

Prudential International Investments Advisers, LLC.

Global Investment Strategy – November/December 2009

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Financial Market Outlook & Strategy: Stocks to Rally into Year-end & into 2010 with Solid Growth & Earnings Recovery. Bonds Under Pressure

John Praveen's Global Investment Strategy – November/December 2009 expects equity markets to rally into 2009 year-end and into 2010, driven by: 1) GDP rebound sustaining in Q4 and into 2010, and growth expectations being revised higher; 2) Q3 earnings surprising on the upside outlook and earnings recovering further in Q4 and 2010 with solid GDP growth, widening margins and improved pricing power; 3) Inflation moving from disinflation to low inflation with excess capacity and high unemployment; 4) Global central banks holding interest rates at crisis lows levels, long-term rates remaining low, and plenty of liquidity; and 5) Continued stabilization in financial market conditions and risk appetite improving further.

With stock markets enjoying the macro sweet spot and earnings recovering, we remain confident that the S&P500 index will reach our year-end target of 1200. However, stocks are likely to remain volatile with: valuations getting stretched, fears about a double-dip, and uncertainty about central banks QE exit strategies and interest rate normalization.

The global economic recovery is likely to put upward pressure on bond yields. Further, headline inflation appears to have troughed and is expected to turn positive in Q4. The winding down of asset purchase programs by central banks is another negative, but will have less of an impact until the central banks begin to unwind their purchases.

Among global stock markets, we remain overweight Emerging Markets, and modest overweight in the Eurozone. We have upgraded U.K. to overweight and downgraded Japan to underweight. We remain underweight on the U.S. Among global government bond markets, we remain overweight in Japan and Emerging Markets, and modest overweight on U.K. We remain neutral in Eurozone bonds and underweight in U.S. Treasuries. Among global sectors, we remain overweight in Information Technology. We upgraded Energy and Materials to overweight. We downgraded Financials and Industrials to modest overweight. We upgraded Consumer Discretionary to neutral. We remain modest underweight in Consumer Staples and Healthcare, but downgraded Telecomms to underweight. We remain underweight in Utilities.

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Financial Market Outlook: Stocks to Rally into Year-end with Solid Growth & Earnings Recovery. Bonds Under Pressure

Stocks: Stocks to Rally into Year-end and into 2010 with Solid Growth, Earnings Recovery, Liquidity & Low Rates

- After record gains in Q3, global equity markets paused in October. Stocks had a modest technical correction early in October before stronger macro data helped push up stocks through the middle of the month. However, stocks gave up gains at the end of the month with macro data disappointments, along with concerns over new financial markets regulations.
- Stock markets continue to enjoy the macro sweet spot with strong, synchronized and sustainable GDP growth, low inflation, ample liquidity, and interest rates remaining at crisis lows.
- The global recession appears to be over with the U.S. and Eurozone exiting recession in Q3 and GDP growth accelerating in China, India and several other emerging economies. We expect the GDP rebound in H2 2009 to be sustained in 2010 with substantial fiscal stimulus in the 2010 pipeline, low short and long-term rates, and inventory rebuild. Headline inflation is on track to move from disinflation to low inflation. Core inflation remains low. The large slack in the economy with high unemployment and low capacity utilization is likely to keep core inflation under control.
- U.S. Q3 earnings surprised on the upside and the global earnings outlook continues to improve with the recession ending in the U.S. and Eurozone in Q3 and solid recovery in Emerging Markets. Global earnings revisions continued to improve in October after turning positive in the prior 2 months. Current consensus expectations for global EPS growth over the next 12 months are around 22.4% and 27% for full-year 2010.
- Equity market valuation multiples improved in October as the stock market paused during the month after the sharp gains since March. Valuation multiples for the Developed Market Index moderated to 24.6X after jumping to 25.2X in September. Valuation multiples (P/E) are expected to improve in coming quarters with earnings recovering sharply with the rebound in global GDP growth. Stocks remain cheap relative to bonds.
- ***We remain positive on the outlook for stocks and expect equity markets to rally into 2009 year-end and into 2010, driven by: 1) GDP rebound sustaining in Q4 and into 2010, and growth expectations being revised higher; 2) Q3 earnings surprising on the upside outlook and earnings recovering further in Q4 and 2010 with solid GDP growth, widening margins and improved pricing power; 3) Inflation moving from disinflation to low inflation with excess capacity and high unemployment; 4) Global central banks holding interest rates at crisis lows levels, long-term rates remaining low, and plenty of liquidity; and 5) Continued stabilization in financial market conditions and risk appetite improving further.***
- ***With stock markets enjoying the macro sweet spot and earnings recovering, we remain confident that the S&P500 index will reach our year-end target of 1200. However, stocks are likely to remain volatile with: valuations getting stretched, fears about a double-dip, and uncertainty about central banks QE exit strategies and interest rate normalization.***

Bonds: Yields under Pressure with GDP Rebound, Positive Inflation & Ending of Asset Purchases

- Global government bonds were mostly unchanged in October. U.S. Treasuries and Eurozone bonds were unchanged in LC. Japanese JGBs fell in LC, while U.K. Gilts eased in LC. Emerging Market bonds posted modest gains, but less than they had in recent months.
- The global economic recovery is likely to put upward pressure on bond yields. Further, headline inflation appears to have troughed and is expected to turn positive in Q4. The winding down of asset purchase programs by central banks is another negative, but will have less of an impact until the central banks begin to unwind their purchases.
- U.S. Treasury yields are likely to be under pressure relative to other bond yields with stronger U.S. GDP growth and inflation turning positive. Fed purchases of Treasuries are ending, but continued demand for Treasuries and declining core inflation are likely to dampen the rise in Treasury yields. The solid rebound in Eurozone GDP growth is likely to put upward pressure on Eurozone bond yields. However, Eurozone inflation momentum is relatively weak. Hence Eurozone yields are likely to be range-bound. U.K. Gilts remain supported by weak U.K. GDP rebound. Continued deflation fears, the BoJ remaining on hold through 2010, and GDP slowdown in 2010 are positive for JGBs. However, the rising fiscal deficit is a negative. EM spreads are likely to narrow further.

Investment Strategy: Stocks to Rally into Year-end & into 2010 with Solid Growth & Earnings Recovery. Bonds Likely to be Under Pressure

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ASSET ALLOCATION: Stocks vs. Bonds

Stocks - Remain Overweight: Stock market rally to continue into year-end and into 2010, driven by solid GDP growth, earnings recovery with the GDP rebound and widening margins, deflation concerns easing with inflation turning positive, global central banks holding interest rates at crisis lows levels, and continued stabilization in financial market conditions and risk appetite improving further.

Bonds - Remain Underweight: The sharp, synchronized rebound is likely to keep bond yields under pressure. Further, headline inflation appears to have troughed and is turning positive. In addition, the winding down of asset purchase programs by central banks is another negative. However, banks continue to buy safer government bonds to take advantage of the carry.

GLOBAL EQUITIES

Overweight: Emerging Markets, U.K. 1) E.M.: GDP growth set to accelerate in H2 due to exports and massive stimulus. Earnings expectations are being revised up with solid consumption growth and gains in oil and commodity prices. However, EM now trades at a premium to DM on some valuation measures. Further, currency appreciation is a negative. 2) U.K.: Growth expected to turn positive in Q4. Continued expansion of QE is a positive. Valuations and sector composition are attractive.

Modest Overweight: Eurozone Eurozone GDP rose 1.5% in Q3 and expected to improve to 2.8% in Q4. Eurozone earnings expected to rise sharply in Q4 and grow 27% in 2010. Eurozone stocks attractively valued and trading at a discount to U.S., Japan and EM.

Underweight: Japan, U.S. 1) Japan: Consumer fundamentals weak, raising fears of double-dip in 2010. Earnings have been recovering strongly, but Japanese equities are still expensive. 2) U.S.: GDP is expected to rise 3.2% in Q4. Earnings outlook revised higher, but valuations still remain expensive relative to other markets. U.S. underperforms international markets during equity rallies.

GLOBAL BONDS

Overweight: EM, Japan 1) EM spreads should narrow further given rising risk appetite, solid commodity prices and strong GDP growth in emerging economies. The ongoing economic recovery is likely to further increase risk appetite and continue to put downward pressure on EM yields. 2) Persistence of deflation and fears of a double dip are positives for JGBs. Further, the BoJ is expected to remain on hold through most of next year. Valuations are attractive. Rising fiscal deficit is a negative.

Modest Overweight: U.K. Relatively weaker GDP recovery and more dovish BoE stance should support U.K. Gilts. However, inflation is likely at a trough and will begin to rise.

Neutral: Eurozone Eurozone bonds are likely to be under pressure from the H2 GDP rebound and headline inflation turning positive. However, inflation momentum is relatively weak for Eurozone, helping to keep yields more range-bound.

Underweight: U.S. Treasury yields likely to be under relatively greater pressure with a strong GDP growth in Q4, headline inflation turning positive, and still low nominal Treasury yields. However, Treasuries are supported by demand from commercial banks and foreign central banks and declining core inflation.

GLOBAL SECTORS

Overweight: Energy, Info. Technology, Materials. Modest Overweight: Financials, Industrials.

Neutral: Consumer Discretionary. Modest Underweight: Consumer Staples, Healthcare. Underweight: Utilities, Telecomm.

CURRENCIES

Overweight: Euro, EM currencies; Neutral: Sterling, Yen; Underweight: U.S. Dollar.

The U.S. dollar is likely to remain in a downtrend ahead, though the pace of declines are expected to slow as the strong increases in risk appetite eases with the global economic recovery already priced in. Long-term secular trends for dollar depreciation, like the elevated fiscal and trade deficits, will continue to exert downward pressure on the dollar.

Regional Equity Strategy

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Emerging Markets (EM): Emerging economies recovery accelerates in H2 after the strong rebound in Q2. Exports and massive fiscal stimulus packages continue to drive robust growth in Asia. In China, investment spending surged. Exports drove strong growth in Korea and Taiwan. The recovery in oil and commodity prices pulled Latin America and Emerging Europe out of the recession. EM earnings expectations for 2009 and 2010 were further revised up in October and expected to rebound to 26% in 2010. EM Asia earnings expected to rise 30% in 2010 with China's earnings growth revised up to 28%. However, EM now trades at a premium to DM on some valuation measures, but EM stocks still have a lower trailing P/E. Currency appreciation is a further negative for EM stocks. **Remain Overweight.**

U.K.: U.K. GDP disappointed but expected to turn positive in Q4. Valuations and sector composition remain positives for U.K. stocks. The BoE again held the U.K. bank rate at 0.5% at their November meeting but decided to increase its asset purchase plan by £25bn to £200bn following the weaker than expected Q3 GDP report. **Upgrade to Overweight.**

Eurozone: Eurozone recession ended with Q3 GDP rising 1.5% QoQ annualized and expected to accelerate to around 2.8% in Q4. The ECB held rates at their record low of 1% in November and is likely to remain on hold through mid-2010. Eurozone earnings expected to rise sharply in Q4 and grow 27% in 2010 with solid, sustainable GDP growth and improved margins. Earnings revisions for Eurozone companies turned positive in October for the first time in 23 months. Eurozone stocks still attractively valued and trading at a discount to the U.S., Japan and Emerging Markets. **Maintain Eurozone at Modest Overweight now but expect to upgrade to overweight in December. Remain Modest Overweight.**

Japan: The Japanese recovery continued in Q3 with GDP rising a better-than-expected 4.8% annualized. However, consumer fundamentals remain weak raising concerns about the sustainability of GDP growth in 2010. Recent yen strength is another headwind for Japan's recovery. BoJ left its target overnight call rate unchanged at 0.1% in October, and is likely to remain on hold through 2010. Japanese earnings recovered strongly in Q3 with the global recovery boosting Japanese exports. Japanese earnings expected to rise further in Q4 and in 2010. However valuations remain expensive relative to U.S., Europe and Emerging Markets. **Hence, downgrade Japan to underweight.**

U.S.: U.S. GDP grew 3.5% in Q3 and is on track to around 3.3% growth in Q4. Solid GDP growth likely to be sustained into 2010. Fed remained on hold in October and is expected maintain the rates at "exceptionally low levels for an extended period." U.S. Q3 earnings post upside surprises. U.S. earnings are expected to rise 26% in 2010. The improvements in the earnings thus far have been mainly driven by cost-cutting and dollar weakness. With solid U.S. GDP growth, top-line sales are expected to rebound contributing to earnings growth. The weak dollar is another positive for the U.S. earnings in Q4. U.S. market remains expensive relative to other markets. During past equity market rallies, the U.S. has underperformed international markets due to its defensive characteristics. Given our expectations of further stock gains, international markets are likely to outperform the U.S. Hence we remain underweight in the U.S. **Remain Underweight.**

Regional Bond Strategy

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Emerging Markets: EM spreads should narrow further given rising risk appetite, solid commodity prices and strong GDP growth in emerging economies. The ongoing economic recovery is likely to further increase risk appetite and continue to put downward pressure on EM yields, but there is a risk that it is already priced in. EM bonds have rallied significantly over the past two quarters and yields actually edged up last month. Growth in emerging economies is on track to accelerate in Q4 with exports growing and massive fiscal stimulus packages, particularly in China. However, most of the improvement in growth has already been priced in, given the large rally. However, there is still room for spreads to narrow, since they are still higher than before the crisis. Commodity prices have mostly been trading in a range recently, but further increases in prices could put downward pressure on yields. After a long period of cutting rates sharply, EM central banks are now on hold, but are preparing to remove the monetary stimulus. **Remain Overweight.**

Japan: Continued deflation fears and the BoJ remaining on hold through 2010 are the primary factors making JGBs attractive relative to other developed market bonds. Further, there are concerns about the sustainability of GDP growth in 2010. However, the prospect for further increase in the fiscal deficit, given recent speeches and interviews from the new DPJ administration, is a negative for JGBs. Japan's recovery continued in Q3 with GDP improving to 4.8% annualized. Japanese nationwide headline consumer inflation held at the record-low level of -2.2% YoY in September. Nationwide core prices recovered to -2.3% in September. According to the OECD, Japan's output gap is currently at around -6% and will remain depressed in 2010, keeping significant downward pressure on prices in 2010. The BoJ left its target overnight call rate unchanged at 0.1% in late October, as expected. The Bank highlighted that it will maintain the "extremely accommodative financial environment for some time." Prime Minister Hatoyama announced that the government may issue additional debt to offset the decline in tax revenue. Further, Vice Finance Minister said that bond sales for this year could exceed ¥50trn. Increased supply is a negative for yields. **Remain Overweight.**

U.K.: The outlook for U.K. Gilts remains relatively favorable with U.K. GDP rebound lagging U.S. Japan and Eurozone, while the BoE appears to have a relatively more dovish stance. However, U.K. inflation is likely at its trough and will begin to rise in the coming months, which should be a negative for Gilts. U.K. Q3 GDP unexpectedly decline, falling -1.6% QoQ annualized, after a -2.3% decline in Q2 and -9.6% in Q1. GDP is still expected to turn positive in Q4, but there is still weak data coming from the U.K. The BoE again held the U.K. bank rate at 0.5% at their November meeting. However, the BoE decided to increase its asset purchase plan by £25bn to £200bn following the weaker than expected Q3 GDP report. **Remain Modest Overweight.**

Eurozone: The solid rebound in Eurozone GDP growth, especially in Germany and France, is likely to put upward pressure on bond yields. Eurozone GDP rose 1.5% QoQ annualized in Q3, and is expected to accelerate to around 2.8% in Q4. In addition, headline inflation is set to turn positive with reversal of oil price base effects. However, inflation momentum is relatively weak in Eurozone due to recent euro strength and the ECB's greater focus on price stability. Further, a more hawkish ECB remains a negative for Eurozone bonds, particularly if they hint at raising rates earlier than other central banks. These are likely to keep Eurozone yields range bound. **Remain Neutral.**

Global Investment Strategy – November/December 2009

U.S.: U.S. Treasury yields are likely to be under pressure relative to other bond yields. GDP growth is expected to rebound strongly relative to other markets. U.S. GDP rose 3.5% in Q3, and track to solid GDP growth in Q4. The GDP rebound is expected to be sustained into 2010. U.S. headline consumer prices continued to turn around in September. Oil price base effects are likely to push up headline CPI significantly in October and November, hitting a peak of around 2% at the end of the year. This is likely to pressure Treasury yields. Further, nominal yields are low and Treasury valuations are still unattractive relative to stocks. Fed Treasury purchases are ending, but continued demand for Treasuries from commercial banks and foreign central banks along with declining core inflation are likely to dampen the rise in yields.

Remain Underweight.

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.

- **Energy** - Oil prices broke \$80 in October after being range bound around \$70. Solid, sustained global recovery a positive for oil prices. Global energy demand expected to resume its upward trend led by emerging economies. Earnings expected to rise in 37% in 2010. Earnings likely to surprise on the upside in Q4 and 2010. European companies cheaper than U.S. **Upgrade to Overweight.**
- **Materials** - Best performer YTD. Commodity prices set to rise further on dollar weakness while China continues to recover strongly. Valuation very expensive. Earnings expected to rise 57% in 2010. Earnings revision jumped to 7.2% in October from 2.8%. Earnings are likely to be revised further up given the sharp recovery in commodity prices. **Upgrade to Overweight.**
- **Information Technology** - Sector posted sharp gains YTD, second only to Materials. Valuation among the most expensive. Sharp upward earnings revisions, higher than any other sectors. Orders for Tech products continued to improve. Successful launch of Windows 7, and new round of M&A are positives. Semiconductors and hardware to outperform software. **Remain Overweight.**
- **Financials** - Financials Q3 earnings much better than expected. Credit markets continued to improve. M&A activities recover. Earnings to be revised further up. Valuation expensive, but likely to improve. Continued deterioration in commercial real estate market and new regulations for the financial industry are negatives for the sector. **Downgrade to Modest Overweight.**
- **Industrials** - Solid global recovery and improving business confidence positives for the sector. Infrastructure demand from EM, especially China & India, is another positive. European Industrials to benefit from high EM exposure. Valuations turned expensive. Earnings expected to recover in 2010. Stimulus spending should continue to support. **Downgrade to Modest Overweight.**
- **Consumer Discretionary** - Sector fundamentals are negative with unemployment remaining high and household earnings growth anemic in developed economies. Labor markets showed early signs of recovery, positive for the sector. Valuation expensive after recent rally. Earnings recovered in Q3 and on track to further sharp increase in 2010. **Upgrade to Neutral.**
- **Consumer Staples** - Easing risk aversion a negative for this defensive sector. Solid recovery in staples sales. Earnings remain resilient. Valuation very attractive. The sector offers attractive dividend yields while low payout ratios indicating further potential for dividend increase. Stock market volatility or correction would be positive for the sector. **Remain Modest Underweight.**
- **Healthcare** - Easing risk aversion remains a negative for the sector. Obama administration's healthcare reform remains a negative. The outbreak of H1N1 and the risk of a potential escalation into a global pandemic are positives for drug manufacturers. Current valuations attractive relative to the market. Earnings growth and dividend yield remain relatively solid. **Remain Modest Underweight.**
- **Telecomm Services** - Consumer fundamentals remain negative. Further M&A activity is a positive for European Telecomms. The earnings outlook for the sector remains negative, while margins are under pressure as Telecomms cut down their prices to maintain market share. Sector valuations have turned attractive with a very high dividend yield. **Downgrade to Underweight.**
- **Utilities** - Defensive sector likely to underperform with the decline in risk aversion. Valuations most attractive among all sectors. Attractive dividend yield, and above historical average. However, the high pay-out ratio will limit the upside for dividends. European Utilities face headwinds of expensive valuations, regulatory headwinds and weak pricing backdrop. **Remain Underweight.**

Strategy Summary:

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

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

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

Global Sectors – Overweight: Energy, Info. Technology, Materials. Modest Overweight: Financials, Industrials.

Neutral: Consumer Discretionary. Modest Underweight: Consumer Staples, Healthcare. Underweight: Telecomm, Utilities.

Currencies – Overweight: Euro, EM Currencies; Neutral: Sterling, Yen; Underweight: U.S. Dollar.

Disclosure:

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