

Prudential International Investments Advisers, LLC.

Global Investment Strategy – May 2009

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Financial Market Outlook & Strategy: Stocks Bottoming On Track to Recovery. Near-term Risks

John Praveen's Global Investment Strategy – May 2009 raises stocks to a modest overweight relative to bonds with stocks on track to a sustainable recovery as the macro and earnings outlook continues improve. Although stocks are likely to face a correction given the strong rally since March, they are unlikely to test the March lows since the rate of decline in economic activity and earnings have abated. Stock markets have historically begun to recover 3-5 months before the economy bottoms. The improved tone of recent macro data suggests that the global economy bottomed in H1 and remains on track to recover in H2 2009. The improving economic data validates the stock market recovery since the March lows and supports the view that stock markets are on a sustainable recovery track.

Government bond yields are likely to be range bound, under competing influences. Central bank bond purchases and other QE measures, and deflation fears are positive for bonds. However, improving macro data, increasing risk appetite, and rising bond supply are likely to push yields higher.

Within stocks, we are overweight the Emerging Markets and the U.K. The U.S. is downgraded to neutral. Eurozone is also downgraded, joining Japan as modestly underweight. Within bonds, we are modestly overweight on Japanese bonds (JGBs) & U.K. Gilts, and modestly underweight on U.S. Treasuries & Eurozone bonds.

The global asset allocation and strategy models presented are hypothetical models shown for illustrative purposes only, and does not necessarily reflect the management of any actual account. Following the models presented may not result in profitable investments.

Financial Market Outlook: Equities on Track to Sustainable Recovery as Macro & Earnings Outlook Continues to Improve

Stocks: Equities on Track to Sustainable Recovery as Macro & Earnings Outlook Continues to Improve

- Global equity markets continued their strong rally in April as macro data continued to improve, Q1 earnings, while still negative, were not as bad as feared, and the event risks – worst case GM and Chrysler outcomes, and the need to inject even more capital into banks following the bank stress-tests – did not materialize. Risk appetite began to improve as investors looked favorably at recent economic and earnings data.
- The global economy continues to show signs of improvement in April even though the U.S., Europe and Japan and many emerging economies remained deep in recession in Q1. Leading economic indicators, business and consumer confidence indicators and actual activity data have stopped falling, indicating that the rate of decline in economic activity is slowing - or the second derivative is improving. The GDP decline in Q2 is likely to be less negative pointing to a global recovery in H2 2009.
- While Q1 reported earnings remain sharply negative, the rate of decline appears to be abating (second derivative improving). In the U.S., Q1 earnings are tracking -36% and the earnings results were slightly better-than-expected. With 85% of S&P 500 companies having reported, 65% beat analyst expectations and the reported earnings were 6.0% above estimates. In Eurozone, while Q1 earnings are tracking around -42%, they are still better than expected with 29% more companies beating estimates than missing them.
- Financial markets were also relieved by the results of the Stress Test for the U.S. banks which confirmed that of the 19 institutions, 9 do not need capital, while 10 need to raise capital. Overall, firms need around \$75bn. Some of the largest U.S. financial institutions have successfully raised capital to meet the requirements of the U.S. government's stress test.
- Equity market valuation multiples rose further in April from record low levels earlier in the year as equity markets continued their strong run in April from the March lows. However, equity valuations still remain attractive.
- ***Looking ahead, given that stock markets had a strong rally since March, they are perhaps due for a correction. However, stocks are unlikely to test the March lows since the rate of decline in economic activity and earnings has abated.***
- ***During past global banking crises over the last 100 years, stocks markets have declined around -56%, on average. In the current banking crisis, equity markets have already declined around -60%, worse than the average of prior banking crises.***
- ***Further, stock markets have historically begun to recover 3-5 months before the economy bottoms. The improved tone of recent macro data suggests that the global economy bottomed in H1 and remains on track to recover in H2 2009. Having already fallen further than in previous banking crises, the improving economic data validates the stock market recovery since the March lows and supports the view that stock markets are on a sustainable recovery track.***

Bonds: Bonds Range Bound. Improving Macro Data Pressure Bonds. Deflation Fears & CB Buying Support Bonds

- Global government bonds were flat in April after strong gains in March. U.S. Treasuries and U.K. Gilts both unwound some of their gains from March, but Japanese JGBs declines were more moderate. Eurozone bonds edged up. Emerging Markets bonds again rose sharply as investors moved back into riskier assets during the equity market rally.

Global Investment Strategy – May 2009

- *Looking ahead, government bond yields are likely to be range bound, under competing influences. Central bank bond purchases and other Quantitative Easing (QE) measures and deflation fears are positives for bonds. However, improving macro data, increasing risk appetite, and rising bond supply are likely to push yields higher.*
- *U.S. Treasuries are likely to be range bound with 10-year yield between 2.75-3.25% with Fed's Treasury buying putting a de facto ceiling on yields. U.K. Gilts are supported by BoE's Gilt purchases and continued GDP declines, but the growing fiscal deficit is likely to limit gains. Eurozone bonds are supported weak GDP growth, but less aggressive ECB easing is a negative. Japanese JGBs are likely to be supported by sharply weaker GDP data and deflation fears, but the large fiscal deficit is a negative.*

Investment Strategy: Equities on Track to Sustainable Recovery as Macro & Earnings Outlook Continues to Improve

ASSET ALLOCATION: Stocks vs. Bonds

The global asset allocation models presented are hypothetical models shown for illustrative purposes only, and does not necessarily reflect the management of any actual account. Following the allocation models presented may not result in profitable investments.

Modest Overweight Stocks: Stock markets appear to be on a sustainable recovery track with the improved tone of recent macro data suggesting that the global economy bottomed in H1 and remains on track to recover in H2. Hence we raise stocks to modest overweight. *Will use any equity corrections to increase equity overweight.*

Modest Underweight Bonds: Government bond yields are likely to be range bound, under competing influences. Central bank bond purchases and other QE measures, and deflation fears are positive for bonds. However, improving macro data, increasing risk appetite, and rising bond supply are likely to push yields higher.

GLOBAL BONDS

Modest Overweight: UK & Japan 1) Gilts are likely to post further gains with continued weakness in economic activity and Gilt purchases by the BoE. However, the increased supply from the growing fiscal deficit is likely to limit gains. 2) JGBs are likely to be supported by another double-digit decline in GDP growth in Q1 and continued weakness in Q2. However, the already low level of yields, and rising bond supply from the fiscal stimulus are likely to keep gains limited.

Modest Underweight: U.S. & Eurozone 1) Treasuries are likely to be range bound, with 10-year yield between 2.75-3.25%, as Fed's Treasury buying and deflation fears push yields lower, while improving macro data and increasing risk appetite, and rising bond supply with the growing fiscal deficit are likely to push yields higher. 2) Eurozone bonds are likely to be supported by weak GDP data and the ECB's starting QE. However, the less aggressive ECB easing than the Fed and BoE is a negative for Eurozone bonds.

GLOBAL EQUITIES

Overweight: Emerging Markets, & U.K. 1) Emerging Markets: Macro and earnings outlook continues to improve. Further rate cuts, improved valuations and increased risk appetite are positive for EM stocks. 2) UK: Valuations are attractive. Aggressive QE measures and sterling weakness are other positives.

Neutral: U.S. With risk appetite improving and global stock markets on a sustainable recovery track, U.S. is likely to underperform Emerging Markets. Hence, we reduced U.S. to neutral.

Underweight: Eurozone & Japan 1) Eurozone: Macro outlook is weaker relative to the U.S., U.K. and the Emerging Markets while policy response is less aggressive. Q1 earnings tracking -42%, valuations attractive relative to the U.S. and Japan. 2) Japan: Macro and earnings outlook weaker than in the U.S., U.K. and the Emerging Markets with a -15.2% annualized decline in Q1 GDP. Earnings are expected to post another big decline in Q1 with an even sharper decline in Q1 GDP growth.

GLOBAL SECTORS

Overweight: Financials, Info Technology. Modest Overweight: Materials, Consumer Staples.

Neutral: Industrials, Healthcare. Modest Underweight: Energy, Telecomm, Utilities. Underweight: Consumer Discretionary.

CURRENCIES

Overweight: U.S. Dollar; Neutral: Sterling; Underweight: Euro & Yen.

The dollar is likely to remain strong against major currencies with the U.S. on track to recover from recession ahead of the others. Eurozone and U.K. GDP growth outlook still remains bleak, but U.K. monetary policy has been more aggressive than in Eurozone. The return of risk appetite is a negative for the yen as the carry trade returns.

Regional Equity Strategy

The strategy models presented are hypothetical models shown for illustrative purposes only, and does not necessarily reflect the management of any actual account. Following the strategy models presented may not result in profitable investments.

Emerging Markets (EM): Macro and earnings outlook continues to improve. Several green shoots of recovery are seen in emerging economies led by the recovery in China. Exports have stabilized after the freefall in Q4 2008 while energy and commodity prices recovered significantly. Most Emerging Markets central banks continue to cut interest rates. Central banks in Latin America were particularly active in recent months in cutting rates. Further, IMF financing and the decline in inflation will give EM central banks room to cut rates further. EM valuations have improved, with EM now trading at a discount to Developed Markets. Growing signs of a global economic recovery have increased risk appetite that is likely to lead to further gains for EM stocks. **Overweight. Within EM, we are Overweight Asia, Neutral on Latin America and Underweight Emerging Europe.**

U.K.: The Bank of England left rates unchanged at 0.5% in May, but expanded the asset purchase program by £50bn to £125bn. Valuations and sterling weakness continue to be positives for U.K. stocks. GDP contracted -7.4% annualized in Q1 2009. However, Q2 GDP decline is likely to be smaller than in Q1, with support from aggressive rate cuts and Quantitative Easing. Earnings are estimated to fall -32% in 2009. **Modest Overweight.**

U.S.: U.S. GDP declined -6.1% QoQ annualized in Q1 2009 after the -6.3% decline in Q4 2008. However, the composition of Q1 GDP is positive for Q2 growth outlook with GDP likely to decline -0.5%. Forward looking indicators are improving suggesting that the U.S. remains on track for positive growth in H2 2009. The Fed was on hold at the April meeting and made no change to its asset purchase plans to buy up to \$1.75 trillion of agency debt, agency MBS, and Treasury securities. U.S. Q1 earnings are tracking -36% and the earnings results were slightly better-than-expected. While Q1 reported earnings were sharply negative, the rate of decline appears to be abating. With risk appetite improving and global stock markets on a sustainable recovery track, the U.S. is likely to underperform Emerging Markets. Hence, reduced U.S. to neutral. **Downgrade to Neutral.**

Eurozone: Eurozone macro outlook is weaker relative to the U.S., U.K. and the Emerging Markets while policy response is less aggressive. Eurozone GDP posted an even bigger -9.8% annualized decline in Q1, with German GDP plunging 14.4% while Spanish GDP declined -7% annualized. However, forward looking business and consumer confidence continue to show modest improvement. The ECB cut rates by 25bps to 1% at the May meeting following the 25bps rate cut in April and took the first step towards Quantitative Easing by agreeing to purchase "around €60bn" of euro-denominated covered bonds. Eurozone earnings in Q1 are tracking around -42%, and earnings expectations for full year 2009 revised down to -13% in 2009 after a -25% decline in 2008. Eurozone valuations are attractive relative to the U.S. and Japan. **Downgrade to Modest Underweight.**

Japan: Japan's macro and earnings outlook is weaker than in the U.S., U.K. and the Emerging Markets. Japan's GDP posted the sharpest decline since 1955, plunging -15.2% QoQ annualized in Q1 after the revised-down -14.4% decline in Q4 2008. The plunge was led by the -26% QoQ decline in exports and -10.4% in private investment with IP falling -22.2% QoQ. However, there are signs of improvement with IP posting the first increase and a smaller decline in exports. Deflation fears re-emerge with headline inflation falling further to -0.3% YoY in March, while core prices fell -0.1%. The BoJ left its target overnight call rate unchanged at 0.1% in April, but expanded the range of collateral of its liquidity provision measures. The Aso government announced a new fiscal stimulus package of ¥57trn (\$580 billion) in April, the largest ever. Earnings are expected to post another big decline in Q1 with the economy declining -15.2% in Q1. Earlier, earnings declined -98% in 2008. **Modest Underweight.**

Regional Bond Strategy

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U.K.: Gilts are likely to post further gains with continued weakness in economic activity and Gilt purchases by the BoE. However, the increased supply from the growing fiscal deficit is likely to limit gains. The BoE held the bank rate at 0.5% in May but expanded the size of their Quantitative Easing program by £50bn to £125bn. The U.K. economy contracted -7.4% QoQ annualized in Q1 2009, after the -6.1% decline in Q4. However, business and consumer confidence continued to improve. Rising Gilt supply is likely to be a negative. The U.K. Chancellor of the Exchequer announced that the fiscal deficit would grow to 12% of GDP and the debt/GDP ratio is expected to rise to 80%. **Modest Overweight in U.K. Gilts.**

Japan: JGBs are likely to be supported by another double-digit decline in GDP growth in Q1 and continued weakness in Q2. However, the already low level of yields and rising bond supply from the fiscal stimulus are likely to keep gains limited. Japan's GDP posted the sharpest decline since 1955, plunging -15.2% QoQ annualized in Q1 after the revised-down -14.4% decline in Q4 2008. The plunge was led by the -26% QoQ decline in exports and -10.4% in private investment with IP falling -22.2% QoQ. However, there are signs of improvement with IP posting the first increase and a smaller decline in exports. Deflation fears re-emerge with headline inflation falling further to -0.3% YoY in March, while core prices fell -0.1%. The BoJ left rates unchanged at 0.1% in April but expanded the range of collateral of its liquidity provision measures. The Aso government announced a new fiscal stimulus package of ¥57trn (\$580 billion) in April, the largest ever. **Modest Overweight in JGBs.**

U.S.: Treasuries are likely to be range bound, with 10-years yields between 2.75-3.25%, as Fed's Treasury buying and deflation fears push yields lower, while improving macro data and increasing risk appetite, and rising bond supply with the growing fiscal deficit are likely to push yields higher. The Fed left rates in the 0-25bps range in April and made no change to its asset purchase plans. Treasury yields backed up in April, but mortgage yields did not follow Treasury yields higher. Should mortgage yields begin to rise, refinancings could slow and defeat the Fed's objective. In this situation, the Fed will likely act to contain the rise in rates. U.S. GDP declined -6.1% annualized in Q1 2009 after a -6.3% decline in Q4 2008. However, the composition of GDP (inventory liquidation and improved consumption) is more

encouraging for the Q2 GDP outlook. Macro data and confidence indicators continue to improve pointing to a H2 recovery. **Modest Underweight in Treasuries.**

Eurozone: Eurozone bonds are likely to be supported by weak GDP data and the ECB's starting QE. However, the less aggressive ECB easing than the Fed and BoE is a negative for Eurozone bonds. The ECB cut rates by 25bps to 1% at the May meeting and took the first step towards Quantitative Easing by agreeing to purchase "around €60bn" of euro-denominated covered bonds. Eurozone GDP decline accelerated in Q1 with GDP declining an even bigger -9.8% QoQ annualized after the -6.2% fall in Q4. German GDP plunged -14.4%, Spanish GDP declined -7%, while Italian GDP fell -9.4%. However, Eurozone bonds are likely to underperform with relatively less aggressive ECB easing. **Modest Underweight in Eurozone Bonds.**

Global Sector Strategy

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Our global sector model ranks sectors on a comparative basis using macro factors, valuation, earnings and risk measures.

- **Financials** - The outcome of the bank stress test has been positive for Financials in removing some of the concerns about capital adequacy. The implementation of the Public Private Investment Program and change in mark to market accounting are positives. Further, U.S. Q1 earnings have come in better than expected and earnings growth expected to improve over 2009. Continued loss write-downs, rising delinquencies, asset quality concerns, and credit deterioration are negatives. **Overweight.**
- **Information Technology** - Macro score is negative, but growing signs of revival in tech orders. Earnings revisions remain negative, but better than in other sectors. Valuations are expensive relative to other global sectors. High cash levels are a positive for the sector. European Tech firms likely to benefit from the currency tailwind and high net cash position. European Software less exposed to consumers and Financials and hence defensive. **Overweight.**
- **Materials** - Commodity prices (CRB index) rose 0.9% in April after rising 4.2% in March as Chinese manufacturers continued restocking. Construction Materials remains weak with housing markets still in a decline. M&A activity is a positive. Improvement in demand due to increased fiscal spending likely to support prices and is a positive for the sector. **Modest Overweight.**
- **Consumer Staples** - Sector benefits from increased market share as consumers cut back on discretionary spending. Earnings growth is relatively better compared with other sectors. U.S. Tobacco likely to benefit from its high dividend yield, low valuation, and solid earnings growth. Sector rotation towards cyclicals from defensives is a negative for the sector. **Modest Overweight.**
- **Industrials** - Macro fundamentals remain weak due to the ongoing global recession. Although industrial activity continues to decline globally in early Q2, the pace of decline is moderating. Manufacturing confidence has rebounded, but remains in negative territory. The fiscal stimulus in the U.S. and China are positive for infrastructure spending. **Neutral.**
- **Healthcare** - Sector's earnings and dividend growth remain relatively solid. Valuations are attractive on a historical basis, but expensive relative to other sectors. M&A activity is positive for the sector. Pharma faces headwinds such as regulatory risk, political pressures, pricing weakness and downgrades to long-term earnings outlook. Elevated risk aversion is a positive. **Neutral.**
- **Energy** - Oil prices have risen close to \$60 in early May after plunging from the record highs in 2008. In the near-term, the global recession is likely to weigh on oil prices. Earnings outlook has been revised down while sector valuation is on par with other global sectors. Oil Services are likely to benefit from continued demand for maintenance requirements. **Modest Underweight.**
- **Telecomm Services** - Sharp deterioration of consumer fundamentals remains a negative. Seasonality in H1 is a negative for the sector. Sector earnings expected to decline, but less than most other sectors. Valuations are at par with other global sectors. Big Telecomms favored with their strong and stable cash flows and cost saving opportunities. European Telecomms have attractive dividend yield and earnings stability. **Modest Underweight.**
- **Utilities** - This defensive sector is expected to underperform as risk aversion eases. However, sector benefits from defensive characteristics with markets still likely to remain volatile. Sector valuations are attractive. Earnings revisions have held up well due to the ability of Utility operators to pass on higher input costs to customers. European Utilities face headwinds of expensive valuations, regulatory headwinds and weak pricing power. **Modest Underweight.**
- **Consumer Discretionary** - Consumers continue to face headwinds of rising unemployment and sharply negative wealth effects. Sector earnings outlook is negative relative to other global sectors. Sector is likely to struggle with job losses and unemployment rising. Outlook for Eurozone, U.K., and Japan Discretionary is also weak with weak consumer fundamentals. **Underweight.**

Strategy Summary: Equities on Track to Sustainable Recovery as Macro & Earnings Outlook Continues to Improve

Asset Allocation – Modest Overweight: Stocks. Modest Underweight: Bonds.

Global Bonds – Modest Overweight: UK & Japan. Modest Underweight: U.S. & Eurozone.

Global Equities – Modest Overweight: Emerging Markets, & U.K. Neutral: U.S. Underweight: Eurozone & Japan.

Global Sectors – Overweight: Financials, Info Technology. Modest Overweight: Materials, Consumer Staples. Neutral: Industrials, Healthcare. Modest Underweight: Energy, Telecomm, Utilities. Underweight: Consumer Discretionary.

Currencies – Overweight: U.S. Dollar. Neutral: Sterling. Underweight: Euro & Yen.

Disclosure:

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