



**THIRD QUARTER 2025 OUTLOOK**

# **DECELERATION, DIVERGENCE & DIVERSIFICATION**

**Published July 2025**

For professional investors only.  
All investments involve risk, including possible loss of capital.

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# 01 MARKET PULSE

## Executive Summary

As we enter the third quarter of 2025, investors are navigating through a more fractured macro landscape. While risk markets have rallied back from the immediate aftermath of Liberation Day, volatility remains high across developed and emerging markets amid slowing global growth trend, continued uncertainty around tariff and future path of inflation, and increased geopolitical tensions. Diverging policy responses – particularly across the US, Europe and China – are creating regional asymmetries in interest rate paths and capital flows. The result is an environment where uncertainty is elevated and that demands strategic repositioning.

### Key Questions for Consideration:

- Is US resilience sustainable or are stagflation risks rising?
- In a “higher for longer” stock-bond correlation regime, where do investors uncover true diversification?

### Our Third Quarter 2025 Outlook explores five key macro and investment themes:

1. Persistent stagflation and recession risks
2. Divergent global monetary policies
3. US exceptionalism under pressure
4. Fiscal sustainability concerns and “higher for longer” stock-bond correlation
5. Liquidity as a strategic anchor

## Market Pulse

Following a volatile second quarter marked by mixed economic signals and intensifying policy divergence, the global investment environment remains in flux. Growth lost steam across major regions, prompting the World Bank to downgrade its global real GDP growth forecast to 2.3% for 2025. In the US, the Fed held rates steady despite a recent market rally and a temporary pause in most Liberation-day tariffs. The Fed remains cautious on inflation stickiness and elevated geopolitical risk, while projecting slower GDP growth and higher unemployment. Globally, central banks have begun to decouple. The ECB has moved decisively to cut rates as European growth slowed and inflation softened, while China expanded monetary support to stabilize the property market and bolster domestic demand. These diverging policy paths are reshaping global yield curves, contributing to interest rate differentials and capital reallocation.

While US exceptionalism is fading with capital shifting abroad, the US economy has proved resilient so far. However, stagflation and recession risks remain elevated, and rising fiscal sustainability risks are weighing heavily on the market outlook. The traditional role of fixed income as a diversifier is being eroded by a sustained positive stock-bond correlation – after being negative for more than 20 years – a new investing environment for many investors. Alternative diversifiers such as private credit are becoming increasingly central to navigating this new paradigm. As we navigate the third quarter of the year, allocating across a broader spectrum of assets and geographies while maintaining liquidity, yield diversification and macro adaptability will be critical to managing the regime shifts underway.

## Exhibit 1: Market Snapshot (As of June 30, 2025)

		Benchmark	Current Levels Govt Bond = Current Yield (%) Equities = Index Level Credit = OAS (bps)	Q2 2025 Yield / Spread Change ▲ ▼	YTD 2025 Yield / Spread Change ▲ ▼	Q2 2025 Returns	YTD 2025 Returns
Fixed Income	2 Yr Treasury	US Government 2 Year Note	3.72%	(16)	(52)	1.09%	2.64%
	10 Yr Treasury	US Government 10 Year Note	4.23%	2	(34)	1.09%	4.97%
	US Investment Grade Credit	Bloomberg US Credit Index	80	(9)	3	1.82%	4.22%
	US Long Credit	Bloomberg US Long Credit Index	104	(14)	3	1.25%	3.75%
	US High Yield	Bloomberg US HY 2%	292	(54)	4	3.53%	4.57%
	Leveraged Loans	Credit Suisse Lev Loan Index	459	(39)	(16)	2.33%	2.96%
	CLO	JPM CLOIE Index	215	2	10	1.79%	2.89%
	Agency MBS	Bloomberg US MBS Index	37	1	(6)	1.14%	4.23%
	CMBS (Investment Grade)	Bloomberg US CMBS Investment Grade Index	91	(4)	3	1.86%	4.48%
	ABS	Bloomberg US Agg ABS Index	57	(3)	13	1.38%	2.93%
	EM Debt (Local)	JP Morgan GBI-EM Global Diversified Index	6.01%	(29)	(38)	2.73%	4.41%
	EM Debt (Hard)	JP Morgan EMBI Index	322	(27)	(3)	3.32%	5.64%
Equities and Real Assets	US Large Cap Equity	S&P 500	6,205	--	--	10.94%	6.20%
	US Small Cap Equity	Russell 2000	2,175	--	--	8.50%	-1.79%
	Global Developed Equity	MSCI World Index (Net Total Return)	12,843	--	--	11.47%	9.47%
	EM Equity	MSCI EM Equity Index (Net Total Return)	1,034	--	--	11.51%	15.15%
	Global Public Real Estate	FTSE / Nareit Developed Index (Net)	5,282	--	--	4.41%	6.07%
Commodities	Energy	Bloomberg Energy Subindex	70	--	--	-10.94%	-1.16%
	Precious Metals	Bloomberg Precious Metals Subindex	798	--	--	4.88%	24.05%
	Industrial Metals	Bloomberg Industrial Metals Subindex	367	--	--	-0.42%	8.12%
	Agriculture	Bloomberg Agriculture Subindex	135	--	--	-4.02%	-2.08%

Source: Bloomberg, JP Morgan and PGIM. Data as of June 30, 2025.

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In a new regime defined by decelerating growth, diverging policies, and enduring positive stock-bond correlation, diversifying into private assets may become increasingly important in building a more resilient portfolio.”

Xiang Xu, Vice President, Portfolio Research, Multi-Asset Solutions

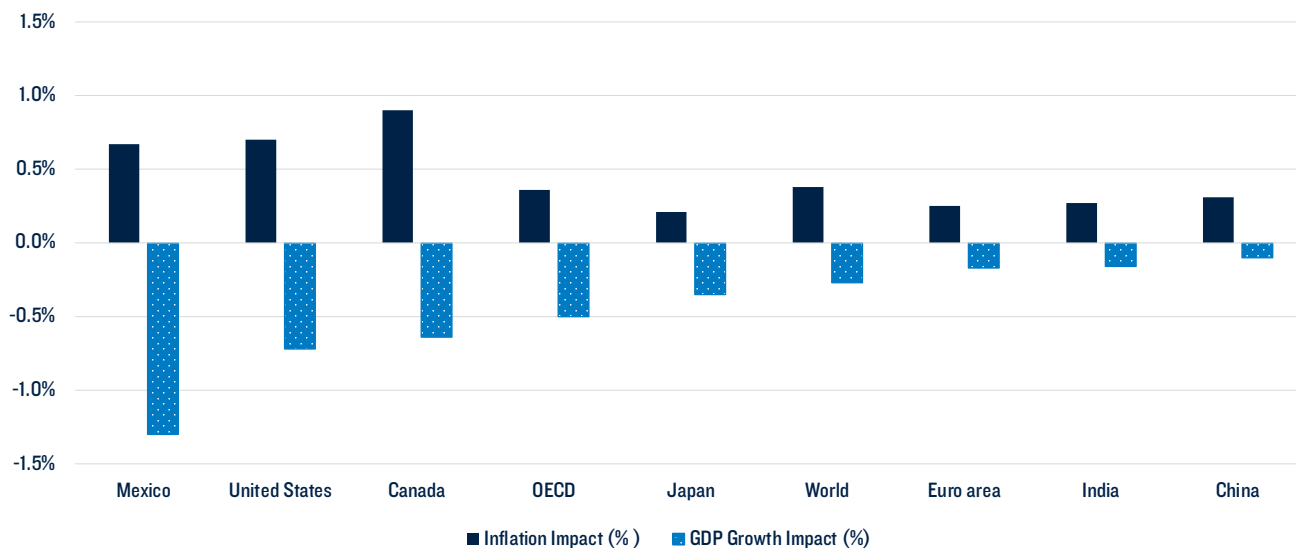


## 02 KEY CONVICTIONS & INVESTMENT THEMES

**1. Persistent Stagflation and Recession Risks:** Increased trade policy uncertainty and mounting geopolitical tensions continue to cloud the global economic outlook. According to the OECD, a 10% US tariff would disproportionately impact the US vs. Europe and China (Exhibit 2). In the second quarter, the Fed has projected further deceleration in US growth, lowering its 2025 real GDP growth forecast from 1.7% in March to 1.4% in June. Core PCE inflation is expected to remain above target and exceed 3% this year (up from 2.8% in March). The Fed also expects unemployment to climb to 4.5%, reflecting a softening labor market. The likelihood of a recession within the next 12 months moderated after the tariff pause but is still above 60% as of June with the risks of productivity and employment deterioration remaining high (Exhibit 3).<sup>1</sup>

Core macro risks – including tariffs, which function like fiscal tightening and significantly impact, in the short term, consumer spending and business investment and hiring – remain elevated. Fiscal expansion (e.g., from the “One Big Beautiful Bill Act”) may also exacerbate inflation. In addition, the potential oil shocks from geopolitical tensions and labor supply disruptions in the US due to mass deportation could add to the upsurge in inflation or inflation expectations, forcing the Fed to delay easing. On the other hand, despite elevated interest rates and strong US asset performance, the US dollar weakened by 10% in the first half of 2025. The decline was in part driven by increased hedging activity by foreign investors rather than capital outflows. However, hedging costs remain high and hedged yields are still negative. As the Fed maintains higher rates and tariff-related inflationary pressures persist, the dollar could stabilize if hedging activity subsides. Over the balance of 2025, asset allocation strategy should remain diversified and inflation-hedged.

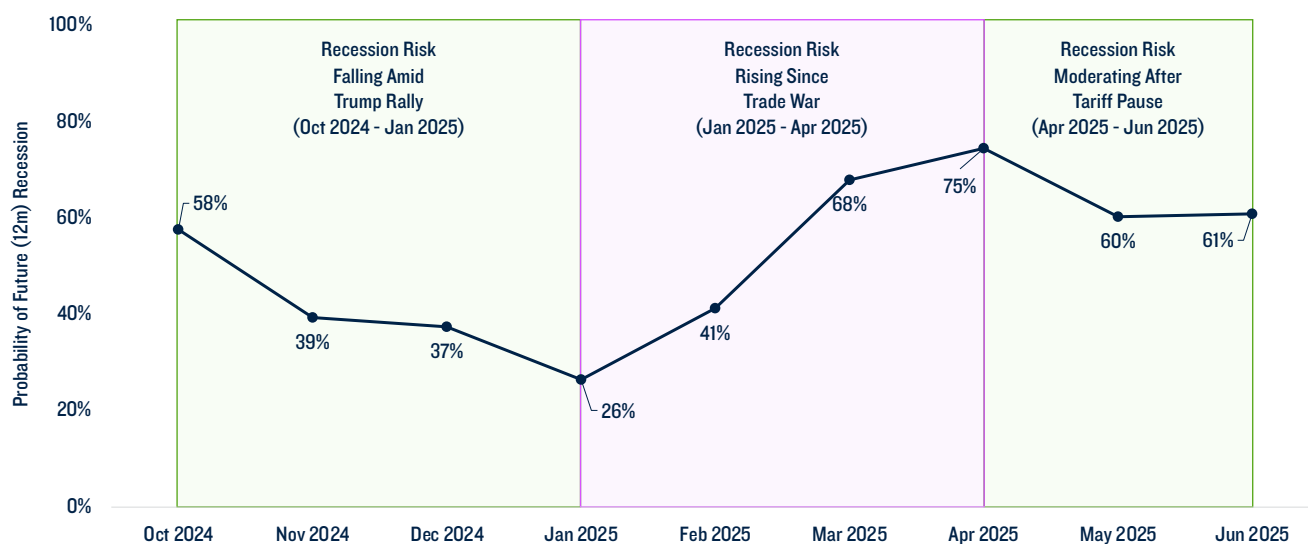
**Exhibit 2: Tariffs Will Hurt the US the Hardest Among Major Trading Partners**



Note: Based on OECD simulation of a rise of 10% in US tariffs on non-commodity imports from all countries and 10% higher tariffs on non-commodity imports from the United States by all countries. The inflation impact is the average annual % difference in the first 3 years, and the GDP impact is the % difference from baseline by year 3. Source: OECD, Faisal Khan, PGIM. Data as of June 30, 2025.

<sup>1</sup>See What to Expect When Expecting a Recession: A CIO's Guide to Interpreting the Probability of Recession, X. Xu, June 2023, PGIM.

### Exhibit 3: Recession Risk Moderated After the Tariff Pause, but Still Remains Elevated



Note: The June month-end recession probability estimate assumes the trailing 12-month percentage change in industrial production (one of the inputs in our recession model) as of June, which may not be released until mid-July, to be the same as the value in May. Source: Federal Reserve Board, Matteo Iacoviello and PGIM. Data as of June 30, 2025.

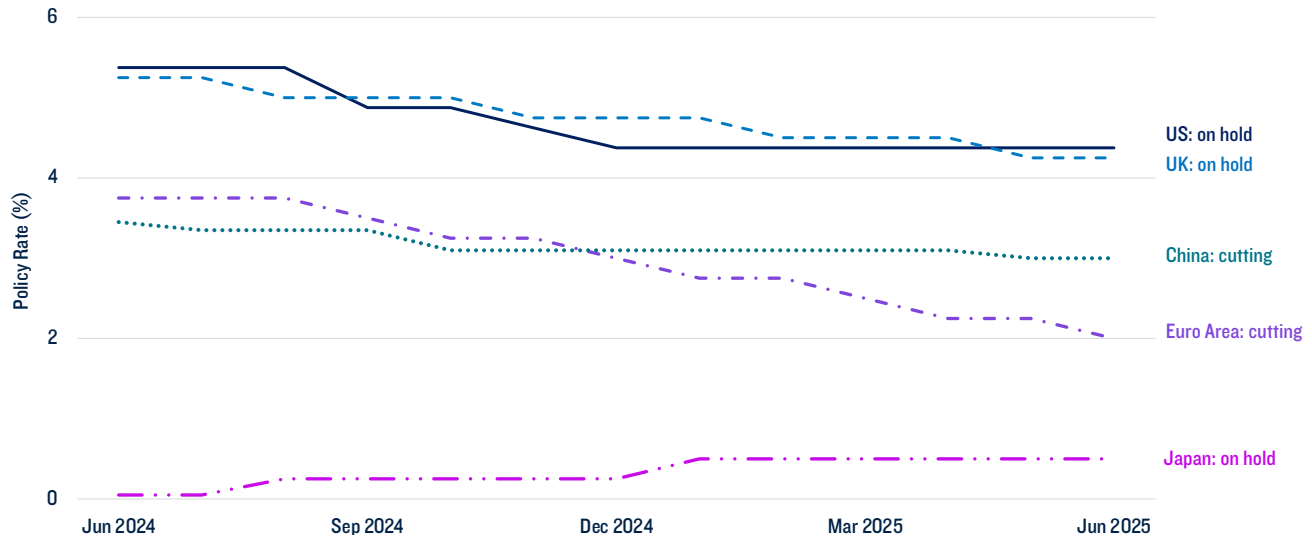
**2. Divergent Monetary Policy:** In the second quarter of 2025, monetary policy divergence, a phenomenon not seen in recent economic cycles and a likely unintended consequence of Trump-era tariffs — remains a defining theme for global markets (Exhibit 4). In the US, the Fed has maintained a cautious stance (holding the fed funds rate steady at 4.25% to 4.5%), opting instead to preserve flexibility amid potential inflation stickiness and elevated uncertainty from the evolving tariff policies. The Fed is likely to remain data-dependent, with any easing contingent on clearer signs of labor market deterioration (unemployment has remained stable around 4.2%) or a sharper decline in inflation expectations. Following the Fed, the Bank of England is holding rates steady as policymakers face upward pressure on inflation, which remains above target.

Meanwhile, the European Central Bank (ECB) has signaled a greater willingness to cut rates, with softening growth and moderating inflation. It has cut rates for the eighth time in a year, lowering its deposit rate to 2% by the second quarter of 2025. While US tariffs are inflationary for the US economy, they might be deflationary for Europe, redirecting cheaper Chinese and Asian goods destined for the US to Europe. Increased fiscal spending, particularly on defense and infrastructure, is expected to provide medium-term support, but the immediate outlook favors continued monetary accommodation. Similarly, in China, the People's Bank of China (PBOC) has shifted to a “moderately loose” monetary policy, implementing tactical stimulus measures, including a 50bps cut in the reserve requirement ratio and interest rate reductions, to counter the economic fallout from US tariffs. The measures aim to support the property market, bolster domestic demand amid weakening export prospects, and restore consumer and investor confidence.

In contrast, the Bank of Japan (BOJ) continues to signal a cautious approach to further tightening, after moving away from long-standing ultra-loose policies in March 2024, with potential rate hikes dependent on economic data and global conditions.



## Exhibit 4: Divergence in Monetary Policy



Source: Bank of England, Bank of Japan, European Central Bank, Federal Reserve Board, Haver Analytics, People's Bank of China and PGIM. Data as of June 30, 2025.

- 3. US Exceptionalism Under Pressure:** Despite the immediate impact from the global tariff announcement on April 2nd, the US economy continued to perform strongly in the second quarter, demonstrating resilience in the face of geopolitical headwinds and continued uncertainty surrounding tariff policy. In the job market, non-farm payroll numbers exceeded economists' predictions, and the unemployment rate held steady. Consumer spending continued to rise, although at a slow rate.

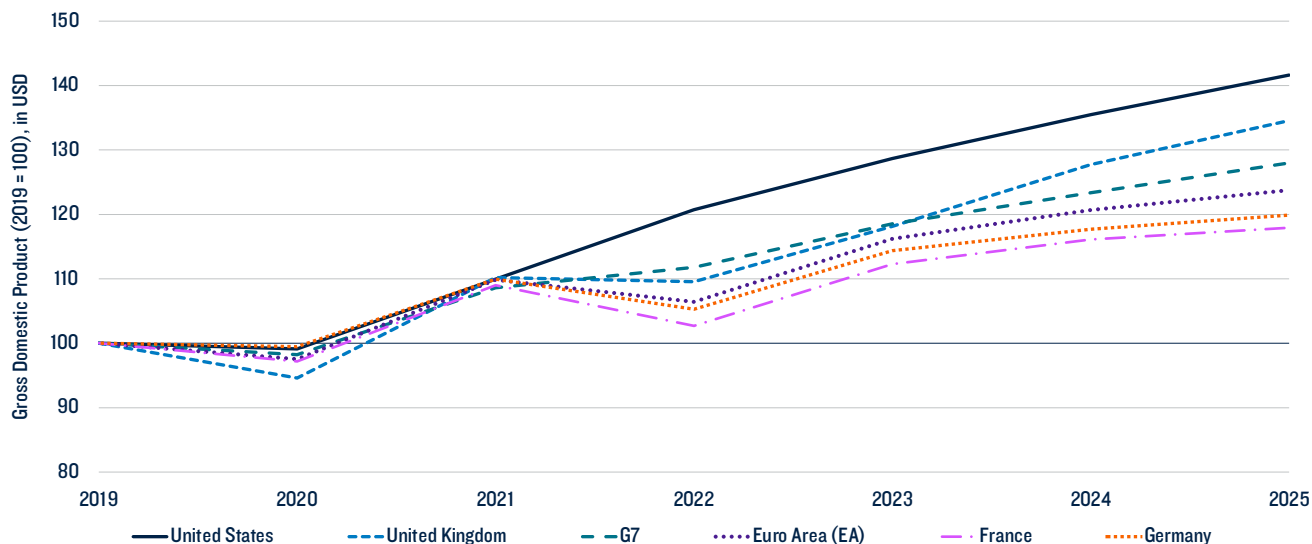
The US economy and equity market had been standout performers since the 2020 pandemic, bolstering the notion of US exceptionalism (Exhibit 5). Global investors have naturally been keen to use its deep, open and transparent capital markets so that they can share in the US's success.

However, the recent quarter has shown signs that these capital flows may be reversing. Flows into non-US equity funds have outpaced those into US equity funds; the dollar has fallen relative to other currencies; and other equity markets have been outperforming the US. We continue to believe in the underlying strength of the US economy. Its culture of innovation, favorable demographics, and established lead in technology continue to make it an attractive investment destination.

Nonetheless, shifting political currents are rebalancing the investment playing field, making the case for greater geographical diversification going forward. Even if the stop-start tariff war aims to reshore US manufacturing and rebalance US trade deficits, the wave of deglobalization being unleashed is forcing policy makers elsewhere to reconfigure their economies, reducing their dependence on unfettered global trade. The Canadian government has introduced a bill aiming to remove barriers to trade within Canada. The UK government is encouraging, and may even force, pension plans to invest in the local economy. Both the UK and Canada are attempting to make it easier for large infrastructure projects to proceed, potentially opening new investment opportunities as well as having a strong economic impact. And Europe, finding itself stuck between geopolitical tensions among the US, Russia, and Middle East, is prioritizing the re-creation of a domestic defense industry.

As such, while we expect the US to continue to be a significant driver of global growth, we see opportunities to diversify geographically into areas such as European equities (e.g., defense-related exposures), European securitized credit, and Japanese financials.

## Exhibit 5: US Economic Growth Has Been Resilient Up to This Point



Source: IMF and PGIM. Data as of June 30, 2025.

**4. Fiscal Sustainability Concerns and “Higher for Longer” Stock-Bond Correlation:** Concerns over US fiscal sustainability are mounting as the debt-to-GDP ratio approaches 130% (Exhibit 6). Fiscal debt is poised to continue its climb as the Congressional Budget Office (CBO) estimates that the “One Big Beautiful Bill Act” would add approximately \$3 trillion to the deficit over the next decade.<sup>2</sup> This expanding fiscal footprint is also fueling scrutiny of “r - g” – the critical gap between the average interest rate on government debt and the economy’s growth rate. When economic growth outpaces borrowing costs, debt burdens are more manageable. But as growth is currently decelerating while rates remain elevated, that cushion is shrinking. This dynamic raises the perceived riskiness of US government debt, pushing yields higher, tightening financial conditions, and in turn, dampening growth. The feedback loop – higher rates, lower growth, and depressed valuations across both equities and fixed income – is manifesting in sustained positive stock-bond correlation.<sup>3</sup>

The second driver of positive stock-bond correlation has been discretionary monetary policy – raising rates when the economy is cooling (pushing down both stock and bond prices) and cutting rates when the economy is heating up (pushing up both stock and bond prices). Over the past 2+ years, the actual fed funds rate has been deviating from a rules-based framework, a sign of monetary policy’s growing reliance on discretion. Emerging political pressures from the Trump administration on the Fed to alleviate the fiscal debt burden by cutting rates could further compromise the Fed’s independence.

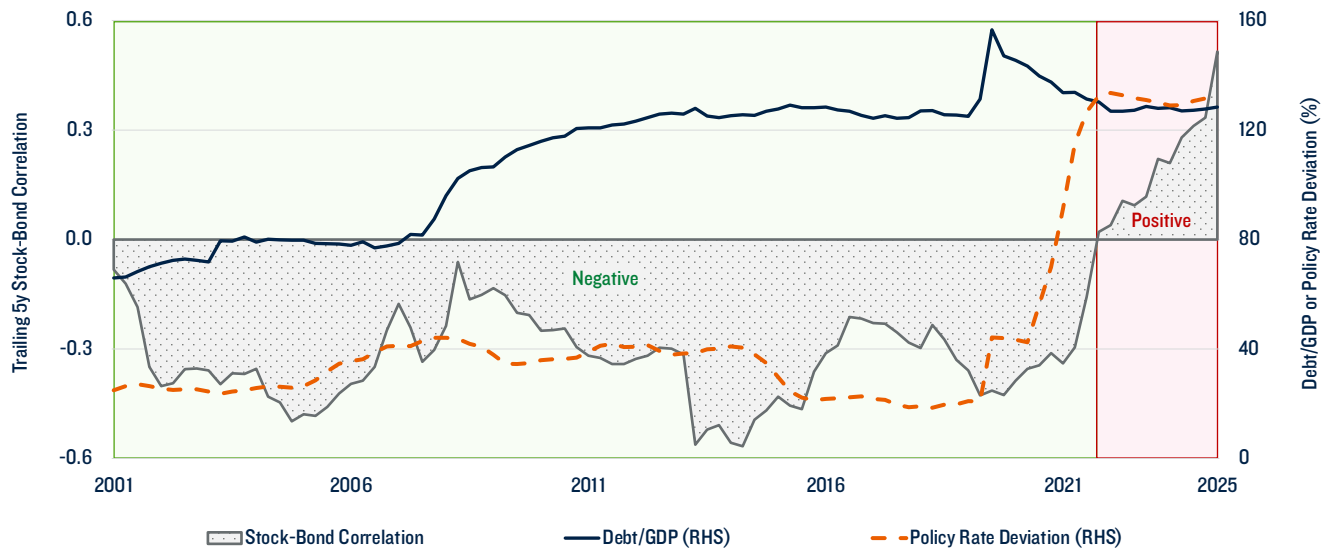
More recently, geopolitical tensions have raised the risk of an oil-price supply shock. This could fuel inflation while dragging economic growth down, depressing both stock and bond returns, and pushing stock-bond correlation further into the positive territory. The combination of unsustainable fiscal path and discretionary monetary policy has placed stock-bond correlation on a “higher for longer” trajectory, reaching a historical high of 0.5, and diluting the traditional diversification benefits that have underpinned portfolio construction for decades. The shift in the correlation regime – from negative to positive – has manifested across developed markets, where stock-bond correlations have been highly synchronized. Consequently, institutional investors may need to broaden their toolkits and search for alternative diversifiers. Private credit, infrastructure, and real assets may offer compelling diversification potential in a world where the traditional stock-bond playbook may no longer apply. As we navigate the third quarter, we remain focused on building resilient portfolios to adapt to the positive correlation regime and capture opportunity in a more complex macro landscape.

<sup>2</sup> Based on CBO’s estimate as of June 5, 2025.

<sup>3</sup> See Stock-Bond Correlation: A Global Perspective, X. Xu, June 2022, and Positive Stock-Bond Correlation: Prospects & Portfolio Construction Implications, X. Xu, March 2024, PGIM.



## Exhibit 6: “Higher for Longer” Stock-Bond Correlation Amid Unsustainable Fiscal Policy & Discretionary Monetary Policy



Note: Stock-bond correlation is calculated as the trailing 5y rolling correlation between 1m %-change in S&P 500 Total Return Index and 1m %-change in US 10y Treasury Constant Maturity Total Return Index. Policy rate deviation is calculated as the trailing 5y rolling standard deviation of the quarterly difference between the effective fed funds rate and Taylor-rule implied rate, rescaled by a factor of 40x for charting consistency purposes. Debt/GDP is the general government debt as a % of SAAR GDP. Source: Bureau of Economic Analysis, Federal Reserve Board, Haver Analytics, Standard & Poor's, US Treasury and PGIM. Data as of June 30, 2025.

**5. Liquidity as a Strategic Anchor:** The market backdrop characterized by rising policy divergence, recalibration of global trade flows and a reevaluation of US economic dominance introduces uncertainty not only in asset price trajectories but also in the timing and accessibility of capital, making liquidity provision a strategic anchor. Liquidity, in this context, extends beyond readily transactable assets to encompass instruments that generate consistent income streams, providing both cash flow and portfolio flexibility.

Investors are increasingly prioritizing assets that offer both tradability and reliable returns such as government and investment grade bonds, structured credit, and short duration seasoned private credit. Additionally, high-dividend equities and private assets with higher income potential, such as real estate, infrastructure debt, or private equity strategies with strong cash flow profiles, are gaining traction as liquidity sources. While these private assets may be less liquid, they do offer regular distributions, helping investors meet recurring portfolio liquidity needs without forced liquidation.

Looking ahead through the rest of 2025, liquidity provision will remain a strategic linchpin for investors navigating persistent uncertainty. By anchoring portfolios with a mix of liquid, income-generating assets, investors can balance defensive positioning with the flexibility to capitalize on undervalued opportunities. Having a full understanding of the portfolio's liquidity waterfall, assisted by robust portfolio construction tools, will be imperative in this environment to inform the appropriate mix of public and private strategies that can weather stress scenarios.



**The current market backdrop introduces uncertainty not only in asset price trajectories but also in the timing and accessibility of capital, making liquidity provision a strategic anchor.”**

Junying Shen, Principal, Portfolio Research, Multi-Asset Solutions



## 03 OUTLOOK BY ASSET CLASS

**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 seeking long-term growth.**

### Public Fixed Income

The second quarter presented a complex backdrop for public fixed income investors, as stubborn inflation met decelerating growth and diverging global monetary policies. In the US, the Fed has paused at 4.25–4.5%, but markets still price in two cuts by year-end. This supports a preference for short-duration and floating rate exposure, which offers attractive carry with limited interest rate risk.

In contrast, long-dated bonds continue to face headwinds from sticky inflation, fiscal uncertainty, and persistent budget deficit concerns further exacerbated by the “One Big Beautiful Bill Act”, all contributing to higher term premia and yield curve steepening. The rise in projected debt issuance should also act to push yields higher. The US Treasury 2Yr/10Yr yield curve has re-steepened from –70bps in mid-2023 to +52bps as of June 2025 (Exhibit 7). While elevated term premium suggests greater value at the long end, geopolitical tensions have increased market volatility and sustained strong upward momentum in long yields – undermining long-dated bonds’ traditional role as a “safe haven.”

In this environment, diversifying yield sources becomes increasingly important. Higher quality credit, particularly structured products, continues to offer resilient income in light of flat credit curve and continued interest rate volatility. Outside the US, securitized credit within Europe is an emerging fixed income sector that can provide attractive return-risk tradeoffs. Selected emerging market debt – such as India, which benefits from credible monetary policy and strong growth momentum – can also offer opportunities. Others, including Brazil and Mexico, offer compelling real yield advantages, though investors must navigate country and currency risks.

### Private Credit

In May 2025, the House of Representatives initially passed a spending bill which included provisions to expand the pass-through deduction for income from certain business development companies (BDCs) that can benefit private credit investors, especially those investing via BDCs. However, the measure was later dropped from the Senate’s version, and the final version of the legislation enacted into law in July excluded BDC related provisions.

While private structured credits such as CLOs and ABFs continue to be attractive to institutional investors, loan-level private credits also gain momentum. Adding Residential Whole Loans (RWLs) to a multi-asset portfolio provides diversification beyond commercial real estate (CRE).

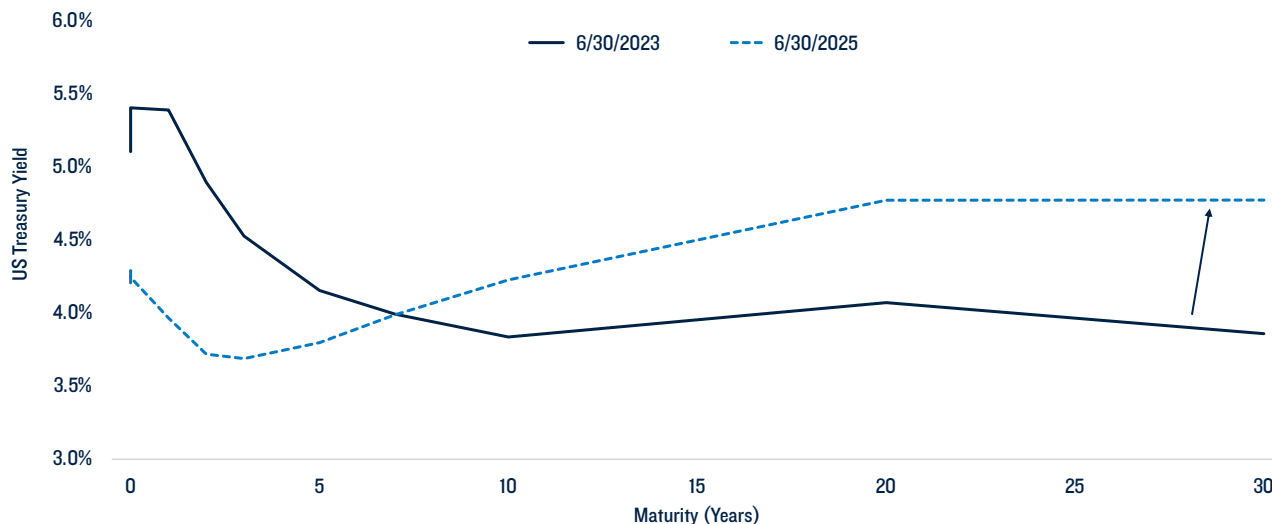
Today, banks and insurance companies actively invest in RWLs. Insurance companies have been increasing investments in RWLs, with \$47bn in purchases in 2024, accounting for 36% of all residential & CRE loan acquisitions.<sup>4</sup> Residential whole loans, with less liquidity and more exposure to losses, can provide more spread pickup than the securitized RMBS. Particularly, for insurance companies, whole loans benefit from more favorable capital treatment than securitizations. RWLs also broaden investable assets for better duration management. Insurance companies have been interested in certain segments of RWLs such as Non-QM DSCR<sup>5</sup> with longer duration and better convexity to match their long-duration liabilities.<sup>6</sup> We expect investors’ participation in RWLs to remain strong.

<sup>4</sup> BofA RMBS Research

<sup>5</sup> Note: A non-QM DSCR residential whole loan is backed by a residential investment property where loan approval is based on rental income (DSCR, or Debt Service Coverage Ratio) rather than the borrower’s personal income.

<sup>6</sup> J.P Morgan, “RMBS Credit Commentary: Residential Whole Loan Demand”, February 28, 2025

## Exhibit 7: US Treasury Curve has Significantly Steepened Over the Past 2 Years



Source: Bloomberg and PGIM. Data as of June 30, 2025.

## Equities

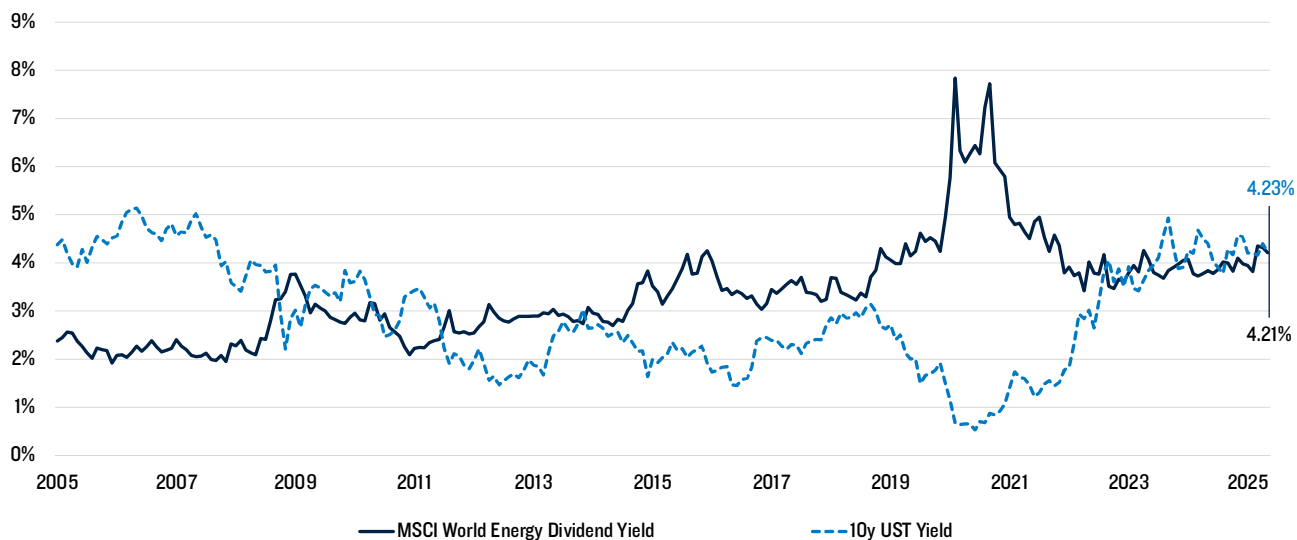
Despite macro risks and geopolitical uncertainty, US equities have rallied back to new highs in the second half of the previous quarter amidst temporary pause in tariffs, better-than-expected inflation print, the boost to earnings from the fiscal expansion under the “One Big Beautiful Bill Act”, and renewed optimism over AI. While we believe US equities maintain strong earnings growth prospects due to positive operating leverage, downside risks remain amidst weaker growth trend, continued uncertainty on trade deals, geopolitical tensions, and uncertainty around monetary and fiscal policies. We remain neutral on US equities and prefer greater diversification geographically. Within US equities, we prefer large-cap, high-quality and defensive exposures with stronger pricing power, operational efficiency, and greater foreign revenue that benefits from a weaker US dollar. However, we remain bearish on small cap equities which face margin pressure from rising costs and limited pricing power amid trade tensions.

Internationally, we see selective opportunities in European equities, especially renewables – driven by the energy transition – and defense – supported by growing defense spending. However, the downside risk remains given slower

growth, soft consumer demand, and weak manufacturing. In particular, economies that are energy-sensitive and manufacturing-heavy (*e.g.*, Germany) continue to underperform. Japanese equities remain a rare bright spot amid global uncertainty. Economic recovery, corporate governance reforms, and increasing domestic equity inflows continue to support the market. Within emerging markets, while we remain cautious on China given weaker economic growth and continued uncertainty around trade tension with the US, we are constructive on select countries and structural growth themes (*i.e.*, EVs, fintech, digital platforms, AI applications) can be accretive. For instance, we prefer India on above-trend economic and earnings growth – with India accounting for 20% of incremental global GDP growth in the next decade – combined with lower exposure to trade tariffs and relatively low volatility.

One potential bear case for equities would be a significant spike in oil prices driven by supply disruptions, which could pose a threat to the business cycle. In this case, energy stocks are a better portfolio hedge than government bonds. Importantly, the dividend yield on energy stocks is similar to the 10y US Treasury yield (Exhibit 8).

## Exhibit 8: Energy Stocks Offer Dividend Yields Similar to the 10y UST



Source: Bloomberg and PGIM. Data as of June 30, 2025.

### Real Estate

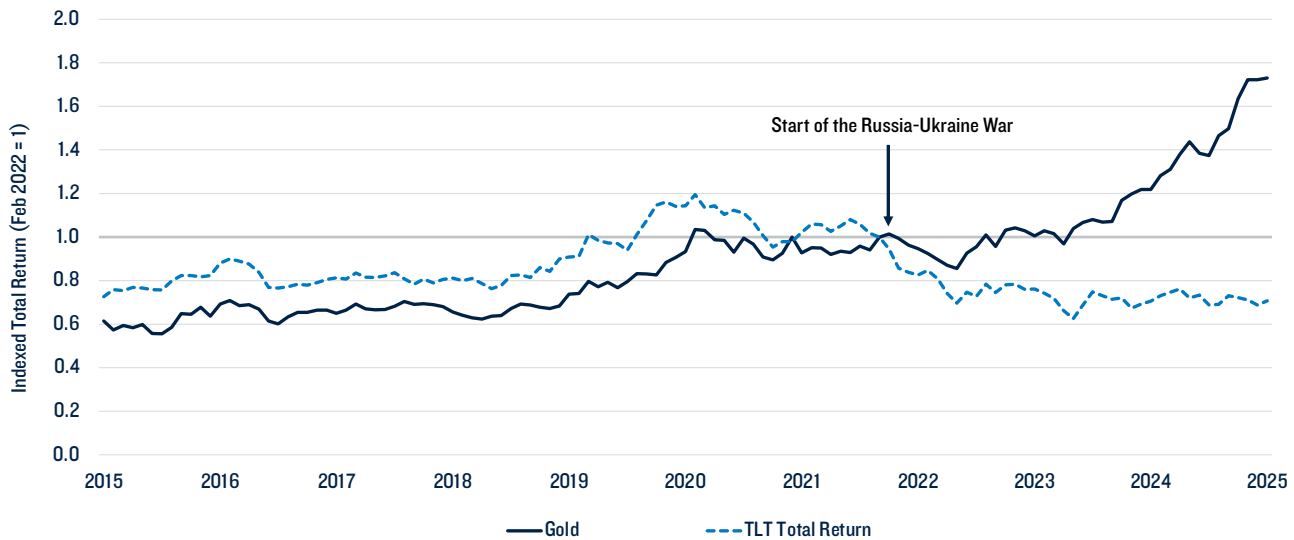
As the real estate markets are going through a cyclical trough, elevated trade policy uncertainty and interest rate volatility are likely to pose a headwind in the recovery of real estate, given the slower rental and capital growth. However, the overall commercial real estate fundamentals remain healthy, as low supplies in many markets potentially support higher rents and property values, even in the face of higher rates and tighter lending. Industrial and logistics remain attractive, driven by continued growth of e-commerce and associated demands for fast deliveries. Data centers, especially inference-driven assets, maintain their appeal. In addition, rental housing, *e.g.*, single-family rentals and senior living serves as a compelling investment opportunity as US home prices reached a record high in June 2025.<sup>7</sup> Private real estate credit continues to provide favorable risk-adjusted returns. Investors can benefit from floating rate and shorter duration real estate credit investments that offer flexibility in a high-rate environment.

### Commodities

The Russia–Ukraine war marked a turning point in how investors view traditional “safe haven” assets. Since early 2022, long-duration US government bonds have sold off, while gold has steadily climbed to new highs (Exhibit 9). Besides inflation concerns, in a more fractured and uncertain world, commodity prices may remain elevated as countries and companies seek greater resource independence by stockpiling key materials (energy, grains, precious and industrial metals, uranium, *etc.*). In addition, for the past 80 years, commodities relied on seamless global flows, enforced in part by US military presence. If the US is no longer willing to provide protection, price dislocations that were once quickly arbitrated away may now persist. This shift could lead to higher and more volatile prices for all commodities, but particularly for those that are easy to store, such as precious and industrial metals.

<sup>7</sup> Redfin research shows, the median price of a home sold in the US during the four weeks ending June reached a record high of \$396,500

## Exhibit 9: Gold Outperformed Long-Dated US Government Bonds Since the Russia-Ukraine War



Source: Bloomberg and PGIM. Data as of June 30, 2025.

## Short Term Views (3-12 Months)\*

Risk Factor / Asset Class		UW	N	OW	Comments
Main Market Risk Factors	Rates		●		Rate volatility remains elevated due to fiscal uncertainty, sticky inflation, and geopolitical risk. The steepening yield curve and elevated term premia suggest caution and tight hedge on long duration. Favor shorter duration exposure for lower risk
	Credit		●		Credit offers attractive income amid rate uncertainty, but spreads have retraced to pre-Liberation Day tight, and defaults may rise if recession risks materialize. Focus on defensive sectors and structured credit for risk-adjusted yield and liquidity
	Equities		●		We remain cautious on equity risk due to continued elevated macro volatility. Equities have rallied back as pause on tariffs and softer inflation prints provided temporary relief. Earnings also remain resilient in select regions, but valuations are still high with risk premia compressed. We also emphasize greater geographical diversification from US
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
		IG Corporate	●		Credit spreads have retraced back to pre-Liberation Day tight. While fundamentals and technicals are supportive of corporate credit, tight spreads present risk to the downside. Therefore, we maintain higher quality focused
		High Yield	●		Ongoing elevated recession risk and tightening financial conditions suggest caution in high yield. Spreads may not fully compensate for rising default risk. Focus on short-duration names
		CLO		●	CLOs continue to attract institutional flows due to their floating-rate structure and enhanced spread pickup. Risk-adjusted returns remain compelling, especially for senior tranches in seasoned vintages
		Agency MBS	●		Sector has cheapened with risk markets but near term may face challenges, although medium-to-long term outlook is positive amidst regulatory relief and a more benign prepayment forecast
		CMBS	●		Valuations remain stable, but fundamentals vary by sector, and selectivity is key. Favor senior tranches and high-quality issuers

Risk Factor / Asset Class		UW	N	OW	Comments
	Fixed Income	ABS		●	While we remain cautious on consumer fundamentals, especially given continued uncertainty with tariffs, structuring remains robust and technical continues to be favorable
		EMD Local	●		EM local debt remained resilient despite recent tariff-driven volatility. However, currency volatility and geopolitical spillovers remain key risks
		EM Corporate Debt	●		EM Corporates offer attractive carry and improving fundamentals, but with potential downside driven by interest rate volatility. Need active selection and risk monitoring
	Equities	US Large Cap	●		US large caps have rallied back due to temporary tariff relief and renewed optimism on AI. However, given uncertainty around economic impact from tariffs, progress of trade deals, fiscal debt, and monetary policy will continue to sources of potential volatility. Diversifying geographically may be beneficial
		US Small Cap	●		Small caps face margin pressure from rising costs and limited pricing power amid trade tensions. Less global exposure also limits benefit from weakening dollar
		Japanese Equities		●	Japanese equities are supported by corporate reforms and domestic inflows. BOJ's gradual stance supports equity valuations. Relatively attractive vs. Other DMs
		European Equities		●	Tailwinds from energy transition and growing defense spending can provide continued momentum in related European equity sectors
		EM Equity	●		While we remain cautious on China given weaker economic growth and continued uncertainty around trade tension with U.S., selective opportunities to structural growth themes (i.e., EVs, fintech, digital platforms, AI applications) across EM can be accretive
	Real Estate	Real Estate	●		Uncertainty in policy rates will continue to drive volatility in real estate, but REITs' relatively defensive equity beta can serve as hedge in tail risk scenarios. Growing property types also provide expanded opportunities within private real estate
		Commodities		●	With geographical tensions and less secure global trade flows, countries are seeking greater material independence. We expect sustained support for commodities price – especially in precious and industrial metals

\*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 are 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.



As we navigate the third quarter of 2025, the investment environment has fundamentally shifted from synchronized global markets to a more fractured, policy-driven landscape. With recession risks moderating but remaining elevated, divergent monetary policies reshaping global yield curves, and persistent stagflation concerns, institutional investors face a complex array of challenges and opportunities.

The erosion of traditional diversification benefits – evidenced by sustained positive stock-bond correlation – demands a strategic reassessment of portfolio construction principles. In this environment where uncertainty remains elevated, success will depend on maintaining both defensive positioning and tactical flexibility to capitalize on emerging dislocations.

**As investors position portfolios for the quarter ahead, they may want to consider these key questions:**

**1. How prepared is your portfolio for continued positive stock-bond correlation?**

With fiscal sustainability concerns and discretionary monetary policy driving synchronized movements in stocks and bonds, traditional 60/40 allocations may prove inadequate. Have you increased your allocations to alternative diversifiers such as private credit, real assets or structured products?

**2. Are you positioned to benefit from monetary divergence?**

The unprecedented dispersion in central bank policies – from the ECB's aggressive cutting to the Fed's cautious stance – is creating significant opportunities in currency hedging, international fixed income, and regional equity rotation. How are you capitalizing on these policy dislocations?

**3. Does your illiquidity strategy match the current volatility?**

In an environment where market moves can compress into weeks rather than months, maintaining adequate dry powder for tactical deployment has become essential. Are you balancing liquidity needs with the pursuit of illiquidity premiums in private markets?

**4. How are you hedging against geopolitical tail risks?**

From ongoing trade tensions to potential energy supply disruptions, geopolitical events continue to drive market volatility. Have you stress tested your portfolio against commodity price spikes, supply chain disruptions, and further escalation in global tensions?

The path forward rewards both strategic patience and tactical agility. Those who can effectively navigate this fractured landscape – balancing defensive positioning with opportunistic capital deployment – will be best positioned to deliver resilient returns.

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PGIM's Multi-Asset Solutions Group was launched in 2022 to provide investors with access to a sophisticated suite of public and private markets strategies. The group combines asset-liability management expertise with portfolio strategy and asset allocation to develop integrated solutions for institutional investors. Partnering with the wider PGIM that manages investments for some of the world's largest institutional investors, Multi-Asset Solutions brings together over 150 years of investment and risk management expertise.

The Portfolio Research Group conducts asset class and portfolio level research, and develops proprietary investment frameworks and models. Through this work, the team helps investors navigate asset allocation, portfolio construction, and financial markets.

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