

Lighthouse

Investment Outlook: Q2 2026

TECHNOLOGY | SAFE HAVENS | VALUATIONS | OUTLOOK

Investment insight from the team that manages **PruFund**



For UK investment professionals only

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&G



Welcome to Lighthouse

I'm delighted to introduce Lighthouse, our new quarterly investment outlook from the Life Investment Office – the team managing £155bn of assets, including the PruFund range of funds at £70bn on behalf of the Prudential Assurance Company (PAC). Our 75-strong team of investment specialists bring deep expertise across asset allocation, manager oversight, strategy design, liability management, derivatives and portfolio management.

In this quarter's edition, we focus on three key themes we believe will shape market outcomes and client decision-making in the months ahead. First, **the rise of AI and the growing concentration** of market leadership – a powerful force creating both innovation tailwinds and fragility risks. Second, **the evolving role of safe-haven assets** in a world where traditional anchors are being tested by shifting monetary regimes and geopolitical uncertainty, as seen by recent events in the Middle East. And third, a fresh look at **valuations** through our fair-value framework, helping us assess where markets may be mis-priced against fundamentals.

Together, these themes highlight both the opportunities we see across the global landscape, as well as the risks we are actively managing on behalf of our customers. Finally, we pull these together in our **capital markets philosophy and outlook**, anchored in long-standing investment principles, supported by continuous innovation and a commitment to developing solutions that meet investors' needs in a changing world.

I hope the insights in this edition provide clarity and inspiration, and spark new conversations about what enduring investment stewardship means for you and your clients.



Ciaran Mulligan,
Chief Investment Officer, M&G Life

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Julieth Amaya

Investment Strategist, LTIS Capital Markets Modelling



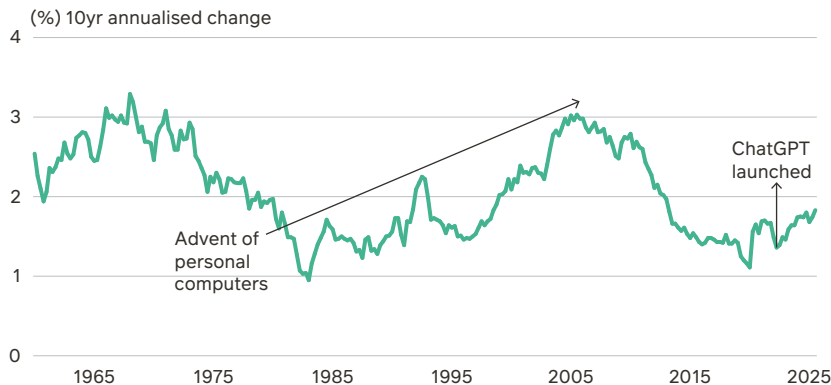
AI and the elephant in the room: **Market concentration**

We don't believe the current price action in the top AI stocks reflects bubblelike conditions. While broadly consistent with expectations, it does set a demanding benchmark for the future.

A broad array of structural forces will determine the pace and scale of AI's deployment, such as geopolitical frictions, supplychain constraints, and uncertainty around productivity outcomes.

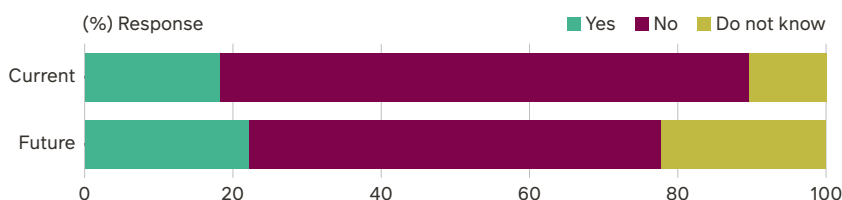
We are participating in the technology cycle in a way that is mindful of US concentration risk, with higher allocations to more attractively valued non-US markets, particularly South East Asia.

New technology adoption historically increases productivity



Over 80% of US business functions are yet to employ AI

Survey Question: Did this business use AI in any of its business functions?



Source: US Census Bureau Survey, Datastream and LTIS Calculations

Are we in an AI bubble?

With the Magnificent Seven accounting for roughly 40% of the S&P 500, and growing at a pace reminiscent of the dot-com boom, the natural question on everyone's lips is: "Are we in an AI bubble?"

We don't believe that the growth in the price of the top AI stocks – such as Nvidia, Amazon, Microsoft and Google – meets that definition yet. Their market cap, albeit high, is backed by strong earnings growth and high demand for their AI services. This wasn't the case during early 2000s mania, when practically any internet-related stock skyrocketed on sheer speculation. However, current valuations have baked in the expectation of continued growth and expansion across the entire AI ecosystem, which sets a high bar for these stocks to meet expectations in the medium to long term.

The risk here is that if these assumptions fall short, there could be a degree of unwinding in the sector. Considering elevated concentration levels, this would result in a drag for entire indices and investment strategies exposed to market-weighted equity building blocks.

Where are we in this technological cycle?

As with the rollout of other groundbreaking technology, the introduction of AI can be tracked across three broad phases, each posing their own hurdles for growth potential:

- **Build-out:** this is where we are now and is currently developing at pace, with a ramp-up of capital expenditure to build infrastructure, resulting in hardware providers seeing exceptional revenue growth.
- **Adoption:** As solutions mature, adoption rates (of which there remains a high degree of uncertainty) are expected to pick up. Whilst appetite and interest appear

strong, surveys indicate we are still in the early stages of this phase at the business level, even if personal adoption rates are far higher.

- **Productivity:** The scale of productivity gains that can be made remain ambiguous. Depending on assumptions around the number of functions impacted and savings made, economists' estimates range from 0.1% productivity boost to 1.5% per annum; it may take time for evidence to come through in economic data, although rising margins of early adopters may provide a marker.

When visualising these phases, parallels can be drawn to credit card adoption during the 1950s to 1970s, or the internet's emergence in the 1990s. At first, commercial businesses were slow to trust systems that felt alien. Mainstream adoption wasn't driven entirely on the tech's merit alone; but because the surrounding infrastructure matured, with confidence levels following suit.

AI finds itself in a similar position now. It's capability is plain for all to see, but the workflows, governance, and skills required to embed it meaningfully in the economy are still playing catch up. We're moving past the novelty stage, but are still far from the point where AI becomes a fully integrated default layer of private and public sector infrastructure. This points to a gradual evolution, which will be far from frictionless as new challenges emerge.

Assessing the range of potential outcomes

There is no doubt that this technology cycle offers enormous potential opportunities, but there are also numerous historical examples when new technologies failed to live up to expectations. When faced with such uncertainties, scenarios help to sketch out the distribution of potential outcomes and are a key pillar of robust portfolio construction.

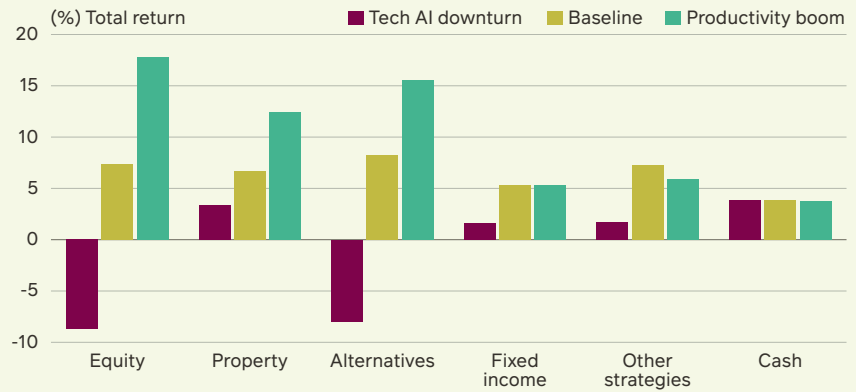
When considering future technology outcomes, we outline two primary scenarios: a "productivity boom" scenario, and an "AI downturn" scenario.

In a productivity boom scenario, we would expect the recent rapacious capex spending on AI infrastructure to continue, and for adoption rates to follow an aggressive "S-curve": accelerating sharply over the next 5 years then slowing as we approach full adoption. Under this scenario, we assume the upper end of productivity growth estimates are achieved.

Such a positive scenario could drive a further extension of strong returns for equity markets. Whilst, we would note that market pricing already embeds elevated expectations for those closest to the AI theme, we would expect a broadening out of gains to continue under this scenario.

Our downside scenario focuses on the impact of a US-centred shock to spending on AI infrastructure. This would be driven by

Equity & alternatives most impacted during an AI downturn



Estimated aggregate one year return for the With-Profits fund calculated as a forward-looking pricing using LTIS capital market assumptions and factoring in starting yields for fixed income. Source: Long Term Investment Strategy

slower business adoption due to implementation challenges, lower productivity gains, and inflated expectations of consumer preferences for AI goods and services.

Such a scenario may lead to a hit in AI capital expenditure by businesses and lower earnings than expected for tech stocks. This repricing, combined with lower investment, may lead to a sharp slowdown in growth. Based on a number of assumptions, including a 50% lower AI-related revenue growth than current analyst estimates, leading to a 10-25% lowering of earnings expectations, we would expect tech sector valuations to drop, dragging tech-heavy indexes like the S&P 500 lower. This would have a significant impact on any market-weighted investments in the US including passively constructed multi-asset funds.

Additional factors shaping future growth

Geopolitics will play an outsized role

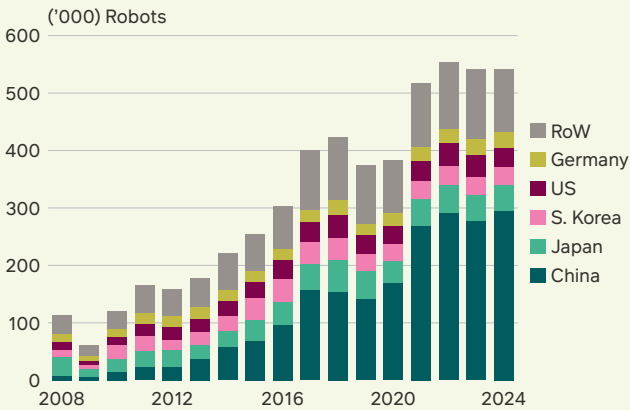
AI dominance has become a hotly contested square on a fast-moving geopolitical chessboard. When the US restricted sales of advanced Nvidia AI chips to China in 2022, the intention was to slow progress. Instead, it accelerated China's push to develop domestic alternatives, exposing just how tightly global innovation is tied to US technology. While

the US is likely to retain an advantage in cutting-edge chips, China has rapidly closed the gap in software, with the launch of DeepSeek R1 in early 2025 delivering performance comparable to ChatGPT at lower cost.

China has also made clear that AI isn't just about code and cloud servers. Its recent military parades showcased advanced robotics and autonomous systems. Indeed, since 2017, China has deployed more industrial robots than the US, Japan, South Korea, and Germany combined, accounting for 54% of the global total by 2024. Sustained efforts in R&D – Chinese patent filings exceeding 1 million in 2024 – have translated into tangible gains, with labour productivity growth averaging 6% since 2021 compared to 1% in the US.

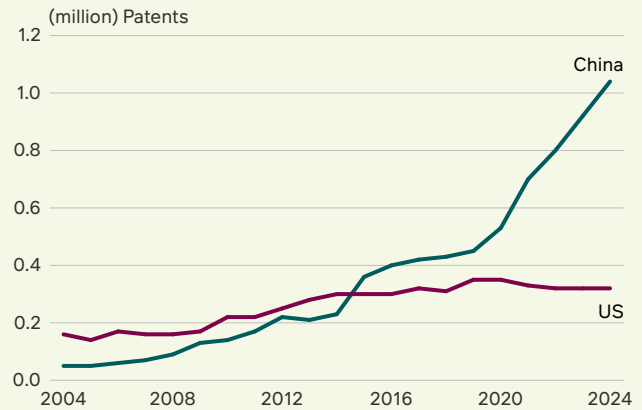
However, when technological leadership is at stake, the US is never likely to take a backseat and the government has shown a willingness to intervene in this critical sector. The AI ecosystem is set to benefit from significant state backing through subsidies, long-term contracts, and strategic partnerships. Recent collaborations between OpenAI, Google, and Palantir, to embed AI agents into US defence departments highlights how closely public policy and private innovation are now linked. In the global AI arms race, government support may prove just as important as computing power.

China's adoption of industrial robots far ahead of peers



Source: Macrobond

China's R&D efforts has outstripped the US for over a decade



Burgeoning resource needs are a growing problem

Power and energy have emerged as the key bottlenecks in the continued growth of advanced computing, a challenge expected to drive \$1.2 trillion of investment in power and cooling infrastructure by 2030 (source: PitchBook). In a development that once might have sounded like science fiction, some hyperscalers – operators of massive data centre infrastructure – are now exploring whether such facilities could even be built in space. Meanwhile, growing shortages in key hardware such as chips is an emerging theme. The fact that Amazon, Google and Microsoft own 58% of the estimated 1,297 hyperscale data centres worldwide (source: Synergy Research Group), is another stark reminder of the dominance of the US behemoths. The scope for supply to meet demand on this front will be a key factor in determining the ability for AI to effectively and efficiently scale.

How PruFund is invested

Our forward-looking approach to asset allocation is consistent with our enduring commitment to comprehensive diversification. The Magnificent Seven's role in shaping the future of technology and productivity is undeniable. But for investors focused on risk management, resilience, and



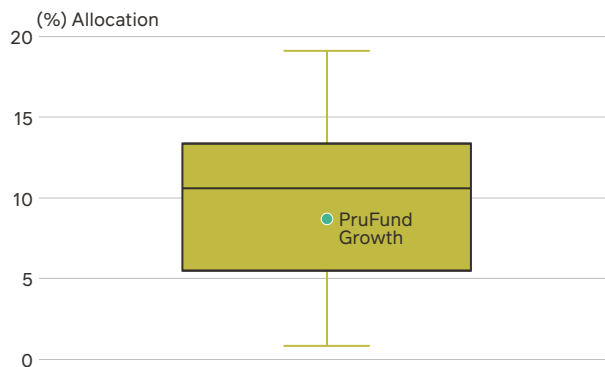
Too much power in too few hands can distort the principles on which prudent investing is built.

long-term outcomes, their dominance is a reminder that too much power in too few hands can distort the principles on which prudent investing is built.

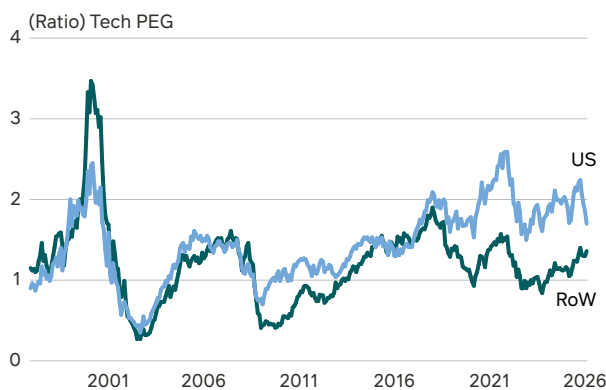
As such, our positioning tilts towards where we see market capitalisation evolving – regions expected to be sources of growth over the long-term. This approach has worked well of late, enhancing absolute and risk-adjusted returns, although in 2025 the returns were dominated by a small number of sectors.

For PruFund, the total equity allocation to technology is broadly in line with our peers' average. Last year, tech companies outside the US had strong returns, and whilst their performance was underpinned by strong earnings growth, this was from lower starting valuations. Our allocation is globally diversified, with a significantly lower exposure to US, and a larger exposure to pan-Asian tech. The average peer holds around 60% of their tech exposure in North America, PruFund allocates only about 25%, with a further 45% distributed across China, South Korea, and Taiwan. Such an approach allows us to participate in this broadening technology cycle while mitigating the risk of a de-rating in the US tech stocks.

PruFund tech exposure is in line with the average of our peers



Tech exposure is acquired at a lower price for non-US equity



Source: LTIS calculations and Datastream, Peers (20 different peers tech exposure approximated based on regional equity exposure, where peers cite Global Equity sleeve we assume a pro-rata regional exposure that is the average of rest of the peers)



Sejuty Chowdhury

Investment Strategist,
LTIS Capital Markets Modelling

What is a **safe haven** now?

Heightened geopolitical uncertainty and a rising risk of fiscal dominance are drawing greater market scrutiny, given their potential inflationary implications.

Traditional safe havens (government bonds, the US dollar, the yen) have shown signs of strain, while gold's role endures but behaves more cyclically – and sometimes pro-risk – than in the past.

Portfolio resilience calls for a diversified mix of safe-haven assets and complementary, low-correlation strategies that can support performance across regimes.

Rethinking safe havens

Heightened geopolitical uncertainty and a rising risk of fiscal dominance are drawing greater market scrutiny, given their potential inflationary implications. Add in AI and digital assets' radical economic potential and it's hard to escape the sense that we're on the cusp of a genuine paradigm shift.

In this fast-moving landscape, the idea of what constitutes "safety" has become far more fluid. Familiar relationships between "risk on" and "risk off" assets are evolving. Even once unquestioned options, such as government bonds and the US dollar, have shown signs of recent strain. Such sentiment is driving investors to re-evaluate the traditional allocation strategies such as the 60/40 blend and seek portfolio constructions that can weather structural volatility and shifting macro drivers.

Ultimately, our view is that "safety" has become a moving target – and preparing for changing tides is wiser than anchoring to yesterday's certainties. As the world continues to evolve, building a substantially diversified mix of safe-haven assets and orthogonal strategies is becoming increasingly essential.

What exactly constitutes "safety"?

A range of characteristics are broadly agreed to be good indicators of a safe haven. While investors may weight these differently, these features provide context for why

certain assets have historically behaved defensively during times of uncertainty. These are:

- **Liquidity and accessibility:** must be highly liquid and tradable on the global stage, with limited price impact
- **Stable demand:** should have persistent demand for perceived security, helping to limit the impact of market downturns lead by risk assets
- **Negative or low correlation:** low, or ideally, negative correlation to 'risk-on' assets such as equities means they hold or gain value in times of market stress
- **Capital preservation:** primary role is in protecting capital for defensive portfolio positioning, rather than for their growth potential

Perceived safe havens and shifting perceptions

Gold

Ironically, in a world where technology reigns supreme, gold – a metal as old as time itself – is now commanding the spotlight. Despite offering no yield, gold has long been regarded as a traditional safe haven – historically serving as a hedge against currency debasement, inflation, and systemic shocks.

Pattern wise, gold and real yields are inversely correlated. Its performance through past cycles

underscores this: gold soared during the inflationary surge of the 1970s, yet faltered in the early 1980s when high real interest rates diminished its appeal. In 2025 it posted its strongest return since 1979, remaining resilient even as real yields rose. Notably, gold simultaneously entered an "explosive phase" territory alongside equities for the first time in half a century, according to a report by [Bank for International Settlements](#). This is an unconventional pattern supported by robust ETF inflows and ongoing, though moderating, central bank demand.

Looking ahead, rising concerns over fiscal dominance and heightened geopolitical tensions, as recently seen in the Middle East, reinforce gold's relevance in an increasingly uncertain world. Yet, its dual identity – as both a currency-like asset and a commodity – means its behaviour adapts to economic conditions, resulting in correlations that can shift unpredictably over time.

On the topic of gold, parallels have been drawn with Bitcoin – a finite and decentralised form of money which sits beyond the influence of any single party. It's capped supply, decentralised structure, and independence from monetary policy, theoretically position Bitcoin as a hedge against inflation and currency debasement. Our view is that Bitcoin's price remains largely driven by speculative demand and its higher volatility means that it fails the test of it being a 'safe' store of value.

Even as some investors re-evaluate what constitutes "safety" in today's market environment, cryptocurrencies like Bitcoin still have a way to go before they can be considered reliable safe-havens.

Currency

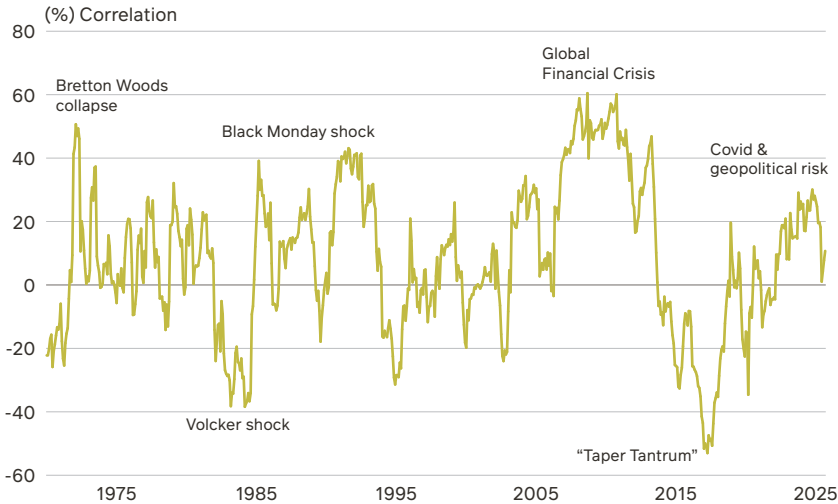
The Swiss franc, Japanese yen, and US dollar have traditionally been viewed as safe-haven currencies thanks to their stability, liquidity, and resilience during

Historical correlation to equities

Correlation	US Treasury (%)	USD (%)	Gold (%)	Bitcoin (%)
5-Year	17.1	-39.2	16.8	42.0
10-Year	-5.0	-36.3	14.1	26.0
20-Year	-25.6	-39.1	12.2	
GFC	-35.0	-49.0	10.0	
Covid	-32.0	-50.0	28.0	30.0

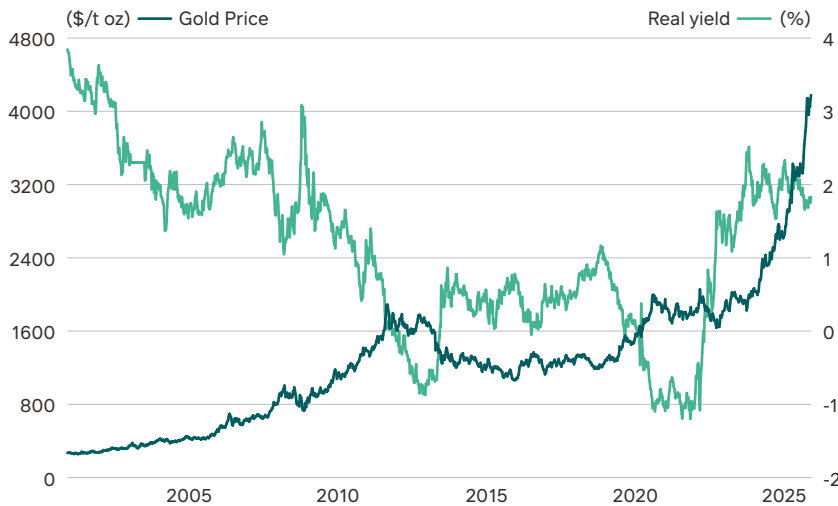
Source: LSEG Datastream, LTIS calculation, as at 10th March 2026

Gold's correlation to inflation is regime dependant



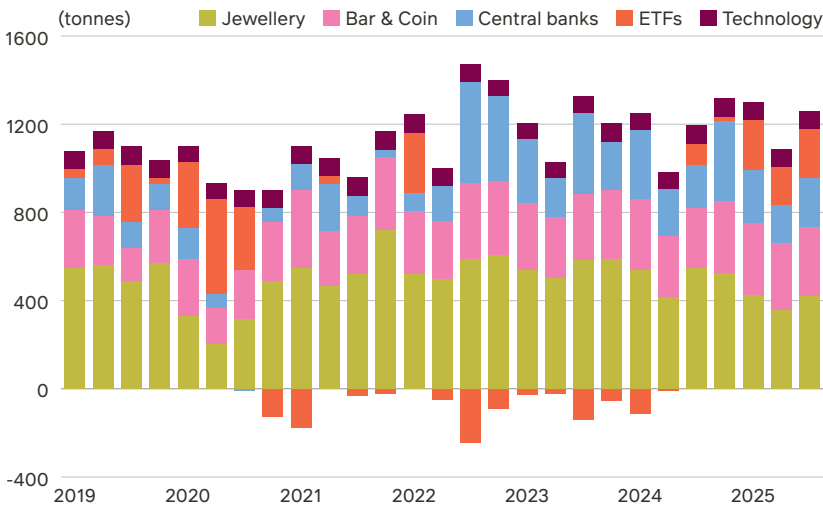
Source: LSEG Datastream, as of 5th September 2025

Gold and real yield movement reflects the opportunity cost of holding a non-yielding asset



Source: LSEG Datastream, as at 8th December 2025

Gold demand has been supported by ETF inflows and sustained central bank buying



Source: World Gold Council, as at Q3 2025

In a world where technology reigns supreme, gold – a metal as old as time itself – is now commanding the spotlight.



periods of market stress. During the 2008 financial crisis, both the franc and yen surged in value as investors unwound carry trades and sought more secure assets.

Since then, their roles have evolved. The yen's safe-haven reputation has weakened, largely because Japan's ultra-loose monetary policy turned the currency into a funding vehicle for carry trades. Recent developments – such as Trump-era tariffs – have added further pressure on the yen. Meanwhile, questions around US fiscal dynamics and inflation volatility have challenged the dollar's traditional defensive leadership. In fact, the US Dollar Index, which measures the dollar's performance against a basket of its major trading partners' currencies, weakened by nearly 10% in 2025. This marked its worst annual performance since 2017. Indeed, for the first time in many years, US markets experienced a rare 'triple decline' across equities, bonds, and the dollar during the April 'Liberation Day,' signalling a shift in investor

behaviour under acute market stress. That said, the dollar did show renewed strength during the more recent conflict in the Middle East.

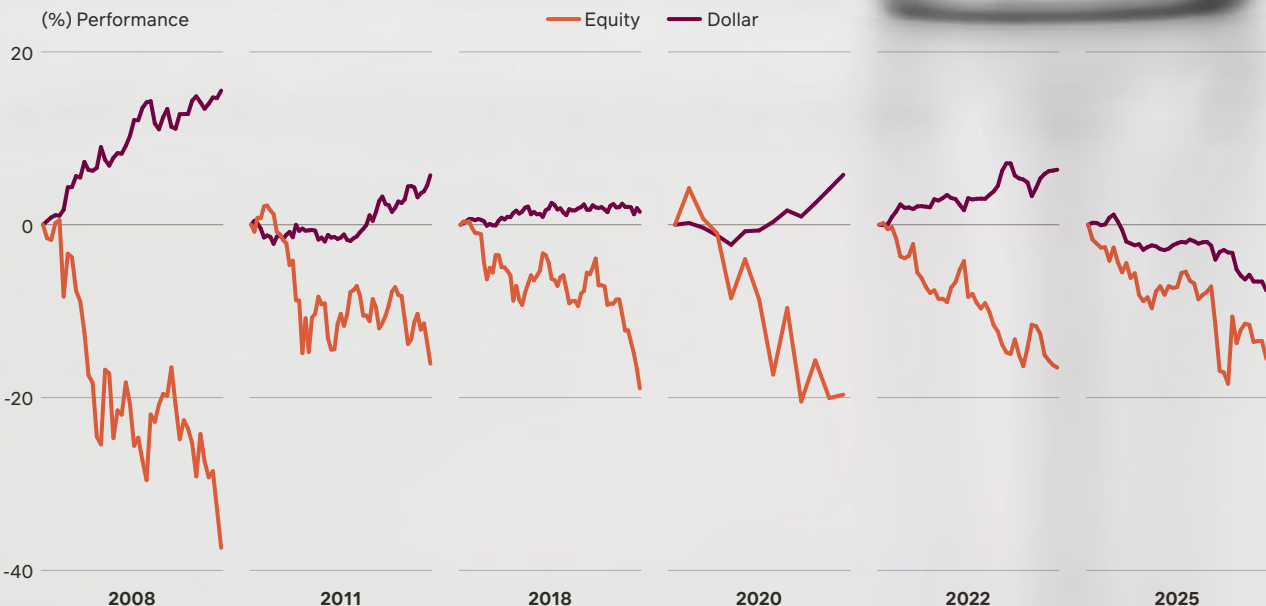
In contrast, the Swiss franc has remained consistently strong. Switzerland's institutional stability, disciplined fiscal approach, and comparatively low debt-to-GDP ratio (below 40%, versus Japan's 230%+) have reinforced the franc's position as one of the most reliable safe-haven currencies.

Developed market government bonds

For decades, government bonds have served as the ultimate safe-haven asset, offering stability and negative correlation to equities during market stress. That status is increasingly being questioned as prime issuer nations like the UK and the US grapple with relentless fiscal challenges that are eroding away the perception of them being 'risk-free'. This once unquestioned assumption is now being tested



Historical performance when US equity declined by at least 15%



Source: LSEG Datastream

We can't predict the future. Past performance isn't a guide to future performance.

Safety has become a moving target – and preparing for changing tides is wiser than anchoring to yesterday's certainties.



as the threat of persistent inflation has forced markets to reassess the attractiveness of future returns based on promises made in nominal terms, but lived in real terms.

Mounting concerns over governments' ability to responsibly handle debt obligations – coupled with increased spending – has seen bond yields surge worldwide. Nowhere is this more symbolic than in Japan, where once near-zero rates have given way to a gradual uptick, with their 40-year bond yield making headlines due to surpassing 4% for the first time. This is a marked change from decades of perceived stability, driven by the newly appointed prime minister Takaichi's fiscal spending plans. All of this has repercussions for the risk lens through which government bonds as an asset class are starting to be viewed.

In the US, Treasury ownership has shifted from global institutions and central banks toward yield sensitive domestic investors such as banks,

money market funds, and hedge funds, who demand compensation for rising fiscal uncertainty. During the current war with Iran, this dynamic was evident as markets exerted upward pressure on bond yields. Meanwhile, the government is finding new avenues to keep demand steady. For example, stablecoins – cryptocurrencies designed to maintain a constant value by pegging to assets such as the US dollar or short-dated Treasury bills – are expanding rapidly, enabled by supportive regulation. As issuers accumulate growing volumes of T-bills to back these coins, they are reshaping demand for US Treasuries and introducing a new channel of potential market volatility. This underscores the need to maintain exposure to a basket of bonds as diversification within developed market government bonds (hedged back to the investor currency) will help to mitigate concentrated exposure to fiscal risks.

Orthogonal strategies

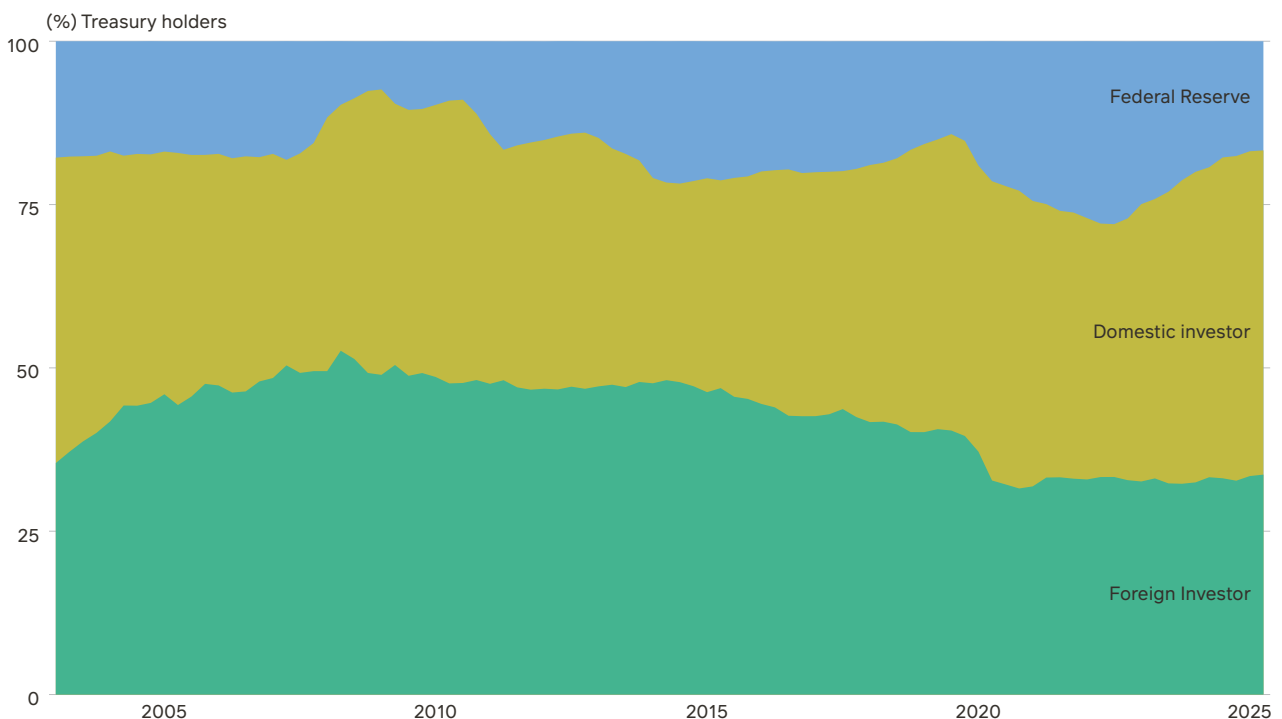
Other strategies, such as cross-asset momentum, are designed

to target sources of return that are uncorrelated with traditional assets. They exhibit a mix-and-match quality of safe-haven characteristics: some offer strong diversification and low correlation, while others differ in liquidity, stability, and capital preservation, making the category diverse rather than uniformly safe-haven. The most important safe-haven quality these strategies possess is their low or negative correlation with equities and bonds, especially during periods of market stress. Naturally, such approaches are only as sound as the methodology used to underpin them. Nonetheless, as portfolio overlays, they can be an effective tool in any risk-management arsenal.

PruFund's approach – one anchor won't hold in every tide

Recent moves in perceived safe-haven assets – drifting away from the correlations we would

US Treasury ownership has shifted to yield-sensitive domestic investors



Source: FRED, as at 8 December 2025

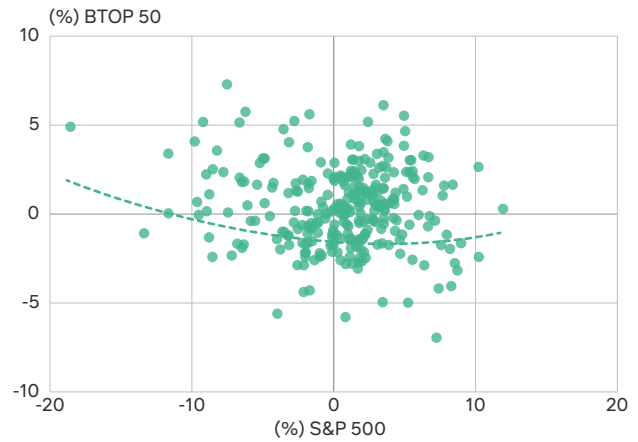
ordinarily expect – reinforces our conviction in the need for comprehensive, robust diversification. With increasingly complex market dynamics and liquidity squeezes at play, it's no longer sufficient to solely rely on strategies that worked well in the past.

- As an asset class, government bonds remain a cornerstone of stability, yet the importance of distributing exposure across major developed markets has grown markedly. Doing so provides a meaningful hedge against fiscal strain and currency risk.
- Gold retains its relevance as an asset untethered to government solvency. But its behaviour has become more volatile – evidenced by a 10% downturn in late January, triggered by Trump's nomination of Kevin Warsh as the Federal Reserve chair. The fact it increasingly moves in tandem with equities, reflects a more speculative character that makes its 'safe-haven' status less consistent.
- While non-traditional “orthogonal strategies” may not fit the classic definition of safe-haven, they offer innovative ways to stay invested as market dynamics and investor expectations evolve. Importantly, they fit the bill of low correlation and capital perseverance which is most important to multi asset investors

In summary, portfolio resilience today demands a multi-dimensional approach – one that acknowledges the shifting behaviour of traditional safe havens while embracing a wider set of tools capable of absorbing shocks across a range of economic regimes. As such, there is a place for orthogonal strategies which seek to add a further layer of diversification against mainstream assets.

Dynamic signals help trend strategies smile during broader market stress

Trend Strategy returns exhibit a 'Smile' across S&P500 market regimes



Example of how trend strategies build positioning based on signals

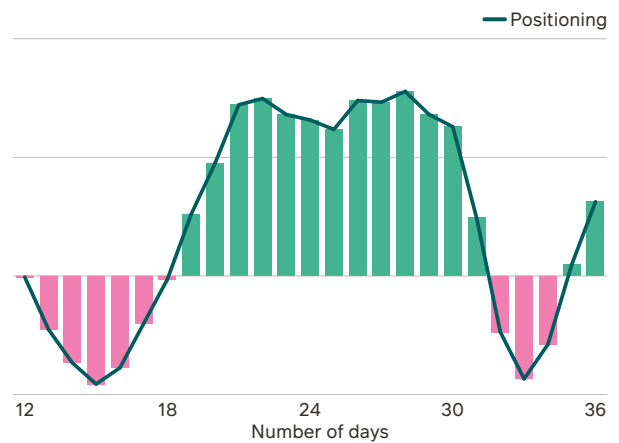
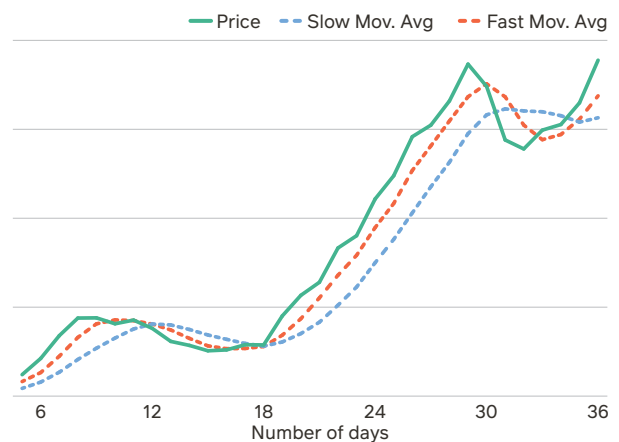


Illustration of moving averages used as signals by trend strategies



Note: The 'smile' refers to the tendency for trend strategies to deliver stronger returns during periods of elevated volatility and market stress, while returns are typically lower in range-bound markets.

Source: LSEG Datastream, LTIS calculations

Ben Troke

Senior Investment Strategist, LTIS Capital Markets Modelling



Valuations as our north star

Gains in risk assets have been driven by an expansion in valuations rather than an improvement in fundamentals, which tempers our outlook across public markets for the medium term.

A core challenge in forming a grounded outlook is recognising the distinction between price and value – and how that relationship can evolve; this is why we draw on a broad suite of models and valuation frameworks designed to anchor our thinking in fundamentals.

Our approach is shaped by the mantra that there is one realised past, but many potential futures – this underpins our comprehensive approach to analysing potential risks and opportunities.

Price vs value

We're believers in the view that while sentiment, momentum, and the emergence of new information can drive asset prices in the short term, it's ultimately fair valuations that shape returns over longer time horizons.

The challenge is recognising when price and value meaningfully diverge, during what can be prolonged periods of irrational market exuberance or pessimism – it's not uncommon for markets to behave in ways that appear disconnected from fundamentals. Arguably, prudent forward-looking investing depends less on how quickly one reacts to price, and more on how effectively one can weigh underlying value. After all, price is observable – value must be determined.

One past, many futures

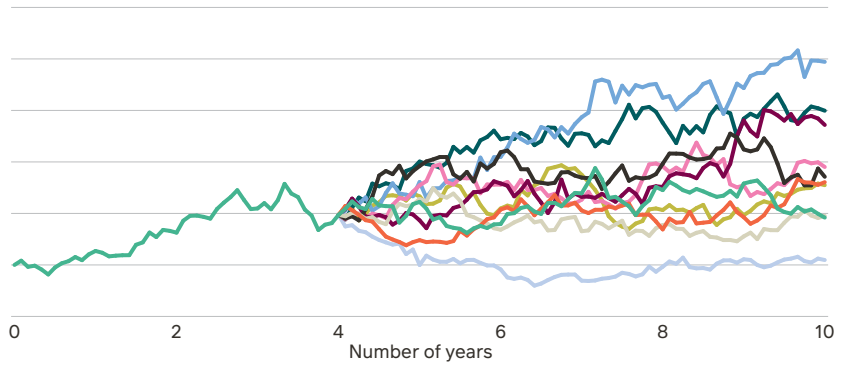
In a fast-changing world, where the only certainty is uncertainty, a key tenet of our overall investment philosophy is that there is one realised past, but many potential futures. This is why we devote significant time and resource to analysing and calibrating qualitative as well as quantitative scenarios, including optimistic and pessimistic technology cycle scenarios, fiscal risks and geopolitical escalations.

The setting of strategic asset allocation requires a long-term perspective, and for us the starting point is to establish a sense of where the long-term anchor for expected returns sits across different asset classes based on their underlying characteristics, the prevailing level of interest rates and the required risk premium in equilibrium. This provides the starting point for our asset class views.

In practice, markets and economies are rarely in equilibrium, so we must consider our starting position with respect to economic cycles, market valuations and prevailing trends. This approach builds on our view that

One past, many futures

Illustration of stochastic simulation of future asset class returns



markets are, at best, only semi-efficient. While investors seek to value securities based on expected cash flows, asset classes have differing levels of certainty around those cash flows which drive varying levels of volatility. Investors must explicitly or implicitly make assumptions around the growth trajectory of those cash flows, or the certainty of them in the case of debt-like instruments.

Different assets – different toolsets

The central challenge for any valuation framework is to establish a sensible anchor against which current market prices can be assessed. In practice, valuation is as much an art as it is a science; there is no single definitive method for projecting future cash flows, and each approach carries its own assumptions and limitations.

At their simplest, value assessments may rely on backward-looking measures such as earnings or book value. However, most long-term investors ultimately seek some form of fundamental value – whether grounded in historical metrics in the case of value investors, or forward-looking expectations of cash-flow growth in the case of growth investors.

Valuation estimates have varying performance in the prediction of subsequent asset class returns:



For fixed income, starting yield is often viewed as a good predictor of future returns. This can be further enhanced with the estimation of roll down depending on the shape of the yield curve. For investors with a clear long-term view on where yields are headed, anticipated changes in yields can provide valuable insight into expected total returns.

In corporate credit, the starting level of spreads relative to government bonds offers a useful guide to potential excess returns. This matters in today's environment, where spreads across much of the market have compressed. Although factors such as shifts in credit ratings bands, or the strength of corporate balance sheets can influence outcomes, spreads this tight have historically been associated with weaker excess returns.

For equities, there is a broad spectrum of valuation approaches, reflecting the significant uncertainty inherent in this asset class. Whilst some see benefit in using long-term trend estimates of measures such as earnings or book value, others prefer to derive value by discounting projections of future cash flows. Both approaches have their merits and their drawbacks, the former relying

on mean reversion, the latter better capturing structural shifts but also vulnerable to extrapolation. Both tend to perform less well over shorter term horizons of under three years, exhibiting better predictive power over a much longer timeframe.

Regardless of asset class, the trade-off between predictive power and time horizon underscores the challenge for investors aiming to take a long-term approach. Ultimately, the long term is made up of many short-term periods, and investors relying solely on valuations can experience extended stretches where markets remain "wrong" relative to their assessment of fair value. For fixed income and equities, the starting level of valuations generally have a poor predictive ability in the short term. However, at time horizons of five years or more they offer a useful indication.

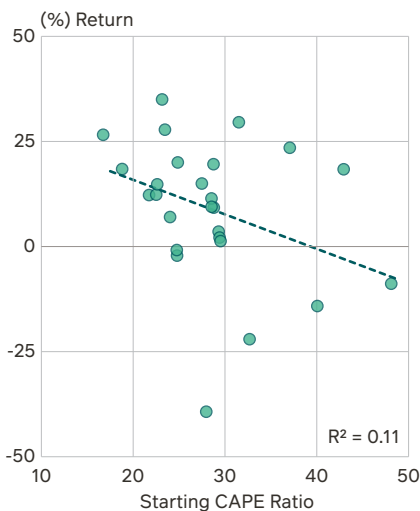
A spotlight on our valuation framework

We believe that choosing the right valuation anchors is essential for building a grounded perspective – one that looks beyond, but doesn't disregard, immediate momentum.

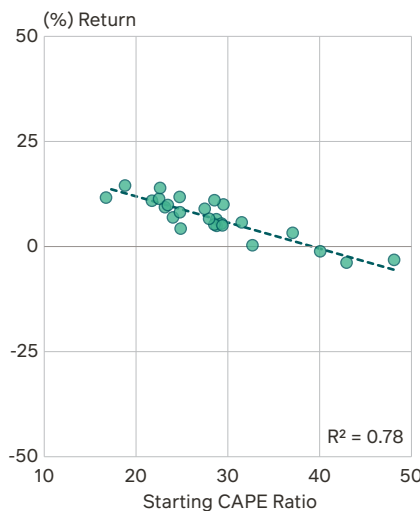


Subsequent US equity returns versus starting valuations over different time horizons

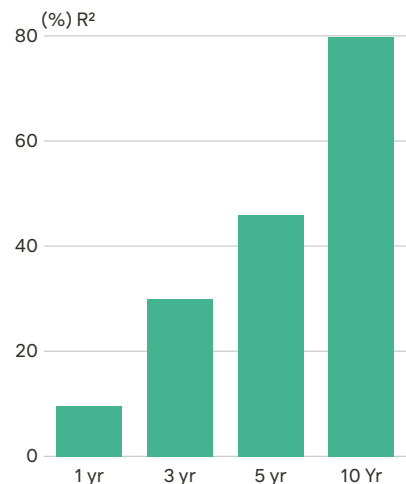
Starting valuations vs 1 yr returns



Starting valuations vs 10 yr returns

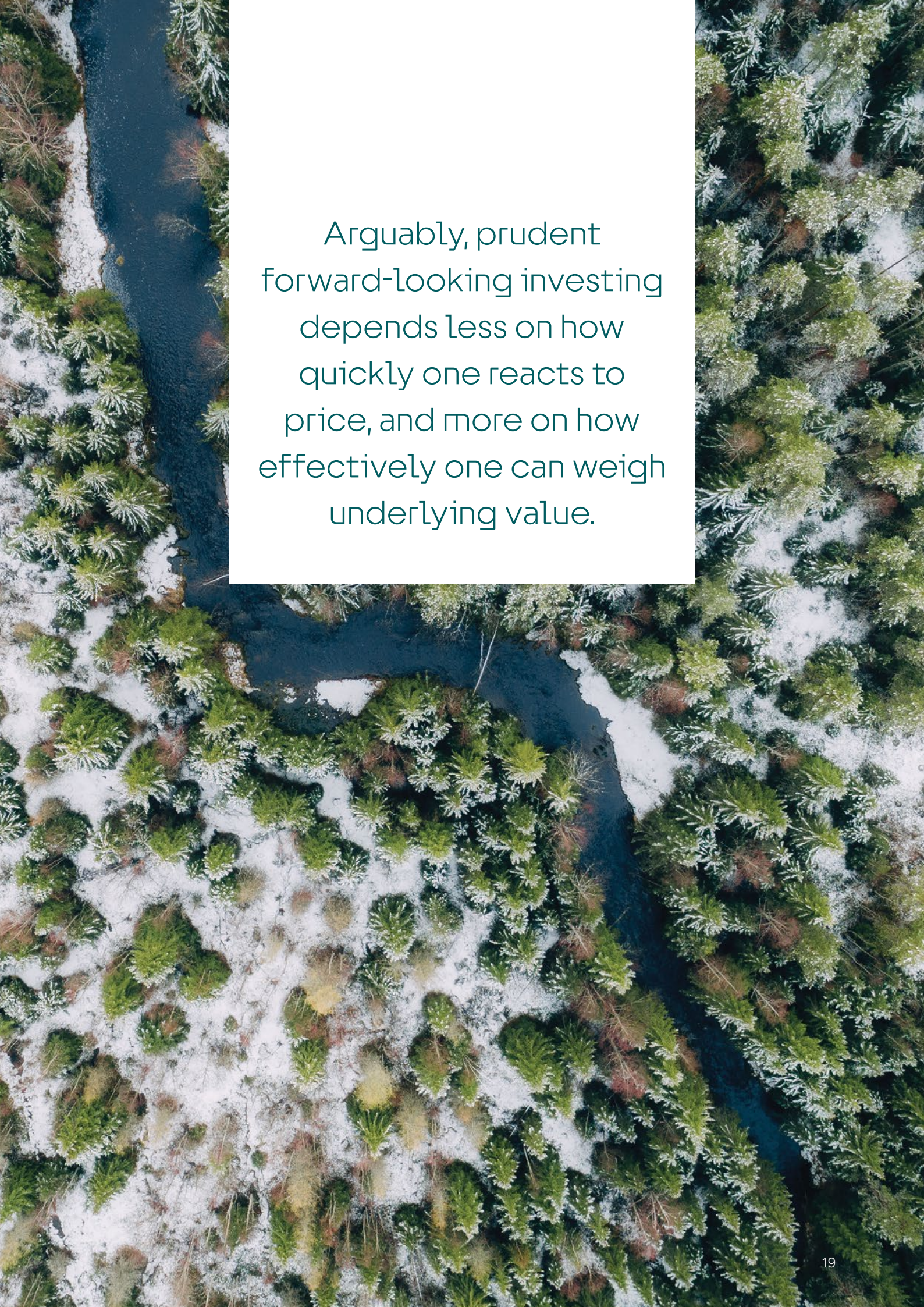


Relationship over different horizons



Source: LSEG Datastream and LIO calculations



An aerial photograph of a river winding through a lush, tropical forest. The river is dark blue and flows from the top left towards the bottom right. The surrounding forest is dense with various types of trees, including many palm trees, and patches of white sand or light-colored ground are visible between the trees. The overall scene is vibrant and natural.

Arguably, prudent forward-looking investing depends less on how quickly one reacts to price, and more on how effectively one can weigh underlying value.

Our medium term assumptions draw on two key inputs: (1) estimates of an asset class's starting valuation, and (2) long-term assumptions that reflect where we expect valuations to ultimately settle. The combination of these inputs – and a view of time-lines over which they may converge – allows us to build a full picture of potential future capital market returns. This underpins our entire investment strategy and shapes the expected growth rate (EGR) which we provide for our smoothed funds.

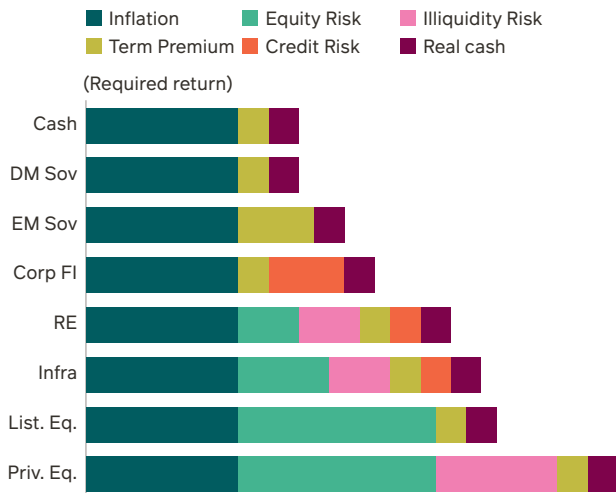
An essential first step is establishing well-founded priors – grounded expectations for how asset classes tend to behave given the prevailing macro environment, and in relation to one another. Being explicit about the assumptions underpinning our valuation estimates also helps us identify where those estimates, rather than the market itself, may be flawed, and to frame appropriate confidence bands around them. Naturally, such confidence bands are looser over the short term, but narrow over time.

How PruFund is invested

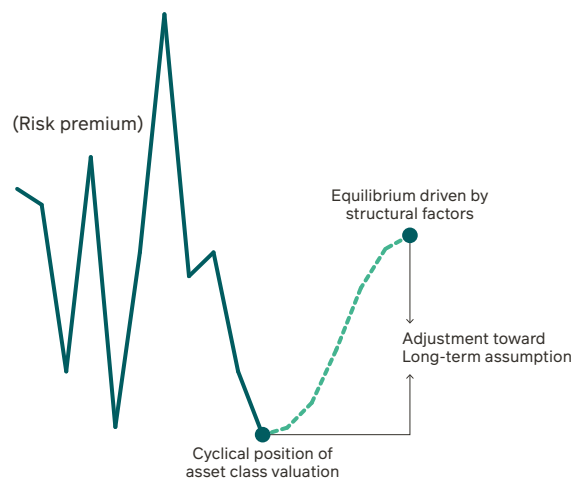
Much of the record gains in 2025 have been driven largely by an increase in valuations, rather than an improvement in fundamentals. In fixed income, elevated starting yields have combined with a decline in US yields and a further tightening in credit spreads. In equities, global (ex US) markets benefited from a rotation away from US assets, alongside a recovery

Process to generate a path of expected returns draws on starting valuations and our long-term assumptions

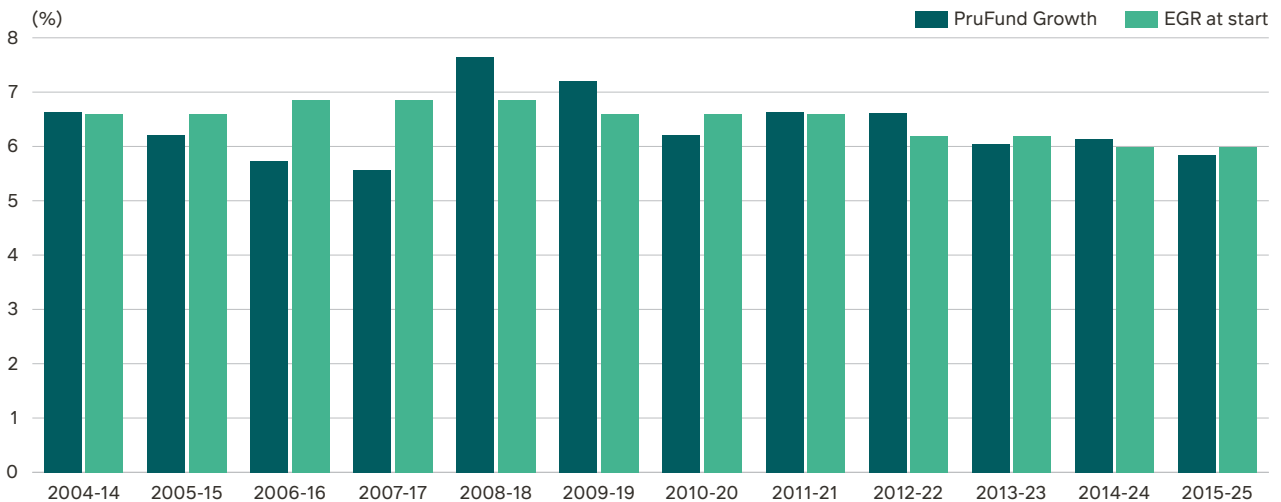
Long-term building blocks illustration



Term structure of assumptions illustration

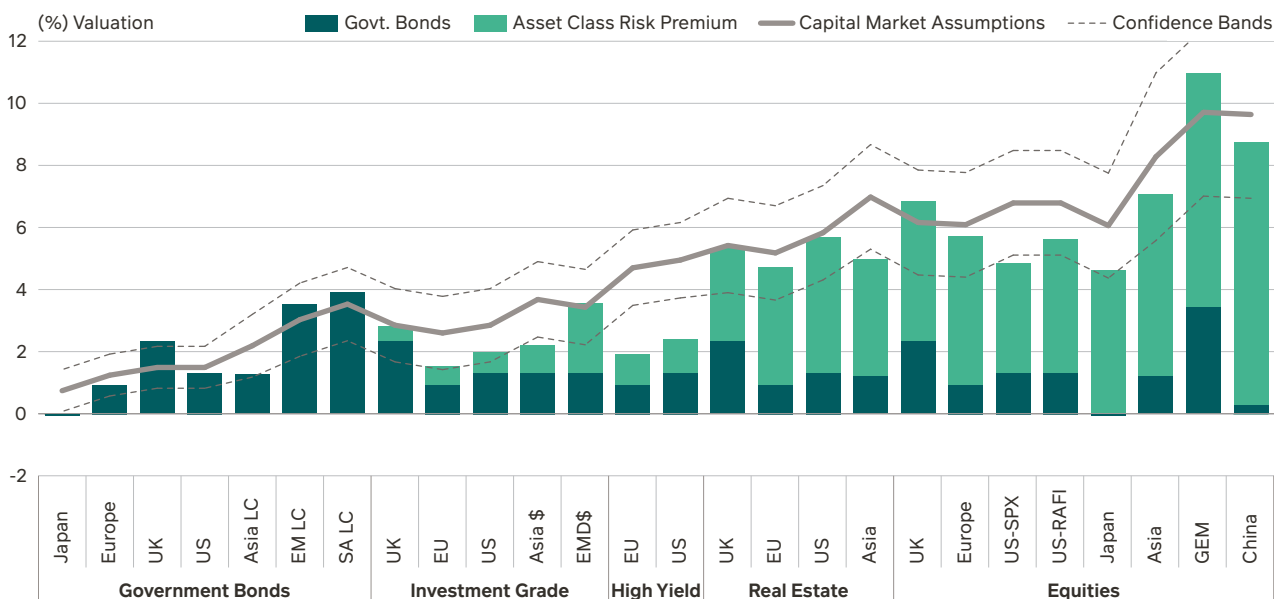


Process in practice: PruFund expected growth rate (EGR) vs subsequent realised returns



Source: Prudential and FE Analytics 02.01.2026. Figures are for PruFund Growth Fund held within PruFund Investment Plan. The figures cover the 10-year annualised return from the 30th November of each year and are based on the smoothed prices, which include excess surplus distributions.

Valuations broadly in line with our assumptions with some pockets such as credit flagging expensive



Source: LSEG Datastream and LIO calculations

in price multiples that had compressed somewhat last year.

As a result, our medium-term assumptions have moderated across most public markets. In absolute terms, total yields are not far from our long-term assumptions, allowing us to remain constructive on portfolio returns over these horizons. While volatility is to be expected, its impact can be mitigated through broad diversification across regions and risk factors, and by avoiding concentration and valuation extremes.

In particular, our regional diversification within global equities has been accretive to returns over the past year, and shown a significant differentiation to peers who are on average placing greater reliance on a global market-cap approach that is disproportionately weighted to the US, and missing out the growth in European, Asian and Emerging Market equities. Given this strong performance, we are closely weighing current equity valuations. Whilst on average these markets have become more expensive, it is not as clear cut as credit markets which have been

exhibiting signs of valuation extremes, with spreads relative to government bonds at (or near) cycle lows. While such conditions can persist in the near term, history suggests they are typically followed by spread widening and lower excess returns.

In the near term, markets may continue to extend these trends further into 2026. However, over the longer time horizons which guide our strategic allocations, we expect fundamentals to reassert themselves and valuations metrics to matter much more meaningfully.

Parit Jakhria

Director of Long Term Investment Strategy — Life Investment Office

Our capital markets philosophy and outlook

Our building blocks framework for constructing capital market assumptions for the PruFund range of funds.

We construct our capital market views and assumptions for all asset classes and geographies over a medium to long term investment horizon. This breadth of scope is combined with a depth of analysis to build a holistic framework that can be used for formulating asset allocation decisions. This allows us to capture the key drivers and interactions of asset classes and geographies whilst also considering the additional dimension of term structure and multiple future scenarios.

- We use a range of diverse inputs and modelling in our process, including bespoke in-house modelling of structural factors like demographics trends, economic growth models, globalisation and technological change.
- This is combined with deep-dive analysis of future scenarios – both qualitative using known risk factors, as well as quantitative work using GeneSIS, our in-house Monte Carlo engine.

- We consider each of the structural building block components of asset class returns, including: real cash rates and term premia; inflation; risk premia by asset class and geographical region; and illiquidity premia.

This enables us to build capital market assumptions that provide an anchor for where we expect returns to sit over the medium to long-term.

The philosophy underpinning our long-term capital market assumptions is based on an intuitive principle: investors face a risk-return trade-off when choosing assets, and in particular, they expect to receive higher returns for adding risk to their portfolio. The amount of risk and return will vary depending on the macro-economic backdrop, monetary policy, risk appetite, and a host of other factors. Yet the overall structure of the risk-return trade-off between asset classes is maintained over the long-term.





Over short and medium-term time horizons, the valuation of an asset is an important consideration in determining the risks and returns that we can achieve by investing in that asset. While there might be short-term movements away from longer-term fundamentals, if this anomaly persists over a longer time frame then rational investors will move in and out of asset classes until an equilibrium trade-off between risks and returns is reached.

Our approach acknowledges that market behaviour is uncertain and stochastic and short-term factors can cause asset prices to deviate significantly from their long-term fundamentals, and allows us to assess to what extent such deviations may be expected to persist. Ultimately, it allows us to build a term structure of returns that informs our expected growth rates.

Scenario analysis – living in an uncertain world

Finally, a key tenet of our capital markets framework is how we model

and account for inherent future uncertainty. While there is only one realised past, we must consider many potential futures. As such, a significant proportion of our time is spent calibrating and analysing qualitative as well as quantitative scenarios.

The qualitative scenarios focus on key themes that we expect to drive capital markets over the near term, which have, most recently, focused on optimistic and pessimistic technology scenarios, fiscal risks, and scenarios that would lead to geopolitical escalation e.g. the recent Middle East crisis. This allows us to create robust portfolios for clients, which are highly diversified by geography and asset type, across a range of scenarios.

Rather than relying on any single area to generate significant returns, we use the sum of many parts to create attractive risk-adjusted returns from a highly diversified mix of assets that we believe are well positioned for future growth.

GeneSIS

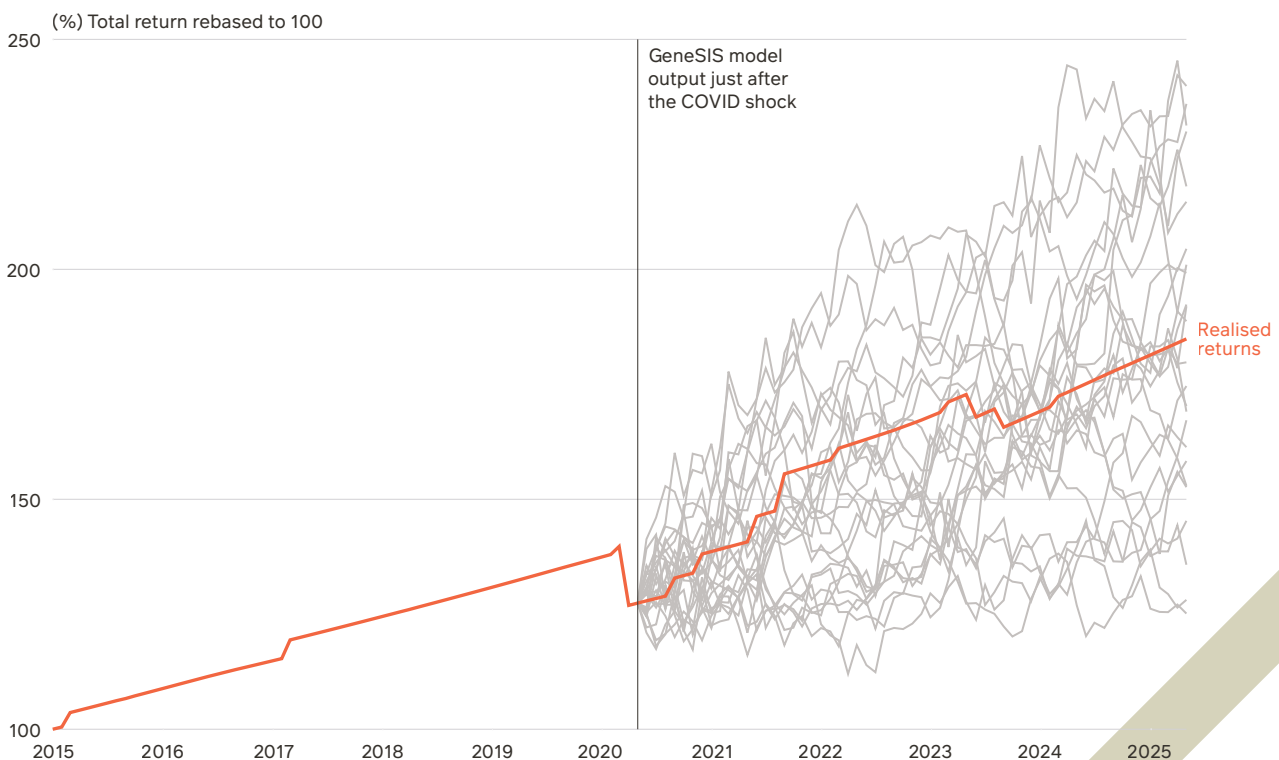
We model the impact of these quantitative scenarios using GeneSIS, our proprietary Monte Carlo scenario generator, which also enables us to capture dependency and volatility structures and build a term structure approach to risk premia and volatility.

We use our unique in-house, stochastic modelling tool, GeneSIS, to map out a broad range of future scenarios, to help us anticipate the impact of changes to interest rates, inflation and global events.

The process enables us to build:

- A complete term structure for each of our asset class building blocks.
- A number of scenarios which show the range of possibilities around the central estimate for each building block component, and capture the interrelationship across asset classes.
- This, in turn, allows us to build a clear picture of the forward looking distribution of the PruFund expected growth rate.

One past, many futures



Source: LIO

A key tenet of our investment philosophy is that there is one realised past, but many potential futures.



Asset class outlook

Equities

Developed markets

2025 delivered strong double-digit returns across major indices, but elevated US valuations – driven by AI enthusiasm and ample liquidity – heighten risk, especially with potential growth shocks or policy missteps.

Emerging markets

Stronger relative growth, widening valuation discounts and potentially weaker dollar support emerging market prospects for 2026, though tariff risks, trade tensions and broader geopolitical risks remain key watchpoints.

Fixed income

Government bonds

Government bonds delivered solid returns in 2025, thanks to high starting yields and steadier rate expectations. For 2026 and beyond, policy rates are set to converge, with the US and UK easing, Japan tightening gradually, and Europe remaining relatively stable. Yield curves have steepened as term premia normalise, and while positive real yields improve return prospects, inflation and fiscal risks could still drive volatility. Overall, government bonds now offer better value and useful downside protection, but a mix of regions is critical to avoid being overly exposed to any one fiscal pathway.

Corporate bonds

Corporate bond yields edged lower in 2025 as rates fell and spreads tightened, led by the US dollar market, while European investment grade finished broadly unchanged. Credit spreads relative to government bonds are now close to historic lows, and whilst defaults are expected to stay contained into 2026, we are wary of downside risks. Ultra-tight spreads, slowing growth, tricky monetary policy

decisions and external pressures such as tariff uncertainty could challenge credit markets over the medium term.

Orthogonal strategies

Traditional markets are driven largely by macro forces like rates and growth, leaving returns closely tied to the economic cycle. To improve diversification, we're adding "orthogonal" return sources such as cross-asset momentum and volatility risk premium, which tend to behave differently from equities and bonds.

These strategies have historically shown low correlation with traditional assets, helping portfolios stay more resilient during periods of stress.

More importantly, cross asset momentum, for example has delivered returns in scenarios where other asset classes have struggled, for example the Global Financial Crisis, or 2022. As such, even small allocations can enhance risk-adjusted expected returns, reducing reliance on macro conditions and adding an extra layer of protection when volatility spikes.

Real estate

Commercial real estate enters 2026 still regaining ground after higher interest rates, with 2025 delivering steady but muted returns versus public markets. Rental growth is emerging in select areas – especially in Europe – though analysts expect performance to diverge widely across sectors and locations. The return outlook for 2026 is cautiously positive, supported by normalising vacancy rates, limited new supply, stable demand and broadly attractive valuations. While a strong rally is unlikely, sentiment is improving in the US.

Private equity

Private equity endured another stop-start year in 2025, with early

momentum stalling amid tariff uncertainty and a quiet summer before activity improved in the second half. The key question for 2026 is whether deal flow can truly accelerate or if "extend and pretend" will continue to dominate.

Private credit

Private credit – lending outside traditional banks – has grown rapidly since the financial crisis, offering attractive returns and diversification. But 2025 highlighted risks, with a few failures raising concerns around lending standards and covenants, although overall default rates have remained low to date.

For investors, manager discipline is essential: selecting lenders who maintain rigorous standards rather than chasing yield. Private credit can add income and diversification, but it's not without risk. Careful selection and a focus on quality lending are essential to avoid surprises if markets turn.

Infrastructure

Infrastructure remains a major long-term theme. Although activity has been quieter since the 2021-2022 boom, momentum is improving as economies invest in AI buildout, urbanisation, energy transition and climate resilience.

For investors, infrastructure continues to offer stable, inflation-linked cash flows, but stretched public finances mean private capital will play an even larger role. Selectivity is crucial: core assets face return compression, so focusing on strong fundamentals and avoiding political or technological risks is key.



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