PGIM

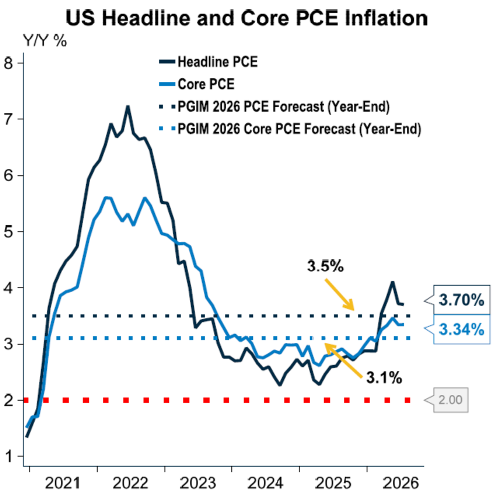
Rationale for a Rising Rate Regime

WEEKLY VIEW FROM THE DESK | September 21, 2026

LINK TO WEEKLY RETURNS TABLE

MACRO

- In what was once a contrarian Federal Reserve interest rate call (see our Mid-Year Outlook at PGIM.com), the Fed's 25 bp rate hike last week was in line with the expectations that we provided in June, and we expect another two 25 bp hikes this year followed by an extended pause in 2027. However, we see the current risk to our rate call as being to the upside for further policy tightening as opposed to fewer hikes.
- The revised language in the Fed's statement highlighted elevated economic uncertainty due to geopolitical risks, and we recently raised our anticipated 12-month oil price range from $80–$100 to $90–$120 per barrel due to the continuing shipping issues in the Middle East. For additional perspective, Chicago Fed President Goolsbee recently stated that restoring price stability requires reducing demand, indicating that the Fed recognizes tighter policy could create economic pain, which traditionally manifests through the labor market.
- We also note that the economy has become progressively less sensitive to interest rates, meaning the Federal Reserve might need more hikes than in past cycles to cool inflation. At this point, core and headline PCE inflation are running in excess of 3% and have remained above the Fed's target for 65 months (see accompanying chart).
- Non-shelter services inflation, which represents more than 50% of PCE, has risen from approximately 2% before the pandemic to nearly 4% and has shown almost no improvement. Five-year, five-year inflation swap pricing had also begun moving higher after declining at the start of the year, contributing to the Fed's more hawkish communication (more on the five-year, five-year swap below).
- The potential need for more than 75 bps in cumulative U.S. policy tightening aligns with our increased probability for recession, which at 20% (up from 10% previously) is consistent with approximate historical recession probabilities. We also updated the probability due to the potential for a correction in AI-related activity—possibly driven by political backlash, companies slowing investment, or investor concerns about returns.



- The major central banks are taking different approaches to addressing inflation. The ECB and the Fed have recently hiked rates. while the Bank of England kept rates on hold, but the 6-3 voting (hold versus hike) split as well as concerns about second-round effects of headline inflation show a clear hawkish shift. The Bank of Japan hiked rates as expected, but the fact that two out of nine policymakers opposed the hike suggests some caution in the pace of tightening ahead. The sharp weakening of the JPY vs. USD late last week is also consistent with a patient approach (see our BoJ perspective on PGIM's Long Story Short blog).

DEVELOPED MARKET RATES

- We think it's unlikely that the U.S. 10-year yield remains wrapped around 5% through the balance of the year. Positioning in the 10-year will shake out as yields continuing to move higher or if they might temporarily move lower through a bout of hedge fund short covering. We see the 10-year range extending from 4.50% to 5.25% with yields likely gravitating toward the upper end over time.
- The increase of about 20 bps in five-year, five-year inflation expectations (a gauge monitored by the Fed; see accompanying chart) since Kevin Warsh's appointment as Fed chair is primarily attributable to higher shorter-term inflation expectations and elevated real yields. The measure often moves in tandem with short-term inflation expectations and it may also be experiencing pressure given that the selloff in nominal yields has been driven by higher real yields.
- Our view on the MBS sector has turned more favorable after it corrected to cheaper valuations amid historically light net supply. Although rates could rise further and extend mortgage duration, production coupons already extended substantially and significant deleveraging over the prior two weeks makes further deleveraging from small rate moves unlikely.

Sources: PGIM, Macrobond, and Citi

IG CORPORATES

- Last week saw new issuance of nearly $53B, with deals 4.2x oversubscribed and coming with a 2.1 bps concession. Mutual fund flows turned negative for the first time since April with a $400M outflow.
- A proposal to include 144A securities in U.S. corporate and credit indices is out for comment. We estimate that adding 144A securities would produce relatively small issuer-weight changes in a pro forma benchmark. Most of the top 10 144A issuers would represent approximately 25–40 bps, while Saudi Arabia would represent about 90 bps. Existing large issuers, particularly major banks, would generally see their credit-index weights decrease by about 25–40 bps and their corporate-index weights decrease by roughly 20–40 bps.

- In Europe, following a volatile week for both credit and broader markets, IG cash spreads closed the week 2 bps wider. The dominant macro theme remains the conflict in Iran, with little progress to either an end to the conflict or a re-opening of the Strait of Hormuz. Supply is expected to remain elevated, with syndicates calling for $17-20B of supply this week.

LEVERAGED FINANCE

- U.S. high-yield spreads tightened by 33 bps last week, while CDX tightened by 3 bps and the CDX basis tightened by 10 bps to 18 bps. Airlines underperformed on higher oil prices, and high-yield funds experienced $1.2B of outflows. After approximately $20B of earlier inflows, recent outflows and limited new supply has created a more balanced market.
- September high-yield issuance is running well below expectations, although SoftBank announced approximately $10B of U.S. dollar bonds alongside euro debt across three-and-a-half-, five-and-a-half-, and seven-and-a-half-year maturities. The five-and-a-half-year tranche was expected to price around a 9% yield, equivalent to approximately a 450 bps spread for a BB+ issuer. Given the company's tech holdings, we viewed the structure as a 25% margin loan on artificial-intelligence-related assets, making some high-yield creditors uncomfortable.
- We raised our expected annual total return for the loan market to 5.5%. The higher forecast reflects the possibility of another two base-rate hikes, with double-B loans currently yielding just over 4% and the index at approximately 3.7%.
- European leveraged-finance issuance remains muted but well supported, with 10 deals priced the prior week, mainly refinancings, and six additional deals currently flagged, predominantly large-scale LBOs. Fundamentals and technicals remains strong in performing names, with high-yield money managers holding roughly 2–3% cash on average and some holding 5–6% while waiting for new issuance.

EMERGING MARKETS

- We remain cautious in the near term given tight valuations and the tenuous risk backdrop. Geopolitics remain complicated and fluid, and while EM fundamentals remain relatively supportive, there are weak spots. Our caution is a function of valuations and tail risks, and broader global macro spillover. EM is likely to remain resilient over the medium to longer term, but there will be dispersion in performance.
- EM rates are likely to remain under pressure. We continue to believe hikes priced in the EM curve are less likely to materialize under our base case, and extracting risk premium in the 2- to 5-year part of the curve in EM vs underweight positioning in the 5-year UST offers the best risk/reward under the current macro backdrop of hawkish DM central banks and no resolution in sight in the Middle East.
- The EMFX index fell 102 bps last week with all three regions in the red by similar amounts: LATAM -135 bps, EUROPE -136 bps, and ASIA -83 bps. The main macro event was the Fed meeting where an expected 25 bps hike was delivered and Warsh was perceived as hawkish, driving a bear flattening in U.S. rates that gave a bid to the USD. Oil was volatile during the week but ended the week flat, which gave some reprieve to EMFX sell-off.
- Our takeaway from the Fed meeting is that if Warsh is to be taken seriously, his aim is to tighten financial conditions. If he succeeds, this in turn will likely produce higher volatility and could lead to de-risking in higher carry EMFX, which has held in exceptionally well this year.

SECURITIZED PRODUCTS

- Securitized product spreads remained relatively steady amid the recent rate selloff, while credit curves continued to flatten as mezzanine spreads tightened and issuance remained strong. ABS senior spreads were unchanged, with credit-card bonds at Treasury plus 40 bps and unsecured consumer bonds at Treasury plus 75 bps. We are using the flatter curves to rotate into higher-quality sectors and ABS pools that had outperformed, including equipment leases.
- In CMBS, single asset single buyer (SASB) issues continued to pay a premium for fixed-rate bonds: floating-rate AA spreads cleared around 120–130 bps, compared with fixed-rate spreads in the high 80s. Private-label issuance was up more than 20% year over year, driven in part by CRE CLO issuance that was approximately 60% higher than the same period last year
- CLO triple-B and double-B tranches had tightened by approximately 30 and 40 bps, respectively, as investors actively bought floating-rate assets. The triple-A to triple-B basis had compressed to about 100 bps versus a 140 bps annual average. In RMBS, benchmark AA spreads were around Treasury plus 125 bps, while benchmark-to-non-benchmark spreads had decompressed by approximately 10–15 bps; we continue to favor non-QM AAA bonds and rotated away from bonds with greater extension risk at spread-flat or better levels
- In terms of CLO diversification, AI infrastructure spending has yet to contribute as much issuance to the leveraged-loan market as to high yield, but issuance is exepcted to become a larger factor. We are adding deal language and other measures to limit unintended single-sector exposure across CLOs, while monitoring the underlying loans and managers to inform views on activity.

MUNICIPALS

- Weekly flows turned negative with $1.8B in outflows, led by open-end and longer duration. Supply remains elevated with ~$15B expected this week.
- Rate vol and heavy issuance weighed on the market, leading to recent underperformance. Valuations are looking better, with cheaper ratios and elevated taxable equivalent yields likely to draw in support.
- There is limited activity in the taxable muni space, where spreads can also be characterized as tight by historical standards.

THE RETURNS TABLE AS OF SEPTEMBER 18, 2026

				Yield / OAS change (bps)					Total return (%)				
	Duration	YTM	OAS	WTD	MTD	QTD	YTD	Prior year	WTD	MTD	QTD	YTD	Prior year
Sovereign rates													
U.S. 2-Year	1.84	4.75	---	12	40	57	127	118	-0.15	-0.55	-0.21	0.29	1.40
U.S. 5-Year	4.37	4.86	---	7	36	63	113	119	-0.25	-1.40	-2.00	-2.17	-1.40
U.S. 10-Year	7.79	5.00	---	3	25	53	83	89	-0.17	-1.79	-3.33	-3.31	-2.63
U.S. 10-Year Breakeven	--	2.32	---	-5	0	9	7	-7	---	---	---	---	---
U.S. 10-Year TIPS	4.32	2.68	---	8	25	45	78	96	-0.69	-2.14	-3.29	-2.22	-2.25
U.S. 20-Year	12.21	5.37	---	-1	13	41	58	68	0.20	-1.52	-4.30	-3.86	-3.95
U.S. 30-Year	14.94	5.33	---	-3	8	37	48	60	0.42	-1.19	-4.92	-3.91	-4.63
U.S. SOFR	---	---	---	23	17	17	-2	-29	0.07	0.18	0.81	2.67	3.87
UK 10-Year	7.66	5.29	---	-5	23	54	82	62	0.32	-0.99	-2.14	-1.40	1.09
Germany 10-Year	8.34	3.52	---	1	19	66	66	79	-0.15	-1.43	-3.94	-2.57	-2.92
Switzerland 10-Year	8.49	0.55	---	0	13	28	27	37	-0.11	-1.18	-2.30	-1.65	-2.62
Japan 10-Year	7.50	2.97	---	0	4	30	91	138	0.13	-0.07	-1.46	-4.04	-6.77
Australia 10-Year	7.85	5.27	---	-10	17	54	53	108	0.69	-1.07	-2.41	-0.01	-2.71
Canada 10-Year	8.11	3.88	---	-6	14	50	45	69	0.47	-0.89	-2.69	-0.53	-1.23
Major fixed income multi-sector indices		**YTW**											
Global Aggregate Unhedged	6.21	4.31	29	0	1	2	2	0	-0.63	-1.23	-1.31	-1.52	-1.47
Global Aggregate Hedged	6.21	4.31	29	0	1	2	2	0	0.04	-0.85	-1.75	-0.63	0.14
U.S. Aggregate	5.92	5.32	28	-1	0	2	2	1	-0.03	-1.16	-2.07	-1.46	-0.44
Euro-Aggregate (Unhedged)	6.11	3.90	50	2	5	6	7	2	-0.21	-1.40	-3.31	-2.06	-1.74
Japanese Aggregate	7.85	2.66	1	0	0	0	0	0	0.03	0.06	-1.39	-4.14	-6.31
Major fixed income credit indices		**YTW**											
Mortgage-Backed (Agency)	5.68	5.60	34	-1	4	9	12	2	-0.05	-1.49	-2.38	-1.42	0.22
Global IG Corporate Bonds	5.85	5.31	79	-2	-1	2	0	2	-0.38	-1.42	-1.93	-1.76	-1.16
U.S. IG Corporate Bonds	6.72	5.77	75	-3	-3	1	-2	3	0.13	-0.99	-2.23	-1.39	-0.70
European IG Corporate	4.53	4.19	84	2	5	4	5	5	-0.20	-1.21	-2.38	-1.08	-0.73
U.S. High Yield Bonds	3.42	7.73	267	2	6	-2	1	6	-0.28	-0.93	-0.22	1.73	2.98
European High Yield Bonds	3.22	6.44	287	1	10	3	5	7	-0.10	-0.98	-0.71	1.15	1.87
U.S. Leveraged Loans	0.3	9.57	468	-2	-9	-32	13	22	0.16	0.41	2.18	3.58	4.89
European Leveraged Loans	0.3	8.04	461	-2	-13	-20	-13	-2	0.18	0.41	1.22	3.00	3.72
EM Hard Currency Sovereigns	6.17	6.83	171	-2	-11	-17	19	54	-0.19	-1.00	-1.54	1.81	5.13
EM Corporates	3.91	6.54	156	-1	-3	-2	7	12	-0.17	-0.68	-0.56	1.64	2.88
EM Currencies	---	5.82	---	0	0	0	0	0	-1.02	-0.54	2.44	3.67	5.01
EM Local Rates	5.22	6.44	6	0	0	0	1	1	0.05	-0.26	-0.53	1.15	2.77
CMBS	3.61	5.49	63	-1	-3	-2	-12	-14	-0.18	-0.98	-1.15	-0.39	0.94
ABS	2.95	5.20	40	-2	-4	-4	-12	-10	-0.06	-0.56	-0.39	0.67	1.99
CLOs	3.86	5.78	125	0	0	-2	-6	-8	0.10	0.24	1.08	3.50	4.96
Municipal Bonds	7.01	4.37	---	9	39	80	78	83	-0.31	-2.05	-4.08	-1.86	-0.67

		Total return (%)				
	Level	WTD	MTD	QTD	YTD	Prior year
Equity / volatility indices						
S&P 500 Index	7,651	-0.1	-0.4	2.3	12.7	16.7
DAX	25,304	-1.0	-3.6	1.2	3.3	6.9
Stoxx 600	635	-0.5	-2.4	-0.6	10.3	18.2
Nikkei 225	65,019	1.6	-1.9	-7.1	30.3	46.0
Shanghai Composite	3,912	0.7	-1.7	-3.7	0.3	4.4
MSCI ACWI Index	1,138	-0.5	-0.9	1.9	13.6	18.2
FTSE 100	10,659	0.1	-1.5	2.3	10.1	19.2
MOVE Index	81	-1.9	7.1	12.1	26.1	12.1
VIX Index	15	-6.5	-0.7	-10.0	-0.9	-5.7

		Change (%)				
	Spot	WTD	MTD	QTD	YTD	Prior year
FX / commodities						
EUR / USD	1.1	-1.0	-1.1	0.6	-2.2	-2.6
USD / JPY	156.9	2.1	-1.8	-3.5	0.1	6.0
GBP / USD	1.3	-1.0	-1.1	1.0	-0.6	-1.2
EUR / CHF	0.9	-0.3	0.5	2.3	1.5	1.1
USD / CHF	0.8	0.7	1.7	1.7	3.8	3.8
USD (DXY)	100.2	1.1	0.8	-1.0	1.9	3.0
Oil	100.3	0.2	17.0	44.3	74.7	57.8
Gold	4378.6	0.7	-1.3	9.2	1.4	20.2

Past performance is not a guarantee or a reliable indicator of future results. Sources: Bloomberg except EMD (J.P. Morgan), HY (ICE BofAML), Bank Loans (S&P), and CLOs (Palmer Square). European returns are unhedged in euros unless otherwise indicated. An investment cannot be made directly in an index.

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Source(s) of data (unless otherwise noted): PGIM as of September 21, 2026.

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