PGIM REAL ESTATE

2Q23

Global Real Estate Securities Market Review

GRES Strategy Performance (%)	Inception Date	Second Quarter	Year-to-Date	1 Year	3 Year (Annualized)	5 Year (Annualized)	10 Year (Annualized)	Since Inception (Annualized)
Global Real Estate Strategy (gross)	1/31/2007	1.15	3.87	-0.97	4.06	2.87	4.76	3.21
Global Real Estate Strategy (net)		0.92	3.39	-1.89	3.10	1.92	3.78	2.28
FTSE EPRA/NAREIT Developed Index		0.24	1.02	-4.56	3.33	-0.10	2.89	1.21
Variance (gross – benchmark)		**0.91**	**2.85**	**3.59**	**0.73**	**2.97**	**1.87**	**2.00**
U.S. Real Estate Strategy (gross)	12/21/2010	3.94	8.82	2.37	10.05	8.19	8.57	9.53
U.S. Real Estate Strategy (net)		3.68	8.28	1.34	8.95	7.11	7.37	8.27
FTSE NAREIT Equity REIT Index		2.62	5.37	-0.13	8.91	4.55	6.42	7.88
Variance (gross – benchmark)		**1.32**	**3.45**	**2.50**	**1.14**	**3.64**	**2.15**	**1.65**
Select Real Estate Strategy (gross)	8/1/2014	1.01	4.41	-0.99	4.96	6.95	--	6.72
Select Real Estate Strategy (net)		0.76	3.89	-1.99	3.89	5.85	--	5.60
FTSE EPRA/NAREIT Developed Index		0.24	1.02	-4.56	3.33	-0.10	--	1.81
Variance (gross – benchmark)		**0.77**	**3.39**	**3.57**	**1.63**	**7.05**	--	**4.91**
Real Estate Income Strategy (gross)	9/29/2014	1.88	2.11	0.74	7.74	4.03	--	4.19
Real Estate Income Strategy (net)		1.60	1.55	-0.37	6.56	2.89	--	3.07
Blended Benchmark[1]		2.02	4.20	-3.78	2.69	0.36	--	1.94
Variance (gross – benchmark)		**-0.14**	**-2.09**	**4.52**	**5.05**	**3.67**	--	**2.25**

Source: PGIM Real Estate, Bloomberg. Performance as of June 30, 2023. Net performance shown is based on the mutual fund fee schedule. **Past performance is not a guarantee or a reliable indicator of future results.**

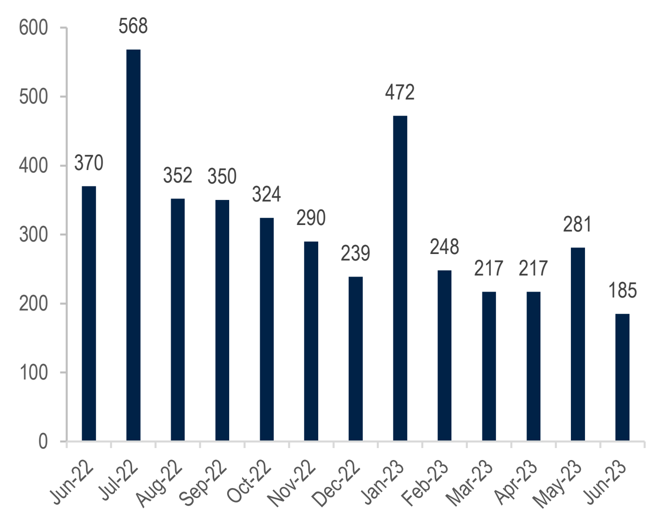
United States

Market Review

The U.S. real estate investment trust (REIT) market gained 2.2% in the second quarter of 2023, lagging the S&P 500's 8.7% return. Year-to-date REITs are up 4.6%, well behind the broader market's 15.9% return. We continue to view the REIT market as overly discounting a likely slowdown in the U.S. economy. With low supply growth in recent years and strong secular demand trends in many sectors, we expect fundamentals will remain resilient even if economic growth softens. Recent Federal Reserve hawkishness has created an incremental sentiment headwind for the sector, but we expect that the phenomenon will be short-lived as the market works its way toward the end of the current rate-hiking cycle.

The U.S. economy remains resilient despite the Federal Reserve's 500-basis-point (bps) increase in rates during the past year and a half. The second quarter added 730,000 jobs to the economy, with 209,000 of them added in June. Despite the better-than-expected jobs increase, wage growth continues to slowly moderate from last year's historic pace—up 4.4% during the quarter versus 4.5% in the first quarter of 2023.

Monthly Gains (000) for Office-Using and Non-Office-Using Jobs[2]



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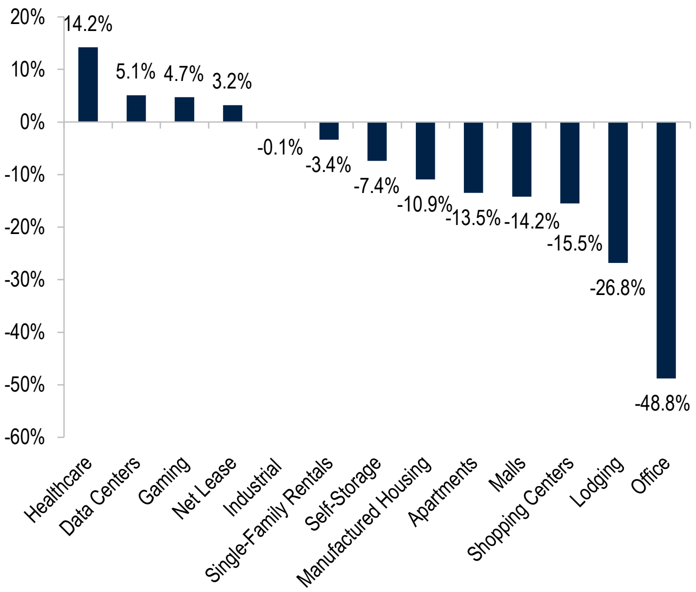
Despite recent hawkish rhetoric from Fed officials, continued progress on decelerating wage growth could keep inflation trending in the right direction, thereby supporting the view that we may be nearing the end of the current tightening cycle. That should bode well for REITs' relative performance going forward. From a historical perspective, REITs have outperformed the S&P 500 after the conclusion of the three most recent Fed-tightening cycles for the proceeding one-year periods. The underlying makeup of the U.S. REIT market has also shifted dramatically versus prior cycles, with more defensive sectors with secular demand support, such as data centers, healthcare and industrial having grown dramatically in size. Meanwhile, challenged sectors with more sensitivity to economic cycles such as office, lodging and malls have witnessed a considerable drop in market cap within the REIT benchmarks.

U.S.-Sector Price/Net Asset Value[3]



A look at the quarter's results shows that the best-performing sectors were data centers and apartments. The data center sector experienced a dramatic rerating after better-than-expected results from chipmaker NVIDIA. The artificial intelligence (AI) revolution is likely to provide a nice secular demand tailwind for the data center sector. We are overweight that sector and believe we are only in the early days of incremental AI-related demand for this asset class. Apartments outperformed as rental growth updates following a busy spring leasing season proved more resilient than expected. We continue to favor the apartment REIT sector given attractive valuation, strong private-equity interest and a steady labor market.

The worst-performing sectors during the month were the net lease and storage sectors. Storage weakness during the quarter was related largely to some performance reversion after a very strong first quarter. The sector got buoyed early this year when M&A activity boosted valuations and sentiment, but post announced merger between Extra Space Storage and Life Storage, the group's valuation has normalized. After a strong 2022, the net lease sector lagged, given limited organic growth and compressing acquisition spread.

The office sector remains one of the most controversial sectors in REITs today. The sector once again lagged the broader REIT market in the quarter, down roughly 1%. That said, a positive sale announcement from SL Green on its 245 Park Avenue asset rallied the group roughly 10% in June. We've been significantly underweight office for the past several years but did tactically add to the office sector during the quarter because some of the higher-quality names became too cheap to ignore.

Market Outlook

A more resilient labor market combined with softening inflation data bodes well for a near-term end of the Fed's current rate-tightening cycle and improved REIT sentiment. Outside the office sector, fundamentals remain steady, with roughly 4% funds from operations per share growth expected in 2023, followed by 7% in 2024. Barring a major economic contraction, we expect REIT fundamentals will remain steady for most property types given long lease durations, low supply risk and defensive and secular-based demand.

The current spread between REIT implied valuations and private real estate apprised values is at a historically wide spread: roughly 15% on an equally weighed basis. As rates stabilize, that valuation discrepancy is likely to lead to increased M&A opportunities for private-equity players looking to deploy capital toward the discounted REIT sector. We would also expect large institutional investors to rotate their real estate allocations from private to public to take advantage of this arbitrage opportunity. The liquidity benefit of the publicly traded REIT structure has become abundantly clear in recent months, and that benefit will likely have long-term implications for real estate allocations.

Public REIT-to-REIT M&A has also increased in recent months, with Regency Centers announcing acquisition of smaller-cap peer Urstadt Biddle Properties. The current environment is rewarding REITs with better balance sheets and superior platforms with premium valuation. As such, many REITs are taking advantage of the valuation spread to consolidate attractive, smaller-cap peers. We've even witnessed hostile REIT-to-REIT M&A activity during the past 12 months. Without a dramatic change in the current macro backdrop, we see that trend as likely to continue.

We continue to favor taking a barbell approach to our sector allocation, minimizing unintended factor exposure. We have added to our apartment and data center overweight given attractive valuation and defensive net-operating-income growth. We view the apartment REIT sector as most attractive for private equity today given portfolio quality and discounted valuations. Despite data centers' outperformance in May, the sector remains discounted and represents the only sector in REITs to directly benefit from AI-related demand.

In addition, we remain positive on sectors with embedded occupancy upside and limited economic sensitivity, such as healthcare and cold storage. Both sectors were negatively affected by labor cost pressures in 2022, but we expect such pressure to moderate in 2023. In addition, occupancy overall remains roughly 400–600 bps below pre-COVID levels, which should allow for significant top-line growth as trends continue to normalize.

We remain cautious on lodging and retail because both sectors are more susceptible to a downturn in economic growth. We remain cautious on office despite discounted valuations because we view the sector as only in the early stages of a multiyear secular headwind. That said, we also believe that because some office names are approaching attractive valuations, they may present tactical opportunities for relative outperformance.

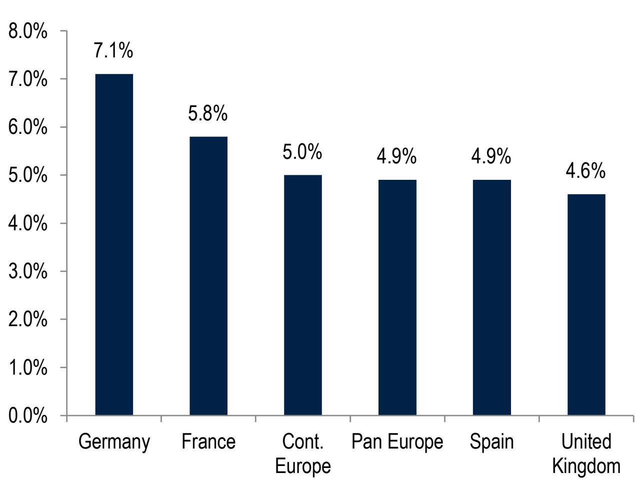
Europe

Market Review

Europe saw a slightly positive return of 0.9% (U.S. dollar gross total return) in June, just edging Asia Pacific but still lagging well behind North America's positive, 4.7% return for the month. In both the second quarter (–3.2%) and the first half (–6.1%), Europe trailed well behind North America. Stubborn inflation data and longer central bank tightening cycles have been the main factors behind Europe's continued underperformance this year.

All European countries except Germany and Switzerland posted significant negative returns for the second quarter. Finland was the weakest performer in the second quarter, with –15.6%, as the residential outlook there soured. Sweden saw a –12.4% total return for the quarter, as investor concerns over stretched balanced sheets and looming refinancings again moved into focus and as bond yields and interest rates climbed higher. The UK, too, was an index underperformer in the second quarter, with a return of –4.5% as inflation significantly exceeded market expectations and as interest rate tightening by the central bank accelerated. France did considerably better, with a –0.5% total return, helped by strength in its retail sector. Germany, the weakest country in the first quarter, saw a positive, 7.3% return in the second quarter as investors turned slightly more positive on heavily discounted valuations and some disposal evidence in the highly indebted multifamily residential sector.

Europe-Sector Implied Cap Rates[4]



Market Outlook

Inflation figures have been on the decline in the region since November 2022, but the level of inflation still remains high throughout Europe. That high level especially true in the UK. Headline inflation is coming down only slowly, and core inflation has so far resisted the pressure of higher interest rates. Companies with weak balance sheets remain on near-record discounts to net and gross asset values because they are still exposed to refinancing risk and falling cash flows. Cap rates moved up quickly in the second half of 2022 in response to major upward moves in bond yields last year and have moved out further this year, but share prices are still implying further moves in private market cap rates. Our focus remains on companies better equipped to withstand the risk of further corrections as macroeconomic and geopolitical risks remain prevalent in the region.

Asia Pacific

Market Review

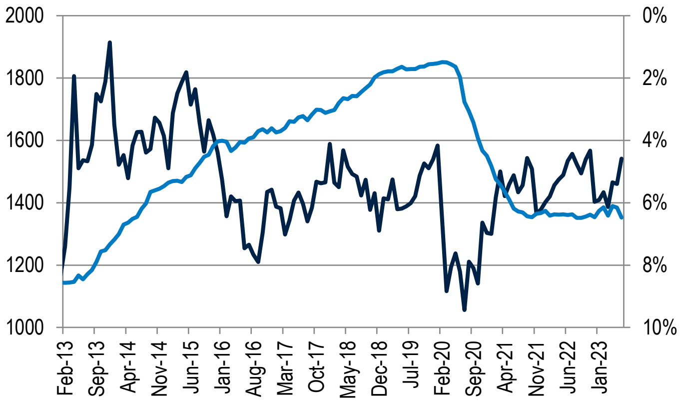
The Asian real estate equity market ended the second quarter weaker, delivering a –3.3% return[5] Hong Kong declined the most (–9.6%) for the quarter, followed by Singapore (–4.9%) and Japan (–1.2%). Australia was the only exception, delivering a 0.2% return for the quarter.

In Australia, the central bank paused a cash rate hike in early July, after it unexpectedly raised the rate in early June by 25 bps to 4.10%, the highest level since April 2012. However, the central bank has already alluded to further tightening that may be needed to keep inflation at bay. A couple of REITs announced that their June 2023 asset valuations were down 4% on average. Perhaps unsurprisingly, office corrected the most, at –7.2%, retail at –3.5% and industrial at –1%, whereas self-storage recorded a 2.6% revaluation. For the residential sector, positive home price momentum sustained despite relative hawkishness from the Reserve Bank of Australia. However, transaction volumes and auction clearance rates show signs of cooling.

In Japan, the big three developers—Mitsui Fudosan, Mitsubishi Estate and Sumitomo R&D—announced during the quarter their results from the fiscal year ended March 31, 2023, which were in line with expectations based on post-COVID reopenings and strong fundamentals in condominium sales and brokerage operations. Forward guidance for the fiscal year ending March 2024 by Mitsui Fudosan and Sumitomo R&D looks as if it will be in line with consensus. Mitsubishi Estate came in below street estimates due to lack of office sales in the UK.[2] During the quarter, GLP J-REIT and Nippon Prologis REIT conducted major capital raising that amounted to more than US$440 million. Demand was robust, albeit both JREITs have traded weaker in the postmarket. Other takeaways include the Japanese government's approval to construct the nation's first casino in Osaka, with hotels, conference venues and gambling facilities scheduled to open in late 2029.

Singapore announced additional stamp duty cooling measures for the residential market, driven partly by a 3.2% rise in the first-quarter-2023 property price index and strong launches year to date at record-high prices. CapitaLand Ascendas REIT and Mapletree Industrial Trust conducted equity raisings during the quarter, primarily for overseas acquisitions and debt repayment. In the macro environment, the government revised up its first-quarter-2023 GDP to 0.4% year over year from the advance estimate of 0.1% year over year. Going forward, a deeper downturn in manufacturing is expected, which could be offset by recoveries in the tourism and aviation-related sectors. For 2023, the government forecasts a 0.5%–2.5% annual GDP growth range with the base case of no recession.

Japan Developers Index vs Tokyo Central 5 Wards Office Vacancy[6]



Hong Kong's significant underperformance in the June quarter could be attributable largely to China's slower-than-expected economic recovery, which had a knock-on effect on sentiment in Hong Kong retail landlord share price despite recovering tourist arrivals and luxury retail sales. Hong Kong will hand out the second installment of this year's consumption vouchers beginning on July 16 to consolidate the city's economic recovery with a HK$13-billion (US$1.6-billion) boost to consumer spending. Residential prices fell by only 0.6%[7] in the second quarter despite the higher interest rate environment and lackluster local stock market sentiment. Developers remain competitive at pricing primary launches, which explains their strong demand, with the primary market taking market share from the secondary market.

Market Outlook

The year 2022 was a challenging one for REITs, as the world faced a perfect storm of rising inflation, sustained rate hikes, the Russia–Ukraine conflict and COVID-disrupted supply chains that affected millions of people. The COVID-19 pandemic ushered in a period of unprecedented global monetary easing and stimulus. As a consequence, the world is now witnessing sustained and heightened inflation. Equity and bond market volatility is the norm as markets alternate between greater rate hike expectations induced by strong inflation data versus slower hikes on indications of weaker economic data.

The situation presents an interesting dilemma wherein bad macroeconomic news could benefit real estate equities as long as interest rate hikes slow while net operating income is maintained. In Asia Pacific, attention would center on how the Fed, the Bank of Japan and the Chinese government move in the coming months. With continued evidence of sustained inflation in the core services sector in the United States, the Fed recently telegraphed two further 25-bps hikes in the Fed funds rate. This was largely contrary to prior market expectations of rate cuts in the latter half of 2023. The possibility of rate cuts has been further delayed on the back of persistent, sticky core inflation in the United States. With 2024 as an election year, it remains to be seen how forceful the Fed would be in pushing rates higher, which could inadvertently engineer a recession in the United States. In China, expectations remain that the government would have to stimulate its economy in the coming weeks albeit in a more controlled fashion. The Bank of Japan is widely expected to adjust monetary policy at its upcoming meeting as a result of stronger wage and inflation data.

We remain positive on Australian self-storage and manufactured housing. Demographic and market consolidation trends provide structural tailwinds for those sectors. As Hong Kong's reopening remains on track, we are positioned to benefit from the retail and residential sectors. Given rising interest rate pressure, we are underweight the Japanese developers, but we prefer names that exhibit strong shareholder returns with greater reopening exposure. We are neutral the JREITs but maintain sizable overweight in hospitality names that benefit from tourism reopening. We are also overweight logistic JREITs given their strong fundamentals leading to growth in distribution per unit. In Singapore, we are overweight the fund manager/landlord plays. For SREITs, we like hospitality and industrial names with solid dividend growth underpinned by strong fundamentals.

The market is now focusing on the timing, depth and scale of a potential U.S. recession as the Fed maintains interest rate hikes aimed at arresting core inflationary pressures caused by stronger-than-expected wage growth and low unemployment. Deglobalization and geopolitics such as continuation of the Russia–Ukraine conflict and United States–China relations are other factors that warrant concern. In Asia, managing higher costs of living while ensuring economic growth remain the predominant challenges. The path whereby China manages its fiscal and monetary policies to boost economic growth as well as its housing market policies presents an uncertain economic outlook. For the rest of Asia, economic growth and monetary policy outlook remain largely dependent on Fed policy and global growth. On the flip side, a resilient U.S. economy could further stoke inflationary pressures and reaccelerate expectations of rate hikes. Within our individual sectors, a sharper rise in long-term real interest rates could negatively affect regional REIT valuations. In the event of setbacks on the geopolitical front and the severity of a potential U.S. recession, risk appetite could remain in check heading into the latter half of the year.

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[1] Blended benchmark is 80% FTSE/EPRA NAREIT Developed Index/ 20% BofA Merrill Lynch 7 Const. REIT Preferred Securities Index
[2] Bloomberg. As of June 30, 2023
[3] PGIM Real Estate. As of June 30, 2023
[4] Morgan Stanley, Citi. As of June 30, 2023
[5] FTSE EPRA NAREIT Developed, Asia Pacific. As of June 30, 2023
[6] Bloomberg. As of June 30, 2023.
[7] Centaline Property Ce