PGIM MULTI-ASSET SOLUTIONS

OUTLOOK

BEYOND RESILIENCE: STRATEGIC POSITIONING FOR AN EVOLVING LANDSCAPE

Published January 2025

MARKET PULSE

2024 was a tremendous year. The defining characteristic of 2024 was not merely resilience, but rather, an emphatic defiance of widespread pessimism that started the year. Last year began with market narratives dominated by concerns of economic slowdown and potential economic recessions. What materialized instead was a demonstration of remarkable economic durability, culminating in one of the most complex and compelling years for financial markets in recent memory. This also translated into remarkable runs for risk assets throughout 2024 (**Exhibit 1**), building onto what had already been a stellar 2023.

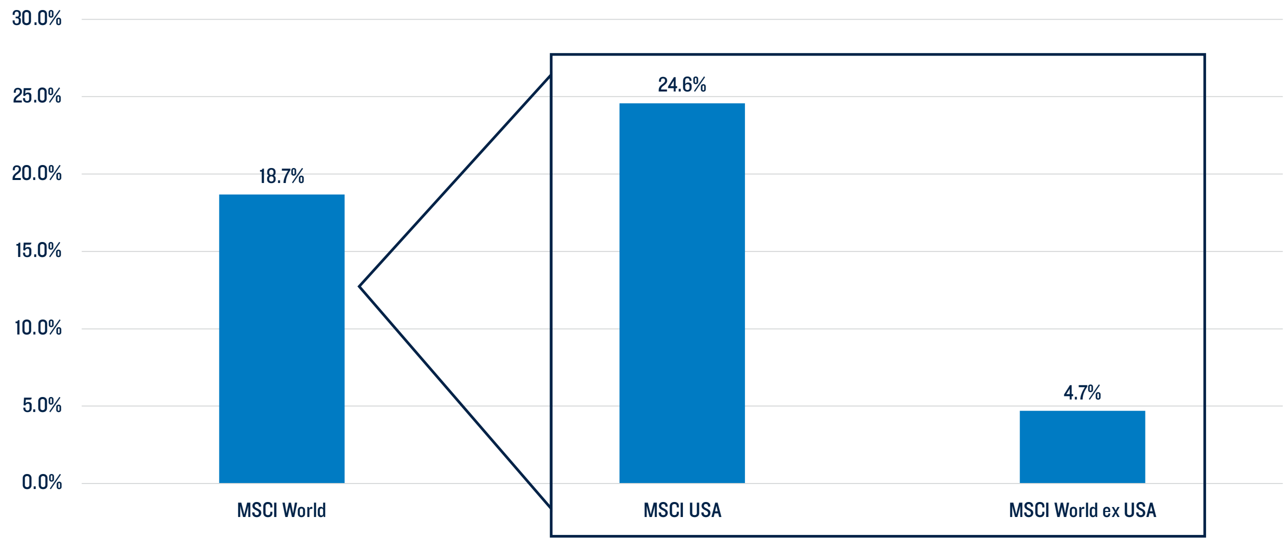
Exhibit 1: Market Snapshot (As of December 31, 2024)

		Benchmark	Current Levels Govt Bond = Current Yield (%) Equities = Index Level Credit = OAS (bps)	2024 Yield / Spread Change ▲▼	2024 Returns ▲▼
Fixed Income	2 Yr Treasury	US Government 2 Year Note	4.24%	(1)	3.70%
	10 Yr Treasury	US Government 10 Year Note	4.57%	69	-1.68%
	US Investment Grade Credit	Bloomberg US Credit Index	77	(16)	2.03%
	US Long Credit	Bloomberg US Long Credit Index	100	(17)	-2.01%
	US High Yield	Bloomberg US HY 2%	287	(36)	8.19%
	Leveraged Loans	Credit Suisses Lev Loan Index	475	(53)	9.05%
	CLO	JPM CLOIE Index	205	(48)	8.31%
	Agency MBS	Bloomberg US MBS Index	43	(3)	1.20%
	CMBS (Investment Grade)	Bloomberg US CMBS Investment Grade Index	88	(49)	4.96%
	ABS	Bloomberg US Agg ABS Index	43	(25)	5.02%
	EM Debt (Local)	JP Morgan GBI-EM Global Diversified Index	6.39%	20	3.77%
	EM Debt (Hard)	JP Morgan EMBI Index	325	(58)	6.54%
Equities and Real Assets	US Large Cap Equity	S&P 500	5,882	--	25.00%
	US Small Cap Equity	Russell 2000	2,230	--	11.53%
	Global Developed Equity	MSCI World Index (Net Total Return)	11,731	--	18.67%
	EM Equity	MSCI EM Equity Index (Net Total Return)	574	--	7.44%
	Global Public Real Estate	FTSE / Nareit Developed Index (Net)	4,979	--	0.93%
Commodities	Energy	Bloomberg Energy Subindex	71	--	1.18%
	Precious Metals	Bloomberg Precious Metals Subindex	643	--	25.26%
	Industrial Metals	Bloomberg Industrial Metals Subindex	339	--	3.54%
	Agriculture	Bloomberg Agriculture Subindex	138	--	-3.92%

Source: Bloomberg, JP Morgan and PGIM. Data as of December 31, 2024.

However, headline performance numbers tell only part of the story. When we look underneath the hood, the real driver of this tremendous growth was standout performance by the US economy. MSCI World returned 18.7% in 2024. This masked a striking divergence in regional performance. The US served as a decisive force, surging 24.6% and significantly outpacing other developed markets which showed a more modest 4.7% gain (**Exhibit 2**). This contrast underscores a key theme: the broad-based global recovery was visibly uneven in its distribution. It also raises important questions about market concentration, global economic dynamics, and the persistence of the US' market leadership in the coming year.

Exhibit 2: Equity Returns in 2024



Source: Bloomberg; PGIM Multi-Asset Solutions.

"While we are constructive on growth and risk asset returns heading into Q1, valuations are stretched, leaving open more asymmetric outcomes against an environment with greater macro uncertainties."

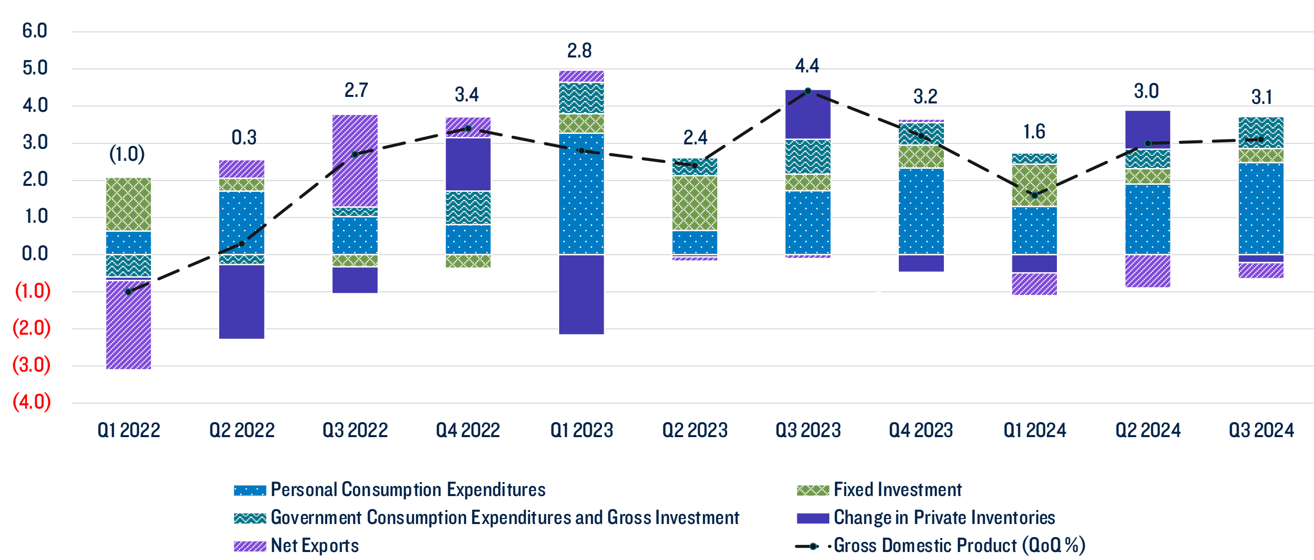
Mao Dong, Co-Head of Portfolio Management, PGIM Multi-Asset Solutions

As we look ahead to 2025, a number of macro themes will emerge as key drivers of market performance:

1. **Major Economies' Divergent Growth Trajectories:** The historical correlation amongst developed markets continues to fragment, particularly as the US has increasingly pulled away from rest of the developed market in recent years. We expect this to continue into 2025. Robust consumer spending, corporate investment, and stimulative fiscal policy have propelled US GDP above trend (**Exhibit 3**). Looking back at the last two years, the US has certainly not behaved in line with trends implied by a typical economic cycle. As the Fed tightened monetary policy to combat elevated inflation between 2022 and 2023, conventional wisdom would suggest that this would have dampened growth and, consequently, asset returns. Instead, inflation moderated, and the US economy continued to grow at-or-above trend, sending US equites surging almost 60% cumulatively between 2023 and 2024[1]. A combination of the normalization of pandemic-era supply constraints across goods and labor, and strong fiscal support both contributed to this outcome. However, we also believe structural shifts, such as the rise of AI, have fueled this phenomenon and will continue to have a significant role in shaping the future of US performance.

   While we don't expect US markets to generate similar double-digit growth in 2025, we expect the US to continue to lead the global market in growth. We also expect the Fed's measured approach to monetary easing, albeit at a slower rate, to continue supporting risk assets. On the contrary, European growth has been significantly weaker, resulting in continued aggressive monetary easing by the ECB. The economic, fiscal and political challenges across European economies such as that of Germany, France, and the UK, will continue to contribute to greater volatility in economic performance. Outside of developed markets, the Chinese economy has struggled amidst the aftermath of the property crisis and weaker consumer demand, despite efforts by the central government to stimulate economic growth. While we saw a short-term 30% rally in Chinese equities during Q3 2024 as a result of a coordinated central government stimulus, structural growth headwinds remain. The potential trade tension with the US may exacerbate the situation. Similarly, ongoing geopolitical tensions in Eastern Europe and the Middle East remain tail risks, and any further escalation could be catalysts for negative returns across risk assets. The divergence in performance across geographies will likely contribute to volatility as we progress through the year, but will also set the stage for relative value opportunities that provide differentiated returns. As such, being able to nimbly rotate across markets and asset classes as these opportunities arise will be critical in driving additional sources of alpha.

Exhibit 3: US GDP Breakdown



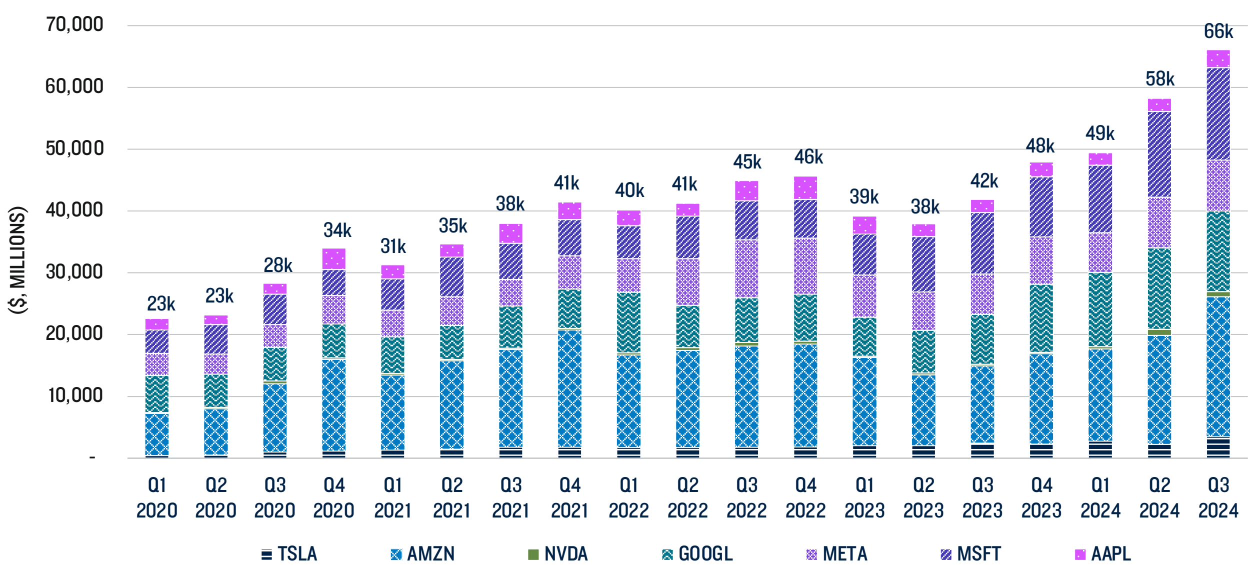
Source: Bloomberg; PGIM Multi-Asset Solutions

[1]Cumulative performance of S&P 500 from 1/1/2023 to 12/31/2024 was 57.8%.

2. **US Policy Landscape Evolution Amidst Trump Presidency and Republican Congress:** While a healthy macroeconomic backdrop, robust corporate earnings and ample liquidity will keep risk assets generally positive in 2025, we also believe this will be accompanied by increased volatility. One potential source of such volatility will be the US policy landscape. The market's positive response to potential policy shifts of the incoming Trump Administration contributed significantly to 2024's robust performance, but not all of the new Administration's policies will have the same exuberant impact if implemented. Trump's pro-business tax cuts and deregulation policies should be positive for risk assets, like equities and credit. These policies could also spur increased M&A activities, which will be a tailwind for private assets. In fact, much of the optimism was priced-in in the days immediately following the election. However, some estimates suggest that these pro-business policies will add approximately $10 trillion to the already mounting federal deficit, which will undoubtedly put upward pressure on interest rates. While Trump indicated he would levy tariffs to help fund his policies, such tariffs would contribute to inflation and dampen productivity and growth. Further, Trump's trade policy and labor market reforms could reduce labor force supply and increase labor costs. The "tug-and-pull" impact of different proposed policies emphasizes the complex interplay across a number of factors. For instance, while tariffs can have a negative impact on overall productivity, growth and inflation, the Trump Administration has also inherited a robust US economy with moderating inflation. Thus, the question now becomes: "Which of the proposed policies will have a more dominant net impact?" Further, how the Administration chooses to prioritize and implement these proposed policies will also influence the net outcome.

3. **AI Investment and Quantum Computing Materialization:** The AI revolution evolved from speculative enthusiasm to tangible capital deployment in 2024. This is particularly evident in the Magnificent 7's expenditure patterns (**Exhibit 4**), which have been quite significant and partially responsible for the robust growth we have seen in the US.

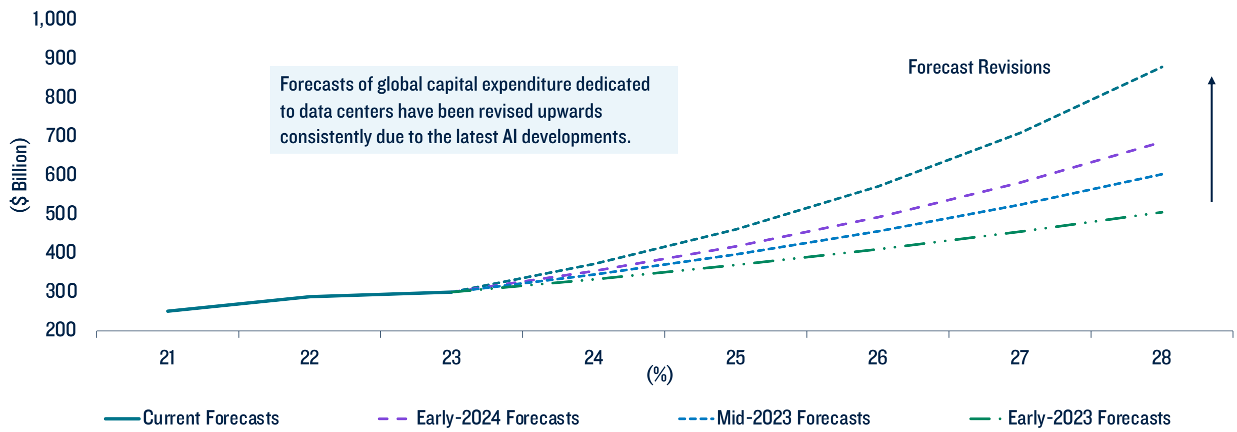
Exhibit 4: Magnificent 7 Capital Expenditures



Source: Bloomberg; PGIM Multi-Asset Solutions

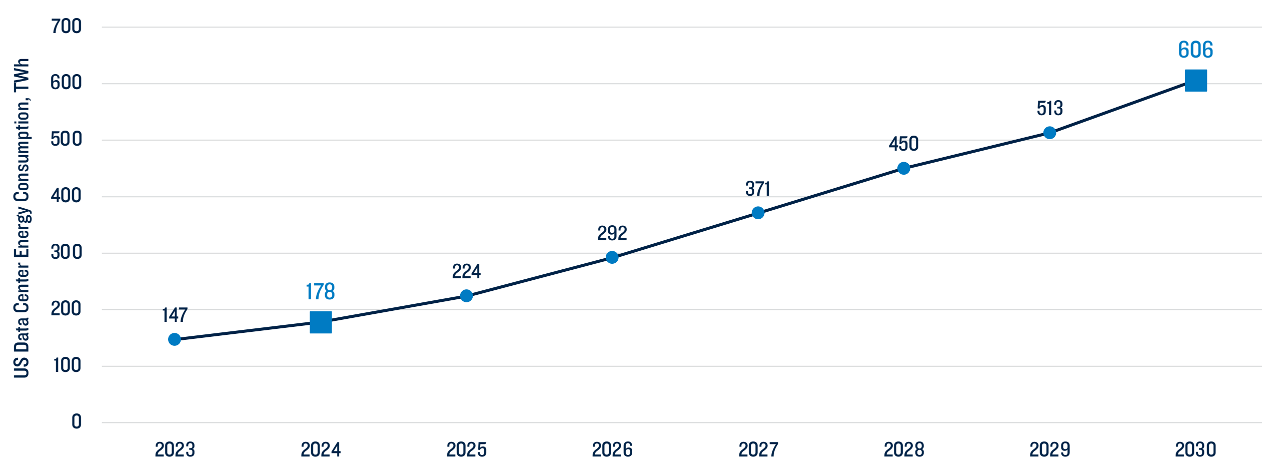
While direct returns on AI investments will take time to realize, this AI boom is already manifesting itself through other major regions and industries in a more immediate way. For instance, the construction of data centers and demand for energy has increased significantly. Based on research conducted by the PGIM Real Estate team, capital expenditure on data centers is projected to grow by an average of around 25% per year over the next few years (**Exhibit 5**). Similarly, demand for energy consumption by data centers is expected to grow by over three times in the next five to seven years (**Exhibit 6**).[2]

Exhibit 5: Data Center Capital Expenditure Forecasts



Source: Arthur D. Little, Dell'Oro, International Energy Agency, New Street Research, PGIM Real Estate as of December 2024.

Exhibit 6: Growing Demand for Power



Source: Global Energy Perspectives 2023, Mckinsey.

[2]To read more about the research on the AI and Data Center Revolution conducted by PGIM's Real Estate Team, please click the following link: [Hyperscale: The Artificial Intelligence and Data Center Revolution]

Last, but not least, the demand for materials, such as industrial metal (e.g., copper) will also benefit from the continued investment into AI. As such, leaning into regions (e.g., US), industries (e.g., semiconductor design, data center construction, and energy), and raw materials (e.g., industrial metals) that are integral to the supply chain on which the AI evolution depends will be value-additive.

As with any structural shifts, the AI evolution will also have its bumps along the road. Given all the capital spent on AI and the excitement around its potential, any setback or disappointment relative to the high expectations set will undoubtedly lead to short-term volatility across assets. That being said, we believe the AI evolution is here to stay in the long-run and will benefit many different asset classes.

As we head into 2025, we will encounter a complex tapestry of market dynamics that demand tactical and strategic considerations. As the last couple of years have demonstrated, markets will not necessarily behave in accordance with conventional trends implied by historical performance. Recent developments have also reinforced the delicate balance between resilience and volatility in global markets. As such, complementing a thoughtful and well-diversified strategic investment program with a nimble, dynamic asset allocation framework will be increasingly important.

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We expect global fragmentation to continue in 2025, which presents a number of risks but also sets the stage for attractive relative value opportunities.”

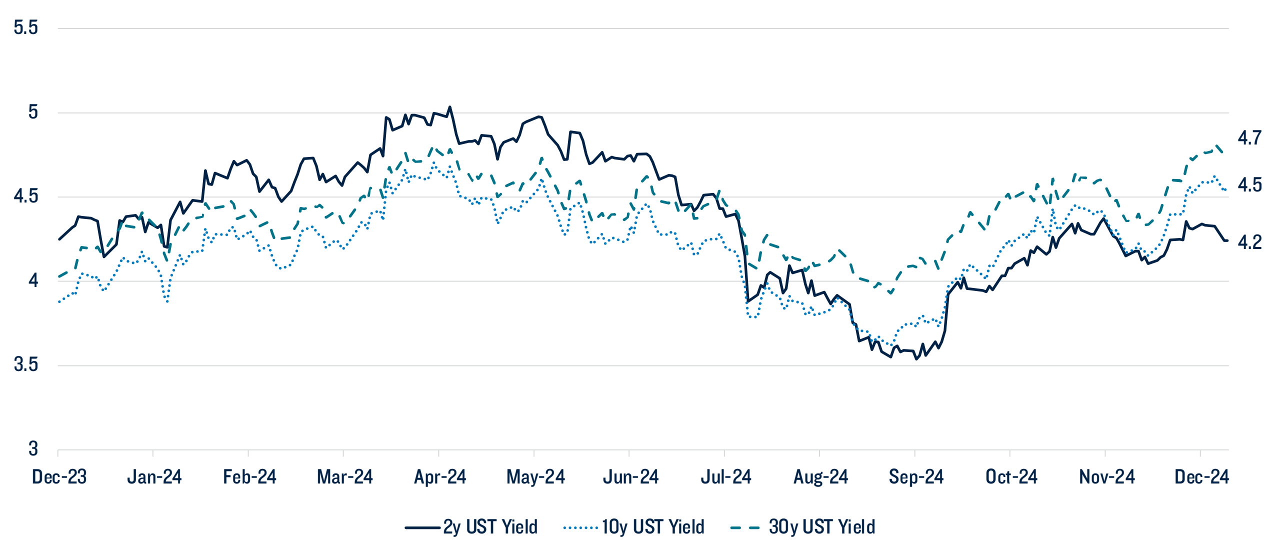
Mao Dong, Co-Head of Portfolio Management, PGIM Multi-Asset Solutions

KEY CONVICTIONS AND INVESTMENT THEMES

The global economic landscape continues to demonstrate remarkable resilience, with the US maintaining its position as the primary engine of growth. This backdrop presents both compelling opportunities and notable challenges for institutional investors over the next 12 months. Below are some of the key investment themes and high-conviction ideas we are focused on from a multi-asset perspective:

1. **Strategic Rate Positioning:** The interest rate environment demands nuanced positioning given competing forces at play. Our neutral positioning on rates reflects this complex interplay of forces. The anticipated path of Fed policy actions remains subject to considerable uncertainty. While the December FOMC meeting resulted in the widely expected 25 bps policy rate reduction to a range of 4.25% to 4.50%, it also introduced additional complexity. The updated median dot plot suggests a gradual, more conservative rate-cut trajectory. Despite Chairman Powell's policy-neutral stance on the incoming administration, the Fed's revised forecasts—higher growth and inflation, alongside lower employment— suggest implicit consideration of proposed policies by the Trump Administration. This runs contrary to the Fed's message to date that it would remain "data-driven," sending front end rates up by 12bps following the speech. Net-net, while front-end Treasury yields ended the year at effectively the same place they started, the intra-year movement has been quite significant (**Exhibit 7**). The long-end of the Treasury curve, on the other hand, has moved up considerably, as markets anticipate a more restrictive Fed policy in response to proposed tariffs and tax cuts. This further underscores the strategic importance of maintaining robust interest rate hedging protocols across the yield curve, especially for liability-driven institutional investors such as pensions and insurers, who are subject to similar interest rate impacts.

Exhibit 7: 2y, 10y & 30y US Treasury Yields

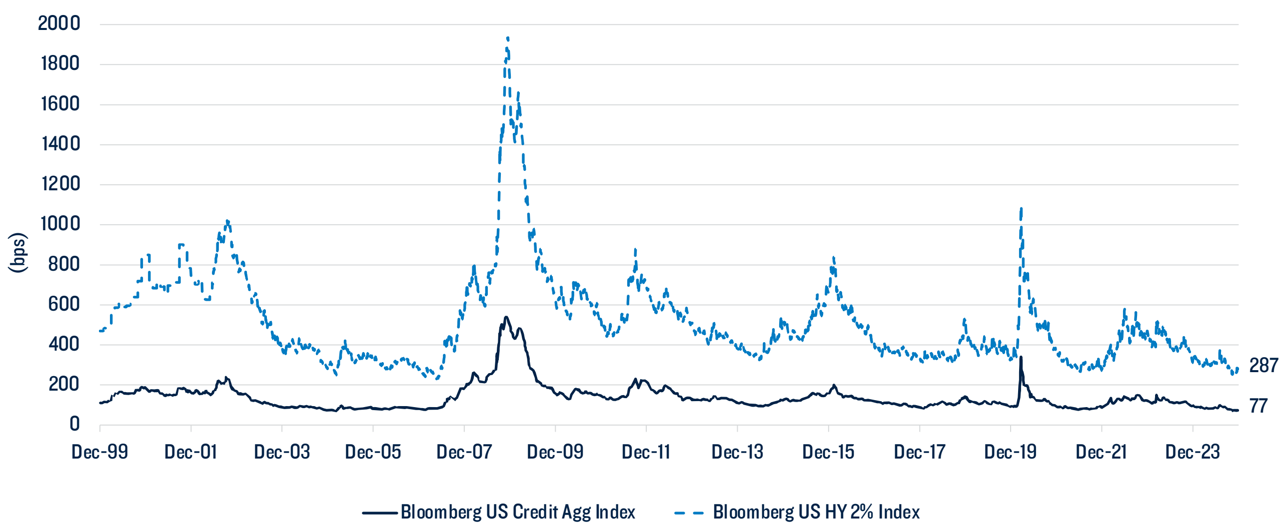


Source: Bloomberg; PGIM Multi-Asset Solutions

2. **Quality-Focused Credit Allocation:** A melding of favorable macroeconomic backdrops, robust corporate earnings, and the demand for yield have helped credit markets reach compelling technical levels. Investment Grade and High Yield spreads tightened 16 bps and 36 bps year-to-date, respectively. While credit fundamentals remain robust and default rates subdued, Public IG and High Yield spreads are at multi-decade tights (**Exhibits 8a and 8b**) which makes credit markets susceptible to more asymmetric outcomes, especially if growth deteriorates. Moreover, as fixed income investors move down the capital structure stretching for yield, the question becomes whether or not the risk-return tradeoff is appropriately priced. In our view, a combination of tight valuation and a flat credit curve suggests there is better risk-reward tradeoff by remaining higher in the capital stack. At the same time, we advocate maintaining sufficient liquidity to capitalize on potential spread widening opportunities, particularly in segments where underlying fundamentals remain robust.

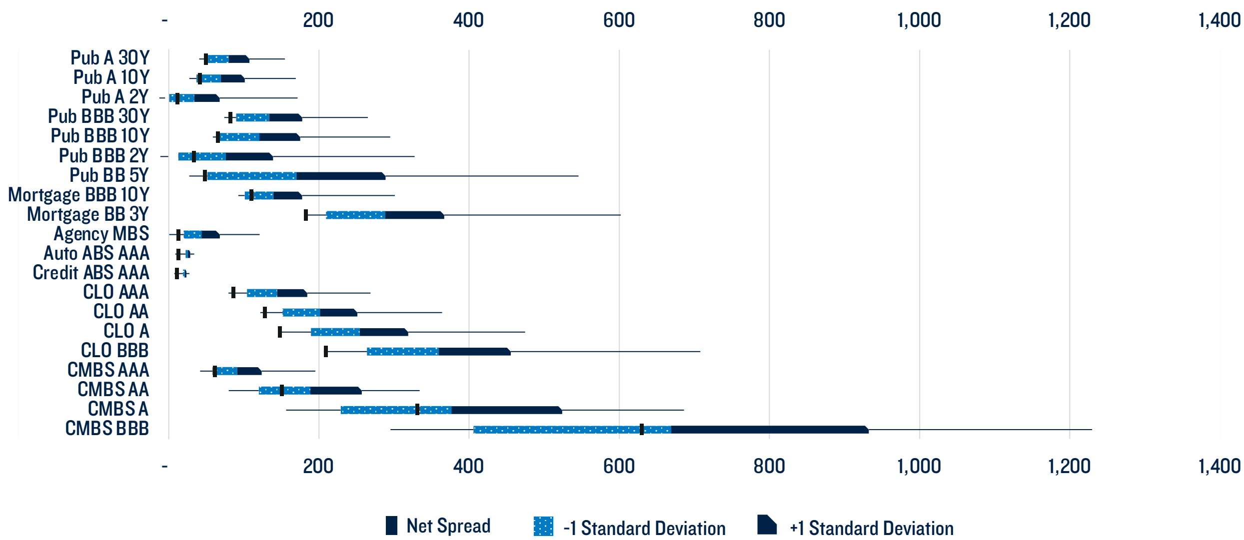
3. **Private Market Opportunities:** Private credit continues to offer attractive relative value. While spreads have come in across the board, private credit continues to command yield premium relative to public corporates and offers compelling secular opportunities (**Exhibit 9**). As the AI evolution continues, private credit has also become an increasingly popular source for capital funding, presenting attractive opportunities. We believe leaning into areas such as middle market direct lending and asset-backed finance will prove value-additive. We also believe we are near, or at, the trough for private real estate overall, and NOI growth and stabilizing cap rates will present re-entry opportunities. While office CRE continues to face structural headwinds, especially in the face of a potential financing wall, other real estate sectors have seen robust growth. The asset class will also benefit from the increasing demand for data center construction and leasing in support of the AI boom. Nonetheless, rigorous underwriting standards remain a critical element in managing the downside risk associated with private investments.

Exhibit 8a: Public Credit (IG and High Yield) Option-Adjusted Spread (As of December 31, 2024)



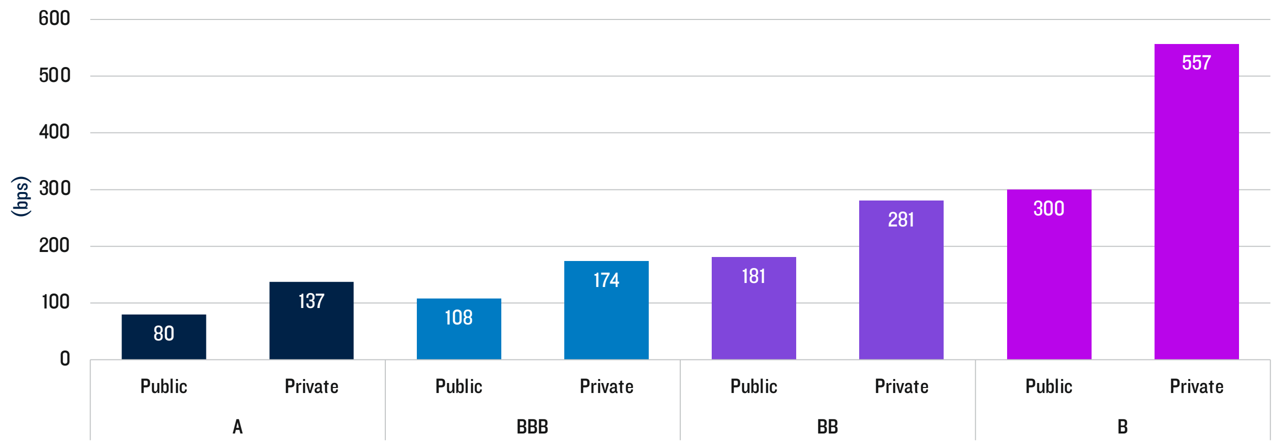
Source: Bloomberg; PGIM Multi-Asset Solutions

Exhibit 8b: Historical Net Spreads (March 30, 2020 - December 31, 2024)



Source: PGIM Multi-Asset Solutions

Exhibit 9: Public vs. Private Credit Option-Adjusted Spread Comparison (As of December 31, 2024)



Source: Bloomberg; PGIM Multi-Asset Solutions

4. **Maintain Geographic Overweight to US:** As a result of resilient US economic growth, the Fed's easing cycle and the excitement over AI, the US equities market saw an almost 60% return between 2023 and 2024, led by the Magnificent 7. While US equity valuations appear elevated, they are supported by earnings expansion and profitability. Additionally, an extension of corporate tax cuts under the Trump Administration could further expand profit margins, while proposed protectionist policies could provide additional tailwinds for US equities. We expect these factors to contribute to positive US equity returns, although the magnitude may be more tempered relative to what we have seen in the past couple of years. On the other hand, while European and Chinese equities exhibit significant valuation discount relative to US equities, a combination of weak consumer spending, lackluster manufacturing output, potential strengthening of US Dollar from a protectionist US Administration, and potential trade tensions may present continued relative headwinds. Further, given the AI revolution, geopolitics will increasingly focus on protecting intellectual property, which may strain global relations and likely result in less cooperation amongst global powers.

ASSET CLASS OUTLOOK

Our cross-asset class views indicate where we see the best relative value opportunities within global financial markets. These are not intended to represent a specific portfolio, and assume a multi-asset investor investor seeking long-term growth.

Public Fixed Income

The transition from the zero-rate environment has fundamentally transformed fixed income's role in institutional portfolios. Beyond traditional liability-hedging purposes (e.g. against insurance or pension liabilities), the asset class now offers compelling total return potential with lower volatility than equities. This evolution has attracted increased allocations, particularly from return-seeking investors. From an asset allocation perspective, this leads to a more balanced asset allocation as an increasing amount of assets move into fixed income.

However, if we look under the hood, fixed income marked-to-market performance has also been very interesting to observe, as it combines the interplay between interest rate movements, which is driven by factors such as central bank monetary policies, geopolitical risks, and credit spread, which is more heavily dependent on economic growth and corporate fundamentals. This year, we have seen significant volatility in the interest rate market as a result of pricing the Fed's easing path. As such, we remain neutral in aggregate interest rate duration. On the other hand, spreads have compressed significantly, in line with a broader rally across risk assets. As noted above, credit spreads are at extremely tight levels. Despite sound corporate fundamentals and more muted default levels relative to history, we remain neutral on overall credit spread risk. Within credit strategies, we see attractive value in structured credit relative to corporates. In particular, we favor senior tranche CLOs relative to corporates given more favorable risk/reward tradeoff, despite spreads having compressed in the sector as well.

Equities

Equities have seen a remarkable run over the past couple of years, led by US equities and, in particular, performance of the Magnificent 7. However, as noted above, within equities, performance across regions and market caps have differed in a significant way. Looking ahead, we are cautiously optimistic on overall equity performance as we expect a healthy macroeconomic backdrop and continued earnings growth potential to be supportive of equities growth.

However, high valuation presents headwind. Within equities, we are relatively more bullish on US Large Cap and Small Cap equities driven by robust earnings, and a continued Fed easing cycle (albeit a potentially shallower one). We also have favorable views on Japanese equities given corporate governance reforms and a focus on return on equity, although appreciating Yen and mixed policy signals from the Bank of Japan may present potential headwinds. We are relatively more bearish on European and Chinese equities, driven by near-term weakness across both economies which we believe will take more time to work through. Outside of China, opportunities and risks also exist as certain EM markets will stand to benefit from the challenges faced by China (e.g., India) but while others may be challenged should the Trump Administration's trade policies and tariffs (e.g., Mexico) be implemented. Remaining active within equities will help identify potential market dislocations and add value.

Private Credit

The private credit landscape presents compelling secular opportunities. The growth and evolution of the asset class represents a transformative opportunity for institutional investors positioned to capture illiquidity premiums. Multiple secular trends are converging to reshape the landscape: traditional bank retrenchment driven by heightened regulation, an advantageous floating rate return profile in the current rate environment, and robust market fundamentals marked by relatively contained default rates. These dynamics have created a compelling value proposition for investors seeking enhanced yield potential. In particular, we find middle-market direct lending quite attractive.

Further, innovation within private credit continues to accelerate, with strategies evolving beyond traditional direct lending. Private ABF has emerged as a particularly dynamic segment, offering diversified exposure across sectors such as consumer, renewable energy, mortgages, and fund finance. The energy transition theme has also spawned specialized direct lending opportunities, while growing retail investor participation has catalyzed the development of more accessible vehicle structure, including perpetual and semi-liquid vehicles. Despite these promising developments, we emphasize that rigorous underwriting standards and comprehensive risk management frameworks remain critical success factors.

Real Estate Debt

Across real estate markets, we see emerging value opportunities as the market reaches a cyclical trough. This might suggest that valuations are reaching an inflection point. While the office sector continues to face structural headwinds, we maintain conviction in a broad-based rebound across other property types. This optimistic outlook is supported by anticipated Federal Reserve easing, moderating inflation trends, and stabilizing fundamentals in both operating income and capitalization rates. For institutional investors seeking to position for this recovery sentiment, real estate debt may offer an attractive risk-adjusted entry point, providing both spread premium and portfolio diversification benefits within fixed income allocations.

Short Term Views (3-12 Months)*

		Risk Factor / Asset Class	UW	N	OW	Comments
Main Market Risk Factors		Rates		●		While we expect the Fed's easing cycle to continue, Treasury yields can still see significant near-term volatility as the market continues to re-calibrate its expectation on the extent of Fed cut
Main Market Risk Factors		Credit		●		Strong fundamentals and technicals are supportive of credit assets. However, we are cautious of tight spread levels, which can widen should growth or corporate fundamentals deteriorate. We can look for relative value within credit sectors (see below)
Main Market Risk Factors		Equities			●	We expect continued earnings growth potential and policies from Trump's Administration to be supportive of equities growth. However, high valuation presents headwind
Asset Class Views	Fixed Income	US Treasuries		●		We expect US Treasuries to be range bound given near-term volatility from uncertainties around the Fed's reaction function
Asset Class Views	Fixed Income	IG Corporate		●		Sound fundamentals and technicals are supportive of corporate credit but tight spreads present risk to the downside, particularly at any sign of economic slowdown
Asset Class Views	Fixed Income	High Yield		●		Reasonable leverage and relatively benign default environment are supportive of high yield, but spread levels remain all-time tight

Underweight =UW, Neutral = N, Overweight = OW. Past performance is not an indicator of current or future results. Weightings represent an assessment of the market environment at a specific time and is not intended to be a forecast or guarantee of future results. This information should not be construed as investment advice or an offer or solicitation to buy or sell securities.

Risk Factor / Asset Class			UW	N	OW	Comments
Asset Class Views	Fixed Income	CLO			●	Spreads have compressed but remain attractive relative to other fixed income sectors; in particular, we favor more senior CLO tranches given attractive risk/return tradeoff
		Agency MBS	●			Spreads have compressed but less so than other credit sectors. Near term may face challenges given technicals but medium-to-long term outlook is positive
		CMBS		●		Spreads relative to other fixed income sectors remain relatively attractive and we believe much of the negative impact from CRE has been priced in. However, more elevated cap rates and lower valuation can continue to be a headwind in the near term
		ABS		●		Consumer credit is generally healthy and spreads have not compressed significantly. However, we remain cautious of impact from lower disposable income and elevated, albeit moderating, inflation
		EMD Local		●		Near term performance will be range bound and will be impacted by trade policy and tariffs from the new administration. Consequently, we will likely see divergence in EM performance
		EM Corporate Debt		●		EM spreads have compressed, in line with positive credit performance more broadly, but we expect near term performance to be rangebound driven by impacts of trade policy and potential tariffs
	Equities	US Large Cap			●	Strong US corporate earnings and broadening of breadth in performance should be tailwind for the asset class, although significant upside will be muted given valuation
		US Small Cap			●	Rate cutting cycle should be supportive of small cap equities
		Japanese Equities			●	Corporate governance reform and focus on return on equity should be supportive of equity returns, but appreciating Yen and mixed policy signals from the Bank of Japan can present headwind
		European Equities	●			Economic activities to remain relatively weak, and unlikely to see significant rebound in near term
		EM Equity	●			Broader EM equity heavily influenced by Chinese equity performance, which we expect to be a continued headwind
		Public Real Estate		●		Lower policy rates should be beneficial for real estate and REITs' relatively defensive equity beta can serve as hedge in tail risk scenarios, but office CRE can continue to be a headwind
	Commodities	Energy		●		We expect near term performance to be range bound and tied to geopolitical developments and supply / demand dynamics
		Precious Metals		●		Has benefited in 2024 from flight-to-quality sentiment amidst more elevated geopolitical risk. However, we expect precious metals to be more rangebound as tail risks has moderated and amidst strong dollar
		Industrial Metals			●	Increasing AI and quantum computing adoption will be constructive for industrial metals such as Copper
		Agriculture		●		We expect near term performance to be range bound and tied to geopolitical developments and supply / demand dynamics

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CONCLUDING PERSPECTIVES & CONSIDERATIONS

As we navigate the first quarter of 2025, the investment landscape presents a complex interplay of opportunities and challenges. The remarkable resilience of the US economy continues to anchor global markets, yet diverging regional growth trajectories create both tactical opportunities and potential risks. Similarly, political landscape shifts in the US and structural forces such as the AI evolution will be major drivers of returns and risks. This further reinforces the importance of thorough portfolio construction and a dynamic asset allocation framework, while the evolution of private markets offers compelling diversification potential. Against this backdrop, institutional investors should consider three critical questions:

1. How might the convergence of the Fed's policy shifts and the agendas of the incoming Administration reshape short-term and long-term risk-free rates, and what implications will this hold for cross-asset correlations?
2. Given elevated valuations across public markets, how can portfolios be positioned to capture alpha through market dislocations while maintaining appropriate risk parameters?
3. As private market opportunities expand across major asset classes such as credit and real estate, how should investors balance the attractiveness of illiquidity premiums against the need for portfolio flexibility in the evolving macro environment?

The answers to these questions will likely prove decisive in navigating what promises to be a dynamic investment environment through 2025 and beyond.

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