

Prudential International Investments Advisers, LLC.

Global Investment Strategy – April 2009

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

John Praveen's Global Investment Strategy – April 2009 sees stocks in the bottoming process as the aggressive policy measures appear to be making a dent in the economic and earnings gloom, and several green shoots of recovery are appearing. Markets also appear to be more optimistic that the U.S. Treasury's plan will address the problem of toxic assets on banks' balance sheets. Stock markets have historically begun to recover 3-5 months before the economy bottoms. The improved tone of recent macro data strengthens our confidence that the global economy will start recovering in H2. Hence we continue to expect a sustainable recovery in stock markets in late Q2 / early Q3 2009. However, in the near-term there are several risks that could lead to a pullback in stocks. The bleak earnings and GDP data in Q1 and beyond, the uncertainty about the future of automakers, the possibility of more capital injections into banks following the stress-tests, and profit-taking after the recent rally is likely to keep stocks struggling and volatile.

Global bonds are likely to remain range bound over the coming months, after the sharp decline in bond yields in March, with few catalysts to push them sharply lower. Still weak macro outlook and central bank bond purchases and Quantitative Easing measures are positives. However, rising bond supply from expansionary fiscal policy and growing budget deficits are negatives, keeping yields volatile.

Within stocks, we remain modestly overweight the U.S. and U.K., and raised Emerging Markets to overweight. We remain neutral on Eurozone, and underweight on Japan. Within bonds, we are modestly overweight on U.S. Treasuries & U.K. Gilts, and modestly underweight on Japanese bonds (JGBs) & Eurozone bonds.

Financial Market Outlook: Stocks on Track to Recovery but Near-term Risks with Recession & Earnings Decline

Stocks: Stocks on Track to Recovery but Near-term Risks with Recession & Earnings Decline

- Global equity markets rebounded sharply in March after a sharp sell-off in February and early March which took stocks to their lowest levels since the mid-1990s. The rally was fuelled by positive comments by CEOs of major U.S. banks on the earnings outlook, the Obama administration's detailed plan to address the problem of toxic assets on banks' balance sheets, and central banks' decision to step up their asset purchase programs. Most global markets gained over 20% from the March 9 low to early April.
- Several green shoots of recovery have been sprouting on the global macro landscape. However, the global economy remains deep in recession, with the U.S., Europe, Japan, and several emerging economies on track to post big GDP declines in Q1. Nevertheless, the improving macro data suggests that GDP declines will be smaller and the global economy appears on track to a H2 2009 recovery.
- Policy makers stepped up their aggressive measures in the battle against economic gloom. The Fed, the Bank of England and the Bank of Japan stepped up their asset purchase programs and appear to be succeeding in pushing down bond yields and mortgages rates. Further, the Obama administration finally unveiled the details of its plan to clean up toxic assets on banks' balance sheets.
- Equity market valuations rose from the record low level in February as global equity markets rallied in March, while earnings continued to be revised lower. However, valuation multiples remain near historical lows.
- The Q1 earnings season in the U.S. is set to kick-off in April with markets nervous about the earnings outlook. S&P500 Q1 earnings are expected to decline -36.7%. Consensus expectations for global earnings growth for 2009 continue to be revised lower, down to -7% in April from -4% in March and -1% in January. The earnings outlook remains bleak with developed and several emerging economies remaining in recession.
- ***Looking ahead, stocks appear to be in the bottoming process as the aggressive policy measures appear to be making a dent in the economic and earnings gloom, and several green shoots of recovery are appearing. Markets also appear to be more optimistic that the U.S. Treasury's plan will address the problem of toxic assets on banks' balance sheets.***
- ***However, in the near-term there are several risks that could lead to a pullback in stocks. The bleak earnings and GDP data in Q1 and beyond, the uncertainty about the future of automakers, the possibility of more capital injections into banks following the stress-tests, and profit-taking after the recent rally are likely to keep stocks struggling and volatile.***
- ***Stock markets have historically begun to recover 3-5 months before the economy bottoms. The improved tone of recent macro data strengthens our confidence that the global economy will start recovering in H2. Hence we continue to expect a sustainable recovery in stock markets in late Q2 / early Q3 2009.***

Bonds: Central Bank Bond Purchases, Quant Easing & Recession Support Bonds. Rising Supply Limits Gains

- Global government bonds posted modest gains in March as central banks expanded Quantitative Easing (QE) programs and started purchasing government bonds. U.S. Treasuries and U.K. Gilts posted big gains in March, but Eurozone bonds declined. Japanese bonds were largely unchanged. Emerging Markets bonds rose sharply in March as investors moved into riskier assets during the equity rally.
- Looking ahead, after the sharp decline in bond yields in March, global bond yields are likely to remain range bound over the coming months with few catalysts to push them sharply lower. Still weak macro outlook and central bank bond purchases and QE measures are positives. However, rising bond supply from expansionary fiscal policy and growing budget deficits are a negative, keeping yields volatile over the coming months.
- *U.S. Treasuries are likely to post modest gains with Treasury purchases by the Fed and continued GDP declines, but concerns about increased Treasury supply are likely to limit gains. U.K. Gilts are supported by BoE's Quantitative Easing and the big GDP contraction. However, Eurozone bonds are likely to underperform with relatively less aggressive ECB easing. Japanese JGBs are likely to underperform with relatively limited support from policy measures.*

Investment Strategy: Stocks on Track to Recovery but Near-term Risks with Recession & Earnings Decline

ASSET ALLOCATION: Stocks Vs. Bonds

Neutral Stocks: appear to be in the bottoming process as the aggressive policy measures appear to be making a dent in the economic and earnings gloom. While the green shoots of recovery have begun to sprout on the macro landscape, the earnings and GDP data is likely to be bleak in Q1 and beyond. Other event risks, like the future of GM and Chrysler, the need to inject more capital into banks following the stress-tests, and profit-taking after the recent rally, are likely to keep stocks struggling and volatile. ***Hence maintain neutral stance for now but expect to start increasing equity exposure once the near-term risks ease.***

Neutral Bonds: After the decline in bond yields in March, global bond yields will likely remain range bound over the coming months with few catalysts to push them lower. Still weak macro outlook and central bank bond purchases are positive for bond. However, concerns over rising bond supply from expansionary fiscal policy are a negative, keeping bond yields volatile over the coming months.

GLOBAL BONDS

Modest Overweight: USA, UK 1) Weak U.S. macro data, Treasury purchases and other Quantitative Easing measures by the Fed are positives. Concerns about increased Treasury supply is a negative. 2) Gilts supported by the further GDP contraction in Q1 and BoE's purchase of Gilts as part of Quantitative Easing.

Modest Underweight: Eurozone, Japan 1) Eurozone: Weak Eurozone growth and further ECB rate cuts should continue to support Eurozone bonds. However, Eurozone bonds are likely to underperform with a relatively less aggressive ECB easing. 2) Japan: JGBs are likely to be supported by weak economic outlook with GDP growth on track to another double-digit decline in Q1 GDP. JGBs likely to underperform with limited support from policy measures.

GLOBAL EQUITIES

Modest Overweight: U.S., Emerging Markets, & U.K. 1) USA: Recession continues in H1, but macro outlook better relative to other markets. Policy response remains more aggressive and credible. 2) Emerging Markets: Macro data remains weak but several indicators are showing improvement and pointing to stabilization. Earnings outlook revised down. However, aggressive policy measures are a positive. Improved relative valuations. 3) UK: Valuations are attractive. Aggressive QE measures and sterling weakness are other positives.

Neutral: Eurozone. 1) Eurozone: GDP expected to decline by -6% in Q1. Earnings outlook weak with recession and Financials' losses due to exposure to EM Eastern Europe. Sector composition is positive. Valuations are attractive on current basis.

Underweight: Japan. Double-digit GDP decline in Q1 after Q4 collapse. Bleak earnings outlook with GDP collapse and prior yen strength.

GLOBAL SECTORS

Overweight: Consumer Staples, Health Care, Utilities. Modest Overweight: Info Technology.

Neutral: Materials, Financials, Telecomm. Underweight: Consumer Discretionary, Energy, Industrials.

CURRENCIES

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

The dollar likely to remain strong against major currencies during H1 2009 with the U.S. on track to recover from recession ahead of the others. The sterling likely to remain weak against the dollar with the U.K. GDP growth outlook remaining bleak. The increasingly poor Japanese growth outlook will put downward pressure on the yen.

Equity Outlook & Regional Equity Strategy

Equity Market Outlook: Stocks on Track to Recovery but Near-term Risks with Recession & Earnings Decline

Stocks appear to be in the bottoming process as the aggressive policy measures appear to be making a dent in the economic and earnings gloom. Markets are also more optimistic that the U.S. Treasury plan will address the problem of toxic assets on banks' balance sheets.

However, in the near-term there are several risks that could lead to a pullback in stocks. While the green shoots of recovery have begun to sprout on the macro landscape, the earnings and GDP data is likely to be bleak in Q1 and beyond. Other event risks, like the future of GM and Chrysler, the need to inject more capital into banks following the stress-tests, and profit-taking after the recent rally, are likely to keep stocks struggling and volatile.

Stock markets have historically begun to recover 3-5 months before the economy bottoms. The improved tone of recent macro data strengthens our confidence that the global economy will start recovering in H2. **Hence we continue to expect a sustainable recovery in stock markets in late Q2 / early Q3 2009.**

Regional Equity Strategy

U.S.: U.S. economic data points to the recession continuing in H1 after GDP contracted -6.2% annualized in Q4 but recent macro data has an improved tone with several green shoots of recovery. Consumer spending tracking over 1% in Q1, an improvement after the sharp decline in Q4. Despite the modest improvement in Q1, consumer fundamentals remain poor with U.S. households experiencing devastating losses in their equity and housing wealth. Business confidence continues to remain weak. However, U.S. macro outlook is better relative to other markets. Policy response remains aggressive with the Obama administration unveiling a Public-Private Investment Program to "de-tox" banks' balance sheets and the Fed continuing QE. Earnings outlook remains bleak with Q1 earnings expected to decline -37% after the -67% fall in Q4. **Modest Overweight.**

U.K.: The Bank of England left rates unchanged at 0.5% in April and reaffirmed its commitment to the Quantitative Easing program started in March with an initial £75bn asset purchase plan. Valuations and sterling weakness continue to be positives for U.K. stocks. GDP growth expected to decline around -5.5% in Q1 after falling -6.1% in Q4. However, business confidence and housing data showing signs of improvement. Earnings are estimated to fall -29% in 2009. **Modest Overweight.**

Emerging Markets (EM): March macro data remains bleak, but several indicators are showing improvement and pointing to stabilization. Signs of recover in China driven by strong credit growth and massive government spending. Korean and Taiwanese GDP are likely to show a smaller decline in Q1 following a smaller decline in exports and encouraging IP numbers. In Latin America, Brazil's industrial production has recovered for the past two months. EM Eastern Europe GDP growth outlook remains negative with Eurozone in recession and banking problems. The earnings outlook continues to be revised lower. However, EM policy makers have been quick to adopt aggressive policy actions to support growth. Inflation is in a down-trend. Valuations have improved following the recent sell-off, with EM now trading at a discount to Developed Markets. **Raise to Modest Overweight. Within EM, we are Overweight Asia, Neutral on Latin America and Underweight Emerging Europe.**

Eurozone: Eurozone GDP is expected to decline sharply again in Q1 with industrial production falling sharply, unemployment rising, the trade balance widening, and business confidence depressed. Relative valuation for Eurozone at par relative to the global index. The ECB cut rates by 25bps to a record low of 1.25% in April but deferred decision on use of "non-standard" measures to its next "policy" meeting in May. Although consensus forecasts for 2009 Eurozone earnings are relatively better than other markets, earnings expectations are likely to be revised down due to sharply declining GDP growth and continued losses at Financials, with Eurozone banks' exposure to Emerging Europe. **Remain Neutral.**

Japan: Japan's GDP is likely to post another double digit decline in Q1 after plunging -12.1% QoQ annualized decline in Q4 2008 with net exports remaining weak in Q1 and Industrial Production continuing to plunge, down -9.4% MoM, -37.7% YoY in February after a -10% MoM decline in January. Deflation fears re-emerge with headline inflation easing to -0.1% YoY from 0% in January and a high of 2.3% in July 2008. The BoJ held rates at 0.1% in April and decided to increase its outright purchases of JGBs by ¥0.4trn per month. Earnings collapse in Q4 2008 but favorable base effects boosting earnings growth in 2009. **Remain Underweight.**

Regional Bond Strategy

U.S.: Treasuries are likely to post modest gains primarily with Quantitative Easing keeping rates low for an extended period of time, while economic data like business confidence, unemployment, and industrial production, still remain weak. After months of bleak macro data, recent data releases have an improved tone. However, the recession continues, with unemployment rising, industrial production weak, and inflation in a downtrend. All these should support bonds. However, yields are likely to come under pressure from the rising bond supply with the Federal deficit ballooning to over \$1.5 trn and set to grow further, and the Fed unable to monetize all the national debt. Hence interest rate volatility is expected to remain high. **Modest Overweight in Treasuries.**

U.K.: U.K. Gilts are likely to be supported by the weak outlook for economic growth in H1 and continued Gilt purchases by the BoE. However, increased supply is likely to limit gains. The BoE left the Bank rate at 0.5% in April but reaffirmed its commitment to the Quantitative Easing program it began in March with an initial £75bn asset purchase plan. IP and unemployment data in the U.K. remains weak, suggesting the recession will continue, but there have been some improvements in home price and confidence data. While current production data remains weak, business and consumer confidence improved. **Modest Overweight in U.K. Gilts.**

Japan: JGBs are likely to be supported by another double-digit decline in GDP in Q1, but the relatively milder Japanese Quantitative Easing and the low level of yields are likely to limit further gains. The Bank of Japan left its policy rates unchanged in April and maintained its bleak outlook for the economy. The Bank also decided to expand the range of collateral of its liquidity provision measures. Earlier in March, the BoJ decided to increase its outright purchases of Japanese government bonds (JGBs) by ¥0.4trn per month (¥4.8trn per year). Japan's GDP on track to another double-digit decline in Q1 after plunging -12.1% QoQ annualized in Q4 2008. Leading economic indicators fell -19.7% YoY. Business and consumer confidence remains weak. The collapse in exports continued in February, down -49.4% YoY. JGBs are likely to underperform with limited support from policy measures. **Modest Underweight in JGBs.**

Eurozone: Eurozone bonds are likely to be supported by further ECB rate cuts, the possibility of ECB purchasing European bonds, and weak GDP data. The ECB cut rates by 25bps to 1.25% at the April meeting but postponed decision on the use of "non-standard" measures to its meeting in May. Recent economic data in Eurozone have shown little sign of improvement. Industrial production remains in a steep downtrend. Country business confidence indicators remain at depressed levels, though PMI has shown some signs of improvement and consumer confidence remains mixed. Further, there is a smaller scope for fiscal stimulus, particularly in Germany. However, Eurozone bonds are likely to underperform with relatively less aggressive ECB easing. **Modest Underweight in Eurozone Bonds.**

Global Sector Strategy

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

- **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. Staples' earnings expected to decline only -7% in Q1. U.S. Tobacco likely to benefit from its high dividend yield, low valuation, solid earnings growth and rising taxes largely priced in. **Overweight.**
- **Utilities** - Utilities underperformed in March as risk aversion eased. 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. **Overweight.**
- **Healthcare** - Sector's earnings and dividend growth remain relatively solid. Valuations 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 a positive. **Overweight.**
- **Information Technology** - Macro outlook remains negative, but growing signs of revival in tech orders. Earnings revisions remain negative. Valuations are expensive relative to other global sectors. High cash levels are a positive for the sector. European Tech firms benefit from the currency tailwind and high net cash position. European Software less exposed to consumers and Financials and hence defensive. **Modest Overweight.**
- **Financials** - Continued loss write-downs, rising delinquencies, asset quality concerns, and credit deterioration are negatives for U.S. Banks. U.S. Treasury's Public Private Investment Program, change in mark to market accounting, and prospects of better Q1 performance by big banks are positives. Significant policy actions by global central banks and governments are a positive for the sector. European Banks are likely to remain under pressure due to their exposure to EM Europe. **Neutral.**
- **Telecomm Services** - Sharp deterioration of consumer fundamentals remains a negative. Seasonality in H1 is a negative for the sector. The sector is a good alternative for both dividend yield as well as dividend growth. Sector earnings expected to decline, but less than most other sectors. Big Telecomms favored with their strong and stable cash flows and cost saving opportunities. European Telecomms have attractive dividend yield and earnings stability. **Neutral.**
- **Materials** - Commodity prices (CRB index) rose 4.2% in March as Chinese manufacturers started restocking. Construction Materials remains weak with housing markets still in recession. M&A activity is a positive. Valuations are cheap relative to other sectors. Improvement in demand due to increased fiscal spending likely to support prices and a positive for the sector. **Neutral.**
- **Consumer Discretionary** - Consumers continue to face headwinds of rising unemployment and sharply negative wealth effects. Outlook for U.S. auto remains weak with auto sales continuing to fall steeply. Sector likely to underperform until job losses show some sign of stabilization. Outlook for Eurozone, U.K., and Japan Discretionary are also weak with weak consumer fundamentals. **Underweight.**
- **Energy** - Oil prices hovering around \$50 in March/April after plunging from the record highs in 2008. In the near-term, the global recession continues to weigh on oil prices. Oil Services are likely to benefit from continued demand for maintenance requirements. European Oil & Gas is likely to benefit from resilient gas prices due to the closer crude price linkage. **Underweight.**
- **Industrials** - Macro fundamentals remain weak due to the intensification of the global recession. Industrial activity has plunged globally in Q1 2009 and likely to remain weak in H1. Manufacturing confidence remains deep in negative territory. The fiscal stimulus in the U.S. and China are positive for infrastructure spending. **Underweight.**

Strategy Summary: Stocks on Track to Recovery but Near-term Risks with Recession & Earnings Decline

Asset Allocation – Neutral: Stocks, Bonds.

Global Bonds – Modest Overweight: U.S., U.K. Modest Underweight: Japan, Eurozone.

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

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

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

Disclosure:

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