U.S. Higher Quality High Yield Strategy

PGIM FIXED INCOME

As of March 31, 2020

STRATEGY HIGHLIGHTS

Objective[1]	To add +125 basis points (bps) of annualized excess return over a high quality high yield index over a full market cycle.	
Target Sources of Excess Return	• Security Selection	100 bps
	• Industry Allocation	15 bps
	• Beta & Spread Curve Positioning	10 bps

Inception Date	July 01, 1998
Strategy Assets[2]	$4.1 billion
Benchmark	Bloomberg Barclays High Yield BB/B 1% Issuer Capped Index

INVESTMENT PHILOSOPHY & PROCESS

- The Strategy focuses primarily on the upper quality tier (BB and B rated credits) of the high yield market, which historically has exhibited the most attractive risk/return characteristics.
- Total exposure to sectors other than high yield bonds is less than 20%. These sectors may include investment grade corporate bonds, bank loans, and foreign corporate bonds, depending on client guidelines, the market environment, and relative value opportunities.
- PGIM Fixed Income manages Higher Quality High Yield portfolios based on the philosophy that bottom-up, research-based subsector and security selection can lead to consistent outperformance versus a broad high yield index with a high information ratio.
- We seek to construct well diversified portfolios of performing credits that are carefully researched. Intensive fundamental research is conducted by an internal research staff to identify strong and improving credits. The breadth and experience of our research organization permit us to apply intense focus on individual securities identified from a broad pool of investment opportunities. Portfolios are actively managed to capture the best opportunities and minimize credit losses, within an environment of disciplined risk management oversight.
- We do not take extremely large positions—either on an absolute basis or relative to benchmark—in any single issuer or industry as a primary means to achieve outperformance.
- All portfolios are managed within a pre-determined risk budget that includes thresholds for industry, issuer, and credit quality exposures.

1 Senior portfolio manager develops top down themes by leveraging firms resources

2 Investment team selects securities and constructs portfolio

Fundamental Value Assessment

Credit analysts evaluate all industries and issuers in the universe. Focus on downside protection:

- Asset quality
- Capital structure
- Covenants

Relative Value Security Selection

Sector portfolio managers and credit analysts evaluate and maximize relative value among approved universe:

- Choose credits with strong fundamentals and best relative value

Position Sizing

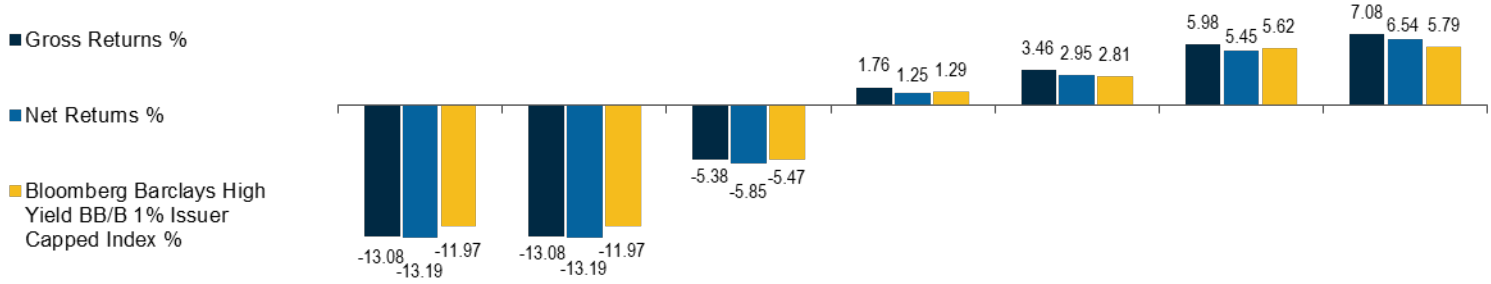
Sector portfolio managers size positions:

- Evaluate industry, issuer and market fundamentals
- Achieve top-down beta and curve positioning objectives
- Refine position sizes as risk profiles and thresholds change

3 Portfolio managers and risk managers monitor portfolio risk at all levels— interest rate, beta, industry, issuer, and quality

Your capital is at risk and 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. *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]There can be no guarantee that this objective will be achieved, on average, over a full market cycle defined as three to five years. [2] AUM as of December 31, 2019.* ***Available for professional and institutional investors only. Please see the Notice for important disclosures regarding the information contained herein.***

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

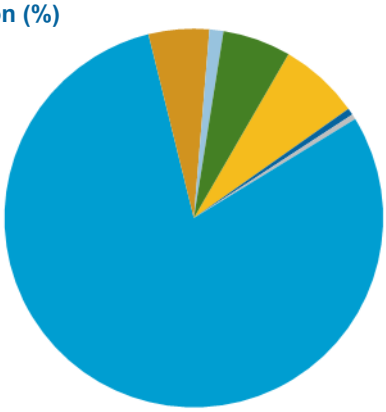


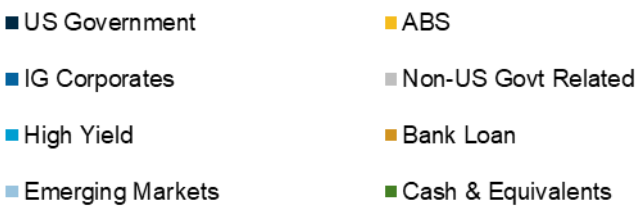
	QTD	YTD	1 Year	3 Year	5 Year	10 Year	Since Inception (01 Jul 1998)
Gross Excess Returns (bps)	-111	-111	+10	+46	+65	+36	+128
Tracking Error (%)	NM	NM	NM	0.84	0.91	0.86	2.14
Information Ratio	NM	NM	NM	0.61	0.71	0.40	0.53

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 (%)





	Portfolio	Bloomberg Barclays High Yield BB/B 1% Issuer Capped Index
US Government	0.0	0.0
ABS	6.9	0.0
IG Corporates	0.6	0.1
Non-US Govt Related	0.4	0.0
High Yield	79.9	97.8
Bank Loan	5.2	0.0
Emerging Markets	1.2	2.1
Cash & Equivalents	5.8	0.0
Total	**100.0**	**100.0**

Representative Characteristics[3] (%)

	Portfolio	Bloomberg Barclays High Yield BB/B 1% Issuer Capped Index
Effective Duration (yrs)	4.08	4.42
Effective Yield (%)	8.92	8.10
Spread (bps)	784	735
Average Coupon (%)	5.97	5.78
Average Quality (Moody's)	B1	Ba3
Number of Issuers	304	652

Corporate Industry Allocation (%)

	Portfolio	Bloomberg Barclays High Yield BB/B 1% Issuer Capped Index
Finance	4.7	10.0
Industrial	76.4	86.9
Utility	5.1	3.1
Non Credit	0.9	0.0
Top 10 Industries (%)		
Capital Goods	7.8	5.0
Building Mat. & Const.	7.1	4.4
Technology	6.1	6.8
Health Care & Pharma	5.9	6.9
Telecom	5.9	7.1
Media & Entertainment	5.5	6.0
Electric	5.1	3.1
Cable	4.8	6.6
Gaming	4.2	3.2
Energy - Other	4.2	6.0

Quality Distribution[4,5](%)

	Portfolio	Bloomberg Barclays High Yield BB/B 1% Issuer Capped Index
AAA	6.9	0.0
BBB	0.6	0.1
BB	29.6	58.3
B	41.6	41.6
CCC & Below	14.4	0.0
Not Rated	1.2	0.0

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INVESTMENT COMMENTARY

Markets

Following the dislocation and dysfunction seen in the high yield market during Q1, we expect continued volatility going into Q2. The market's view on the length of the Covid-19 shutdown, the extent of its economic impact, and effectiveness of policy response will drive returns in the market over the short term. Additional uncertainty is fueled by the potential for an influx of paper from previously BBB-rated issuers as they are downgraded to below-investment grade. Helping to balance some of this risk, high yield issuers were more defensively positioned heading into this downturn than previous ones.

As our base case, we assume no more than a four-month shutdown, and additional fiscal and monetary stimulus as needed. Under this scenario, we assume an annualized default rate of 8% over the next three years. This compares to an implied default rate of 9%-10% at current spread levels, thus a reasonable amount of compensation for our default scenario. Further, spreads have reached a level that has historically been an attractive entry point. Therefore, we are cautiously bullish over the medium term and our two-year outlook is very constructive.

In terms of positioning, we are adding to credits we view as clear survivors and selectively to those with default risk but are trading at prices well below our expected recovery values. We are cutting exposure to higher levered credits that have not appropriately repriced due, in our view, to market perception that their industry is more insulated than we believe. We are also purging default candidates that we expect to have low recovery values.

Portfolio

From a beta perspective, on average, having more risk in the portfolio relative to the benchmark detracted from returns. During Q1, overweight positioning to electric & water and chemicals and underweight positioning to transportation & environmental services, REITs, and downstream energy contributed to performance. Underweight positioning to consumer non-cyclicals and cable & satellite detracted from results.

In terms of security selection, positioning within the telecom, electric & water, chemicals, energy midstream, and finance industries added to results. Security selection within the energy downstream, gaming & lodging & leisure, and media & entertainment industries were among the largest detractors from performance.

PORTFOLIO MANAGERS

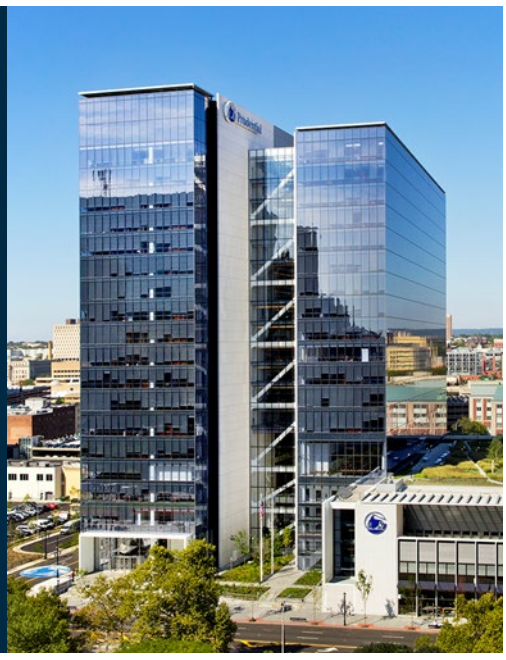
Robert Cignarella, CFA
Managing Director and
Head of U.S. High Yield

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 January 2017, the benchmark for this composite was changed historically from inception to the Bloomberg Barclays U.S. High Yield Ba-B 1% Issuer Capped Index. This benchmark is an issuer-constrained version of the Bloomberg Barclays U.S. Corporate High-Yield Index that covers the USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bond market. The benchmark limits issuer exposures to a maximum 1%. Securities must be rated Ba/B using the middle rating of Moody's, S&P, and Fitch. Source of the benchmark: Bloomberg Barclays. The benchmark change was made to more accurately reflect the industry standard. Previously the benchmark was the Bloomberg Barclays U.S. Corporate High Yield Bond Index.

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