EMD Hard Currency Strategy

PGIM FIXED INCOME

As of March 31, 2020

STRATEGY HIGHLIGHTS

Objective[1]	To add +200 basis points (bps) of annualized excess return over a broad emerging markets debt index over a full market cycle.	
Target Sources of Excess Return	• FX	30 bps
	• Country Selection	90 bps
	• Security Selection	80 bps

Inception Date	July 01, 1996
Strategy Assets[2]	$25.4 billion
Benchmark	JPM EMBI Global Diversified Index

INVESTMENT PHILOSOPHY & PROCESS

PGIM Fixed Income's Emerging Markets Debt investment philosophy is grounded in four beliefs:

1. The ever-changing risk appetite of investors is a primary contributor to both market opportunity and market volatility. We therefore begin our investment process with a comprehensive assessment of the global appetite for risk.
2. Country allocation is a primary determinant of emerging markets portfolio returns. We therefore focus a significant part of our investment process on determining our country views. Our country decision process incorporates our global risk view along with an analysis of a country's foreign exchange, local bonds, and hard currency bonds from a fundamental, relative value, and technical perspective. We heavily emphasize qualitative factors in our fundamental analysis, as they are often the best predictors of performance.
3. Security selection is also a primary source of alpha generating opportunities. Our philosophy is to seek the widest possible universe of security selection opportunities, guidelines permitting. We analyze sovereign issuers as well as "quasi-sovereign" issuers within the same country. We evaluate opportunities in both hard currency and local currency bond curves based on potential changes in policy rates and inflation outlook. We evaluate corporate issuers, guidelines permitting.
4. Dynamic risk budgeting provides a disciplined framework for investment decision-making and provides important risk management as well. We heavily rely on risk budgeting and management to provide a consistent and disciplined framework for all investment decisions. We develop a broad strategic risk budget for each client portfolio that reflects the client's long-term objectives and risk parameters, as well as a tactical risk budget that permits us to incorporate our day-to-day views of market risk tolerances and opportunities within the broader strategic risk budget.
   - PGIM Fixed Income's investment approach seeks to add value primarily through research-based country allocation, security selection, FX, and, to a lesser extent, yield curve management. Duration management decisions are made on a country by country basis based on the outlook for central bank policy, inflation, and output gaps.
   - Duration management is also a function of our assessment of the global appetite for risk, which is Step 1 of our investment process.
   - Yield curve decisions are made with similar considerations.
   - When we interpret the global appetite for risk as a positive factor (i.e. global investors appear willing to assume more risk), we will tend to express this through slightly more aggressive yield curve positioning.

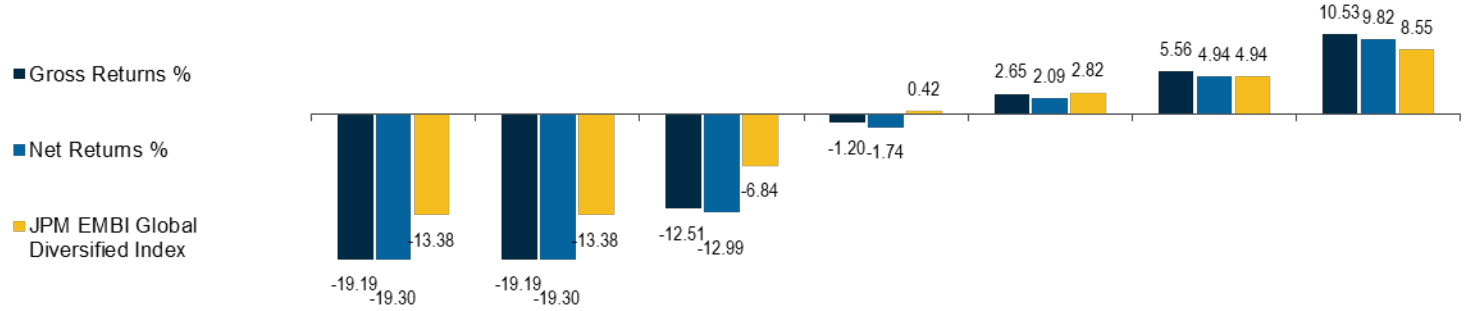
1 Global Backdrop & Portfolio Strategy
Senior Portfolio Manager
- Assess global risk appetite to determine portfolio risk profile and refine portfolio positioning, leveraging firm's resources

2 Country Analysis
Regional Economists
- Develop comprehensive economic outlook by country
- Evaluate each country from quantitative and qualitative perspective & assign internal rating

3 Asset & Security Selection
Regional Portfolio Managers/ Economists/Analysts
- Seek to determine best risk/ reward opportunities across hard currency, local rates, and FX
- Use proprietary tools to highlight relative value opportunities within markets

4 Risk Monitoring
Senior Portfolio Manager/Risk Manager
- Employ a rigorous process to tightly monitor risk at all levels
- Use proprietary tools to verify performance achieved is appropriate for risk taken

PERFORMANCE[1,2] | PERIODS ENDING MARCH 31, 2020

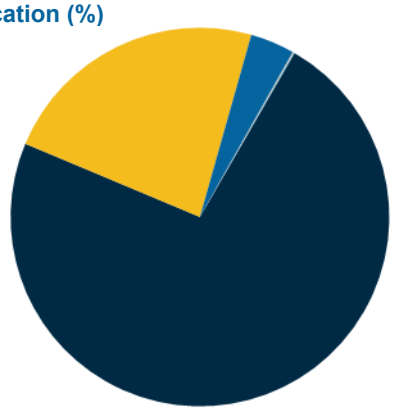


	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (01 Jul 1996)
Gross Excess Returns (bps)	-581	-581	-568	-162	-17	+63	+198
Tracking Error (%)	NM	NM	NM	3.65	2.97	2.60	2.78
Information Ratio	NM	NM	NM	-0.33	0.04	0.31	0.71

Gross Excess Returns may reflect rounding differences. Information ratio and tracking error are not meaningful (NM) for periods less than 3 years. Additional performance information is available upon request. Please visit www.pgimfixedincome.com for contact information.

PORTFOLIO HIGHLIGHTS

Sector Allocation (%)



Hard Currency Sovereign
Hard Currency Quasi-Sovereign
Hard Currency Corporates
Local Currency Sovereign
Local Currency Quasi-Sovereign

Sector Allocation (%)

	Portfolio	JPM EMBI Global Diversified Index
Hard Currency	**98.3**	**100.0**
Sovereign	71.9	80.4
Quasi-Sovereign	22.7	19.4
Corporates	3.7	0.2
Local Currency	**0.2**	**0.0**
Sovereign	0.1	0.0
Quasi-Sovereign	0.0	0.0

Representative Characteristics[3] (%)

	Portfolio	JPM EMBI Global Diversified Index
Effective Duration (yrs)	7.85	7.20
Effective Yield (%)	9.40	6.79
Spread (bps)	841	591
Average Coupon (%)	6.08	5.57
Average Quality (Moody's)	Ba2	Baa3
Number of Issuers	160	123

Top 10 Country Allocation (%)

	Portfolio	JPM EMBI Global Diversified Index
Mexico	6.0	4.5
Indonesia	5.4	4.6
Brazil	4.9	3.2
Ukraine	4.4	2.4
Russian Federation	3.9	3.7
Turkey	3.8	3.5
South Africa	3.2	2.3
Dominican Republic	2.8	2.5
Egypt	2.6	2.3
Argentina	2.6	1.0

Quality Distribution[4,5](%)

	Portfolio	JPM EMBI Global Diversified Index
AA	3.1	7.0
A	5.7	14.8
BBB	28.9	36.2
BB	16.6	14.5
B	33.8	23.5
CCC & Below	8.5	3.3
Not Rated	1.9	0.7

Past performance is not a guarantee or a reliable indicator of future results. The value of investments can go down as well as up. No investment strategy or management technique can guarantee returns or eliminate risk in any market environment. Please see the Notice for important disclosures regarding the information contained herein. *Totals may not sum due to rounding. Source: PGIM Fixed Income. Source of Benchmark: JP Morgan. Where overseas investments are held the rate of currency may cause the value of investments to fluctuate. Investments in emerging markets are by their nature higher risk and potentially more volatile than those inherent in some established markets. Non-USD securities are converted to USD using a spot rate conversion. [1]Periods over one year are annualized. [2]Net returns reflect the deduction of investment advisory fees and other expenses. Gross and net performance have been calculated in U.S. dollars and reflect the deduction of transaction costs and withholding taxes, if any, and the reinvestment of income. [3]Effective yield is calculated excluding the yield impact of foreign exchange positions and derivatives (other than interest rate futures, which are included in the calculation). [4]Excludes cash and FX hedges. [5]Middle of Moody's, S&P and Fitch ratings -- excluding cash and cash equivalents.* ***Available for professional and institutional investors only.***

INVESTMENT COMMENTARY

Markets

While the Q1 performance of emerging market debt reflected the twin shocks of Covid-19 and decline in oil prices, the speed and intensity of the selloff exacerbated the underperformance as liquidity worsened to levels not even seen during the 2008 financial crisis. Although policy measures implemented by fiscal authorities, the Fed, and other developed market central banks provided support toward quarter end, we believe more meaningful measures from the IMF and G-20 will be needed.

Within hard currency sovereigns, distinguishing between technical dislocations and fundamental changes is paramount. Select BBB- and BB-rated sovereigns, those whose spreads more than doubled, appear attractive. Longer-dated bonds within the same ratings buckets also offer value. We are focused on higher-rated segments of the market but will look to the new issue market to gain exposure given the difficulty of trading in the current, liquidity-challenged market.

For EM corporates, the combination of global recession, depressed commodity prices, and selloff within EMFX created significant headwinds. We now expect the high yield corporate default rate to increase to 6-8% for 2020. However, we believe current valuations are attractive and spreads of around 600 bps adequately compensate for the risks. In terms of positioning, we prefer higher-quality high yield names and are underweight sub-scale oil & gas and commodity producers.

Portfolio

Long spread duration in Argentina, Sri Lanka, Mexico, and Ecuador, as well as positioning in energy sensitive oil-exporting countries, drove negative performance. Short spread duration in Chile, Philippines, Panama, and Uruguay offset some of the declines. Sovereign positioning in Angola, Argentina, Venezuela, Lebanon, and Brazil was negative, while positioning in flatteners in Oman and Romania contributed to performance. Corporate and quasi-sovereign positioning in Mexico, South Africa, Brazil, and Venezuela detracted from performance.

In terms of FX, overweight positioning in the Indonesian rupiah, Russian ruble, Czech koruna, and Singapore dollar, along with underweight positioning in the Israeli shekel, detracted from performance. Overweight positioning in the Egyptian pound and underweight positioning in the Brazilian real, Chilean peso, South African rand, and Colombian peso offset some of these declines.

PORTFOLIO MANAGERS

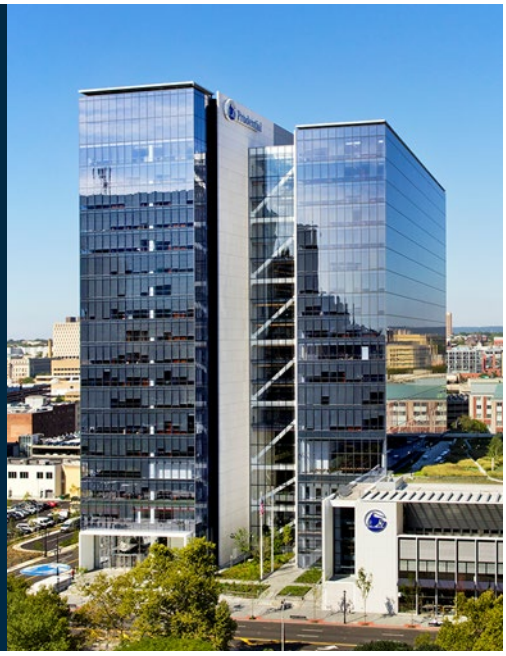
Cathy L. Hepworth, CFA
Managing Director and
Head of Emerging Markets
Debt Team

PGIM FIXED INCOME

PGIM Fixed Income is a global asset manager offering active solutions across all fixed income markets. As of December 31, 2019, the firm had $851 billion of assets under management, and over 759 institutional asset owners have entrusted PGIM Fixed Income with their assets.

At PGIM Fixed Income our extensive size and scale benefits our clients in our ability to have the necessary resources to maintain large and deep research teams, implement world-class risk management systems, establish ourselves as a known entity to both corporate issuers and sell side analysts and add considerable value to our investment process in finding key opportunities for our investors.

Our investment approach is supported by 301 investment professionals based in the U.S., London, Amsterdam, Tokyo, and Singapore as of December 31, 2019. Senior investment personnel average 23 years tenure with the firm, providing stability and leadership. Nine regional macroeconomists, 110 fundamental analysts, and 56 analysts in quantitative modeling, risk management, and portfolio analysis provide deep, broad perspectives on the global fixed income markets.



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INDEX DESCRIPTION: As of March 1, 2006 the benchmark for this composite is the JP Morgan Emerging Markets Bond Index Global Diversified (JP Morgan EMBI Global Diversified). The Emerging Markets Bond Index Global Diversified (EMBI Global) tracks total returns for USD-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, and Eurobonds. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. Source of the benchmark: JP Morgan. Prior to March 1, 2006 the benchmark for this composite was the JP Morgan Emerging Markets Bond Index Plus. This index is a liquid US-dollar emerging markets debt benchmark that tracks total returns for actively traded external debt instruments by emerging market sovereign entities: US-dollar denominated Brady bonds, Eurobonds, and loans. Countries included in the index must be rated Baa1/BBB+ or below by Moody's/S&P rating agencies. Source of the benchmark: JP Morgan. The change in benchmark was made to more accurately reflect the strategy of the composite.

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