PRUDENTIAL GLOBAL BALANCED FUND
30 SEPTEMBER 2018

PRUDENTIAL

QUARTERLY COMMENTARY

GLOBAL MULTI-ASSET

MARKET OVERVIEW

The third quarter of 2018 saw a sharp escalation in the trade war between the US and China, in addition to still-strong US growth, rising US interest rates, a strengthening US dollar and financial crises in Turkey and Argentina. The result: stronger equity markets in developed economies but heightened investor risk aversion that impacted particularly negatively on emerging markets. Developed equity markets ended the quarter returning 5.1% in US dollars, while emerging equity markets delivered -1.1%. In South Africa, negative local economic news weighed on financial markets, as did poor global sentiment, with local bonds losing ground but the weaker rand underpinned rand hedges and Resource shares on the JSE.

Global bonds lost 0.9% (in US$) during the quarter, largely on the back of rising US interest rates. More bond issuance also weighed on the US Treasury bond market as the Trump tax cuts expanded the budget deficit. The yield on the benchmark 10-year US Treasury bond ended the quarter at 3.05% from 2.9% at the end of Q2. As widely expected, the US Federal Reserve hiked interest rates by 25bps at its September FOMC meeting, while also upping its 2018 growth outlook to 3.1%. The Fed also removed its policy description as "accommodative", signalling that it considers its benchmark target range, now at 2.0-2.25%, to be close to a "neutral" level, meaning it is no longer supportive of economic expansion, but neither is it a constraint. The Fed still foresees another 25bp hike this year (consensus in December) and three more 25bp hikes through 2019, as well as one in 2020. Fed Chairman Jerome Powell's post-FOMC comments that he didn't expect a near-term recession further boosted the US dollar and US stocks late in the quarter.

The US economy picked up steam, recording 2.9% GDP growth in Q2 (q/q annualised) stoked by Trump's tax cuts as consumer and business spending rose. Inflation remained under check as August CPI came in at 2.7% y/y from 2.9% in July, slower than forecast as rising energy costs were offset by declines in healthcare and apparel costs. The Fed's key core Personal Consumption Expenditure (PCE) measure for August was reported at 2.0%, hitting the target for the third time in 2018. Equity markets reflected the bullish sentiment as the S&P 500 returned 7.7%, the Nasdaq 8.6% and Dow Jones Industrial 30 Index 9.6% (all in US$), although September returns were much more muted due largely to rising trade tensions.

In contrast with the US, Eurozone growth slowed to 2.2% (q/q annualised) in Q2 from 2.5% previously, impacted by higher fuel prices and slower consumer spending, while August CPI decelerated to 2.0% y/y from 2.1% in July, softer than expected. The European Central Bank (ECB) kept its benchmark interest rate unchanged at 0% at its 13 September meeting, as had been expected, and officials said rates should remain at record lows for at least the next nine months. However, it also began scaling back its bond-buying programme. The Dow Jones Eurostoxx 50 returned -0.2% (in US$) for the quarter. Meanwhile, UK growth picked up slightly to 1.3% (q/q annualised) from 1.2% in the previous quarter, and the Bank of England surprised by hiking its interest rate by 25bps in August - the first time since the Financial Crisis. This was on the back of a strong labour market and credit growth, and despite worsening uncertainty over the outcome of Brexit as the government faces heightened internal party conflict and a renewed stalemate with the EU. The UK's FTSE 100 Index returned -1.8% (in US$) for the quarter.

After contracting by a revised 0.9% (q/q annualised) in Q1 2018, the Japanese economy rebounded to 1.9% growth in Q2, beating expectations of 1.4%. Apart from some once-off factors dampening Q1 growth, the rebound was attributed to a pickup in consumer spending amid a tight labour market and rising real incomes. However, the expansion is forecast to lose steam gradually as Japan's export-led economy is impacted by worsening global trade conditions, despite the central bank's supportive policies. The Nikkei 225 Index returned 6.3% (in US$) in Q3, reaching 27-year highs. In China, Q2 GDP growth came in at 6.7% (q/q annualised), as expected, slightly down on the 6.8% reported for Q1 due to slower industrial output and business fixed investment. Business confidence is being hit by growing concerns over the widening impact of US tariffs on Chinese exports, the full extent of which is set to be felt later in the year and is likely to exacerbate the slowdown. Chinese stocks were weaker as a consequence.

Emerging markets (EMs) in general experienced capital outflows during the quarter, with bonds hit particularly hard. Financial crises in Turkey and Argentina in late August and early September worsened already-poor investor sentiment, with the contagion effect spreading across most EMs. For the quarter the MSCI Turkey lost 20.5% (in US$), despite returning 20.6% in September, and the central bank was forced to hike interest rates by nearly 7.0% to 24% to protect a plunging lira. The MSCI China returned -7.4% and the MSCI South Africa delivered -7.2%, while MSCI Russia returned 6.6% and Brazil's Bovespa 5.0% (all in US$).

PERFORMANCE

The fund returned 1.7% (net of fees) for the quarter, versus 2.6% from its benchmark (65% MSCI All Country World Index, 5% FTSE EPRA/NAREIT Global REIT Index, 25% Bloomberg Barclays Global Aggregate Bond Index and 5% USD 1m LIBOR). For the 12 months ending 30 September 2018, in US dollar terms the fund returned 3.3% (net of fees), underperforming its benchmark by 3.0%.

The fund's underperformance for the quarter is largely due to the fund's preference for cheaper valued equity markets, mostly EMs, which struggled given the current risk-off environment. Stock selection within equities further detracted from performance, though partly offset by the fund's underweight to treasuries and exposure to hard currency EM bonds.

STRATEGY AND POSITIONING

In our global portfolios we remain underweight global bonds and global cash, and overweight global equities, with the latter offering attractive valuations in many markets, particularly when viewed relative to bonds, and much higher potential returns over the medium term.

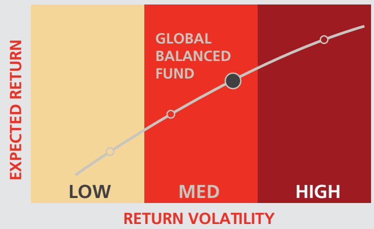
In global fixed income, as in previous quarters, despite rising government bond yields, they continue to trade at very low yields (and high valuations) historically, and remain at risk to rising interest rates globally. We remain underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds.

For global equities, gains in the US pushed valuations to higher levels there as we maintained our underweight in that market. Other developed markets like Germany and Japan remained broadly attractive, however, and valuation disparities between developed and EMs widened further in Q3. Broad EM selling made many even more attractive compared to markets like the US. We continue to prefer the global banking sector, which has underperformed the broader market, as well as certain developed markets where equities are undervalued but fundamentals for earnings growth remain positive, including Germany and Japan, and selected EMs such as South Korea, Indonesia and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent. ■

ANNUALISED PERFORMANCE	B CLASS	BENCHMARK
1 Year	3.3%	6.3%
Since Inception	4.0%	6.7%

Inception date B Class: 31 July 2017

RISK/RETURN PROFILE:



INVESTMENT MANAGER:
M&G Investment Management Limited (UK)

FUND MANAGERS:
Marc Beckenstrater and Craig Simpson

MORNINGSTAR CATEGORY:
Flexible Allocation

BENCHMARK:
65% MSCI All Country World Index TR (Net), 5% FTSE EPRA/NAREIT Global REIT Index, 25% Bloomberg Barclays Global Aggregate Bond Index, 5% USD 1m LIBOR

INCEPTION DATE:
19 June 2017

CURRENCY:
US Dollar

FUND SIZE:
USD 30.7 million

Sources: Prudential, Morningstar & Deutsche Securities