PGIM FIXED INCOME

Q4 24 QUARTERLY OUTLOOK

Published October 2024

WHATS INSIDE?

Select a section to jump ahead.

	Total Returns (%)				
Individual FI Sectors	Q3 '24	YTD '24	2023	2022	2021
U.S. Long IG Corporates	8.21	4.53	10.93	-25.62	-4.65
Long U.S. Treasuries	7.82	2.42	3.06	-29.26	-1.13
EM Hard Currency Sovs.	6.15	8.64	11.09	-17.78	-1.80
U.S. IG Corporate Bonds	5.84	5.32	8.52	-15.76	-1.04
Mortgage-Backed (Agency)	5.53	4.50	5.05	-11.81	-1.04
U.S. High Yield Bonds	5.28	8.00	13.45	-11.19	5.36
EM Currencies	5.24	3.78	8.44	-7.14	-3.09
U.S. Treasuries	4.74	3.84	4.05	-12.46	-2.32
CMBS	4.65	6.25	5.42	-10.91	-0.64
EM Local (Hedged)	3.78	4.55	7.60	-8.85	-5.52
European High Yield Bonds	3.65	7.00	12.78	-11.13	3.32
European IG Corporate	3.27	3.83	8.19	-13.65	-0.97
Municipal Bonds	2.71	2.30	6.40	-8.53	1.52
U.S. Leveraged Loans	2.08	6.61	13.04	-1.06	5.40
European Leveraged Loans	1.95	7.02	13.53	-3.36	4.87
Multi-Sector					
Global Agg. (Unhedged)	6.98	3.60	5.72	-16.25	-1.54
U.S. Aggregate	5.20	4.45	5.53	-13.01	-1.39
Global Agg. Hedged	4.24	4.38	7.15	-11.22	-0.15
Euro Aggregate (Unhedged)	3.74	2.49	7.19	-17.18	-4.71
Yen Aggregate	1.47	-1.72	0.51	-5.30	-2.85
Other Sectors					
S&P 500 Index	5.89	22.08	26.29	-18.11	28.71
SOFR	1.39	4.15	5.18	1.66	0.03
U.S. Dollar (DXY Index)	-4.81	-0.55	-2.11	8.21	6.37

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 September 30, 2024. An investment cannot be made directly in an index.

SECTION 1

KEY CONVICTIONS & INVESTMENT THEMES

01

KEY CONVICTIONS & INVESTMENT THEMES

1 **Hang On; Bull Market Still in Early to Middle Innings:** Interest rates have passed their peaks, adding momentum to the existing bull market. Quarter-to-quarter fluctuations notwithstanding, odds favor stable to lower yields ahead—which bodes well for fixed income returns whether they come from carry or total return.

2 **Uncertainty = Opportunity:** The one constant in recent years—the high degree of uncertainty regarding the political, geopolitical, and economic environment—is intensifying before our eyes. While that uncertainty can be disorienting, it is also the foundation for opportunities to add value through active management.

3 **Surfing the Sea of Shifting Paradigms:** From secular stagnation to generational highs in inflation, paradigm shifts and market swings normally observed across an entire market cycle are playing out in a matter of quarters. Navigating an ever-changing market underscores the importance of agility and anticipation, particularly when signs of another paradigm shift emerge.

4 **Cash turning to trash: potential to spur the mother-of-all asset allocation trades:** Surging equity prices have undoubtedly boosted investors' equity allocations, and money fund balances continue to mount. Will strong bond fund inflows continue to swell as cash yields decline, questions regarding equity valuations mount, and the search for income intensifies? If so, these potential inflows will likely keep downward pressure on yields and maintain spreads near their all-time tights.

PGIM FIXED INCOME

SECTION 2

BOND MARKET OUTLOOK

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

02

Living the Dream

Fixed income once again posted solid returns in Q3, continuing the DM bond bull market born out of the ashes of the 2022 bear market.[1] We are optimistic on the broad fixed income outlook, although now, as at every point along the way, questions remain, such as:

1. We are past the peak in rates, but how low will they go?

2. Moderation in economic activity and inflation have spurred central banks to ease, but will the softer growth picture threaten the outlook for credit products?

Unusual Bull Market Trundles On

So far, the bull market has not really been fueled by a shift lower in yields—bund and Treasury yields are near the same levels that existed in the Fall of 2022 when the bull market began. Instead, **the strong returns have largely been the result of simply earning yield itself and capturing the strong excess returns from credit products as spreads have narrowed.**

Rates: How Low Will They Go?

As for short-term interest rates, central banks are poised to continue cutting their policy targets. Given the current trend of economic moderation, the potential has opened up for a return to the pre-COVID secular stagnation levels.

Considering the heavy degree of yield curve inversion (the 10-year Treasury and bund yields are both at least 1 percentage point below their respective cash rates), **a substantial amount of optimism regarding economic moderation and rate cuts is already factored into long-term yields (Figure 2). That may limit their scope to decline further in the short term.**

As a result, long rates may consolidate around current levels until a clearer picture emerges regarding the terminal rates for the DM central bank rate cutting cycles. With short rates falling as central banks ease policy and longer rates consolidating, the yield curve is poised to continue gradually steepening.

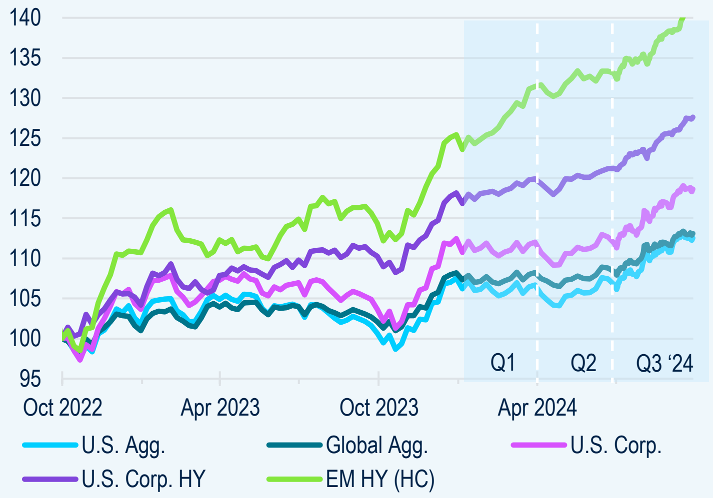
One Bullish Caveat…

One point worth considering: DM economies averted recessions this cycle in spite of the steep rise in interest rates. This raises another important question: if the current DM expansions have been fairly insensitive to the significant central bank rate increases, maybe the same will hold on the way down.

[1] Our developed market reference excludes Japan, where a stand-alone rate hike cycle is playing out.

Figure 1

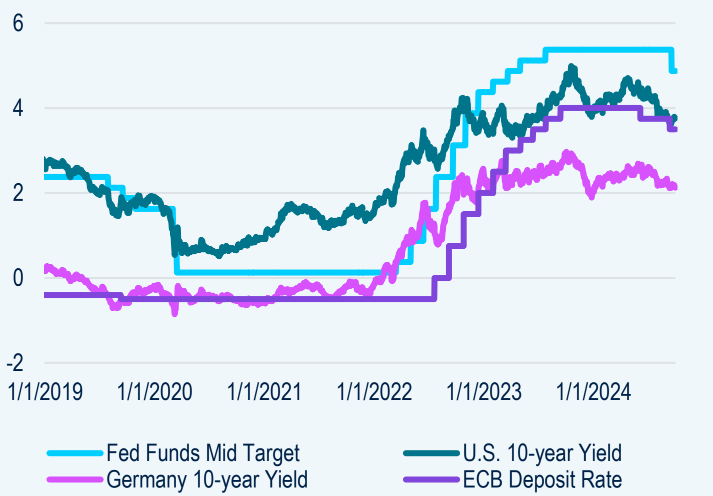
Stealth Bull Market Shifts into High Gear (100=9/30/2022)



Source: Bloomberg

Figure 2

Following the impressive recent drop, long-term yields may be due for some consolidation as they wait for short-term rates to catch up (%)



Source: Bloomberg

That is, if the ECB wants growth to pick up to at least 1% or higher and the Fed wants growth to accelerate at least enough to curtail further deterioration in the labor market, maybe they will have to cut rates much more than expected in order to get the desired effect. If this is the case, then rates may be set to fall below consensus expectations in this rate cutting cycle.

Spreads: the "Priced to Perfection" Problem

Spreads are near historic lows, leaving little room for capital appreciation from further compression. Does this mean the bull market in spread product is over? We would guess not, although **excess returns going forward are likely to be relatively measured, resulting more from incremental yield rather than additional spread narrowing.**

Balanced Drivers Likely to Keep Spreads Narrow

No doubt the level of spreads, as well as anxiety about the economic and geopolitical environment, are giving investors pause. And yet spreads remain tight (Figure 3). Why?

Credit fundamentals have remained relatively solid (Figure 4), and, while growth is moderating, central banks have switched their focus to spurring growth and appear on track for achieving soft landings.

The balance of factors suggest spreads are likely to remain range bound and fluctuating around their historic tights.

As surging equity prices have undoubtedly boosted equity allocations for some investors, cash balances also continue to mount (Figure 5). While yet another question remains as to when concerns may come home to roost regarding stock market valuations, the appeal of cash is clearly under threat as central banks cut rates. **As cash rates fall, investors may be spurred to extend out on the curve and into spread product in order to lock in yields for the long term.**

Bond fund inflows—which are already running strong—are likely to swell further as cash yields decline and the search for yield intensifies. **This dynamic should generally keep downward pressure on yields and keep spreads near their all-time tights.**

Confidence Grows in the Bond Bull Market

While a near-term consolidation is possible in the wake of the third-quarter's stunning drop in rates, **our prognosis for the market remains relatively unchanged: with yields and spreads set to remain relatively range bound, investors should earn solid returns from fixed income.** Our one adjustment in Q4 is that, **with the economic situation downshifting and rate cutting cycles now starting in earnest, the intermediate to longer-term prospects for falling rates to boost returns have improved.**

Figure 3

Spreads remain narrow despite heightened geopolitical uncertainty… (percentage points).

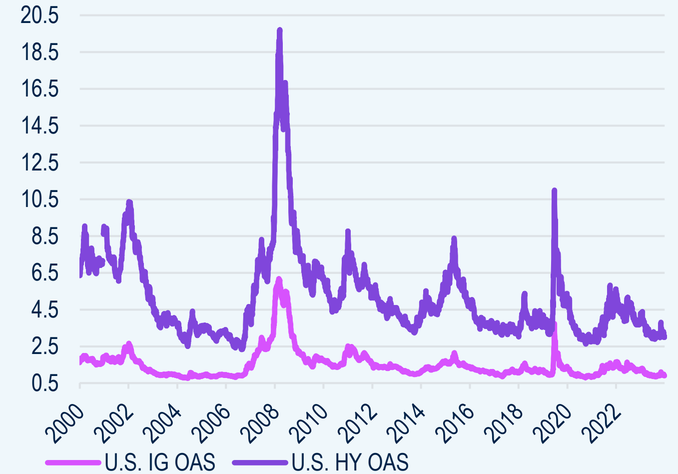


Figure 4

…Supported by underlying fundamentals as well as strong demand (Cumulative net rising stars vs. fallen angels, $ billions as of 8.31.24).

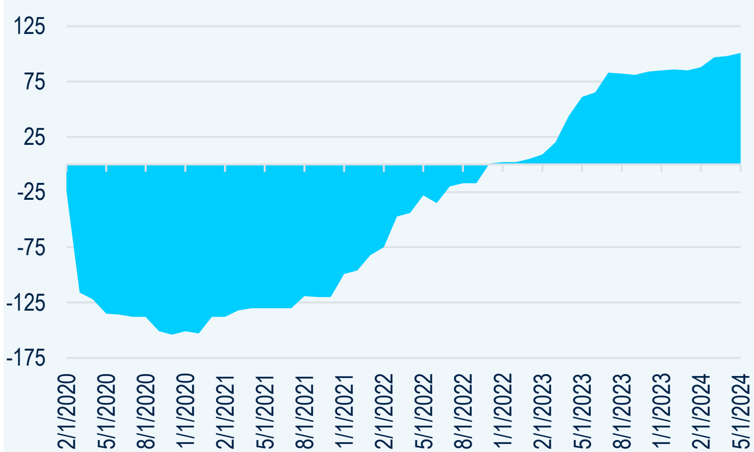
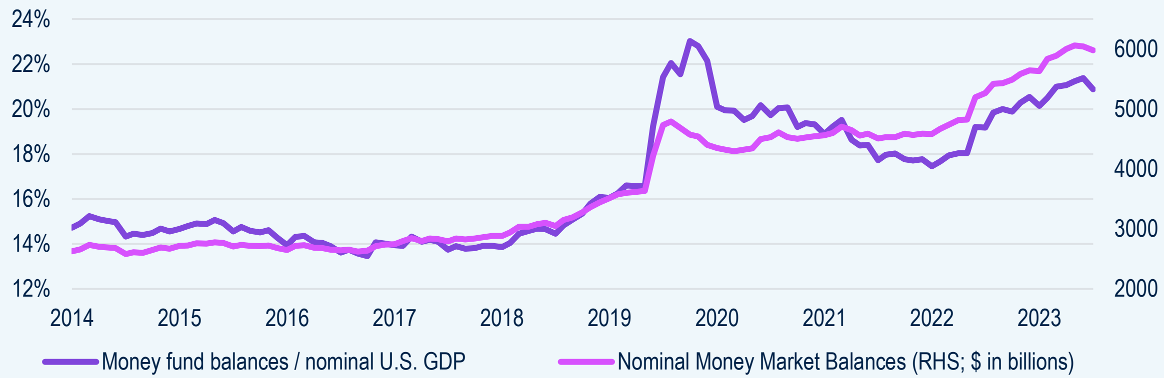


Fig. 3 source: Bloomberg. Fig. 4 source: JP Morgan.

Meanwhile, the one constant—**a high degree of uncertainty** regarding the political, geopolitical, and economic environment—**is likely to continue to generate both confusion, as well as opportunities to add value through active management.**

Bottom line: Some near-term consolidation is possible. But overall, the favorable outlook for fixed income returns over the intermediate to long term remains, thanks to rates and spreads that appear range bound or set to decline from current levels.

Figure 5
Money fund balances are at elevated / distressed levels in both absolute terms as well as relative to nominal GDP. As cash rates fall, these assets may extend along the yield curve in an effort to lock in higher yields for the long term.



Source: Bloomberg

Figure 6
Strong bond inflows may swell further if and as money fund assets extend along the yield curve in an effort to lock in higher yields for the long term ($ in millions).

Source: EPFR

LOOKING FOR MORE INSIGHTS?

Check out more of PGIM Fixed Income's latest thought leadership and media spotlights at www.PGIMFixedIncome.com

BLOG POST

FIVE RISKS U.S. TARIFFS POSE TO EU COMPETITIVENESS

We see five reasons why renewed trade tensions could be particularly economically damaging for the EU at this fragile time.

VIDEO

FED DELIVERS A "CATCH-UP" CUT

PGIM Fixed Income's Chief U.S. Economist, Tom Porcelli, highlights some key takeaways from the Federal Reserve's September monetary policy meeting, which includes the rationale behind the Fed's decision to recalibrate policy with a 50 bps rate cut.

BLOG POST

THE CASE FOR GOING GLOBAL, IN PICTURES

We've made the case that it's generally a good time for fixed income given bonds' revaluation to yields well above the secular stagnation levels that existed prior to the 2022 bear market. But where or how does global fixed income fit within this context?

SECTION 3

GLOBAL MACROECONOMIC OUTLOOK

By the Global Macroeconomic Research Team

03

When Tail Risks Become Tangible

The economic environment in the wake of the pandemic was characterized by a relatively flat probability distribution amidst the presence of elevated, yet undefined, tail risks. There were indications of the risk genre, ranging from intensifying geopolitical strife to the fallout from global central bank tightening cycles. Yet, the precise nature of those risks largely remained obscured in the tails.

As specific risks from the left tail of the distribution emerge, they are notable for the combination of seemingly intractable issues as well as cyclical developments considering our base case for further global moderation and the slight increase in our recession probabilities.

Although most global markets have yet to conclusively react to the ongoing wars in Europe and the Middle East as well as the Great Power Competition between the U.S. and China, the conflicts are among the prominent global risks as we look ahead. As such, our outlook starts with a summary of our geopolitical probabilities and risk scenarios (Figure 1).

From an economic perspective, the prospect of a hot war involving oil-producing countries and regions, such as Russia and the Middle East, is often manifest by higher crude oil prices and, consequently, rising inflation expectations.

Figure 1: Key geopolitical risks (base case and assumptions)	Signposts	Benign case	Adverse case	Direction and impact
Escalation of Russia's War vs Ukraine Escalation leads to further attrition **(reduced from 80% to 70%)** **Assumptions:** Potentially new U.S. admin., U.S., German refusal to allow long-range weapons use in Russia, Russia's sig. weapons production, and Western skepticism about military support may force Kyiv to consider peace talks with Russia.	Continued support from West. Battlefield beakthroughs (lack thereof). Secondary sanctions. Next U.S. President.	Mutual understanding that victory is impossible. Fragile ceasefire with external participation. West - Russia security talks	Faced w/ defeat Russia responds via WMDs, risking escalation with NATO **(5%)**	↓ Rising/ high
Expansion of Israel - Hamas War Conflict remains limited to Gaza **(reduced from 50% to 45%)** **Assumptions:** Israel's shift to Hezbollah aims to return of 60K displaced citizens. Increased risks of a broader war involving Iran and the U.S.	De-linking Hezbollah attacks with ceasefire in Gaza. Calibrated Hezbollah and Iranian actions. Role of Iran's proxies. Iran's sensitivity to pressure not to escalate.	Long-term ceasefire. Hostage diplomacy succeeds. PA-led admin takes over. Israel accepts discussion of two-state solution—Gaza reconstruction.	Wider ME conflict in Gulf region, including the U.S. and Iran KSA-Iran truce breaks down **(increased from 40% to 45%)**	↓ Rising/ high
Escalating Military Tensions on the Korean Peninsula NK's nuclear and diplomatic coercion **(80%)** **Assumptions:** Military build up to coerce diplomatic recognition as nuclear state	Advance of nuclear program. Perceived strength of U.S./allies' deterrence. China & Russia's relationship.	Return to status quo. Denuclearization talks resume in exchange for sanctions relief.	War with SK, possibly with nuclear weapons. Nightmare scenario—attack coincides with China's invasion of Taiwan **(15%)**	↓ Rising/ high
Escalating Dispute Between China and Philippines Uneasy status quo with risks of accidental military confrontation **(65%)** **Assumptions:** Philippines strengthens U.S. ties, challenging China's presence in disputed islands	Continuation of China's coercive actions against Manila; re-launch of bilateral, regional treaty talks.	Pre-Marcos status quo: Philippines and China launch negotiations resulting in cooperation to address disputes.	Military conflict. Fear of wider credibility gap forces US to act **(25%)**	↓ Rising/ high
China's Military Invasion of Taiwan China continues to erode status quo in preparation for takeover short of war **(85%)** **Assumptions:** China prepares for reunification using deterrence against U.S.' involvement.	Continued U.S. support and its "strategic ambiguity" policy. Whether Taiwan's Lai signals drive for independence.	Current status quo broadly persists.	War over Taiwan: Taipei pushes for & US supports independence. Misunderstandings lead to Chinese invasion **(5%)**	↔ Stable/ High

While energy prices hardly responded to the early stages of the conflict between Israel and Iranian proxies, oil prices jumped following Iran's direct attack on Israel, which pledged to respond. It serves as a stark reminder that, even though the evolution of supply/demand dynamics continue to redefine the relationship between commodity prices and inflation, geopolitics can quickly re-assert themselves as a primary driver of both.

Upcoming geopolitical developments will also remain subject to the divisive political sentiment across several major developed market economies. The U.S. political backdrop remains as fraught as ever amidst a presidential race based more on rhetoric than policy details—particularly regarding the country's future role in global geopolitics. The divisiveness in European politics has been a running theme throughout 2024 and was recently emphasized by the success of the far-right AfD party in Germany's state elections.

Efforts of political suasion also indicate the potential for additional, near-term fiscal stimulus across the developed markets. With the caveat that the use of fiscal stimulus matters greatly—e.g., if it successfully boosts productivity measures—markets have repeatedly surprised participants by quickly latching onto specific fiscal narratives, such as those in the UK and France. Looking ahead, it's possible the U.S. could also face mounting questions about its fiscal trajectory and the plans—or lack thereof—to address its expanding fiscal deficit (see Developed Markets Rates for more).

The long-term concerns about debt sustainability are not only prevalent in developed economies, such as the U.S. and Italy, but also in China amidst its now-stalled—albeit with hopes for revival—economic ascent. The prevalence of rising indebtedness highlights emerging markets (ex. China) as the apparent stalwarts when it comes to fiscal fundamentals (Figure 2).

China's prolonged economic malaise also resided in the left tail of the probability distribution with the risk becoming more acute considering the ineffectiveness of authorities' prior drip approach to stimulus. However, the lack of economic responsiveness—in the context of the country's 5% annual growth target—prompted a more urgent response as Q3 concluded.

The urgency is evident in the composition of the stimulus. After heavily relying on monetary stimulus and credit provision to support the supply side of the economy, the latest package includes several demand-side measures, amounting to about 2% of China's GDP. Initiatives, such as unemployment benefits amidst record levels of youth unemployment, child benefit support, and pension reform, may represent the initial stages of a social safety structure. Prior to the latest stimulus announcements, China was on pace for GDP growth of about 3%, which was solidly below authorities' stated target. We believe the announced measures may place growth closer to that 5% objective over the next year.

Figure 2
Debt levels in the G7 and China stand in stark contrast to those in EMs (% of GDP).

Source: Macrobond

While China's export sector is a relative bright spot, it may also face the specter of additional global trade tariffs or interventions, which could introduce further economic uncertainty across China and its key trading partners, such as the Euro Area (Figure 3). For example, recent ECB analysis indicates that a 30% price dop in Chinese sectors classified as over-capacity and potentially disinflationary (see Figure 4) would depress EU prices by about 1 percentage point (comprised of 0.3pp from direct consumer impact and 0.6pp from indirectly competition).

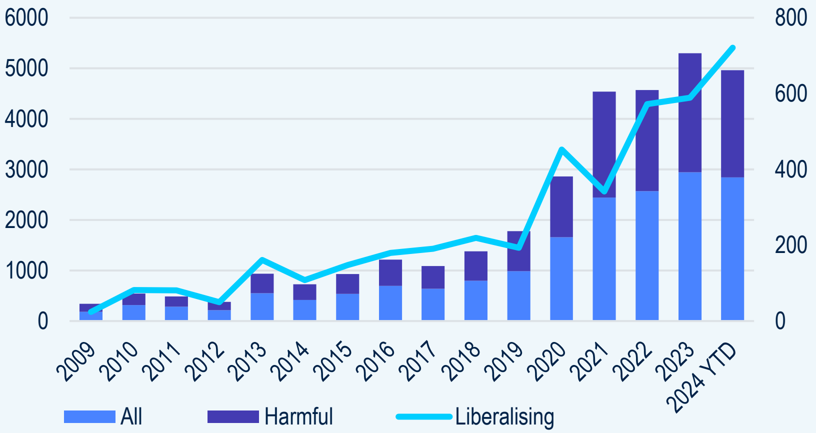
From a European perspective, even the concept of new or additional [tariffs on European exports may further restrain Europe's growth](), particularly considering the sharpened focus on improving its economic competitiveness.[1] The trade backdrop adds context to the waning cyclical momentum across Europe as September's initial read on the Purchasing Managers' Index reiterated France and Germany's precipitous drop in demand. Meanwhile, the peripheral economies continue to appear more dynamic as [Italy's debt-to-GDP]() was revised lower due to upward revisions to GDP as Q3 concluded.

The weakness in Europe's core economies paved the way for inflation to drop below the ECB's 2% target as Q4 commenced. Furthermore, the current ECB policy rate of 3.5% remains significantly restrictive at 100-150 bps above neutral, according to the Bank's own estimates. Therefore, we now expect a 25 bp rate cut in October, followed by sequential 25 bp cuts until June 2025, which would take the deposit rate to 2.25% (i.e., estimated nominal neutral).

Labor conditions also remain central for the U.S. Federal Reserve, and the data released after its initial [50 bps cut of the cycle]() continue to justify the sizable policy easing. For example, the labor differential—i.e., the difference between those saying jobs are easy/difficult to obtain—continued to decline in August. This labor measure exhibits a high level of negative correlation with the civilian unemployment rate (Figure 5). However, in a nod towards our base case of ongoing economic moderation in the U.S., recent data on the consumer and September's payroll report arrived stronger than expected, supporting the probability for an extended expansion.

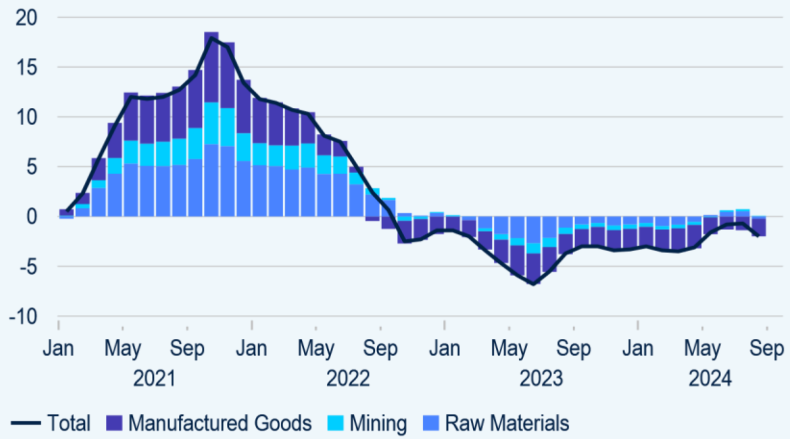
[1] *European Commission: "The Future of European Competitiveness: Report by Mario Draghi," September 9, 2024.*

Figure 3
The prolonged surge in global trade tariffs and interventions (# of new trade interventions per year).



Source: Global Trade Alert. as of June 2024

Figure 4
Falling producer prices in China reflect domestic weakness and deflationary spillover risks (Y/Y, percentage points).



Source: Macrobond

With the Fed appearing comfortable to take the steps necessary to extend the cycle, the focus going forward remains centered on the size and speed of its approach to the neutral policy rate. Although the Fed anticipates two 25 bps cuts through the remainder of the year and another 100 bps of cuts in 2025, that would still leave the policy rate solidly above the Fed's terminal rate projection of 2.9%. The Fed expects to reach neutral by early 2026, but if the data resume showing further labor weakness, we believe the Fed could reach neutral in the second half of 2025.

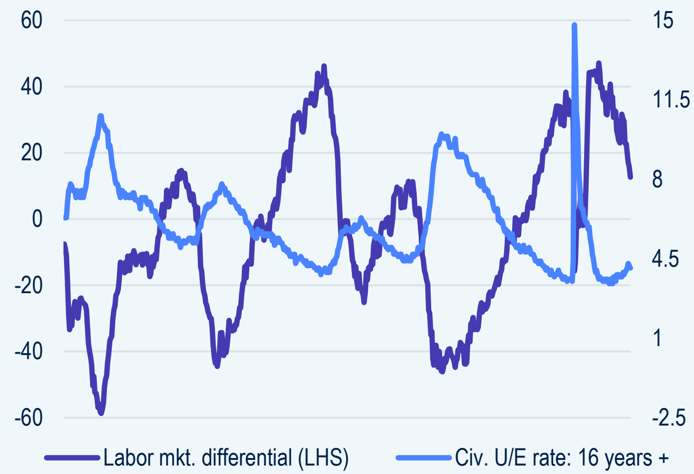
One caveat regarding U.S. monetary policy is the economy's evolving sensitivity to changes in interest rates. The economy largely withstood more than 500 bps of rate hikes, and, if that reduced sensitivity persists, it remains to be seen how much the easing in monetary policy might boost economic activity and otherwise extend the expansion (see our series on interest-rate sensitivity).

Additional Fed policy easing may also address another risk that recently emerged from the tails as U.S. rate cuts relieve pressure on the Bank of Japan to support the yen. Following the BoJ's Q3 rate hike that caught many participants by surprise, we think the bar for additional hikes over the near term is relatively high. While wages in Japan are rising, the increases have yet to translate into sustainably higher consumption and domestically-generated inflation. The prospect of waiting to adjust monetary policy further is also logical given the elevation of Shigeru Ishiba as Japan's next Prime Minister. As we await further details of Ishiba's economic views, he is regarded as a defense hawk, thus the country's defense spending may continue to increase going forward.

Our survey of emerging tail risks also warrants a look at the right tail of the distribution, which we'll view through our economic scenarios. As Q4 commences, we're maintaining low, but conceivable, probabilities for an NGDP Boom across the U.S., Europe, China, and the emerging markets (Figure 6). Indeed, potential developments emanating from the right tail include fiscally-driven productivity enhancements, artificial intelligence breakthroughs, and—in what would be a most-welcome development—lasting cease fires that pave the way for reconstruction efforts.

While those developments have yet to emerge from the right tail, our global base case continues to call for ongoing economic moderation to varying degrees. The other notable change to our scenarios reverts back to our theme of risks emerging from the left tail as our recession probabilities increased in each of our regional scenarios, as observed to the right.

Figure 5
U.S. jobs appear more difficult to obtain, portending a further increase in the unemployment rate (LHS, % Balance; RHS, %).



Sources: The Conference Board, Bureau of Labor Statistics/Haver Analytics

Figure 6
Moderation remains the global base case with rising recession probabilities (%).

	U.S.		Europe		China		EM*	
Scenario	**Q3**	**Q4**	**Q3**	**Q4**	**Q3**	**Q4**	**Q3**	**Q4**
Moderation	35	35	40	35	75	70	49	46
Weakflation	25	25	30	30	0	0	19	19
NGDP Boom	15	10	5	5	5	5	10	7
Roaring 20s	5	5	5	5	5	5	3	5
Recession	20	25	20	25	15	20	19	24

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 SECTOR OUTLOOKS

04

DEVELOPED MARKET RATES

Outlook: Tactical and wary. The dynamic between market pricing and our expectations for monetary policy outcomes will continue to provide our direction for global duration positioning. We're wary of what may surprise markets from here, including the possibility of a renewed focus on deteriorating fiscal situations.

■ For most of 2024, participants' attention centered on the various central bank action to come. With the third quarter's flurry of activity behind us, the focus turns to the time-and-distance expectations for the respective policy trajectories as well as the potential market events that may unfold along the way.

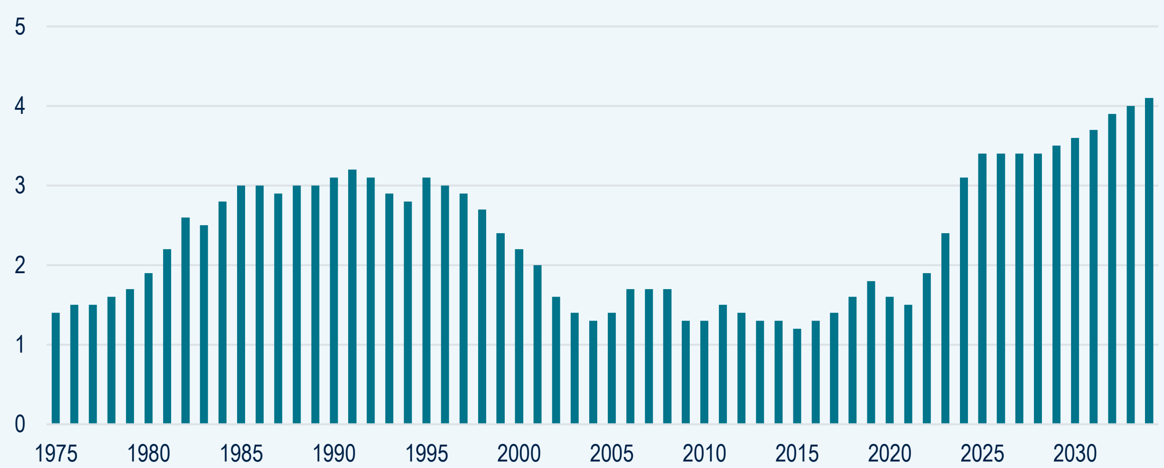
■ Given the significant anticipation about the start of the Federal Reserve's rate cutting cycle, we begin in the U.S. At this point, the policy easing indicated by market pricing remains more aggressive than the Fed's projections, but not by much. In terms of the distance, Treasury forwards are coalescing around the Fed's terminal rate level of 2.9%, and they subsequently plateau within a 30-40 bps range from there.

■ As for time, the Fed is projecting that it may reach 2.9% level by early 2026, while market pricing arrives at that level slightly sooner, and we expect that the Fed could reach that level around mid-2025. Turning to the upcoming Fed meetings, market pricing for the November meeting is leaning toward a 25 bp cut, while pricing for the December meeting is split between a 25 bp and a 50 bp cut.

■ For perspective where nominal cash rates may trade under our base case of ongoing economic moderation, we look to the 2019 cycle prior to the pandemic. As that cycle concluded, the U.S. two-year yield ended up in the vicinity of the Fed funds rate and the 10-year yield was less than 100 bps higher. When extrapolating to our base case, that could place the two-year yield in the 3.40% area and the 10-year yield in the 3.80% range.

■ That relatively flat 2- to 10-year yield curve may receive consistent support at the back end as investors continue to lock-in relatively compelling long-term yields. The general stability in forward Treasury rates and the cash curve should also contribute to declining volatility across the Treasury complex. For example, the market is pricing in about 5 bps of moves a day. However, long-term rates could bounce near the U.S. election on the anticipation of another surge in fiscal stimulus (see below) before possibly turning lower—as long as inflation continues to moderate.

Attention may turn to the U.S. fiscal picture as net interest expenses may climb towards 4.5% of GDP over the coming decade (net interest as % of GDP).



Source: Bloomberg

- With European growth also expected to moderate further, anticipation around ECB rate cuts are mounting as well. While we continue to expect that the ECB will hold rates at 3.5% in October, an acceleration in the easing process may come soon thereafter as the market is pricing in a deposit rate of about 3.0% by year end. Hence, if the ECB opts for a 25 bp cut in December, easing may accelerate in early 2025. In general, we're maintaining a neutral stance on European duration and will monitor for potential signs of demand fatigue from the broader market as the ECB's quantitative tightening progresses.

- We're also maintaining a neutral view on Japan duration following the Bank of Japan's larger-than-expected hike in July. We believe the BoJ may again be in a holding pattern following the LDP election as the Fed's presumed easing cycle may continue to relieve pressure on the yen.

- In terms of what may surprise the markets from here, an unexpected acceleration in inflation, particularly based on the various core measures, could catch participants leaning the wrong way. Furthermore, renewed strength across the labor market could certainly prompt market participants to re-evaluate their time-and-distance projections for monetary policy.

- Finally, while it wouldn't necessarily be a surprise, unchecked fiscal conditions continue to prompt numerous questions. Indeed, with recent bouts of sharp repricing in the UK and France, the ongoing deterioration in U.S. fiscal measures raises the specter of whether a similar event could occur within the Treasuries complex. Rather than the outright level of debt, we believe the net interest expenses may capture more attention as it continues progressing to about 4.5% of GDP. It also highlights the uncertainty about where the balance sheet will come from in terms of taking down the additional debt. Therefore, Treasury auction results will remain an area to watch closely going forward.

AGENCY MBS

Outlook: Negative in the short term given tight spread levels. We are still positive over the long term vs. rates given muted net supply expectations even after the Fed's initial rate cut. We prefer staying long convexity in the form of seasoned 30-year pools.

- With MBS Index spreads at the tightest levels since the beginning of 2023, our near-term negative outlook is primarily due to the relative tightness of current valuations. However, we remain constructive over the longer term versus rates given muted net supply expectations while Treasury issuance is expected to remain heavy. From a general perspective, MBS would benefit if the Fed can deliver on expectations for further rate cuts.

- From a technical perspective, although mortgage rates have fallen from local highs, the lack of affordable housing remains a headwind for mortgage application activity. Although a growing percentage of the MBS Index is nearing the window for refinancing, higher originations from refinancings is net supply neutral. Meanwhile, steady inflows into fixed income ETFs have been supportive.

- On the demand side, primary dealer holdings are now at levels last seen in 2020, pointing to full balance sheets and possibly the need to pare down settled positions. However, REITs are better positioned than in prior years, suggesting we are unlikely to see a repeat of forced selling. The Federal Reserve has also indicated final bank capital rules will likely be far less restrictive than originally proposed, hence less capital-intensive for banks' MBS holdings.

- The potential risks to our outlook pertain to the Fed, particularly if it doesn't deliver the policy easing anticipated by markets. Furthermore, if the Fed adjusts its quantitative tightening initiative, it is unlikely to stop MBS from rolling off the balance sheet, and it is also unlikely to add them again in the instance of another quantitative easing program. Finally, expectations of rate cuts have also limited the opportunity set in the sector as convexity risk continues building in production coupons. With lower primary rates, we could see a sharp rise in refinancings of higher coupons.

- We prefer specified pools over TBAs for better convexity profiles and less duration sensitivity. We are looking to rotate into select laggard GNMAs, 15-year issues, and super-seasoned cohorts.

MBS Index Spreads at Local Tights (bps)

Source: Bloomberg

SECURITIZED CREDIT

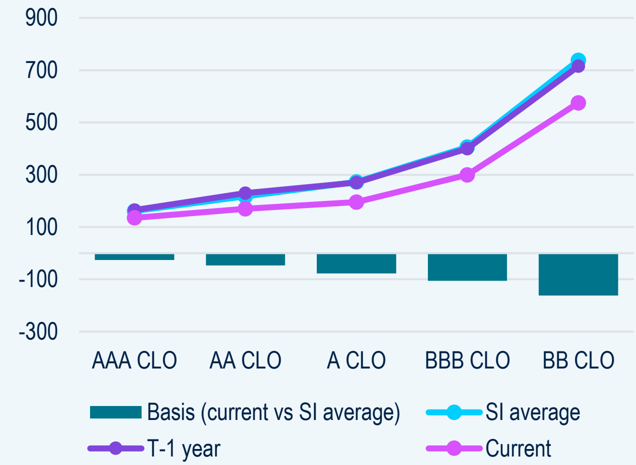
Outlook: We continue to favor tranches at or near the top of the capital structure given their attractive relative value and risk-adjusted return potential. We expect spreads to remain range bound around historical averages, making carry the dominant theme. While strong technicals could lead to further spread and credit curve compression, we are positioning in shorter spread duration at/near the top of the capital stack, while also remaining tactical and extremely selective regarding more credit-sensitive investments throughout the capital structure. Credit curves appear too flat, and the downside risks associated with traveling indiscriminately down the capital stack outweigh the potential rewards.

■ In **CMBS**, high interest rates continue to pressure cap rates and valuations. However, current CRE valuations better reflect the higher rate environment and are now closer to the trough—we project peak-to-trough aggregate property value declines of 20% but dispersion will abound, with office likely hit hardest. While we believe CRE transaction activity should rebound in the latter half of 2024, elevated interest rates and a challenging financing environment may continue to keep activity suppressed. We continue to see value within 5-year conduit AAA securities as spreads look attractive relative to similar tenor IG corporate bonds. Down the stack, we continue to see value in select single-asset single-borrower securities and are selectively adding exposure.

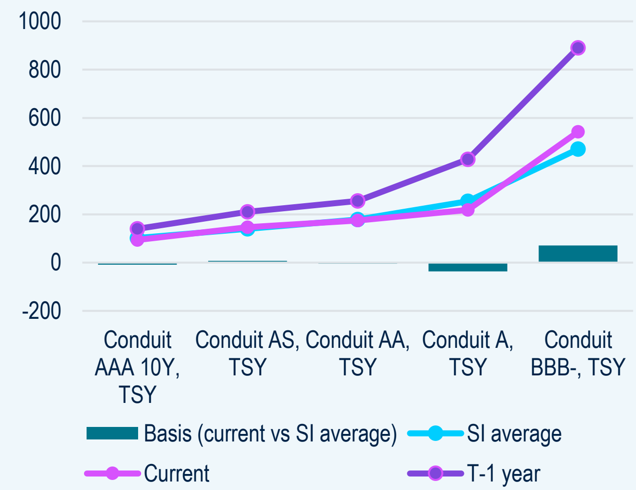
■ In **RMBS**, while higher mortgage rates could weigh on affordability and demand, the supply of existing homes for sale, while growing, remains below the long-term average, leading to a stable housing market. We remain positive on mortgage credit instruments, as strong mortgage underwriting practices persist, although we acknowledge the uptick in delinquencies in FHA and non-qualified mortgage (non-QM) pools. We see value in reperforming loans (RPLs) and second-lien bonds given their wider spreads over corporates and other non-agency securitized products. Despite our positive view on mortgage credit, valuations of credit risk transfer bonds (largely from Fannie/Freddie mortgages) are stretched as spreads rallied significantly over the last year.

■ Senior **CLO** tranches continue to offer attractive relative value compared to many fixed income asset classes. We remain cognizant of potential downside credit concern scenarios in the underlying bank loans that could outweigh prevailing technical support for CLOs. Furthermore, while bank loan spreads have been supported by low net supply and strong demand, we expect to see some credit deterioration in the underlying CLO collateral via downgrades to CCC, increased default rates, and lower recovery rates.

CLO Credit Curve (OAS bps, SOFR)



CMBS Credit Curve (OAS bps, Tsy)



Sources: JPMorgan ABS, CMBS Indices. Dates January 3, 2012 to September 16, 2024. 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

Thus, we continue to broadly favor senior CLO tranches in the U.S. and in Europe, but are also seeing total return opportunities in new issue mezzanine tranches. In the U.S., we find value in selling higher priced bonds and rotating into higher spread primary transactions. In Europe, the opportunity to purchase bonds at a discount, to a degree, offers 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 and are starting to weigh on the near-prime segment. An environment of declining inflation and easing monetary policy could be beneficial, but this will take time. Thus, we remain vigilant for signs of consumer credit weakening more broadly. 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, we expect increased banking regulation may lead to more opportunities via asset sales or regulatory transactions.

INVESTMENT GRADE CORPORATES

Outlook:. U.S and European IG corporate yields have come off their YTD peaks as the market has anticipated and priced in monetary policy easing. Demand should remain consistent, but lower yields, generally tight spreads—with Euro spreads continuing to trade solidly wide of the U.S.—and heavy issuance may limit an increase in demand. Given our continued expectations for moderating economic conditions, we are modestly constructive on the sector in the short term but remain mindful of the downside risks.

■ In Q3, **U.S. IG** excess returns were positive with electric utilities, tobacco, and life insurers emerging as the top performers while home construction, independent energy, and automotive lagged as cyclicals underperformed non-cyclicals.

■ Overall, corporate revenue grew 1.1% (YoY) and EBITDA ex-commodities increased by 7.1%, the fastest pace in the past eight quarters. However, credit metrics have softened somewhat so far this year. Indeed, companies are absorbing higher interest expense, which has contributed to the continued erosion of interest-coverage ratios. Net leverage remains somewhat elevated at 2.9x, but there is some divergence by ratings as Baa3 rated issuers deleveraged even while A2 rated issuers increased their leverage. Upgrades have strongly outpaced downgrades this year and only a small percentage of bonds are at risk of a downgrade.

■ **An Abundance of Supply**. The $1.2 trillion gross issuance estimate for 2024 has already been surpassed YTD. Supply for the full year is now estimated to be between $1.5 trillion and $1.6 trillion. The significant amount of debt maturing in 2025 and 2026 will likely keep supply elevated, and, if yields decline further, we may see additional issuance pulled forward.

■ To date, issuance has been readily absorbed by the market on demand from overseas investors (drawn to the U.S. market amidst a decline in hedging costs) and robust mutual fund inflows. As the yield curve has steepened, demand for long corporates—particularly amongst insurance companies—has caused this portion of the index to outperform shorter maturities.

■ **Positioning:** Despite our base case of a soft landing, the forward excess return estimates (based on our U.S. economic scenarios over the next 12 months) are asymmetrically skewed to the downside with underperformance possible due to a still somewhat elevated risk of recession. Therefore, we generally target a spread duration underweight in the portfolios. With valuations fairly valued to rich, we favor carry and idiosyncratic opportunities. Our IG portfolios are overweight BBBs. But with BBB spreads tight to As and a focus on generating carry, the majority of our BBB overweight is allocated to shorter maturities. We don't see a large slate of crossover candidates from high yield to investment grade, which limits our positioning in high yield. Industries we favor include banks, electric utilities, and pipelines.

■ **Key Downside Risks:** An economic slowdown, consumer weakness, elevated stock valuations, rate volatility, leveraging events like resurgent M&A or share buybacks (note that the amount of share buybacks authorizations has increased), geopolitical risks, and the upcoming U.S. presidential election.

■ Swap spreads in the 5-year and 10-year part of the **Euro IG** curve have been elevated since the invasion of Ukraine and the ensuing challenges in the European economy. As investors have become more comfortable with risk, swap spreads have compressed, bringing them back in line with historical levels. As a result, credit spreads, while being a little volatile, remain near the lower bounds of the historical range, and we are consequently more cautious in our risk positioning than we have been in previous years.

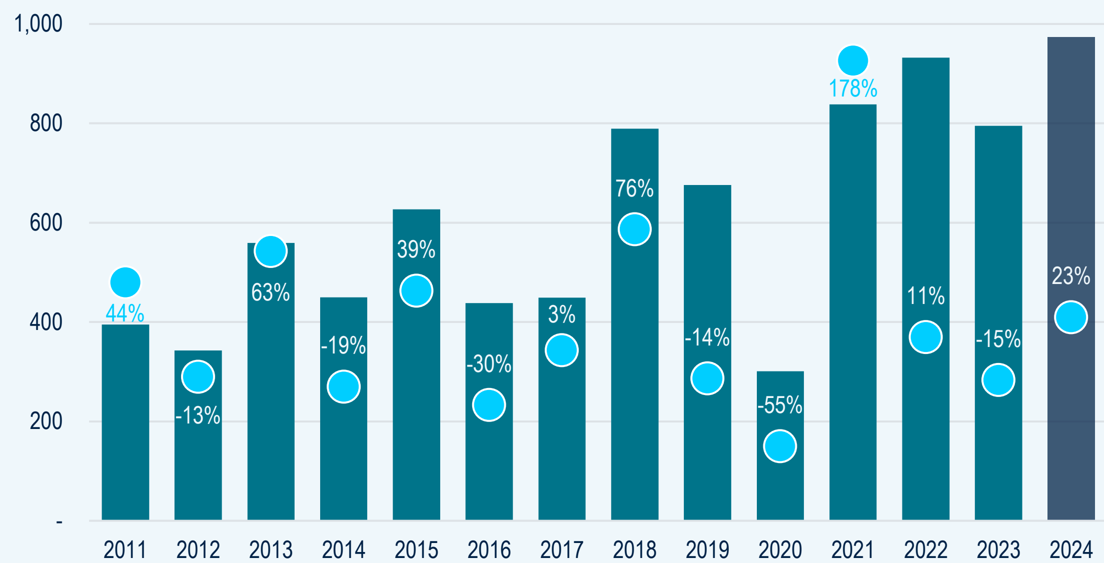
■ The European market experienced record issuance in August/September, albeit not quite to the same degree as the U.S. Overall, yields remain attractive and are drawing flows, but the spread component looks distinctly less interesting.

■ **Euro IG Positioning:** The overall beta compression of spreads has been driven by the financial sector's material outperformance. This, in turn, has led to less bank risk in our European portfolios than typical, and it is generally concentrated at the front end of the yield curve.

■ Corporate fundamentals remain solid, although there is some stress in industries such as Automotives. We are focusing on bottom-up security selection rather than market level risk positioning to generate returns. We are long risk and neutral spread duration in Euro funds, with a focus on front end carry and risk further out the curve.

■ **Global IG Positioning:** We have a similar risk position in global IG portfolios with a small underweight in spread duration (including underweight USD long end) and a moderate skew to more risk in the Euro side of the portfolio. As spreads have rallied, we have reduced overall exposure to the Euro corporate market (more than 25 bps of compression to USD corporate spreads YTD), but still find attractive opportunities in individual issuers and bonds.

U.S. share buyback authorization announcements through September 20, 2024
($ billions, percentage change year over year)



Source: Goldman Sachs Global Investment Research (as of October 2, 2024)

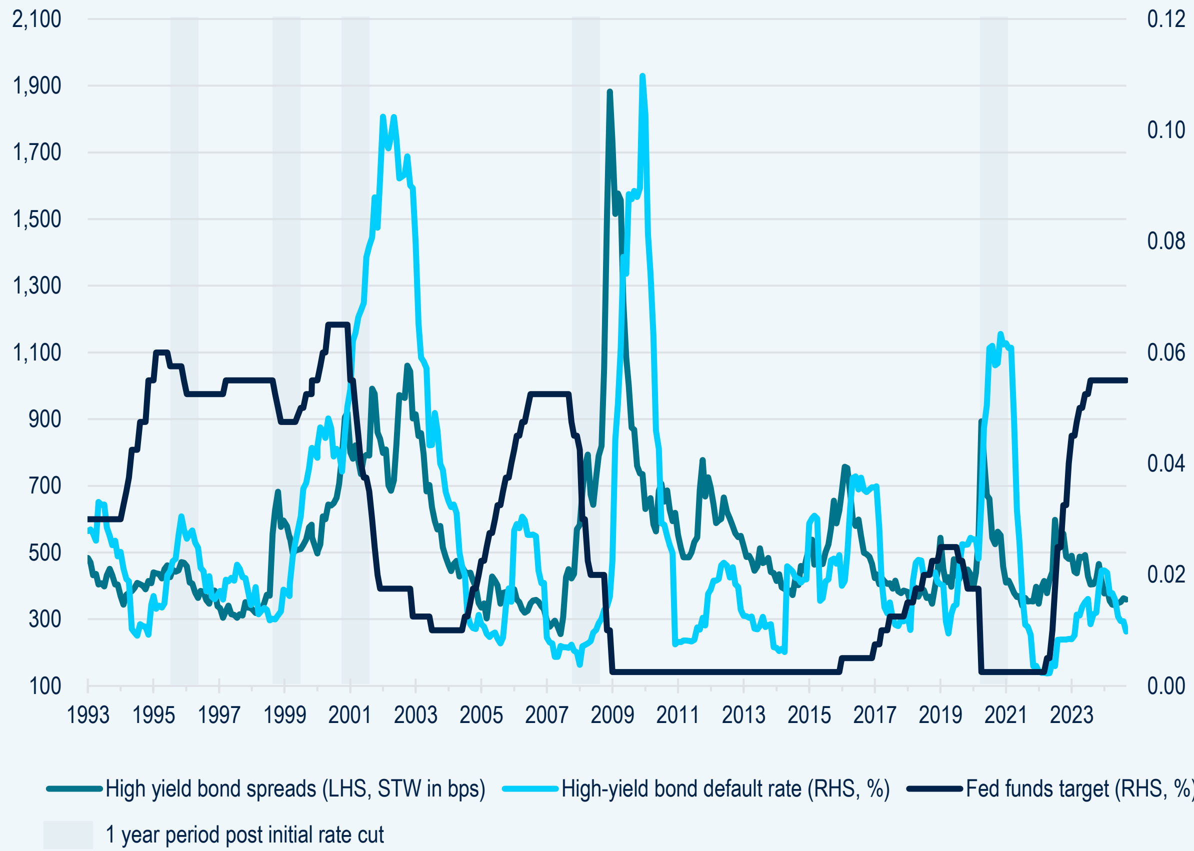
GLOBAL LEVERAGED FINANCE

Outlook: Solid technicals, stable fundamentals, and a low chance of recession should keep spreads rangebound and demand for new issuance robust. Given elevated geopolitical risks, we remain focused on adding high-quality issues with a preference for short duration. Careful credit selection and a focus on relative value opportunities should be rewarded.

- With HY spreads at lows, further spread tightening is possible, but limited in scale. The U.S. economy is currently chugging along at a rate supportive of current HY levels, yet expectations for growth continue to ease under the weight of weakening labor demand, as demonstrated by the soft Q2 2024 earnings from Russell 2000 constituents (highly representative of the HY market). That said, with corporate balance sheets currently in good shape overall, the U.S. high yield market is at historically high levels of credit quality.

- Corporate profitability remains strong as margins continue to benefit from successful cost-cutting, while most new issuance this year has helped to push out the maturity wall. Our base-case is for default rates to decline over the next 12 months.

High yield spread and default rate changes near Fed Funds rate cuts



Source: JP Morgan

- In the event our recession scenario comes to fruition, we believe the increase in defaults would remain manageable. The technical backdrop remains solid, as companies continue to pay down debt, migrate into the investment grade space, or source capital from other markets.

- That said, we believe that prevailing geopolitical and U.S. election risks are not reflected in current spreads, leaving open the potential for sudden widening as those scenarios evolve. Furthermore, the increased frequency of aggressive liability management exercises and distressed exchanges from issuers is significant, as it accounts for approximately half of all defaulted issuers YTD. Indeed, refinancing of high yield debt at much higher interest rates eventually increases interest expenses and credit risk.

- With the yield curve continuing to steepen, spread tightening on longer duration high yield has led to better relative value in the front end. We can maintain interest-rate exposure through Treasury futures while seizing this relative-value opportunity. Similarly, we maintain positions in floating-rate AAA-CLOs at attractive spreads relative to the BB segment of the high yield market. Looking at sectors, we remain overweight home construction and electric/independent power producers. We increased our overweight in gaming and reduced, but are still overweight, building materials. We moved to neutral in cable & satellite, and remain underweight technology, retailers, and media/entertainment.

- **U.S. leveraged loans** have thus far outperformed our expectations year-to-date, on supply and demand dynamics as well as better-than-feared fundamentals. While the loan default rate has picked up recently and should remain a tail risk, we don't expect it to weigh materially on the market over the next three to six months. Looking ahead, a lot of what's driven the market this year will continue through year-end, i.e. demand from CLOs should remain strong against a backdrop of limited net new supply.

- With YTD returns on solid ground, we maintain our leveraged loan total return forecast of 8.0-8.5% for 2024. Our forecast is supported by high all-in current coupons and yields, strong CLO formation, continued inflows into bank loan funds, loan paydowns, and modest net new supply as refinancing and repricing activity comprises most of the primary activity. Our forecast is also rooted in the strong total returns experienced thus far in 2024, the anticipation of higher-for-longer SOFR rates, and expectations that loan prices will hover around current levels.

- While leveraged loan defaults rates continue to linger over their long-term average amid rising corporate headwinds, we don't anticipate a significant rise in default rates through the remainder of 2024. We expect the higher cost of capital to continue to pressure free cash flows of lower-quality, sponsor-owned companies for the remainder of this year, but we maintain our view that default rates (including distressed exchanges) will likely remain in the 3-3.5% range through year-end 2024.

- 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 to be most impacted by the challenging fundamental backdrop. We believe that credit selection and deep, fundamental credit research/modeling is becoming increasingly important and that the avoidance of defaults will be the biggest driver of alpha over the next 12-24 months.

- Spreads for **European high yield** and **European loans** tightened further during Q3 as markets shrugged off a softening U.S. labor market and continued to factor a low probability of recession through year-end. As such, we expect spreads to remain rangebound in Q4 barring any unforeseen shocks. Yields should remain attractive on an absolute basis, and we expect high yield bonds and loans to generate positive excess returns over the next 12 months on a probability-adjusted basis for various economic scenarios. Further, we expect defaults to remain around current levels over the same time, as the vast majority of the market is high quality, performing businesses.

- As for positioning, we are running market neutral levels of risk given our view that spreads are roughly at fair value. With recession and geopolitical risks heightened we remain underweight cyclical businesses. We remain focused on relative value opportunities, particularly in idiosyncratic credit stories, where there is still meaningful dispersion.

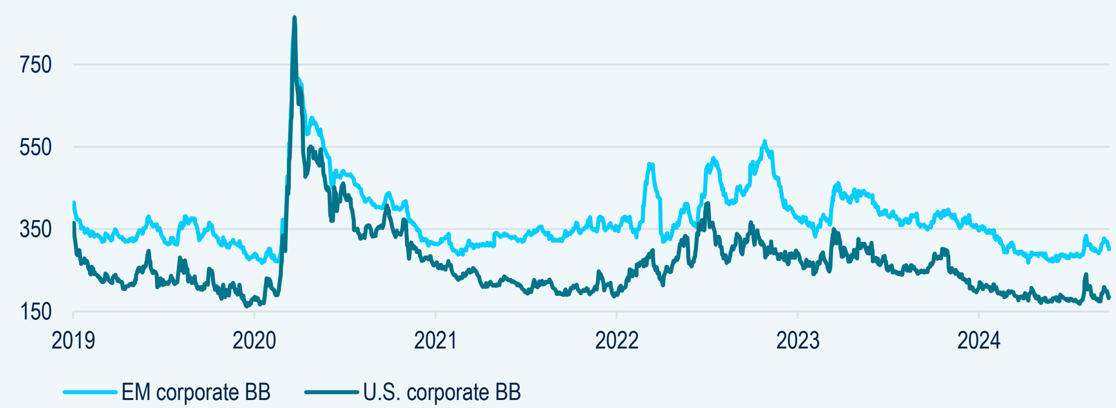
EMERGING MARKET DEBT

Outlook: Constructive, while mindful of uncertainty related to the U.S. election and policy outcomes. Performance dispersion between and within EMD sectors will continue to reveal alpha opportunities. Our base case of an orderly economic slowdown, accompanied by the tailwind of lower global rates, calls for a moderate level of risk in spreads and EMFX, with a higher conviction in local rates.

EM Hard-Currency Sovereigns

- Our base case is for hard currency spreads to remain rangebound in Q4 amid continued crosscurrents across EM, thus our spread risk utilization remains constrained. While spreads remain around their long-term averages in all but the weakest issuers, EMs as a whole should benefit from a U.S. Fed cutting cycle and a benign macro outlook.
- While EM investors have navigated around geopolitical uncertainty and armed conflict for years, uncertainty regarding U.S. foreign and domestic policy is elevated given the tight U.S. presidential race. Both candidates have starkly different visions around trade policy, tax policy, immigration/labor supply, and price controls—all factors with the potential to affect EM conditions.
- Importantly, with a second Trump administration looking at 60% tariffs on China and 10% on the rest of the world, the growth impact would be harshest in China, the U.S., and Europe. While EM sentiment could be hurt under this scenario, EM fundamentals and spreads performed well amid the first Trump administration's trade war. That said, the starting point is different (especially in China), so the outcome could be different.
- There are upside risks in a scenario where a trade war is avoided. Democrats are not campaigning on tariffs, and it is possible that Republicans could move away from more draconian measures in the name of preserving economic growth. Moreover, trade between EM countries is increasing and policies emphasizing re-shoring/near-shoring are likely to continue, to the benefit of EM countries.
- U.S. exceptionalism is also likely to stay intact over the short-term amidst supportive fiscal policy, Europe's muted recovery, and China's languishing property sector and a weakened consumer. Recent fiscal and additional monetary measures announced in China to address sagging consumer sentiment and to put a floor under property prices seems meaningful.

EM corporate BB vs. U.S. corporate BB spreads
(spreads to worst in bps)



Source: J.P. Morgan, Bloomberg as of 6/12/24

■ Importantly, growth elsewhere in EM remains well ahead of the rest of the world, with the EM growth premium potentially growing over the medium term as fiscal dominance and other factors constrain growth in developed markets.

■ We continue to see value in our barbell approach. Despite near-term uncertainty, the varied sensitivities of the EM universe to apparent and potential shocks (e.g., trade, commodities, growth) provides for a diverse opportunity set. Within IG sovereigns, Dubai and Saudi Arabia stand out. Quasi-sovereigns, particularly in Mexico, Kazakhstan, Saudi Arabia, and UAE, also offer value. Within BBs, the opportunity set widens given the improving fundamentals and healthy spreads in sovereigns and quasi-sovereigns in Brazil, Serbia, Ivory Coast, Dominican Republic, Colombia, Guatemala, Costa Rica, and Morocco. With major EM elections now past, the market will focus on bottom-up idiosyncratic policy and growth consequences of the outcomes.

■ Among higher-beta issuers, the stressed-performing and distressed space still offers value given attractive country-specific idiosyncratic drivers in Egypt, Ecuador, Zambia, Angola, Turkey, Senegal, and Pakistan. The resolution of defaults in Zambia, Ukraine, and (soon) Ghana is positive for the asset class. Even if a mild global recession were to materialize, we do not anticipate a meaningful uptick in sovereign defaults that are not already priced into the market. Of note, we still see most of EM adequately financed (no huge financing gaps and good demand) despite negative fund flows. FDI and portfolio flows continue, and there is sufficient funding from multilateral and bilateral sources.

■ While EM corporate yields and spreads have compressed closer to fair levels, fundamentals remain resilient. Even though YTD gross issuance has been higher than anticipated, net supply is still deeply negative. Loan loss provisioning amongst EM banks has increased but remains relatively low, with the cost of risk trending back toward pre-pandemic averages. The bond maturity wall of 2026/27 has been extended, and we expect corporate high yield defaults to remain within the historical range of 3-4%, i.e., in line with developed markets. We have had fewer idiosyncratic surprises, and non-dedicated investors have shown increased appetite for the asset class given the pick-up in spreads.

■ We still see the best value in EM corporate BBs and select longer-dated BBB issuers. We recently added some quasi-sovereign new issues in Mexico and Brazil, as well as some lower-quality India. We have been more selective in Turkish corporate new issues given tight valuations and have been wary of the heavy pipeline from Argentina corporates. We trimmed some Brazil corporate risk on the weaker currency and risks from potentially higher rates.

■ Risks to the asset class include sustained EMFX weakness post U.S. elections or a deeper commodity price correction driven by slowing global growth.

EM Local Markets

■ In the near term, we believe top-down factors are likely to remain the dominant drivers for local markets.

■ We continue to favor exposure to EM duration, but acknowledge that after a 50 bp rally over the past quarter, the value proposition is not as strong as it was at the beginning of Q3. The Fed's 50 bp cut in September will likely embolden EM central banks in their easing stance and could lead to market conditions that are similar to those from Q4 2023.

■ Within our barbell, we are overweight high-beta names such as Mexico, South Africa, and Indonesia, as well as low-beta names such as Peru, India, China, and Thailand. Given high negative carry and roll, we prefer the 5- to 7-year part of the curve. Given the stretched valuations in many EM local markets and the momentum-driven nature of the asset class, our bias will be to trade tactically and reassess our stance after the U.S. election in November.

EMFX

■ With aggressive Fed cuts priced in, slowing global growth, uncertainty around the U.S. elections, and the U.S. dollar currently sitting at a multi-year support level, we believe recent dollar weakness is unlikely to be sustained. Therefore, we remain relative value focused with a small, long U.S. dollar bias. We are selectively long high carry currencies, such as the Brazilian real (probable hiking cycle), Turkish lira (improving fundamental story), Egyptian pound (improving fundamental story), and Mexican peso (judicial reform uncertainty largely priced in/near-shoring to continue). We are short certain low carry currencies, such as the Chinese yuan (poor growth/sensitive to U.S. election), Taiwan dollar (very low carry/sensitive to U.S. election), and Czech koruna (open economy/sensitive to slowing growth).

MUNICIPAL BONDS

Outlook: As a late-cycle beneficiary of a slowing economy, we are positive on the muni market to finish out the year. Whether the Fed continues to cut rates aggressively or moderately, further policy easing should create a favorable environment for munis. We believe relative value, which has cheapened due to the heavy supply over the past quarter, will continue to support the market.

- Despite lower Treasury rates and a much steeper curve, the muni yield curve is flatter on the year. As the muni curve presumably steepens, year-end roll will contribute more to Q4 price returns.

- Spreads have tightened ~ 50 bps YTD due to positive flows, primarily into open end mutual funds, with inflows into high yield muni funds being a notable trend. These flows should keep spreads relatively tight.

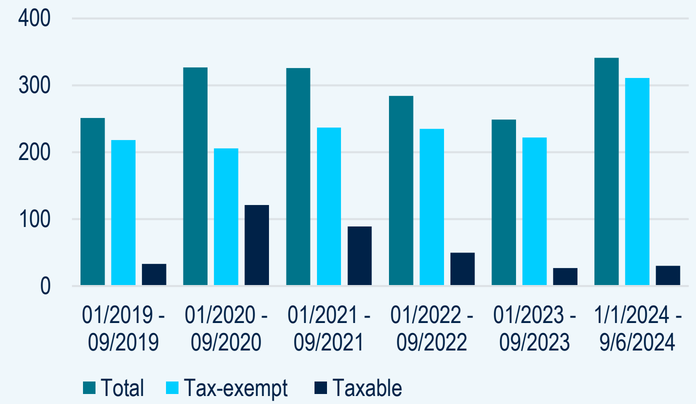
- Elevated supply has been a significant theme YTD and has led to muni underperformance, pushing Muni/Treasury yield ratios higher. Historically, supply has tapered off beginning in November and December of election years as much of the year's issuance is front loaded.

- Activity in the taxable muni market has been extremely low. The main theme has been BABs calls moving bonds out of the taxable market and into the tax-exempt market, causing repricing in the BABs market. Although taxable munis are cheap relative to corporate bonds, we don't expect a pick-up in activity.

- **Tax Policies:** With many tax cuts that were put in place by the Tax and Jobs Act set to roll off in 2025, the demand picture for munis could be materially reshaped, depending on the election outcome. Major tax policies at stake include corporate tax rates, personal income tax rates, capital gains taxes, alternative minimum tax treatment, and state and local tax deductions. It remains to be seen if either candidate will target the tax exemption as a means of paying for other spending priorities. Further out, a potential split congress will make many partisan aspirational tax changes challenging to pass. This should also attract investors to the municipal market's tax shelter.

- **Positioning:** Credit fundamentals remain sound, with the upgrade vs. downgrade ratio still elevated (~1.7x), albeit down from last year. Tight spreads justify moving into higher credit quality names. Ahead of the steepening that will occur in the muni market, we are reducing flatteners. We favor yield enhancement strategies (e.g., AMT spread and prepaid gas). We find the most value in off-the-run structures.

Gross Issuance in 2024 has been drive by well above-average tax-exempt supply
($ billions)



Source: Bloomberg Finance LP and J.P. Morgan

PGIM FIXED INCOME

SECTION 5

SUMMARIES

05

SUMMARY OF OUTLOOKS & ASSET CLASS VIEWS

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

NEGATIVE VIEW   POSITIVE VIEW

Market Scores

U.S.   Europe
EM

Sector	Short-term Outlook		
DM Rates	Tactical and wary. The dynamic between market pricing and our expectations for monetary policy outcomes will continue to provide our direction for global duration positioning. We're wary of what may surprise markets from here, including the possibility of a renewed focus on deteriorating fiscal situations.	U.S. Europe	UK Japan
Agency MBS	Negative in the short term given tight spread levels. We are still positive over the long term vs. rates given muted net supply expectations even after the Fed's initial rate cut. We prefer staying long convexity in the form of seasoned 30-year pools.	Agency MBS	
Securitized Credit	We continue to favor tranches at or near the top of the capital structure given their attractive relative value and risk-adjusted return potential. We expect spreads to remain range bound around historical averages, making carry the dominant theme. While strong technicals could lead to further spread and credit curve compression, we are positioning in shorter spread duration at/near the top of the capital stack, while also remaining tactical and extremely selective regarding more credit-sensitive investments throughout the capital structure. Credit curves appear too flat, and the downside risks associated with traveling indiscriminately down the capital stack outweigh the potential rewards.	CMBS CLOs	ABS
Global IG Corporates	U.S and European IG corporate yields have come off their YTD peaks as the market has anticipated and priced in monetary policy easing. Demand should remain consistent, but lower yields, generally tight spreads—with Euro spreads continuing to trade solidly wide of the U.S.—and heavy issuance may limit an increase in demand. Given our continued expectations for moderating economic conditions, we are modestly constructive on the sector in the short term but remain mindful of the downside risks.	U.S. Corps. 1-10 U.S. Corps. 10+	European Corps. 1-5 European Corps. 5+
Global Leveraged Finance	Solid technicals, stable fundamentals, and a low chance of recession should keep spreads rangebound and demand for new issuance robust. Given elevated geopolitical risks, we remain focused on adding high-quality issues with a preference for short duration. Careful credit selection and a focus on relative value opportunities should be rewarded.	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	Constructive, while mindful of uncertainty related to the U.S. election and policy outcomes. Performance dispersion between and within EMD sectors will continue to reveal alpha opportunities. Our base case of an orderly economic slowdown, accompanied by the tailwind of lower global rates, calls for a moderate level of risk in spreads and EMFX, with a higher conviction in local rates.	Sov. Hard Currency IG Sov. Hard Currency HY Local rates[2]	EMFX[2] Corps. IG Corps. HY
Municipal Bonds	As a late-cycle beneficiary of a slowing economy, we are positive on the muni market to finish out the year. Whether the Fed continues to cut rates aggressively or moderately, further policy easing should create a favorable environment for munis. We believe relative value, which has cheapened due to the heavy supply over the past quarter, will continue to support the market.	Taxable	

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

SUMMARY OF MARKET PERFORMANCE

Sector		Subsector	Spread change (bps) Q3	SOFR OAS 9/30/24
CMBS	CMBS: Conduit AAA	First-pay 10-year	1	136
	CMBS: Conduit BBB-	BBB-	-110	556
	CMBS: SASB – Senior	AAA	-20	150
	CMBS: SASB – Mezz	BBB-	-20	280
	CMBS: Agency Multifamily	Senior	3	90
Non-Agency RMBS	Legacy	RPL Senior	2	149
	Legacy	'06/'07 Alt-A	5	245
	GSE Risk-Sharing	M2	0	160
CLOs	CLO 2.0	AAA	0	135
	CLO 2.0	AA	-5	165
	CLO 2.0	BBB	-5	290
ABS	Unsecured Consumer Loan ABS	Seniors	3	139
	Unsecured Consumer Loan ABS	Class B	3	174
	Refi Private Student Loan	Seniors	3	144
	Credit Card ABS	AAA	2	71

Source: PGIM Fixed Income.

	Total Return (%)		Spread Change (bps)		OAS (bps)
	Q3	YTD	Q3	YTD	9/30/24
U.S. Corps.	5.84	5.32	-5	-10	89
European Corps.	3.27	3.83	-2	-21	117

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

	Total return (%)		Spread / yield change (bps)		OAS (bps)/ yield %
	Q3	YTD	Q3	YTD	9/30/24
EM Hard Currency	6.15	8.64	-30	-22	361
EM Local (Hedged)	3.78	4.55	-49	-8	6.11
EMFX	5.24	3.78	-108	-226	6.67
EM Corps.	4.48	8.50	-4	-49	263

Source: J.P. Morgan.

	Total return (%)		Spread change (bps)		OAS/ DM (bps)
	Q3	YTD	Q3	YTD	9/30/24
U.S. High Yield	5.28	8.00	-14	-28	295
Euro High Yield	3.65	7.00	-13	-42	357
U.S. Leveraged Loans	2.08	6.61	-15	-37	509
Euro Leveraged Loans	1.95	7.02	-11	-48	486

Source: ICE BofAML and Credit Suisse.

	Total return (%)	
	Q3	YTD
High Grade Tax-exempt	2.71	2.30
High Yield Tax-exempt	3.21	7.48
Long Taxable Munis Agg. Eligible	6.15	5.19

Source: Bloomberg. Represents the Bloomberg Municipal Bond Indices.

IMPORTANT INFORMATION

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

For Professional Investors only. Past performance is not a guarantee or a reliable indicator of future results and an investment could lose value. All investments involve risk, including the possible loss of capital.

PGIM Fixed Income operates primarily through PGIM, Inc., a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended, and a Prudential Financial, Inc. ("PFI") company. Registration as a registered investment adviser does not imply a certain level or skill or training. PGIM Fixed Income is headquartered in Newark, New Jersey and also includes the following businesses globally: (i) the public fixed income unit within PGIM Limited, located in London; (ii) PGIM Netherlands B.V., located in Amsterdam; (iii) PGIM Japan Co., Ltd. ("PGIM Japan"), located in Tokyo; (iv) the public fixed income unit within PGIM (Hong Kong) Ltd. located in Hong Kong; and (v) the public fixed income unit within PGIM (Singapore) Pte. Ltd., located in Singapore ("PGIM Singapore"). PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. Prudential, PGIM, their respective logos, and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

These materials are for informational or educational purposes only. The information is not intended as investment advice and is not a recommendation about managing or investing assets. In providing these materials, PGIM is not acting as your fiduciary. PGIM Fixed Income as a general matter provides services to qualified institutions, financial intermediaries and institutional investors. Investors seeking information regarding their particular investment needs should contact their own financial professional.

These materials represent the views and opinions of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person's advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of PGIM Fixed Income is prohibited. Certain information contained herein has been obtained from sources that PGIM Fixed Income believes to be reliable as of the date presented; however, PGIM Fixed Income cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Fixed Income has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy.

Any forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fee. These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. PGIM Fixed Income and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Fixed Income or its affiliates.

Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. **Mortgage- and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and while generally supported by a government, government agency or private guarantor, there is no assurance that the guarantor will meet its obligations. **High yield, lower-rated securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. Currency rates may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **Commodities** contain heightened risk, including market, political, regulatory and natural conditions, and may not be suitable for all investors. **Diversification** does not ensure against loss.

In the **United Kingdom**, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR.PGIM Limited is authorised and regulated by the Financial Conduct Authority ("FCA") of the United Kingdom (Firm Reference Number 193418). In the **European Economic Area** ("EEA"), information is issued by PGIM Netherlands B.V., an entity authorised by the Autoriteit Financiële Markten ("AFM") in the Netherlands and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited including those available under temporary permission arrangements following the exit of the United Kingdom from the European Union. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II). In **Switzerland**, information is issued by PGIM Limited, London, through its Representative Office in Zurich with registered office: Kappelergasse 14, CH-8001 Zurich, Switzerland. PGIM Limited, London, Representative Office in Zurich is authorised and regulated by the Swiss Financial Market Supervisory Authority FINMA and these materials are issued to persons who are professional or institutional clients within the meaning of Art.4 para 3 and 4 FinSA in Switzerland. In certain countries in **Asia-Pacific**, information is presented by PGIM (Singapore) Pte. Ltd., a regulated entity with the Monetary Authority of Singapore under a Capital Markets Services License to conduct fund management and an exempt financial adviser. In **Japan**, information is presented by PGIM Japan Co. Ltd., registered investment adviser with the Japanese Financial Services Agency. In **South Korea**, information is presented by PGIM, Inc., which is licensed to provide discretionary investment management services directly to South Korean investors. In **Hong Kong**, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors as defined in Section 1 of Part 1 of Schedule 1 of the Securities and Futures Ordinance (Cap.571). In **Australia**, this information is presented by PGIM (Australia) Pty Ltd ("PGIM Australia") for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). PGIM Australia is a representative of PGIM Limited, which is exempt from the requirement to hold an Australian Financial Services License under the Australian Corporations Act 2001 in respect of financial services. PGIM Limited is exempt by virtue of its regulation by the FCA (Reg: 193418) under the laws of the United Kingdom and the application of ASIC Class Order 03/1099. The laws of the United Kingdom differ from Australian laws. In **Canada**, pursuant to the international adviser registration exemption in National Instrument 31-103, PGIM, Inc. is informing you that: (1) PGIM, Inc. is not registered in Canada and is advising you in reliance upon an exemption from the adviser registration requirement under National Instrument 31-103; (2) PGIM, Inc.'s jurisdiction of residence is New Jersey, U.S.A.; (3) there may be difficulty enforcing legal rights against PGIM, Inc. because it is resident outside of Canada and all or substantially all of its assets may be situated outside of Canada; and (4) the name and address of the agent for service of process of PGIM, Inc. in the applicable Provinces of Canada are as follows: in **Québec**: Borden Ladner Gervais LLP, 1000 de La Gauchetière Street West, Suite 900 Montréal, QC H3B 5H4; in **British Columbia**: Borden Ladner Gervais LLP, 1200 Waterfront Centre, 200 Burrard Street, Vancouver, BC V7X 1T2; in **Ontario**: Borden Ladner Gervais LLP, 22 Adelaide Street West, Suite 3400, Toronto, ON M5H 4E3; in **Nova Scotia**: Cox & Palmer, Q.C., 1100 Purdy's Wharf Tower One, 1959 Upper Water Street, P.O. Box 2380 -Stn Central RPO, Halifax, NS B3J 3E5; in **Alberta**: Borden Ladner Gervais LLP, 530 Third Avenue S.W., Calgary, AB T2P R3.

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.

ICE DATA INDICES, LLC IS LICENSING THE ICE DATA INDICES AND RELATED DATA "AS IS," MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY, QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE DATA INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THEIR USE, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND PGIM FIXED INCOME OR ANY OF ITS PRODUCTS OR SERVICES.

U.S. SENIOR SECURED LOANS

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

EUROPEAN SENIOR SECURED LOANS

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

EMERGING MARKETS U.S.D SOVEREIGN DEBT:

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

EMERGING MARKETS LOCAL DEBT (UNHEDGED)

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

EMERGING MARKETS CORPORATE BONDS

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

EMERGING MARKETS CURRENCIES

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

MUNICIPAL BONDS

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

U.S. TREASURY BONDS

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

MORTGAGE BACKED SECURITIES

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

COMMERCIAL MORTGAGE-BACKED SECURITIES

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

U.S. AGGREGATE BOND INDEX

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

The **S&P 500®** is widely regarded as the best single gauge of large-cap U.S. equities. There is over U.S.D 9.9 trillion indexed or benchmarked to the index, with indexed assets comprising approximately U.S.D 3.4 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.