



MID-YEAR 2026

# GLOBAL MARKET OUTLOOK



**A Tale of Tailwinds  
and Thicker Tails**



All investments involve risk, including the possible loss of capital.

# CONTENTS

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|   |           |
|---|-----------|
| <b>Themes and Investment Implications</b>                 | <b>03</b> |
| <b>A Tale of Tailwinds and Thicker Tails</b>              | <b>04</b> |
| <b>The New Yield Paradigm</b>                             | <b>07</b> |
| <b>Diversification Approaches</b>                         | <b>09</b> |
| <b>The AI Evolution and Fundamentals</b>                  | <b>12</b> |
| <b>Near and Far: The Multi-Asset View Out to 10 Years</b> | <b>14</b> |

# THEMES AND INVESTMENT IMPLICATIONS

## A Tale of Tailwinds and Thicker Tails



The significant effects from the conflict in the Middle East are reflected by thicker left-tail risks in our economic scenario analysis. Yet, the historic AI buildout, global fiscal stimulus, and resiliency of high-end consumers support our base cases for potentially accelerating growth and above-target inflation in the U.S. as well as middling, durable growth in Europe and China.

### Portfolio Considerations

- A constructive base case with prominent tail risks calls for caution on broad-market beta and greater emphasis on alpha opportunities, i.e., relative value, regional, sector, and single-name selections
- Real assets, such as real estate, commodities, and infrastructure, offer a partial hedge against elevated inflation
- Identify resilient regions, countries for emerging market (EM) debt and equity opportunities
- Global growth equities to harness prevailing tailwinds
- High-quality assets and assets offering downside protection can add portfolio ballast if risk scenarios materialize

## The New Yield Paradigm



The repricing in developed market (DM) interest rates marks a transition to a higher yield structure, driven by fiscal concerns, persistent inflation, and resilient growth. Elevated, range-bound interest rates combined with compressed credit spreads indicate an environment where attractive “all-in” yields eventually translate into solid long-term returns. Although credit fundamentals remain solid, issue selection is paramount given valuations and looming tail risks.

### Portfolio Considerations

- Multi-sector fixed income exposure with risk flexibility
- Global bonds for a broader opportunity set and diversification
- Short-duration credit amid monetary policy and inflation uncertainty
- High-quality securitized credit, including asset-based finance and CLOs

## Diversification Approaches



Thicker tail risks underscore the importance of diversification. In private credit, asset-based finance and infrastructure offer non-corporate credit risk with customization and structuring attributes. Direct lending, including credit secondaries, with stringent underwriting can complement public credit exposure while providing flexibility around liquidity preferences.

Real estate offers broad diversification amidst early-cycle conditions, supported by needs-based structural factors (referred to as Everyday Life) and tactical opportunities (referred to as Market Momentum).

### Portfolio Considerations

- Direct lending, including credit secondaries, with stringent underwriting standards
- Public-private credit strategies guided by a flexible relative value framework
- Private real estate, REITs for diversification, inflation protection, and the sector’s early-cycle characteristics

## The AI Evolution & Fundamentals



The effects of the AI buildout will continue to emerge, highlighting the need to identify winners that can capitalize on multi-year opportunities bolstered by innovation, durable competitive moats, and sector leadership.

### Portfolio Considerations

- Global growth equity as AI adoption accelerates
- Private real estate for exposure to the AI-infrastructure buildout

# A TALE OF TAILWINDS AND THICKER TAILS

Our 12-month macroeconomic outlook assesses how AI-driven investment and the Middle East energy shock are reshaping growth and inflation trajectories. While resilient, the U.S. economy faces overheating risks as Europe confronts its energy vulnerability and China balances structural issues with policy support.

Despite the global macro challenges, the U.S. economy remains remarkably resilient. We expect real GDP growth of 2.3% this year, extending the above-trend results and exceeding most advanced economies. U.S. outperformance is driven by the AI buildout, the wealth effect on consumption, and fiscal stimulus. Higher-than-usual tax refunds and a still-low unemployment rate are providing ongoing support to consumers. Wealth effects from rising financial asset prices—driven by the AI ecosystem—continue to power spending among upper-income households, especially in discretionary services.

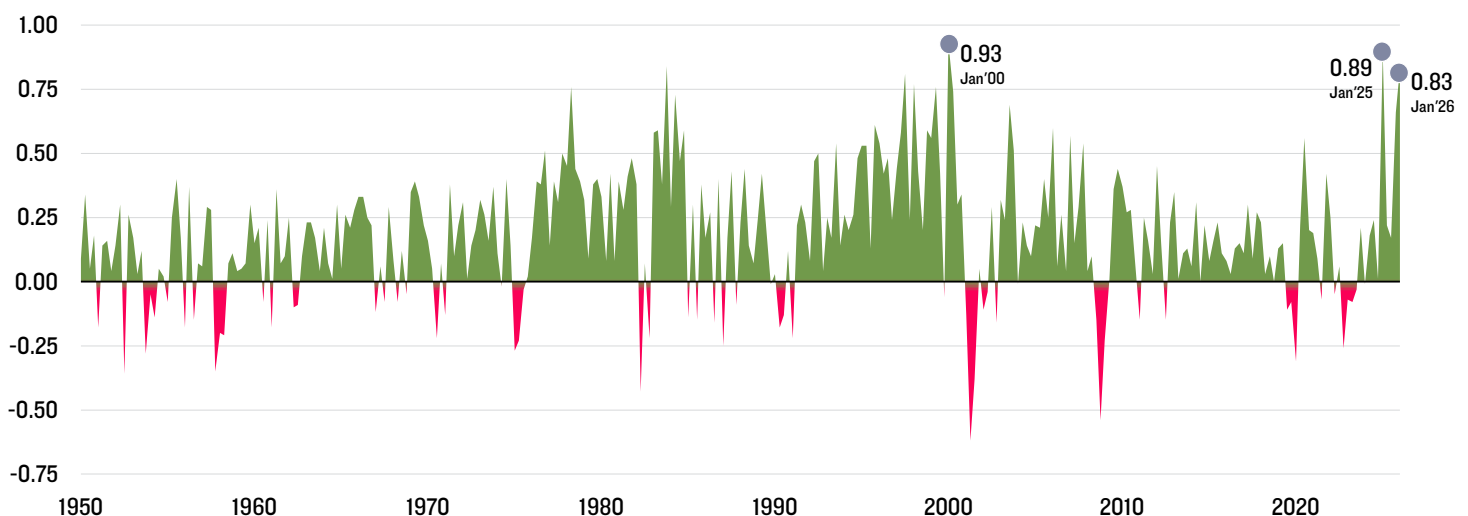
The exponential growth of tech sector capex is boosting economic growth as it approaches levels from the telecom buildout of the late 1990s (Exhibit 1). While AI may eventually lift productivity growth and push inflation lower, the demand-side boom in AI investments is colliding with ongoing supply-side constraints (especially in energy, labor, and trade) and boosting inflation well above the Fed's target.

Indeed, U.S. headline PCE inflation has surged to 3.8% year-over-year as of April amid higher energy prices. Core PCE inflation, which excludes food and energy prices, is also uncomfortably high at 3.3%. We still see the risks to inflation—at least in the near term—as skewed to the upside, for a few reasons. One, the longer the oil shock persists, the higher the risk that elevated energy prices spill over into non-energy products. Our base case (50% probability) for the conflict in the Middle East remains that the war's fragile ceasefire produces a lingering risk premium on Brent crude prices, resulting in a trading range of \$80-100 per barrel. Two, leading indicators of the “pipeline pressure” for consumer inflation, such as the producer price index, remain firm. Three, we see upside risks to goods prices due to pressures from AI capex and the potential for a new round of tariffs.

Our assessment of the labor market is that it is somewhere between stabilization and acceleration. Strikingly, payrolls growth

## Exhibit 1: Tech-related capex nears levels from the telecom era

Business fixed investment in information processing as percentage point contribution to real GDP growth



Sources: PGIM and Macrobond. As of January 2026.

has averaged 188k per month for the last three months, up sharply from 2025, and above all estimates of the “breakeven” job growth required to stabilize the unemployment rate.

These combined factors provide a challenge for Federal Reserve Chair Kevin Warsh. Given this backdrop, and considering that the Fed has missed its 2% target to the upside for more than five years, we expect the Fed will raise rates three times this year to shore up institutional credibility and anchor inflation expectations. Our sense is that there will be political cover if the rate hikes are framed as a “precautionary” solution to supply-side inflation and to recent volatility in long-term Treasuries. We expect the Fed to reverse these hikes relatively quickly with three rate cuts in 2027 and one additional cut in 2028 for a terminal rate of 3.375%—a notch lower than the current rate and likely close to the neutral rate.

So far in 2026, the strength of nominal GDP growth has validated our U.S. economic base case of Overheating (40%, Exhibit 4). That scenario consists of above-trend real GDP growth (2.0-2.5%) and above-target inflation (about 3%). Considering the heightened risk of geopolitical shocks and energy shortfalls, we increased the risk of our Mild Stagflation scenario (from 10% to 15%) and reduced the likelihood of our Muddle Through scenario (from 20% to 15%). We maintain a 10% probability on a Recession scenario, below consensus estimates, alongside a 20% probability on a Productivity Boost outcome, which is one where growth accelerates to an above trend run rate, with inflation descending towards the 2% target.

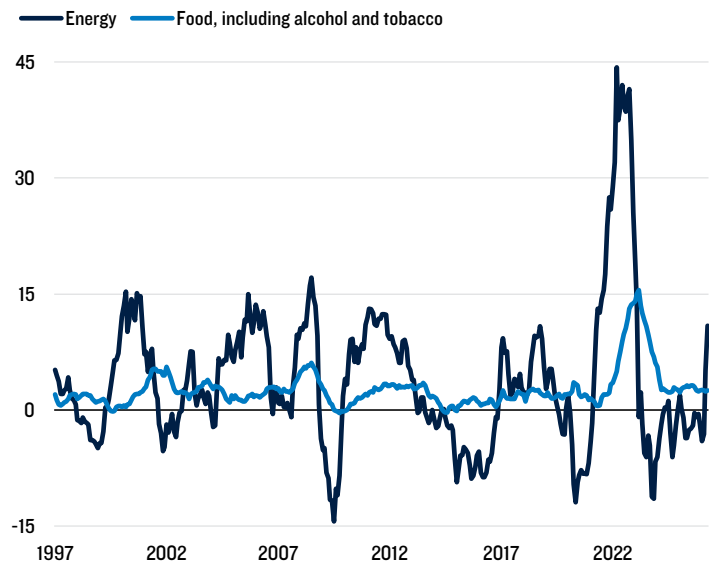
## Europe’s Vulnerable Position

Europe finds itself in a more vulnerable position due to its energy sensitivity, with Italy appearing as the most vulnerable of the major EU economies as reflected in the recent widening of its sovereign spreads over Bunds. In addition to the energy shock, food prices are also likely to climb in the coming months (Exhibit 2), not only from higher energy input costs, but also due to the disruption in fertilizer supply amidst the Strait’s closure.

The combination of rising food and energy prices is expected to add further pressure on households and will likely influence their inflation expectations going forward. When looking ahead, medium-term inflation expectations (three to five years) bear close monitoring as it pertains to the ECB’s response function. At this point, we see ECB rate hikes in June and September taking the deposit facility rate to 2.5% by year end. The energy shock is also eliciting relatively modest fiscal responses across the region—from subsidies to tax cuts—adding to already mounting fiscal pressures from rising defense and infrastructure spending. Higher rates and a squeezed consumer will

## Exhibit 2: The pending rise in euro area food prices

Euro area food and energy inflation; annual percentage change



Sources: PGIM and Macrobond. As of April 2026.

presumably weigh on domestic demand in the euro area, where economic activity was already expected to be fairly sluggish.

The factors above feed into our Muddle Through base case (40%) for the euro area economy. Fiscal support committed prior to the recent crisis in the Middle East is expected to put a floor under growth, especially in Germany. The prominence of the economic risks is reflected in our tail scenarios as we shifted five percentage points (pp) from our Overheating scenario (now 15%) to our Mild Stagflation scenario (now 20%).

## China’s Near-Term Effects and Structural Challenges

The energy shock introduces what may be a manageable near-term development for China given its reserves buffer, a pivot to alternative energy markets, and active rollout of disruption mitigation strategies. Yet, the country continues to grapple with the structural challenges stemming from its deflated property bubble and its pivot to domestically-led consumption. Exhibit 3 shows the prolonged rise in China’s real per capita consumption growth, which turned sharply lower in recent years as the property market repriced.

China’s property market in AI- and tech-centric cities has been showing signs of green shoots, accompanied by resilient high-end consumption. But inventory overhangs in lower-tier cities as well as weak labor market conditions and wage growth in the broader economy remain a drag on overall sentiment and consumption

trends, giving rise to a K-shaped, two-speed economy. China is looking to gradually address the consumption shortfall with structural underpinnings, orienting consumption towards services and new technologies. However, it does not want to boost demand via a fiscally financed consumerist bubble.

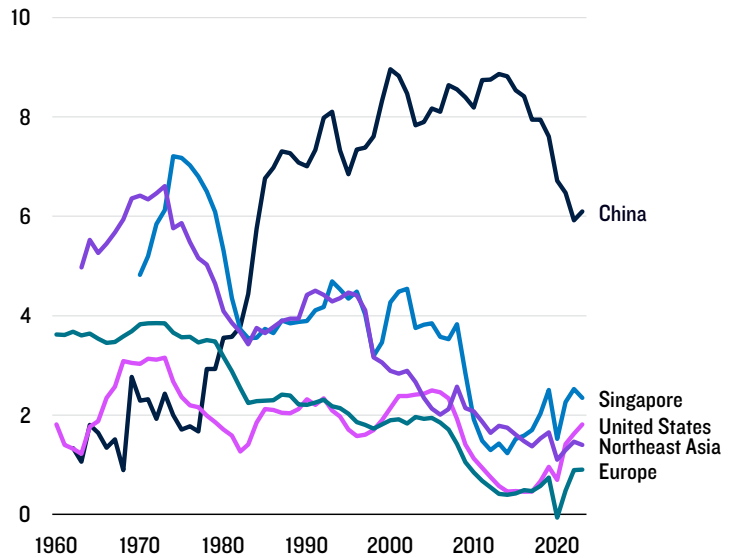
After a strong first quarter, recent retail sales and fixed-asset investment turned noticeably weaker amid anemic credit growth and waning consumer-oriented fiscal support. We expect policy settings to remain accommodative—with more targeted fiscal and monetary easing to become apparent by the July Politburo meeting—to ensure China does not fall short of its growth target.

In our base case, we expect growth in China will continue to benefit from an industrial-policy mix supporting infrastructure upgrades, AI-related capex, continued strength in advanced sectors (e.g., electric vehicles), and clearer fiscal incentives.

The combination of the energy shock, structural domestic challenges, and sizable tailwinds feeds into our Muddle Through base case (now 55%) for China. Given the factors at play, we shifted five pp from the base case into our Mild Stagflation scenario (now 10%).

### Exhibit 3: China's structural challenges have restrained domestic consumption growth

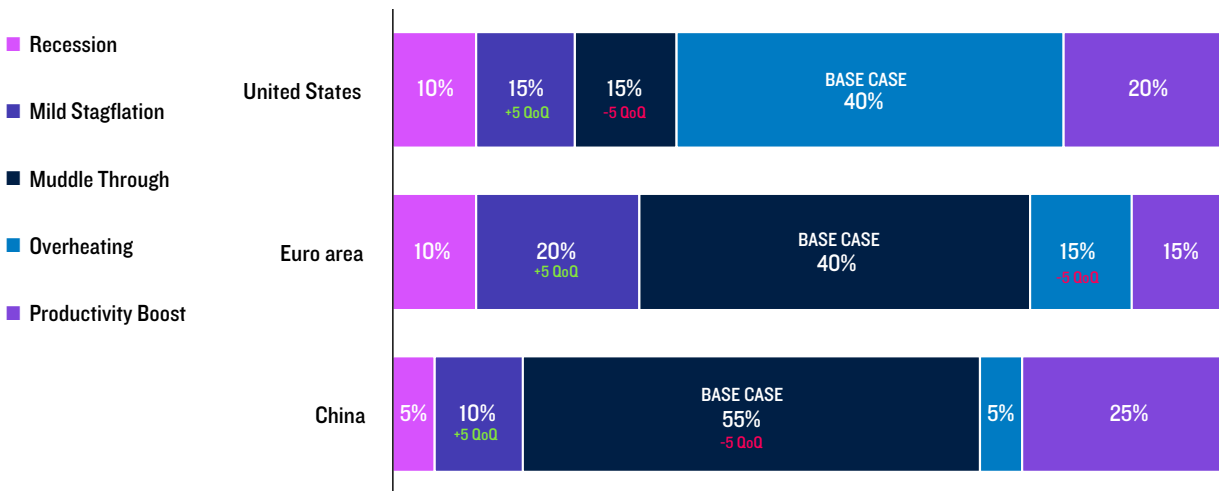
Real per capita consumption growth; 10-year moving average, %



Sources: Penn World Table and Macrobond. As of January 2023.

### Exhibit 4: Mid-year macroeconomic scenarios

Probability, % of 100; quarter-over-quarter change, if applicable, denoted below each data label



**United States:** Our base case involves strong growth. Activity growth is softer in our alternative scenarios, except for the Productivity Boost scenario. Inflation risks are tilted to the upside, with Mild Stagflation the main upside risk. This is due to negative supply shocks related to energy prices, tariffs, and immigration.

**Euro area:** Our base case consists of broadly balanced risks. Upside risks include fiscal expansion, a strong U.S. economy, and the AI-related productivity boom. The main downside risk is the energy shock leading to Mild Stagflation. Inflation risks are tilted to the upside given Stagflation and Overheating risks.

**China:** Our base case is accompanied by growth risks skewed to the upside. U.S.-China trade tensions and the global energy shock are the main downside risks, while policy easing, productivity gains, and U.S. overheating are upside risks. Risks to inflation are tilted to the downside given deflationary forces.

**Emerging markets:** Our base case is Muddle Through (36%), based on a weighted average of the U.S. (35%), Euro area (35%), and China (30%).

Source: PGIM. As of June 2026.

# THE NEW YIELD PARADIGM

## Investing Through the Arc of the Crisis

Once again, geopolitics have come to the fore, creating a swirl of possibilities for the world's economies and shockwaves for the markets. The drama playing out in the Middle East is pushing energy prices higher, exacerbating what is now a widespread problem of perniciously above-target inflation.

As a result of the macro backdrop, traders rushed to price in central bank rate hikes, pushing yield curves higher and flatter. Equities and credit product have nonetheless proved resilient with stocks hitting new highs while, similarly, credit spreads have almost recovered from March's widening, taking them back toward historic lows.

## Rates Selloff: Enough or Not Until Oil Crests?

In the abstract, following the recent rise in rates, most economists and investors would probably see value in the bond market, with the hawkish rate paths now priced in appearing quite aggressive. Indeed, with markets now anticipating 75 bps of hikes over the next year or so in both the UK and euro market, 100 bps of hikes in Japan, and nearly 50 bps of hikes in the U.S., it raises the question of whether yields overshot fair value on the high side.

But there is nothing abstract about the rising price of oil and supply chain shocks aggravated by the situation in the Middle East. As a result, while we're inclined to think the majority of the bad news is priced in and rates are near the top of their new range (Exhibit 5), a stabilization of yields may have to wait for a topping of energy prices and a cresting of inflation risks.

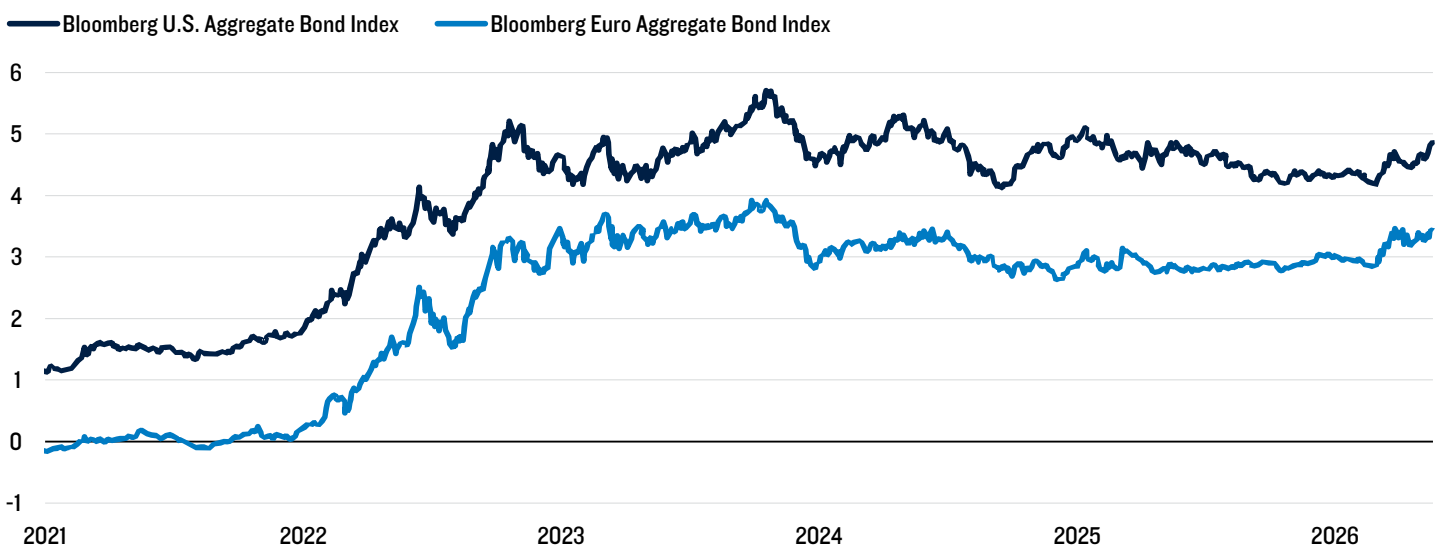
## Credit and the Crisis

It's a bit surprising that after an initial widening in reaction to the outbreak of war, credit spreads have nearly fully recovered, and stocks have rallied to new highs. Are the markets Pollyannish and underestimating the risks, or is there a message in the strong trading behavior to date?

Looking at the bigger picture, periods of risk-off trading since COVID—spread widenings in response to the 2022 rate hikes

### Exhibit 5: The war pushed long-term government rates higher. More to come or opportunity knocking?

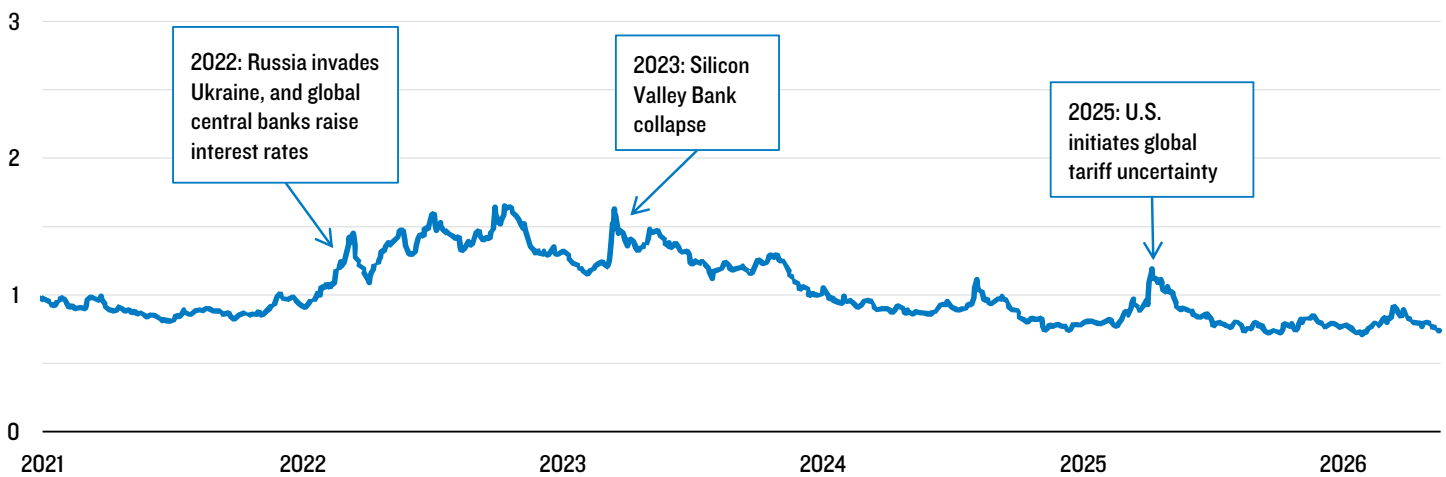
U.S. and European aggregate bond indices yield-to-worst; %



Source: Bloomberg. As of May 19, 2026.

## Exhibit 6: Post-COVID spreads remain resilient—will fundamentals allow credit to come through relatively unscathed?

U.S. investment grade corporate spreads; percentage points



Source: Bloomberg. As of May 21, 2026.

and the Russia-Ukraine conflict, 2023's Silicon Valley Bank collapse, 2025's tariff developments—have been progressively mild, with each successive crisis having less of an adverse impact on the market than the last.

Our working assumption is that, in the wake of COVID, credit fundamentals are not only strong, but also fairly resilient to shocks. As investors catch on to this fact, each successive event experiences a shorter, shallower risk-off dip, followed by a speedier recovery (Exhibit 6), raising the possibility that credit markets may weather the unfolding Middle East crisis relatively unscathed.

### Wait and See

If the Russia-Ukraine conflict is any indication of modern warfare, we could be in for an extended period of uncertainty surrounding the Middle East conflict as well as the economy and markets, leaving substantial upside and downside risks surrounding our outlook.

### Yields in the Strategic Buy Zone

As we noted in late 2022—when yields first returned to their currently higher, but historically normal range—over the long run, yield is, more or less, destiny. On that point, the Middle East conflict has, in our view, pushed yields up to attractive levels. So, while it's difficult to know when we've passed the peak of the current crisis in terms of yields and volatility, we are guardedly optimistic that most of the increase in rates is likely behind us. In that event, the market is well poised from current respectable yield levels to deliver solid returns in the years ahead.

[READ THE FULL FIXED INCOME VIEW](#)

# DIVERSIFICATION APPROACHES

## Private Credit's Diversification Attributes

Our mid-year 2026 outlook across private credit remains constructive, underpinned by persistent investor demand and healthy borrower supply. Defying headlines, credit fundamentals have been stable to improving in many private market sectors.

While uncertainties permeate the economic outlook—and thus the outlook for credit—we continue to see strong demand for the customization and structuring provided by private credit. While capital formation may have slowed in certain segments of the direct lending space, there is no slowdown in capital being allocated to the ABF and infrastructure debt markets.

The market's reaction to concerns around creative destruction in software will be to seek out less volatile, old-economy assets and industries. Indeed, the acronym “HALO” (heavy assets, low obsolescence) has emerged to reflect a newfound respect for these borrowers. In corporate markets (e.g., direct lending, private placements), this will likely mean more industrial issuance at the expense of asset-light businesses in technology and financial services. In asset-based markets, we will likely see more companies utilizing their hard assets, receivables, and inventories to finance their operations more efficiently. As a result, the heavy infrastructure investment needed by the global economy will be met with more eager buyers. All else equal, debt of these borrowers and assets may outperform that of asset-light companies whose sensitivity—particularly on the downside—to AI-related disruption is less certain.

The ABF and infrastructure markets are likely to be major beneficiaries of these trends. We see opportunity in both land banking—with scaled, high credit quality sponsors—and residential mortgage finance given that the structural housing shortage in the U.S. should support performance through the cycle.

Likewise, assets financing home improvement and manufactured housing are also attractive. Demand for digital infrastructure and energy transition projects should also remain considerable among investors, and funds continue to raise capital to deploy across these sectors.

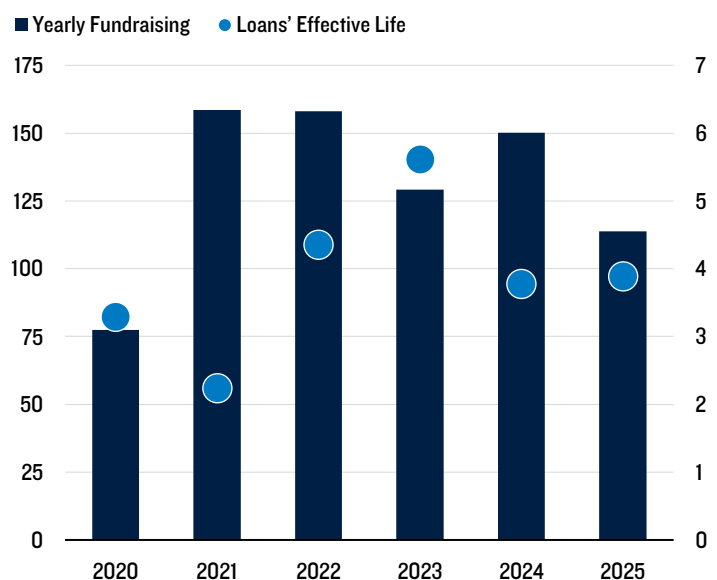
We are constructive on direct lending, though valuations in the first half of the year will produce unimpressive returns. Weighted average deal life has begun to fall after extending considerably between 2022 and 2024 (Exhibit 7). As deals

continue to realize and average deal life continues to decline, recent downward price gaps will be crystallized or recovered. Broadly speaking, competition for deal flow may be reduced as weak returns will limit some investors' ability to raise new funds.

Given the direct lending cycle at play, overall demand for the 2026 vintage is likely to be strong, particularly among managers with stringent underwriting standards. On balance, and especially in the core middle market, terms and spreads are now meaningfully stronger and wider than they were two to three years ago. Hence, investor capital will likely be rewarded with solid returns for this vintage of new loans. We are comfortable with base rates in the current range. A rapid, significant move in either direction would suggest an environment in which our view could become more defensive.

### Exhibit 7: Moderating direct lending fundraising may add to market discipline

Left: yearly fundraising, USD billion. Right: loans, effective life, years



Source: S&P Global, WithIntelligence. As of April 2026.

## Real Estate's Resilient Income and Diversification

Real estate is well positioned in an environment of elevated global economic and geopolitical uncertainty, providing investors with the opportunity to invest in assets with inflation-linked income at relatively low values after the big market correction in recent years.

Low supply growth across the board means that real estate occupancy rates are set to remain elevated regardless of economic outcomes, adding to cash flow predictability (Exhibit 8). Concern that higher short-term market interest rates persist is holding back liquidity. However, in turn, this creates opportunity to finance or acquire assets at attractive valuations and position portfolios to capture future cyclical upside.

Among global investors, diversification is returning to prominence. This relates to two main factors. First, there is a high degree of unpredictability in how global events will play out, making it wise to spread exposure to avoid strategic or geographic concentration risk. Second, differences in the drivers of market, regional, and sector returns—as well as forecast outcomes—have widened, so the benefits of holding a diverse portfolio—and the potential for outperformance from effective portfolio allocation—are rising.

### Structural and Tactical Pillars

Our strategic allocation tilt across real estate equity and real estate credit strategies is firmly toward assets tied to basic needs demand, providing a defensiveness and resilience to underlying cash flows. This first, structural investment pillar is Everyday Life: development, financing, and ownership of the types of real estate that form the foundation of cities and metropolitan

areas around the world. In other words, providing spaces for households to live, source essential goods, and meet growing data and connectivity requirements.

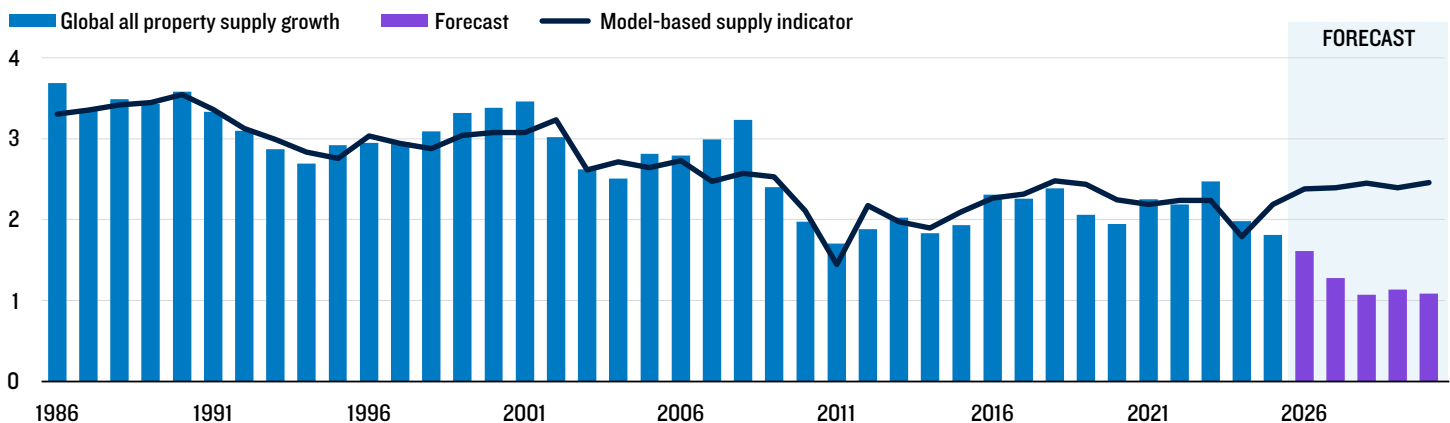
The second pillar is more tactical in nature and linked to areas where we see favorable Market Momentum. Cyclical upside potential, low entry values, and ongoing capital needs connected to refinancing and capex requirements support opportunities to drive returns through value creation over time. However, near-term market headwinds imply a need for selectivity in pursuing such opportunities in today's market.

### Everyday Life

The most important sector for Everyday Life investing—living—is expansive. The way to play living can vary significantly across and within global regions. There are some universal threads, though: stretched ownership affordability, shortages of modern housing stock in major cities, and rising numbers of students and seniors that need more specialized accommodation provision. In addition, the effects of technology and rising productivity on the labor market are creating winners—for whom rising incomes and wealth drive demand for lifestyle accommodation—and losers—for whom job displacement and slower wage growth increase the importance of affordable housing provision.

### Exhibit 8: Historically low supply pipeline points to ongoing shortages of grade-A space

Net additions to global all property supply growth versus Construction Attractiveness Index; % per year



Sources: CoStar, JLL, PMA, Oxford Economics, Bureau for Labor Statistics, World Bank, and PGIM. As of April 2026.

Note: Construction Attractiveness Index is estimated using a regression that includes real global construction costs (three-year lag) and real prime global all property rents (two-year lag). Forecast is from 2026-2030.

Senior housing is a high-conviction strategy underpinned by an imminent wave of growth in the 80+ population segment across most developed markets, as well as a strong rental growth outlook backed by existing low vacancy and a limited supply pipeline (Exhibit 9). The U.S. remains the main investment market globally, but opportunities to establish and scale operating platforms in less mature markets in Europe and Asia Pacific are becoming increasingly attractive.

Apartment and multifamily strategies face more near-term execution headwinds amid elevated building costs. But in the U.S., there is still a legacy of excess apartment supply to work off, pointing to a relative attractiveness of credit opportunities for now, including bridge-to-agency lending strategies. Higher-rent U.S. submarkets are outperforming, supported by productivity and wage growth in major cities. Multifamily rental growth forecasts in Australia, Japan, and core continental Europe are supported by low vacancy rates and expanding urbanization-related demand.

High-density living concepts, such as student accommodation and co-living, offer a route to improved development feasibility and, importantly in Europe, are not as closely bound by rent controls, allowing stronger rental growth underwriting. U.S. manufactured housing offers attractive risk-adjusted returns supported by a low capex burden, which is attractive in a volatile cost environment.

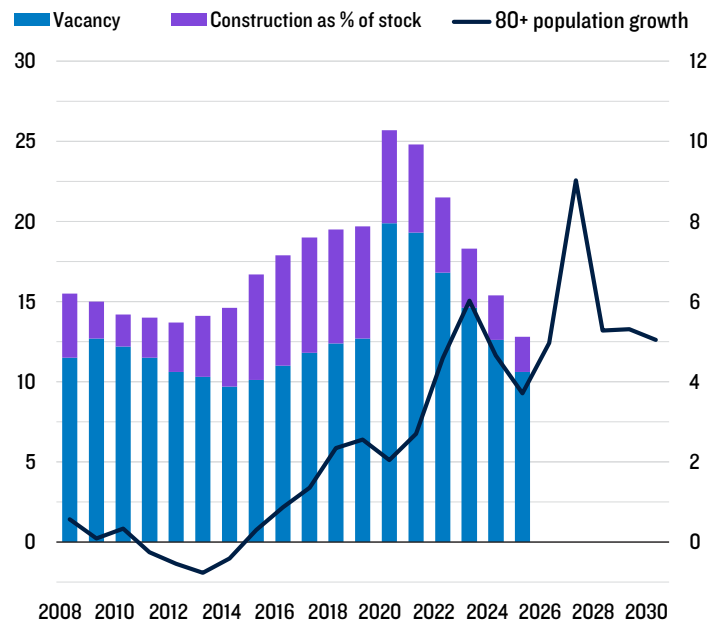
Alongside living, urban infrastructure also offers opportunities, including necessity retail and medical outpatient facilities in the U.S. Urban logistics still offers a strong demand story in most parts of the world amid a shortage of modern facilities in and around major cities. Low-latency data center rental growth is poised to remain elevated. Cloud and AI-related needs are driving a sharp increase in demand, while supply is constrained by power availability, planning restrictions, and network bottlenecks.

## Market Momentum

Cyclical real estate strategies show greater variation in theme around the world across both equity and credit perspectives. Hotels look attractive in Europe and Asia Pacific as tourism rebounds. Markets such as Australia, Italy, Japan, Singapore, and Spain are well positioned to capture further cyclical upside. There

### Exhibit 9: Limited senior housing availability set to persist against rising demand

U.S. senior housing supply (left axis) compared to senior population growth (right axis); %



Sources: NIC, Oxford Economics, and PGIM. As of June 2026.

is also an opportunity to modernize Europe's smaller hospitality platforms, including in the open-air hospitality segment.

Among commercial sectors, modern logistics represents an opportunity in major Asia-Pacific distribution markets, as supply chain reconfiguration creates demand; in Mexico, as manufacturing reshoring toward North America continues; and in the U.S., where larger unit vacancy has compressed, pointing to renewed rental growth potential.

Office opportunities fall into two groups. The first relates to rental growth potential as occupiers compete for scarce grade-A space in high-value, tight-supply central business district markets, primarily in Europe and Asia Pacific. The second, notably in both Europe and the U.S., is where this thesis doesn't hold and well-located existing office assets can be converted into alternative uses, notably living and hotels.

[READ THE FULL REAL ESTATE VIEW](#)

# THE AI EVOLUTION AND FUNDAMENTALS

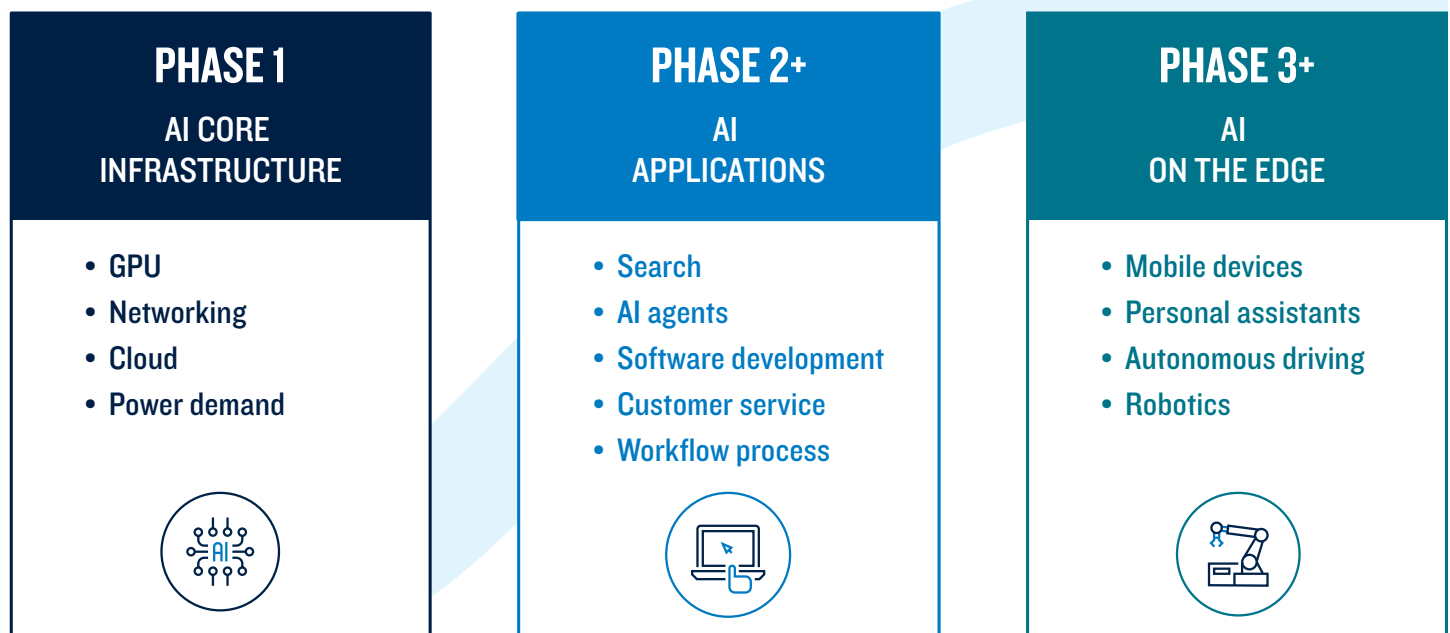
## Finding Quality Across Key Drivers

Equity markets appear poised to extend their gains beyond the first half of 2026, with leadership increasingly tilting toward growth as earnings momentum continues to validate AI-driven demand. Looking ahead, companies with durable competitive advantages, expanding margins, and leveraged exposure to structural growth—particularly AI infrastructure and power solutions—are likely to remain key drivers of market performance.

Equity markets generated solid returns through most of the first half of 2026, though the path was marked by meaningful volatility and sector rotation. The first quarter was dominated by geopolitical risk stemming from the Middle East conflict and resulting disruptions to the Strait of Hormuz, which sharply constrained global oil supply and drove energy prices higher even as headline CPI remained relatively stable. These dynamics led markets to reprice Federal Reserve policy expectations, with fewer rate cuts now anticipated through 2026, and triggered a defensive rotation toward commodity-sensitive sectors and away from growth equities.

Since the end of the first quarter, the market environment shifted back in favor of growth equities, with a strong earnings season rewarding companies demonstrating durable demand, margin expansion, and clear forward visibility. Despite ongoing geopolitical noise, the strength and breadth of earnings drove market returns. Earnings validated the fundamental investment theses: AI infrastructure, power demand, and advanced semiconductors reinforce the durability of underlying demand and provide continued leadership across these areas.

Exhibit 10: Potential sources of alpha along the S-curve



Source: Jennison. For illustrative purposes only.

Looking ahead, the remainder of 2026 will likely be shaped by several fluid macro factors: the future status of replacement tariffs implemented following the Supreme Court's rejection of initial levies, upcoming midterm elections in November, and the broader geopolitical backdrop.

Our investment approach remains focused on identifying companies that can capitalize on multi-year structural opportunities founded on unique products, differentiated innovation, durable competitive moats, and positions of market leadership. While near-term performance may remain influenced by macro conditions, we believe that over longer time horizons, equity market returns will be driven primarily by earnings growth and underlying business fundamentals. This dynamic should be particularly evident in AI-driven and structurally advantaged areas.

In our view, artificial intelligence remains the most important driver across global equity markets. Leading AI-focused companies deployed substantial capital in 2025, and capital expenditure remains historically strong in 2026. By 2030, global data center capacity demand is expected to increase significantly, while AI-specific capacity could account for the vast majority of total data center demand by decade end. This expected buildout is accelerating the shift toward chiplet-based architectures, tighter system-level integration, and broader design innovation to address power, bandwidth, and yield constraints.

This backdrop continues to support robust demand for advanced logic semiconductors, high-bandwidth memory, and networking silicon. Importantly, hyperscaler cash flow is funding the bulk of the buildout; financing constraints are not currently a material issue, and both capital expenditure and AI product demand are accelerating. The fundamental driver is compute intensity, which remains insatiable as token volumes and model complexity continue to grow.

The AI opportunity is evolving across three distinct monetization phases (Exhibit 10). Phase 1 encompasses core infrastructure—GPUs, networking equipment, cloud infrastructure, and power generation—which is currently seeing the heaviest investment. Phase 2 represents applications and software, including search enhancement, AI agents, software development tools, customer service automation, and workflow optimization. Phase 3 covers AI on the edge: mobile devices, personal assistants, autonomous driving systems, and robotics, representing longer-term frontier opportunities.

One of the most important emerging trends is the shift from single-shot AI interactions to more complex, multi-step agentic workflows. Token intensity (i.e., the amount of compute consumed per user interaction) is rising sharply as models become more capable and use cases become more complex. Anthropic's research on building effective agents highlights a transition from traditional chatbot-style interactions to workflows involving prompt chaining, routing, parallelization, orchestrator-worker structures, and tool use.

While much attention has focused on semiconductor supply and cloud infrastructure, the most binding constraint in the AI buildout is now reliable electric power. In the U.S., a structural shift is underway as power demand inflects higher, driven largely by the proliferation of data centers needed to support AI workloads. This demand shock is pushing traditional power generation back to the forefront, especially gas-fired capacity. To meet the surging demand, the use of gas turbines is accelerating, yet supply is constrained by structural bottlenecks. The heavy-duty gas turbine market is highly concentrated, with three major providers dominating global supply. Manufacturing slots are already reserved several years out, with backlogs reportedly extending well into the late 2020s and some delivery timelines being discussed as far out as 2030. Even at full operational capacity, the top three gas turbine providers are unable to supply enough incremental power to keep pace with the escalating needs of AI data centers. This structural shortfall creates a clear opening for alternative power solutions, including distributed generation and fuel cells.

AI is best understood not as a software-led theme, but as a full-stack capital cycle spanning semiconductors, networking, data center buildout, power generation, distributed energy, cloud platforms, and application-layer technologies. The shift toward more agentic AI architectures reinforces the view that infrastructure intensity will continue to rise, with compute and energy demands increasing on a per-interaction basis. Within this stack, power has emerged as the most binding constraint, positioning companies that can deliver incremental generation capacity across gas, grid equipment, and distributed solutions as critical enablers of the next phase of growth. As a result, AI infrastructure remains in a sustained supercycle, with capital deployment broadening across the ecosystem and demand durability extending beyond current expectations.

[READ THE FULL FUNDAMENTAL EQUITY VIEW](#)

# NEAR AND FAR: THE MULTI-ASSET VIEW OUT TO 10 YEARS

Our multi-asset, quantitative perspective for the second half of 2026 frames an investment environment that remains supportive of risk assets, though increasingly shaped by persistent inflation, geopolitical tail risks, and shifting cross-asset dynamics. The key implication for investment strategy is not a weakening growth backdrop, but a transition to an environment where inflation remains elevated.

Resilient global growth driven by fiscal expansion, still-accommodative financial conditions, and a structural AI-led investment cycle continues to sustain corporate earnings and supports exposure to equities and other pro-cyclical assets. Our quantitative regime indicator signals risk-on. However, growth remains uneven, especially in the U.S. This suggests favoring assets tied to structural capex and productivity gains over those reliant on general consumer strength. Still, our recession sentiment and unemployment attentiveness indicators remain benign.

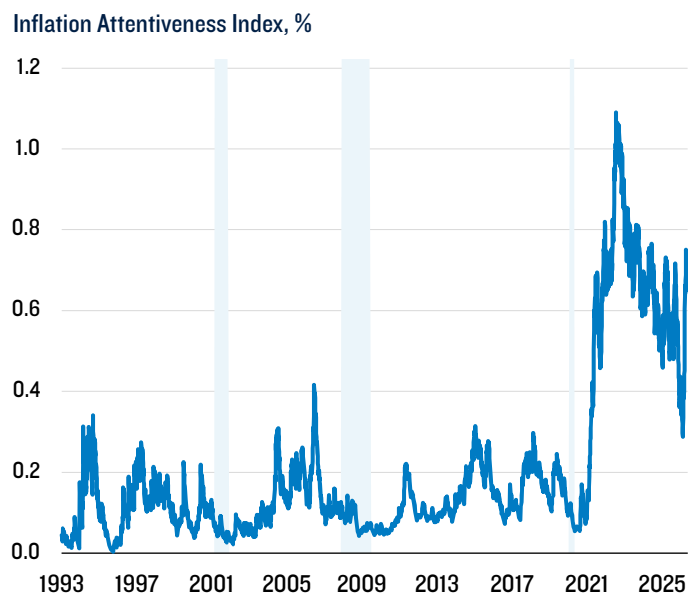
A shift in the outlook has been the re-emergence of inflation as the dominant macro driver. The Middle East conflict has reintroduced upside inflation risks at a time when disinflation was expected to continue. As a result, monetary policy expectations have been repriced, with the anticipated rate-cutting cycle scaled back and policy likely to remain above neutral for longer. Indeed, our quantitative inflation attentiveness and central bank tone indicators suggest an increased focus on inflation (Exhibit 11).

For asset allocation, this creates a more challenging backdrop and one that calls for more tactical asset allocation. Bonds may provide less of the diversification benefits seen in prior cycles, particularly if inflation stays elevated and central banks remain cautious. This increases the importance of tactical asset allocation, with a bias toward shorter-duration positioning. Policy uncertainty, including around Federal Reserve leadership, adds further questions to the rates outlook.

In equities, gains are increasingly driven by earnings rather than multiple expansion. Strong productivity growth, especially in the U.S., is sustaining margins and profit growth despite rising costs. These support maintaining equity exposure, but with greater tactical selectivity. Elevated valuations, especially in developed markets, limit re-rating potential and increase sensitivity to macro shocks.

Commodities remain a key portfolio component. In an environment of elevated inflation, geopolitical uncertainty, and resilient demand, they offer both attractive carry and an effective hedge against inflation and supply-side disruptions. Their strong relative performance reinforces their role as an

**Exhibit 11: Our inflation attentiveness index reflects the rise in upside inflation risks**



Sources: Bloomberg and PGIM. As of May 18, 2026. Shaded areas indicate recession periods.

important diversifier as traditional hedging relationships show signs of weakening.

Emerging markets present opportunities for investors in the second half of 2026. While higher energy costs may weigh in the near term, the broader backdrop remains constructive, supported by improving policy frameworks, solid earnings growth, and continued fiscal support in China.

Finally, changing cross-asset correlations carry important portfolio implications. The shift to a positive stock-bond correlation challenges traditional diversification, increasing the need for alternative hedges, such as commodities. At the same time, a persistently negative dollar-equity correlation underscores the value of currency hedging, particularly during periods of dollar volatility driven by shifting rate expectations and geopolitical risk.

[READ THE FULL MULTI-ASSET VIEW](#)

PGIM's mid-year 2026 Capital Market Assumptions (CMAs) provide a 10-year outlook for returns, volatility, and portfolio positioning across asset classes. Our latest report reflects a macro environment shaped by resilient global growth, elevated geopolitical risks, and higher, but stabilizing, inflation.

## Macroeconomic Backdrop

Global growth remained solid entering 2026, led by the U.S. and supported by strong capital expenditure tied to AI and productivity trends. However, geopolitical tensions, particularly the conflict involving Iran, triggered a temporary spike in oil prices, increasing inflation pressures. U.S. CPI rose to 3.3% in March 2026, though core inflation remained more moderate around 2.6%. Over the long term, we expect inflation to stabilize near 2.5% in the U.S. and slightly lower in developed markets.

## 10-Year Return Expectations

Expected returns have increased modestly versus our first-quarter views due to improved valuations—following equity market declines—and higher starting yields for fixed income. Below are our estimated returns for a host of asset classes.

### Equities

- U.S. large cap: ~6.5%
- Developed ex-U.S.: ~7.2%
- Emerging markets: ~7.9%

We expect equity returns to benefit from better valuations, but to remain constrained by modest economic growth and still-elevated U.S. valuations.

### Fixed Income

- U.S. aggregate bonds: ~4.9%
- U.S. Treasuries: ~4.3-5.2% depending on maturity
- High yield: ~5.9%

Higher starting yields and improved credit assumptions support more attractive outlooks compared with prior years.

### Real Assets

- REITs: ~6.6-6.8%
- TIPS: ~4.9%
- Commodities: ~3.5%

### Private Markets

- Buyout private equity: ~9.1%
- Venture capital: ~9.6%
- Direct lending: ~7.8%
- Private real estate: ~7.7-9.1%

We see a traditional 60/40 portfolio delivering between 6.4-6.6% annually, reflecting improved bond yields and moderate equity gains.

## 10-Year Investment Considerations and Positioning

- Overweight international equities relative to U.S. equities, due to more attractive valuations and better relative return prospects
- Overweight fixed income relative to equities, given improved yields and diversification benefits
- Increase allocations to private assets, particularly buyout equity, direct lending, and real estate, for enhanced returns and diversification

Across model portfolios, allocations have shifted away from U.S. large-cap equities toward international and emerging markets. Fixed income exposure has increased, while commodities exposure has declined slightly.

## Risk and Uncertainty

We use simulation modeling to account for macro uncertainty, showing wide ranges around expected returns. Downside risks include prolonged inflation, geopolitical instability, and slower global growth, while upside scenarios are tied to stronger productivity gains and easing inflation.

## Steady-State Outlook

Over very long horizons, returns are expected to converge toward higher equilibrium levels, with global equities near 8% and a 60/40 portfolio near 7%. This reflects normalized valuations once current distortions fade.

## Bottom Line

The mid-year 2026 CMAs highlight a more balanced investment environment than recent years, with improved fixed income returns, moderate equity upside, and continued advantages for global diversification and private markets in long-term portfolios.

[READ THE FULL 10-YEAR CMA](#)



Source(s) of data (unless otherwise noted): PGIM as of June 2026.

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