

Prudential International Investments Advisers, LLC.

Global Investment Strategy – March 2009

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Financial Market Outlook & Strategy: Stocks Likely to Struggle Near-Term. Modest Bond Gains

John Praveen's Global Investment Strategy – March 2009 expects the tug of war between economic and earnings gloom and the aggressive policy response is likely to continue in H1 2009. Equity market volatility is likely to remain high with the recession continuing and earnings declining, nagging questions about the soundness of the financial system and the problem of toxic assets in the banking system, while policy makers continue to respond aggressively. Stocks are unlikely to begin a sustainable recovery until there is some evidence that the policy measures have begun to address the problem of toxic assets on banks' balance sheets, and the rate cuts have begun to make a dent in the recession.

Bonds are likely to post further gains in the near-term with developed economies deep in recession and several emerging economies slipping into recession. While rates are low and likely to stay low for some time, Quantitative Easing programs will provide additional easing and in some countries provide additional demand for longer-term government bonds. However, concerns about rising bond supply resulting from expansionary fiscal policy and growing budget deficits are a negative for bonds. With many conflicting influences, bond yields are likely to remain volatile in the coming months.

Within stocks, we are modestly overweight the U.S. & U.K., neutral on Eurozone and Emerging Markets, 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 Struggle with Recession, Earnings Decline & Policy Uncertainty. Modest Bond Gains

Stocks: Stocks Continue to Struggle Near-term with Recession, Earnings Decline & Policy Uncertainty

- The misery in equity markets deepened in February with another vicious sell-off pushing global equity markets to lows last seen in the mid-1990s. The sell-off began with disappointment over the lack of detail in the U.S. Financial Stability Plan and the back loading of the U.S. fiscal stimulus package. The sell-off accelerated with fears about bank nationalization, continued dismal economic data, and downgrade of earnings expectations. Developed Markets fell -9.2% in local currency in February, -10.5% US\$, while Emerging Markets fell -2.9% LC, -5.7% US\$.
- The global macro backdrop for stock markets remains challenging in Q1 2009 after worsening in Q4 2008. The global economy remains deep in recession in H1 2009 with another big GDP contraction expected in the developed economies and in several emerging economies. Earlier, Q4 GDP declined sharply in the U.S. (-6.2%), Eurozone (-6%), U.K. (-5.9%) and Japan (-12.1%).
- Central banks continued to cut rates to record lows and undertake other unconventional measures to stimulate economies and stabilize markets. However, the rate cuts have yet to make an impact in halting the growth decline.
- The outlook for corporate earnings in H1 2009 continues to worsen with the developed economies sinking deeper into recession and several emerging economies falling into recession, depressed oil and commodity prices, and further losses by Financials.
- Equity market valuations improved further in February as stocks declined to new bear market lows during the month. Developed Market P/E multiples are trading at multi-decade lows. Record low valuations are likely to be a key support to stocks once the macro uncertainty clouding financial markets clear. At current depressed valuation levels a lot of the bad news is already reflected in equity prices.
- ***Looking ahead, equity market volatility is likely to remain high in the near-term with the recession continuing and earnings declining, nagging questions about the soundness of the financial system and the problem of toxic assets in the banking system, while policy makers continue to respond aggressively. This tug of war between economic and earnings gloom and the aggressive policy response is likely to continue in H1 2009.***
- ***Stocks are unlikely to begin a sustainable recovery until there is some evidence that the policy measures have begun to address the problem of toxic assets on banks' balance sheets, and the rate cuts have begun to make a dent in the recession. Stock markets have historically begun to recover a few months before the economy bottoms. Based on our expectation for the global economy to start showing signs of bottoming in H2, we continue to expect stock markets to start a sustained recovery in early H2 2009.***

Bonds: Recession, Risk, Rate Cuts & Quant Easing Support Bonds. Concerns About Rising Supply Limits Gains

- Global government bonds gained further in February as investors sought safety from tumbling equity market, outweighing concerns over rising bond supply. U.S. Treasuries fell in February, but bonds in Eurozone, U.K. and Japan all posted modest gains in LC terms.
- Looking ahead, global bonds are likely to post further gains in the near-term with developed economies deep in recession and several emerging economies slipping into recession. While rates are low and likely to stay low for some time, Quantitative Easing programs will provide additional easing and in some countries provide additional demand for longer-term government bonds. However, concerns about rising bond supply resulting from expansionary fiscal policy and growing budget deficits are a negative for bonds. With many conflicting influences, bond yields are likely to remain volatile in the coming months.
- ***U.S. Treasuries are likely to post modest gains with the weak U.S. macro outlook, 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 limited support from policy measures.***

Investment Strategy: Stocks Continue to Struggle Near-term with Recession & Earnings Decline

ASSET ALLOCATION: Stocks vs. Bonds

Neutral Stocks: Stocks are likely to remain volatile in the near-term with the recession continuing and earnings declining, and the problem of toxic assets in the banking system, while policy makers continue to respond aggressively. This tug of war between economic and earnings gloom and the aggressive policy response is likely to continue in H1 2009.

Neutral Bonds: Global bonds are likely to post further gains in the near-term with developed economies deep in recession and several emerging economies slipping into recession. While rates are low and likely to stay low for some time, Quantitative Easing programs will provide additional easing and in some countries provide additional demand for longer-term government bonds. However, concerns about rising bond supply resulting from expansionary fiscal policy and growing budget deficits are a negative for bonds.

GLOBAL BONDS

Modest Overweight: USA, UK 1) U.S. macro data remains dismal and GDP on track to contract again in Q1, around -4.8%. Fed continues aggressive Quantitative Easing and considering Treasury purchases. Concerns about increased Treasury supply is a negative. 2) Gilts are likely to post gains, supported by 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 cut rates should continue to support Eurozone bonds. However, uncertainty over degree of easing and rising debt burdens should limit gains by Eurozone bonds. Eurozone bonds are likely to underperform with relatively less aggressive ECB easing. 2) Japan: JGBs are likely to be supported by bleak economic data pointing to another double-digit annualized decline in Q1 GDP after the -12.1% contraction in Q4. JGBs are likely to underperform with limited support from policy measures.

GLOBAL EQUITIES

Modest Overweight: U.S. & U.K. 1) USA: Macro outlook while weak is better relative to other markets. In addition, the policy response is more aggressive with massive fiscal stimulus, bank rescue plans and Fed's QE. 2) UK: Valuations are attractive. BoE rate cuts and implementation of QE are positives. Sterling weakness is another positive. Sharp GDP decline is a negative.

Neutral: Eurozone, Emerging Markets. 1) Eurozone: GDP declines further by -5% in Q1. Earnings outlook weak with recession and Financials' losses. Sector composition is positive. 2) Emerging Markets: Macro outlook deteriorating with several EM economies slipping into recession. Earnings outlook revised down. However, aggressive rate cuts are a positive. Improved relative valuations after the recent sell-off.

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: Yen; Underweight: Sterling & Euro.

The dollar is likely to remain strong against major currencies with the U.S. likely to recover from recession ahead of the others. The dollar should remain strong against the euro and sterling given the weaker growth outlook for Europe relative to the U.S. The increasingly poor Japanese growth outlook will put downward pressure on the yen.

Equity Outlook & Regional Equity Strategy

Equity Market Outlook: Stocks Continue to Struggle Near-term with Recession, Earnings Decline & Policy Uncertainty

Stock markets are likely to remain volatile in the near-term with the recession continuing and earnings declining, nagging questions about the soundness of the financial system and the problem of toxic assets in the banking system, while policy makers continue to take aggressive measures. This tug of war between economic and earnings gloom and aggressive policy response is likely to continue in H1 2009. Stocks are unlikely to begin a sustainable recovery until there is clarity on the policy measures, there is some evidence that the policy measures have begun to address the problem of toxic assets on banks' balance sheets, and the rate cuts have started to make a dent in the recession. However, as Chairman Bernanke put it: "stabilizing the financial system is the key to economic rebound" and equity market recovery. Stock markets have historically begun to recover a few months before the economy bottoms. Based on our expectation for the global economy to start showing signs of bottoming in H2, we continue to expect stock markets to start recovering in early H2 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. The big loss of momentum in consumption, investment spending and housing in Q4 2008 has increased the downside risk to GDP growth in Q1 2009. Consumer confidence has collapsed with unemployment rising and a further decline in household wealth due to the renewed equity sell-off. Business confidence continues to languish in recession territory. However, U.S. macro outlook is better relative to other markets. Policy response remains aggressive with Fed continuing QE, a \$787 billion fiscal stimulus, and rolling out of the Financial Stability Plan and the Homeowner Affordability & Stability Plan. Earnings outlook remains bleak with Q1 earnings expectations for a -33% decline after the -67% decline in Q4. **We are Modest Overweight.**

U.K.: The Bank of England also cut the Bank Rate by 50bps to 0.5%, and began implementing Quantitative Easing with an initial £75bn asset purchase plan. Valuations are very attractive. Sterling weakness is another positive for U.K. stocks. The U.K. economy continues to decline, around -5% annualized in Q1, after falling -6% in Q4. GDP growth expected to decline around -4% in Q1. Earnings outlook remains weak. **We are Modest Overweight.**

Emerging Markets (EM): Macro data remains bleak with IP and exports growth remaining in a sharp decline. The collapse in exports, with the deepening recession in developed economies', combined with depressed oil and commodity prices accelerated the growth slowdown in several economies and pushed some emerging economies into recession. The earnings outlook has been revised lower with the deteriorating growth outlook. 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. **We are Neutral.**

Eurozone: Depressed business and consumer confidence, declining leading economic indicators, slowing global growth, falling exports and rising unemployment point to another sharp decline in Q1 GDP. Eurozone GDP plunged -6% annualized in Q4 as the export collapse percolated into domestic demand. Relative valuation for Eurozone at par relative to the global index despite the sharp sell-off in recent months. The ECB cut rates by 50bps to a record low of 1.50% in March. The Bank sharply revised down its GDP and inflation forecasts, suggesting that the ECB is likely to cut rates further. 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 exposure to Emerging Europe a new problem for Eurozone banks. **We are Neutral.**

Japan: Japan's GDP plunged -12.1% QoQ annualized, -4.6% YoY in Q4 2008, led by a -45% QoQ annualized plunge in exports. GDP growth is expected to post another double-digit decline in Q1 with exports and IP remaining very weak in Q1. Deflation fears have re-emerged with headline inflation falling -0.6% MoM in January, with the YoY pace slowing to 0%. The BoJ held rates at 0.1% in February and has announced measures to ease credit to the corporate sector. Earnings revised down sharply to -69% decline in 2009 due to weak global growth, elevated yen, and the drag from Financials. **We are Underweight.**

Regional Bond Strategy

U.S.: Treasuries are likely to post modest gains as U.S. macro data remains dismal. Several indicators, ISM business confidence, jobless claims, and job losses, remain deep in recession territory. Headline inflation edged down to -0.2% YoY in January, the weakest since 1954 and likely to fall further below zero with favorable base effects. The Fed left the Funds rate in a range between 0 and 25bps in January and made an open ended commitment to keeping the Funds rate at "exceptionally low levels ... for some time." The Fed expanded its Quantitative Easing, purchasing up to \$100bn in agency debt and \$500bn in agency-guaranteed MBS. However, Treasury gains are likely to be limited by concerns about rising Treasury supply with higher government spending as part of the \$787bn fiscal stimulus package and the \$1.75tn budget deficit. **We are Modest Overweight on Treasuries.**

U.K.: U.K. Gilts are likely to post modest gains supported by further GDP contraction in Q1 and BoE's purchases of gilts as part of Quantitative Easing. The U.K. economy contracted -6% QoQ annualized in Q4, after the -2.8% decline in Q3. U.K. GDP is expected to post another big decline in Q1. U.K. headline inflation was marginally lower in January at 3% YoY from 3.1% in December. The BoE cut UK rates by 50 bps to 0.5% in March after reducing rates by 50bps in January and February. Further, the Bank began implementing Quantitative Easing with an initial £75bn asset purchase plan. However, concerns about a rise in Gilts supply will be a headwind. **We are Modest Overweight U.K. Gilts.**

Japan: JGBs are likely to be supported by bleak economic data pointing to another double-digit annualized decline in Q1 GDP after the -12.1% contraction in Q4. Japanese inflation continues to fall with both core and headline down to 0% in January. The BoJ remained on hold in February after lowering the call rate to 0.1% from 0.3% in December. Further, the BoJ announced measures to ease the credit markets by extending its special lending program, commercial paper purchase program, and detailed its plan for corporate bonds purchase. Concerns about the prospects of a more expansionary fiscal policy are a negative. JGBs are likely to underperform with limited support from policy measures. **We are Modest Underweight on JGBs.**

Eurozone: Weak Eurozone growth, and further ECB cut rates should continue to support Eurozone bonds. However, uncertainty over degree of easing and rising debt burdens should limit gains by Eurozone bonds. Recent economic data indicates that the Eurozone will remain in a recession with business and consumer confidence near record lows. Eurozone GDP plunged -6% QoQ annualized in Q4. Eurozone headline inflation remains in a downtrend. The ECB cut rates by 50bps to 1.50% in March. The significant downside revisions to growth forecasts suggest that the ECB is likely to cut rates further. However, it is still unclear how low the ECB is likely to cut rates. Eurozone bonds are likely to underperform with relatively less aggressive ECB easing. **We are Modest Underweight 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 -6% in Q1. U.S. Tobacco likely to benefit from its high dividend yield, low valuation, solid earnings growth and rising taxes largely priced in. **We are Overweight.**
- **Utilities** - Sector benefits from defensive characteristics with markets still under pressure. Sector valuations improved after the decline YTD. 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. **We are Overweight.**
- **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 political pressures, pricing weakness and downgrades to long term earnings outlook. Elevated risk aversion a positive. **We are Overweight.**
- **Information Technology** - Price momentum is less negative for sector than other sectors. Macro outlook is negative with decreased demand for tech equipment. Earnings revisions remain negative in March. 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 very defensive. **We are Modest Overweight.**
- **Financials** - Continued loss write-downs, fears about nationalization, rising delinquencies, asset quality problems, and credit deterioration negative for U.S. Banks. Several major banks have noted improved business environment in Q1 due to higher margins and lower competition. Significant policy actions by global central banks and governments a positive for the sector. European Banks are likely to remain under pressure due to their exposure to EM Europe. **We are 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. **We are to Neutral.**
- **Materials** - Commodity prices (CRB index) declined -4% in February on weak global demand. However, there are some signs of price stabilization in Commodities such as copper, driven by renewed China demand. Construction Materials remains weak with housing markets still in recession. Growing M&A activity is a positive. Valuations are cheap relative to other sectors. Any improvement in demand due to increased fiscal spending likely to support prices and a positive for the sector. **We are Neutral.**
- **Consumer Discretionary** - Consumers continue to face headwinds of rising unemployment and sharply negative wealth effects. U.S. consumer spending remains weak with retail sales falling -9.5% in February. Outlook for the U.S. auto industry remains weak with auto sales continuing to fall steeply. Sector likely to underperform till job losses show some sign of stabilization. **We are Underweight.**
- **Energy** - Oil prices hovering around \$40 in February 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 energy runs the risk of dividend cuts as profits contract with lower oil prices. **We are Underweight.**
- **Industrials** - Macro fundamentals remain weak due to the intensification of the global recession. Industrial activity has plunged globally in January. Manufacturing confidence remains deep in negative territory. The fiscal stimulus proposed by Obama Administration is a positive for U.S. infrastructure. **We are Underweight.**

Strategy Summary: Stocks Continue to Struggle Near-term with Recession & Earnings Decline. Modest Bond Gains

Asset Allocation – Neutral: Stocks, Bonds.

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

Global Equities – Modest Overweight: U.S., U.K. Neutral: Eurozone, Emerging Markets. 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: Yen; Underweight: Sterling & Euro.

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