

Prudential International Investments Advisers, LLC.

Global Investment Strategy – October 2009

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Financial Market Outlook & Strategy: Stock Rally Continues with Sharp GDP Rebound, Earnings Recovery. Bonds Under Pressure

John Praveen's Global Investment Strategy – October 2009 expects the stock market rally to continue to year-end. Further equity market gains are likely to be driven by: 1) Strong, synchronized and sustainable GDP rebound and growth expectations being revised higher; 2) Earnings outlook improving with the GDP rebound, widening margins and improved pricing power; Q3 earnings are likely to surprise on the upside; 3) Disinflation concerns easing with headline inflation on track to turn positive but remains low with excess capacity and high unemployment; 4) Global central banks holding interest rates at crisis-low levels, long-term rates remaining low, and plenty of liquidity; and 5) Continued stabilization in financial markets and rising risk appetite.

With stock markets enjoying the macro sweet spot and Q3 earnings likely to beat expectations again, we remain confident that the S&P500 index will reach our year-end target of 1200. However, stocks are likely to remain volatile with: overbought conditions, valuations getting stretched, concerns about the sustainability of the GDP recovery, and uncertainty about central banks Quantitative Easing (QE) exit strategies and rate normalization.

The sharp, synchronized rebound is likely to keep bond yields under pressure. Further, headline inflation appears to have troughed and is expected to turn positive in Q4. 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.

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

Financial Market Outlook: Stock Rally Continues with Sharp GDP Rebound, Earnings Recovery. Bond Under Pressure

Stocks: Stock Rally Continues with Sharp GDP Rebound, Positive Earnings Surprises, Liquidity & Low Interest Rates

- The global stock market rally continued in September and early October on solid macro data and earnings on track to recover and expectations being revised higher. Stocks were volatile, falling in early September on profit taking but recovered in late September.
- The GDP recovery is going “global” with the U.S., the rest of Europe, and other emerging economies on track to post solid GDP growth in Q3, while GDP growth is set to accelerate in China, India and several other emerging economies. Earlier Asia, and parts of Europe and Latin America exited the recession in Q2. Deflation fears are easing with headline inflation on track to turn positive in the U.S., Eurozone and China after being deeply negative during the summer. However, inflation pressures are not yet picking up as the large slack keeps prices under control.
- The earnings outlook continues to improve with sharp synchronized GDP rebound and growth forecasts being revised higher. Earnings results for Q3 are likely to beat expectations again driven by widening profit margins (with falling labor costs), improved pricing power (with deflation ending) and improvement in revenue growth (with GDP recovery). After several quarters of declines, earnings are expected to turn positive in several sectors in Q3 and in all sectors by Q4.
- Equity market P/E multiples rose further in September as global stock markets continued to rally. The trailing P/E multiples in Developed Markets (25.2X), U.S. (25.3X) and EAFE (26.2X) are at the highest levels since the end of the last bear market. However, P/E multiples are expected to improve in coming quarters as corporate earnings recover with the rebound in global GDP growth.
- ***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.***
- ***We expect the equity market rally to continue, driven by: 1) Strong, synchronized and sustainable GDP rebound and growth expectations being revised higher; 2) Earnings outlook improving with the GDP rebound, widening margins and improved pricing power; Q3 earnings are likely to surprise on the upside; 3) Deflation concerns easing with headline inflation on track to turn positive but remains low with excess capacity and high unemployment; 4) Global central banks holding interest rates at crisis low levels, long-term rates remaining low, and plenty of liquidity; and 5) Continued stabilization in financial markets and increasing risk appetite.***
- ***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: overbought conditions, valuations getting stretched, concerns about the sustainability of the GDP recovery, and uncertainty about central banks QE exit strategies and rate normalization.***

Bonds: Yields Likely to Rise with GDP Rebound & Headline Inflation Trough. Low Core Inflation Caps Rise in Yields

- Global government bonds again posted modest gains in LC, but the weak dollar has pushed up returns in US\$. U.S. Treasuries, Eurozone bonds, U.K. Gilts, and Japan JGBs posted modest gains in LC. Emerging Market bonds posted solid gains both in local currency and US\$ terms.
- *The sharp, synchronized rebound is likely to keep bond yields under pressure. Further, headline inflation appears to have troughed and is expected to turn positive in Q4. 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.*
- *U.S. Treasury yields are likely to be under pressure relative to other bond yields. GDP growth is expected to rebound strongly in H2 2009. Fed Treasury purchases are set to end soon. However, the demand for Treasuries from banks and foreign central banks are expected to limit the rise in yields. Eurozone bonds are likely to be pressured by the GDP growth rebound. However, the expected rise in headline inflation is likely to be weak relative to other markets keeping Eurozone yields range bound. U.K. gilts are likely to be under pressure with rising GDP growth expectations, relatively higher U.K. inflation and the BoE likely to be the first major central bank to start normalizing interest rates. In Japan, persistence of deflation and fears of a double dip are positives for JGBs.*

Investment Strategy: Stock Rally Continues with Sharp GDP Rebound, Earnings Recovery. Bond Under Pressure

ASSET ALLOCATION: Stocks vs. Bonds

Stocks - Increase Overweight: Stock market rally continues, driven by the strong synchronized GDP rebound in H2, earnings outlook improving with the GDP rebound and improved pricing power, deflation concerns easing with headline inflation at a trough and on track to turn positive, ample liquidity and global central banks on hold, and continued stabilization in financial markets and rising risk appetite.

Bonds - Increase Underweight: Bond yields are likely to remain under pressure due to the sharp, synchronized rebound. Headline inflation appears to have troughed and is set to turn positive in Q4, removing a tail wind for bonds. The winding down of asset purchases 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 GDP growth set to accelerate in H2 due to exports recovery and massive stimulus after strong rebound in Q2. Earnings expectations are being revised up with solid consumption growth and gains in oil and commodity prices. Increased risk appetite is another positive for EM stocks. However, EM now trades at a premium to DM on some valuation measures.

Modest Overweight: U.K., Eurozone, Japan 1) U.K.: GDP growth expected to turn positive in Q3 and improve in Q4. Valuations and sector composition remains positive for U.K. stocks. 2) Eurozone: GDP growth on track to turn positive in Q3 and accelerate further in Q4. Relative valuations are attractive. Earnings are expected to rise sharply in H2 after declining in H1. Valuations remain attractive. Rising euro is a negative. 3) Japan: GDP recovery continues in Q3. Earnings are on track to recover strongly with improvement in revenues as well as solid margins. However, Yen strength is a negative for exporters and overall GDP growth.

Underweight: U.S. GDP is estimated to have risen 3.4% in Q3 and improve further to 3.6% 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: Japan Persistence of deflation and fears of a double dip are positives for JGBs. BoJ remains on hold. Valuations attractive.

Modest Overweight: U.K. Relatively weaker GDP recovery and BoE's Quantitative Easing should support U.K. Gilts. However, the higher level of inflation is likely to pressure Gilts.

Neutral: Eurozone Eurozone bonds are likely to be under pressure from the H2 GDP rebound and headline inflation turning positive. Less active monetary policy is a negative. However the rise in inflation will be relatively weak.

Underweight: U.S. Treasury yields likely to be under relatively greater pressure with a strong H2 GDP rebound, headline inflation turning positive in Q4, and the Fed ending Treasury purchases. However, Treasuries are supported by demand from commercial banks and foreign central banks and declining core inflation.

GLOBAL SECTORS

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

Modest Underweight: Consumer Discretionary & Staples, Healthcare, Telecom; Underweight: Utilities.

CURRENCIES

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

U.S. dollar is likely to remain in a downtrend as the global economic recovery continues and risk appetites rise further. Expanding fiscal deficit is a negative. However, relatively stronger U.S. GDP rebound in H2 is likely to support the dollar. Yen is likely to remain firm with the rebound in Japanese GDP growth and the new administration's tolerance of stronger yen.

Regional Equity Strategy

Emerging Markets (EM): EM spreads are likely to narrow further with continued improvement in EM growth outlook. Emerging economies recovery accelerates in H2 after the strong rebound in Q2. The strong Asian rebound was driven by exports and the massive fiscal stimulus packages. The recovery in oil and commodity prices has pulled the Latin America and Emerging Europe out of the recession. With inflation contained, emerging central banks are likely to remain accommodative for an extended period. Emerging Market (EM) earnings expectations were further revised up in September to 20% for the next 12-months and 27% for 2010. However, EM now trades at a premium to DM on some valuation measures. Currency appreciation is a further negative for EM stocks. **Remain Overweight.**

U.K.: U.K. expected to turn positive in Q3 and improve further to around 2% in Q4. Valuations and sector composition remain positives for U.K. stocks. The BoE held the Bank rate at 0.5% in October. The BoE also made no changes to its £175bn asset purchase plan and expects to finish the purchases by the end of November. **Remain Modest Overweight.**

Eurozone: Eurozone GDP is on track to turn positive in Q3, driven by Germany and France. Eurozone GDP is on track to rise around 1.5% QoQ annualized in Q3 before accelerating to around 3.2% in Q4. The ECB held rates at their record low of 1% at the October ECB Council meeting and is likely to remain on hold through mid-2010. Eurozone earnings are expected to improve sharply in H2 2009 after declining around -40% in H1 given the GDP rebound both in Eurozone and globally, and improvement in margins. Eurozone stocks still attractively valued. **Upgrade to Modest Overweight.**

Japan: The Japanese economy recovered further in Q3 with the massive fiscal stimulus and continued recovery in exports. GDP is estimated to have risen around 3.2% annualized. However, Japanese consumer fundamentals remain weak. The recent yen strength is another headwind for Japan's recovery. BoJ left its target overnight call rate unchanged at 0.1% in October, and upgraded its assessment of the economy. Japanese earnings are on track to recover strongly in H2 2009 after the sharp decline in the previous three quarters with improvement in the global and Japanese GDP outlook. Margins remain solid while revenue growth likely to improve in coming quarters with the recovery in GDP growth. **Upgrade to Modest Overweight.**

U.S.: U.S. GDP is estimated to have grown around 3.4% in Q3 and is on track to around 3.6% growth in Q4. Solid GDP growth likely to be sustained into 2010. The Fed remained on hold in September and expected to maintain the rates at "exceptionally low levels for an extended period." U.S. earnings expectations for the next 12-months have been revised up to 16%, and 27% in 2010, driven by revenue growth following the GDP rebound and widening margins after the aggressive cost cutting in earlier quarters. U.S. Q3 earnings are likely to surprise to the upside. 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

Emerging Markets: The ongoing economic recovery is likely to further increase risk appetite, and continue to put downward pressure on EM yields. However, EM bonds have rallied significantly over the past two quarters limiting scope for further gains. Growth in emerging economies is on track to accelerate in Q3 with exports growing and massive fiscal stimulus packages, particularly in China. Commodity prices improved in Q3, but have been mostly trading in a range recently. After a long period of cutting rates sharply, EM central banks are now on hold. Given the decline in inflation, these banks are likely to keep rates depressed for some time. **Remain Overweight.**

Japan: The Japanese economy is set to improve further in Q3 with the massive fiscal stimulus and continued recovery in exports. GDP likely rose around 3.2% annualized. Net exports continued to contribute to Japan's recovery after leading the Q2 rebound. However, there are concerns about the sustainability of the Japanese GDP recovery and fears of a double-dip due to weak consumer fundamentals. JGBs are likely to benefit from the persistence of deflation with core inflation plunging to a new record-low in August, down -2.4% YoY in August from -2.2% in July. Continued declines in core inflation have made JGBs more attractive with the risk that inflation will rise substantially in 2010 currently low. The BoJ held rates in October. The Bank remained cautious on the downside risks "stemming from future developments in the global financial and economic situation, as well as from changes in firms' medium- to long-term growth expectations." JGBs benefit from the BoJ being expected to remain on hold well into 2010. However, prospects of a new fiscal stimulus program are a negative for JGBs. **Remain Overweight.**

U.K.: U.K. GDP growth is expected to turn positive in Q3 and further strengthen in Q4. However, the GDP recovery in the U.K. is relatively weaker compared to the recovery in other economies. U.K. headline CPI inflation eased to 1.1% YoY in September from 1.5% in August. Inflation still elevated and expected to trough in September. Further, relatively higher U.K. inflation and the BoE likely to be the first major central bank to start normalizing interest rates, are likely to pressure yields higher. **Reduce to Modest Overweight.**

Eurozone: Eurozone GDP is on track to turn positive in Q3 after Germany and France lifted Eurozone Q2 GDP to almost flat reading. The rebound in global trade will help boost Eurozone exports and industrial output. Eurozone GDP is on track to rise around 1.5% QoQ annualized in Q3, accelerating to around 3% in Q4. The solid rebound in Eurozone GDP growth is likely to put upward pressure on bond yields. Though headline inflation fell -0.3% YoY in September from -0.2% in August, it is set to turn positive with fading oil price base effects. However, the rise in inflation will likely be weak relative to other markets due to euro strength the ECBs greater focus on price stability. Further, less active monetary policy is a negative in Eurozone relative to many of the other markets. These are likely to keep Eurozone yields range bound in the near term. **Remain Neutral.**

U.S.: U.S. Treasury yields are likely to be under pressure relative to other bond yields. U.S. GDP growth is on track to turn positive in Q3. U.S. LEIs are rising strongly, while ISM manufacturing confidence was above 50 for the second straight month. We expect the U.S. economy to grow around 3.4% annualized in Q3. Inflation is also set to rise. Headline inflation continued to turn around in September, with the YoY rate improving to -1.3% YoY from -1.4% in August and on track to reach 2% by year-end. Further, nominal yields are low and Treasury valuations are still unattractive relative to stocks. Fed Treasury purchases are set to end soon, although they have been slowing and have been less of an impact on the market recently. However, the demand for Treasuries from commercial banks and foreign central banks is expected to support Treasuries. **Remain Underweight.**

Global Sector Strategy

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

- **Financials** - Earnings outlook remains positive with earnings growth expected to recover during H2. Financial market conditions continue to improve. Diversified Financials benefit from wider margins and increasing capital market activities. Insurance continues to benefit from equity market gains. Valuations are expensive. Commercial real estate is a negative. **Remain Overweight.**
- **Information Technology** - Macro outlook remains positive with further recovery in tech orders. Earnings momentum is strong. Profit margins resilient and set to expand further. However, valuations are expensive. More economically levered segments such as Semi and Communication Equipment to outperform defensives such as Software. **Remain Overweight.**
- **Industrials** - Industrial activity is rebounding as IP continue to recover globally. Business confidence continues to rise with manufacturing confidence indices posting gains in all regions. Infrastructure benefiting from fiscal stimulus in the U.S. and China. Valuations becoming expensive. Earnings outlook remains relatively weak, but likely to be revised higher. **Upgrade to Overweight.**
- **Energy** - Oil prices move above \$75 with dollar weakness. Global demand revised up with synchronized recovery in global economy. Relative earnings outlook is negative, but likely to be revised higher with strong earnings revisions in recent months. However, sector valuations are at par with the market. **Remain Modest Overweight.**
- **Materials** - Commodity prices set to go higher after the consolidation in September driven by the recovery in global demand. Valuation very expensive. Outlook for Construction Materials still remains weak despite some improvement in the housing markets. M&A activity and improvement in demand due to increased fiscal spending are positives. **Remain Modest Overweight.**
- **Consumer Discretionary** - Sector fundamentals are negative with unemployment remaining high and household earnings growth anemic in developed economies. Relative valuations are expensive. Consumer confidence continues to recover. Consumer fundamentals in EM are supported by government spending. **Upgrade to Modest Underweight.**
- **Consumer Staples** - Reduced risk aversion due to strong, synchronized global GDP recovery is a negative for the sector. Earnings growth is better compared with other sectors due to solid margins. Valuations are attractive. **Remain Modest Underweight.**
- **Healthcare** - Easing risk aversion remains a negative for the sector. Obama administration's healthcare reform remains a negative. Increased demand due to potential outbreak of H1N1 flu a positive. Current valuations are modestly attractive relative to the market. Sector's earnings growth and dividend yield remain relatively solid. **Upgrade to Modest Underweight.**
- **Telecomm Services** - Consumer fundamentals remain negative. Earnings outlook is negative with continued negative earnings revisions due to weak consumer and business spending. Margins are under pressure. Valuations are at par with other global sectors. European Telecomms benefitted from EM subsidiaries. M&A activities are positive for European companies. **Upgrade to Modest Underweight.**
- **Utilities** - Sector likely to underperform with the decline in risk aversion. Carbon legislation risk in the U.S. has subsided, but possible revival of the bill still concerns investors. Dividends are high and above historical average. European Utilities face headwinds of expensive valuations, regulatory headwind, and weak pricing power. **Remain Underweight.**

Strategy Summary:

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

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

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

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

Modest Underweight: Consumer Discretionary & Staples, Healthcare, Telecomm; Underweight: Utilities.

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

Disclosure:

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