

PGIM MARKETS

Insights on Events Moving the Financial Markets

THE GLOBAL ECONOMY IS CLEARED FOR TAKE-OFF

On the June PGIM Global Partners CIO call hosted by QMA, chief investment officers and senior investment professionals from PGIM's international businesses, PGIM Fixed Income and QMA discussed the acceleration of global growth, the outlook for inflation and the prospects for global equities.

The global economic recovery is shifting into a higher gear as the Eurozone and Japan join the US with solid GDP growth in the second quarter of 2021 after contracting in Q1 when renewed restrictions on activity dampened growth. US Q2 GDP is on track to strengthen to around 9.0% annualized, with upside risks, after solid 6.4% growth in Q1. The economy continues to benefit from unleashed pent-up demand stemming from the fiscal stimulus approved in the first quarter of this year and most of the states removing their COVID-19 restrictions. The upcoming infrastructure bill is also likely to support the economy in the second half of 2021. Eurozone Q2 GDP is expected to rebound by 5.6% quarter-over-quarter annualized after falling -3.6% in Q1 as countries started to slowly remove COVID-19 restrictions. With the acceleration of vaccine rollout, growth is expected to improve in the major Eurozone economies. Japanese real GDP contracted -5.1% quarter-over-quarter in Q1. The economy is on track to a slow recovery in Q2 as COVID-19 cases are close to record highs, and a smaller percentage of the population has been vaccinated thus far. However, the government has opened mass vaccination sites in Tokyo and Osaka, so vaccine administration is expected to accelerate.

Chinese GDP growth is expected to remain strong in Q2 (around 8% year-over-year), slowing from the 18.3% growth in Q1 2021. China's activity data for April was mixed as industrial production and retail sales slowed, while fixed asset and real estate investment were robust. In Taiwan, near-term risks to economic growth have increased as the government has imposed mobility restrictions amidst the surge in COVID-19 infections and due to uncertainty around drought and electricity supply. However, export demand remains very strong with increasing demand for electronic components and semiconductors. The Taiwan team maintains its constructive view on Taiwan's manufacturing given its critical position in the global chip supply chain and believes growth momentum can be restored in H2 2021. India's GDP grew 1.6% year-over-year in Q1 2021. India's economy was on a path to recovery, but momentum has slowed as states re-imposed restrictions in Q2 as COVID-19 cases soared. Lockdowns have been extended into June and are likely to have a significant negative impact on Q2 growth.

The Organization for Economic Co-operation and Development (OECD) in its May 2021 Economic Update has a much-improved outlook for the global economy for 2021 and 2022, in sharp contrast to its earlier gloomy prognosis. However, like the International Monetary Fund, it expects the recovery to be uneven across economies. In the developed economies, the progressive rollout of vaccines has begun to allow more contact-intensive activities to reopen gradually, after being restrained to contain infections. In addition, aggressive fiscal stimulus is helping to boost demand, reduce spare capacity and minimize the risks of significant scarring from the pandemic.



John Praveen, PhD
Managing Director and
Portfolio Manager, QMA

VIEW BIO



Manoj Rengarajan, CFA
Principal and Portfolio
Manager, QMA

The OECD now expects global GDP to rise by 5.75% in 2021 and around 4.50% in 2022. Growth in developed economies is expected to increase by about 5.25% in 2021, led by a strong upturn in the United States, and strong private spending in most countries. The strong growth pace of 2021 is seen moderating to 3.75% in 2022. While GDP in China has already caught up with pre-pandemic levels and is expected to remain solid in 2021 and 2022, other emerging-market economies, including India's, might continue to have large shortfalls in GDP relative to pre-pandemic expectations and are projected to grow strongly only after the impact of the virus fades.

The Inflation Debate: The inflation debate continues with central banks taking a more benign view, i.e., that the current rise in inflation is “transitory,” while markets worry that the rise in inflation could be the start of a new phase of higher inflation after decades of low inflation and deflation fears in 2020. Headline inflation started to rise in early 2021 across most developed markets, primarily due to rising energy prices and base effects from declines in 2020. However, the base effects are expected to peak soon. US inflation jumped 4.2% year-over-year in April from 2.6% in March, largely due to rising energy prices and base effects. Core inflation rose to 3.6% from 1.6% previously. Eurozone inflation was up 2.0% in May from 1.6% in April, also largely driven by energy prices. Eurozone core inflation also increased slightly to 0.9% from 0.7% previously. However, in Japan, nationwide inflation edged down to -0.4% year-over-year in April from -0.2%, while core inflation decreased to -0.2% from 0.3%. Looking ahead, inflation is expected to peak in late Q2 as that was the lowest level of price declines in 2020. Thereafter, base effects will have an offsetting impact, limiting the rise in annual inflation.

As with other central banks in the developed countries, the US Federal Reserve and the European Central Bank expect that much of the sharp rise in inflation will turn out to be transitory. Several Fed officials commented that the chief causes of rising prices are temporary shortages of key supplies and labor tied to the reopening of the economy. Nevertheless, they have indicated that they are monitoring the evolution of inflation closely. One difference, however, between periods of rising prices in the past versus today is the changed mindset and operative framework of the Fed. In the past, the Fed has been preemptive and committed to simple inflation targets, which helped anchor inflation expectations, while now it is committed to maximizing employment and is being “reactive” rather than “proactive” on the inflation front.

The debate about whether elevated inflation is transitory or may persist longer than what the central banks believe continues, but Ellen Gaske, a senior economist at PGIM Fixed Income, and QMA Portfolio Manager Ed Keon agree that while we might not see 1970's-style run-away inflation in the US, there is still a possibility that inflation may persist a little longer. This would be due mainly to the shortages that will likely persist for some more time, both from supply-side bottlenecks that are impacting industries such as semiconductors, as well as labor market shortages, which could take longer to normalize. However, Mike Collins, senior portfolio manager at PGIM Fixed Income pointed out that several companies are responding to the shortages by ramping up production and increasing supply. This raises the risk that there might be an oversupply in many of these areas six to 12 months down the line and that we could see some negative month-over-month inflation readings as shortages start to moderate and demand side adjustments pay-off. There is already some evidence of demand side adjustments as people delay purchases of houses and cars due to rising prices. There are also signs that consumers have started postponing travel or planning alternatives as airline ticket prices rise sharply. This supports the view that inflation pressures could ease later in the year and into 2022.

In its May update, the OECD acknowledged that signs of higher input cost pressures have appeared in recent months, but sizeable spare capacity is likely to prevent a significant and sustained pick-up in underlying inflation. The recent upturn in headline inflation rates reflects the recovery of oil and other commodity prices, a surge in shipping costs, the normalization of prices in hard-hit sectors as restraints are eased and one-off factors such as tax changes. These, should ease in the near term. With unemployment and employment rates unlikely to attain their pre-pandemic levels until the end of 2022 in many countries, there should be only modest pressures on capacity over the coming 18 months. According to the OECD, prolonged high or rising inflation is unlikely if central banks take necessary measures to keep inflation expectations anchored to their target and if structural changes that limited pressures on inflation during the past three decades continue. However, there is still uncertainty about their evolution, which could pressure inflation higher over the longer term.

Policy Backdrop: Developed central banks remain on hold as they consider rising inflation to be “transitory.” The Fed is set to meet in mid-June, when it is expected to leave policy unchanged. While the Fed is expected to remain on hold, Fed officials are coming around to the view that it is time to start thinking about QE taper. In Gaske’s view it would be appropriate for the Fed to begin tapering QE purchases by the end of the year as the recovery continues, especially with liquidity in the banking system rising to the point of becoming excessive and ample evidence that this flood of liquidity is starting to come up in the short-term market. The ECB is next set to meet in mid-June; it is not expected to make any changes to policy. However, market expectations are for the ECB to tweak its monetary policy statement pledging to maintain favorable financing conditions but not renewing its pledge to keep Pandemic Emergency Purchase Programme (PEPP) purchases at the recent “significantly higher” pace for the next three months. This would prepare the ground for a very gradual taper beginning in Q3 and for net PEPP purchases to end in March 2022. The Bank of Japan left policy unchanged at its last meeting in April. The BoJ may potentially reduce the JGB purchase amount further to improve the sustainability of the current policy measures. However, that is unlikely as the economic recovery remains fragile with the government declaring the state of emergency again.

Among emerging markets, there is a split between central banks that have begun down a normalization path as the recovery gains strength and financial stability concerns move to the fore and other central banks still grappling with virus-related downside risks. Tightening of credit and housing policies already is underway in China, which was the first to exit the pandemic. The Bank of Korea took its first steps toward normalization at its latest meeting, with a more hawkish tone in its statement and press conference. By contrast, in the wake of a large second wave of infections in India, the Reserve Bank of India could continue to add to its accommodative measures with additional bond purchases and by relaxing regulatory controls and enhancing liquidity measures. Latin American central banks are turning more hawkish in the face of rising inflation expectations. The Brazilian central bank has signaled another 75 basis-point rate hike in June after a widely anticipated hike of 75 basis points in May that brought the Selic rate to 3.5%. The odds of the Mexican central bank hiking rates this year has also risen with Banxico increasing its inflation forecast path in its quarterly report. The Russian central bank surprised with two rate hikes totaling 75 basis points in March and April and is expected to hike modestly further in the rest of the year if inflationary pressures remain high.

Bottom-line: The June CIO Call participants expressed confidence that stock markets are likely to add to the solid gains thus far in 2021. Markets remain supported by broadening global growth as widespread vaccine administration is reducing infection cases, allowing for reopening of economic activity and unleashing pent-up demand. The earnings outlook remains strong as more companies are beating expectations. However, a by-product of the growth rebound is rising inflation, which is fueling an active debate as to whether the rise in inflation is “transitory” or more long-lasting. This, in turn, is raising concern that global central banks may have started to “think” about ending the ultra-easy monetary policy that provided the liquidity for the rally. Further, with the solid market gains thus far, equity valuations have become rich. These cross currents are likely to keep markets volatile.

IN OTHER NEWS...

PGIM Fixed Income contributed the following analysis.

- One question leading up to this week's European Central Bank (ECB) policy meeting centers on whether it will taper its Pandemic Emergency Purchase Programme. As euro area government yields rose in 2021—from a GDP-weighted 10-year average of about -0.2% to a recent high of about +0.4%—PEPP purchases rose slightly in Q1 and increased notably in Q2. While they may be poised to decline in Q3, we regard the PEPP as more of a sideshow relative to the steps the institution will need to take in order bolster its policy credibility over the medium term.
- Indeed, the ECB's upcoming framework review, which is set to conclude in September, may address the steps needed to meet its inflation target over the longer run. For example, we believe the combination of a new flexible, symmetric 2% inflation target, a significant increase in its open-ended Asset Purchases Programme, and forward policy guidance tied to the inflation outlook are some potential preconditions that may anchor inflation expectations at the target level. Fiscal spending in the area of 3% of euro area GDP would also support a return to an improved pre-crisis growth trend.
- Although the US payroll report for May was weaker-than-expected, we continue to see further signs of healing in the labor market. For instance, average weekly payrolls for private industries has climbed from a pre-virus level of about 34.5 hours per week to the cusp of 35 hours per week. With a rule of thumb that 0.1 of an hour increase in weekly hours equates to 400,000 job vacancies, about 2 million jobs could be landed in the months ahead. That said, labor market performance remains highly bifurcated with the subdued payroll gains in recovering industries, such as vehicle manufacturing, retail, and food and lodging, offsetting the continued gains in expanding industries, such as warehousing and storage and residential construction.
- Developed market debt levels coming out of the pandemic may become a topic of concern, particularly if interest rates move higher. For example, the US Congressional Budget Office estimates a total deficit of -4.3% of GDP in 2022. It also assumes an average interest rate of 3.5% over the next 30 years, which could indicate that net interest costs account for most of the total deficit in the 20 years leading up to 2051 when the total deficit is expected to reach -13.3% of GDP. Yet, research shows that higher debt levels are associated with lower interest rates in developed market economies, thus an average interest rate of less than 3.5% could indicate capacity for additional fiscal expenditures in the future.

For Professional Investors only. All investments involve risk including the possible loss of capital. Past performance is not a guarantee or reliable indicator of future results.

These materials represent the views and opinions of the author(s) regarding economic conditions, asset classes, and strategies. Distribution of this information to any person other than the person to whom it was originally delivered is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of QMA LLC (“QMA”) is prohibited. Certain information contained herein has been obtained from sources that QMA believes to be reliable as of the date presented; however, QMA cannot guarantee the accuracy of such information, assure its completeness, or warrant that such information will not be changed. **Any forecasts cited are for informational purposes only. There can be no assurance that forecasts will be achieved.**

These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. No liability whatsoever is accepted for any loss (whether direct, indirect, or consequential) that may arise from any use of the information contained in or derived from this report. QMA and its affiliates may make investment decisions that are inconsistent with the views expressed herein, including for proprietary accounts of QMA or its affiliates. These materials are for informational or educational purposes. In providing these materials, QMA is not acting as your fiduciary.

In Hong Kong, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors as defined in Section 1 of Part 1 of Schedule 1 (paragraph (a) to (i) of the Securities and Futures Ordinance (Cap.571).

In the United Kingdom, information is issued by PGIM Limited with registered office: Grand Buildings, 1-3 Strand, Trafalgar Square, London, WC2N 5HR. PGIM Limited is authorised and regulated by the Financial Conduct Authority (“FCA”) of the United Kingdom (Firm Reference Number 193418). In the European Economic Area (“EEA”), information is issued by PGIM Netherlands B.V. with registered office: Gustav Mahlerlaan 1212, 1081 LA Amsterdam, The Netherlands. PGIM Netherlands B.V. is, authorised by the Autoriteit Financiële Markten (“AFM”) in the Netherlands (Registration number 15003620) and operating on the basis of a European passport. In certain EEA countries, information is, where permitted, presented by PGIM Limited in reliance of provisions, exemptions or licenses available to PGIM Limited under temporary permission arrangements following the exit of the United Kingdom from the European Union. These materials are issued by PGIM Limited and/or PGIM Netherlands B.V. to persons who are professional clients as defined under the rules of the FCA and/or to persons who are professional clients as defined in the relevant local implementation of Directive 2014/65/EU (MiFID II).

In Japan, investment management services are made available by PGIM Japan, Co. Ltd., (“PGIM Japan”), a registered Financial Instruments Business Operator with the Financial Services Agency of Japan. In Hong Kong, information is provided by PGIM (Hong Kong) Limited, a regulated entity with the Securities & Futures Commission in Hong Kong to professional investors as defined in Section 1 of Part 1 of Schedule 1 (paragraph (a) to (i) of the Securities and Futures Ordinance (Cap.571). In Singapore, information is issued by PGIM (Singapore) Pte. Ltd. (“PGIM Singapore”), a Singapore investment manager that is licensed as a capital markets service license holder by the Monetary Authority of Singapore and an exempt financial adviser. These materials are issued by PGIM Singapore for the general information of “institutional investors” pursuant to Section 304 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”) and “accredited investors” and other relevant persons in accordance with the conditions specified in Sections 305 of the SFA. In South Korea, information is issued by QMA, which is licensed to provide discretionary investment management services directly to South Korean qualified institutional investors.

PFI of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom. QMA and the QMA logo are registered service marks of PFI and its related entities. The Rock design is also a service mark of PFI and its related entities, registered in many jurisdictions worldwide.

The opinions expressed herein do not take into account individual client circumstances, objectives, or needs and are therefore are not intended to serve as investment recommendations. The financial indices referenced herein is provided for informational purposes only. You cannot invest directly in an index. The statistical data regarding such indices has been obtained from sources believed to be reliable but has not been independently verified.

Certain information contained herein may constitute “forward-looking statements,” (including observations about markets and industry and regulatory trends as of the original date of this document). Due to various risks and uncertainties, actual events or results may differ materially from those reflected or contemplated in such forward-looking statements. As a result, you should not rely on such forward-looking statements in making any decisions. No representation or warranty is made as to future performance or such forward-looking statements.

Certain information contained in this product or report is derived by QMA in part from MSCI’s Index Data. However, MSCI has not reviewed this product or report, and MSCI does not endorse or express any opinion regarding this product or report or any analysis. Neither MSCI nor any third party involved in or related to the computing or compiling of the Index Data makes any express or implied warranties, representations or guarantees concerning the Index Data or any information or data derived there from, and in no event shall MSCI or any third party have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) relating to any use of this information. Any use of the Index Data requires a direct license from MSCI. None of the Index Data is intended to constitute investment advice or a recommendation to make (or refrain from making) any kind of investment decision and may not be relied on as such

Information has been obtained from sources believed to be reliable, but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan’s prior written approval. Copyright 2021, J.P. Morgan Chase & Co. All rights reserved.

London Stock Exchange Group plc and its group undertakings (collectively, the “LSE Group”). © LSE Group 2021. FTSE Russell is a trading name of certain of the LSE Group companies. “FTSE Russell ® “ is a trade mark of the relevant LSE Group companies and is/are used by any other LSE Group company under license. All rights in the FTSE Russell indexes or data vest in the relevant LSE Group company, which owns the index or the data. Neither LSE Group nor its licensors accept any liability for any errors or omissions in the indexes or data and no party may rely on any indexes or data contained in this communication. No further distribution of data from the LSE Group is permitted without the relevant LSE Group company’s express written consent. The LSE Group does not promote, sponsor or endorse the content of this communication.

For financial professional use only. Not for use with the public.

BLOOMBERG ® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively “Bloomberg”). BARCLAYS ® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, “Barclays”), used under license. Bloomberg or Bloomberg’s licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall have neither any liability or responsibility for injury or damages arising in connection therewith.

Copyright 2021. Standard & Poor’s, a division of The McGraw-Hill Companies, Inc. Standard & Poor’s including its subsidiary corporations (“S&P”) is a division of The McGraw-Hill Companies, Inc. S&P and/or its third-party licensors have exclusive proprietary rights in S&P data. S&P data may only be used internally for business purposes and shall not be used for any unlawful or unauthorized purposes. Dissemination, distribution or reproduction of S&P data in any form is strictly prohibited except with the prior written permission of S&P. S&P does not guarantee the accuracy, adequacy, completeness or availability of any information and is not responsible for any errors or omissions or for the results obtained from the use of such information.

QMA-20210607-158

Certain information in this commentary has been obtained from sources believed to be reliable as of the date presented; however, we cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. The manager has no obligation to update any or all such information, nor do we make any express or implied warranties or representations as to the completeness or accuracy. Any projections or forecasts presented herein are subject to change without notice. Actual data will vary and may not be reflected here. Projections and forecasts are subject to high levels of uncertainty. Accordingly, any projections or forecasts should be viewed as merely representative of a broad range of possible outcomes. Projections or forecasts are estimated, based on assumptions, subject to significant revision, and may change materially as economic and market conditions change.

This material is being provided for informational or educational purposes only and does not take into account the investment objectives or financial situation of any client or prospective clients. The information is not intended as investment advice and is not a recommendation. Clients seeking information regarding their particular investment needs should contact their financial professional.

Consider a fund's investment objectives, risks, charges, and expenses carefully before investing. The prospectus and summary prospectus contain this and other information about the fund. Contact the PGIM Investments Sales Desk at (800) 257-3893 to obtain the prospectus and summary prospectus. Read them carefully before investing.

Investment products and services are distributed by Prudential Investment Management Services LLC, a Prudential Financial company. QMA, Jennison Associates and PGIM are registered investment advisors and Prudential Financial companies. QMA is the primary business name of QMA LLC. QMA LLC (QMA) a wholly owned subsidiary of PGIM. PGIM Fixed Income and PGIM Real Estate are units of PGIM. ©2021 Prudential Financial, Inc. and its related entities. Jennison Associates, Jennison, PGIM Real Estate, PGIM and the PGIM logo are service marks of Prudential Financial, Inc. and its related entities, registered in many jurisdictions worldwide.

© 2020 Prudential Financial, Inc. (PFI) and its related entities. PGIM, the PGIM logo, and the Rock symbol are service marks of PFI and its related entities, registered in many jurisdictions worldwide.

Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

1049289-00001-00 PI6643 ID 12312021