Macro Opportunities Strategy Update —Navigating the Rate Cut Landscape

April 23, 2024

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Macro Opportunities

Why Now?

We believe Macro Opportunities is favorably positioned to realize attractive absolute and excess returns in the year ahead.

- **Over time, as the backdrop of receding inflation continues, short rates should eventually be reduced.**
- **The prospect of lower rates supports our favorable outlook for a broad variety of fixed-income sectors.**
- **Macro Opportunities' overall long duration positioning should benefit as the disinflationary process accelerates.**
- **Concentrated themes of short USD versus select developed market and emerging market countries as well as financial and industrial credit exposure support a base case of slower but positive US and global growth with decelerating inflation.**
- **Current positive carry of 5.2% aids ability to maintain overweight positions to high-conviction themes.**
- **In the event of a Fed policy error, Macro Opportunities' long-dated duration is favorably positioned if the Fed needs to cut rates to stimulate growth.**

Source: Western Asset.
The above reflects current opinions of Western Asset and are subject to change with market conditions. As of 31 Mar 24

2024 Global Outlook

Disinflation ongoing but uneven

Central banks will ease policy to normalize real interest rates

Economy has remained resilient, but is set to slow

Fixed-income outlook

- US growth will slow but should avoid recession
- Global growth has downshifted and China is now a source of deflation
- US core PCE already near Fed target
- Global inflation will continue to recede
- The US dollar will weaken moderately
- Emerging markets—particularly in Latin America—should outperform
- Central banks will need to pivot policy adroitly
- Spread sectors are still attractive but the outlook is clouded by macro risk
- Geopolitical uncertainty continues to add to volatility

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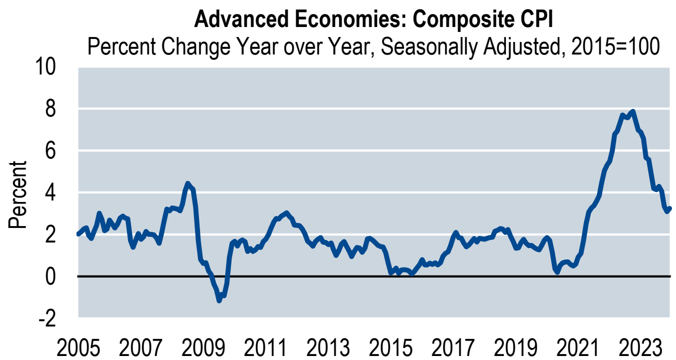
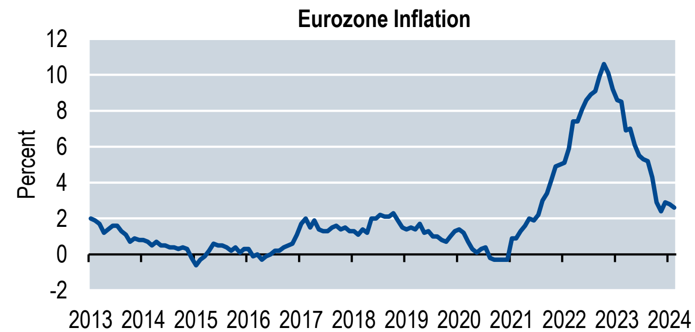
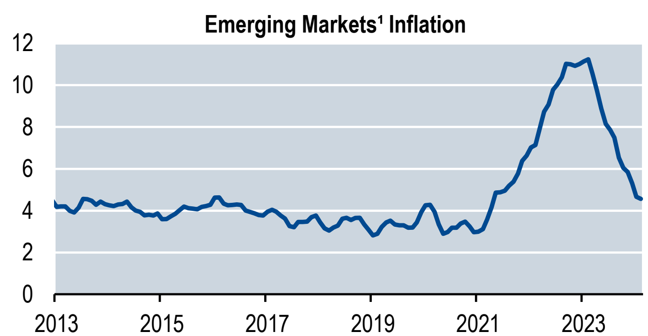
Global Disinflation Is Broad-Based and Ongoing



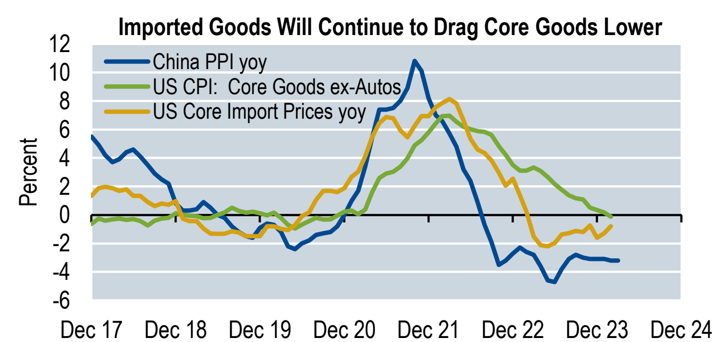
Source: Haver Analytics. As of 31 Dec 23



Source: Bloomberg. As of 29 Feb 24



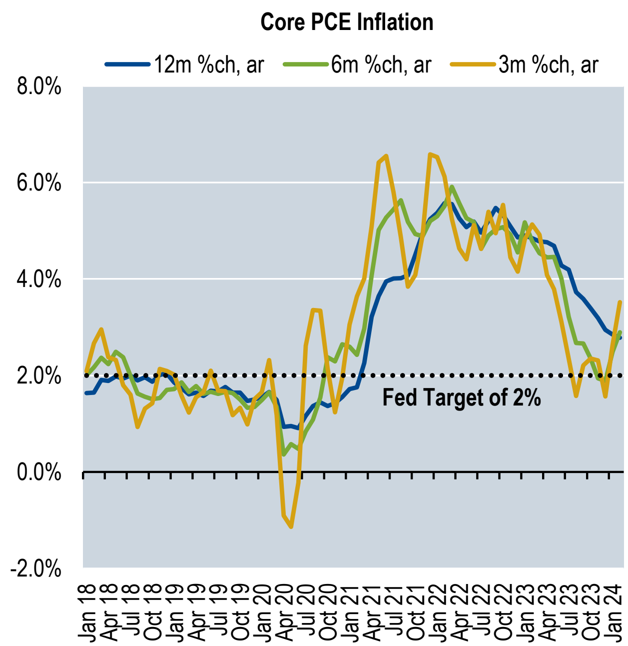
Source: Bloomberg, Western Asset. As of 29 Feb 24
¹EM = Brazil, Mexico, Colombia, Chile, South Africa, India, Indonesia and Poland



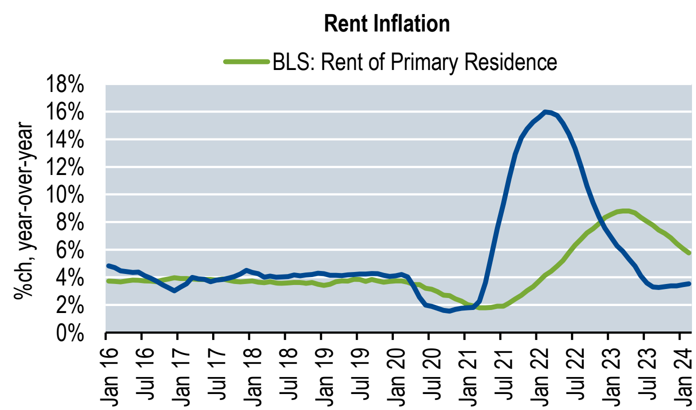
Source: Bureau of Economic Analysis. As of 31 Mar 24
*US CPI and US Core Import Prices as of 29 Feb 24

US Inflation: More Disinflation Ahead

CPI housing inflation measures still elevated relative to surveys; goods prices can stay in deflation



Source: BEA, Haver. As of 29 Feb 24



Source: BLS, Zillow, Haver. As of 28 Feb 24

Source: BLS, Haver. As of 28 Feb 24

"I think they haven't really changed the overall story which is that of inflation moving **down gradually on a sometimes-bumpy road** toward two percent."

— Chair Powell, March 20, 2024

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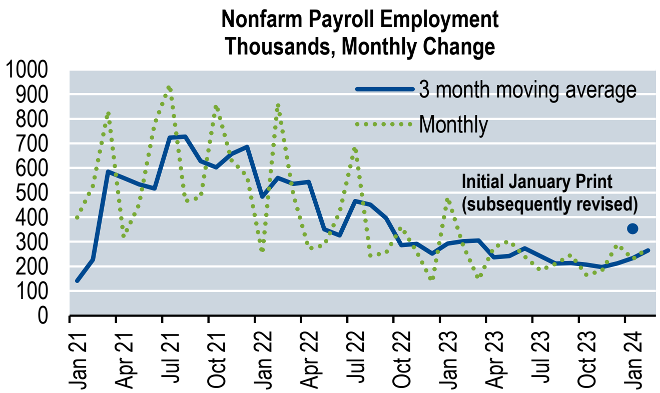
Labor Demand Settling Into A Moderate Range – Wage Growth May Already Be Consistent With Fed Mandate

Wage growth ~4%, Productivity ~2% ➔ Inflation ~2%



Source: BLS, NFIB, Haver. As of 28 Feb 24

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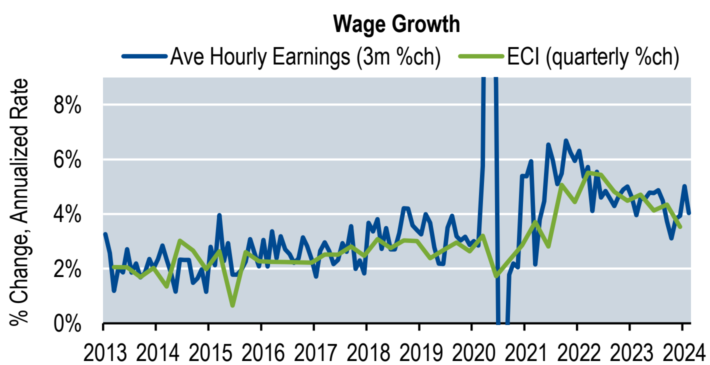
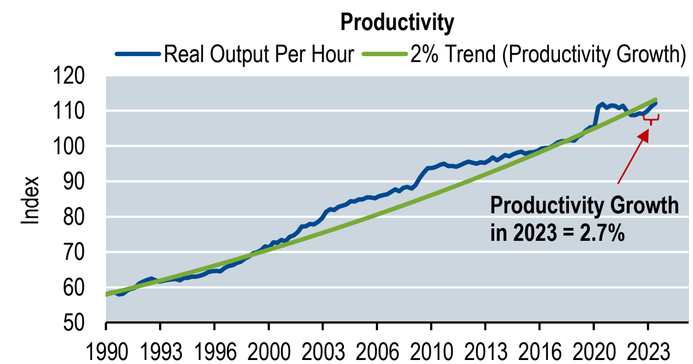


Source: BLS, Haver. As of 28 Feb 24



Source: BLS, Haver. As of 28 Feb 24

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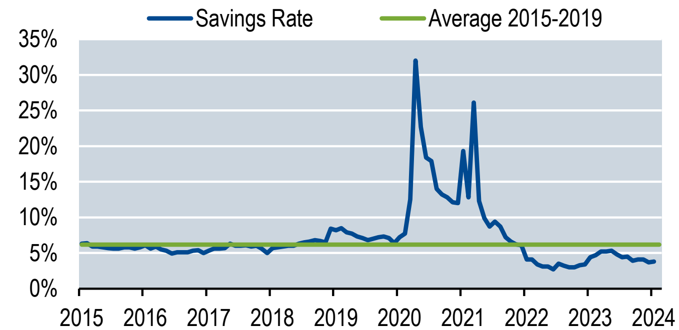
US Growth Outlook: Moderation Likely to Continue, but Recession Risks Fading

Savings rate likely to rise (headwind to consumption); tight credit conditions/bank lending has been flat

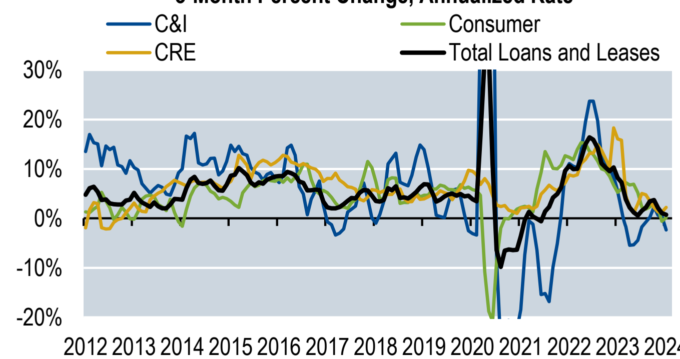
Balance sheets not problematic; Inflation was most cited concern

Savings Rate



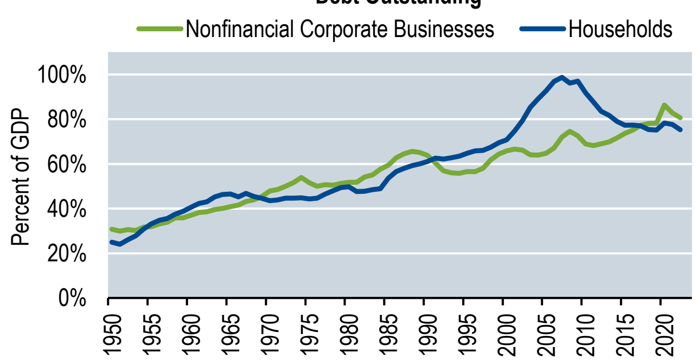
Source: BEA, Federal Reserve, Haver. As of 31 Jan 24

Change in Bank Lending
3-Month Percent Change, Annualized Rate



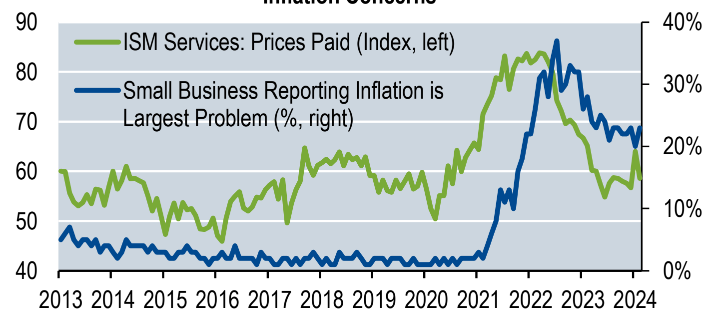
Source: BEA, Federal Reserve, Haver. As of 31 Jan 24

Debt Outstanding



Source: Federal Reserve, Bureau of Economic Analysis. As of 31 Dec 22

Inflation Concerns



Source: NFIB, Haver. As of 28 Feb 24

Rest of World

Europe: Low growth trajectory, inflation close to target, wages moderating

- ECB: First cut likely in June, three 25-bp cuts currently priced in for 2024

UK: Continued depressed growth, inflation likely to fall below target by April, wage growth slowing

- BoE: Should cut more than current market pricing, two 25-bp cuts currently priced in for 2024

Japan: Firming up of growth and wage leading to higher inflation forecasts

- BoJ, FinMin: Further rate hikes possible if trend continues – core CPI expected above 2%, currency weakness problematic

China: Likely to avert acute contraction amid ongoing policy response to offset headwinds from de-globalization, prioritizing new economy infrastructure/manufacturing

- PBoC: Room to cut RRR further, $3.25 trillion of FX reserves, relatively closed capital account, lack of systematic leverage

EM: Investors are focused on 2nd and 3rd order effects of China's reoriented growth priorities and implications for commodity prices, trade relations and regional growth, EM FX relatively stable, local yields relatively attractive, nearshoring and geopolitics to benefit Mexico, Brazil, India, Indonesia

- CBs: Trying to stay ahead of the curve with cuts across many CBs with falling inflation after having spent most of 2021-22 raising rates

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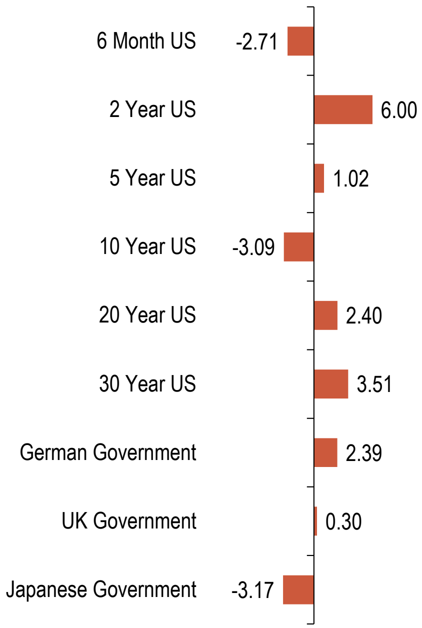
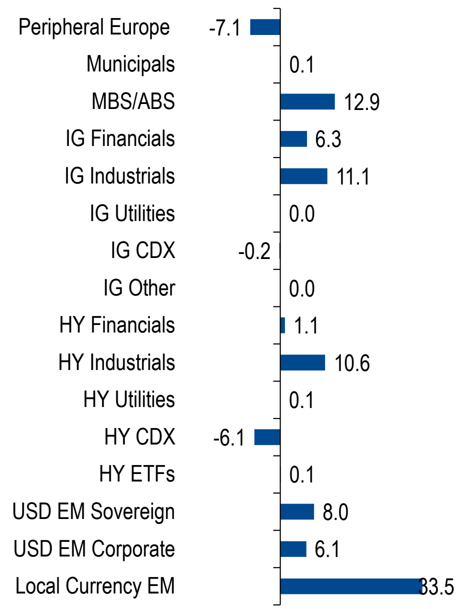
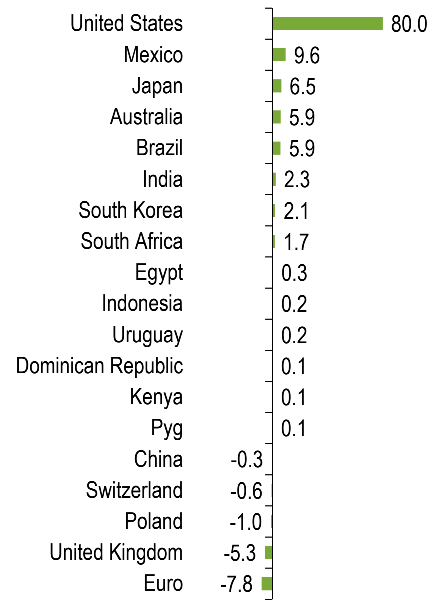
Sector Exposure

Macro Opportunities

March 31, 2024



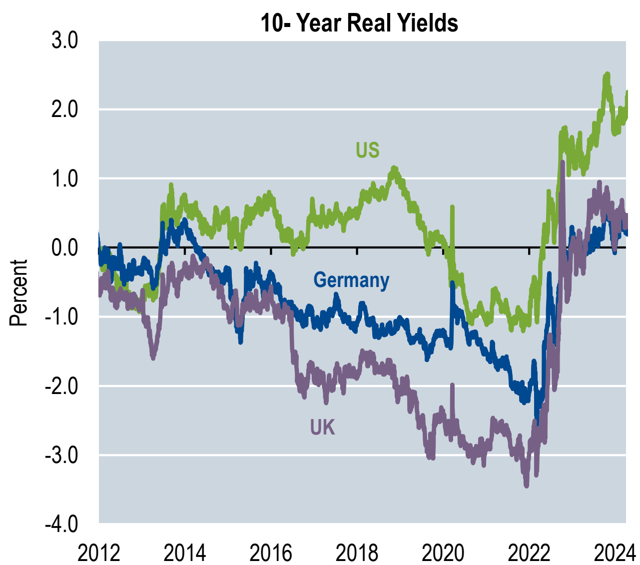




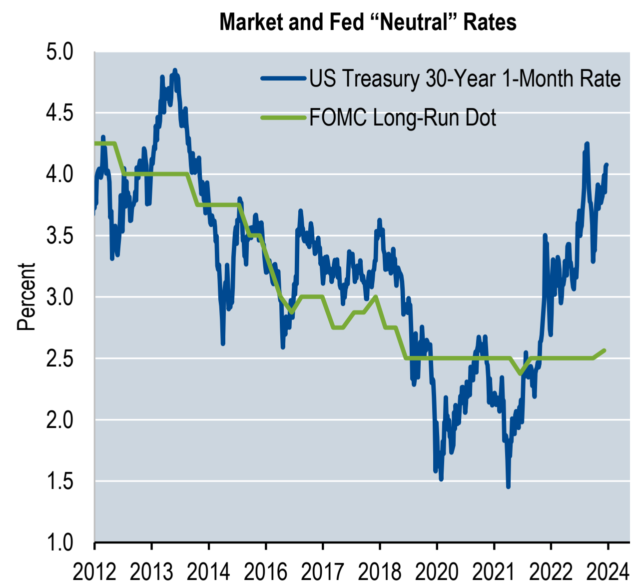
Statistics	
Effective Duration (yrs)	9.32
Average Rating[1]	BBB

Source: Western Asset.
Sectors subject to change. Data may not sum to total due to rounding.
[1]Higher Of ratings

Interest Rates Remain Elevated



Source: Bloomberg. As of 31 Mar 24



Source: Bloomberg. As of 31 Mar 24

"We are waiting to become more confident that inflation is moving sustainably down to 2%. When we do get that confidence, **and we're not far from it**, it will be appropriate to begin to dial back the level of restriction so that we don't drive the economy into recession."

– Chair Powell, March 7, 2024

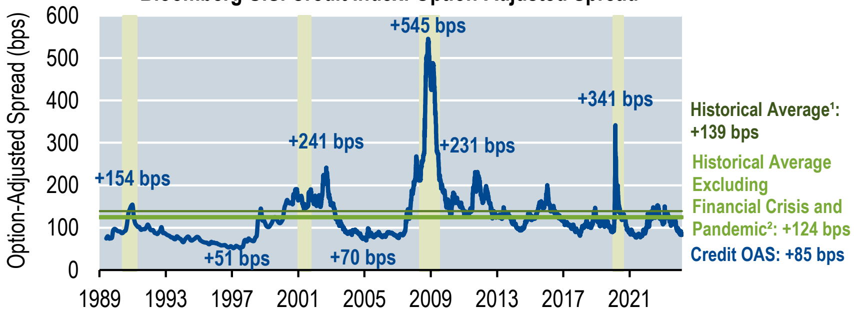
"You saw last year very strong hiring and inflation coming down quickly. We now have a better sense that a big part of that was supply-side healing, particularly with, with growth in the labor force. So, in and of itself, **strong job growth is not a reason for us to be concerned about inflation**"

– Chair Powell, March 20, 2024

Investment-Grade and High-Yield Credit

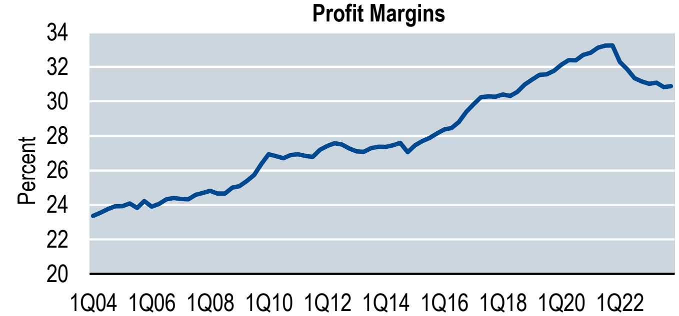
- US investment-grade credit at +87 OAS is "Richly Valued", but cash flow and debt metrics are healthy
- Foreign demand remains elevated, has helped absorb record net supply
- High-yield default rate off record lows, but debt maturity wall meaningful only in 2028 - low refinancing needs

Bloomberg U.S. Credit Index: Option-Adjusted Spread



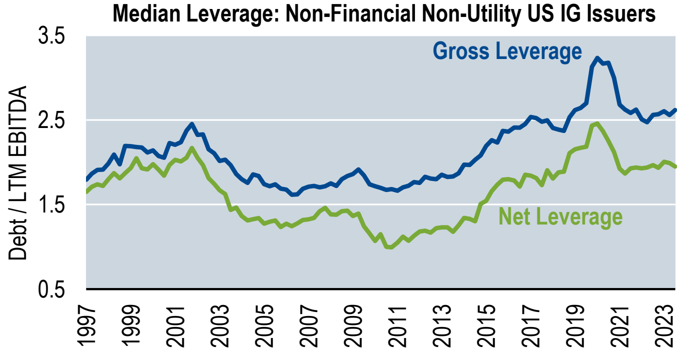
Source: Bloomberg. As of 29 Mar 24
Periods of recession highlighted in yellow
[1]Average based on monthly data from 30 Jun 89 – 31 Jul 00, and daily end of business days from 15 Aug 00 to current
[2]Excludes data from 01 Dec 07 – 30 Jun 09, 01 Feb 20 – 31 Aug

Profit Margins



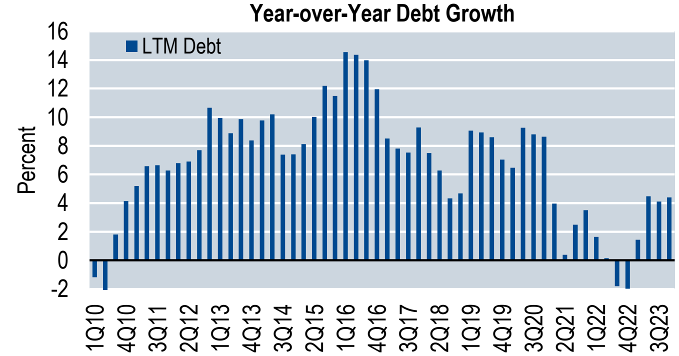
~180 Non-Financial Companies (JULI Based)
Weighting based on amount of debt in the benchmark
Source: J.P. Morgan. As of 31 Dec 23

Median Leverage: Non-Financial Non-Utility US IG Issuers



Source: BofA Global Research. As of 31 Dec 23*

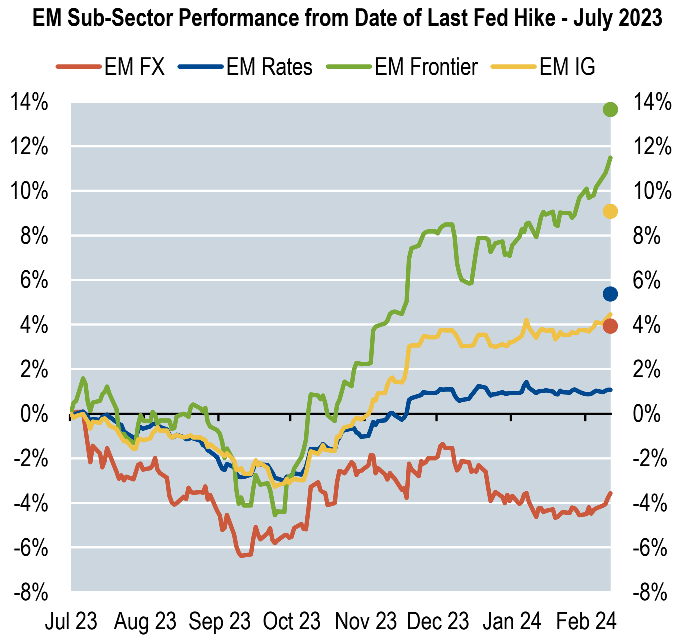
Year-over-Year Debt Growth



Source: J.P Morgan. As of 31 Dec 23

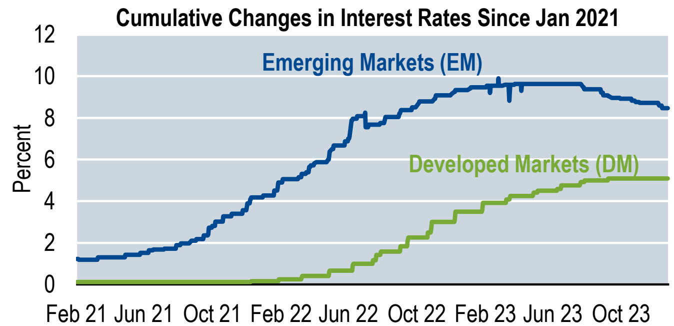
The USD and Commodities: Key Emerging Market Drivers

EM local market performance has underperformed previous cycles—US exceptionalism has weighed on returns

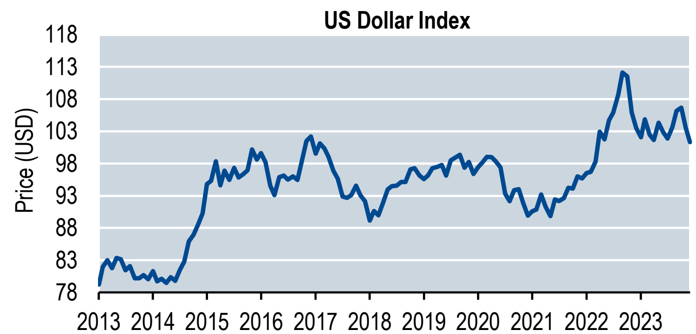


Source: J.P. Morgan. As of 07 Mar 24
The dots are the average performance of the 4 subsectors at this point in the prior 2 Fed cycles

- EM central banks are further into the easing cycle than DM
- A Fed pause coupled with moderate economic growth bodes well for EM
- USD weakness going forward should provide a tailwind to EM FX



Source: Bloomberg. As of 31 Dec 23
Note: Emerging Markets (EM)=Average of Brazil, Chile, Czech Republic, Mexico, Peru and Poland; Developed Markets (DM)=Average of US, EU and UK



Source: Bloomberg. As of 31 Dec 23
Note: The US Dollar Index is the value of the US dollar relative to a basket of foreign currencies

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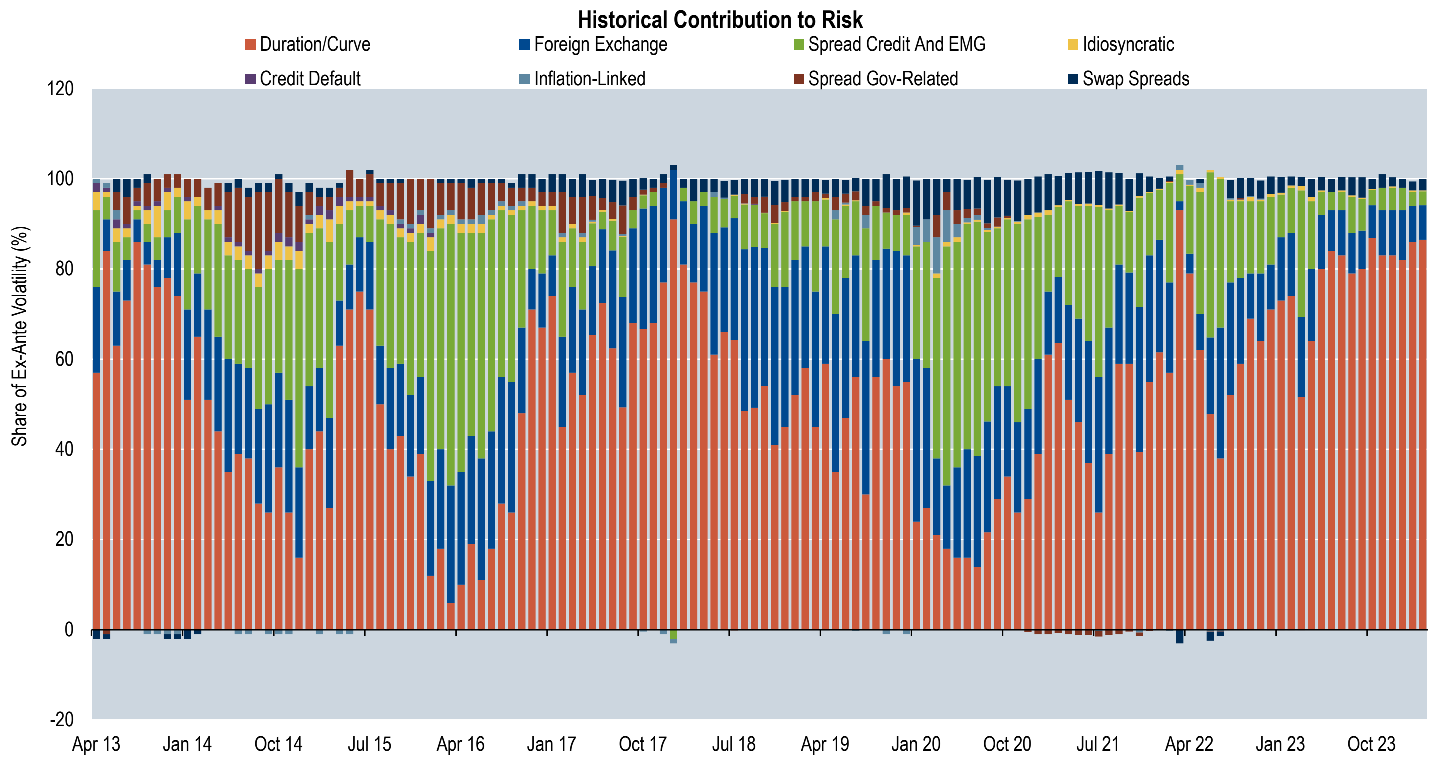
Historical Contribution to Risk

Macro Opportunities Ex-Ante Volatility

April 30, 2013 – March 31, 2024



Source: Bloomberg, Western Asset

Note: Barclays POINT through 31 Jan 16 and Western Asset from 01 Feb 16 to present

Past performance does not predict future returns.

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Questions & Answers

Thank you.

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