PRUDENTIAL GLOBAL INFLATION PLUS FEEDER FUND
30 JUNE 2021

PRUDENTIAL INVESTMENT MANAGERS

QUARTERLY COMMENTARY

GLOBAL MULTI-ASSET

MARKET OVERVIEW

During the second quarter (Q2) of 2021, more progress in vaccine rollouts worldwide, as well as positive corporate earnings reports and economic news, continued to lift equity returns, particularly in developed markets, even as concerns emerged over high valuations. Bonds – both government and corporate credit – also recorded solid performances, retracing some of their Q1 losses and buoyed by reassurances from central banks that easy monetary policies would not be halted any time soon. Meanwhile, the approval of even more US government spending helped support the global growth outlook, as did improving conditions in the UK and Europe. However, emerging market equities lagged those of developed markets.

In the US, the economy gathered speed as Q1 GDP growth was recorded at a final 6.4% (q/q annualised) and Q1 consumer spending jumped 11.1% y/y, amid a ramp-up in factory production and signs of labour shortages in some areas. Bullish sentiment was further stoked by the bipartisan approval of a five-year, US$1.2trn infrastructure spending plan. At its June policy meeting, the US Federal Reserve (Fed) left interest rates unchanged, easing investor concerns over rising inflation, while also signalling two 0.25% interest rate hikes by the end of 2023. Longer-dated US Treasuries rallied on the accommodative stance, helping flatten the UST yield curve after its steepening trend in previous quarters. This was despite headline consumer inflation of 5.0% y/y in May, its highest rate in nearly 13 years, which policymakers consider to be temporary. Spurred by the improving growth outlook, US equity markets continued to rally for the quarter (although June gains were more subdued), with the S&P 500 delivering an 8.5% return, the Dow Jones Industrial 30 5.1%, and the technology-heavy Nasdaq 100 11.4% (all in US$).

In the UK, the rapid spread of the Covid-19 Delta variant, in the face of the country's successful implementation of its vaccination programme, proved to be a setback for the economy's anticipated full reopening in June, dampening market sentiment to some extent. The latest GDP figures proved equally bleak as the economy shrank by 6.1% y/y in Q1 2021. Despite this, the Bank of England upgraded its growth forecast for the year to 7.25% from 5% in February, and left its key interest rate unchanged as expected, while warning against any "premature tightening" until it reached its GDP growth and inflation goals.

In the EU, Q1 GDP contracted by 1.7% y/y, disappointing most analysts on the back of slower-than-expected vaccine programme rollouts and the emergence of more contagious virus variants which forced extended lockdown measures. On the other hand, later in the quarter, consumer and business sentiment recorded strong rebounds, albeit not yet reaching pre-Covid levels.

Meanwhile, the European Central Bank (ECB) left interest rates on hold at its June policy meeting, with President Christine Lagarde injecting some bullish sentiment by emphasizing that growth in the region should pick up amid stronger global growth and consumer spending, and that the central bank would continue its bond purchases and other supportive monetary measures. Unlike the US Fed, she refrained from signalling when the ECB might start to ease its accommodative policy. Consumer inflation in the EU rose to 2.3% y/y in May, due largely to a low annual base effect.

For the quarter, French equities far outperformed their regional counterparts as the CAC 40 delivered 10.1%, the UK's FTSE 100 5.8%, and the German DAX 4.4% (all in US$).

Japan's economic contraction for Q1 2021 was revised to -3.9% y/y from a previously estimated -5.1% y/y, above market expectations of -4.8% y/y. However, further restrictions to economic activity due to the worsening spread of the Coronavirus, particularly in the Tokyo region, have led many to expect Q2 growth to be weaker, and again in negative territory. The Bank of Japan left its key short-term interest rate unchanged at -0.1% in June, and also extended the deadline for its pandemic-relief programme from September 2021 to March 2022. In a further move to boost growth, policymakers unveiled a new scheme to provide funds to financial institutions that invest or extend loans related to climate change issues. Japan's CPI hovered around 0%, higher than previous deflation due to the rise in global oil prices, although inflation expectations were unchanged.

In China, GDP growth slowed to 0.6% q/q in Q1 2021 from 3.2% the previous quarter. The People's Bank of China again left its lending rates on hold in June, while noting in its Q1 monetary report that it was more worried about an uneven economic recovery, weak consumer spending and lack of private business investment than rising prices. The government continued its crackdown on the large local IT and fintech companies, introducing more regulations regarding financing and microlending in a bid to curb "monopolistic" practices online.

For the second quarter of 2021, Japan's Nikkei 225 returned -1.6%, the MSCI China produced 2.3% and Hong Kong's Hang Seng delivered 2.9% (all in US$).

Among other large emerging equity markets, in US$ terms Brazil's Bovespa was by far the best performer with a 22.3% return, rebounding from a disastrous Q1, while the MSCI Russia delivered 14.4%. The MSCI India posted a respectable 7.0% and South Korea's KOSPI 6.3%, but the MSCI South Africa and MSCI Turkey both ended in the red with -1.3% and -0.2%, respectively, all in US$.

Finally, the rand appreciated against the major global currencies over the quarter, rising strongly from its oversold position in April and May before retracing some gains in June. It gained 3.3% against the US dollar, 3.1% versus the pound sterling and 2.4% against the euro over the three months.

PERFORMANCE

The fund delivered a return of 1.4% (net of fees) for the second quarter of 2021, while global inflation measured -1.6%. For the year ended 30 June 2021, the fund returned -3.2% (net of fees) as rand strength detracted from absolute performance, while global inflation measured -14.9% year-on-year.

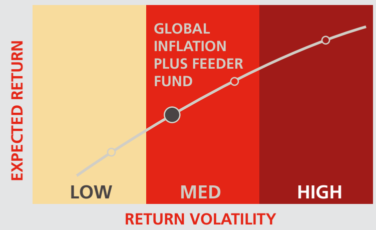
Contributors to absolute performance over the quarter came from the fund's broad exposure to US and European equities; M&G's machine learning and quantitative risk premia funds; US dollar investment grade corporate bonds; US Treasuries held for duration management and diversification purposes as well as Turkish government bonds.

STRATEGY AND POSITIONING

The fund is now much more defensively positioned in terms of major risk assets, as markets have rallied and reduced potential returns. It remains tilted in favour of corporate credit and emerging market sovereign bonds in the fixed income portion, with a more muted preference for equities. For context, global inflation (based on the OECD Major 7 CPI Total Index) was 3.5% for the rolling year ended 31 May 2021.

During the quarter, we reduced the allocation to US investment grade bonds, which had been trading close to record spread tightness in

RISK/RETURN PROFILE:



INVESTMENT MANAGER OF THE UNDERLYING FUND:
M&G Investment Management Limited (UK)

FUND MANAGERS OF THE UNDERLYING FUND:
Marc Beckenstrater and Craig Simpson

ASISA CATEGORY:
Global - Multi-Asset - Low Equity

BENCHMARK:
Global inflation

INCEPTION DATE:
1 March 2004

FUND SIZE:
R203 374 553

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK*	B CLASS
1 year	-3.2%	-14.9%	-2.9%
3 years	7.9%	2.1%	8.2%
5 years	5.3%	1.3%	5.6%
7 years	7.5%	5.0%	7.8%
10 years	10.5%	8.6%	n/a
Since inception	7.7%	6.2%	8.7%

Inception date B Class: 1 July 2013
* The Fund's benchmark changed from the ASISA Global - Multi Asset - Low Equity Category Mean to Global Inflation on 1 November 2018.

Sources: Prudential, Morningstar & Deutsche Securities favour of emerging market local bonds, where spreads were much more favourable. Similarly, we switched some exposure to US dollar floating rate bonds into US Treasuries, as the floating rate bonds were no longer providing meaningful compensation for their potential illiquidity relative to cash. We also chose to replace a passive property equity holding with exposure to the new Prudential Global Property Fund as we consider it more attractive in terms of potential returns.

Since the coronavirus pandemic began, the policies of governments and central banks to support their economies have largely been effective and the global economy is arguably in better shape today than most would have predicted this time last year. Investors are now considering whether central banks can time a graceful exit from these policies and what might be the unintended consequences of doing so.

We believe that, despite some commentators' interpretation of the Fed's increased hawkishness as a significant policy shift, the reality is more subtle. It could be interpreted as the central bank reminding the market that, although long-term inflation is not an issue right now, it remains part of their mandate. We continue to see inflation as transitory. However, we expect this debate to persist until ultimately settled by time and more data points and anticipate that there could be further volatility ahead.

At the moment, we therefore remain positive on the economic cycle, but think it is prudent to prepare for potential volatility and 'episodic' price moves ahead as the market digests new economic data and central bank rhetoric. ■

Sources: Prudential, Morningstar & Deutsche Securities