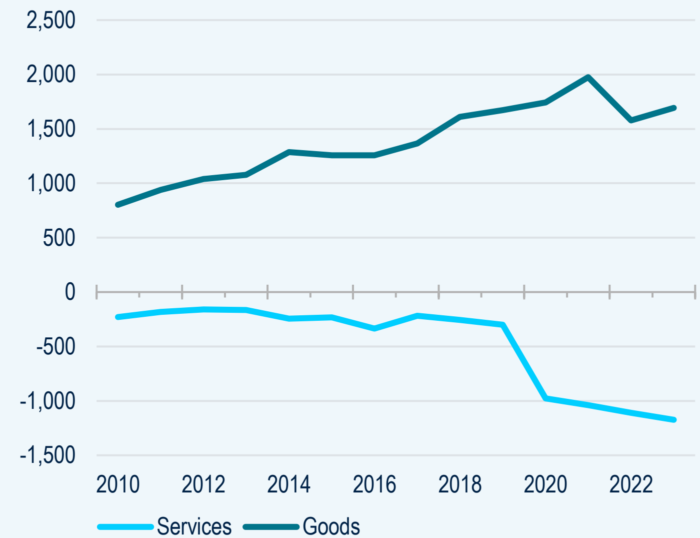
China continues to grapple with the consequences of bursting asset bubbles in the form of excess capacity, weak growth, and deflation. But there are silver linings. The property sector in leading cities is stabilising. Deepseek is lifting private sector sentiment and hopes for a productivity revival. Stimulus announced in late 2024, alongside a temporary boost to exports in an aim to front run rising U.S. trade barriers, puts the near-term growth outlook on better footing. The impact of tariffs will likely feed into the data from May, and the full impact may take a couple of quarters to play out. New support programs will continue to be ramped up through 2025. China's more measured and calibrated approach to both fiscal and monetary policy— as well as a tolerance for lower growth targets around 5%— is expected to cushion the adjustment, but unlikely to create an inflationary impulse. The spillover implications of China's weakly moderating outlook, particular around the prospects for inflation, is potentially significant. Whilst tariff uncertainty is arguably already weighing on global growth, the risk is that, if implemented, these tariffs would push prices up and thus pose a risk to the global inflation outlook. China, and its excess manufacturing capacity, forms a key part of this assessment.

The impact of U.S. tariffs levied on China risks exacerbating the underlying excess capacity issues and the global deflationary consequences. And whilst Europe and Asia's markets are particularly exposed to being flooded by Chinese goods, their exports are also increasingly in direct competition with Chinese goods. China's domination of global supply chains coupled with compositional differences in the trade basket and the underlying shift in Chinese consumption patterns suggests that retaliatory tariffs from China are unlikely to hurt Chinese consumers or change the deflationary narrative. This moderating effect on global inflationary trends acts as an offset to trade barriers and is a key contributing factor to our overarching view of global moderation.

Japan

Growth in Japan has improved and inflation has continued to sustainably converge to the 2% target after years of deflation. On our convergence theme, Japan's GDP growth and inflation exceeded that of the U.S. in Q4 2024. As a result, Japan continues on the path towards policy normalization—tariff uncertainty notwithstanding. Even more so following the reciprocal announcement, we expect the Bank of Japan to follow a measured and predictable approach to normalisation. This is to ensure that further rate increases stay orderly, without triggering excessive volatility in either the foreign exchange market or long-term yields. Our base case is for a further rise in policy rates above the current, psychologically important level of 0.5%, with the possibility of a slight acceleration in balance sheet run off sometime in the summer.

Figure 4: U.S. and EU net trade in Goods and Services (USD billions).



Mexico: A Case Study in Tariffs Effects

"When the U.S. sneezes, Mexico catches a cold," may be an appropriate metaphor in 2025. Indeed, we now expect Mexico to flatline or fall into a recession this year. Domestic issues and U.S. tariffs have significantly damaged investor sentiment and growth prospects.

Given the gloomier U.S. economic outlook, in Mexico we expect GDP contractions in Q1 and Q2 and then recover to zero (at best) for 2025 (consensus 0.5%). Our base case assumes that tariffs are largely removed by Q3 and ultimately limited in scope. However, if tariffs are generalized and become permanent, full year GDP will likely contract between 0.6 and 2.0%.

Inflation in Mexico's will continue its current downward trend as the economic slowdown intensifies. We project headline inflation of 3.5% (Consensus 3.9%, Banxico 3.4%). U.S. tariffs pose limited upside inflation risks from possible MXN depreciation due to the low pass-through that is further compressed by the widening negative output gap. We only expect an inflationary resurgence if Mexico retaliates with high and broad tariffs on U.S. imports causing prices in Mexico to rise.

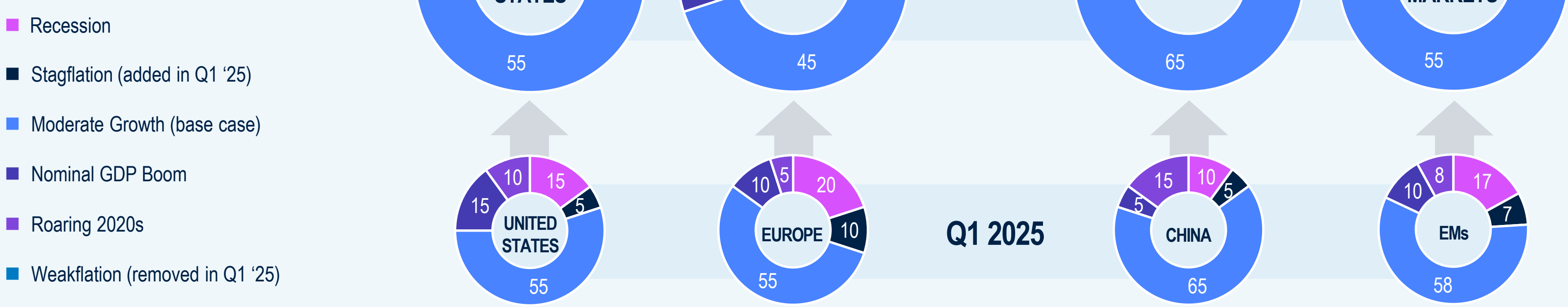
We don't expect President Sheinbaum to take that step. So far, she has been tight-lipped on strategy, but has hinted limited and targeted reciprocal measures. Sheinbaum has been effective in accommodating U.S. non-trade related issues and obtaining carve-outs and delays. She has been prudent in refraining to threaten any retaliatory actions until U.S. policies materialize.

Starting at a 6.0% real rate, we expect the central back to cut interest rates aggressively in light of falling inflation, weakening economic activity, and myriad risk factors. We expect Banxico to cut the overnight rate from 9.0% to 7.25-7.75% (Consensus 8.0%) as it continues the current pace of 50 bps cuts in upcoming meetings.

Longer term, we see significant risks leading up to anticipated review of the USMCA. This will frame Mexican asset performance, which is already compounded by the country's domestic issues, such as the judiciary reform. That said, we expect Mexico to remain an investment grade credit, save a very low probability of chaotic escalation in tensions, leading to a break in trade relations with the U.S. or the unravelling of fiscal and debt trajectories.

Q2 Macroeconomic Scenarios

PGIM Fixed Income's Q2 '25 economic scenarios feature greater concentration around the base case relative to Q1 '25. (% probability)



Source: PGIM Fixed Income. *EM consists of a weighted average of the U.S. (35%), Europe (35%), and China (30%). EM probabilities may not sum to 100% due to rounding.

PGIM FIXED INCOME

SECTION 4

GLOBAL CREDIT RESEARCH OUTLOOK

By the Global Credit Research Team

04

CORPORATE CREDIT OUTLOOK: TARIFF TAKEOVER

The healthy fundamental set-up to start the year has been obscured by considerable trade uncertainty. Fundamentals still skew positive, but earnings expectations are coming down—albeit from healthy levels. We expect fundamental trends to vary by industry and remain watchful of more cyclical and consumer discretionary sectors, as well as those that might be disproportionately impacted by tariffs.

One silver-lining about the broad tariff uncertainty is that even snippets of policy clarity will improve assessments of macro & micro impacts and, importantly, allow companies to adjust accordingly.

More to the healthy starting point for fundamentals, positive U.S. credit migration continued in Q4 2024 as the upgrade/downgrade ratio was 2.1x versus 2.6x in Q3 2024. For all of 2024, the ratio was 4.7x. We expect trends will continue to vary by industry and remain watchful of more cyclical and consumer discretionary sectors, as well as sectors that might be disproportionately impacted by tariffs.

Within high yield, we expect revenue to grow modestly in 2025 but see EBITDA margins and interest coverage weakening.

The potential tariff impact remains top-of-mind, with autos and metals & mining companies expected to be among the most impacted, followed to a lesser extent by consumer, housing, industrial & manufacturing, energy, and technology, but to a lesser extent. Tariff risks to communications, financials, healthcare, and utilities are expected to be low.

WEBCAST SERIES

ON TARIFFS WITH TOM PORCELLI

This three-part webcast series explores the global credit and economic implications of U.S. tariffs. Our credit analysts and economists share their insights and perspectives, discussing outcomes for key sectors, potential reactionary measures by affected countries, and how we're monitoring global markets as details evolve.

VIEW THE SERIES →

OIL / GAS

Dave Winans, U.S. Investment Grade Credit Research Analyst

- Current U.S. pipeline infrastructure lacks the flexibility to reroute more domestic crude to refineries.
- Tariffs could result in direct price increases at the pump, potentially affecting discretionary spending.
- Greater focus on expanding pipelines could alleviate logistical bottlenecks and lower energy costs more effectively than additional drilling.

EUROPEAN AUTOS

Chris Roberts, European Investment Grade Credit Research Analyst

- Autos face 25% tariffs, affecting U.S. sales and imports. Some European OEMs are particularly vulnerable, with a significant reliance on Mexico and Canada.
- OEMs may pass costs to consumers or absorb some within margins.
- Reducing models or changing production locations are medium-term options; localizing production requires 3–4 years.

ASIAN CORPORATE CREDIT ISSUERS

Yanru Chen, Emerging Markets Corporate Bond Credit Research Analyst

- China is focusing more on domestic consumption rather than manufacturing & investment—a major, potentially enduring shift.
- AI adds another layer to economic, trade concerns, providing China with competitive levers beyond tariffs.
- India faces excess supply from rerouted exports, which could impact domestic producers and its high-growth economy.

Our fundamental scores in the accompanying diagram continue to skew positive, with an average score of 3 in IG and 2.5 in HY. While IG trend scores are relatively balanced (average of 2.6), they skew negative in the U.S. leveraged universe, where the average score declined quarter-over-quarter to 2.3 from 2.4.

Nine of 11 sectors in IG and eight of 10 in HY have strong fundamentals, with only communications (IG, HY), utilities & power (IG), and consumer (HY) skewing weaker. In IG, we raised fundamental scores for airlines to 3 from 2 where moderating capacity growth should support margins and lowered autos to 3 from 4 on normalizing inventories and on tariff effects. We lowered trend scores for chemicals, pipelines, and Canadian banks to 2 from 3.

Within HY, we raised fundamental scores for airlines to 3 (from 2) as recent guidance suggests softness in demand and lowered wirelines to 2 (from 3) where elevated capex has yet to drive topline/EBITDA growth for most issuers. Trend scores were lowered for airlines to 2 (from 3), building materials to 1 (from 2), industrials to 2 (from 3), and paper & packaging to 2 (from 3). Trend scores for steel and wirelines were raised to 3 (from 2).

Trend score	
Positive	↗ (4 trend score)
Neutral	● (2-3 trend score)
Negative	↙ (1 trend score)

Q2 2025 U.S. and European Investment Grade Roundtable summary

Sector fundamentals

Weak ◄◄◄ ►►► Strong

	1	2	3	4
Communications	Media ●	Cable ●	U.S. & Euro telecoms ●	
Consumer		Retailers ● Restaurants ● Food/beverage ● Healthcare services ● Supermarkets ●	Airlines ● Automotive ● Lodging ● Consumer products ● Healthcare products ↗ Pharmaceuticals ● Tobacco ●	
Financials		Canadian banks ● Finance co's ●	U.S. money centers ● U.S. regionals ● Life insurance ●	P&C insurance ● REITs ●
Healthcare		Healthcare services ●	Healthcare products ↗ Pharmaceuticals ● Healthcare ●	Healthcare REITs ↗
Housing		Euro Building materials ↙	Building materials ● Lodging ● Homebuilders ●	Residential REITs ●
Industrials & manufacturing		Chemicals ● Railroads ● Euro industrials & services	U.S. & Euro paper & packaging ● U.S. & Euro aerospace/defense ● Euro capital goods ● Euro chemicals ●	Diversified manufactures ● Industrial REITs ●
Metals & mining			Euro steal & related mats ●	Metals & mining ● Euro non-ferrous metals ●
Oil & gas		Oil Field Services ● Refining ↙	Oil field services ● Euro gas E&P Euro oil E&P	Independents ● Integrated ● Refining ● U.S. & Euro pipelines ●
Technology			U.S & Euro technology ●	
Utilities & power		Electric ●	Euro electric/IPPs ↗	
Autos			Automotive ●	

Source: PGIM Fixed Income

PGIM FIXED INCOME

SECTION 5

GLOBAL SECTOR OUTLOOKS

05

DEVELOPED MARKET RATES

Outlook: Focusing on fundamentals and fading extreme moves under volatile conditions.

■ With Q2 underway, the developed market rates complex stands at the crossroads of the economic convergence and market divergence themes highlighted in our preceding bond market and economic outlooks.

■ Some observers may regard Germany's recent fiscal announcements as a sign that Europe is entering a new fiscal paradigm that is on a converging path with the U.S. This potential outcome is reflected in the thicker right tail of our European economic scenarios. The recent jump in 10-year bund yields to a near six-month high seemingly supports that right-tail narrative. However, with a base case for continued economic moderation, we view the market reaction as another case of an extreme market move under uncertain, volatile conditions.

■ Hence, long positioning in bunds—and other European rate markets where moves outpaced fundamentals—could be approached from a carry and roll perspective as well as from a relative value perspective vis-a-vis the U.S. Indeed, bunds appear to have more carry than U.S. Treasuries, but are of higher quality with less outstanding supply and lower government deficits well into the foreseeable future. Furthermore, Europe's latest inflation data remain in line with expectations, which is critical to facilitating our expectation of two additional ECB rate cuts to 2% by midyear.

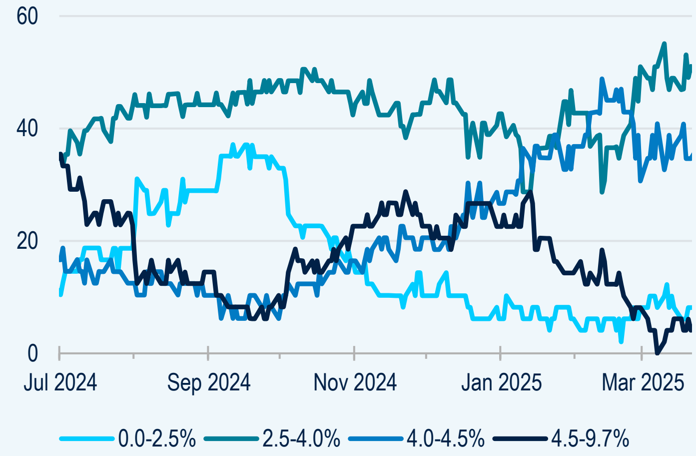
■ Treasuries also reflected the pause in the "American Exceptionalism" trend amid broad policy confusion. The lack of clarity fed into the thicker left tail of our U.S. economic scenarios, potentially pointing to convergence with other, slower growing developed market economies.

■ Yet, the U.S. 10-year yield changed little in Q1. The long government space is one where investors frequently reassess respective deficit and issuance dynamics, maintaining pressure on U.S. long-term rates, particularly in relation to the front of the curve. The front end may also contribute to a steeper yield curve as it may drop with additional Fed rate cuts.

■ While markets have become accustomed to headfakes (see the accompany chart for changes in Fed Funds probabilities), they may sense some clarity in Fed policy. More than three rate cuts are priced in through the remainer of the year (up from two prior to the reciprocal announcement). Our market-implied probability model for three-month SOFR by the end of 2025 is coalescing around the 2.5-4.0% and 4.0-4.5% bands, particularly the former with a probability of more than 50%.

■ Japan's economy also followed a convergence theme amidst its steady recovery and a solid Spring wage round. This should provide the Bank of Japan with room to gradually continue lifting policy rates. And in divergence from the relatively flat move in the U.S. 10-year in Q1, the 10-year JGB yield continued its consistent climb into the 1.50% area.

After some sizable moves, U.S. markets are pricing in rising probability of a Fed Funds rate of 2.5-4.0% by year end.
(market-implied probability, %, for 3-month SOFR)



Source: Bloomberg

AGENCY MBS

Outlook: Negative in the short term. The technical backdrop has deteriorated, and interest-rate volatility is likely to remain elevated. We maintain a preference for seasoned, lower 30-year coupons and production coupons.

■ After performing reasonably well versus Treasuries in Q1, MBS valuations still appear reasonable as spreads have largely remained rangebound. Yet, the technical and relative backdrop has worsened since the beginning of the year, contributing to the potential for a rotation out of the sector.

■ Though we continue to expect net supply to look quite similar to 2024—less than $200 billion in total net issuance—given elevated mortgage rates and lack of affordable housing, we expect a pickup in origination in Q2 amid the sharp decline in rates in early April and as we enter the Spring upswing. Further weighing on technicals, dealer balance sheet deployment has quickly climbed back to local highs (Figure), and we do not expect CMO creation to continue at its current pace.

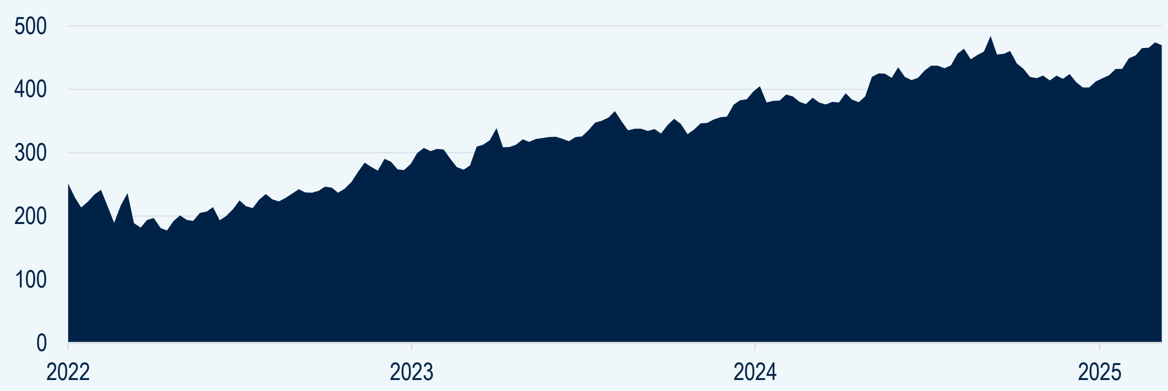
■ Furthermore, the Fed is unlikely to stop MBS from rolling off its balance sheet and unlikely to add them again in the instance of another quantitative easing program. Finally, index-level spreads are currently not overly compelling, but zero-volatility spreads remain attractive, particularly in higher coupons.

■ That said, the outlook for the Fed remains supportive. If the pace of rate cuts remains gradual, prepayment activity is likely to stay muted. Banks are also likely to remain a source of demand in 2025, with the potential that revised regulations under the Trump administration could render MBS holdings less capital-intensive.

■ Within MBS, we maintain a preference for seasoned lower coupon 30-year pools balanced with TBA-like longs in production coupons due to their solid carry profile. We have been more active in adjusting positioning within pools, with a bias to underweight intermediate coupons. We are underweight the 15-year sector due to rich, technically-driven valuations and expect it to disproportionately underperform during any meaningful supply pickup.

■ We are positive on GNMAs versus Conventionals, with a preference for semi-seasoned pools. The sector has underperformed as result of technicals, while CMO takeout and dealer balance sheet commitment has focused in Conventionals. Although the odds of GSE reform are minimal, it is being priced to a near-zero probability and any headlines suggestive of a push toward privatization could be negative.

Primary dealer net positions (USD millions)



Source: Bloomberg as of 3/26/2025. Federal Agency and GSE Pass-Through MBS Specified Pools.

SECURITISED SOLUTIONS FOR THE GREEN TRANSITION

ESG-focused investors often express the need to understand the financed emissions within their portfolio. While a robust and well understood methodology for calculating emissions from corporate bond issuers exists, calculating financed emissions within the securitized space presents unique challenges, particularly as the collateral pools present an efficient approach to financing the energy transition (listen here for more details on securitised solutions for the green transition).

Unique Challenges

For example, financed emissions are not relevant for credit card ABS, where underlying loans are tied to individuals. It doesn't make sense to try to calculate an individual's emissions and then attempt to link that number back to the credit card debt.

However, financed emissions are more relevant for other parts of the securitized market. Here, data can be classified into three components. The first is the emissions profile, or the efficiency, of the underlying assets within the collateral pool. Using auto ABS as an example, this might entail looking at the tailpipe emissions per mile driven for each car within the collateral pool. The second component is the usage of those assets, or the number of miles a borrower drives a car per year.

By multiplying the first and second components, we find the total emissions per year for each car in that collateral pool.

The third component for calculating financed emissions within the securitized space is the allocation of those emissions based on the total investment in the securitization.

Recent years have introduced significant progress in disclosure of asset efficiency within the securitized sector, particularly in CMBS and ABS. However, challenges remain in measuring individual asset usage due to privacy considerations and the lack of post-issuance tracking. That leaves broad estimates around, for example, the average use of a car or average energy use of a home, which we believe leaves the market with very little information on financed emissions. Despite these hurdles, industry initiatives, such as the Partnership for Carbon Accounting Financials, are working towards an industry-wide methodology for allocating emissions across securitizations, with considerable progress made over the past year.

Beyond Emissions

While a great deal of focus is solely on emissions, environmentally-focused investors may also want to focus on collateral pools that enable the green transition.

PODCAST

SECURITISED SOLUTIONS FOR THE GREEN TRANSITION

Securitised credit is emerging as a key driver in financing the green transition, offering investors opportunities to support ESG initiatives without sacrificing return. This episode navigates how securitisation helps fund green assets, the challenges of measuring financed emissions, and the evolving regulatory landscape in the U.S. and Europe.

Check out PGIM Fixed Income's podcast series, Fixed on ESG.

Physical assets, such as real estate, autos, or infrastructure, are economic engines that can help decarbonize significant parts of the global economy. For example, in the corporate sector, an ESG-focused investor may seek to understand a company's changing emissions profile over time. However, a similar securitized credit investor may be less interested in seeing that change and more interested in understanding how the collateralized assets are enabling change. To that end, environmentally-focused investors may opt to invest in physical assets (such as heat pumps or solar panels) via securitizations that are helping to advance the energy transition.

Public versus Private Transactions

Private transactions, often bilateral agreements between issuers and investors, offer even more control and additional opportunities for innovation. With more control over deal structures, there's increased potential to maximize impact, improve disclosure, and generate favorable economics. Using data centers as an example, most green-labeled deals in this space are purely based off of the collateral's energy efficiency. However, by operating bilaterally, there might be a way to structure a deal where proceeds are used, for example, to contribute to the construction of a new power plant fueled by renewables. Through added disclosure in a private transaction, the investor can better understand how much renewable capacity is being created by this type of transaction (listen here for more details about private securitized transactions).

Geographical Differences and Opportunities

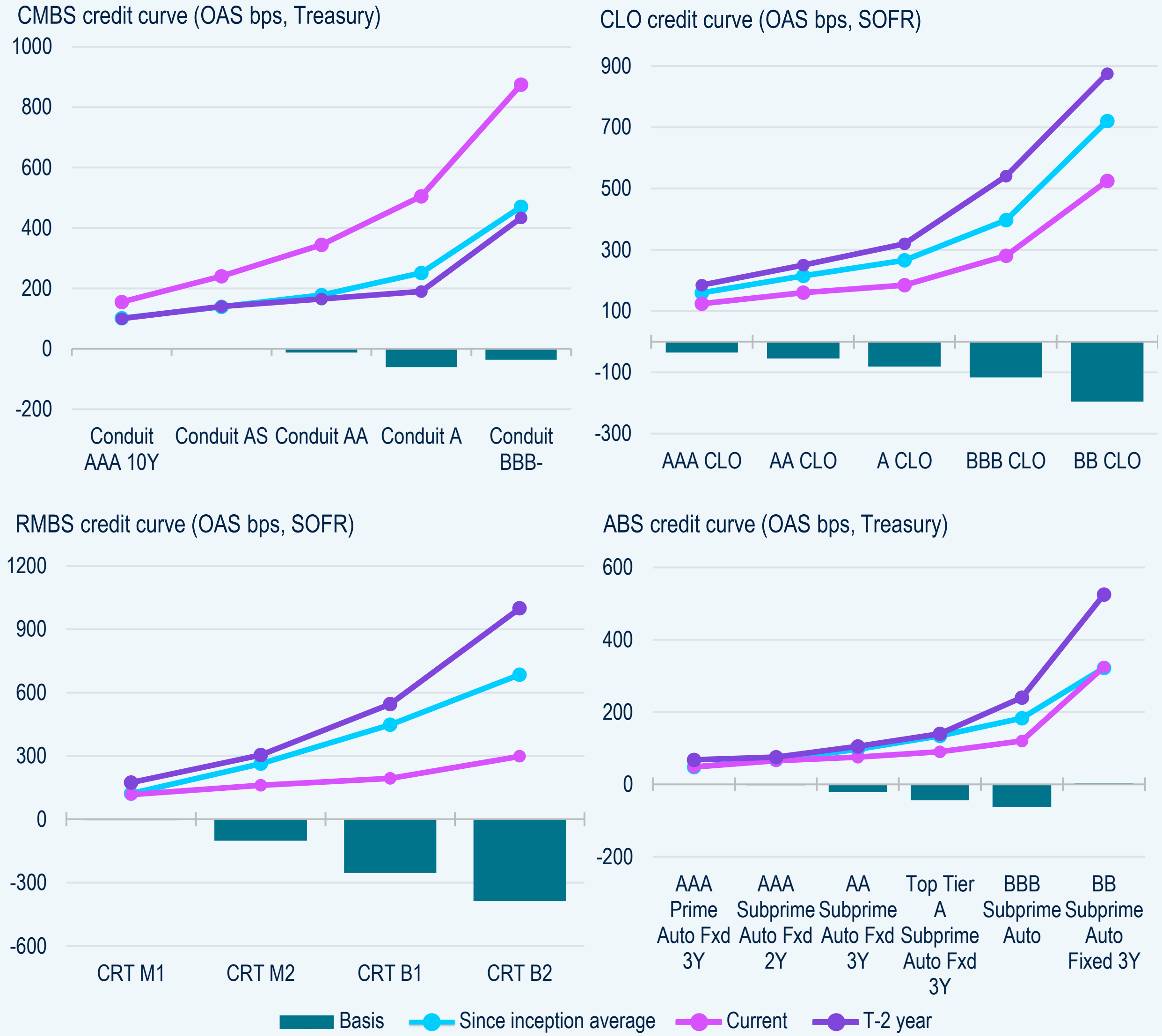
The background above also alludes to somewhat of a paradox. In our experience, much of the demand for ESG products is driven by European clients, yet the European securitized market isn't as well developed as the U.S. market. However, European regulators have recognized the need for securitization as a funding source and are encouraging the green securitization market (click here to read our securitization response to the European Commission). New EU green bond standards have introduced a use of proceeds model, allowing issuers to originate new green loans with the proceeds from securitizations. This development is expected to create new funding opportunities. Meanwhile, European investors can currently participate in the green transition through the U.S. market where many deals are European risk retention compliant.

SECURITIZED CREDIT

Outlook: Despite the broad spread rally over the past year, securitized products continue to offer compelling value vs. other fixed income asset classes. We continue to favor tranches at or near the top of securitized capital structures given their attractive relative value and risk-adjusted return potential. We expect spreads to remain around historical averages, keeping carry as the dominant theme. While solid technicals could lead to further spread and credit curve compression, we favor positioning in shorter spread duration investments. Likewise, we remain extremely selective regarding more credit-sensitive positions as credit curves appear too flat, and the downside risks associated from indiscriminately traveling down the capital stack outweigh the potential rewards.

- In **CMBS**, commercial real estate pricing continues adjusting to the elevated interest-rate environment, with price indices indicating an approaching trough in valuations. Delinquencies and modifications will continue as loans reach maturity or face refinancing challenges due to lower valuations and higher coupon rates. We continue to see value within 5-year conduit AAA securities as spreads look particularly attractive relative to similar tenor IG corporate bonds. Lower in the capital stack, we continue to see value in select single-asset single-borrower securities and are selectively adding exposure.

Credit curves across securitized products still appear too flat



Source for CMBS and ABS credit curve: JPMorgan ABS, CMBS Indices. Dates January 3, 2012 to March 14, 2025. Source for CLO Credit Curve: PGIM Fixed Income. SI dates vary. CLO AAA, AA from December 22, 2014. CLO A, BBB, BB from December 29, 2017. Source for RMBS Credit Curve: JP Morgan RMBS Indices. SI dates vary: CRT M1/M2: January 3, 2017; CRT B1: February 28, 2017 and CRT B2: January 4, 2021.

- In **RMBS**, while higher mortgage rates have weighed on affordability and demand, prices remain firm the below average supply of existing homes. Given the persistence of strong underwriting practices, we remain constructive on mortgage credit instruments while acknowledging the uptick in delinquencies in FHA and non-qualified mortgage pools. We see value in reperforming loans and second-lien bonds given their spreads over corporates and other non-agency securitized products. However, valuations of credit risk transfer bonds (largely from Fannie/Freddie mortgages) are stretched after the significant spread rally.

- In **CLOs**, senior tranches continue to offer attractive relative value compared to many fixed income asset classes. However, credit concerns in the underlying bank loans could outweigh the prevailing technical support. While bank loan spreads have been supported by low net supply and strong demand, we expect to see some credit deterioration via downgrades to CCC, increased default rates, and lower recovery rates. Therefore, we continue to favor senior CLO tranches in the U.S. and Europe. We are selectively adding new issue mezzanine tranches where we see additional carry opportunities. In the U.S., we find value in selling higher premium, longer duration bonds, and rotating into spread-neutral primary transactions. In Europe, discounted bonds offer some total return potential

- In **ABS**, while prime consumer credit remains resilient, the effects of inflation and lower disposable income continue to weigh on the weakest consumer segments. We remain vigilant for signs that the weakening in consumer credit is spreading. We remain positive on spreads in the near term, but are mindful of heavy supply headwinds. We favor top-tier unsecured consumer and subprime auto issuers, as well as significant risk transfers (SRTs) as they provide exposure to high-quality consumer assets. Looking forward, changes in banking regulation may lead to more opportunities via asset sales or regulatory transactions.

INVESTMENT GRADE CORPORATES

Outlook: We are becoming more cautious as the path to strong excess returns over the coming months may narrow. This caution is due to the rollout of U.S.-centric policies, the respective responses, and the likelihood for further market volatility. Although the performance of global IG corporates has been supported by healthy demand for all-in yield, cracks are beginning to emerge as U.S. policy uncertainty climbs dramatically and threatens to reorder global trade relationships.

- In the U.S., while investors have increased the amount of easing expected over the course of the year, that total remains in flux following the reciprocal tariff announcement. Markets priced in slightly more than three cuts through year end. As we look back at previous easing cycles, we have found that while spreads have generally been flat for a six-month period following a rate cut, they then began to move wider over the subsequent six months. This has been the case regardless of whether there was an ensuing recession. Prior to the reciprocal announcement, U.S. credit priced in a lower probability of recession than other risk assets.

- **Spread Ranges:** Historically, U.S. IG spreads have traversed a range of about ~60 bps over the course of a calendar year (excluding 2008-9 and 2020). Yet, even amid high levels of uncertainty, IG CDX options markets still indicate a high probability of spreads staying in relatively narrow range. They have, however, begun to indicate a higher likelihood of a "left tail event," now placing ~15% probability that CDX spreads move to a level wider than 100.

- **Supportive Technicals:** Despite the uncertainty, technicals–which have supported tight IG spreads have thus far – have largely remained in place with strong demand for high all-in yields. However, the relative attractiveness of U.S. IG has moderated. A softer macro backdrop could bring lower yields, an influx of issuance, and a drop in demand, which could lead to supply indigestion. On a positive note, our base case expectations are for net supply to fall as we enter the second quarter with less issuance and higher maturities than seen in the first quarter.

EUR/USD Spreads: Recent outperformance of EUR spreads has been dramatic, but not unprecedented (Euro IG OAS – U.S. IG OAS; bps)

Source: J.P. Morgan, Bloomberg Finance L.P.

- **Fundamentals Are Somewhat Weaker:** Per Q4 2024 earnings releases, EBITDA margins were down 0.2 pp (QoQ), and net leverage was flat (2.9x, QoQ), but up 0.1x (YoY). Since then, Trump's tariffs have exposed sectors such as autos, technology, and chemicals to additional risk. Considering policy uncertainty, Q1 earnings estimates have come down from an expected growth rate of +11.6% (YoY) at the end of 2024 to the current estimate of +7.1% (YoY).

- **Some Management Caution:** Tariff policy announcements have eroded market confidence. As management confidence falls, there could be a drop off in economic activity and capital spending. The potential deferral of capex spending and moderation of M&A activity in the upcoming quarters provide a small degree of reassurance, as it may help maintain corporate credit metrics.

- **U.S. Portfolio Positioning:** In the current market environment, we favor carry and prefer to focus risk on shorter maturities (<5 year) versus bonds in the intermediate and long end of the yield curve. The 10s/30s spread curve is in the 20th percentile for "flatness." BBB-A industrials spreads are snug (40 bps) suggesting a move up in quality may be appropriate. While we are still overweight BBBs (for the carry), we have reduced our positioning and most of this overweight is in the < 5-year portion of the spread curve. In terms of sectors, we are underweight industrials and overweight financials (particularly the "Big 6" money center banks) and utilities.

- European IG spreads have tightened more than U.S. IG spreads YTD, leaving the Euro IG index slightly tighter than the U.S. Index. While this is not the first time this has occurred (Note: 2014-15, 2018, and 2021), it is the first occurrence without ECB intervention in the form of significant corporate bond purchases (e.g., through the corporate sector purchase program, CSPP).

- Given the Euro market's strong performance, we believe it has priced in all the positive developments from Q1–namely Germany's fiscal spending shifts, the divergence in rates between Europe and the U.S., and increased demand from yield buyers, while largely downplaying tariff headlines. Some of the market optimism regarding Europe's economic outlook is likely to have been undermined by Trump's tariff announcements on April 2nd. As stated above, the Euro-area is particularly vulnerable to renewed trade tensions given its weak growth.

- **EA Portfolio Positioning:** Considering the backdrop, we anticipate limited spread tightening to result from upside market risk. Therefore, in our global and Euro IG portfolios, we are moderately cautious. We continue to cut risk and favor carry while seeking out idiosyncratic opportunities. We note that in our global IG portfolios, risk reductions have been made via our Euro IG overweight.

GLOBAL LEVERAGED FINANCE

Outlook: Cautious. Solid market dynamics should hold against elevated macro uncertainty. While the Trump administration's agenda may seek long-term economic benefits, we are wary of the near-term effects. As such, we maintain our close-to-home defensive positioning with an overweight to high-quality, short-duration high yield in the U.S. and underweights to cyclicals as well as potential tariff-impacted names in Europe.

- Current spreads reflect the strength of credit fundamentals and market technicals. However, the potential for further spread widening remains should fiscal policy result in delayed private investment and demand contraction. Although our base-case calls for moderating, yet continued, economic growth and contained inflation, trade conflicts and targeted Federal spending cuts create volatility and uncertainty around the path of economic growth. We've noted recent earnings weakness and tepid guidance in key industries, such as building products and consumer products. Yet, we believe the central bank "put" remains in play should economic conditions deteriorate.

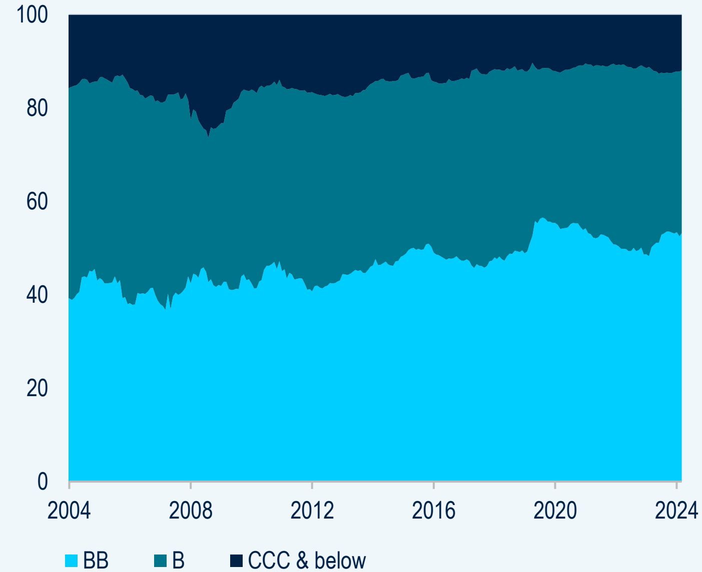
- Technical and credit conditions remain solid. The ongoing net supply deficit and robust inflows are supportive, and absolute yields remain attractive. Further, with overall levels of credit quality in the market at historic highs and a manageable near-term maturity wall, the default rate should remain benign. Furthermore, a significant dispersion in lower-tier credits could create relative value opportunities.

- We are overweight short duration bonds and have positions in AAA CLOs for high-quality carry in place of longer-duration, high-quality issuers. Looking at sectors, we are overweight home construction, healthcare & pharmaceutical, and midstream energy. We are underweight technology, media & entertainment, and retailers & restaurants. Recent reductions have included cash positions trading at historically tight spreads in favor of HY CDS to capture the positive basis.

- While the portion of the U.S. leveraged loan market trading above par recently dipped to around 11%—down from approximately 70% heading into year-end 2024—we note that this is more a function of last year's massive repricing wave that accelerated through the middle of Q1 before dissipating by the end of March. Nearly 60% of the $313 billion that priced YTD were repricing transactions, while over 25% were for refinancing. With the repricing wave over, primary market demand has since turned to new money transactions. On the demand side, while recent readings showed outflows, flows are up $12 billion QTD, a trend we believe should continue.

- Although Q1 returns were muted, we continue see another solid year ahead with a leveraged loan total return forecast of 6.5% in 2025.

U.S. High Yield bond credit quality is historically high (%)



Source: Bank of America

- Our forecast is supported by high all-in current coupons and yields, strong CLO formation, and continued inflows from institutional and retail investors. However, sharply higher net issuance volume and easing SOFR rates bringing coupons lower as the year progresses could ultimately weigh on total returns.

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

- Spreads for European high yield bonds and loans widened slightly during Q1, but meaningfully outperformed U.S. leveraged finance markets. European outperformance was driven by investors focusing on the positives of the European fiscal spending plans and the negatives of growth concerns in the U.S. Given the increased uncertainty around growth and tariffs, we remain cautious and believe spreads are more likely to widen in Q2. While the magnitude of widening will be dictated by broader risk sentiment, strong technicals within European leveraged finance markets—i.e., limited net supply, continued inflows, and robust CLO formation—should continue to dampen volatility. There remains a dispersed, dislocated, and uncorrelated tail to the market where careful credit selection can drive alpha generation.

- We generally remain underweight cyclical, consumer discretionary, and tariff-impacted businesses. We are running roughly market-neutral levels of risk given our view that spreads are fully valued, but strong technicals are likely to persist. We believe careful credit selection and a focus on idiosyncratic relative value opportunities will continue to be rewarded.

EMERGING MARKET DEBT

Outlook: Maintaining focus on fundamentals, while emphasizing relative value and idiosyncratic opportunities. Despite ongoing near-term tariff and global macro risks, EMD should remain resilient over the medium term, and the longer-term constructive attributes of an evolving global backdrop continues to anchor our investment thesis. The potential waning of U.S. economic and market exceptionalism could give way to rest-of-the-world opportunities and clearer identification of potential EM "winners" and "losers." The recent reversal of U.S. dollar strength, healthy global liquidity conditions, and the attractive carry on EMD spreads, FX, and rates also temper our near-term concerns.

EM Hard-Currency Sovereigns

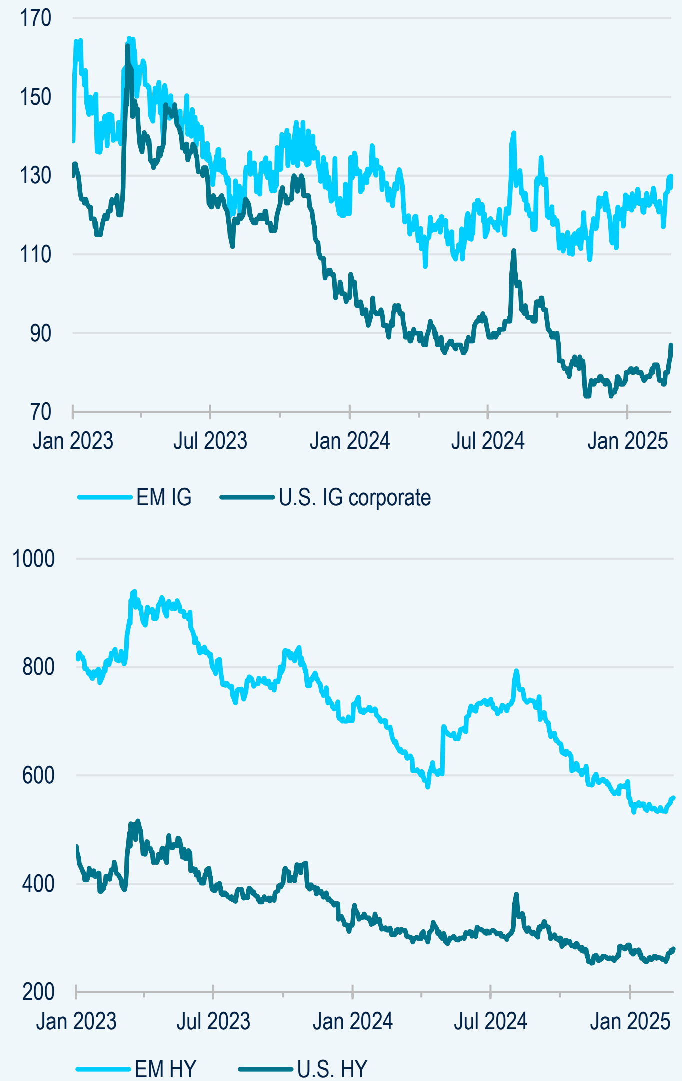
- While U.S. growth appears durable, the direction of near-term travel appears lower. The narrative of U.S. exceptionalism that has been prevalent since the Great Financial Crisis could be waning. The global context is also changing as the EA has altered its growth dynamic, with higher German defense and infrastructure spending likely supportive of European growth and risk assets. Meanwhile, Chinese policy support to boost consumption appears meaningful and could help smooth out pressures from both the property sector overhang and trade confrontation with the U.S.

- Although risks remain, a shifting narrative around U.S. exceptionalism should support EM spreads. Hard currency spreads widened from the tights of mid-February and will likely need some reduction in tariff uncertainty to revert back towards those tights.

- The tariff impact is difficult to predict, and we will see both first- and second-order effects. Trade linkages are not uniform, with EM countries experiencing varying degrees of vulnerability and resilience. Much of the impact on a country will come down to its competitive advantages, relationship with the U.S., and ability to negotiate. This leads us to expect increased differentiation across issuers, but less so within ratings buckets.

- Given the high all-in carry of the hard-currency sovereign index (which can offset 95 bps of spread widening without any move in core rates), we expect total returns to skew positive. A gradual slowdown in the U.S. and sustained improvement in the European and Chinese growth outlooks could be a goldilocks scenario for EM excess returns. Conversely, a sharper slowdown in the U.S. coupled with a severe tariff policy could drive spreads beyond that 95 bp buffer, eating into the carry and leaving core rate performance as the sole engine of positive returns.

EM Hard Currency May Present Value Relative to U.S. Credit



Source: JP Morgan and Bloomberg

■ We continue to prefer high-carry, yet resilient BB issuers, such as Colombia, Serbia, Brazil, Ivory Coast, Dominican Republic, and Guatemala. We also prefer idiosyncratic stories, such as Ghana, El Salvador, Egypt, Ecuador, and Pakistan.

■ Additionally, we see relative value opportunities within individual countries. Mexico remains an overweight, yet we are defensively positioned through exposure to Mexico City Airport (secured debt) and Pemex (down the curve) and maintain an underweight to the sovereign. Saudi Arabia is an overweight through the sovereign and some quasi-sovereigns while our exposure to the Public Investment Fund is limited. Within the UAE, we are neutral in aggregate. However, we have overweights in DP World and Galaxy Pipeline, which are offset by Abu Dhabi and UAE bonds. Kazakhstan is an underweight, however we maintain a large overweight to KazMunayGaz and an equal underweight to the sovereign.

EM Corporates

■ Returns were slightly positive in Q1, outperforming versus developed markets. This was a relatively strong performance given that spreads began the quarter at post-GFC tights. Returns across regions and sectors varied meaningfully, with Asia performing strongly driven by the cyclical upturn in China/Hong Kong and India's structural growth story. Meanwhile, Latin America was pressured by the commodity sectors and policy uncertainty related to immigration and tariffs. Europe was supported by potential fiscal expansion while Africa was weaker, with lower-rated issuers underperforming.

■ We believe the EM corporate outperformance could continue given its reasonable yields and relative value, and we recommend staying invested despite the global uncertainties. Fundamentals are resilient, and we expect high yield defaults to stay within the historical range of 3-4%, or in line with developed markets. Even though gross issuance has been somewhat higher than expected, net supply is still near flat.

■ The sector continues to offer diversification opportunities and has experienced fewer idiosyncratic surprises over the last 12-18 months. Non-dedicated investors have shown increased appetite given the spread pickup—although this may moderate given the recent selloff in U.S. high yield. Over the near term, technicals could weaken on heavier supply and/or tariff-related news.

■ We still see the best value in EM corporate BBs and select longer-dated BBB issuers. We have cut some B rated upstream oil & gas and chemical sector risk and have been more selective in new issues given inadequate concessions. Risks to the asset class include any sustained U.S. dollar strength and/or a U.S. recession.

EM Local Rates

■ U.S. tariff policy, Germany's fiscal expansion plans, and early signs of a bottoming in the Chinese economy have created cross currents in local markets not seen in decades. At the macro level, the narrative around a short-term rise in inflation and a medium-term slowdown in growth has taken hold. We believe EM policy makers will prioritize growth over inflation as long as their currencies remain resilient. However, we remain mindful of the fiscal constraints that many EM countries face. At the margin, even fiscally constrained countries, such as Brazil, Colombia, and South Africa, would benefit if the U.S. Fed were to turn dovish.

■ Within Latin America, we are overweight Mexico due to the economic contraction and a dovish central bank. We are also overweight Peru and Colombia due to their attractive hedged yields and steep yield curves. Within CEEMEA, we are overweight South Africa due to the attractive risk premium in the 10-15 year tenors. Within Asia, we are overweight India and Korea and underweight China due to relative monetary and fiscal policy differences.

EMFX

- EMFX posted surprisingly strong returns in Q1 (led by LatAm and Europe) as concerns around tariffs shifted from inflation to growth, resulting in more Fed cuts being priced in. Retaliatory tariffs from China and Canada, along with DOGE austerity and China's decision not to weaken its currency, contributed to this trend. In Europe, Germany's announced fiscal stimulus and the potential for more defense spending across the EU drove currency strength as well.

- Looking ahead, we expect a weakening (but mixed) USD due to several factors: tariffs may weigh on U.S. growth, prompting additional rate cuts that exceed those from other central banks; EU fiscal measures could offset the growth downside from potential tariffs; and more stimulus measures coming out of China are likely to result in a stable or improved backdrop. Risks to this outlook include the possibility of a U.S. recession or global growth slowdown, the U.S. administration potentially pivoting away from its current tariff and DOGE agenda, and EM fiscal concerns in select countries, such as Brazil and Colombia.

- In terms of positioning, we remain focused on relative value opportunities, with high-carry, long positions in LatAm, TRY, IDR, INR, EGP, and ZAR, and low-carry short positions in TWD, KRW, CNH, THB, and CZK. We have eliminated our small, long USD bias—acknowledging that low-carry Asia shorts are at risk of outperforming if the Fed pivots. These currencies have underperformed their interest-rate differential beta YTD, likely due to tariff developments. Tariffs are likely preventing significant capital movement into Asia and the interest-rate differential beta behavior will be closely monitored to determine any position adjustments in Asia going forward.

MUNICIPAL BONDS

Outlook: Cautious as technicals are expected to become more challenging as net supply turns positive. Yet, muni credit fundamentals remain strong, with healthy balance sheets, although credit fundamentals have likely peaked given ongoing challenges emanating from the new administration. In addition, talks of ending the tax-exemption, while unlikely due to probable bipartisan support for the exemption, could still pull issuance forward (e.g., for private issuers, hospitals, and private universities).

- Muni performance has been relatively flat YTD. Yet, the muni yield curve, particularly the long end, has steepened significantly. This has been a function of retail demand for shorter-dated bonds outpacing demand for longer-dated bonds. In addition, heavy supply has skewed towards the longer end of the curve.

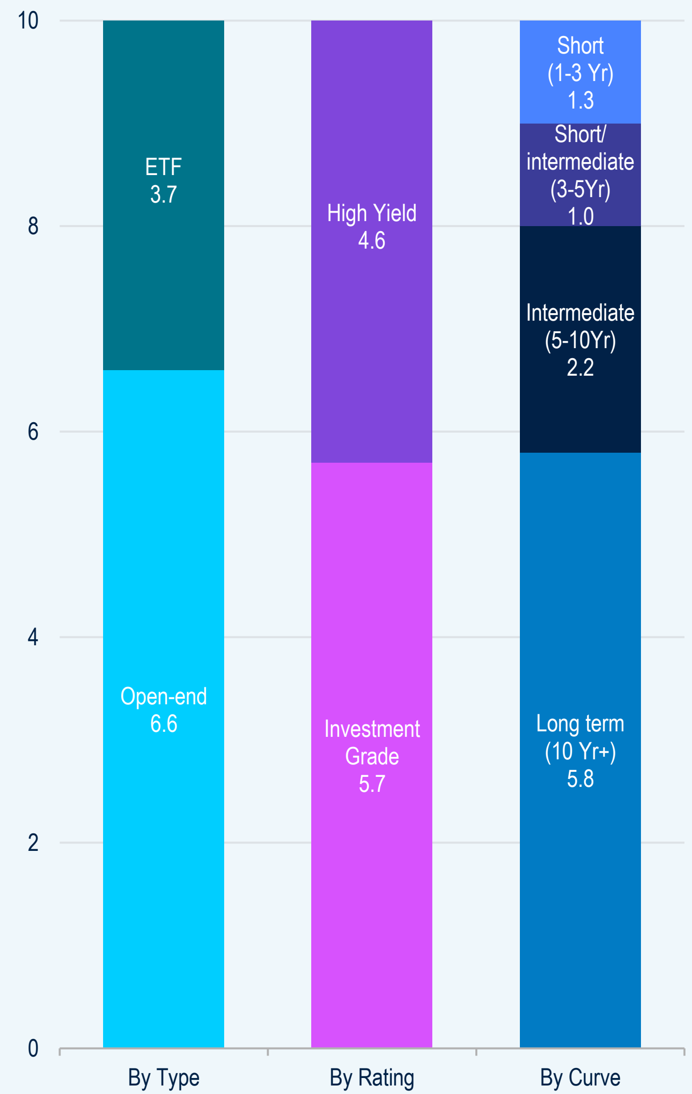
- **Potential long-term bond opportunity:** The final week of Q1 saw significant cheapening in muni yield ratios, including the 30-year, which was above 90%. From a rates perspective, underperformance on the long end of the curve could create a buying opportunity as this ratio potentially moves higher. This threshold is important from a psychological perspective as participation by crossover buyers generally picks up when this ratio is in the high 90s.

- **Weaker technicals:** Supply is ~18% above last year's record over the same period, which we expect to continue, but demand has remained healthy. The Trump administration may suggest limiting the scope of tax-exemptions for specific issuers (e.g., universities)—which, in turn, could exacerbate the pace of issuance. In addition, the amount of reinvestment slows in the second quarter, just as investors may look to sell municipal bonds for tax purposes.

- **Seasonal Outflows:** Muni flows inflows have been skewed toward HY. This has led to marginal positive total return performance for the sector YTD. That stated, IG and HY spreads still sit near their tights, despite increasing economic tail risks.

- **Positioning:** Within IG, airport spreads have tightened. We have been selling into that strength and raising cash for potential dislocations in the market (e.g., during weeks of heavier supply). Rate curve flatteners look more attractive with the M/T ratio yield curve steepening. Given the flatter credit curve and tight spreads, we are inclined to take credit risk on the front end of the curve. We have also been avoiding credits that are less susceptible to Medicaid cuts–such as healthcare providers, which have higher Medicaid payer mixes, or universities that have high leverage, weak balance sheets, and/or are reliant on endowment revenue.

Year to date fund flows (USD billions)



Source: J.P. Morgan, as of March 20, 2025

PGIM FIXED INCOME

SECTION 5

SUMMARIES

06

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	Focusing on fundamentals and fading extreme moves under volatile conditions.	U.S. Europe	UK Japan
Agency MBS	Negative in the short term. The technical backdrop has deteriorated, and interest-rate volatility is likely to remain elevated. We maintain a preference for seasoned, lower 30-year coupons and production coupons.	Agency MBS	
Securitized Credit	Despite the broad spread rally over the past year, securitized products continue to offer compelling value vs. other fixed income asset classes. We continue to favor tranches at or near the top of securitized capital structures given their attractive relative value and risk-adjusted return potential. We expect spreads to remain around historical averages, keeping carry as the dominant theme. While solid technicals could lead to further spread and credit curve compression, we favor positioning in shorter spread duration investments. Likewise, we remain extremely selective regarding more credit-sensitive positions as credit curves appear too flat, and the downside risks associated from indiscriminately traveling down the capital stack outweigh the potential rewards.	CMBS CLOs	ABS
Global IG Corporates	We are becoming more cautious as the path to strong excess returns over the coming months may narrow. This caution is due to the rollout of U.S.-centric policies, the respective responses, and the likelihood for further market volatility. Although the performance of global IG corporates has been supported by healthy demand for all-in yield, cracks are beginning to emerge as U.S. policy uncertainty climbs dramatically and threatens to reorder global trade relationships.	U.S. Corps. 1-10 U.S. Corps. 10+	European Corps. 1-5 European Corps. 5+
Global Leveraged Finance	Cautious. Solid market dynamics should hold against elevated macro uncertainty. While the Trump administration's agenda may seek long-term economic benefits, we are wary of the near-term effects. As such, we maintain our close-to-home defensive positioning with an overweight to high-quality, short-duration high yield in the U.S. and underweights to cyclicals as well as potential tariff-impacted names in Europe.	U.S. High Yield 1-5 U.S. High Yield 5+ U.S. Leveraged Loans	Euro High Yield BB Euro High Yield B and below Euro Leveraged Loans
EM Debt	Maintaining focus on fundamentals, while emphasizing relative value and idiosyncratic opportunities. Despite ongoing near-term tariff and global macro risks, EMD should remain resilient over the medium term, and the longer-term constructive attributes of an evolving global backdrop continues to anchor our investment thesis. The potential waning of U.S. economic and market exceptionalism could give way to rest-of-the-world opportunities and clearer identification of potential EM "winners" and "losers." The recent reversal of U.S. dollar strength, healthy global liquidity conditions, and the attractive carry on EMD spreads, FX, and rates also temper our near-term concerns.	Sov. Hard Currency IG Sov. Hard Currency HY Local rates[2]	EMFX[2] Corps. IG Corps. HY
Municipal Bonds	Cautious as technicals are expected to become more challenging as net supply turns positive. Yet, muni credit fundamentals remain strong, with healthy balance sheets, although credit fundamentals have likely peaked given ongoing challenges emanating from the new administration. In addition, talks of ending the tax-exemption, while unlikely due to probable bipartisan support for the exemption, could still pull issuance forward (e.g., for private issuers, hospitals, and private universities).	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.

Sector		Subsector	Spread change (bps) Q1	SOFR OAS 3/31/25
CMBS	CMBS: Conduit AAA	First-pay 10-year	18	140
	CMBS: Conduit BBB-	BBB-	-26	502
	CMBS: SASB –Sr.	AAA	10	145
	CMBS: SASB – Mezz	BBB-	0	255
	CMBS: Agency Multifamily	Senior	-2	86
Non-Agency RMBS	Legacy	RPL Senior	8	148
	Legacy	'06/'07 Alt-A	5	235
	GSE Risk-Sharing	M2	25	165
CLOs	CLO 2.0	AAA	-1	124
	CLO 2.0	AA	15	175
	CLO 2.0	BBB	35	305
ABS	Unsecured Consumer Loan ABS	Seniors	9	128
	Unsecured Consumer Loan ABS	Class B	-1	135
	Refi Private Student Loan	Seniors	9	133
	Credit Card ABS	AAA	9	68

Source: PGIM Fixed Income.

	Total Return (%) Q1	Spread Change (bps) Q1	OAS (bps) 3/31/25
U.S. Corps.	2.31	14	194
European Corps.	-0.01	-4	98

Source: Bloomberg.

	Total return (%) Q1	Spread / yield change (bps) Q1	OAS (bps)/ yield % 3/31/25
EM Hard Currency	2.24	24	349
EM Local (Hedged)	1.62	-11	6.28
EMFX	3.13	-101	7.20
EM Corps.	2.42	25	265

Source: J.P. Morgan.

	Total return (%) Q1	Spread change (bps) Q1	OAS/ DM (bps) 3/31/25
U.S. High Yield	1.00	60	347
Euro High Yield	0.54	28	346
U.S. Leveraged Loans	0.61	23	498
Euro Leveraged Loans	0.99	22	494

Source: ICE BofAML and Credit Suisse.

	Total return (%) Q1
High Grade Tax-exempt	-0.22
High Yield Tax-exempt	0.82
Long Taxable Munis Agg. Eligible	3.35

Source: Bloomberg. Represents the Bloomberg Municipal Bond Indices.

Past performance is not a guarantee or a reliable indicator of future results. See Notice for important disclosures. All investments involve risk, including possible loss of capital. An investment cannot be made directly in an index. All data as of March 31, 2025.

IMPORTANT INFORMATION

Source(s) of data (unless otherwise noted): PGIM Fixed Income, as of April 2025.

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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.

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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. Copyright 2020, J.P. Morgan Chase & Co. All rights reserved.

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

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