

Webcast Summary



Michael Buchanan
Deputy Chief Investment Officer



Robert Abad
Product Specialist

Markets On Edge

Western Asset Deputy CIO Michael Buchanan sat down with Product Specialist Robert Abad for an interactive webcast in a new, free-flowing conversational format. They provide an accessible commentary for investors by connecting the dots between today's market headlines and Western Asset's macro views. Their discussion of the current credit cycle in particular includes more nuance than many investors may have heard before. Of course, the session also covers the Firm's outlook for the year ahead and features an assessment of the current risks facing fixed-income investors that are keeping "markets on edge."

2019 Macro Backdrop

- US growth expectations have shifted from predictions of 3%+ annual growth earlier this year to current fears of recession.
- We acknowledge that this is one of the more complex market backdrops that we've seen.
- Investment performance has been very positive so far this year and fundamentals continue to look relatively good for most fixed-income asset classes.
- The markets are unsettled by a growing number of interconnected risks, including:
 - US recession—not yet supported by fundamental data
 - Fed policy error—unclear/contradictory Fed communication heightens uncertainty
 - Global trade tension—vacillates by the day
 - Inverted yield curve—not entirely inverted; kinked only at certain points
- The buildup of BBB leverage is also a real risk, with nearly 50% of the investment-grade market in BBBs, but there is a promising trend of corporations deleveraging.
- However, regulation since the crisis has been one of the most comprehensive overhauls of the financial system, intended to make our global banking system more resilient than ever to global shocks.

Western Asset's Base Case and Portfolio Positioning

- Given the market's current risk factors, our base case calls for slow but resilient global growth and stubbornly low inflation. These two forces together will require ongoing accommodation from central banks.
- We see generally healthy market fundamentals and believe this environment will continue to support spread product outperformance. As such, we have been overweighting certain spread sectors and underweighting lower-yielding developed market sovereign bonds.
- We continue to focus on diversified, uncorrelated and, in some cases, negatively correlated strategies.
- To better insulate our portfolios during these periods of stress, we are tactically using duration to balance our overweight to spread sectors.

The Credit Cycle

- Many investors, nervous since the great financial crisis in 2008, have been predicting the end of the credit cycle since at least 2012.
- Early in the recovery following the crisis, our Credit Team determined that this credit cycle would be unlike any prior credit cycles. They cited three primary factors: the sheer severity of the crisis, the expected central bank accommodation to address the crisis and new regulations designed to help safeguard the financial system against future shocks.
- “Mini cycles” are helping to extend the lifespan of the current broader credit cycle.
 - The energy sector, for instance, completed a cycle in 2015-2016 wherein weaker companies were pushed out of the market but the companies remaining are now stronger, with greater attention to deleveraging.
 - As other individual sectors experience similar mini cycles, the longevity of the current cycle may continue for much longer than many had expected at its outset.
- In terms of the four segments of the traditional credit cycle—early (recovery), mid (expansion), late (downturn) and recession (repair)—the timing of each can vary significantly. We believe we are currently still in the expansion phase, perhaps toward the later end but not yet to the downturn.
- We think the expansion could continue for another one to two years or more, and we see selective opportunities in investment-grade corporate bonds, bank loans, emerging market debt, high-yield corporate debt and structured products.
- Relative value is key, even in the later stages of the downturn phase.

Q&A Highlights

- Webcast audience polling indicated that more than 80% of attendees expect that we could see a US recession in the next 18 months.
- With respect to investment opportunities in this lower-rate environment, we continue to like bank loans as they produce more income currently than does the high-yield market.
- CLOs have also become more attractive, with AAA or AA tranches providing some of the best yields. Nice demand is underpinning CLOs and we think the collateral protection is very appealing.

Past results are not indicative of future investment results. This publication is for informational purposes only and reflects the current opinions of Western Asset. Information contained herein is believed to be accurate, but cannot be guaranteed. Opinions represented are not intended as an offer or solicitation with respect to the purchase or sale of any security and are subject to change without notice. Statements in this material should not be considered investment advice. Employees and/or clients of Western Asset may have a position in the securities mentioned. This publication has been prepared without taking into account your objectives, financial situation or needs. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation or needs. It is your responsibility to be aware of and observe the applicable laws and regulations of your country of residence.

Western Asset Management Company Distribuidora de Títulos e Valores Mobiliários Limitada is authorised and regulated by Comissão de Valores Mobiliários and Banco Central do Brasil. Western Asset Management Company Pty Ltd ABN 41 117 767 923 is the holder of the Australian Financial Services Licence 303160. Western Asset Management Company Pte. Ltd. Co. Reg. No. 200007692R is a holder of a Capital Markets Services Licence for fund management and regulated by the Monetary Authority of Singapore. Western Asset Management Company Ltd is a registered Financial Instruments Business Operator and regulated by the Financial Services Agency of Japan. Western Asset Management Company Limited is authorised and regulated by the Financial Conduct Authority (“FCA”). This communication is intended for distribution to Professional Clients only if deemed to be a financial promotion in the UK and EEA countries as defined by the FCA or MiFID II rules.