



Thank you for joining Western Asset's *Trusting Our Convictions* webcast featuring Deputy CIO Michael Buchanan. The presentation will begin shortly.



Our new Q&A discusses the merits of US Core and the new US Core Constrained strategy.

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Trusting Our Convictions

March 21, 2019

Michael Buchanan
Deputy Chief Investment Officer

Outlook for Fixed-Income Spread Sectors

- **Pessimism and fear held markets hostage for most of 2018. After a strong rebound year to date, what's next?**
- **Global growth and credit cycle prospects are not as dire as some would suggest**
- **In our view, “carry” will be the theme in 2019**
- **We are maintaining our overweight to spread products and looking to take advantage of relative value opportunities across:**
 - Bank loans and collateralized loan obligations (CLOs)
 - BBB rated investment-grade credit
 - USD emerging markets

Strong Rebound in Risk Assets After Disappointing 2018

Historical Annual Excess Returns (bps)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 ³ |
|--|--------|-------|-------|--------|-------|------|--------|--------|-------|-------|------|-------------------|
| US Agency | -110 | 238 | 72 | 19 | 97 | -10 | 55 | 8 | 39 | 69 | -6 | 9 |
| US MBS | -232 | 495 | 225 | -106 | 91 | 98 | 40 | -5 | -11 | 52 | -59 | 39 |
| US ABS | -2,223 | 2,496 | 169 | 52 | 246 | 24 | 53 | 44 | 95 | 92 | 13 | 38 |
| US CMBS | -3,274 | 2,960 | 1,501 | 47 | 841 | 97 | 108 | -28 | 236 | 158 | -39 | 114 |
| US Investment-Grade Credit | -1,786 | 1,990 | 192 | -322 | 693 | 226 | -18 | -169 | 442 | 335 | -280 | 222 |
| US High-Yield Credit | -3,832 | 5,955 | 974 | -240 | 1,394 | 923 | -112 | -577 | 1,573 | 610 | -358 | 590 |
| US Bank Loan ¹ | -3,233 | 5,183 | 1,003 | 116 | 932 | 514 | -119 | -540 | 1,004 | 303 | -177 | 374 |
| Emerging Markets Local Currency ² | -2,037 | 2,506 | 768 | -1,283 | 1,364 | -538 | -1,055 | -1,690 | 864 | 1,334 | -765 | 274 |

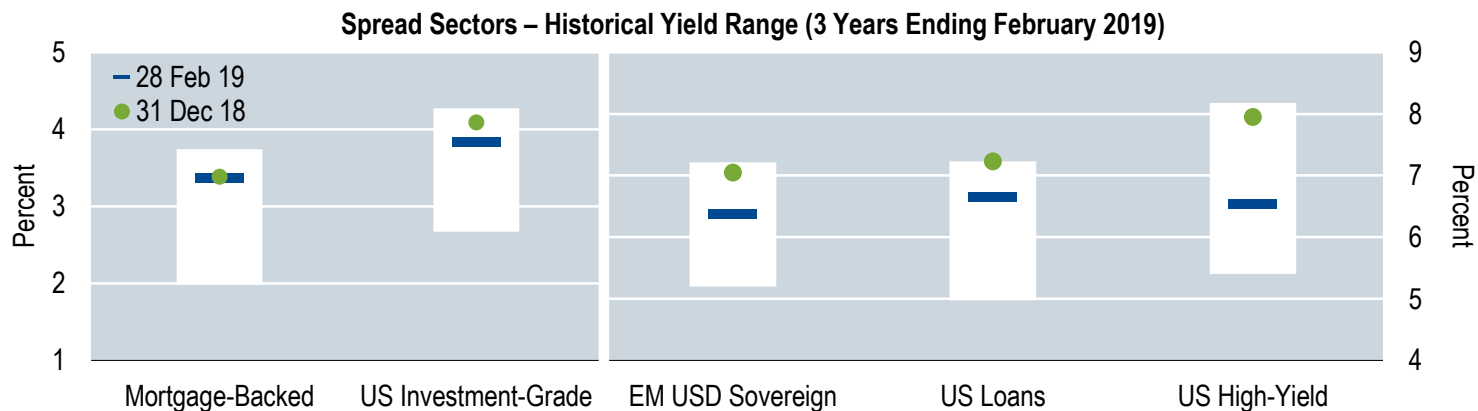
Source: Bloomberg Barclays, J.P. Morgan, S&P Global Market Intelligence, a division of S&P Global Inc.

Sectors represented by Bloomberg Barclays U.S. indices unless otherwise noted; all figures shown in basis points

¹S&P/LSTA Leveraged Performing Loan Index vs. 3-Month LIBOR.

²J.P. Morgan GBI-EM Global Diversified Index USD Unhedged.

³As of 28 Feb 19



Source: Bloomberg Barclays, J.P. Morgan, S&P Global Market Intelligence, a division of S&P Global Inc.

US Investment-Grade represented by Bloomberg Barclays US Credit Index

US High-Yield represented by Bloomberg Barclays US High-Yield Index

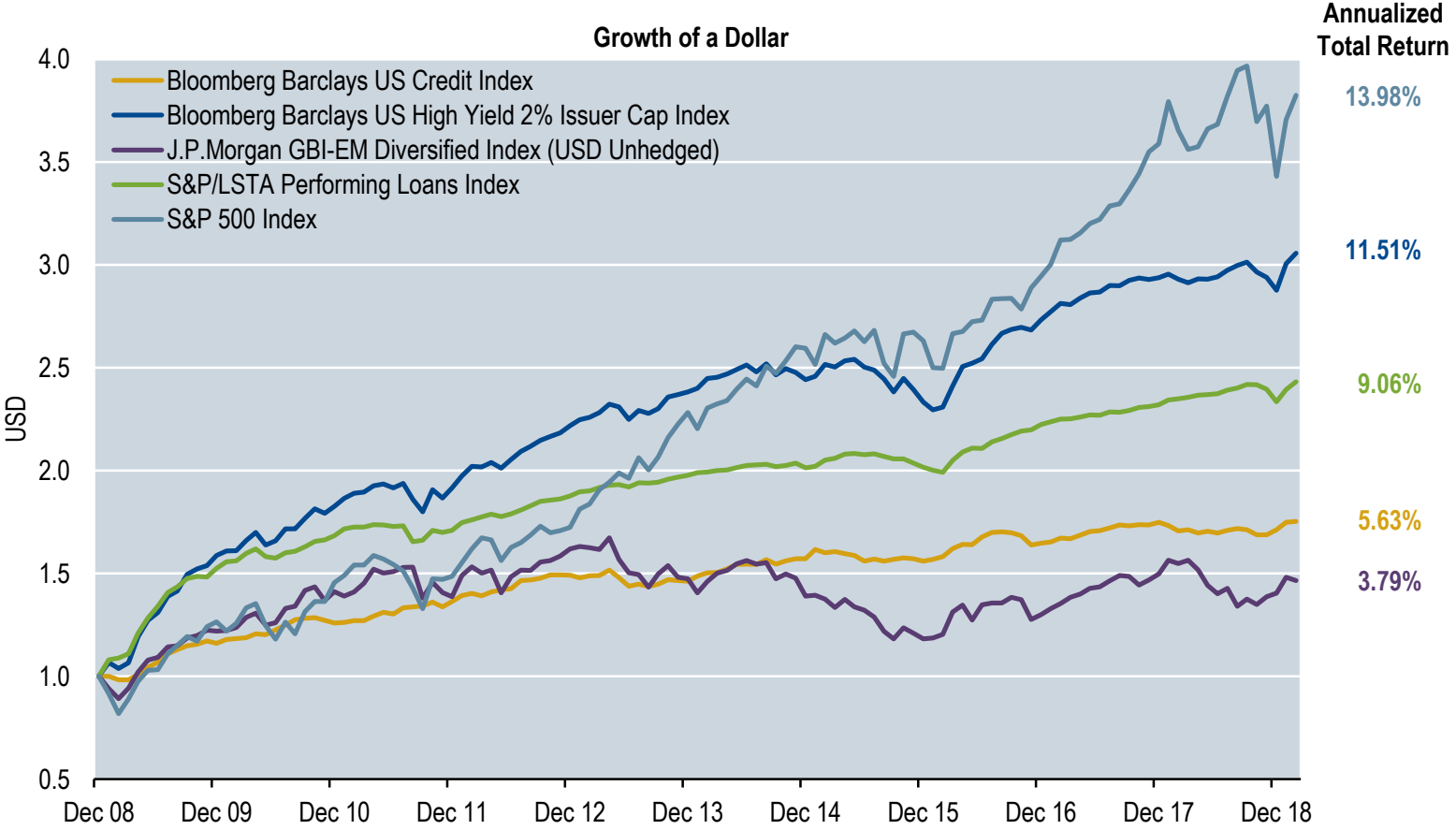
EM USD Sovereign represented by J.P. Morgan Emerging Market Bond Index Global (EMBI Global)

Mortgage-Backed represented by Bloomberg Barclays US MBS Index

US Loans represented by S&P/LSTA US Leveraged Loan Index

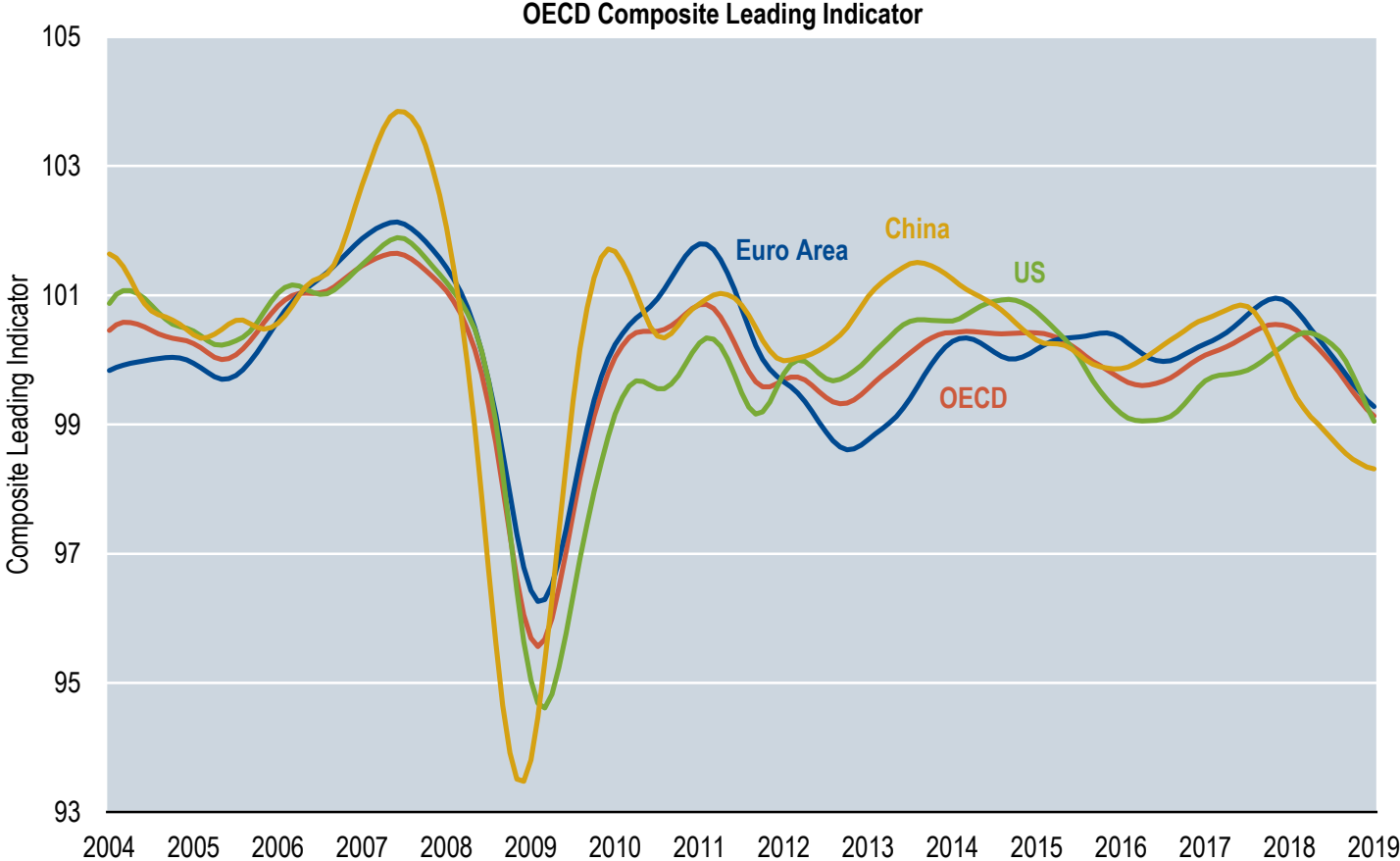
As of 28 Feb 19

Markets Continue to Shrug Off Credit Cycle Concerns



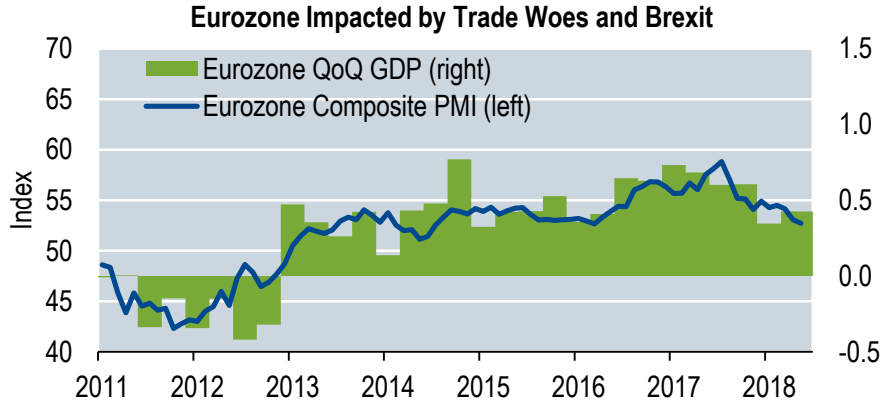
Source: Bloomberg Barclays, J.P.Morgan, S&P. As of 28 Feb 19

Global Growth Turned Lower in 2018, but What's Next?

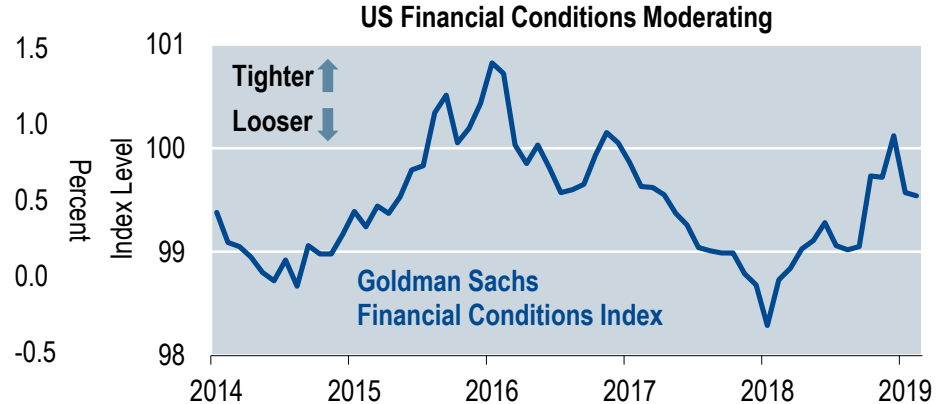


Amplitude adjusted, long-term average = 100, Jan 2004 – Jan 2019
Source: OECD (2019), Composite leading indicator (CLI) (indicator). doi: 10.1787/4a174487-en (Accessed on 19 March 2019). As of 31 Jan 19

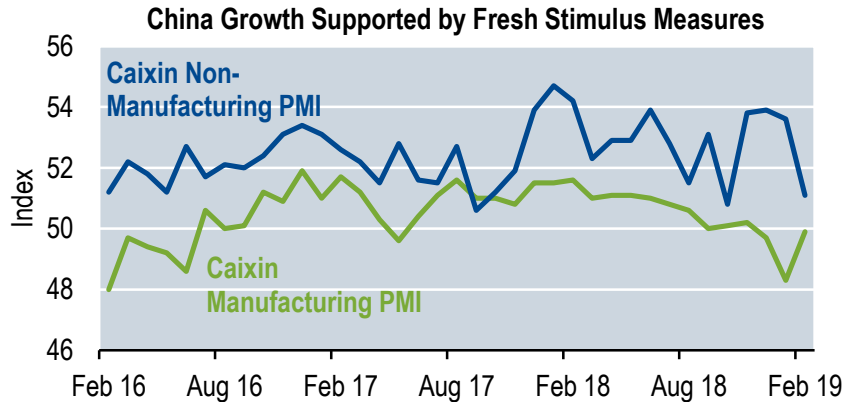
Drivers of Global Growth – Are We at an Inflection Point?



Source: IHS Markit, Haver, Western Asset. As of 31 Dec 18

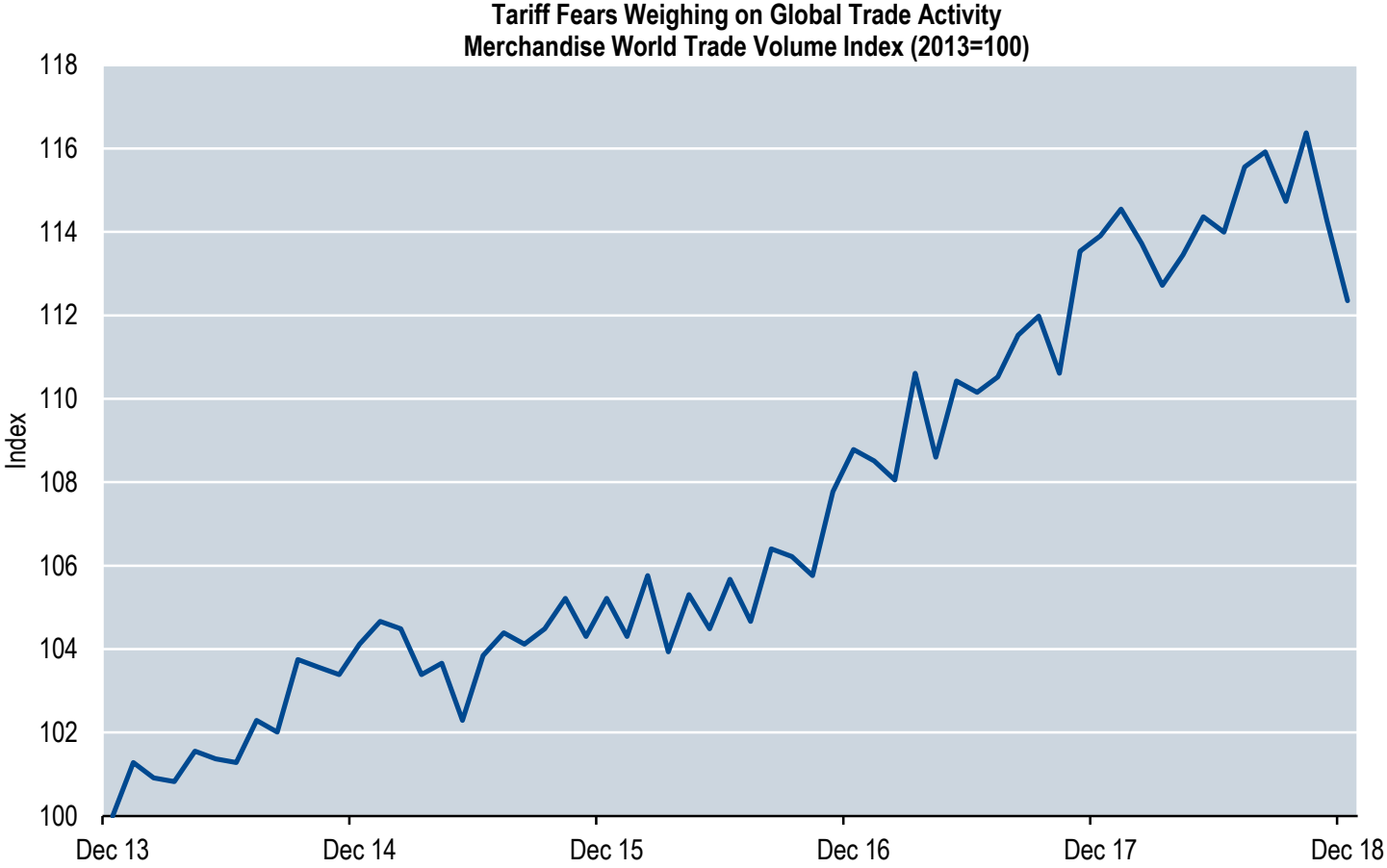


Source: Bloomberg. As of 28 Feb 19



Source: Bloomberg, Markit Economics. As of 28 Feb 19

Tariff Fears Weighing on Global Trade Activity



Source: CPB Netherlands Bureau of Policy Analysis. As of 31 Dec 18

Markets Are Reflecting Continued Policy Accommodation to Support Growth



Source: Bloomberg. As of 19 Mar 19

Evidence of Late-Cycle Behavior

Stripping Collateral

- **J Crew** (Dec '16): Sent all intellectual property to an unrestricted subsidiary, removed from the collateral package
- **Radio One** (Dec '16): Company's stake in MGM was never restricted but viewed as a credit enhancer, but now that stake is rumored to be taken away
- **Petsmart** (Jun '18): Subsidiary Chewy.com—growth part of the business, 40% of Chewy.com sent through restricted payment basket as dividend to the equity sponsor
- **Neiman Marcus** (Sep '18): Subsidiary My Theresa—fastest growing platform, was made into an unrestricted subsidiary, then sent as a dividend to parent company and no longer part of the loan collateral package
- **Refinitive** (Sep '18): New syndicated loan deal whereby the company can sell 40% of assets without being required to pay down debt
- **Envision** (Sep '18): Newly syndicated deal had a clause allowing assets to be sent as dividends without paying back noteholders
- **Rentpath** (Oct '18): Apartment rental company with a strong online presence—rumored to be making web domain names unrestricted subsidiaries to be used as collateral for subordinated debt or as a dividend
- **Power Solutions** (Mar '19): High-profile LBO transaction that allows sponsors to transfer intellectual property to unrestricted subsidiaries. EBITDA definition includes add-back for expected revenue from contract renegotiation

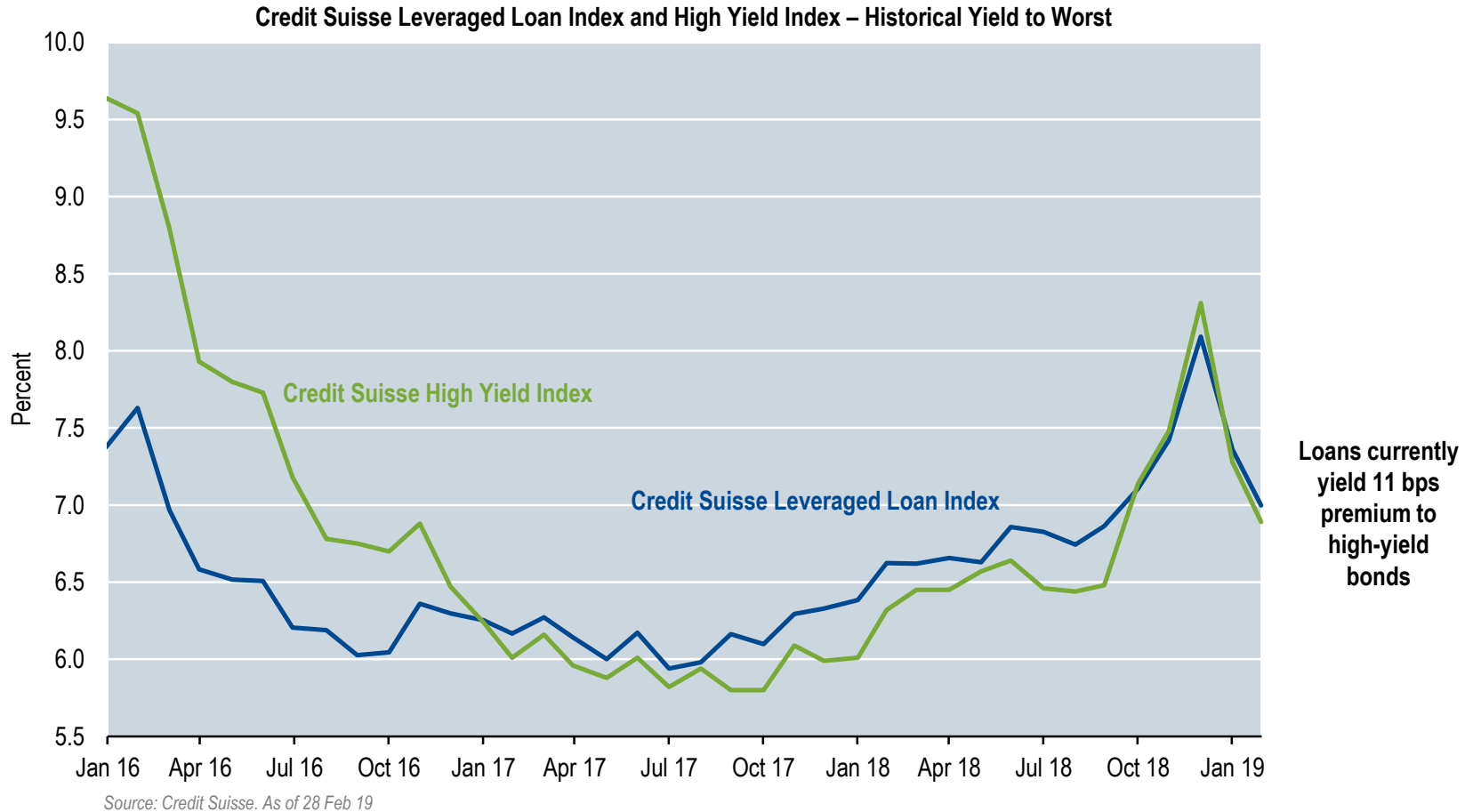
Questionable use of lines of credit/revolvers:

- **Parexel** (Sep '17): Company paid equity sponsors a \$300mm dividend that was funded by drawing on the revolver which is unusual

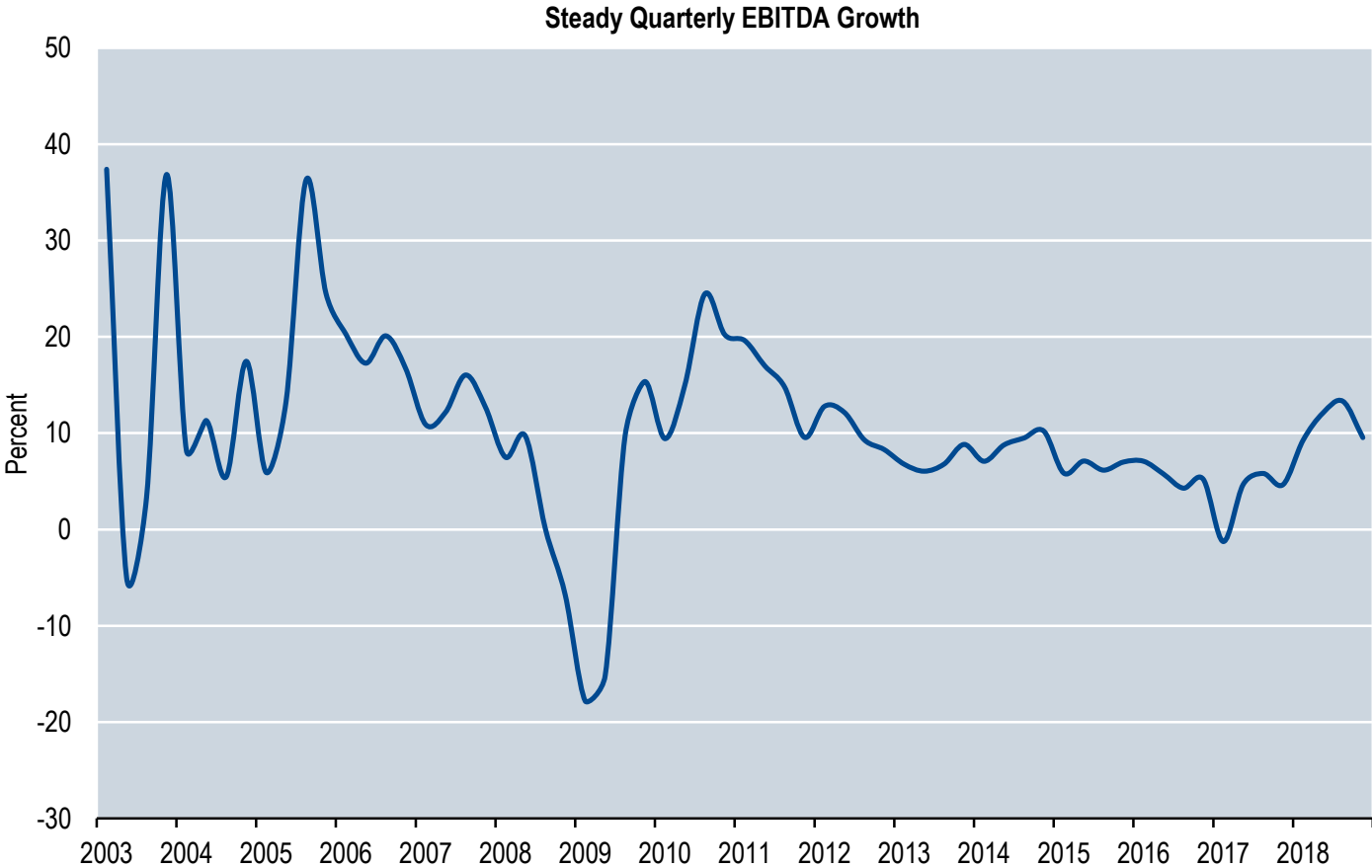
Most equity-sponsored deals allow generous use of the restricted payment basket to take assets. Considering how loose the EBITDA adjustment language has gotten, there is elevated risk of assets being removed from collateral packages.

Bank Loan Valuations Look Attractive Relative to High-Yield

Since 1992, high-yield has historically had a YTW with 110 bps premium over leveraged loans and 106 bps spread over loans driven by a higher risk profile due to unsecured, subordinated position in capital structure relative to loans

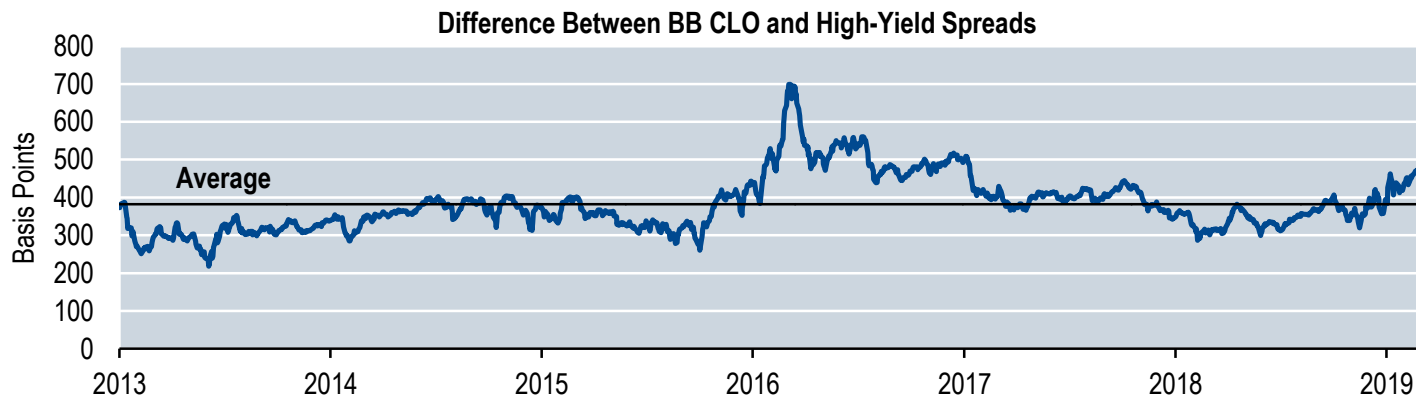


Leveraged Loans: Fundamental Backdrop Has Remained Steady



Source: S&P/LSTA, LCD. As of 31 Dec 18

CLOs Now Offer Value Relative to High-Yield



Source: Bloomberg, J.P. Morgan. As of 28 Feb 19

| Spreads | 03 Oct 18 | 31 Dec 18 | 28 Feb 19 | Q4 Chg | YTD Chg | Retracement ¹ |
|-------------------|-----------|-----------|-----------|--------|---------|--------------------------|
| CLO AAA | 110 | 145 | 137 | 35 | -8 | 23% |
| IG Corp | 99 | 143 | 114 | 44 | -29 | 66% |
| CMBS AAA | 72 | 106 | 90 | 34 | -16 | 47% |
| CLO BBB | 295 | 407 | 373 | 112 | -34 | 30% |
| CLO BB | 601 | 748 | 703 | 147 | -46 | 31% |
| Bank Loans | 355 | 468 | 399 | 113 | -69 | 61% |
| High Yield | 303 | 526 | 379 | 223 | -147 | 66% |
| CMBS BBB | 240 | 420 | 300 | 180 | -120 | 67% |

Source: Bloomberg, J.P. Morgan. As of 28 Feb 19

¹Compares spread changes during 4Q18 period and YTD 28 Feb 19.

2018 "BBB Glut" to 2019 "Debt Diet"

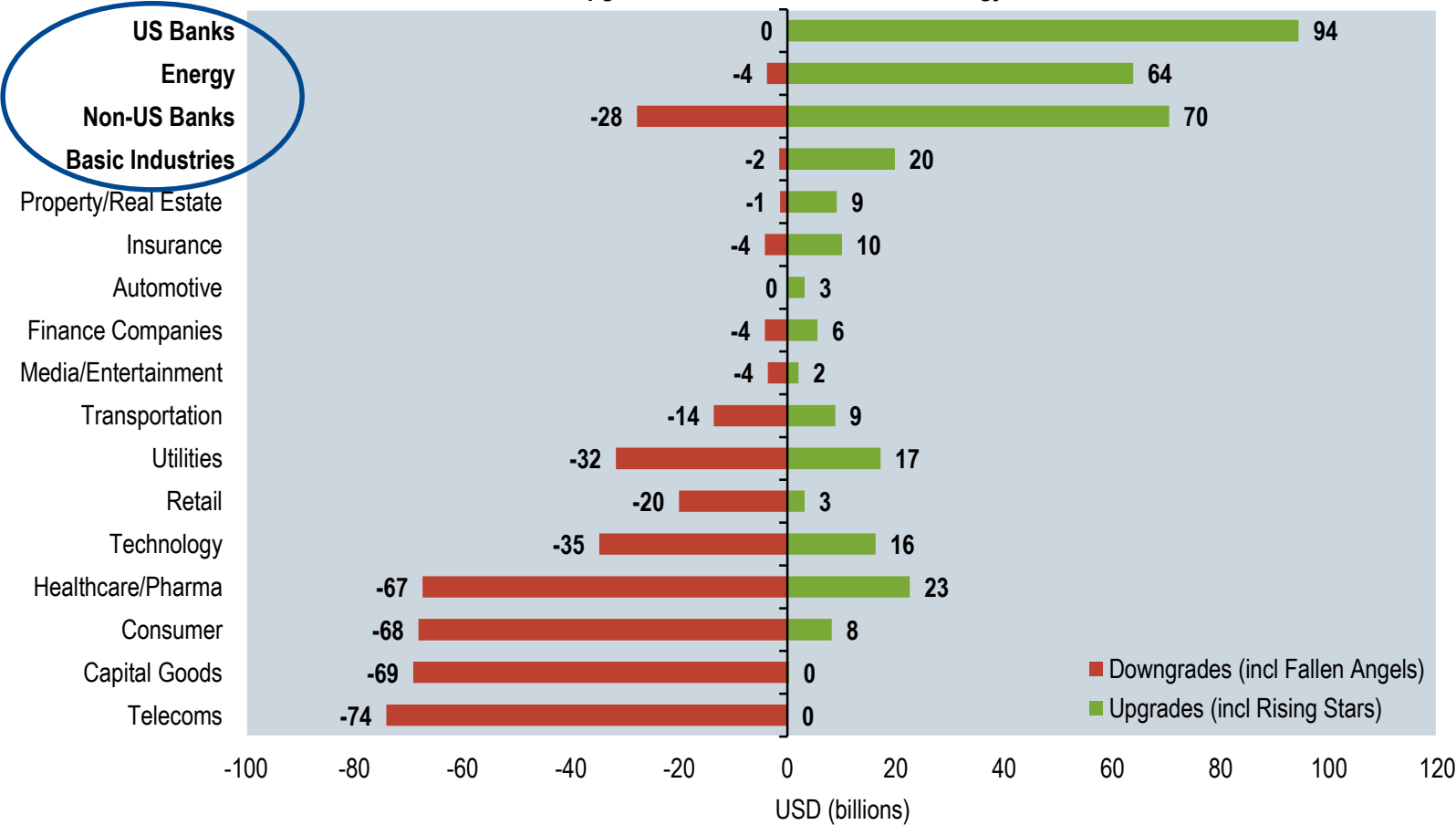
30 Largest BBB Issuers

| | Ticker | Company Name | Index Rating | Total IG Index Debt, (USD, billions) | US IG Index Weight (%) | Industry | Leverage Trend | Management Explicitly Stated Leverage Target |
|----|--------|------------------------------|--------------|---|---------------------------|---------------------------|----------------|---|
| 1 | T | AT&T | Baa2 | \$99.6 | 1.6 | Wireline | Lower | Yes |
| 2 | VZ | Verizon Communications | Baa1 | \$73.1 | 1.2 | Wireline | Stable | Yes |
| 3 | CVS | CVS Health | Baa2 | \$66.2 | 1.1 | Health Care | Lower | Yes |
| 4 | ABIBB | Anheuser-Busch Inbev | Baa1 | \$64.1 | 1.0 | Food & Beverage | Lower | Yes |
| 5 | GE | General Electric | Baa1 | \$45.4 | 0.7 | Diversified Manufacturing | Lower | Yes |
| 6 | GM | General Motors | Baa2 | \$41.2 | 0.7 | Automotive | Stable | No |
| 7 | CHTR | Charter Communications | Baa3 | \$37.7 | 0.6 | Cable Satellite | Stable | Yes |
| 8 | ABBV | Abbvie | Baa2 | \$33.2 | 0.5 | Pharmaceuticals | Stable | No |
| 9 | F | Ford Motor | Baa2 | \$33.1 | 0.5 | Automotive | Higher | No |
| 10 | CI | Cigna | Baa2 | \$32.7 | 0.5 | Health Care Insurance | Lower | No |
| 11 | ETP | Energy Transfer | Baa3 | \$29.9 | 0.5 | Midstream | Lower | Yes |
| 12 | UTX | United Technologies | Baa1 | \$29.3 | 0.5 | Aerospace/Defense | Lower | No |
| 13 | KMI | Kinder Morgan | Baa2 | \$26.6 | 0.5 | Midstream | Lower | Yes |
| 14 | AMGN | Amgen Inc | Baa1 | \$25.0 | 0.4 | Pharmaceuticals | Stable | No |
| 15 | BATSLN | British American Tobacco | Baa2 | \$24.9 | 0.4 | Tobacco | Lower | Yes |
| 16 | DWDP | DowDupont | Baa2 | \$24.5 | 0.4 | Chemical | Stable | No |
| 17 | EPD | Enterprise Products Partners | Baa1 | \$23.9 | 0.4 | Midstream | Lower | Yes |
| 18 | MO | Altria Group | Baa2 | \$22.0 | 0.3 | Tobacco | Lower | No |
| 19 | UNP | Union Pacific | Baa1 | \$21.6 | 0.3 | Railroad | Higher | No |
| 20 | KHC | Kraft Heinz | Baa3 | \$21.5 | 0.3 | Food & Beverage | Lower | Yes |
| 21 | WMB | Williams Cos | Baa2 | \$20.8 | 0.3 | Midstream | Lower | Yes |
| 22 | CELG | Celgene | Baa2 | \$19.6 | 0.3 | Pharmaceuticals | Lower | No |
| 23 | VOD | Vodafone Group | Baa1 | \$17.9 | 0.3 | Wireless | Higher | No |
| 24 | MCD | McDonald's | Baa1 | \$17.9 | 0.3 | Restaurants | Stable | No |
| 25 | AGN | Allergan | Baa3 | \$16.7 | 0.3 | Pharmaceuticals | Lower | Yes |
| 26 | DELL | Dell Technologies | Baa3 | \$16.3 | 0.3 | Technology | Stable | No |
| 27 | ANTM | Anthem | Baa2 | \$16.1 | 0.3 | Health Care Insurance | Higher | No |
| 28 | TACHEM | Takeda Pharmaceutical | Baa2 | \$16.0 | 0.3 | Pharmaceuticals | Stable | Yes |
| 29 | ABT | Abbott Laboratories | Baa2 | \$15.1 | 0.3 | Pharmaceuticals | Lower | Yes |
| 30 | AVGO | Broadcom | Baa3 | \$14.8 | 0.2 | Technology | Stable | No |

Source: Bloomberg, Western Asset. As of 18 Mar 19

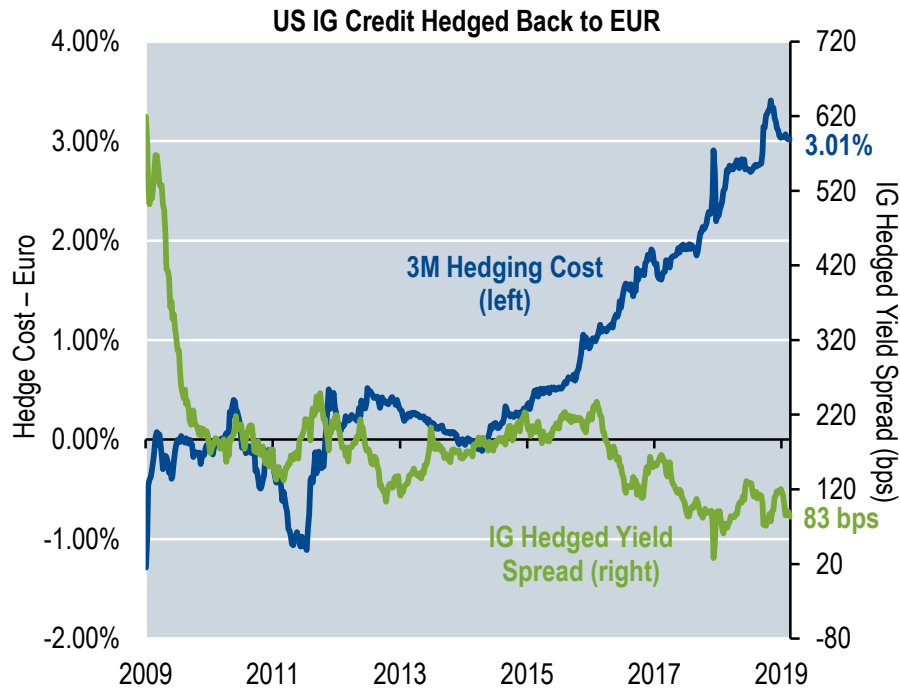
Where Do We See Value Within Corporate Credit?

2018 Upgrades Concentrated in Banks, Energy and Metals

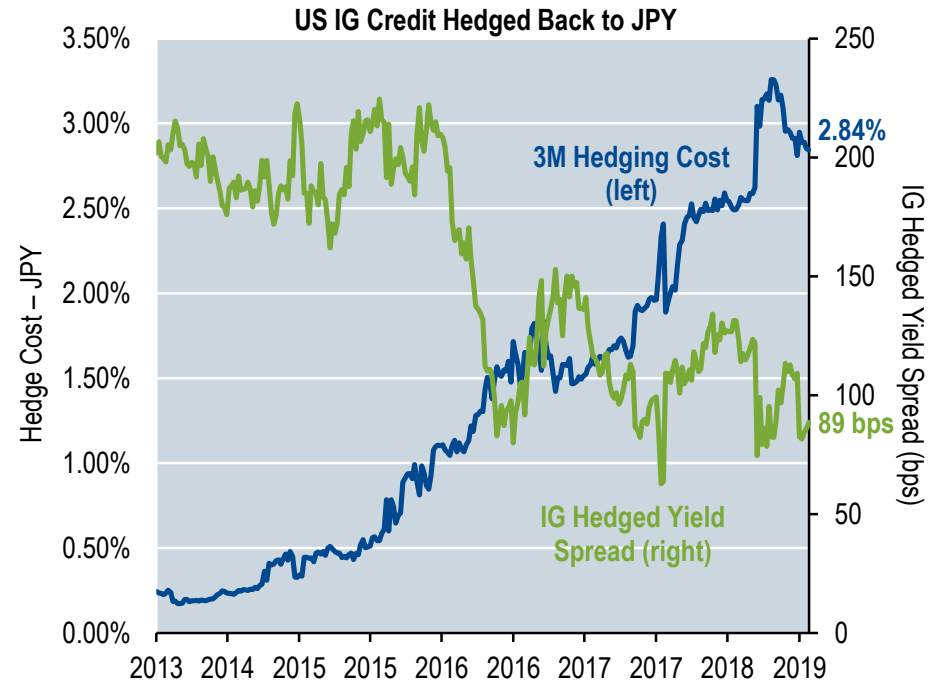


Source: J.P. Morgan. As of 31 Dec 18

Investment-Grade Credit: Hedging-Cost Headwinds Expected to Diminish

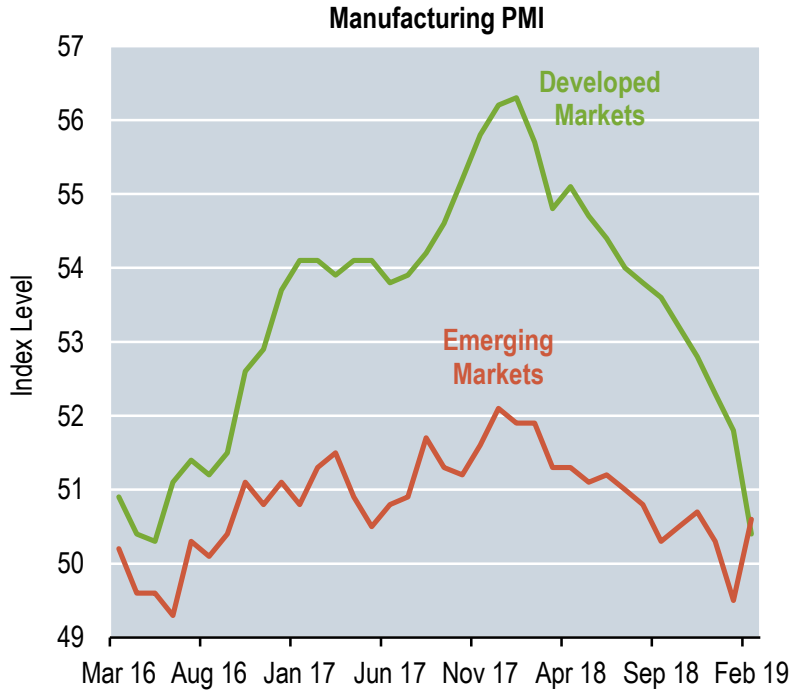


Source: Bloomberg. As of 01 Mar 19

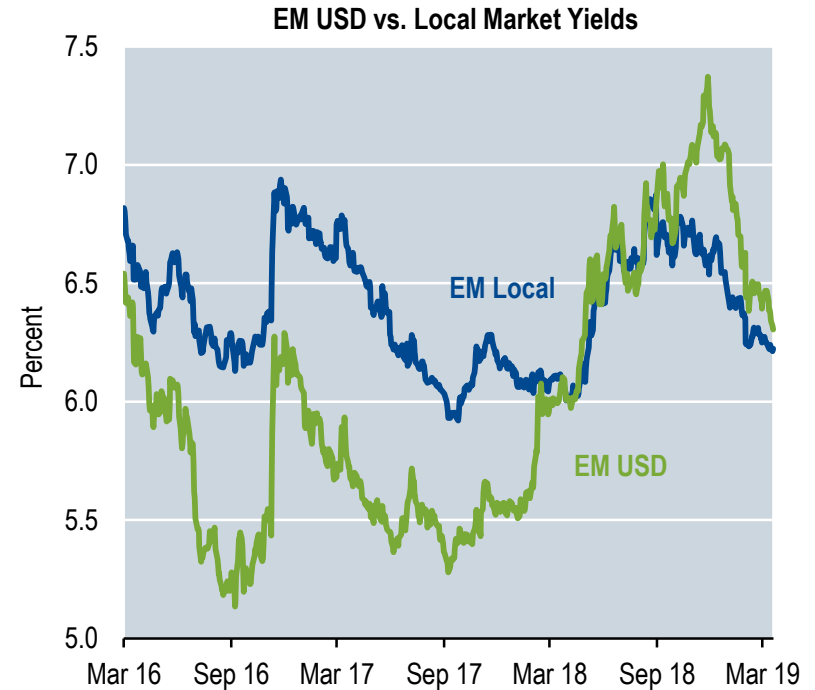


Source: Bloomberg. As of 01 Mar 19

Fundamentals and Valuations Support the Case for Emerging Markets Debt



Source: Bloomberg, IHS Markit. As of 28 Feb 19



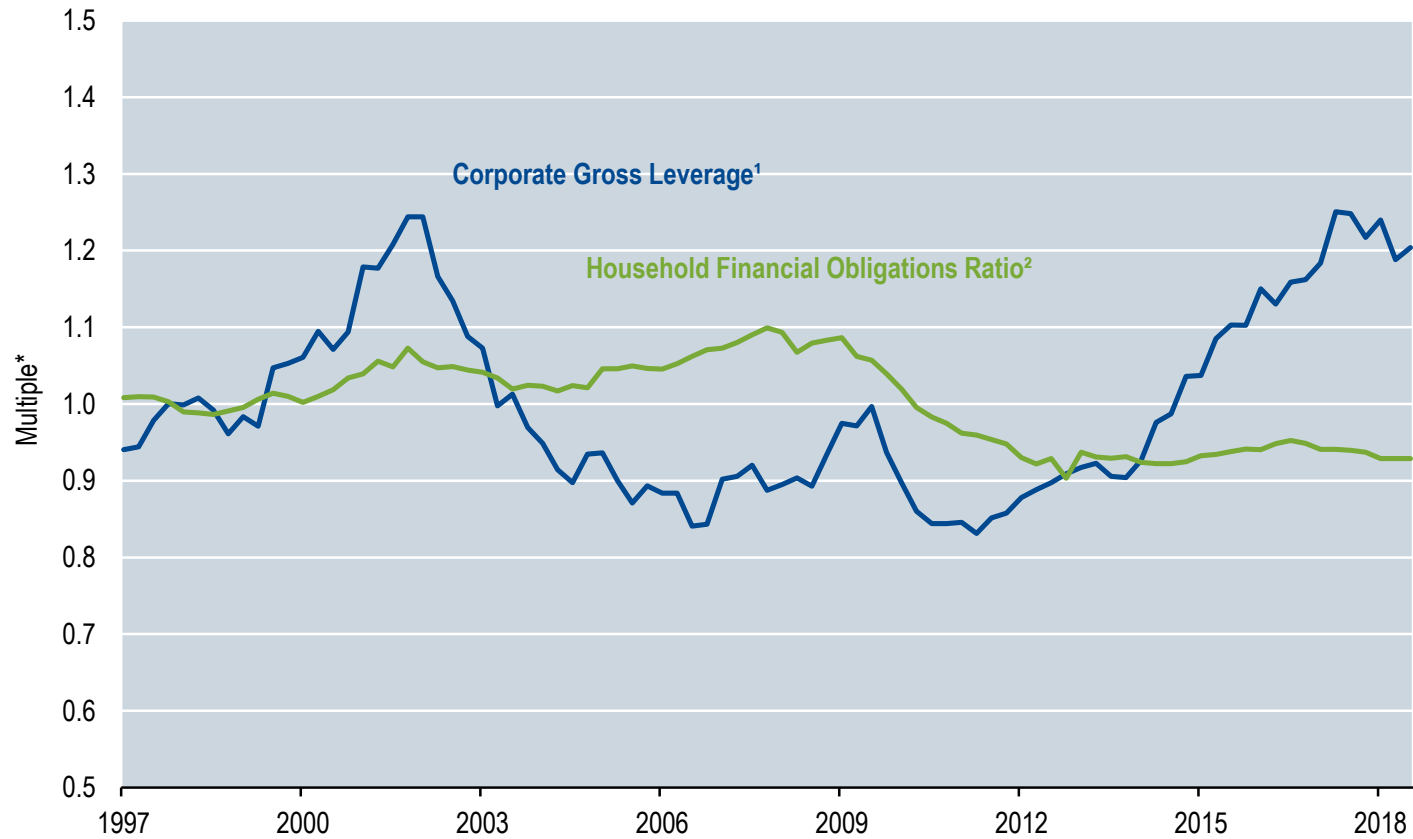
Source: J.P. Morgan. As of 19 Mar 19

EM USD represented by J.P. Morgan Emerging Markets Bond Index Global (EMBI Global)

EM Local represented by J.P. Morgan Government Bond-Emerging Market Index (GBI-EM) Global Diversified

Consumer vs. Corporate Leverage

Consumers Have Reduced Debt While Corporations Have Increased Borrowing



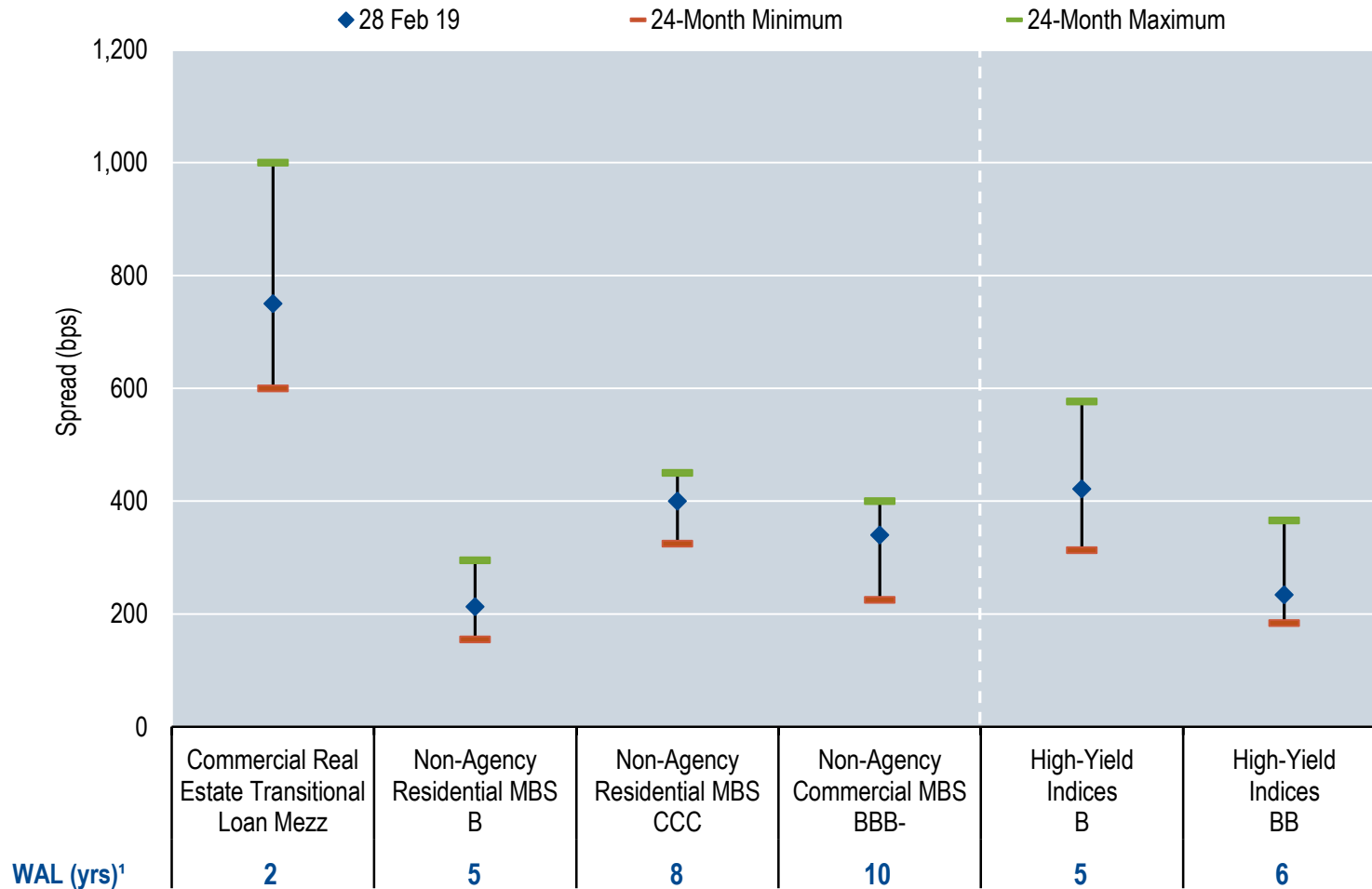
Source: BAML, Federal Reserve, Western Asset. As of 30 Sep 18

¹Non-financial gross debt/EBITDA.

²Household debt to total disposable income in the United States.

*Multiple of long-term average.

Commercial and Residential Credit Bonds Offer Attractive Spreads and Diversification



Source: BofA Merrill Lynch Global Research, Markit Partners, Western Asset. As of 28 Feb 19
¹WAL = Weighted Average Life

Outlook for Fixed-Income Spread Sectors

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- Global growth and credit cycle prospects are not as dire as some would suggest
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Thank you.

Risk Disclosure

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