PGIM

Q4 25

FIXED INCOME OUTLOOK

October 2025

Select a page to jump ahead.

	Total Returns (%)				
Individual FI Sectors	Q3 '25	YTD	2024	2023	2022
EM Hard Currency Sovs.	4.75	10.79	6.53	11.09	-17.78
U.S. Long IG Corporates	3.79	7.56	-1.95	10.93	-25.62
Municipal Bonds	3.00	2.64	1.05	6.40	-8.53
U.S. IG Corporate Bonds	2.60	6.88	2.13	8.52	-15.76
U.S. High Yield Bonds	2.54	7.22	8.19	13.45	-11.19
Long U.S. Treasuries	2.49	5.64	-6.41	3.06	-29.26
Mortgage-Backed (Agency)	2.43	6.76	1.20	5.05	-11.81
EM Local (Hedged)	2.03	6.54	3.77	7.60	-8.85
European High Yield Bonds	1.83	4.17	9.14	12.78	-11.13
CMBS	1.75	6.32	4.68	5.42	-10.91
U.S. Leveraged Loans	1.68	4.69	9.05	13.04	-1.06
U.S. Treasuries	1.51	5.36	0.58	4.05	-12.46
European IG Corporate	0.94	2.76	4.74	8.19	-13.65
European Leveraged Loans	0.90	3.30	9.17	13.53	-3.36
EM Currencies	0.74	11.25	-1.08	8.44	-7.14
Multi-Sector					
U.S. Aggregate	2.03	6.13	1.25	5.53	-13.01
Global Agg. Hedged	1.21	4.05	3.40	7.15	-11.22
Global Agg. (Unhedged)	0.60	7.91	-1.69	5.72	-16.25
Euro Aggregate (Unhedged)	0.17	1.01	2.63	7.19	-17.18
Yen Aggregate	-1.43	-3.98	-3.07	0.51	-5.30
Other Sectors					
S&P 500 Index	8.12	14.83	25.00	26.29	-18.11
SOFR	1.11	3.34	5.40	5.18	1.66
U.S. Dollar (DXY Index)	0.93	-9.9	7.10	-2.11	8.21

Past performance is not a guarantee or a reliable indicator of future results. See Notice for important disclosures and full index names. All investments involve risk, including possible loss of capital. Sources: Bloomberg except EMD (J.P. Morgan), HY (ICE BofA), Bank Loans (S&P UBS). European returns are unhedged in euros unless indicated. Performance is for representative indices as of September 30, 2025. An investment cannot be made directly in an index.

KEY CONVICTIONS & INVESTMENT THEMES

1 **Strategic Buy Zone for Fixed Income:** The 2022 bear market lifted yields to levels not seen for more than a decade, positioning fixed income markets—particularly the higher-yielding sectors—for solid, long-term returns. The Fed's return to easing mode should add momentum to this unusual bull market. Bottom line: fixed income is positioned for solid returns, and if serious downside risks materialize, it should also provide a counterweight to risk assets in portfolios.

2 **Bond Bull Market of Distinction:** The post-COVID market has been one of powerful cross currents—ranging from geopolitics and trade tensions to monetary and fiscal policies—resulting in notable performance dispersion across the global public and private credit spectrum. The dispersion is a stark reminder that just buying bonds and assets won't do; success hinges upon positioning in the right parts of the yield curve, in the right sectors, and in the right currencies.

3 **Look Through the Noise to Find the Fundamental Signal:** As participants struggle to chart a course amidst the cascade of headlines, markets have been prone to dramatic overreactions and directional corrections. The lesson for investors is clear: don't confuse extreme market movements with changes in fundamentals. Rely on in-depth research and credit underwriting to distinguish market spasms from true changes in underlying value and capitalize on reversions back to fundamentals.

UNUSUAL TIMES, UNUSUAL BULL MARKET

The last few years have seen plenty of volatility in the realms of geopolitics, policy, and—notably for investors—economic data. The trajectory of U.S. data has been particularly unstable with months of uncomfortably hot growth or inflation followed by months of cold conditions. But across most developed markets, things seem to keep pointing to one outcome: a "muddle through" scenario characterized by low to moderate growth with mildly-sticky inflation, especially at the core level (see the Economics section for our global 12-month scenarios**).**

The "Yield is Destiny" Bull Market Continues

All of the above has worked for the fixed income markets. The 2022 selloff left yields at respectable levels—which largely remain intact—with an unusual net result: a potentially long-lived bull market primarily driven by the accretion of income, rather than a short bull market fueled by a quick drop in yields (Figure 1). The trend of compressing credit spreads should generally continue, albeit more modestly given the tight spread levels. These conditions describe "a carry market" if there ever was one.

Shifts in Economic Data and Yield Curve Dynamics

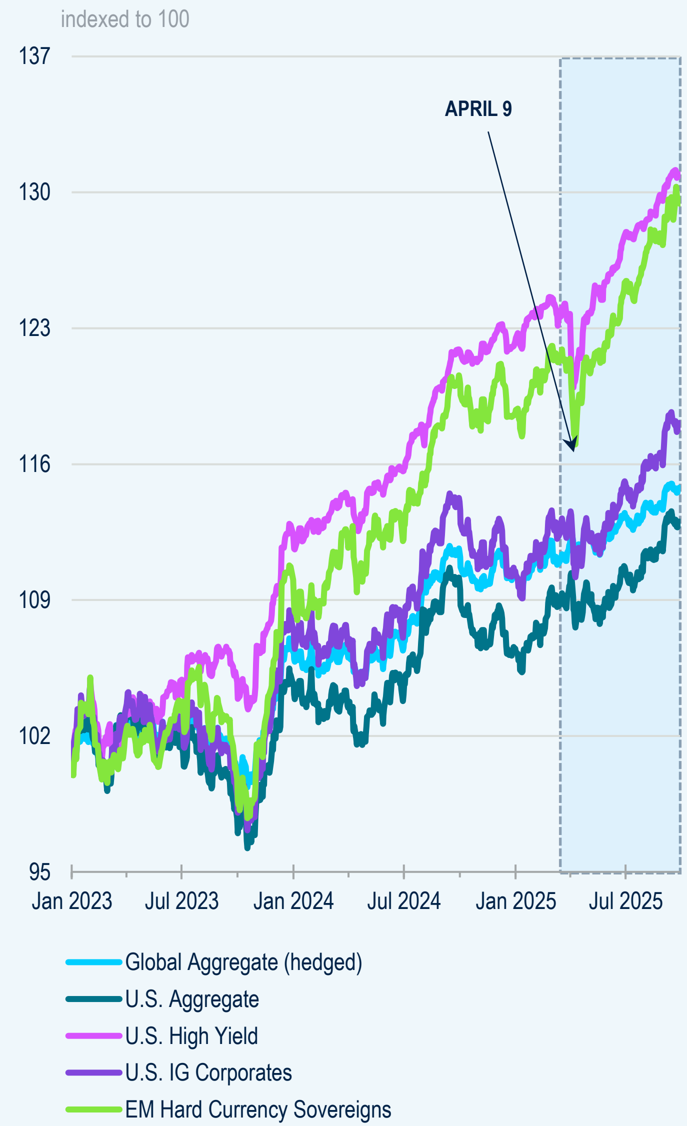
In contrast to the first half's broken yield curve dynamics—when short-term yields fell and long-term yields rose—things have changed in the home stretch of 2025. Yes, yield curve steepening seems likely to continue (see DM Rates section). But long yields are now moving along with short rates and clearly seem past their peak in the U.S., which carries bullish implications for other Western markets given the influence of the U.S. market on cross-market correlations. What's changed?

When Bonds are Backwards, Negatives can be Positives

Two negative developments may bring about the only thing bond investors like as much as high yields—and that's falling yields. The first is the potential for a Federal Reserve capture scenario (see our spotlights on Nixon-Burns and a Fed Capture in Three Acts) where the management motif at the Fed takes a markedly more dovish tack, resulting in a short-rate decline of 100 bps or more relative to prior expectations. Bottom line, while we can debate the longer-term inflationary impact of such a scenario, the short-to-intermediate term implication would likely be a lower and steeper yield curve, turbocharging the bond bull market over the intermediate term.

The second negative-positive development, if you will, is the downshifting in the U.S. employment picture. With Q4—and a partial shutdown of the Federal government—underway, the latest U.S. ADP employment numbers exposed a job market that may be contracting, rather than expanding. The notion of a weaker labor market was echoed

Figure 1: Yield and carry keeps the Bull Market running with the highest yielding sectors likely posting the highest returns.



Source: Bloomberg

in the Challenger survey's hiring intentions for September, which showed a shortfall of several hundreds of thousands vs. the past two years. The Challenger survey being another non-government source of economic data now of elevated importance given the data void during the government shutdown.

Forget about Fed capture; a sustained labor downshift of that magnitude could easily prompt Fed funds pricing to drop from the current expected terminal rate in the 3% area—estimated to be in the neutral range—into the more accommodative 2% realm.. In addition to the bullish implications for the entire U.S. yield curve, this shift also brings marginally bullish ramifications—at the very least—for other Western and EM markets.

Spread Products' Expected Boost: Modest, but Still Positive

Although spreads remain tight, we expect positive technical and fundamental factors to support continued incremental excess returns from both public and private credit products (see the following credit market outlooks).

And Speaking of Positive Technical Factors...

Somewhat shockingly, despite the strong flows into both equity and bond funds, money market assets continue to rise—by nearly $300 billion in Q3—placing them not only at an absolute record, but at historically high levels relative to GDP. The substantial money market balances represent

Figure 2: Yield-curve plays may have a smaller role ahead, but cross-market tactical opportunities, like the rate differential between U.S. Treasuries and German bunds, remain. Although the direction of Western rates is generally highly correlated (top panel), the relative spread between them is fluctuating widely and rapidly (see lower panel boxes) amidst volatile, but mean reverting, economic data. These fluctuations enhance cross-market trading opportunities.

Source: Bloomberg

a massive potential source of demand that could begin to shift into stocks and fixed income if and as cash rates fall (Figure 3).

What Could Possibly Go Wrong? Starting with the Macro…

Distribution tails are thick, not only on the downside in a world of fraught geopolitics and trade tensions, but similarly on the upside if a Fed capture scenario ensues—i.e., possibly positive over the near to intermediate term, but risky longer term. Hence, we remain vigilant. Yet, these potential developments are lower-probability scenarios, and, ultimately, we are guardedly optimistic regarding our base case—global muddle through scenarios—which should be well enough for the fixed income markets.

Micro Volatility: More Opportunity than Risk

This environment continues to challenge investors and analysts alike. Similarly, it continues to create distortions in the interest-rate, sector, issuer, and currency realms, resulting in risks, but also continued opportunities for adding value through active management across the public and private asset spectrum.

Bottom line

The yield-is-destiny theme continues to be driven by the generous yields across markets and may pick up steam if U.S. economic weakness or a Fed capture scenario adds to the downward pressure on rates.

Fed Capture in Three Acts

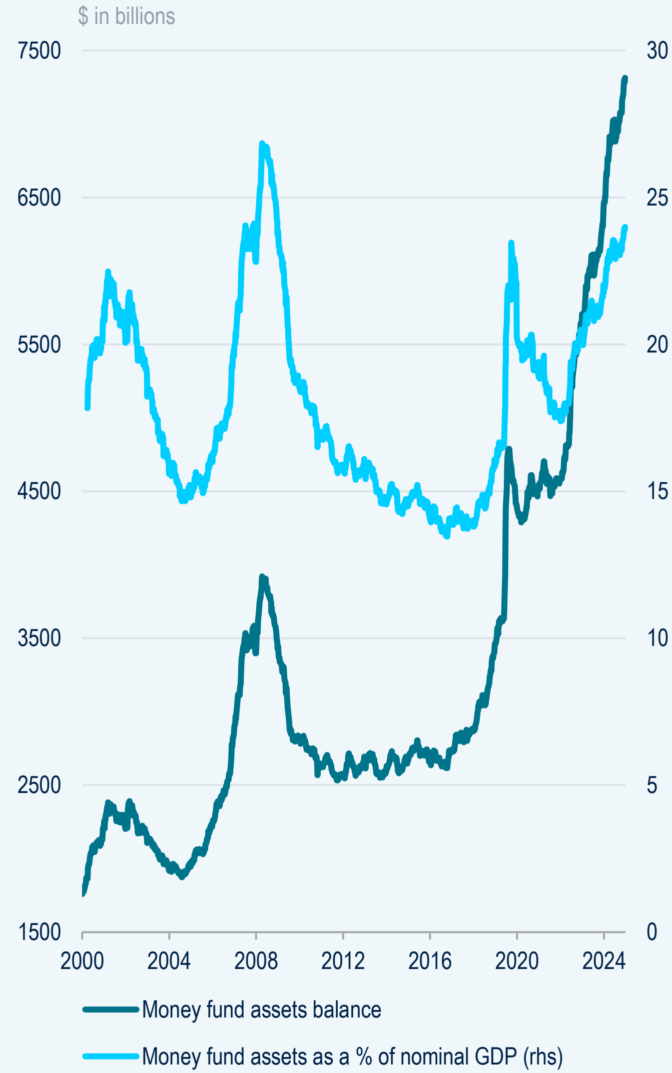
Our Fed capture scenario is not a base case, but rather a risk scenario. It requires both time and an element of chance to play out. We can break this into three Acts. In Act I, we'll see how the Fed's personnel develops through Q1 2026 in terms of progress in the legal case regarding Board Member Cook as well as term renewals of Stephen Miran and the Fed's regional bank presidents.

In Act II, we evaluate the new roster: are they, in fact, inveterate doves, or once at their posts, are they more orthodox and balanced than expected?

If the Administration succeeds in Acts I and II, yields at the front of the curve will likely decline. The final test in Act III will focus on the economic impact. While economic overheating is the sensible outcome to Act III—i.e., exceedingly dovish policy will over-stimulate growth—it's worth remembering that recession was the sensible expectation following 2022's rate hikes. But as it turned out, the impact of the rate hikes, for various reasons, was muted relative to expectations, keeping a recession at bay.

So again, a Fed capture is an interesting outlier scenario that we'll be watching and evaluating carefully: does it happen and, in the event it does, are the results what we'd expect?

Figure 3: Elevated money fund assets continue to rise in absolute terms and relative to the size of the economy. If and as cash rates decline, this represents a substantial source of demand for equities and the fixed income markets.



Source: Bloomberg

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BLOG POST

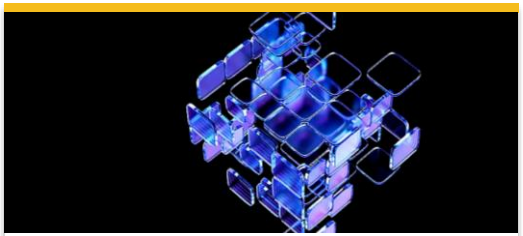
THE LONG GOOD BUY: WHY LONG-DATED MUNIS LOOK CHEAP

This post examines why long-dated municipal bonds have underperformed supply-demand imbalances that led to steep yield curves and relative values.

PODCAST

CENTRAL BANKS: CAN INDEPENDENCE PREVAIL?

In this episode, we highlight the importance of central bank independence, particularly in the context of the U.S. Federal Reserve.



WEBCAST

ON SECURITIZED PRODUCTS AND ASSET-BASED FINANCE

We look at how securitized products and private asset-based finance have monopolized the discourse with investors seeking to diversify their portfolios while capturing additional spread and yield.

FROM TARIFFS TO TRADE DEALS: THE GLOBAL ECONOMY'S BALANCING ACT

Moderate growth remains the base case, but shifting risks, from U.S. policy moves to trade realignments, are reshaping the outlook for major economies.

Global Economy: Resilient, but Risks Are Evolving

The global economy continues to demonstrate resilience despite significant shifts in U.S. trade and investment policies as well as their accompanying uncertainties. While the impact of higher tariffs and changing trade flows is beginning to show in price and production data, consumer spending, labour markets, and corporate performance remain mostly robust, providing a critical buffer. As a result, our base case for major economies remains one of "muddle through," that is moderate growth and inflation, even amid heightened policy uncertainty.

However, the balance of risks has changed.

First, we now see a higher probability that the U.S. economy reacts more sharply to the tariff shock, loose fiscal policy, and additional Fed easing—all of which is complicated by the partial shutdown of the Federal government. The trajectory remains uncertain: the economy could initially "overheat," with stronger real growth and rising inflation. Yet, if tariffs weigh more heavily than expected and labour supply constraints cap productive capacity, a deeper slowdown could follow, ultimately tempering inflationary pressures.

Second, the risk of a similar inflation surge in the Eurozone appears smaller, reinforcing confidence in our central "muddle through" scenario. We see diverging inflation risks instead—downside in the EA (and Japan) and upside in the U.S. and the UK in the near term.

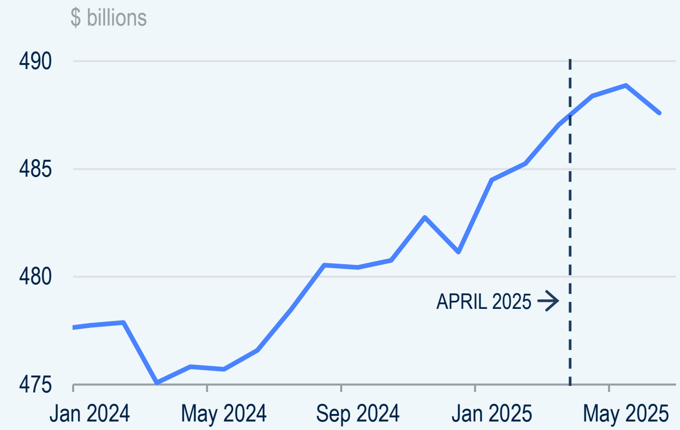
Third, China faces a comparable shift in risks. Growth is moderating into year end, while inflation remains subdued despite policy support. For both the Eurozone and China, we continue to see limited risks of outright recession or sharp slowdown, and even slimmer chances of a productivity-driven boost over the next 12 months.

Fed's Response: The Market's Compass

While "muddle through" remains our base case, the key risk lies in an overheating U.S. economy fuelled by a more dovish Fed, alongside looser fiscal policy. Our baseline assumes the Fed cuts its policy rate to 3.25%, staying "on the higher side of neutral," consistent with Chair Powell's guidance.

And caution is warranted, especially when it comes to inflation. Tariff effects could prove persistent as pre-tariff inventories deplete and higher input costs, such as steel, filter through supply chains (Figure 1).

Figure 1: The U.S. is now depleting inventories accumulated before the new tariffs. U.S. real retail inventories (excluding autos)



Source: Macrobond

Figure 2: Markets are pricing in only a short-term increase in U.S. inflation. U.S. inflation swaps (Bloomberg)

Source: Macrobond

A shrinking labour force adds further pressure, while strong demand from higher-income consumers allows firms to pass on costs without eroding margins. Fiscal expansion will bolster demand, and tariff revenues will mitigate near-term fiscal risks. A likely détente in U.S.-China trade tensions would further support sentiment. Accordingly, markets currently price in moderate easing—slightly more than we expect—and a near-term inflation uptick, followed by stable inflation in the medium term.

However, if the Fed downplays tariff-driven inflation beyond initial effects and prioritizes downside risks, particularly in labour markets, it could cut rates more aggressively than anticipated. This would deliver an additional stimulus, giving markets and the global economy a short-lived "sugar high." Yet, concerns about medium-term inflation could push long-term yields higher (Figure 2). While we do not see this as an immediate risk in Q4, the Fed's reaction function will dominate market narratives (see our accompanying Nixon-Burns spotlight).

Currency Dynamics: Dollar Weakness Persists

We maintain that monetary policy divergence, combined with growth convergence among major economies, points to sustained U.S. dollar weakness. That said, much of this adjustment has already occurred, and the future direction hinges on U.S. policy choices.

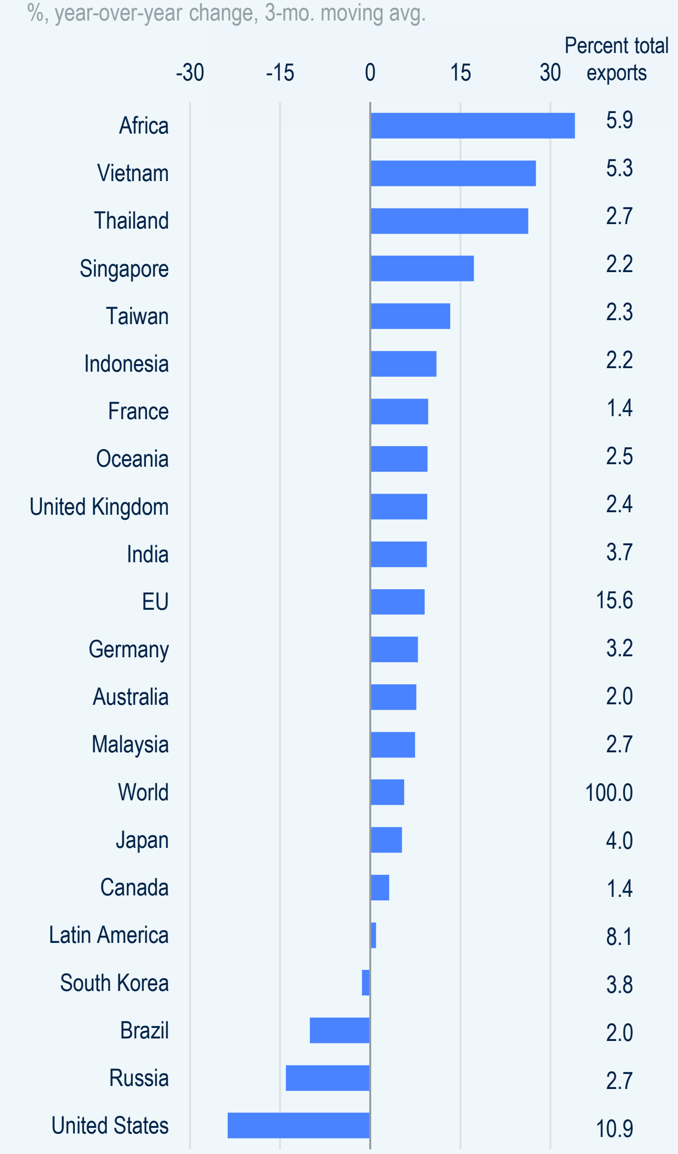
A weaker dollar remains supportive for emerging market currencies and could ease currency-related tensions in U.S.-China trade negotiations. Stronger EM currencies and contained commodity prices will limit upside price pressures, allowing EM central banks to cut rates more (though the picture remains diverse). A weaker U.S. dollar is also positive for external funding options of many lower-rated EMs.

Euro Area: Positive Outlook Amid Shifting Dynamics

The Euro Area enters late 2025 with mixed, but broadly positive, prospects. The earlier-than-expected resolution of U.S.-EU trade negotiations and favourable carve-outs for autos, pharmaceuticals, and semiconductors has provided a near-term boost. However, higher U.S. tariffs (15% versus the 10% expected) will offset the impact of Germany's larger, more front-loaded fiscal stimulus. Meanwhile, exports are normalizing after a pre-tariff surge, cooling activity. We maintain our quarterly growth forecast and see reduced odds of an upside surprise.

Growth patterns are also shifting. Former crisis-hit economies, such as Italy and Spain, continue to outperform, lifting overall activity, supported by EU funds and greater flexibility in their use—benefitting the CEE region (outside the Euro Area) as well. On the risk side, France's sovereign spreads are widening—reaching year-to-date wides vs. bunds following the resignation of former Prime Minister Lecornu—while peripheral ratings are converging toward the core. These outperformers are less exposed to energy or geopolitical shocks, adding resilience to EA growth even as core economies face pressure.

Figure 3: Chinese exports by destination, USD value



Source: Macrobond

Inflation remains subdued, and we believe the ECB has largely concluded its easing cycle, with only one cut expected in 2026 as insurance against downside risks. This stance should reinforce the U.S. dollar weakness discussed earlier. Risks, however, remain skewed to the downside if tariffs and uncertainty weigh more heavily on activity while inflation stays low.

China: Growth Moderates, Trade Outlook Improves

China's growth momentum is softening as earlier stimulus and export front-loading fades while the economy continues to digest the legacy of overinvestment and a construction bubble. The tariff war with the U.S. has been cushioned by trade diversion, especially in ASEAN (Figure 3). Anti-deflation measures are in early stages, but investments are falling as businesses cut back expansion. Policymakers are working on a new mix of structural reforms and near-term stimulus, but at a measured pace. We expect growth to moderate through late 2025 and into 2026, but still see low risk of stagnation. Like in the Euro Area, our base case remains a "muddle through" scenario of moderate growth and subdued inflation, with limited upside surprises.

On trade, the outlook is improving. A recent call between the U.S. and Chinese presidents, planned high-level meetings, and an earlier trade détente suggests that a formal agreement is within reach. It will likely freeze effective tariffs on Chinese exports at 40–50%, ease restrictions on rare earths (China) and microchip exports (U.S.), and include commitments for increased Chinese purchases of key U.S. goods, such as soybeans, LNG, and aircraft. Explicit currency provisions are less likely, as yuan depreciation concerns have eased with a weaker U.S. dollar.

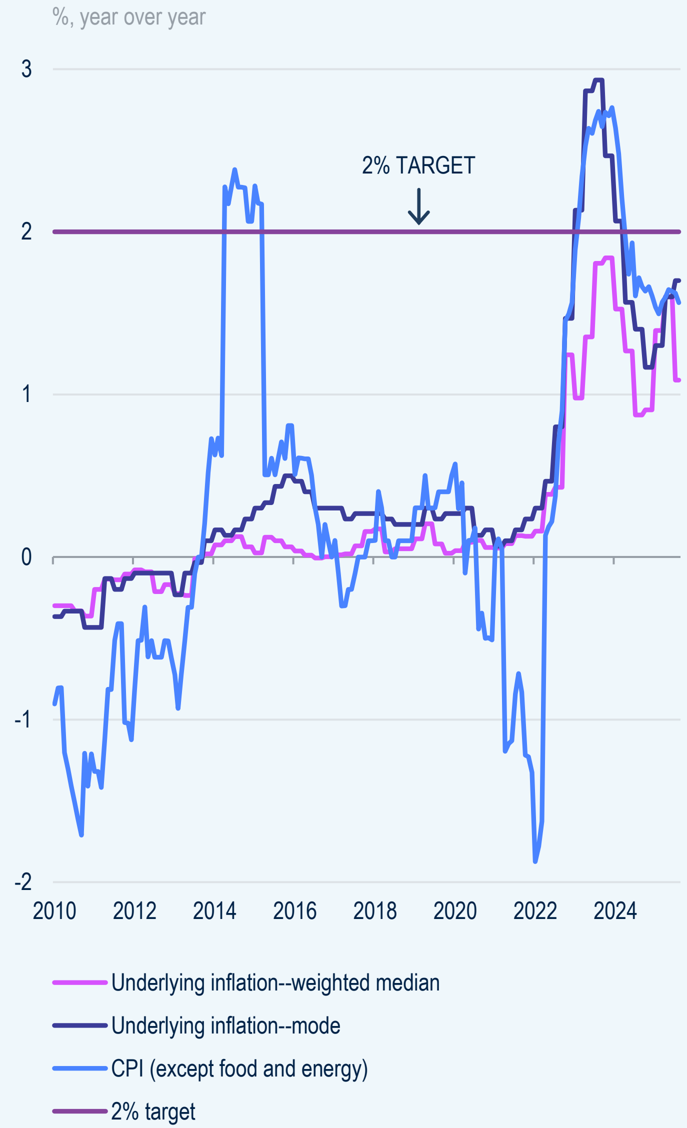
Still, uncertainty remains over whether the agreement will address geopolitical concerns, including China's support for Russia and U.S. policy toward Taiwan. Beyond trade, structural challenges persist: China continues to rely on exports to sustain growth above 4%, while the transition to domestic consumption is limited by employment uncertainty and weak income growth. Strategic decoupling remains a long-term goal, with significant implications for global trade, investments, and geopolitics.

Japan: Stronger Fundamentals, but Policy Patience Prevails

Improving fundamentals, rising inflation momentum, and reduced uncertainty following the recent U.S. trade agreement have fuelled expectations that the Bank of Japan (BOJ) could raise rates later this year. Investment is picking up, corporate profits remain strong, and consumption is resilient, reinforcing the case for tightening.

Yet, the BOJ remains cautious. It sees the macro impact of higher tariffs as uncertain, both through trade and sentiment channels (Figure 4). The exchange rate, to which Japanese inflation is particularly sensitive, is another key concern. Consequently, while we remain constructive on

Figure 4: While Japanese headline inflation picked up, underlying measures remain below the BOJ target



Source: Macrobond

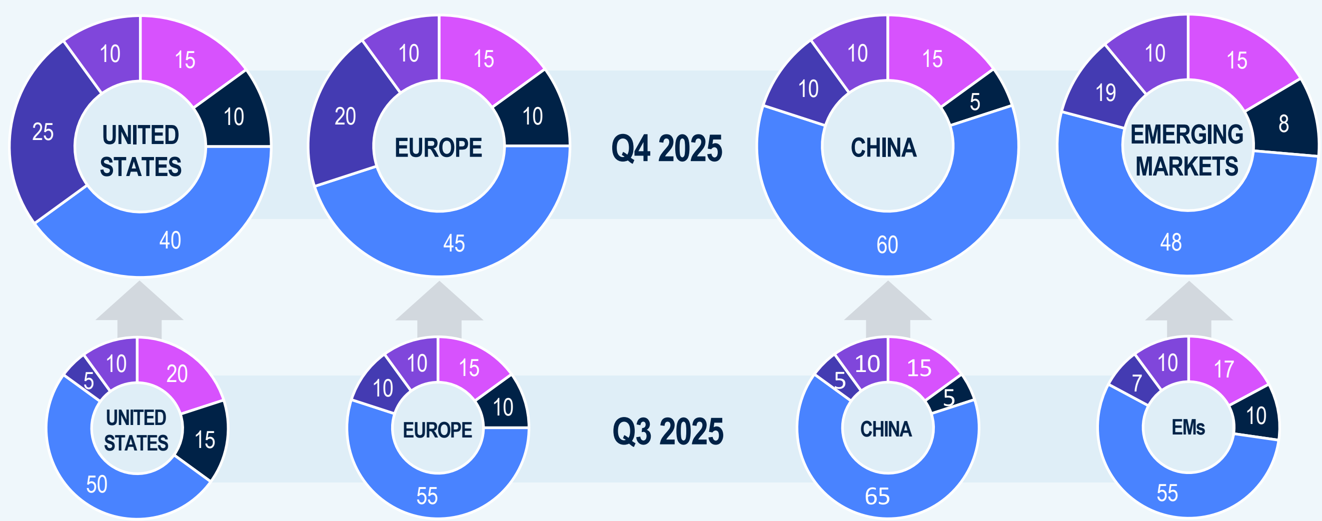
Japan's growth outlook, we expect rates to remain on hold through 2025 followed by a single hike in the first half of 2026 (to 0.75%) and the possibility of moderate additional tightening later that year. Recent ETF and REIT sales underscore the BoJ's intent to reduce its balance sheet at a relatively brisk pace as part of its policy normalisation path.

United Kingdom: External Risks Ease, Domestic Challenges Persist

The UK has also secured a swift trade agreement with the U.S., reducing external risks. Yet, domestic fundamentals remain fragile: employment is weak, while private consumption, investment, and exports continue to lag. Growth is supported by public spending and a favourable inventory cycle. Fiscal challenges and the prospect of higher taxes weigh on sentiment. Inflation remains above target, but is expected to decline sharply in late 2025 and early 2026, particularly as food inflation eases. This, and declining wage growth, will open room for further Bank of England (BOE) policy easing. We now expect one rate cut in December and 75 bps more in total in the first half of 2026, bringing the policy rate to 3.0%. This expectation is greater than what the markets priced in, and we think the BOE will play catch-up with the ECB and the Fed.

Q4 Macroeconomic Scenarios
PGIM's Q4 '25 economic scenarios feature outcomes on both sides of the distribution with a "muddle through" base case (% probability).

- Recession
- Mild Stagflation
- Muddle Through (base case)
- Overheating*
- Productivity Boost



Source: PGIM. EM is a weighted average of the U.S. (35%), Europe (35%), and China (30%). Our key risk scenario of "Overheating" replaces "Nominal GDP Boom" from Q3.

SPOTLIGHT The Nixon–Burns Episode (1970–1973)–A Lesson in Policy Trade-offs

As the U.S. economy emerged from the 1969–1970 recession, President Richard Nixon faced a challenge: sustaining growth ahead of the 1972 election without reigniting inflation. His solution: a combination of fiscal stimulus, pressure on the Fed, and a series of policy measures that would later become known as the "Nixon shock."

Nixon put pressure on Fed Chair Arthur Burns to maintain an easy stance, prioritizing growth over inflation control. The Fed complied, keeping monetary policy loose even as the economy accelerated. By late 1972, real growth surged above 7.5%, well beyond potential, while short-term interest rates stayed low. This policy mix created a tailwind for risk assets, but sowed the seeds of future instability.

In August 1971, Nixon announced a package of measures, including a 90-day wage and price freeze, suspension of the dollar's convertibility into gold (effectively ending the Bretton Woods system), and a 10% import surcharge. They were designed to curb inflation and improve trade competitiveness, but also introduced significant distortions. The combination of easy monetary policy and fiscal stimulus initially buoyed markets. Equities rallied strongly in 1972, even as bond markets began to price in future inflation risks. The U.S. Treasury yield curve steepened: long-term yields rose modestly while short rates remained anchored, reflecting expectations of higher inflation down the road.

However, the increase in long-end yields was relatively small compared to the magnitude of the policy easing, suggesting markets underestimated the inflationary impulse.

By late 1972, inflation began to rise as price controls were lifted and demand pressures intensified. The Fed, having kept policy too loose for too long, was forced into aggressive tightening. This abrupt shift led to a sharp equity market correction: stocks fell roughly 15% even before the 1973 oil embargo triggered a deeper downturn and even higher inflation. The oil shock hit the U.S. economy while inflation expectations were already de-anchored. The Fed was forced to hike rates again and even later struggled to rein in inflation (introducing "stagflation" into the lexicon), even before the second oil price shock in 1979 (Figure 5).

One caveat from the Nixon–Burns era is that the rise in long-term yields was relatively muted, even as inflation risks mounted. This raises a critical question for today: if a central bank cuts rates while underestimating the persistence of inflation, could markets again be slow to price the risk, only to face a sharper adjustment later? And in the world of more frequent supply shocks, be it from commodity prices, trade disruptions, or labour constraints, will inflation shocks persist for longer if central banks are seen as being too accommodative and restoring credibility becomes too costly?

Figure 5: Stocks eventually reflected the economic realities of the "Nixon shock."

Source: Macrobond

DEVELOPED MARKET RATES

Outlook: Although the sector remains vulnerable to numerous global crosscurrents, central bank easing biases create a mild tailwind for Western rates. Positioning remains tactical along yield curves and around market pricing.

■ Developed market rate complexes received some direction in Q3 as the Federal Reserve resumed what could become a prolonged, and possibly deep, rate-cutting cycle. While other Western banks are generally on hold or likely to cut in the quarters ahead, the Bank of Japan is the lone major central bank on a rate-hiking trajectory. With this backdrop, the following outlook examines our policy expectations for the central banks, the pursuant investment implications, and yield curve dynamics.

■ Despite the arrival of an aggressively dovish Fed Governor, the Fed's most recent 25 bp rate cut is likely the first in what continues to look like a fairly gradual path towards neutral, which we estimate to be in the 3.0% area. We expect two more 25 bp rate cuts by year end, which would bring the Fed funds rate to 3.625%. Looking further ahead, Chair Powell's term will conclude in May 2026, likely leading to another dovish adjustment to the Fed board. At this point, the market is pricing in a Fed funds rate of 3.0% by the end of 2026. A push into accommodative territory likely requires a combination of a more dovish Fed voting slate and/or significant slowing in growth and/or inflation.

■ Although the Fed's September cut prompted a decline in long-term yields, credibility and fiscal concerns have generally weighed on the long end of DM yield curves (chart). We expect the major Western curves to normalize further on rate cut expectations, while long rates remain vulnerable to upward, policy-driven pressure. A steeper curve highlights compelling segments, e.g., the 5-year portion of the U.S. curve given the roll-down effects. The 20-year U.S. bond also remains attractive on a relative value basis.

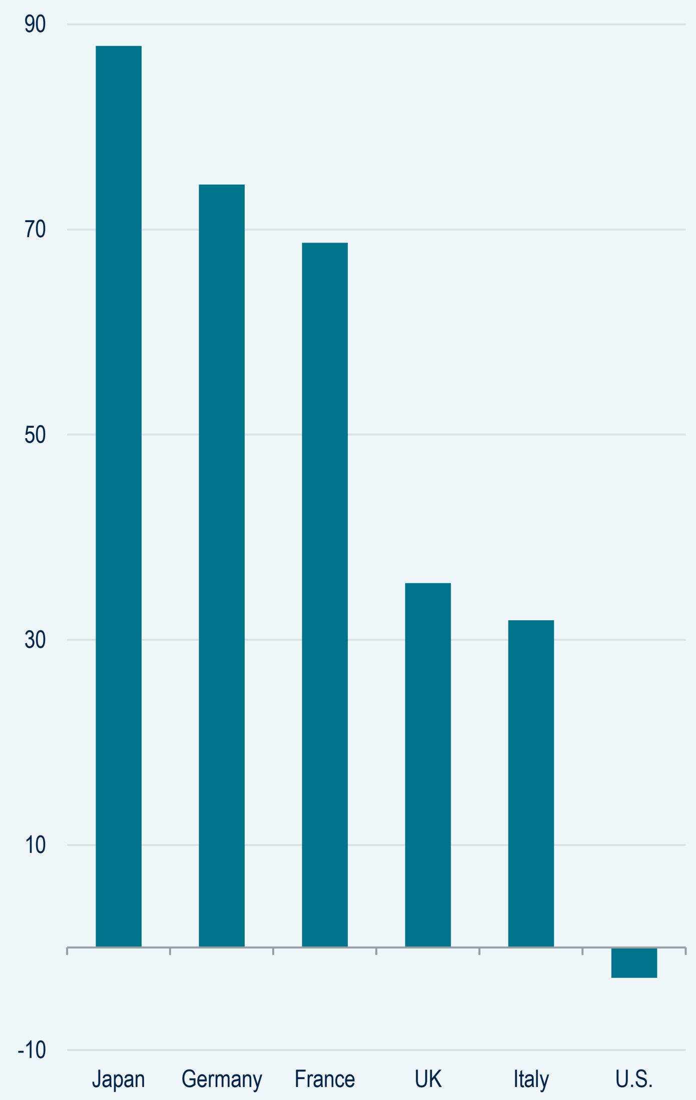
■ Steeper yield curves should remain prominent globally as well. Market pricing around an ECB rate cut next year remains marginal, yet we see two factors potentially supporting an additional 25 bp reduction in the first half of 2026. Further euro appreciation vs. U.S. dollar could contribute to more moderate growth and inflation, and the ECB may also seek to prevent any temporary below-target inflation that is expected in 2026 from becoming entrenched.

■ We expect the Bank of England to cut its policy rate in December to 3.75%, followed by three additional cuts in the first half of 2026 on the back of tight fiscal conditions, weakening labor market, and moderating wage growth.

■ In Japan, underlying economic fundamentals remain firm, likely keeping the Bank of Japan on a measured path of policy normalization. We see modest upward pressure on the yield curve with the BoJ likely to hike once in the first half of

The U.S. Long Bond Outperformed its DM Counterparts YTD

30-year yield changes, YTD, bps



Source: Bloomberg

AGENCY MBS

Outlook: Carry conditions. Even with tight OAS profiles, MBS carry remains intact versus intermediate Treasuries as the Fed easing cycle resumes. We prefer a barbell position consisting of lower 30-year coupons and 30-year coupons near par, while avoiding the middle of the stack. We continue to favor better cashflows and convexity via specified pools rather than TBAs.

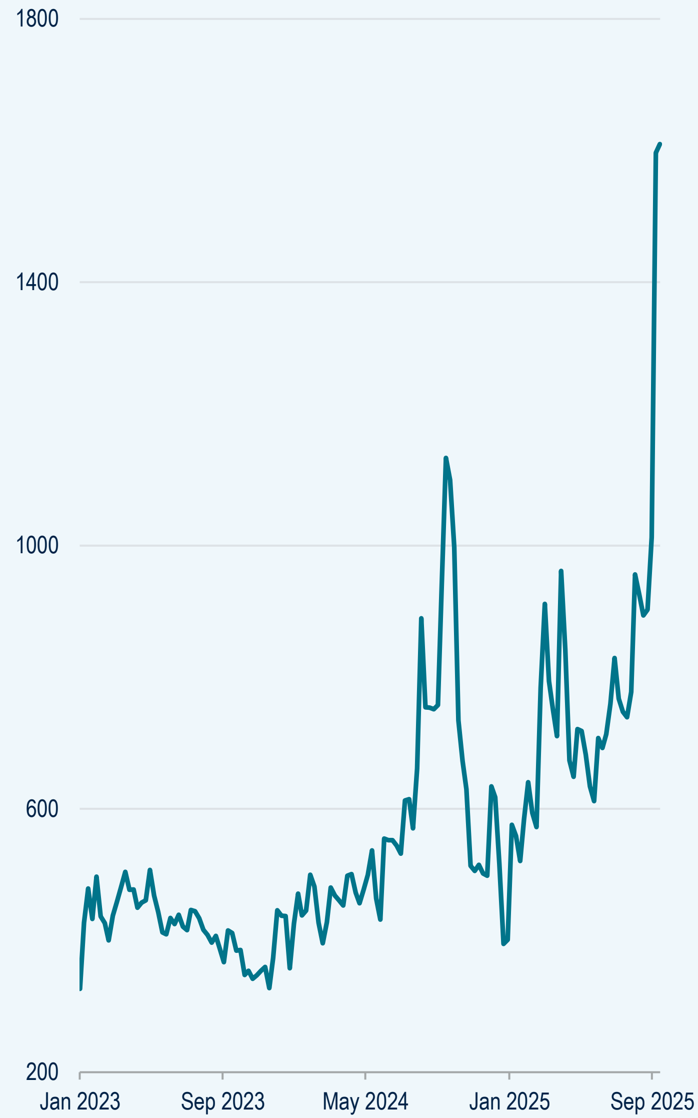
- MBS posted positive excess returns versus U.S. Treasuries in Q3, with the majority of that performance coming from the longer duration, 30-year sector, while the 20-year and 15-year sectors lagged. Lower coupons uniformly outperformed higher coupons in all sectors, and UMBS outperformed GNMAs. Notably, seasoned pools, which comprise much of the Bloomberg MBS Index, recouped performance as rates declined.

- Origination was muted through most of Q3 until primary rates eased during the latter half of the period, and volumes increased moderately. As primary rates decline, we expect originations to increase, initially from refinancings, but eventually from new purchase loans. That said, MBS refinancing is a growing risk, especially in high premium coupons, and is generally not being captured by most production OAS models.

- While MBS begins Q4 firmer than it entered Q3, the market is anticipating Fed rate cuts through the end of 2026. As such, MBS is poised to benefit from lower volatility and steady demand as rates decline. Further, while prepayment activity remained within expectations through most of Q3, higher speeds in premium coupons will increase should primary rates decline further, creating potential opportunities to outperform the MBS Index.

- With the Fed set to continue allowing MBS to roll off of its balance sheet, the market will have to manage prepayment risk—which is likely concentrated in derivative form in leveraged accounts—on its own. Also, the market appears to be less concerned about Fannie Mae and Freddie Mac privatization despite prior headlines.

MBS refinancing index jumps as mortgage rates decline
(seasonally and working day adjusted)



Source: Bloomberg

INSURING AGAINST THE STORM: INSIGHTS ON THE AFFORDABILITY/AVAILABILITY DYNAMIC

One of the most important, yet often misunderstood, topics in global finance is the intersection between severe weather events and insurance, particularly within the property and casualty (P&C) market. The increased frequency and severity of climate risk impacts populations worldwide, with economic losses rising in recent years at approximately double the growth rate of GDP. As weather risks increase, insurers must determine which segments of these risks they wish to retain and which they prefer to avoid altogether in their effort to remain profitable.

Economic losses from natural weather events have been rising steadily over the past decade, with recent estimates placing 2024 economic losses at $300 billion. However, the insured portion of these losses, which is significantly influenced by the location of the weather events, has remained relatively stable at around 40%. Yet, when averaged over the past decade, a steady rise in gross economic losses is evident.

Rising Population and Property Values

Several factors have contributed to this trend. Post-pandemic, property valuations have generally increased, along with construction and labor costs. Rising property values mean that the exposure for insurers has increased. Additionally, the phenomenon known as the Wildland-Urban Interface, which refers to the expansion of populations into areas prone to natural disasters, has exacerbated the risk. For instance, Hurricane Ian in 2022—the second-largest single event after Hurricane Katrina—resulted in approximately $64 billion in estimated insured losses. Despite improved building codes in Florida, the high loss was due to the populations surge in recent years. Urban sprawl and the increased land development created further risks, as water had nowhere to drain.

Rising risk exposure from changing weather events are often thought of as the main driver of uninsured losses. However, the increased losses are being driven by a combination of rising risk exposure and increased vulnerability in terms of more insured assets, which have appreciated in value. The effects are clear: there is a nearly $200 billion global gap between insured risk and economic losses, and this dollar amount continues to rise.

Risk Selection

The insurance industry categorizes natural weather events into "peak perils" and "attritional events." Peak peril events are single, large loss events, typically measured in tens of billions of dollars. Attritional events are more frequent, with lower individual severity, but can aggregate into significant losses.

PODCAST

THE INSURANCE INDUSTRY IN THE CLIMATE CONVERSATION

In this episode of Fixed on ESG, we focus on the economic role of property and casualty insurance as it relates to the increased frequency and severity of climate-related events.

Check out PGIM's podcast series, Fixed on ESG.

These events include thunderstorms, lightning strikes, hailstorms, snow freezes, snow melts, and secondary flooding.

In 2024, approximately 60-70% of total insured losses came from smaller individual events. However, advances in computing and technology are now enabling insurers to process data and model events more accurately, helping to maintain the percentage of insured losses around the low 40%-range over the last five to ten years.

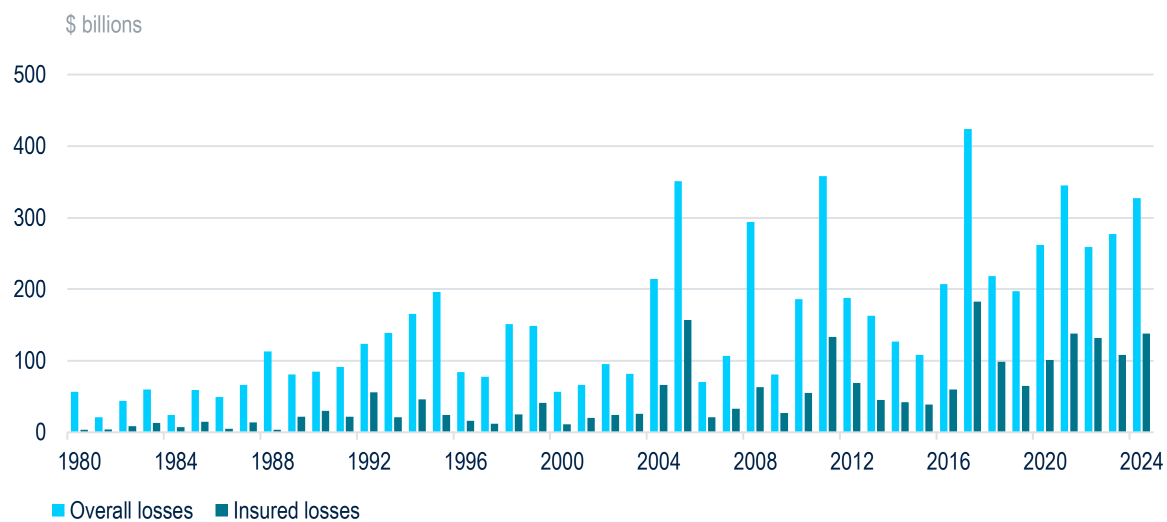
Insurers are not only improving their modeling capabilities, but are building new exclusions into policies, and increasing pricing to mitigate loss experiences. The focus is on modeling risks to size them probabilistically and then pricing them accordingly. In certain jurisdictions, insurers are restricting their exposure in various ways. One method is by non-renewing policies, effectively reducing their exposure. Another approach is by pricing themselves out of the market.

Affordability versus Availability

Insurers are in the business of providing coverage to a diverse group of policyholders, not just to those exposed to specific events, such as natural disasters. To remain operational and maintain their social license to insure, insurers must offer coverage to all their policyholders, making risk selection increasingly critical. When insurers identify particular exposures that they cannot price adequately or model accurately, such as in the case of wildfires, they may choose to non-renew policies or exit the market altogether. This leads to an availability crisis in certain cases.

This approach has helped to sustain profitability. However, the industry has also been supported by significant price increases, with insurers enacting record price increases in recent years. In many cases, pricing is heavily regulated. For instance, California has stringent regulations on the types of price increases that can be imposed. However, even in such environments, regulators are beginning to recognize the ongoing struggle between affordability and availability. Often, individuals focus on the premium price without considering the exclusions in the policy or the extent of coverage. Consequently, while the premium cost may increase by $10,000, the actual coverage may be significantly reduced. This situation exacerbates the lack of risk diversification, concentrating more risk on the policyholder and further underscoring the insurance affordability/availability dynamic.

Natural disaster losses worldwide (1980-2024)



Source: Munich Re, NatCatSERVICE, May 2025 (excluding droughts and heatwaves)

SECURITIZED CREDIT

Outlook: Carry conditions. Securitized spreads generally remain wider YTD, but tighter than historical averages. Amid flat credit curves, high-quality securitized assets continue to offer attractive valuations relative to other fixed income sectors. Our outlooks for CMBS, RMBS, CLOs, and ABS reflect a tighter than average spread environment combined with weaker or normalizing underlying asset fundamentals. Our "carry" base case calls for limited total return potential—from limited capital appreciation—and thicker tails. We remain focused on tranches at or near the top of capital structures and are highly selective regarding more credit-sensitive positions given the risk/reward dynamic. In asset-based finance markets, positive capital flows continue; we are targeting structures suited to perform through the cycle in prime consumer, commercial, and residential subsectors.

■ In **CMBS**, valuations for most property types have stabilized, and we expect price appreciation to be flat for the year—likely no V-shaped recovery given long-term rate expectations. Rent growth continues normalizing across property types and may increase as supply pressures abate, but will likely stay within range of historical averages. Elevated single-asset, single-borrower (SASB) supply has kept spreads in this space attractive, and we see value in high-quality deals with structural protections. In conduit markets, we favor shorter spread duration given the current term-curve profile.

Securitized credit curves generally remain too flat to indiscriminately travel down the capital stack.

Source for CMBS and ABS credit curve: JPMorgan ABS, CMBS Indices. Dates January 3, 2012 to August 31, 2025. Source for CLO Credit Curve: PGIM. SI dates vary. CLO AAA, AA from December 22, 2014. CLO A, BBB, BB from December 29, 2017. Source for RMBS Credit Curve: JP Morgan RMBS Indices. Since Inception date January 17, 2019

- In **RMBS**, relatively tight inventories and strong demographics continue to support housing valuations despite historically high mortgage rates and regional pockets of softness. Mortgage credit remains solid overall, despite rising delinquencies among lower credit tier borrowers. As non-qualifying mortgages are the most scalable opportunity to gain mortgage credit exposure, we favor less negatively convex collateral subtypes. We are adding AAA Non-QM and second-lien/HELOC deals for their attractive spread pickup versus other fixed income. Although we are still constructive on credit risk transfer, we are biased towards rotating away from these instruments as valuations appear stretched.

- **CLO** fundamentals are improving—supported by growth in revenue and earnings as well as generally positive outlooks—but tail risks remain, i.e., more than 10% of underlying collateral features stressed interest-coverage ratios (below 1.5x). Senior CLO tranches continue to offer attractive relative value compared to many fixed income asset classes. We see the most value in senior tranches, while selectively adding higher-quality mezzanine tranches. With spreads still inside of long-term averages, but wide of YTD tights, we expect mixed valuations near term, creating entry points at wider levels. In the U.S. and Europe, we see value in primary transactions—particularly in AAAs and AAs—and in selling secondaries trading at premiums.

- In **ABS**, the consumer remains stretched—especially the non-prime cohort—as they take on more debt and elevated default rates continue in seasoned ABS trusts. Given tight spreads globally and pronounced credit tiering, we're positioned toward top-tier originators. Thematically, we favor bank originated collateral, defined vs. general purpose loans, short-dated consumer loans, and commercial obligor exposures. We're constructive on select, higher-quality issuers across the capital stack within auto, consumer loans, and commercial sectors, offering favorable relative value within a global opportunity set.

- In **ABF**, inflows continue, especially from liability-driven investors seeing demand from retirement products who are diversifying or complementing their corporate credit exposures. As elevated tariff, inflation and macroeconomic risks continue, we are targeting structures that can adequately perform through the cycle. We are focused on prime consumer, commercial, and residential subsectors. In commercial, we are originating financing for critical-use assets in transportation, digital infrastructure, and datacenters, as well as equipment financing for small- and medium-sized businesses. Within consumer, we see opportunities in providing capital to prime homeowners for home improvement and efficiency needs.

U.S. IG credit metrics consist of relatively stable leverage and EBITDA margins that are near the highs last experienced in Q1 '22—a good starting point. The credit quality mix continued to improve—only ~8% of IG debt is rated BBB-, out of 45% in the broader BBB category (the lowest since 2015 and down from 2018's peak of 51%). For fundamental scores, Restaurants and Food & Beverage were lowered from 2 to 1 and Life Insurance was reduced from 3 to 2. The Auto sector was raised from 3 to 4.

Our European IG fundamental scores skew positive, while the trend scores lean slightly negative. Companies reporting Q2 results showed weaker revenue trends. Chemicals and Energy sectors saw several companies miss earnings estimates, while financials generally performed well.

In high yield (U.S. and Europe), Autos, Communications, and Consumer continue to have "weaker" fundamentals, while the other sectors continue to skew positive from a fundamental lens. In U.S. Homebuilding, a soft spring selling season and affordability concerns will likely lead to softer second half results and weaker gross margins. Therefore, we lowered Homebuilding's trend score from 2 to 1. In U.S. Lodging, higher end consumers continue to increase expenditures, but the lower end consumers are reducing travel. The ability for hotels to raise prices is capped, and we reduced the sector's trend score from 3 to 2.

In 2025, after a period of volatility caused by new tariffs, several sectors including airlines and consumer products restored their financial guidance, in most cases better than initially feared.

Trend score	
Positive	↗ (4 trend score)
Neutral	● (2-3 trend score)
Negative	↙ (1 trend score)

Source: PGIM

Weak ◄◄◄ Sector Fundamental Score ►►► Strong

	1	2	3	4
Communications	(IG) Media ● (HY) Print/publishers ↙ (HY) Radio broadcasters ↙ (HY) TV broadcasters ↙	(IG, HY) Cable ● (HY) Wireline ●	(EU IG) Telecom ↗ (IG) Telecom ● (HY) Outdoor ● (HY) Wireless ●	
Consumer	(IG) Restaurants ● (IG) Food/beverage ● (HY) Consumer products ● (HY) Retail ●	(IG) Retailers ● (IG) Healthcare services ● (IG) Supermarkets ● (HY) Restaurants ● (HY) Automotive ●	(EU IG, IG, HY) Lodging ● (EU IG, IG) Consumer products ● (IG) Healthcare products ↗ (IG) Pharmaceuticals ● (IG) Tobacco ● (IG, HY) Airlines ● (IG, HY) Food & beverage ● (HY) Gaming ● (HY) Leisure (HY) Supermarkets ● (EU IG) Luxury goods ●	(IG) Automotive ●
Financials		(IG) Canadian banks ● (IG) Finance co's ● (IG) Life insurance ● (EU IG) European real estate ●	(IG) U.S. money centers ● (IG) U.S. regionals ● (EU IG) Australian banks ● (EU IG) European Insurance ●	(IG) P&C insurance ● (IG) REITs ● (EU IG) European banks ●
Healthcare		(IG) Healthcare services ●	(IG) Healthcare products ↗ (IG) Pharmaceuticals ● (HY) Healthcare ●	(IG) Healthcare REITs ↗
Housing		(HY) Building materials ↙	(EU IG, IG) Building materials ● (IG) Lodging ● (HY) Homebuilders ↙	(IG) Residential REITs ●
Industrials & manufacturing		(IG, HY) Chemicals ● (IG) Railroads ● (HY) Industrials & services ● (EU IG) Chemicals ● (EU IG) European autos ●	(IG, HY) Paper & packaging ● (IG, HY) Aerospace/defense ● (EU IG, HY) Capital goods ● (EU IG) Aerospace/defense ↗	(IG) Diversified manufactures ● (IG) Industrial REITs ●
Metals & mining			(HY) Steel & related mats ●	(IG) Metals & mining ● (HY) Non-ferrous metals ●
Oil & gas		(HY) Oil field services ● (HY) Refining ●	(IG) Oil field services ● (HY) Gas E&P ↗ (HY) Oil E&P ↙	(IG) Independents ● (IG) Integrated ● (IG) Refining ● (IG, HY) Pipelines ●
Technology			(EU IG, IG) Technology ● (HY) Hardware & semis ● (HY) Software ● (EU IG) Media & tech	
Utilities & power		(IG) Electric ●	(HY) Electric/IPPs ↗ (EU IG) Utilities ● (EU IG) Infrastructure & transport ●	
Autos			(IG) Automotive ●	

INVESTMENT GRADE CORPORATES

Outlook: Carry conditions. With IG corporate spreads near multi-decade tights, further spread compression is likely to be limited in Q4. Our base case calls for the U.S. and European economies to "muddle through" and for spreads to be range-bound near current levels. That stated, yields are still relatively high and continue to drive strong demand for IG corporate bonds.

■ **Spread Expectations.** Spreads on the U.S. IG corporate index recently reached new local tights of 72 bps and yields sit near the 80th percentile. Thus, total returns are likely to be more impressive than excess returns. Nevertheless, mutual fund flows are strong, fixed annuity sales (a proxy for insurance demand) are robust, and overseas demand remains healthy.

■ **Stable Credit Fundamentals.** Q3 earnings are expected to increase +7.5% on +6% revenue growth YoY. Leverage has leveled off, interest coverage has stabilized at a solid level, and margins are still near their recent peak.

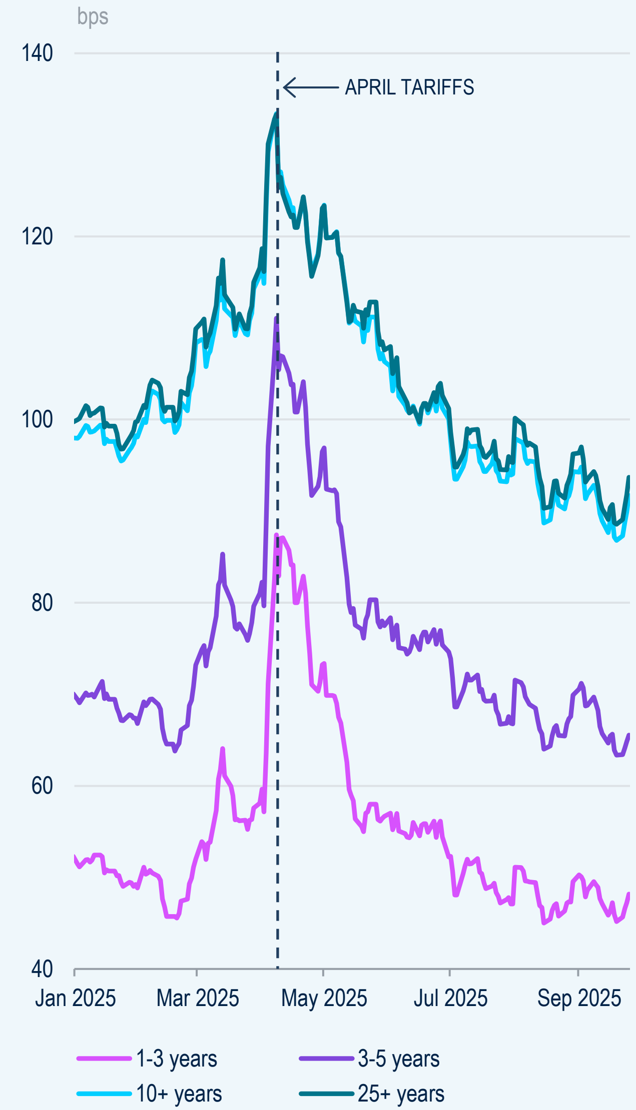
■ **Strong Technicals**: YTD, the pace of gross supply is roughly unchanged vs. 2024, but net issuance is almost 25% lower. With issuers somewhat reluctant to issue longer-maturity bonds at current yields, issuance has had a shorter duration, with an average maturity of 9.1 years. On the other hand, faced with the prospect of continued rate cuts, investors are still trying to extend duration to lock in yields. This has contributed to an especially flat 10s30s spread curve (see chart).

■ **An Uptick in Event Risk.** As the macroeconomic environment has stabilized, equity markets have rallied, and the new administration appears to be more amenable to approving M&A transactions. There has been a significant rise in M&A activity, and the pipeline of unfunded deals has doubled since last year to an estimated $500 billion. This could lead to more 30-year issuance and credit curve steepening.

■ **U.S. Portfolio Positioning.** In the current environment, we are underweight cyclicals, credit-spread duration, and the long end of the IG curve. We are overweight BBBs, primarily with maturities of five years or less. In terms of sectors, we favor banks, REITS, and pipelines—all of which are cheap to industrials and have a domestic focus. While we are overweight autos, exposure is focused in shorter maturities. We also see value in secured bonds in the utilities space as they are less cyclical and more domestically focused. Underweights include healthcare & pharmaceuticals and technology—as both have higher event risk probabilities—as well as consumer, retail & restaurants, and finance companies.

■ **In Europe**, spreads are close to post-GFC tights, reaching a recent low of 78 bps (compared to 73 bps in 2018). However, significant moves

U.S. IG spreads by maturity show a flat 10/30s curve.



Source: Barclays as of September 2025. Based on option-adjusted spreads.

toward pre-GFC tights are unlikely given the subsequent changes in market structure—e.g., longer duration and newly introduced instruments, such as senior non-preferred and corporate hybrids. Technicals, (e.g., strong inflows) continue to drive the market. On a swapped basis, Euro IG remains attractive relative to USD IG for non-domestic investors.

- France is seen as a roadblock for the EUR IG corporates as its fiscal struggles continue, particularly in the aftermath of former Prime Minister Lecornu's resignation. While some corporates trade through the sovereign, this is not expected to drive spreads much tighter unless France becomes distressed, which would bring broader problems. While risks due to French politics are acknowledged, they do not appear to pose immediate threats to broader market stability.

- **Portfolio Positioning:** In our global and Euro IG portfolios, we have light risk positions, with a preference for front-end carry and high quality. We also have a slight preference for banks and utilities (non-cyclical) as they are less likely to widen in a selloff.

GLOBAL LEVERAGED FINANCE

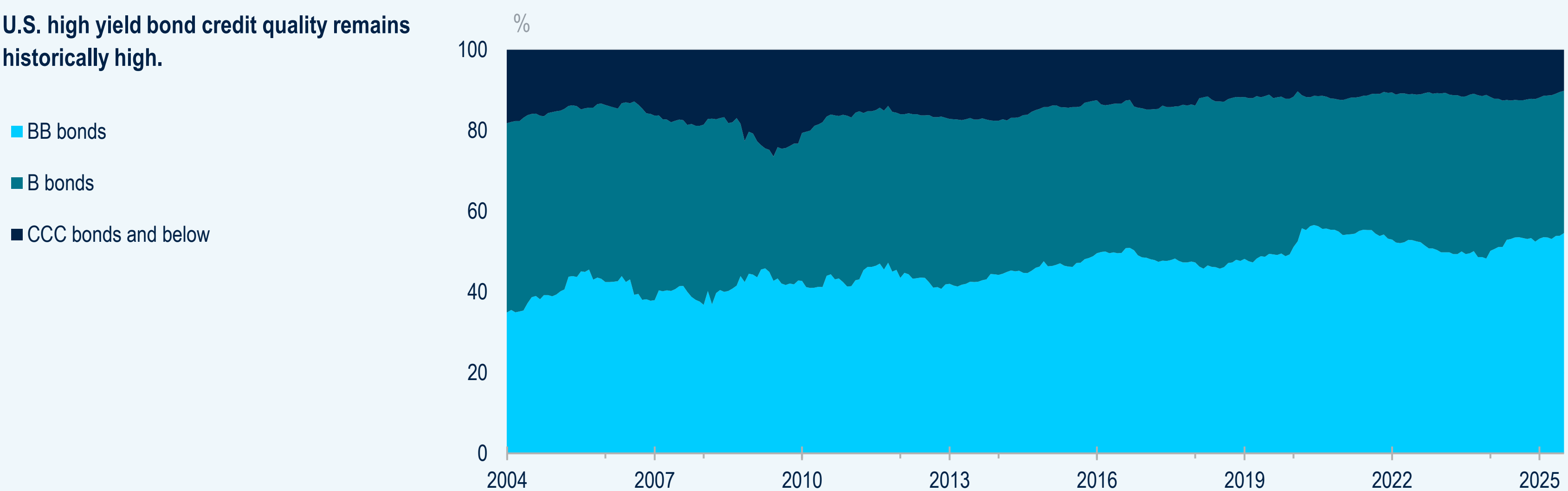
■ **Outlook**: Carry conditions. We expect global leveraged finance spreads to maintain a range near historical tights as persistently strong technicals and a sound credit environment are likely to continue to hold firm against prevailing global macro risks. While still constructive overall, we maintain our close-to-home defensive positioning in U.S. high yield bonds and loans as well as underweights to cyclicals. We are more focused on defensive sectors in Europe.

■ We expect U.S. HY spreads to remain range-bound, but wide of historic tights, over the coming months, as robust technicals and credit fundamentals are likely to withstand ongoing macro risks. From here, spreads could tighten further if inflation eases and AI-fueled productivity drives ongoing corporate profitability. Although there are risks that could prompt spread widening—i.e., overly loose fiscal and monetary policies, stubbornly elevated inflation, and geopolitical tensions—HY's lower spread duration mitigates drawdown risks, while strong coupons help offset potential widening.

■ Despite a recent uptick in new issuance, we continue to expect the strong technical environment to persist as yields remain attractive, strong retail inflows continue, and asset allocators reduce their underweights to HY. Meanwhile, balance sheets are generally solid despite tariffs, maturities are manageable, and overall credit quality remains historically robust with BBs comprising more than half of the market as the share of CCCs continues to decline. Furthermore, while we expect continued light new issuance, we are also anticipating an uptick in M&A deals, which could be positive for the HY market. However, the market's ongoing loosening of documentation standards indicates an increase in the volume of distressed exchanges.

■ We're maintaining our overweight to short-duration bonds and continue to reduce our underweight to high-quality issues. Looking at sectors, we are overweight home construction, telecom, and midstream energy, and underweight technology, media & entertainment, and retailers & restaurants. Recent risk reductions (but still overweight) have included positions in building materials & home construction and health care & pharmaceuticals. We continue to add risk in midstream energy, while reducing our underweight to technology.

U.S. high yield bond credit quality remains historically high.



Source: Bank of America

■ The **U.S. leveraged loan** market remains on solid ground in early Q4, with robust earnings and resilient technicals driving spreads to, or through, all-time tights for mid- to high-quality issuers. Demand is underscored by steady inflows, robust CLO issuance, and light net new supply following Q3's repricing wave—nearly 90% of the $343.3 billion priced in Q3 backed repricing or refinancing transactions. With nearly 50% of loans trading at or above par, we anticipate a firm technical floor under current prices through year end. That said, if rate cuts become more aggressive than anticipated, flows could retreat as investors shift from floating-rate coupons into fixed-rate securities.

■ Following Q3's robust performance, we have renewed our 2025 total return forecast to 6.5%, versus the 6-6.5% range we indicated last quarter. Our forecast is supported by strong year-to-date returns, carry conditions, and relatively low price volatility through year-end. New issuance is expected to remain robust and heavily biased toward repricing and refinancing. Notably, as the investment grade private credit market continues to grow, we see the potential for more IG facilities to ultimately place in the broadly syndicated loan market.

■ We continue to favor public BB and high B loans over sponsor-owned, low B and CCC loans as we expect those lower-quality facilities will be challenged by the fundamental backdrop. We believe that deep, fundamental credit research/modeling is becoming increasingly important to credit selection. To that end, avoidance of defaults will likely be the biggest driver of alpha over the next 12-24 months.

■ **European high yield bond** spreads tightened in Q3, driven by a supportive market backdrop and strong technicals—primary proceeds continue to focus on refinancings and a market with ongoing inflows and solid fundamentals is absorbing the supply. **European bank loans** remained range-bound, buoyed by a similarly strong technical environment with continued CLO formation. While both asset classes remain at the tight end of their respective three-year ranges, they could continue to grind tighter in Q4 barring any broader, externally-driven market risk-off event.

■ We are cautiously constructive—whilst technicals are strong with spreads close to all-time tights and macro risks remain elevated, we still feel caution is warranted in positioning. As such, we remain slightly overweight risk on an aggregate basis, but generally underweight cyclical risk. We continue to focus on relative value opportunities—certain carefully selected opportunities exist among more disperse and dislocated issues, but our bar remains high in this very volatile portion of the market.

PRIVATE CREDIT FOCUS

The demand for private credit remains strong amidst the broad tightening in credit spreads. For instance, issuance of private credit CLOs is on track to reach an all-time high of $50 billion by year-end 2025, far outpacing issuance from last year, according to Bank of America.

While corporate and consumer fundamentals remain strong and default rates remain relatively muted, continued discipline in underlying loan underwriting needs to be maintained, especially when there is greater capital than there are investment opportunity sets. It is critical to maintain protective features (e.g., covenants and protections regarding liability management exercises) in order to ensure that private credit portfolios remain resilient in the event of potential drawdown events.

We remain watchful for any indication of deteriorating credit documentation and security protections in the market place or increase in payment-in-kind arrangements, which allow borrowers to defer cash interest payments until loan maturity, as these can be signs of increased risk taking and greater potential vulnerability to drawdown risks (for additional insights into private assets, explore *Navigating the Shifting Sands of Global Finance* from PGIM's Multi-Asset Solutions team).

EMERGING MARKET DEBT

Outlook: Modest spread tightening and carry conditions. Despite elevated macro uncertainty, EM economic growth remains comparably high, fundamentals have broadly improved, and yields stand out versus other fixed income sectors. We remain focused on resilient issuers and are modestly cautious around spread risk as we have yet to observe the full impact of U.S. tariff policy. Due to stretched valuations, we are cautiously constructive on EM rates and expect the U.S. dollar to maintain its weakening bias. EM corporates continue to offer diversification opportunities.

■ **EM Sovereigns/Spreads:** EM continues to play an active role in the rescripting of the New World Order. EM assets have outperformed year to date, and we expect this to continue over the near-term. Global growth resilience, EM export strength, Fed rate cut expectations, and reduced tail risks remain supportive (see chart). U.S. dollar weakness has also had a multi-pronged benefit: strengthened currencies, improved external positions, and reduced EM debt metrics have alleviated pressure on EM central banks, allowing them to ease of financial conditions and support EM growth outlooks.

■ In an environment oriented towards all-in yields and carry, EMD provides the necessary components: room for spread compression (with lower-rated issuers outperforming), capacity for rate cuts, attractive currency yields and carry, prominent idiosyncratic drivers, and positive flows. Financial engineering and liability management exercises have also created a positive technical backdrop, helping an expanded EM investor base absorb record new issue supply.

■ However, geopolitical, global macro, and country-specific challenges remain. Populist tendencies and polarized political economies are a global phenomenon. So, while fiscal and balance of payment dynamics are currently stable, slippage pressures could mount. We have also yet to observe the full impacts from the U.S. tariff policy. Political dynamics and election calendars (e.g., Argentina/Brazil/Colombia) are examples of how the opportunity set needs to be examined from an upside/downside perspective to price in potential stress scenarios. As a result, we remain selective and modestly cautious around spread risk, focusing instead on resilient issuers and repricing stories.

Sovereign rating upgrades as a percentage of rating actions. Upgrades as % of total ratings actions (rolling 6 months)

Source: Moody's Investors Service, S&P, Fitch Ratings

■ EM hard currency spreads are near the tight end of their range. However, in a scenario where global growth does not contract and the Fed embarks on a rate cutting cycle, we expect spreads to either remain rangebound or tighten from here. Given the high all-in carry of the Index (which can offset almost 100 bps of spread widening without any move in core rates), we expect total returns to skew positive. In a negative global growth shock scenario, rates should help drive performance in hard currency assets. In a scenario where EM growth remains positive, carry alone should provide attractive returns.

■ Fundamentals are also supportive as EM policymakers have moved from pandemic-era stimulus to consolidation. Headline fiscal deficits have narrowed on the back of reform agendas in many EMs, helping to reduce debt-to-GDP. EM central banks tightened earlier and more aggressively than DMs in response to post-COVID inflation, pushing real policy rates into positive territory and anchoring inflation expectations. Now that disinflation is progressing, interest burdens look more manageable and growth is more durable. External positions are sturdier as well: current-account balances have normalized, FX reserve buffers have been rebuilt, and higher shares of local-currency funding have reduced external vulnerabilities to volatility in USD markets. Given the strong issuance in 2025, many sovereigns have also smoothed amortization profiles, bolstered quasi-sovereign balance sheets, and used IMF or multilateral programs to lock in reform commitments.

■ EMs are also benefiting from improving growth differentials versus the U.S. and other developed markets, even as EM growth potentially slows. Historically, high growth differentials (not necessarily the absolute level of growth) have led to EM outperformance. The quality of EM growth is also improving at the margin as it becomes less credit-fueled and more export and investment led. Continued strengthening of institutions is also visible as both central banks and finance ministries lean more orthodox, creating a more predictable policy mix and supporting the domestic environment.

■ While not every EM is improving (e.g., some EMs are still running wide fiscal deficits, China's growth trend is clearly slowing, and geopolitics have kept fundamental dispersion high), the combination of tighter macro anchors, healthier external buffers, and better debt structures points to EM sovereign resilience. This is reflected by ratings actions as far more sovereigns have been upgraded over the past few years than have been downgraded or put on negative watch.

■ **EM Corporates:** Spreads tightened in Q3, retracing the tariff-related widening from March/April. Significant differentiation across sectors and ratings remain, with cyclical sectors, such as oil & gas and real estate, outperforming with telecom lagging. EM corporate high yield, including B-rated issuers, performed especially well. Africa, which is lower-rated and generally sold off, has recovered strongly. Higher-rated Asia has lagged while LatAm was hurt by some idiosyncratic weakness in Argentina and Brazil.

■ Going forward, we believe that mid- to high-single digit annualized returns are possible from carry, roll-down, and some spread compression in higher-quality high yield. Technicals remain supportive, driven by investor motivation to add non-U.S. risk and the accumulated cash on the sidelines—especially in Asia.

■ EM corporate fundamentals are resilient, and we expect EM corporate high yield defaults to remain within the historical average of around 3-4%. The strength in EM currencies supports EM corporates' ability to service their USD bonds and local financial conditions have opened more avenues for refinancing. Tariff risks have been mostly mitigated through realignment of supply chains, changes in product mix, and the pre-emptive build-up of inventory, but we are watchful of pressure on operating margins in the medium term.

■ Year-to-date gross issuance of $350 billion has been higher than expected, driven by the Middle East and Latin America. Year to date, net financing is zero compared to -$70 billion for 2024. We have seen some innovative structures in infrastructure financing, and we expect the area to continue to grow and to provide financing opportunities. Korean and Taiwanese insurance companies have increased issuance due to changes in their capital requirements, and that increase has presented some attractive opportunities. Conversely, some issuers, such as India and China, have chosen to [issue in the local markets](#)due to lower rates and abundant liquidity, keeping corporate spreads anchored.

- EM corporates continue to offer opportunities to diversify, and the asset class has experienced fewer idiosyncratic surprises over the last 12-18 months. Non-dedicated investors have shown appetite for the asset class given the spread pick-up versus U.S. high yield. We still see the best value in EM corporate BBs and select, longer-dated BBB issuers. Risks to the asset class include sustained geopolitical tensions and/or a U.S. recession.

- **EM Local Rates:** Lower U.S. Treasury yields and U.S. dollar weakness have provided a significant tailwind for EM local markets thus far in 2025. While we expect these trends to continue, we are cautiously constructive on EM rates in Q4 due to stretched valuations. The terminal rate is already priced at 3% in the U.S., and, unless the Fed decides to accelerate the cutting cycle, it will be hard for many low-yielding markets to outperform the forward curves.

- Among the low yielders, we are overweight duration in Czech, Korea, and Peru. However, scope for more than one cut in these countries is limited. We see more opportunities in high yielders, such as Mexico, Brazil, South Africa, and Colombia. In Mexico, we expect that Banxico has room to cut its policy rate to 6.5% versus the 7.0% that is currently priced in the curve. In Brazil, real rates are high, and we expect the central bank to begin an easing cycle as early as January of 2026. In South Africa, we favor the long end of the curve and expect issuance to come down in Q4. Meanwhile, Colombia's five-year is our preferred roll-down and carry play.

- **EMFX:** After broad U.S. dollar weakness in Q2, performance was more mixed in Q3, with high-carry currencies outperforming low-carry currencies. Looking ahead, we remain relative-value focused with the expectation that high-carry currencies will continue to outperform in Q4. We also expect a weakening (but mixed) U.S. dollar due to several factors: Fed rate cuts should cap the dollar's upside; EU fiscal measures could offset growth downside, leading to higher growth vis-a-vis the U.S.; and more stimulus measures coming out of China are likely to result in a stable or improved economic backdrop, which could keep volatility low and support higher-beta, cyclical currencies. Risks to this outlook include fewer Fed rate cuts than market expectations, a U.S. recession or global growth slowdown, increased geopolitical risks, and fiscal concerns in select countries, such as Brazil, Colombia, and Poland.

- In terms of positioning, we remain focused on relative-value opportunities, with high-carry long positions in BRL, TRY, INR, EGP, and ZAR, and low-carry short positions in CNH, THB, SGD, and CZK. We also have a small, short USD bias.

MUNICIPAL BONDS

Outlook: Carry conditions. Muni rates remain attractive in both absolute terms and relative to Treasuries. September's improved performance suggests that "Muddle Through" conditions pair well with Munis' resilient profile. While taxable spreads have tightened, they remain wide to corporates, suggesting additional compression is possible.

■ **Tax Exempt Munis**. YTD performance has lagged most other fixed income asset classes, primarily driven by higher supply (up 15% YoY). However, supply is expected to moderate through year end. While September and October are slower reinvestment periods, activity should pick up later in Q4. If supply moderates, we could return to a net negative supply environment.

■ **A Growing Market**. The size of the muni market now stands at ~$4.3 trillion, driven by inflation, sector-specific supply (e.g., healthcare, higher education, and transportation), and post-COVID activity. In addition, the One Big Beautiful Bill Act (OBBBA) likely pulled issuance forward. In Q4, we expect supply to moderate as concerns over munis' tax-exempt status have eased. Issuers may also wait for more attractive rates as the Fed has resumed its rate cutting cycle.

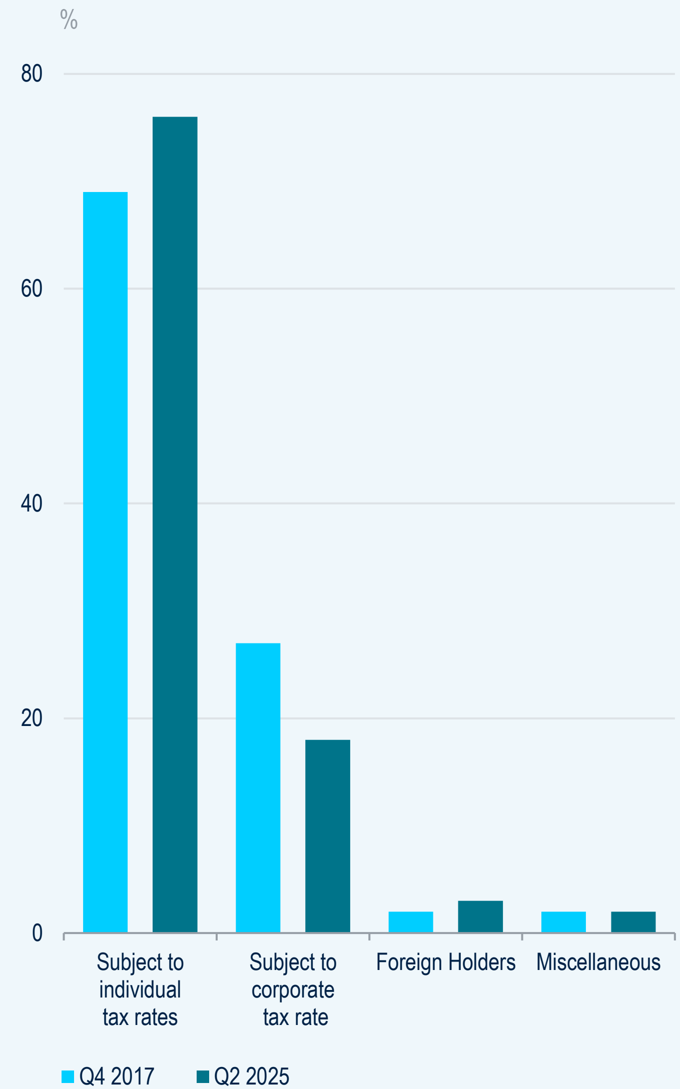
■ **Opportunity for Additional Spread Tightening**. IG and HY munis have shown positive performance, but both underperformed other asset classes due to higher supply and a steeper curve. Muni credit spreads have tightened slightly and remain wide relative to corporates. As a result, there is additional room for tightening.

■ **Muni Valuations are Getting More Expensive as the Market Outperforms.** Higher supply, coupled with the lack of back end support from retail investors and banks, resulted in a 2s/30s muni curve that was 115 bps steeper compared to Treasuries (57 bps steeper) as of August. However, as muni rates outperformed U.S. Treasury rates in September, the curve flattened (18 bps), with the 30-year portion of the muni curve showing the strongest performance as the 30-year M/T yield ratio fell below 90%. Ultimately, Q4 performance may be driven by Treasury rates and broader economic data.

■ **Taxable Munis:** Limited supply continues to support taxable muni tecnhicals. While taxable spreads underperformed corporates, they have broadly moved in-line with the corporate market.

■ **Positioning:** Given the rate volatility, we seek to build durable portfolio(s) that hit alpha target(s) while maintaining index duration. We have complemented this with rate curve flatteners given the steepness of the M/T yield curve. We favor student loans, affordable housing, and prepay gas and are avoiding names that are more susceptible to funding cuts. These include healthcare (e.g., providers that have higher Medicaid payer mixes), universities that have high leverage, weak balance sheets, and/or a reliance on endowment revenue, and local governments that have exhausted their COVID-era aid.

Portion of the Municipal Market held by investor classes. Since 2017, retail demand has increased, while institutional demand has fallen due to lower corporate tax rates.



Source: J.P. Morgan.

SUMMARY OF OUTLOOKS & ASSET CLASS VIEWS

This summary consists of our short- and long-term (1-yr) sector outlooks. The latter is based on a scale of 1-5 with an accompanying description that indicates our expectation for the sector's total excess return.[1]

Market Score

Sell Off	Correction	Carry	Modest Tightening	Bull Market

Sector	Short-term Outlook		
DM Rates	Although the sector remains vulnerable to numerous global crosscurrents, central bank easing biases create a mild tailwind for Western rates. Positioning remains tactical along yield curves and around market pricing.	U.S. Europe	UK Japan
Agency MBS	Carry conditions. Even with tight OAS profiles, MBS carry remains intact versus intermediate Treasuries as the Fed easing cycle begins. We prefer a barbell position consisting of lower 30-year coupons and 30-year coupons near par, while avoiding the middle of the stack. We continue to favor better cashflows and convexity via specified pools rather than TBAs.	Agency MBS	
Securitized Credit	Carry conditions. Securitized spreads generally remain wider YTD, but tighter than historical averages. Amid flat credit curves, high-quality securitized assets continue to offer attractive valuations relative to other fixed income sectors. Our outlooks for CMBS, RMBS, CLOs, and ABS reflect a tighter than average spread environment combined with weaker or normalizing underlying asset fundamentals. Our "carry" base case calls for limited total return potential—from limited capital appreciation—and thicker tails. We remain focused on tranches at or near the top of capital structures and are highly selective regarding more credit-sensitive positions given the risk/reward dynamic. In asset-based finance markets, positive capital flows continue; we are targeting structures suited to perform through the cycle in prime consumer, commercial, and residential subsectors.	CMBS CLOs	RMBS ABS
Global IG Corporates	Carry conditions. With IG corporate spreads near multi-decade tights, further spread compression is likely to be limited in Q4. Our base case calls for the U.S. and European economies to "muddle through" and for spreads to be range-bound near current levels. That stated, yields are still relatively high and continue to drive strong demand for IG corporate bonds.	U.S. Corps. 1-10 U.S. Corps. 10+	European Corps. 1-5 European Corps. 5+
Global Leveraged Finance	Carry conditions. We expect global leveraged finance spreads to maintain a range near historical tights as persistently strong technicals and a sound credit environment are likely to continue to hold firm against prevailing global macro risks. While still constructive overall, we maintain our close-to-home defensive positioning in U.S. high yield bonds and loans as well as underweights to cyclicals and more focused on defensive sectors in Europe.	U.S. High Yield 1-5 U.S. High Yield 5+ U.S. Leveraged Loans	Euro High Yield BB Euro High Yield B and below Euro Leveraged Loans
EM Debt	Modest spread tightening and carry conditions. Despite elevated macro uncertainty, EM economic growth remains comparably high, fundamentals have broadly improved, and yields stand out versus other fixed income sectors. We remain focused on resilient issuers and are modestly cautious around spread risk as we have yet to observe the full impact of U.S. tariff policy. Due to stretched valuations, we are cautiously constructive on EM rates and expect the U.S. dollar to maintain its weakening bias. EM corporates continue to offer diversification opportunities..	Sov. Hard Currency IG Sov. Hard Currency HY Local rates[2]	EMFX[2] Corps. IG Corps. HY
Municipal Bonds	Carry conditions. Muni rates remain attractive in both absolute terms and relative to Treasuries. September's improved performance suggests that "Muddle Through" conditions pair well with Munis' resilient profile. While taxable spreads have tightened, they remain wide to corporates, suggesting additional compression is possible.	Taxable	

[1] The positioning in a respective portfolio may not be identical to the long-term ratings. The ratings and information herein is for comparison purposes.
[2] The scores on the indicated asset classes are based on expectations for total excess returns.

SUMMARY OF MARKET PERFORMANCE

Sector		Subsector	Spread change (bps) Q3	SOFR OAS 9/30/25
CMBS	CMBS: Conduit AAA	First-pay 10-year	-19	124
	CMBS: Conduit BBB-	BBB-	-129	496
	CMBS: SASB –Sr.	AAA	-10	140
	CMBS: SASB – Mezz	BBB-	-15	225
	CMBS: Agency Multifamily	Senior	-8	87
Non-Agency RMBS	Legacy	RPL Senior	-23	152
	Legacy	'06/'07 Alt-A	-55	190
	GSE Risk-Sharing	M2	5	150
CLOs	CLO 2.0	AAA	-6	122
	CLO 2.0	AA	-5	155
	CLO 2.0	BBB	-25	255
ABS	Unsecured Consumer Loan ABS	Seniors	-6	122
	Unsecured Consumer Loan ABS	Class B	4	167
	Refi Private Student Loan	Seniors	-11	127
	Credit Card ABS	AAA	-9	64

Source: PGIM.

	Total return (%)		Spread / yield change (bps)		OAS (bps) / yield %
	Q3	YTD	Q3	YTD	9/30/25
EM Hard Currency	4.75	10.79	-39	-42	284
EM Local (Hedged)	2.04	6.54	-8	-46	5.93
EMFX	0.74	11.25	33	-238	5.83
EM Corps.	3.18	7.34	-32	-7	234

Source: J.P. Morgan.

	Total return (%)		Spread change (bps)		OAS / DM (bps)
	Q3	YTD	Q3	YTD	9/30/25
U.S. High Yield	2.54	7.22	-23	-20	267
Euro High Yield	1.83	4.17	-40	-36	281
U.S. Leveraged Loans	1.68	4.69	-8	-24	451
Euro Leveraged Loans	0.90	3.30	6	-3	469

Source: ICE BofAML and S&P UBS.

	Total return (%)	
	Q3	YTD
High Grade Tax-exempt	3.00	2.64
High Yield Tax-exempt	1.63	1.29
Long Taxable Munis Agg. Eligible	2.94	6.66

Source: Bloomberg. Represents the Bloomberg Municipal Bond Indices.

	Total Return (%)		Spread Change (bps)		OAS (bps)
	Q3	YTD	Q3	YTD	9/30/25
U.S. Corps.	2.60	6.88	-9	-6	74
European Corps.	0.94	2.76	-13	-23	79

Source: Bloomberg.

Past performance is not a guarantee or a reliable indicator of future results. See Notice for important disclosures. All investments involve risk, including possible loss of capital. An investment cannot be made directly in an index. All data as of September 30, 2025.

IMPORTANT INFORMATION

Source(s) of data (unless otherwise noted): PGIM as of July 2025.

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IMPORTANT INFORMATION

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U.S. INVESTMENT GRADE CORPORATE BONDS

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EUROPEAN INVESTMENT GRADE CORPORATE BONDS

Bloomberg European Corporate Bond Index (unhedged): The Bloomberg Euro-Aggregate: Corporates bond Index is a rules-based benchmark measuring investment grade, EUR denominated, fixed rate, and corporate only. Only bonds with a maturity of 1 year and above are eligible.

U.S. HIGH YIELD BONDS

ICE BofAML U.S. High Yield Index: The ICE BofAML U.S. High Yield Index covers US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, and at least one year remaining term to final maturity as of the rebalancing date.

EUROPEAN HIGH YIELD BONDS

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S&P UBS Leveraged Loan Index: The Index is a representative, unmanaged index of tradable, U.S. dollar denominated floating rate senior secured loans and is designed to mirror the investable universe of the U.S. dollar denominated leveraged loan market. The Index return does not reflect the impact of principal repayments in the current month.

EUROPEAN SENIOR SECURED LOANS

S&P UBS Western European Leveraged Loan Index Hedged: All Denominations EUR hedged. The Index is a representative, unmanaged index of tradable, floating rate senior secured loans designed to mirror the investable universe of the European leveraged loan market. The Index return does not reflect the impact of principal repayments in the current month.

EMERGING MARKETS U.S.D SOVEREIGN DEBT:

J.P. Morgan Emerging Markets Bond Index Global Diversified: The Emerging Markets Bond Index Global Diversified (EMBI Global) tracks total returns for U.S.D-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. To be deemed an emerging market by the EMBI Global Diversified Index, a country must be rated Baa1/BBB+ or below by Moody's/S&P rating agencies. 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.

EMERGING MARKETS LOCAL DEBT (UNHEDGED)

J.P. Morgan Government Bond Index-Emerging Markets Global Diversified Index: The Government Bond Index-Emerging Markets Global Diversified Index (GBI-EM Global) tracks total returns for local currency bonds issued by emerging market governments.

EMERGING MARKETS CORPORATE BONDS

J.P. Morgan Corporate Emerging Markets Bond Index Broad Diversified: The CEMBI tracks total returns of U.S. dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries.

EMERGING MARKETS CURRENCIES

J.P. Morgan Emerging Local Markets Index Plus: The JP Morgan Emerging Local Markets Index Plus (JPM ELMI+) tracks total returns for local currency–denominated money market instruments.

MUNICIPAL BONDS

Bloomberg Municipal Bond Indices: The index covers the U.S.D-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds. The bonds must be fixed-rate or step ups, have a dated date after Dec. 13, 1990, and must be at least 1 year from their maturity date. Non-credit enhanced bonds (municipal debt without a guarantee) must be rated investment grade (Baa3/BBB-/BBB- or better) by the middle rating of Moody's, S&P, and Fitch.

U.S. TREASURY BONDS

Bloomberg U.S. Treasury Bond Index: The Bloomberg U.S. Treasury Index measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index.

MORTGAGE BACKED SECURITIES

Bloomberg U.S. MBS—Agency Fixed Rate Index: The Bloomberg U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.

COMMERCIAL MORTGAGE-BACKED SECURITIES

Bloomberg CMBS: ERISA Eligible Index: The index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974, which will deem ERISA eligible the certificates with the first priority of principal repayment, as long as certain conditions are met, including the requirement that the certificates be rated in one of the three highest rating categories by Fitch, Inc., Moody's Investors Services or Standard & Poor's.

U.S. AGGREGATE BOND INDEX

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