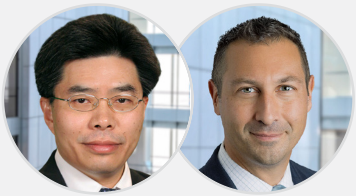
PGIM QUANTITATIVE SOLUTIONS

INVESTING IN TOMORROW: WHY EMERGING MARKETS TODAY

October 2024



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ABOUT PGIM QUANTITATIVE SOLUTIONS:

As the quantitative and multi-asset specialist of PGIM, we combine the agility of an independently run boutique with the stability and scale of a leading global institutional asset manager*. For nearly 50 years, we have designed proprietary methods that seek to solve beyond alpha by combining the latest technology with scalable, rigorous risk controls to nimbly build and manage diversified and customized solutions that help solve clients' evolving challenges. We manage portfolios for a global client base with $103 billion** in assets under management/administration as of September 30, 2024.

FOR MORE INFORMATION

To learn more about our capabilities, please contact PGIM Quantitative Solutions by email at contactus@pgim.com or by phone in the US at +1 (866) 748-0643 or in the UK at +44 (0) 20-7663-3400.

EXECUTIVE SUMMARY

Investors have historically favored emerging markets for their high growth potential, relative inefficiency, and diversification benefits due to their low correlations with developed markets. While timing asset class allocations is notoriously difficult, we believe now is a good entry point for long-term investors to consider a more constructive position on emerging markets. Our perspective is anchored in three key pillars:

- **Historic Valuation Dispersion:** Emerging markets have consistently traded at a discount to developed markets; however, the historical valuation differential is now at its widest level since the dot-com bubble.
- **Future Growth Expectations:** Buoyed by favorable demographics and a growing middle class, emerging markets' contribution to global economic growth will continue to rise. Improvements in corporate governance will help translate GDP growth into corporate earnings growth.
- **Macro Tailwinds:** Declining inflation and the current interest-rate-cutting cycle are set to reduce demand for the US dollar. Coupled with a resilient global economy, emerging markets equities are poised to benefit from these tailwinds.

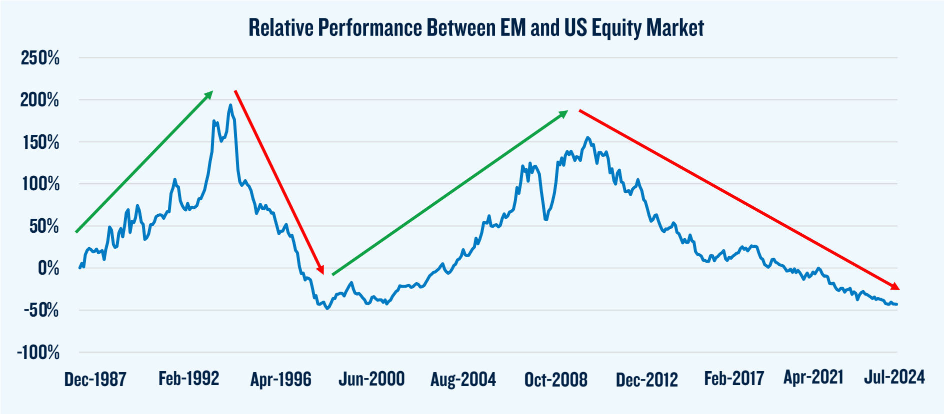
*PGIM is the investment management business of Prudential Financial, Inc. (PFI). PFI is the 12th largest investment manager (out of 411 firms surveyed) in terms of worldwide institutional assets under management based on Pensions & Investments' Top Money Managers list published June 2024. This ranking represents institutional client assets under management by PFI as of December 31, 2023. Participation in the P&I ranking is voluntary and open to managers that have any kind of U.S. institutional tax-exempt AUM. Managers self-report their data via a survey. P&I sends the survey to previously identified managers and to any new managers asking to participate in the survey/ranking.

**PGIM Quant provides model portfolios for certain accounts, the assets of which (Assets Under Administration) are included in the total AUM/AUA figure of $102.9 billion, (AUM $100.1 billion and AUA $2.8 billion).

HISTORIC VALUATION DISPERSION

During the nearly 40-year period starting in 1987, the performance differential between emerging and developed markets has occurred in long, multi-year cycles. Since that time, there have been four super cycles of performance differential, with the average duration lasting about nine years. The current cycle of underperformance for emerging markets has lasted 13 years, notably longer than the historical average, as seen in Figure 1.

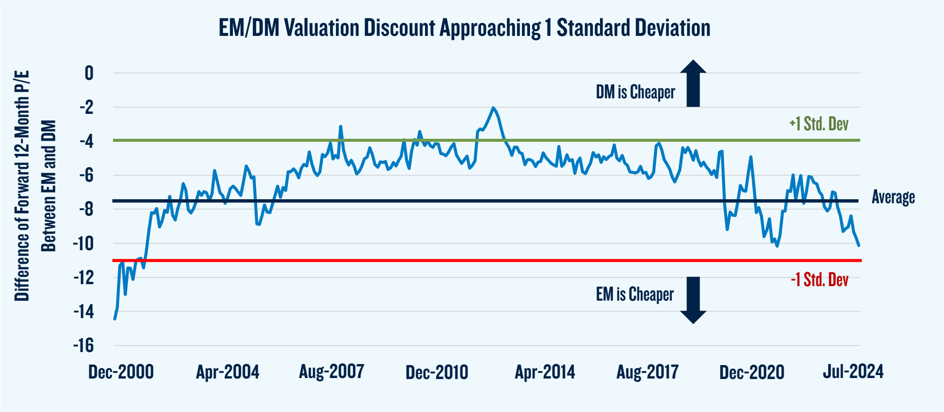
Figure 1: Performance Differential Super Cycles: Emerging Markets vs. Developed Markets



Source: FactSet as of 31-Jul-2024

Playing the mean reversion game is challenging, however, as cycles often persist longer than anticipated. In conjunction with mean reversion, we also consider historical relative valuations to understand when the mispricing is at its widest. Figure 2 illustrates the valuation spread between emerging and developed markets over time. Notably, the Y-axis shows that while emerging markets have consistently traded at a valuation discount to developed markets over the past 25 years, this discount is currently approaching one standard deviation, a level not seen since the dot-com era.

Figure 2: Emerging Market Relative Valuations at Consistent Historical Discount, Now Cheapest Since Dot-Com Era



Source: FactSet as of 31-Jul-2024

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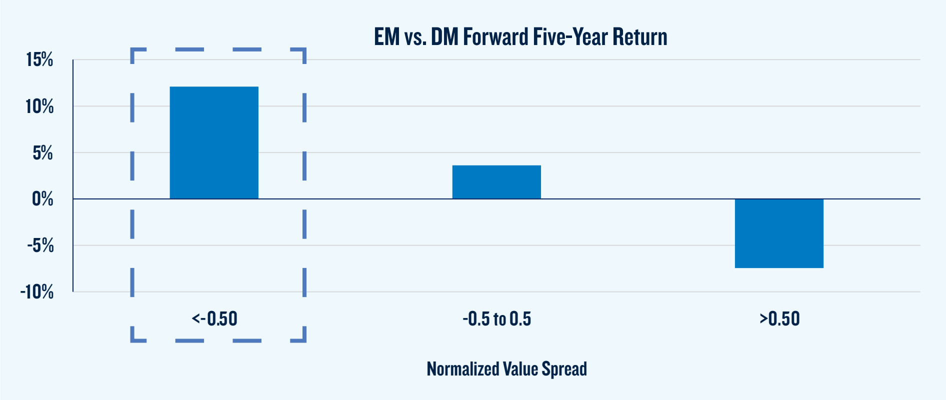
To provide further context around the potential value opportunity in emerging markets, we analyzed the normalized valuation spread relative to the forward five-year return differential since 1999. Figure 3 depicts that, on average, when the normalized value spread, or z-score, is less than -0.5, the forward five-year return of emerging compared to developed markets is 12%. As of July 24, 2024, the z-score is -0.5, suggesting that now is a favorable time to lean in to emerging markets based on valuation.

Figure 3: Mean Five-Year Return of Relative Valuation Z-Scores



Source: FactSet as of 30-Jun-2024

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FUTURE GROWTH EXPECTATIONS

Emerging markets have historically outpaced developed markets in real GDP growth, a trend we believe will continue and likely strengthen. These countries have larger working-age populations (15-64) compared to developed nations, a gap the IMF projects will only widen[1]. This demographic advantage, coupled with robust GDP growth, is fueling the rise of an expanding middle class poised to become the global consumers of tomorrow. Additionally, meaningfully lower debt-to-GDP ratios of many emerging market countries translate to healthier national balance sheets than seen in their developed counterparts. Given these tailwinds, why have emerging markets trailed developed over the past decade?

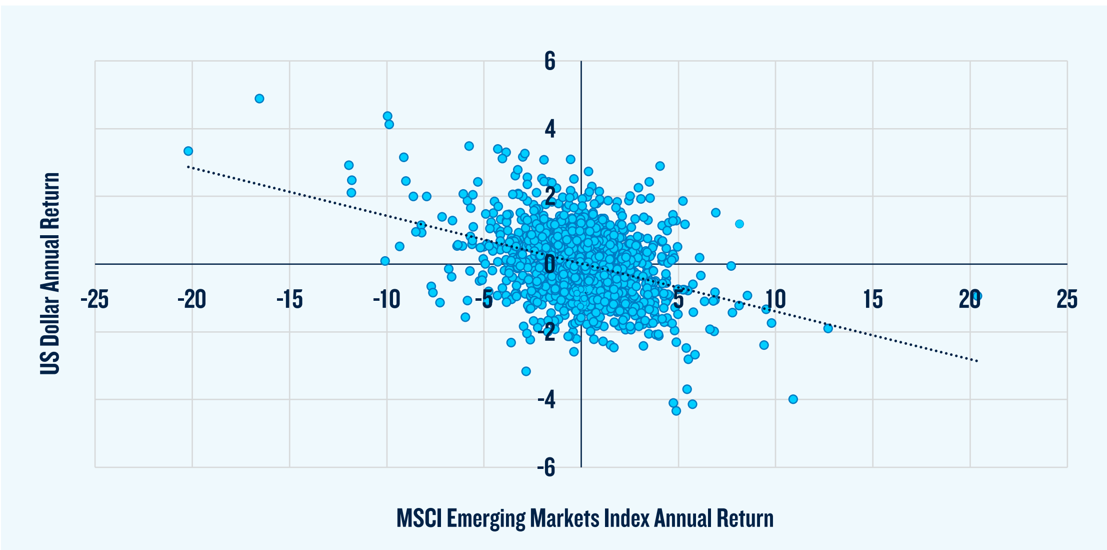
Despite historically higher GDP growth, corporate earnings growth in emerging markets has lagged. For most of the last 12 years, year-over-year corporate earnings growth in emerging markets has consistently trailed that of the US, driven in large part by weaker corporate governance, poor capital discipline, and deficient shareholder protections. However, the earnings drought in emerging markets appears to have bottomed out, with company fundamentals beginning to strengthen. This turnaround can be attributed to recent improvements in corporate governance and financial reforms that focus on greater capital discipline, enhanced shareholder value, investor protections, and information disclosure and transparency.

[1] World Must Prioritize Productivity Reforms to Revive Medium-Term Growth (imf.org)

MACRO TAILWINDS

Many of the cyclical headwinds that have challenged emerging markets are beginning to shift to tailwinds. Historically, the value of the US dollar has shown a strong negative correlation with the performance of emerging market equities, as illustrated by Figure 4. With the Federal Reserve starting its monetary loosening cycle, the impressive bull run of the US dollar over the last decade seems to be drawing to a close. If history is any indication, as the US dollar weakens, emerging market equities would be expected to benefit. Likewise, the debt burden of emerging economies, which is predominantly priced in US dollars, could be alleviated by a weakening dollar, paving the way for expanded growth through potential future fiscal stimulus. In addition to potential dollar weakness and economic expansion, the multi-faceted monetary easing measures recently announced by the People's Bank of China to help stabilize the country's economy, the largest of all emerging markets, could give yet another boost to the broader emerging market universe. These factors, coupled with a resilient global economy, are expected to create a favorable environment for emerging market equities.

Figure 4: Emerging Market Returns Negatively Correlated With US Dollar



Source: Bloomberg as of 04-Oct-2024

THE BOTTOM LINE

The prolonged and cyclical underperformance of emerging markets compared to developed markets is finally showing signs of abating. And while the valuation differential has historically been appealing, it has now widened to a point where investors are being adequately compensated to take on this exposure. Coupled with enhanced corporate governance mechanisms that are expected to translate country GDP growth into corporate earnings growth, along with an improving macroeconomic backdrop, we believe now is an opportune time for investors to revisit their allocations to the emerging markets asset class.

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