PGIM GLOBAL PARTNERS

GLOBAL INVESTMENT OUTLOOK & STRATEGY

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Trade Tensions Cast a Shadow on Stocks but Strong Earnings Outlook & Growth Rebound likely to Lift Stocks as Tensions Cool

Global stock markets remain in a tug of war between rising trade tensions and European uncertainties versus strong earnings and growth fundamentals. However, the risks are more likely to keep markets volatile rather than lead to a major correction. We still expect the strong earnings outlook and solid growth rebound will enable stocks to stabilize and post further gains as the trade tensions cool and German political and Italian fiscal uncertainties are resolved.

Stock Market Outlook: Global equity markets added to gains in early June as the Italian political drama ended with the formation of a coalition government and the Trump-Kim summit took place in June, as scheduled. However, stocks pulled back in mid-June with fresh escalation of trade tensions and political uncertainty with risk of collapse of the Merkel government in Germany. ***The Developed Markets gained a modest 0.2% in June, taking YTD returns to 0.2%. The Emerging Markets declined -2.9% in June, taking YTD decline to -3.9%.***

Looking ahead, equity markets remain supported by: 1) Strong corporate earnings outlook with expectations for 2018 earnings continuing to ratchet higher to 20%, led by the U.S. (22%), Japan (35%) and Emerging Markets (15%); ***2) Solid global growth outlook*** with a strong Q2 GDP rebound in the U.S., a more modest rebound in Eurozone and Japan on track to resume growth. Emerging Markets growth outlook remains healthy; ***3) Developed central banks remain on track to gradual policy normalization,*** but the tone of the Fed and the ECB has turned modestly hawkish with the U.S. Fed now on track for four rate hikes in 2018. In Eurozone, the ECB announced that it would further taper its QE asset purchases in September, and end QE buying in December 2018. However, with trade tensions posing risks to growth, the central banks are likely to remain cautious and take a gradual approach to normalizing policies, and ***4) Equity valuations continue to improve*** with rising earnings.

However, while the Italian political drama has subsided, and Korean tensions have eased, stocks face other risks which could keep markets volatile, including: 1) Rising trade tensions between the U.S. and China and NAFTA uncertainty. These tensions could derail global growth; 2) The European immigration crisis carries risks for the Merkel government with serious differences with her coalition partner the CSU after they rejected the recent EU migration deal. Further, while Italy now has a government, the country could be headed for a fiscal crisis if the populist measures promised by the government are enacted; and 3) Renewed Brexit uncertainty with infighting within the U.K. cabinet.

Bond Market Outlook: Bond yields rose in early June in anticipation of Fed rate hike and reduced safe haven demand. However, yields pulled back modestly in mid-June with safe haven demand with rising trade tensions and European political uncertainty. ***Looking ahead, bonds remain supported in the near-term by: 1) Safe haven demand*** with growing trade tensions between the U.S. and China and other countries, the political uncertainty in Germany, and fiscal risks in Italy; ***2) The BoJ continues to provide liquidity;*** and ***3) Inflation remains low*** and below target in Japan & Eurozone, though creeping higher in the U.S. ***However, bond yields are likely to face upward pressure with: 1) Global GDP growth on track to improve*** with a strong Q2 GDP rebound in the U.S., and a more modest rebound in Eurozone and Japan; ***2) The Fed and the ECB have turned modestly*** hawkish with the Fed now on track to four rate hikes in 2018, while the ECB is set to further taper its QE asset purchases in September and end QE in December.

Renewed Trade Tensions, Brexit, German Political & Italian Fiscal Uncertainties Cast Shadow on Stocks. However, Strong Earnings Outlook & GDP Growth Rebound likely to Lift Stocks as Trade Tensions Cools and Other Uncertainties Ease

Bonds Supported in Near-term with Safe Haven Demand on Rising Trade Tensions. Yields face Upward Pressure from Q2 GDP Rebound & Fed & ECB Tone Turning Modestly Hawkish

Stock Market Outlook (July): Global equity markets added to gains in early June, as Italian political tensions eased with the formation of a coalition government of the Five Star Movement (MS5) and Lega (Northern League). Stocks also received a boost from a strong U.S. labor market report and the Trump-Kim summit taking place on June 12th, as scheduled, despite uncertainty. ***However, stocks pulled back in mid-June*** as trade tensions between the U.S and China escalated. The Trump administration announced details of its 25% tariff on $34 billion of Chinese imports, effective July 6, and deferred its decision on another $16 billion of imports. The Chinese government countered with 25% tariffs on $34 billion of U.S. imports and reserved its decision on another $16 billion of imports. U.S. stocks (S&P 500) rose 0.5% in June, giving up gains from earlier in the month following escalating US-China trade tensions. Stocks had posted strong gains in the first half of the month with U.S. Q1 earnings season ending on a strong note and the economy on track to a solid Q2 GDP rebound. Despite giving up gains in late June, U.S. stocks are up 1.7% YTD. Eurozone stocks gave up gains from early June for a -0.9% decline in June as gains in Spain (2.1%) were offset by declines in France, Italy and Germany. Eurozone stocks are down -2.4% YTD. Japanese stocks declined -0.7 in June despite yen weakness. Japanese stocks are down -4.6% YTD. ***The Developed Markets gained a modest 0.2% in June taking YTD gains to 0.2%. The Emerging Markets declined -2.9% in June taking YTD decline to -3.9%.***

Looking ahead, equity markets remain in a tug of war between strong corporate earnings and GDP growth fundamentals versus escalating trade tensions and European political turmoil: 1) Corporate earnings outlook remains strong, especially in the U.S. and Japan, with earnings expectations ratcheting up to high double-digits, especially after the upside surprises in Q1; 2) Global growth remains on track to improve in Q2 from the temporary Q1 slowdown with a strong rebound in the U.S. and a more subdued rebound in Eurozone and Japan; 3) Major central banks remain on track to gradual policy normalization as growth rebound is offset by risks to growth from simmering trade tensions; and 4)Equity valuations continue to improve with rising earnings.

1) Corporate Earnings Outlook Remain Strong, and expectations for 2018 earnings continue to ratchet higher to 20% after 16% growth in 2017, led by the U.S. (22%), Japan (35%) and Emerging Markets (15%). The U.S. Q1 earnings season ended on a strong note with earnings growth of 26%, while full year expectations have been revised up to 22% after 13% in 2017. Japanese earnings growth expectations remain around +35% for 2018, while Eurozone earnings expectations have been revised slightly higher to 8%. Emerging Markets earnings are expected to grow 15% in 2018, driven by improving GDP growth and rising energy and commodity prices, and with upward revisions to EMEA earnings expectations offset by downward revisions to Latin America earnings.

2) Global Growth on Track to Rebound in Q2 from Temporary Q1 Slowdown: Global growth is on track to improve in Q2 with a strong GDP rebound in the U.S. and a more modest rebound in Eurozone. ***The U.S. economy is on track to rebound to over 4% GDP growth in Q2 from the disappointing 2% growth in Q1.*** The Q2 GDP rebound in the U.S. is being driven by a reacceleration of consumer spending and investment spending expected to remain solid.

Eurozone Q2 GDP growth is on track to rebound to around 2% with some of the activity postponed from Q1 due to severe weather. The Q2 rebound in Europe is likely to be driven by consumer spending which is supported by historically low unemployment, at 8.5% in April, the lowest level since early 2009. Further, construction spending is on track to rebound as projects that were delayed due to heavy snow are resumed. Trade is likely to add to GDP growth in Q2 as the depreciation of the euro in Q2 is likely to boost exports. ***U.K. GDP is likely to rebound in Q2 after a disappointing 0.4% QoQ annualized increase in Q1*** and continue to expand for the remainder of the year. ***Japanese GDP growth is expected to recover from the -0.6% contraction in Q1 and grow at a moderate pace, exceeding the potential growth rate.*** Emerging Markets growth remains healthy led by China (+6.7), India (7.7%), Mexico (4.4%) and Turkey (+7.4%) while Brazil and Russia remain on modest recovery path.

Global Earnings Expectations Revised Higher Following Strong Q1 Earnings

Global Equity Markets - EPS Growth

	2018 (%) Forecast	2017 (%) Actual
USA	22	13
UK	9	22
Eurozone	8	9
Japan	35	31
Emg Mkts	15	23
EM Asia	14	26
Latin America	11	16
EM EMEA	20	17
World Index	20	16

Source: IBES, Reuters, Factset

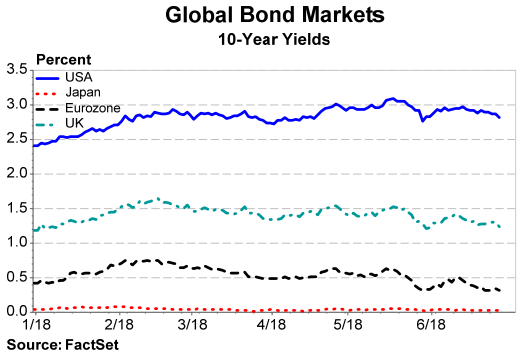
Developed Economies Rebound after Temporary Factors Depress Q1 Growth

Developed Economies - GDP Growth

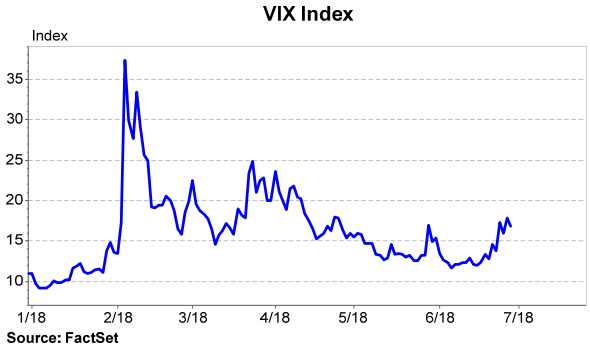
	QoQ Annualized %	
	Q1 2018	Q2 2018 F
USA	2.0%	4.5%
Eurozone	1.6%	2.0%
Japan	-0.6%	1.2%
UK	0.4%	1.6%

Source: FactSet, PGP (Forecast)

Bond Yields Fall on Safe Haven Demand with Rising Trade Tensions



Volatility Rises Again as US-China, US-EU Trade Tensions Escalate



3) Global Central Banks Continue Gradual Policy Normalization but Tone Turns Mildly Hawkish with Solid Growth Outlook: Developed central banks remain on track to gradual policy normalization but tone of the Fed and the ECB has turned modestly hawkish reflecting their confidence in the growth outlook. However, trade tensions pose risks to growth. Consequently, the central banks are likely to remain cautious and take a gradual approach to normalizing policies.

The Fed raised U.S. interest rates by 25bps in June, as expected, but surprised markets by changing rate hike trajectory, with four rate hikes in 2018, up from the three hikes projected at the March meeting. The Fed's also updated its economic projections with GDP growth expectations for 2018 revised up to 2.8% (from 2.7% in March). The Fed's post-meeting statement had a hawkish tone with outlook for growth upgraded to "solid". ***The ECB announced in June that it would further taper its QE asset purchases in September from €30bn to €15bn but will extend QE buying to the end of the year.*** The ECB also signaled that rates would "remain at their present levels at least through the summer of 2019". ***In U.K., the BoE left policy unchanged in June.*** Three members voted for a 25bps hike and the increase in dissenting votes suggests that the BoE may hike rates in Q3, rather than Q4. ***The BoJ made no changes to its monetary policy in June*** and is likely to keep both its asset purchase and yield curve control (YCC) policies intact in coming months. ***Emerging central bank policies remain mixed in 2018, with rates on hold in most EMs, but aggressive tightening in Turkey, and preemptive rate hike in India, Indonesia and Mexico.***

Bottom-line: Global equity markets added to gains in early June as the Italian political drama ended with the formation of a coalition government and the Trump-Kim summit took place in June, as scheduled. However, stocks pulled back in mid-June with fresh escalation of trade tensions and European political uncertainty with risk of collapse of the Merkel government in Germany. ***The Developed Markets gained a modest 0.2% in June, taking YTD returns to 0.2%. The Emerging Markets declined -2.9% in June, taking YTD decline to -3.9%.***

Looking ahead, stocks remain supported by: 1) Corporate earnings outlook remains strong and expectations for 2018 earnings continue to ratchet higher to 20% led by the U.S. (22%), Japan (35%) and Emerging Markets (15%); ***2) Global growth outlook remains solid*** with a strong Q2 GDP rebound in the U.S. and a more modest rebound in Eurozone and Japan. Emerging Markets growth outlook remains healthy supported by the strength in oil and commodity prices, and growth rebound in the developed economies; ***3) Developed central banks remain on track to gradual policy normalization,*** but the tone of the Fed and the ECB has turned modestly hawkish, reflecting their confidence in the growth outlook. However, with simmering trade tensions posing risks to growth, the central banks are likely to remain cautious and take a gradual approach to normalizing policies, and ***4) Equity valuations continue to improve*** with rising earnings.

However, stocks face risks which could keep markets volatile, including: 1) Rising trade tensions between the U.S. and China and NAFTA uncertainty. These tensions could derail global growth; 2) The European immigration crisis carries risks for the Merkel government with serious differences with her coalition partner the CSU after they rejected the recent EU migration deal. Further, while Italy now has a government, the country could be headed for a fiscal crisis if the populist measures promised by the government are enacted; 3) Renewed Brexit uncertainty with fragile negotiations and the U.K. cabinet divided over different proposals for post-Brexit customs arrangements; and 4) Risk of a showdown between President Trump and Special Counsel Mueller and the Dept. of Justice.

Stock markets are likely to remain volatile in the near-term as rising trade tensions and European uncertainties cast a shadow on strong earnings and growth fundamentals. However, our base case remains that the strong earnings outlook and solid growth rebound will enable stocks to stabilize and post gains as the trade tensions cool and German political and Italian fiscal uncertainties are resolved.

Bond Yields Fall after Rising in Early June. Bonds Supported in Near-term with Safe Haven Demand on Trade Tensions. Yields face Upward Pressure from Q2 GDP Rebound & Hawkish Tone of Fed & ECB

Developed market bond yields rose in early June in anticipation of the Fed raising interest rates and reduced safe haven demand. However, yields pulled back modestly in mid-June with safe haven demand on rising trade tensions and European uncertainty. ***The U.S. 10-Year Treasury yield edged up 2bps to 2.85%, while U.K. Gilt yield rose 4bps to 1.27%. However, Eurozone yield declined -3bps to 0.30%. Japanese JGB yield remain unchanged at 0.03%.***

Looking ahead, bonds remain supported in the near-term by: 1) Safe haven demand with growing trade tensions between the U.S. and China and other countries, the European immigration crisis could bring down the Merkel government in Germany, and potential fiscal crisis in Italy, Brexit uncertainty; ***2) The BoJ continues to provide liquidity*** keeping both its asset purchase and yield curve control (YCC) policies intact even as other major central banks are gradually normalizing policies; and ***3) Inflation remains low*** and below target in Japan & Eurozone, though creeping higher in the U.S. ***However, bond yields are likely to face upward pressure with: 1) Global GDP growth on track to improve in Q2*** with a strong rebound in the U.S. and a modest rebound in Eurozone and Japan; and ***2) Developed central banks on track to gradual policy normalization*** but the tone of the Fed and the ECB has turned modestly hawkish.

Investment Strategy:

Asset Allocation: Overweight in Stocks on Support from Strong Earnings & GDP Rebound but Risks from Trade Tensions

Stocks: ***Remain Overweight*** as our base case is that while trade tensions & European uncertainties are likely to keep markets volatile, the strong earnings outlook and solid GDP rebound will enable stocks to stabilize and post gains as trade tensions cool and European uncertainties are resolved.

Bonds: ***Remain Neutral*** as bonds are supported in the near-term by safe haven demand from renewed increase in trade tensions, political turmoil in Germany and Italian fiscal uncertainty. However, yields are likely to face upward pressure with Q2 GDP rebound, and the Fed and ECB turning hawkish.

Global Equity Strategy: U.S. to Outperform on Q2 GDP Rebound & Strong Earnings Outlook. Lower Emg Mkts & Eurozone to Underweight

U.S. Stocks: ***Remain Overweight*** as U.S. stocks are likely to outperform with earnings outlook revised higher after strong Q1 results (+26%). Q2 Earnings outlook remains solid, expected around 20%. Q2 GDP growth rebound to over 4% with reacceleration of consumer spending and solid investment spending.

Japan: ***Remain Neutral*** as Japanese stocks are likely to post modest gains with GDP growth recovering after the Q1 contraction and BoJ continuing its accommodative policies. Earnings outlook solid but risk to earnings from strong yen.

Emerging Markets: ***Lower to Underweight*** as EM stocks continue to struggle in the near term despite their solid growth & earnings outlook as rising trade tensions and dollar strength have increased risks to their growth outlook. Further, EM central bank policies have turned slightly restrictive.

Eurozone: ***Lower to Modest Underweight*** as Eurozone stocks are likely to underperform with a potential fiscal crisis in Italy while the immigration crisis carries risks for the Merkel government in Germany though the latest EU Summit gave her a reprieve. ECB set to end QE in December. Muted GDP rebound and modest earnings growth***.***

U.K.: ***Remain Modest Underweight*** as Brexit uncertainty remains elevated with fragile negotiations and division within the U.K. cabinet. Risk of collapse of PM May's government. Modest GDP growth but BoE could hike rates in Q3.

Global Bond Market Strategy: Bonds Supported in Near-term by Safe Haven Demand but face Upward Pressure from Q2 GDP Growth Rebound

Japan JGBs: ***Modest Overweight*** as the outlook for JGBs remains modestly positive with inflation remaining low and the BoJ likely to keep both its asset purchase and yield curve control (YCC) policies intact, but GDP growth is likely to recover.

EM Debt***: Neutral*** with Emerging Market spreads attractive following their recent sell off. EM fundamentals remain healthy with solid growth. However, risks with strong dollar, trade tensions, central bank tightening, and other idiosyncratic risks.

U.S***. Treasuries: Remain Neutral*** as U.S. Treasury yields are likely to be range bound in the near-term with inflation edging higher and the Fed turns modestly hawkish and now on track to four rate hikes in 2018. However, safe haven demand with rising trade tensions likely to cap the rise in yields.

Eurozone***: Modest Underweight*** as the outlook for Eurozone bonds is modestly negative with the ECB on track to end QE in December and modest GDP rebound. Risk of collapse of the Merkel government and Italian fiscal crisis.

U.K. Gilts: ***Modest Underweight*** as the outlook for U.K. Gilts remains modestly negative with Brexit uncertainty amidst domestic political infighting. While inflation remains at a fourteen-month low, the BoE might hike in Q3 rather than Q4.

GLOBAL SECTORS: ***Overweight:*** Industrials, Financials, Info Technology; ***Modest Overweight:*** Energy, Materials, Consumer Discretionary; ***Neutral:*** Healthcare & Telecomms; ***Underweight:*** Consumer Staples, Real Estate & Utilities.