PRUDENTIAL MUTUAL FUNDS HAVE BEEN RENAMED PGIM MUTUAL FUNDS.# FUND SYMBOLS DID NOT CHANGE.

Click here to access webinar

Michael K. Lillard, CFA
Head of PGIM Fixed Income
and Chief Investment Officer

Michael Collins, CFA
Managing Director and
Senior Portfolio Manager
PGIM Fixed Income

Fixed Income Market Outlook

September 26, 2018—Mike Lillard, Head of PGIM Fixed Income and Chief Investment Officer, and Mike Collins, Senior Portfolio Manager, recently shared their views on the current economic environment and their market outlook for the near-term, as well as how they are positioning portfolios as a result of these views. Read more about their thoughts on global growth, expectations for Fed policy, and potential opportunities in the fixed income marketplace.

Fed Hikes and Keeps its Options, Eyes, and Ears Open; Balance of Risks for the Bond Market Looks Positive

- Global GDP: PGIM Fixed Income's forecast for global economic growth continues to be positive for most of the world, with some areas slowing down. PGIM Fixed Income's outlook for Global GDP growth is 3.7% for 2018 and 3.5% for 2019.
- U.S. GDP: In the U.S., economic data has been strong as the fiscal stimulus packages (e.g. tax cuts and spending bill) continue to provide a boost to growth. PGIM Fixed Income's outlook for U.S. GDP growth is 2.9% for 2018 and 2.5% for 2019. The budget deficit remains an area of concern over the longer term with the deficit expected to increase from 4% towards 5% of GDP.
- U.S. Rates: As expected, the Federal Reserve raised the Fed Funds rate by 25 bps at its September meeting and gave every indication of sticking to its path of gradual rate hikes in the future.
  - The rate hike cycle is set to peak—according to the Fed's so-called "dot plot"—in the years 2020 and 2021 at 3.4% before settling down over the long run at 3.0% (up from 2.9% at their prior meeting).
  - Against that backdrop, PGIM Fixed Income is optimistic on the outlook for U.S. fixed income. While that may be surprising against a backdrop of robust U.S. growth and a Fed possibly mid-course in a rate hiking cycle, the fact of the matter is that 10-year Treasury yields are fully 100 bps above their lows of 2017 and at historically very high—nearly record in many cases—levels relative to major foreign markets.
  - This, in their view, has left the market as attractively priced for a range of scenarios. For example, in an environment where growth slows unexpectedly and the Fed goes on hold, U.S. yields—which, again, are quite high by international standards—would be likely to drop back towards the Fed funds rate, boosting bond prices and fixed income returns.
  - Naturally, there are risks to PGIM Fixed Income's scenario—such as an upside surprise in growth and / or inflation—that could push rates higher in the near term. But on the other hand, the economy is likely at its peak growth rate for the cycle. As growth gradually moderates, U.S. rates may get pulled towards other major market rates as fear of overheating subsides.

#Does not include Prudential Day One Funds.

Fixed Income Markets: Key Positioning for the Coming Quarter

- PGIM Fixed Income continues to be positioned for a flattening U.S. yield curve in many portfolios, although they are beginning to reduce the size of this positioning given the relative flatness of the yield curve.
- Additionally, the firm believes that a 3% yield and above on the 10-year U.S. Treasury represents attractive relative value.
- With the heightened level of market uncertainty, the biggest concern for many investors remains the potential for more volatility. Until last year, there was a high probability of lower economic growth with few deviations. Now that growth has picked up, there is also greater probability of a risk event (positive or negative).
- It is more important than ever to manage tail risk. PGIM Fixed Income's focus is centered around not only doing well in the base case, but also preventing a negative outcome in a tail risk scenario.
- PGIM Fixed Income has pared back exposure to credit sectors that they believe are fully valued or are in the later stages of the credit cycle, such as non-financial corporate bonds. In this somewhat asynchronous cycle, they are focused on sectors that are in the early to middle stages of the business cycle, such as U.S. and certain global money center banks.
- The firm continues to favor high-quality (mostly AAA-rated) structured products, such as CMBS and CLOs. They continue to hold a significant underweight to agency mortgage-backed securities for multiple reasons, including tight spread levels and the ongoing roll-off from the Fed's balance sheet.
- PGIM Fixed Income sees this as a good environment for sector rotation and an opportunity to upgrade portfolios and reduce credit risk.

1003835-00003-00 NS11701 Expiration: 1/31/2019