



4Q20 Market and Strategy Update

October 6, 2020

Ken Leech
Chief Investment Officer

Road Ahead Looks Like a Long Hard Slog

Optimism on virus/medical front

Optimism on economic recovery

Caution – Recovery is coming from such a challenged position

Caution – Extraordinary amount of global economic slack will take years and continued policy support to absorb

Re-ignition of inflation is at best many years away

Renewed COVID Surge

Surge in cases implies more cautious consumer behavior

Diminished death rate suggests renewed broad-based lockdowns are unlikely

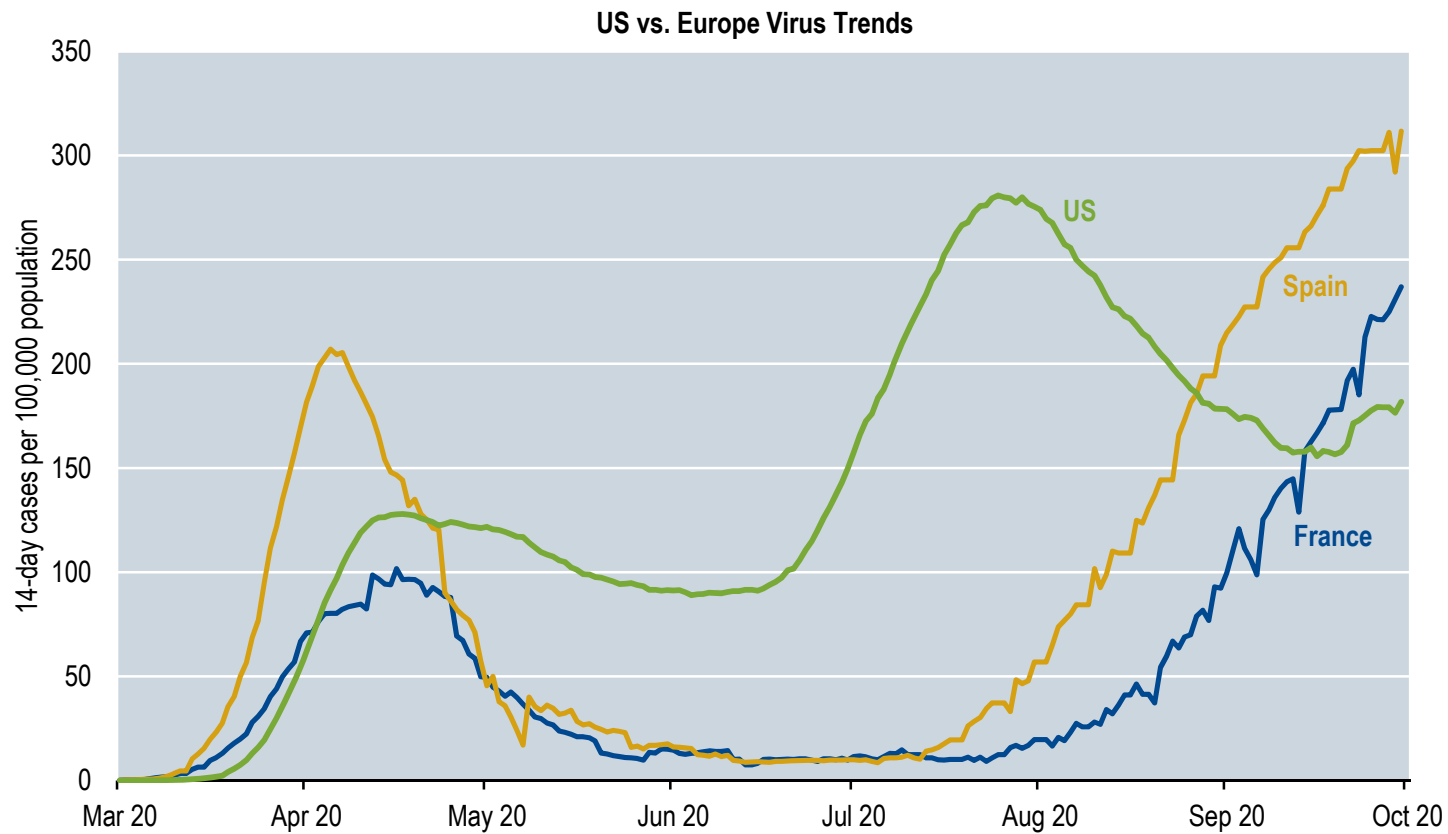
Vaccine hopefulness — no news is good news

Treatments have improved dramatically

Rolling Waves of COVID-19

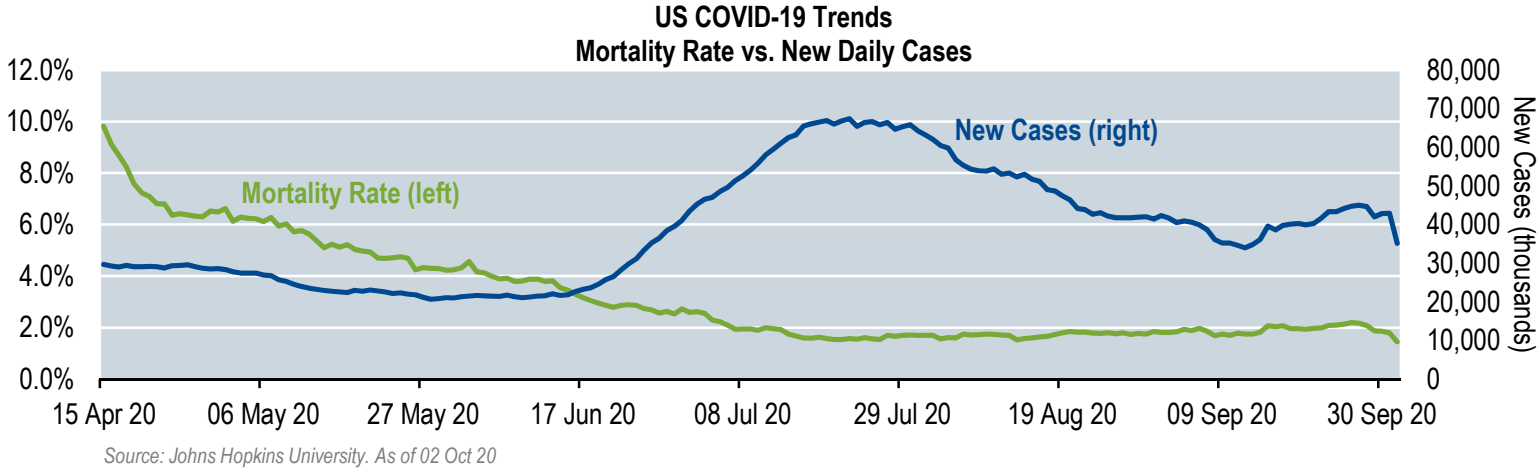
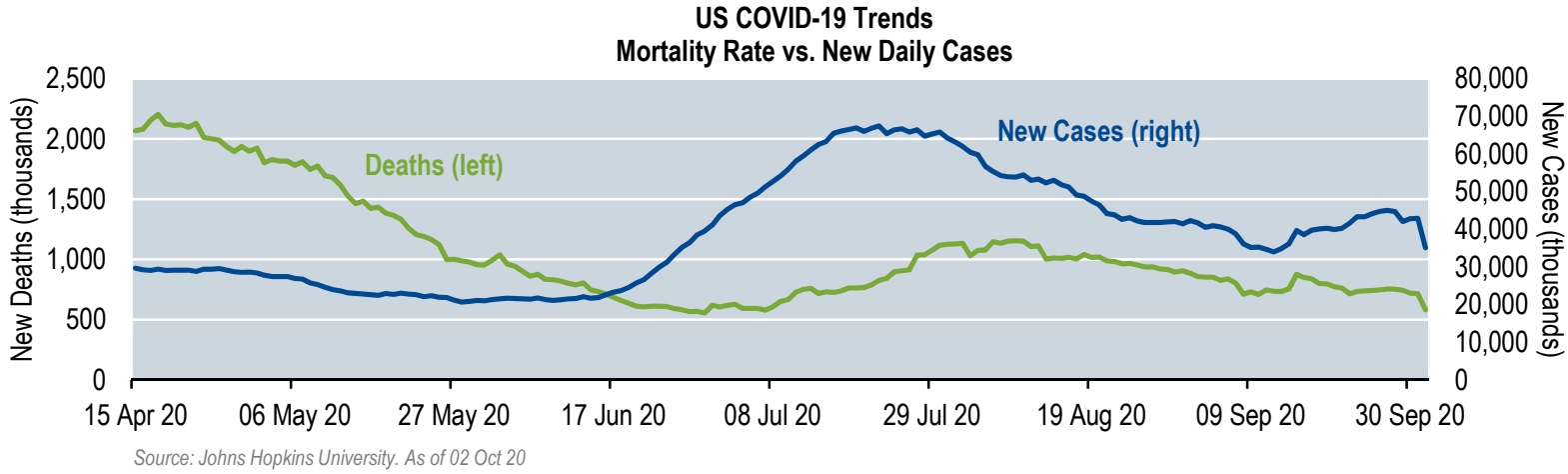
Lockdowns in hard-hit European countries were initially effective, but have graduated into “second waves”

US virus levels still elevated, but below summer highs and now concentrated in more rural, “first wave” states



Sources: Bloomberg, WA analysis. As of 30 Sep 20

COVID-19 Recurrence Cases Increasing – Hospitalization and Mortality Rates Declining

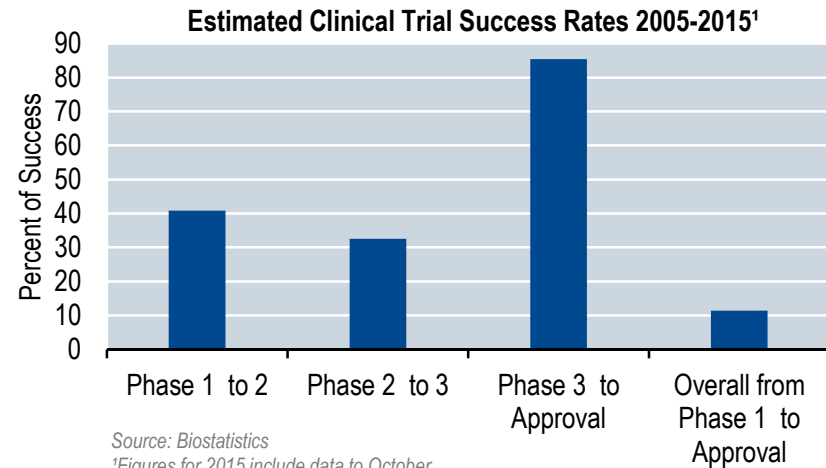


Vaccine Update

We expect initial approval of one or more vaccine by YE20, with more broad distribution during 1H21

Key factors Western Asset will be watching:

- Timing of Phase 3 efficacy data release(s)
- Indications of serious adverse events (e.g. recent AstraZeneca news)
- Aggressiveness of FDA approval process
- Manufacturing and distribution capacity and timeline
- State/federal plans for patient prioritization
- Public willingness to get vaccinated, which could drive progress of herd immunity



COVID-19 Vaccine Technologies

mRNA	Non-Replicating Vectors	Protein Adjuvanted	Live Attenuated
Moderna	AstraZeneca/Oxford U	Novavax	TBD
Pfizer/BioNtech	Janssen	Sanofi/GSK	Sanofi/GSK
+/-	+/-	+/-	+/-
Speed	Speed	Speed	Speed
Efficacy	Efficacy	Efficacy	Efficacy
Cost/Capacity	Cost/Capacity	Significant Human Experience	Cost/Capacity
Cold Chain	One Dose Potential	Cold Chain	One Dose Potential
Safety (lack of experience)	Cold Chain	Safety in Pediatrics	Oral
	Safety (lack of experience)		Safety

Source: Project Warp Speed. Red text indicates a negative attribute of the vaccine. As of 24 Sep 20

Pieces of the Therapeutic Puzzle Are Falling Into Place

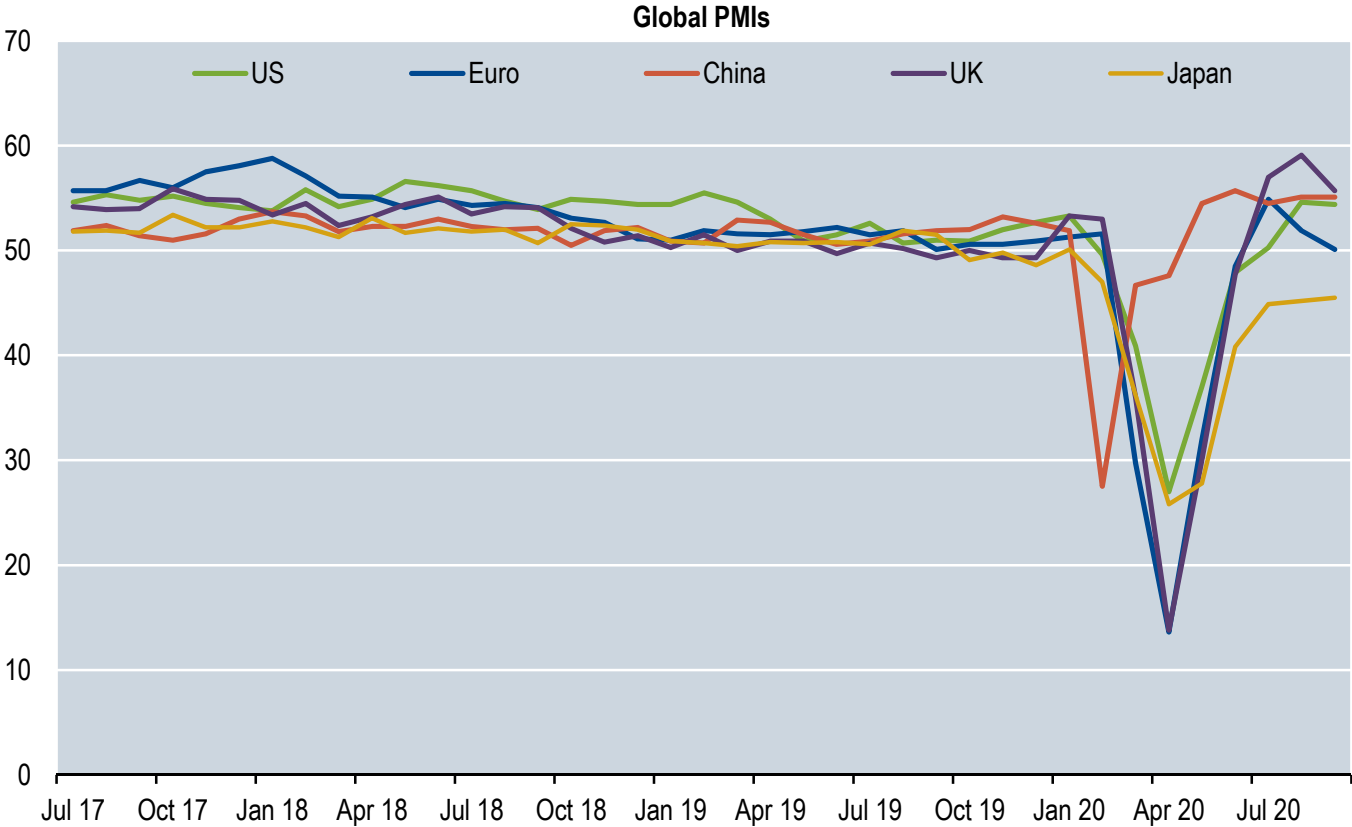
A vaccine leads to the production of antibodies and triggers an antiviral T cell response

Monoclonal antibodies are functionally equivalent to vaccine-induced antibodies

In clinical trials, Regeneron's monoclonal antibodies reduce viral load and symptoms

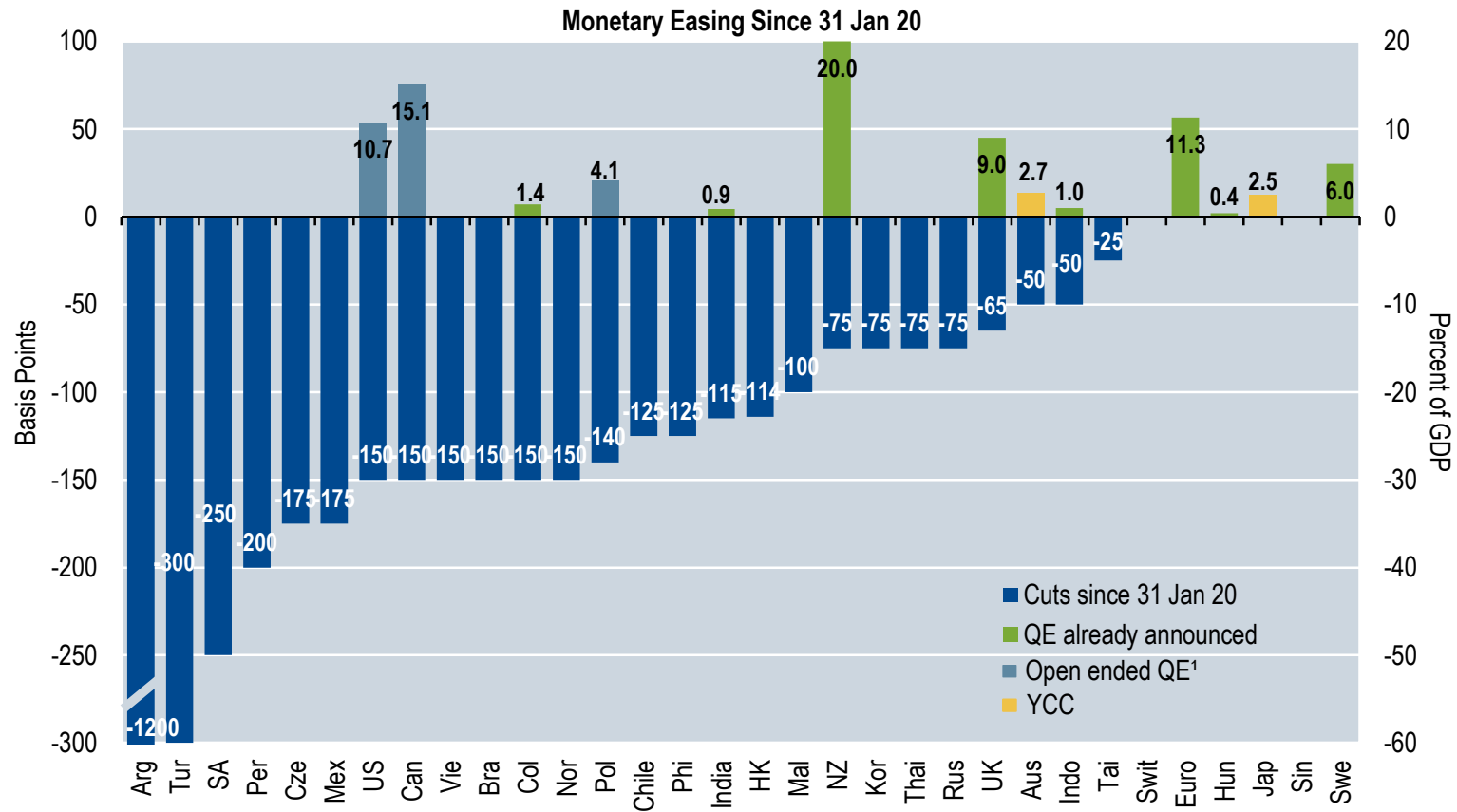
These results increase our confidence that a vaccine will work

The Global Road to Recovery Appears to Have Started



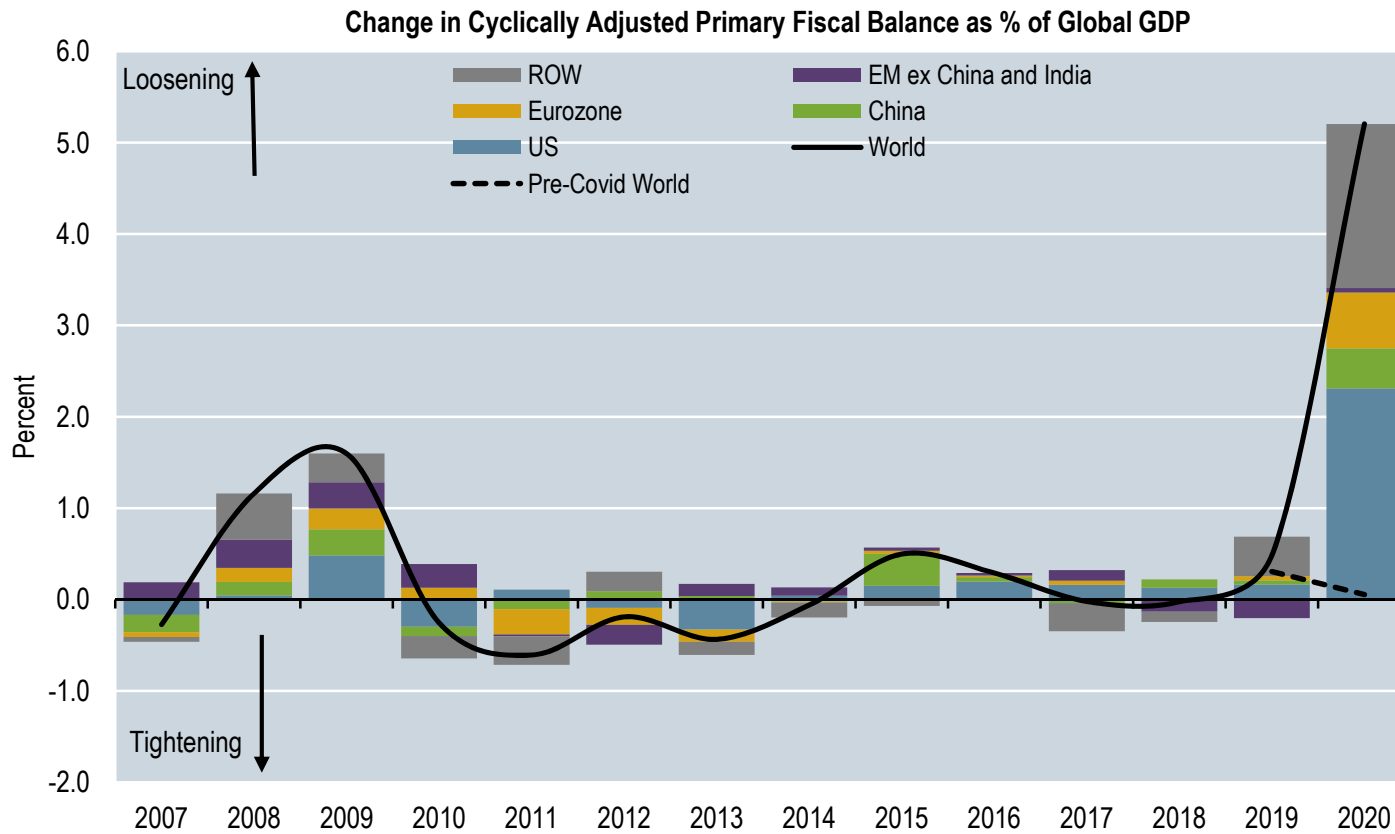
Source: Bloomberg. As of 30 Sep 20

There Has Been a Tidal Wave of Monetary Easing



Source: UBS, Haver. As of 15 Jun 20
 ¹Size of bar denotes CB bal sheet increase since January 2020

Will the Enormity of Global Stimulus Prove Sufficient?

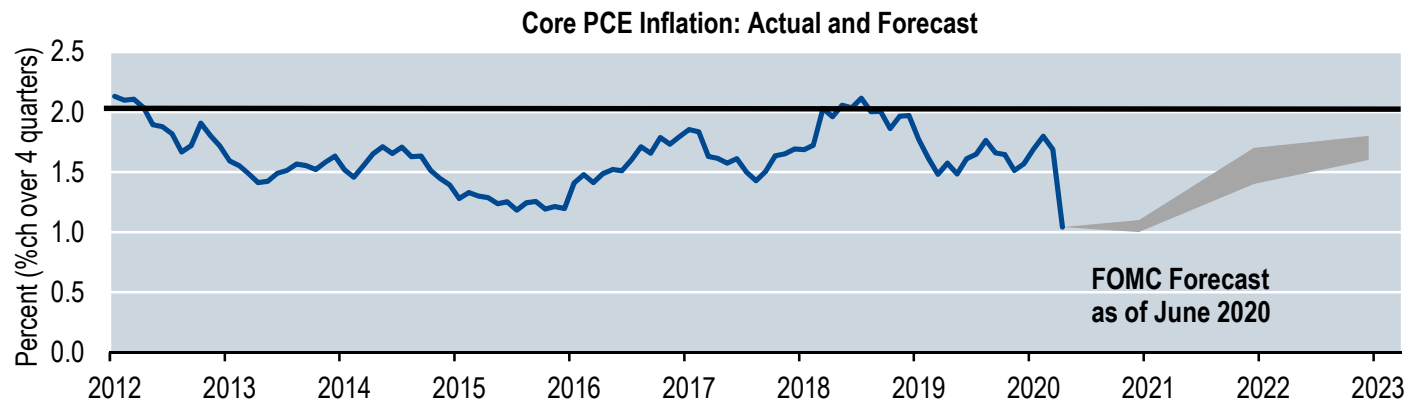


Source: UBS, Haver, European Commission, CBO. As of 29 Jul 20

Fed Will Be Very Slow to Raise Rates

“So, again, we’re — we’re not thinking about raising rates. **We’re not even thinking about, thinking about raising rates.** So, what we’re thinking about is — is providing support for this economy.”

- Chair Powell, June 10, 2020 FOMC Press Conference



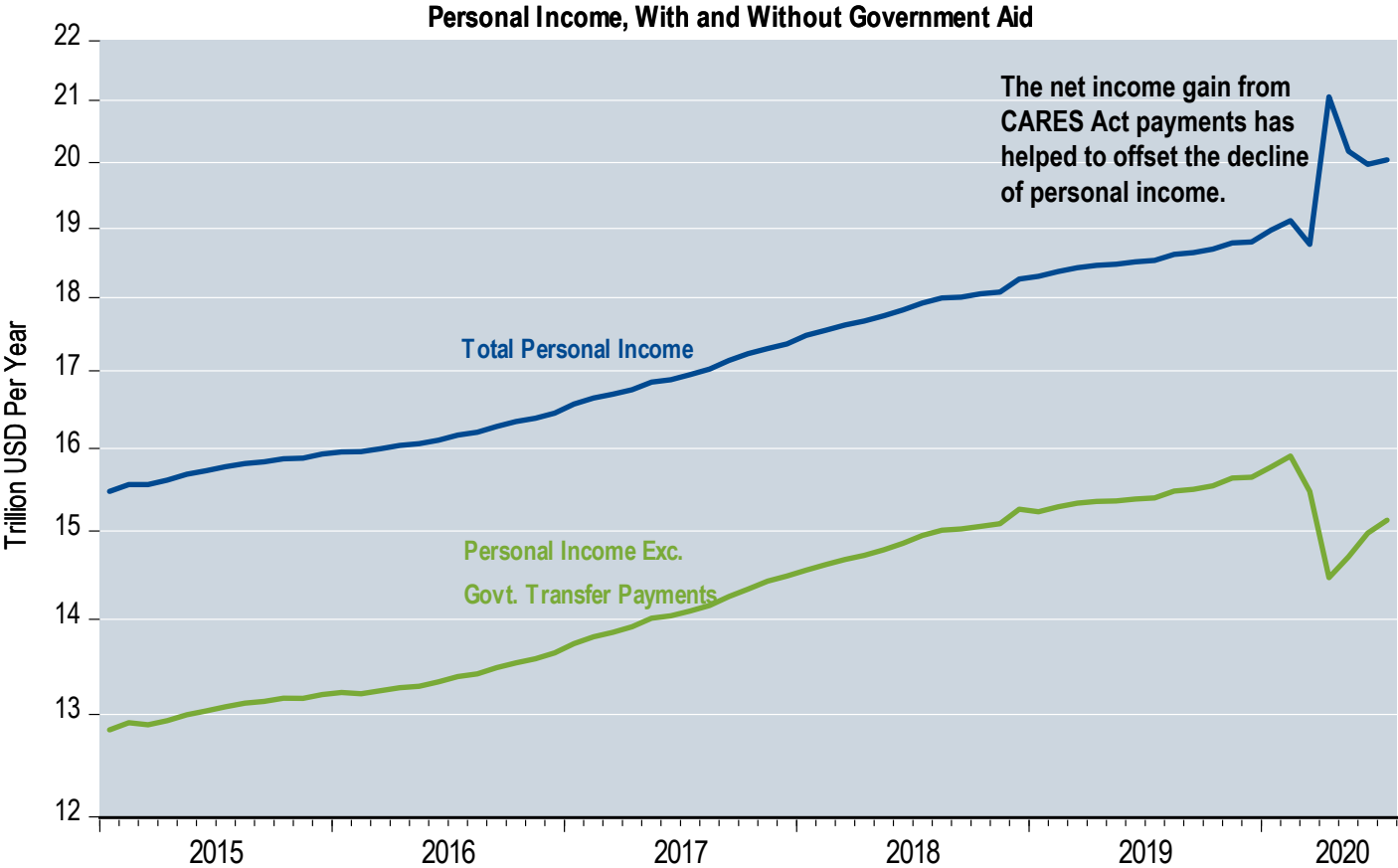
Source: Federal Reserve. As of 10 Jun 20

“**We’re not even thinking about—thinking about raising rates.** We’re — we’re totally focused on providing the economy the support that it will need. We think that the economy will need highly accommodative monetary policy and the use of our tools for an extended period. And we’re absolutely committed to staying in this until — until we’re very confident that that is no longer needed.”

- Chair Powell, July 29, 2020 FOMC Press Conference

Government Support to Households Has Already Been Massive

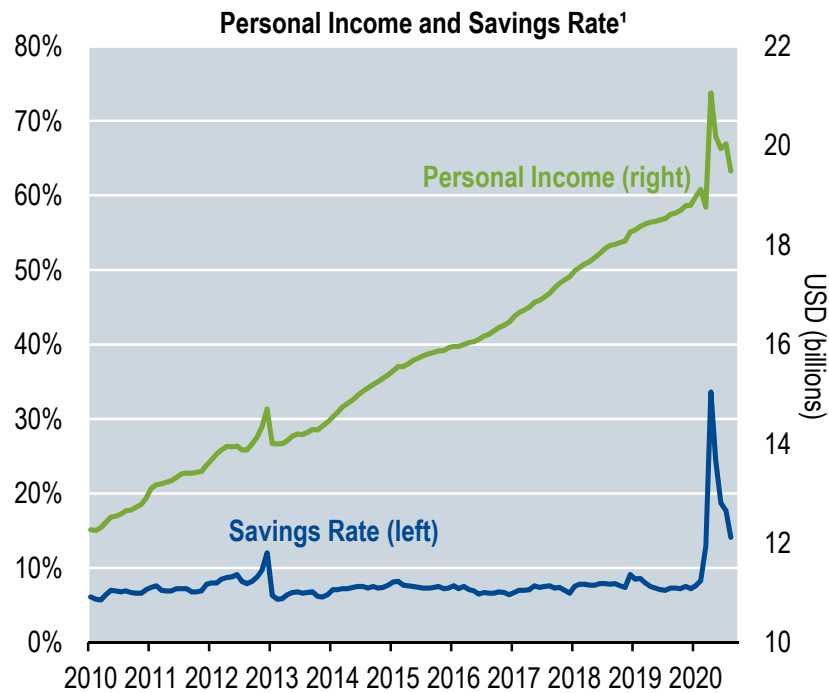
Government direct support to households via the CARES Act and extended unemployment compensation to turn personal income growth positive



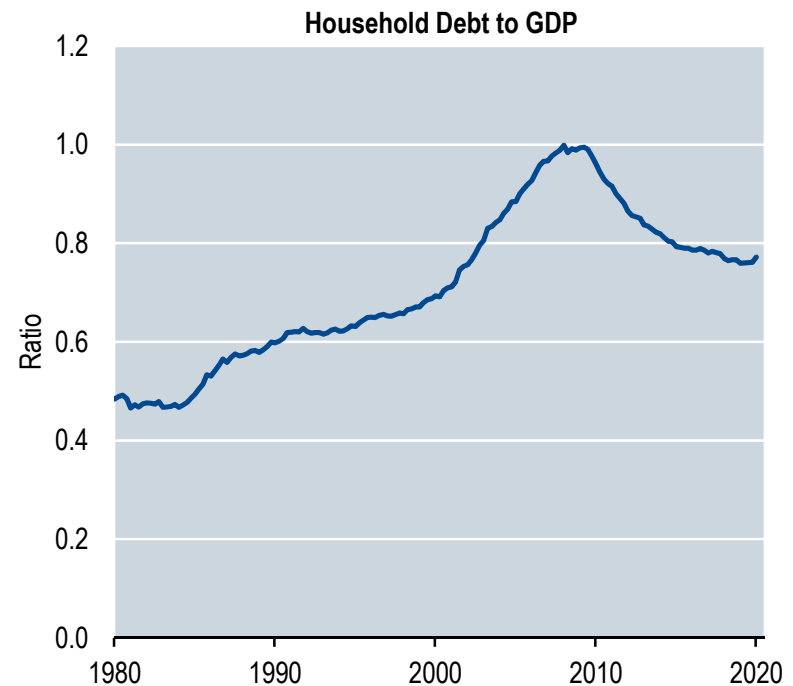
Source: Bureau of Economic Analysis. As of 31 Jul 20

Household Balance Sheets: Leverage Remains Low, Savings Rate Elevated

Savings rate increased sharply as incomes rose and consumption fell. Going forward, fading government support to be offset by increased employment income.

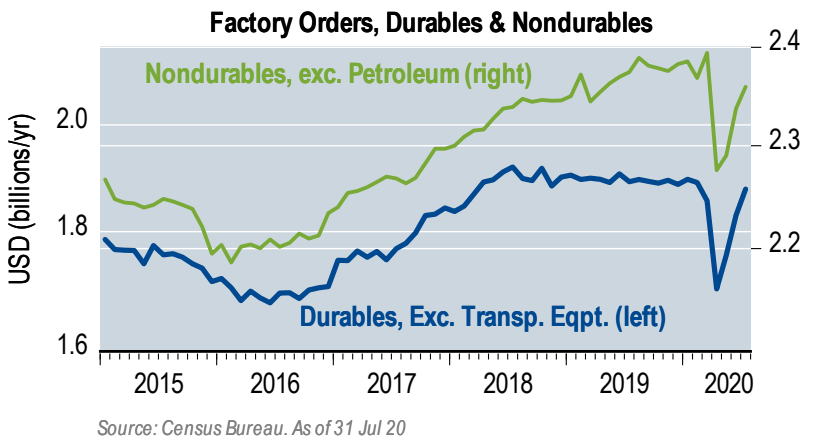
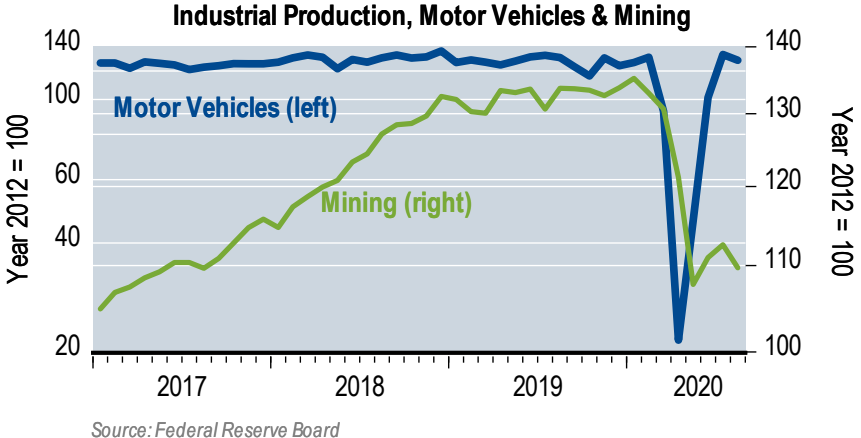
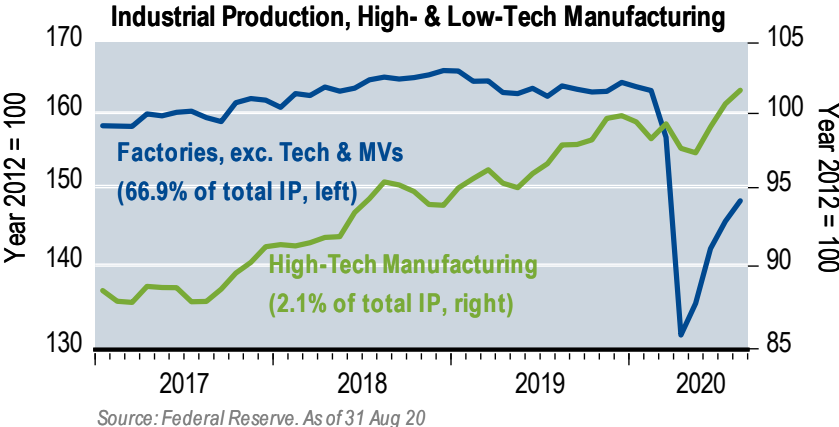
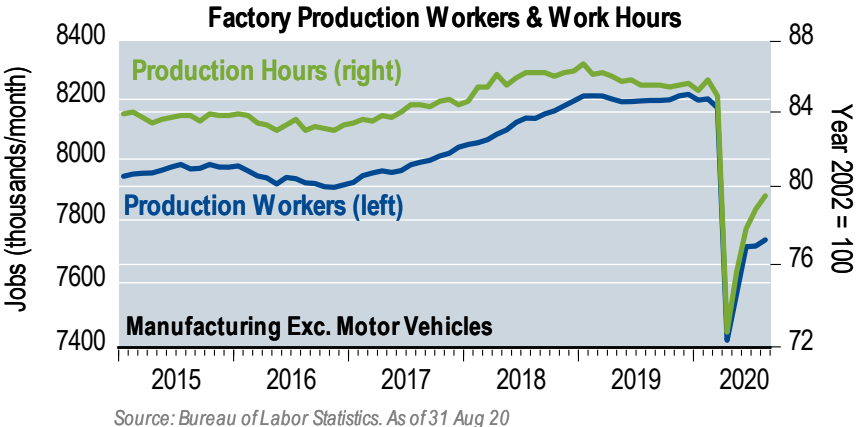


Source: Bureau of Economic Analysis and Federal Reserve. As of 30 Aug 20
¹Seasonally adjusted annual rate

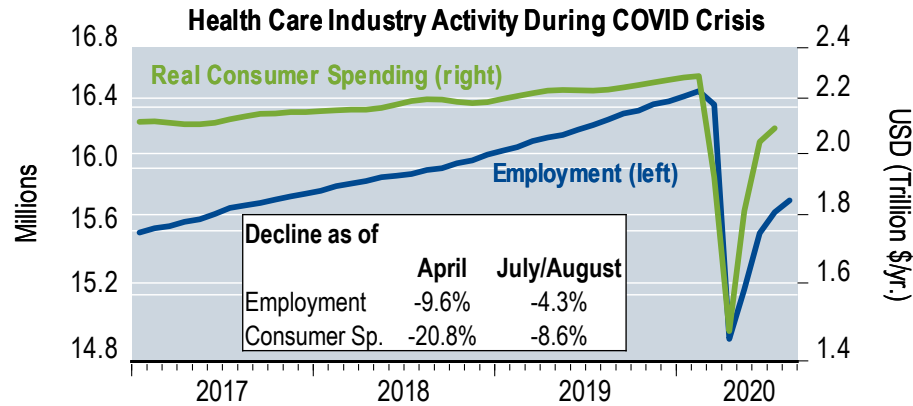


Source: Bureau of Economic Analysis and Federal Reserve. As of 30 Aug 20

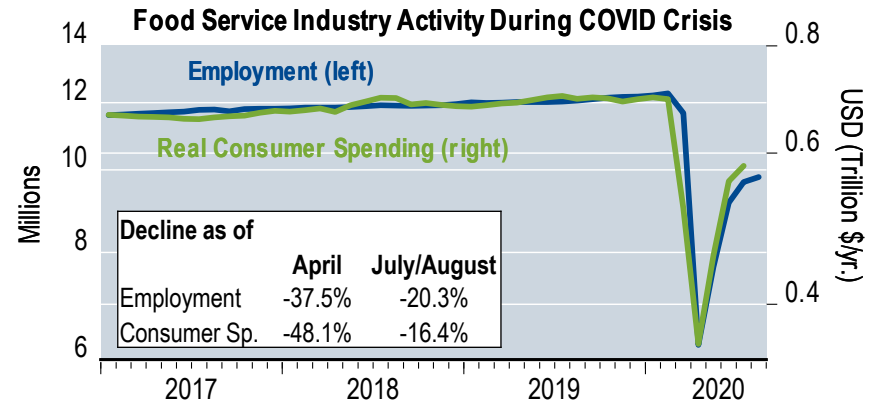
Goods Sectors: While Demand Is Back, Output Is Following Only Gradually



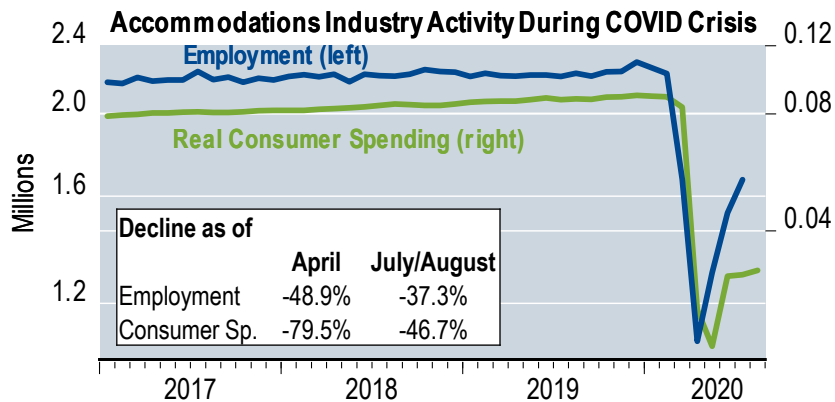
For Most Service Sectors, Recovery Is Only Nascent



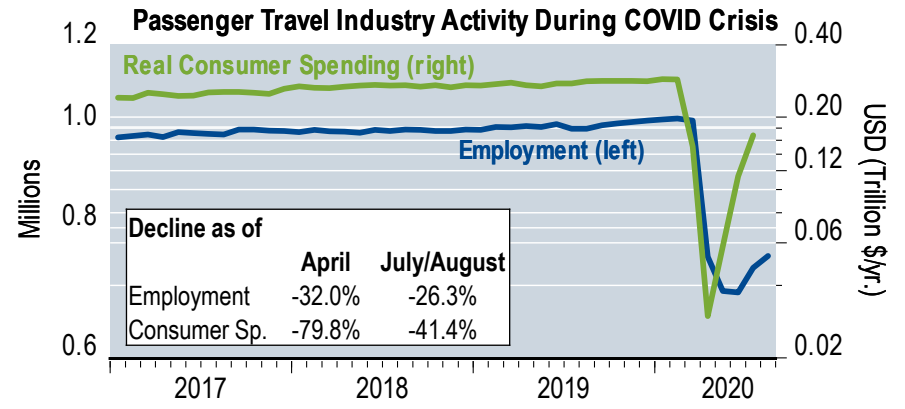
Source: Bureau of Economic Analysis, as of 31 Aug 20



Source: Bureau of Economic Analysis. As of 31 Aug 20



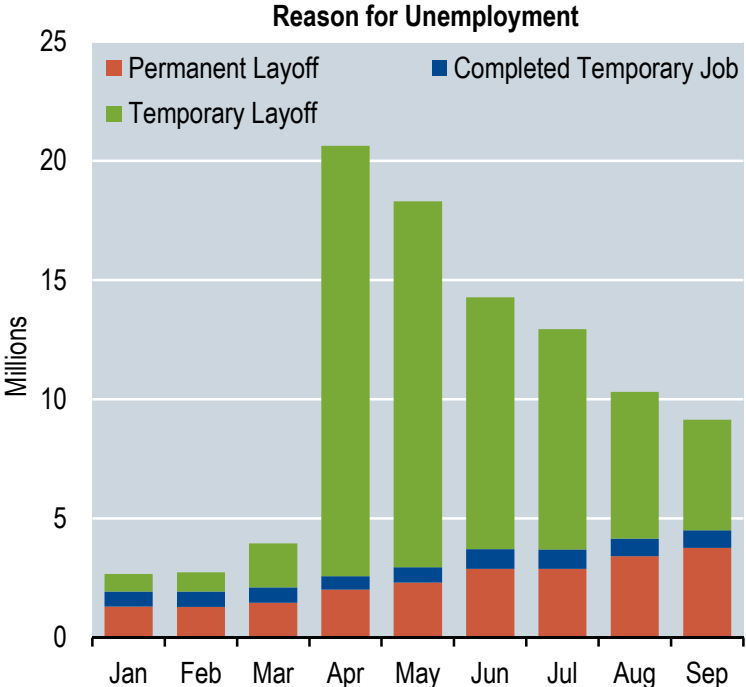
Source: Bureau of Economic Analysis. As of 31 Aug 20



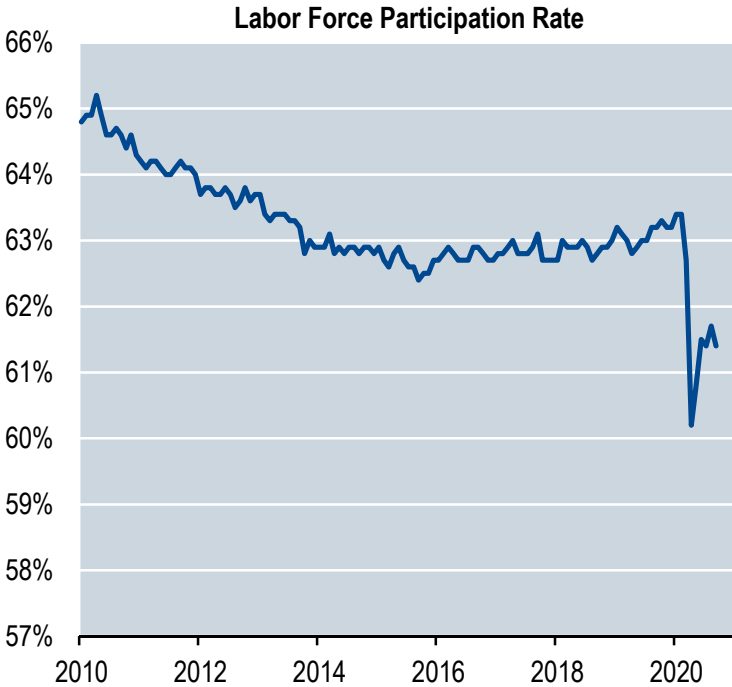
Source: Bureau of Economic Analysis. As of 31 Aug 20

Risks of Significant Scarring Remain

“Permanent” layoffs have steadily increased since March, even as “temporary” layoffs declined. Labor force participation is depressed; decline in the unemployment rate overstates strength in jobs.



Source: Bureau of Labor Statistics. As of 30 Sep 20

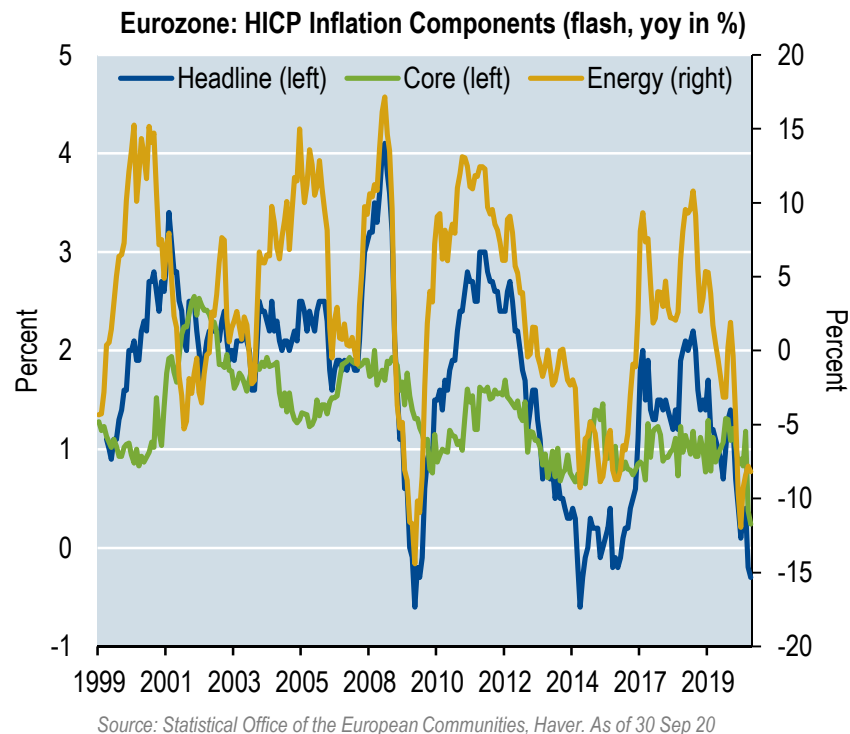


Source: Bureau of Labor Statistics. As of 30 Sep 20

The Road Ahead for Europe Also Appears Challenging

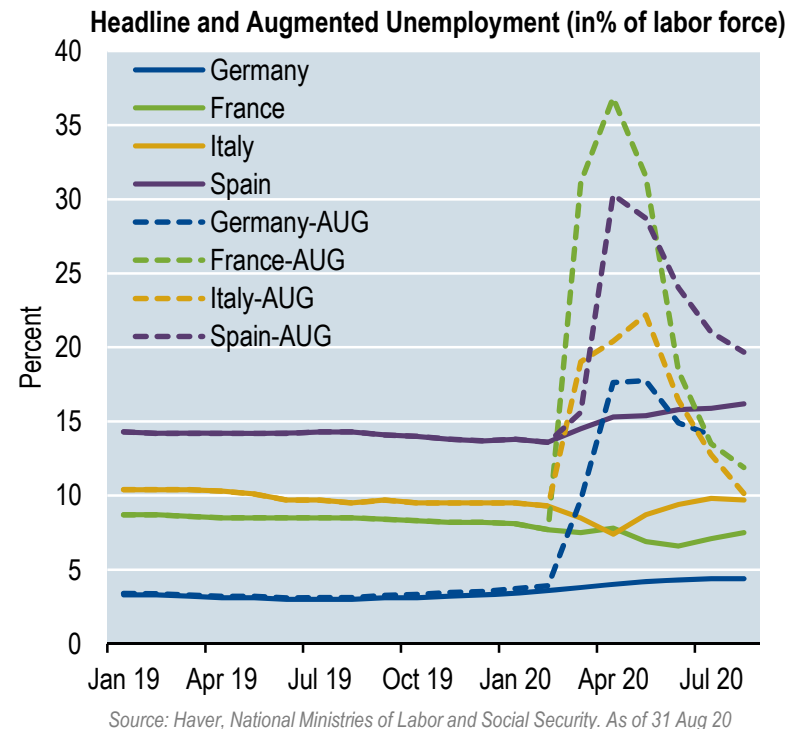
Low eurozone inflation makes the ECB's life ever more complicated

- Core inflation has been around 1 percent for a few years but has now fallen to 0.2 – an all-time low. The actual data – both headline and core – are starting to drift below the ECB macro projections from mid-September



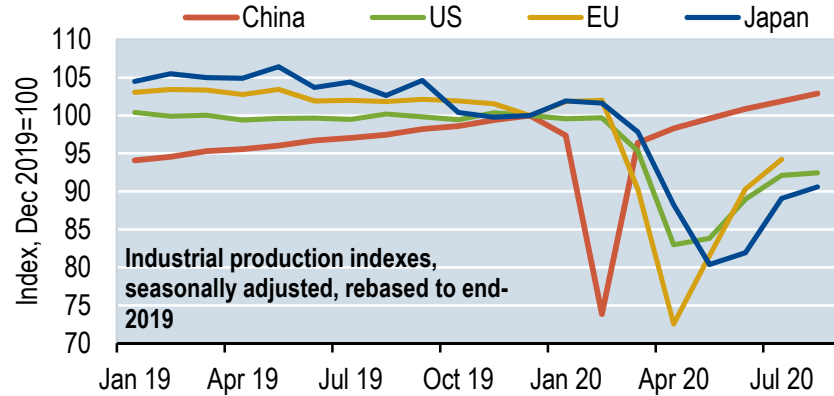
European unemployment dynamics more similar to US than what meets the eye

- A rather limited increase in the official unemployment rate masks a much more significant adjustment in the labor market when furlough and short-time work schemes are taken into account



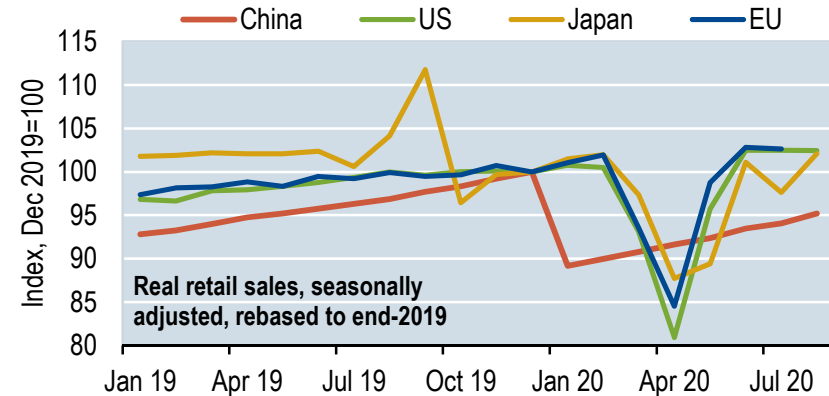
China's Recovery Is Gaining Traction

Chinese Factories Have Reopened Faster Than Their Global Competitors



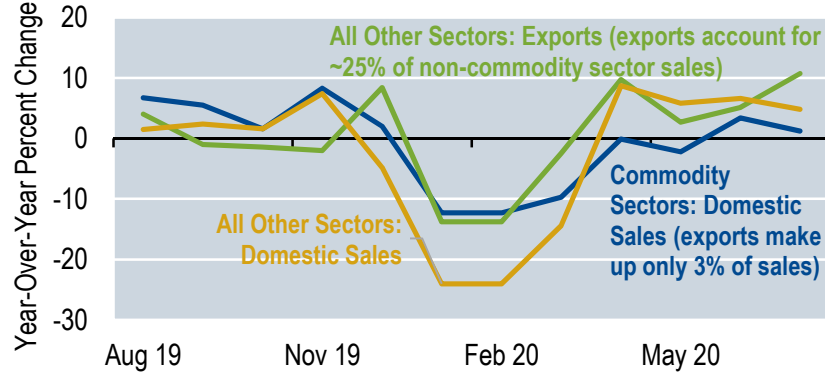
Source: Gavekal. As of 31 Aug 20

China's Consumption Has Lagged Other Major Economies



Source: Gavekal. As of 31 Aug 20

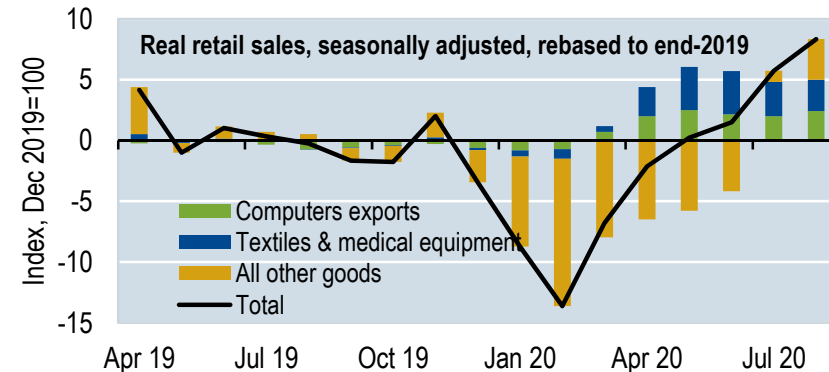
Exports Led the Industrial Sales Rebound & Continue to Be Strong



Source: Gavekal. As of 31 Jul 20

Note: Estimated Domestic & Export Sales By Industrial Sector Grouping

Narrow COVID-related Export Growth Has Now Shifted to Broader Strength



Source: Gavekal. As of 31 Aug 20

Our Current Thoughts on Japan's New PM Suga's Economic Policy (Suganomics)

More than Abenomics, rather than more Abenomics

Short-run

- Most likely market implication of Suga's economic policy
 - In the short run, we expect little impact on the markets due to continuity of macroeconomic policy
 - In the long run, however, Suga's reform-oriented policies might boost Japan's productivity and potential growth rate in the long run, suggesting higher equity prices and Yen's appreciation

Long-run

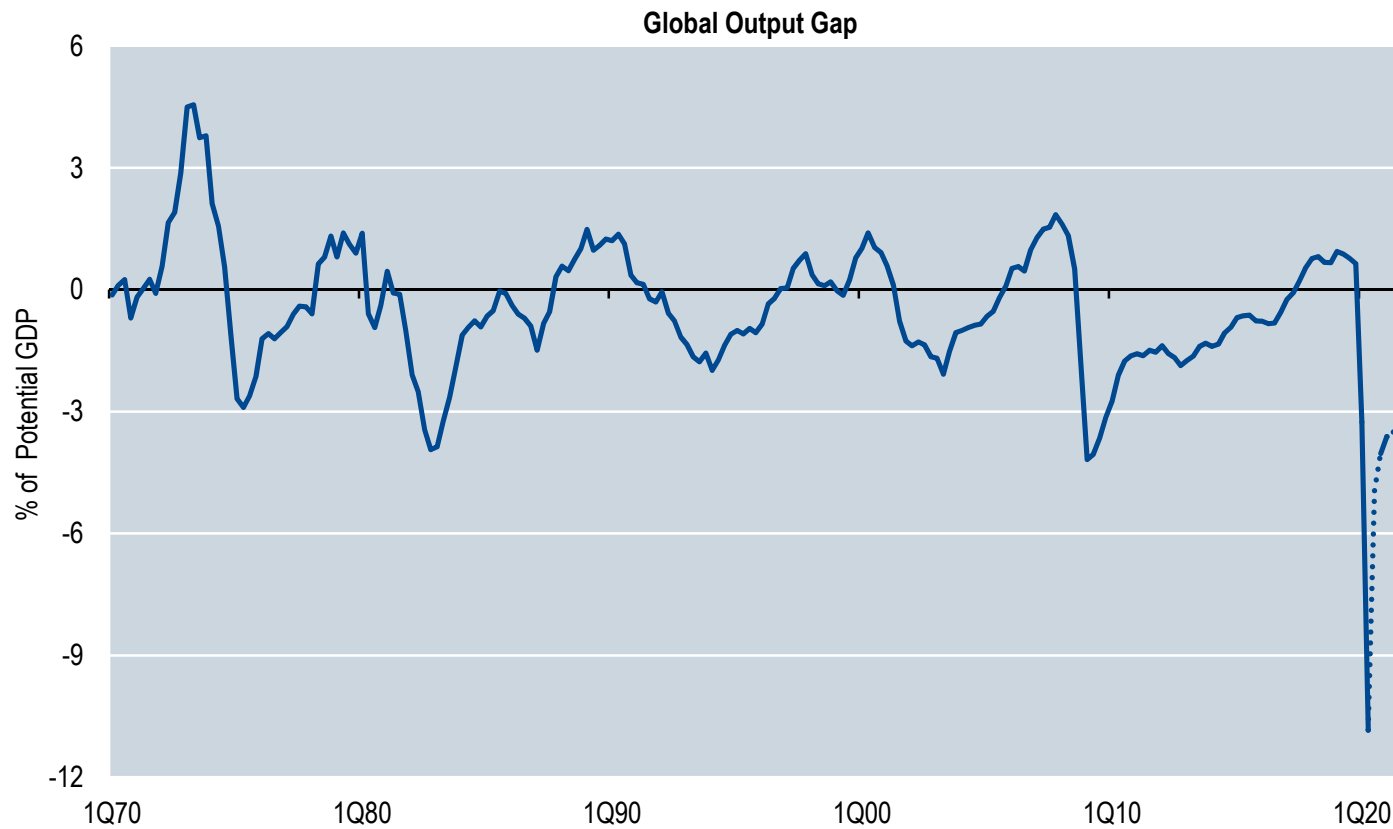
- The package of current monetary and fiscal policies (first and second arrows in Abenomics) will be maintained in principle.
 - Abe had never seriously implemented the third arrow, that is growth strategy with structural reforms
- PM Suga clearly prioritizes the third arrow. Following are his key focus:
 - Regulatory reform
 - Digitalization, including the establishment of a new Digital Agency
 - Lower mobile phone charges
 - Realignment of SMEs (Small and medium-sized enterprises) and efforts to make them more competitive
 - Regional bank realignment
 - Diversification of production bases (supply chain reconfiguration)
 - Integrated resort development
 - Insurance coverage for infertility treatment (as a means of slowing population decline)
- PM Suga is well known for a reform-oriented pragmatist with successful track records such as practically opening up labor markets to foreigners
- We are hopeful that Suganomics can potentially be a much greater success than Abenomics even though this can be a long procedure
- We see interesting contrast; overseas investors had greater hope than domestic investors with Abenomics while domestic investors has greater hope than overseas investors with Suganomics

Source: Western Asset. As of 05 Oct 20

The World Economy Faces a Protracted Period of Output Slack

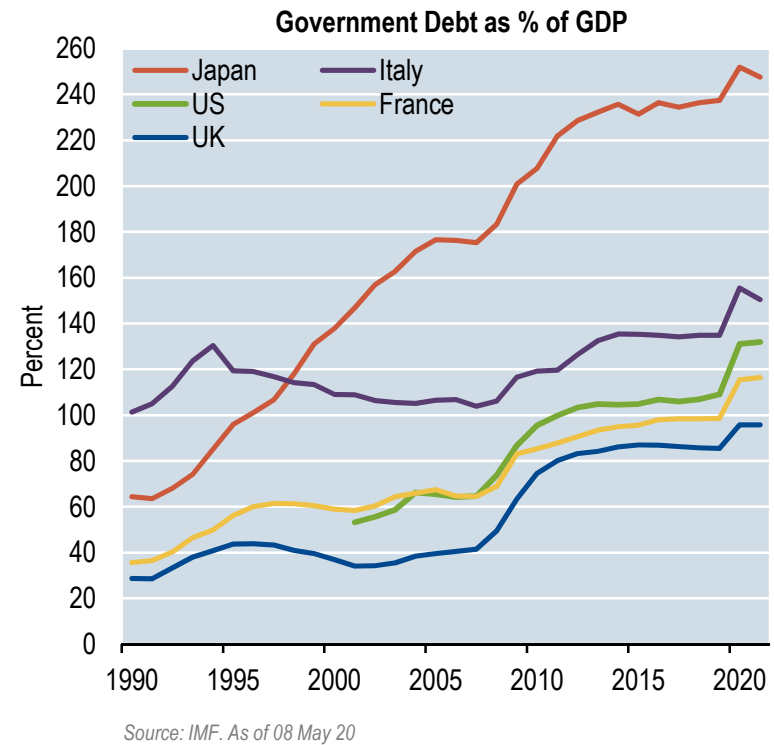
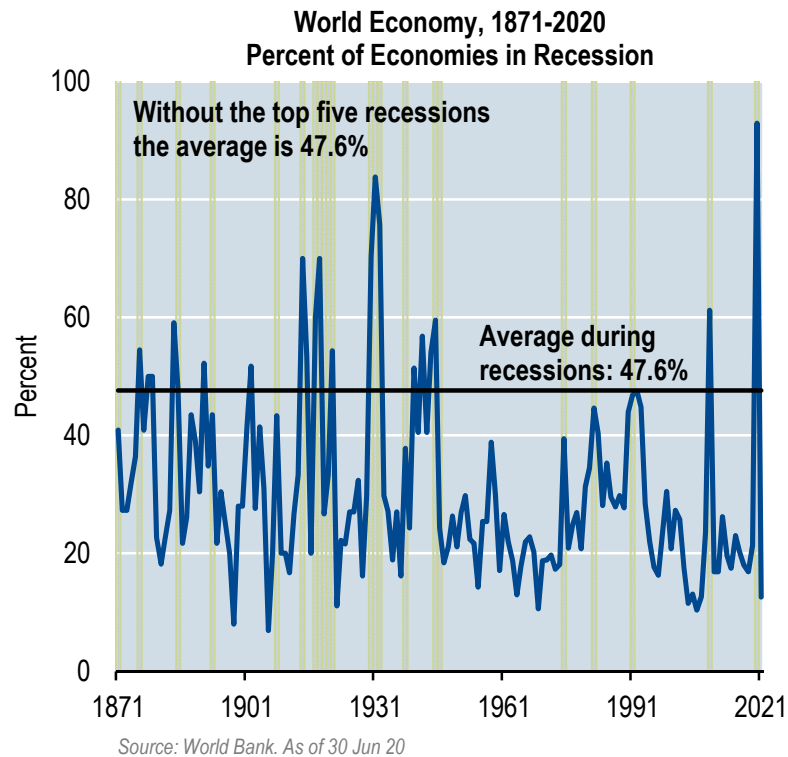
Resumption of activity to pre-COVID levels could take as long as two years

The fall-off in global aggregate demand is by far the steepest in recent history



Source: J.P. Morgan. As of 30 Sep 20

The Challenges of Widespread Global Slack & Debt Burdens Will Retard Future Growth



When it Rains it Pours

Last year's global growth storm clouds return

US-China trade and geopolitical tensions

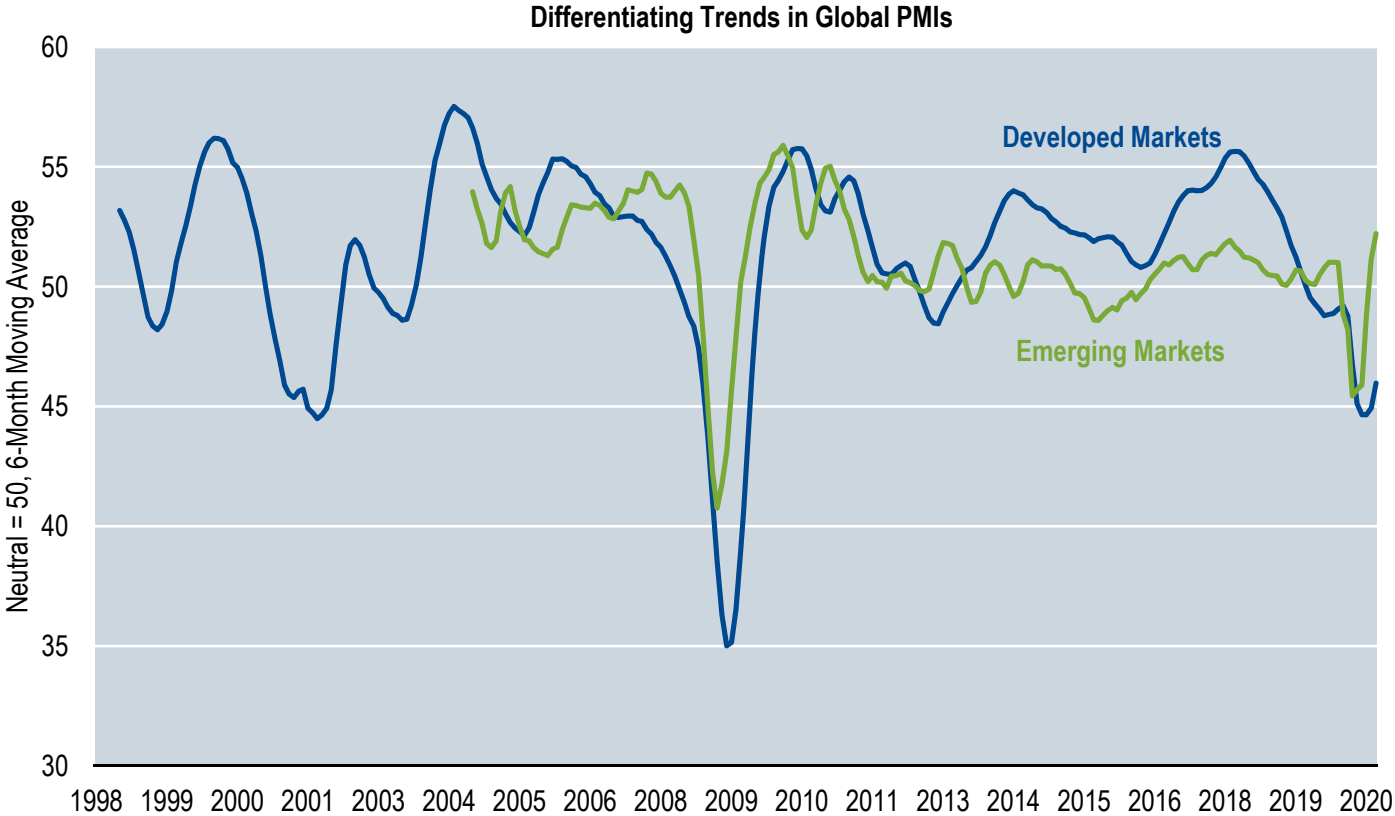
Brexit uncertainty

Russian sanctions and geopolitical tensions

Pace of Recovery to Consolidate Amid Persistent Uncertainties

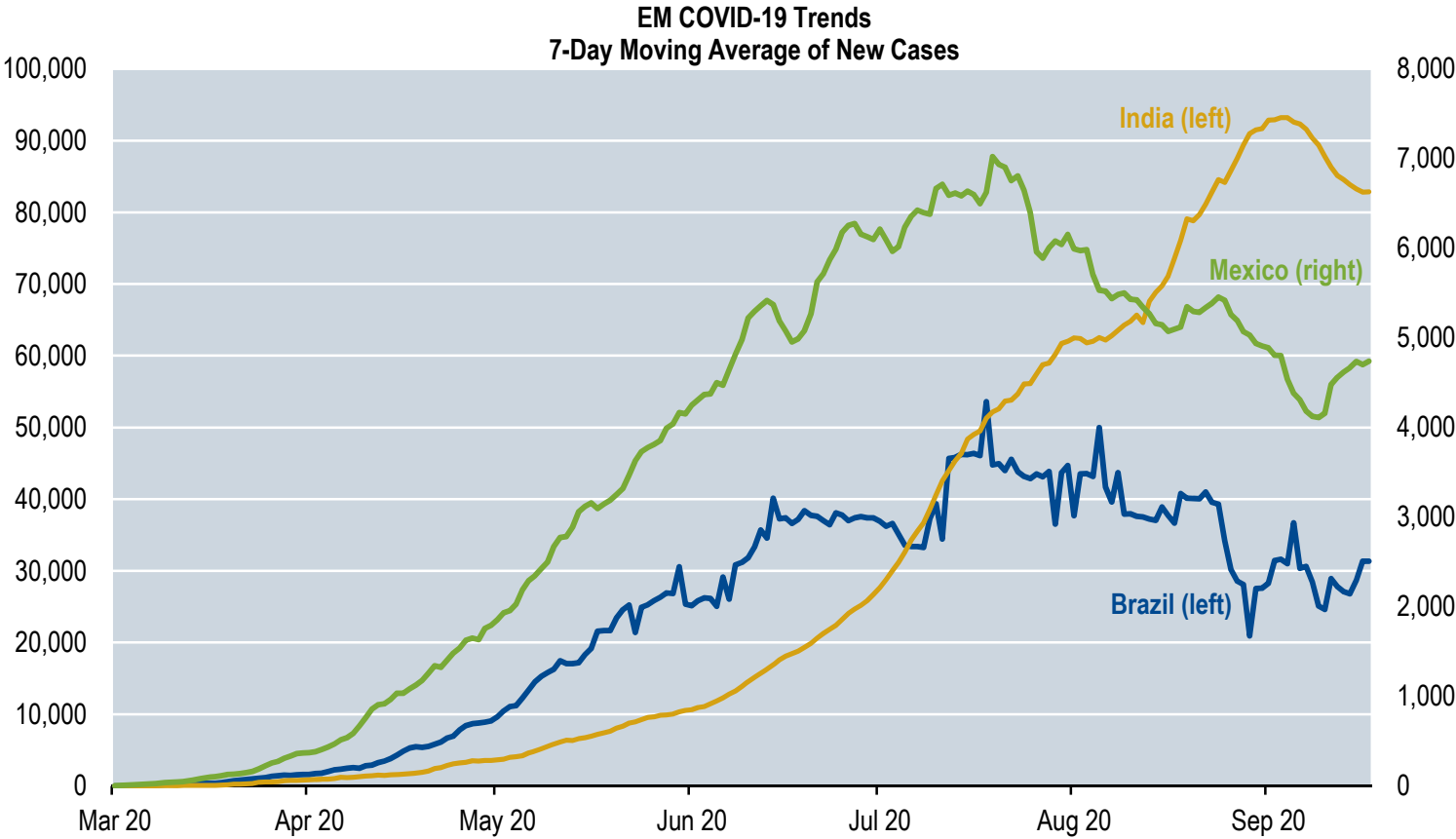
COVID-induced activity drag on developed markets continues to linger

EM PMIs upturn is narrowly based, notably China and North Asia



Source: Deutsche Bank. As of 30 Sep 20

COVID-19 Continues to Be an Immense Emerging Market Challenge



Source: Bloomberg, JP Morgan, www.worldometers.info, WA analysis. As of 30 Sep 20

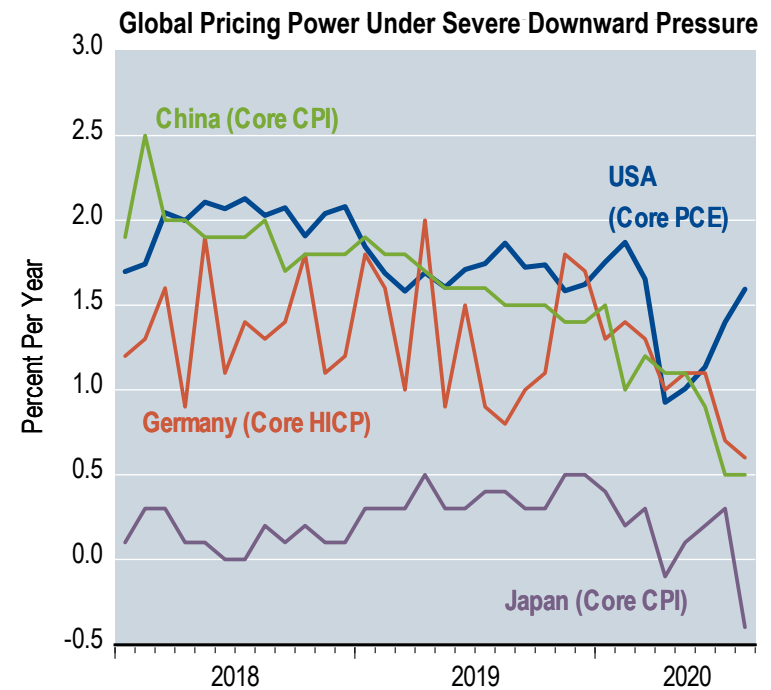
Market Confidence in Renewed Inflation May Be Misplaced

Breakeven Inflation Rates Near Beginning of the Year Levels

10-Year Breakeven Inflation (%)

	31 Dec 19	23 Mar 20	30 Sep 20
Australia	1.41	0.09	1.34
Canada	1.39	0.04	1.18
Germany	0.99	0.23	0.66
Japan	0.16	-0.15	-0.07
US	1.79	0.81	1.63

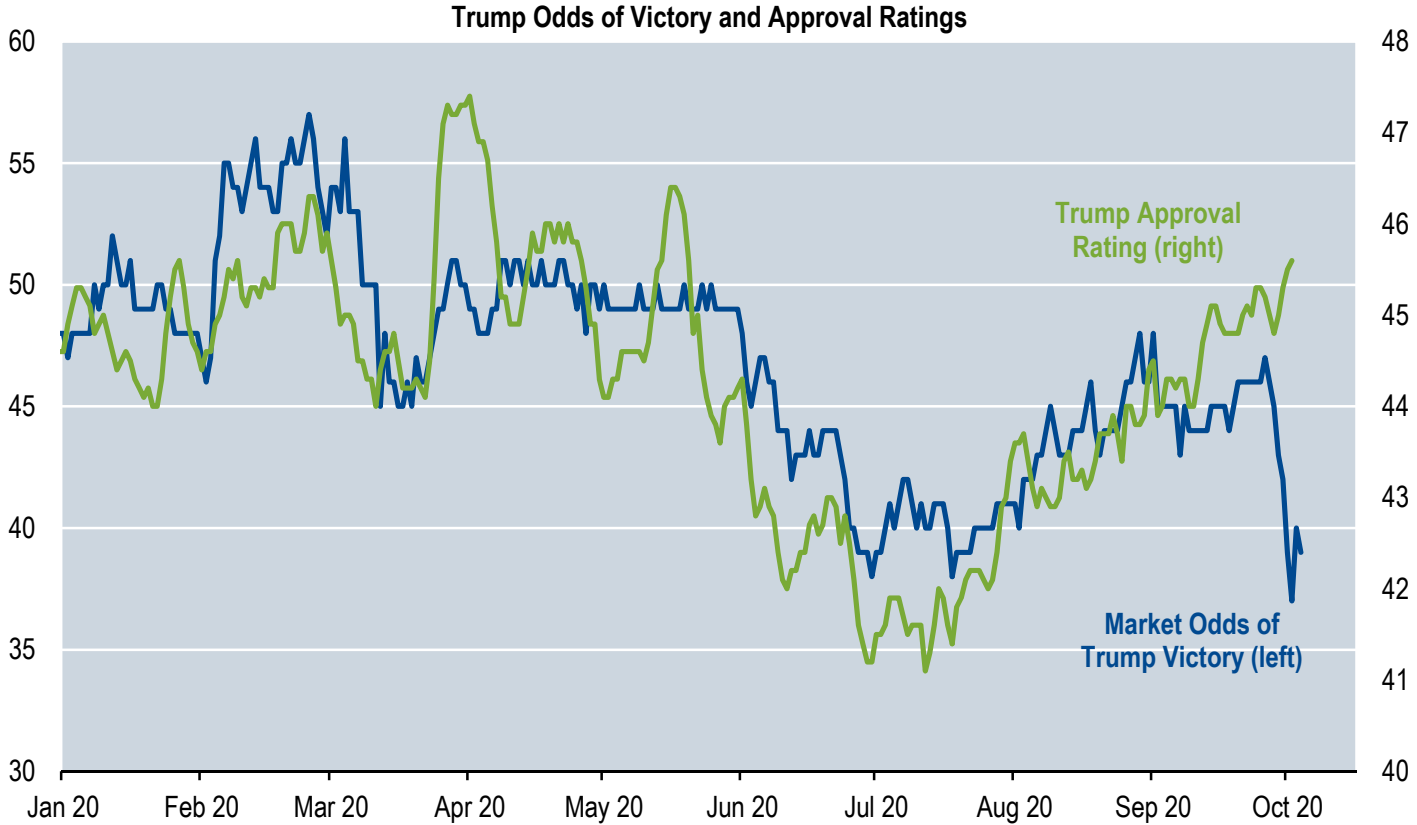
Source: Bloomberg. As of 30 Sep 20



Source: US Bureau of Economic Analysis, Bloomberg. As of 31 Aug 20

Note: Year-on-Year (12 Month) Change in Core Consumer Prices

Market Election Expectations Are Shifting Toward a “Blue Sweep”



Source: Predit, Real Clear Politics and Bloomberg. As of 05 Oct 20

Preliminary Election Thoughts on Possibility of a “Biden Sweep”

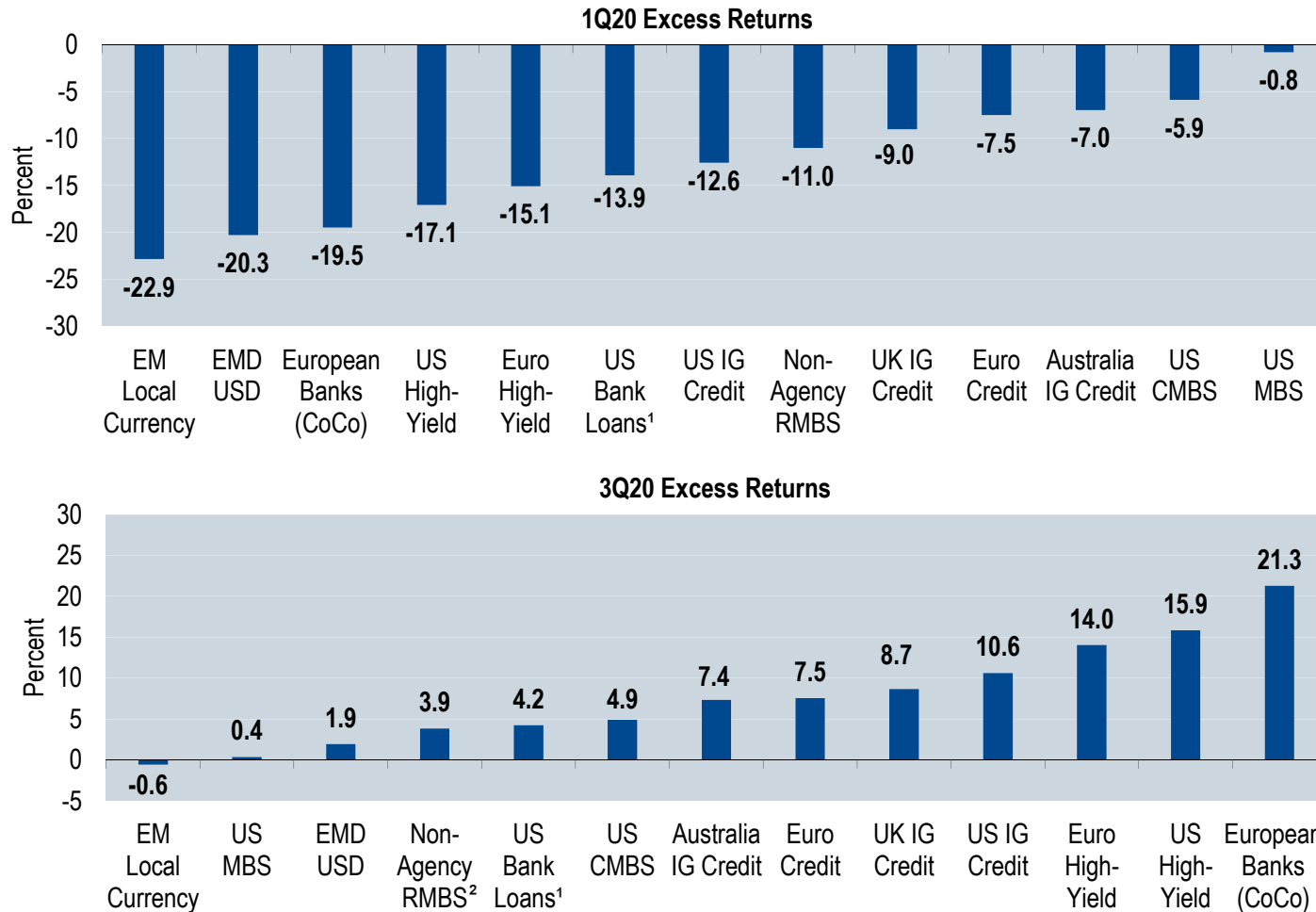
Expectation of much greater and sustained fiscal thrust

Monetary policy should remain very accommodative

- Cyclically, good for near-term growth
- Potentially negative for Treasuries and the dollar
- Reasonable expectation of re-regulation/higher corporate and personal income taxes
- More stable trade policy should help emerging markets
- Energy should face secular headwinds, but cyclically oil prices should improve

A Tale of Two Markets

Spread Sector Excess Returns – 1Q20 vs. 3Q20

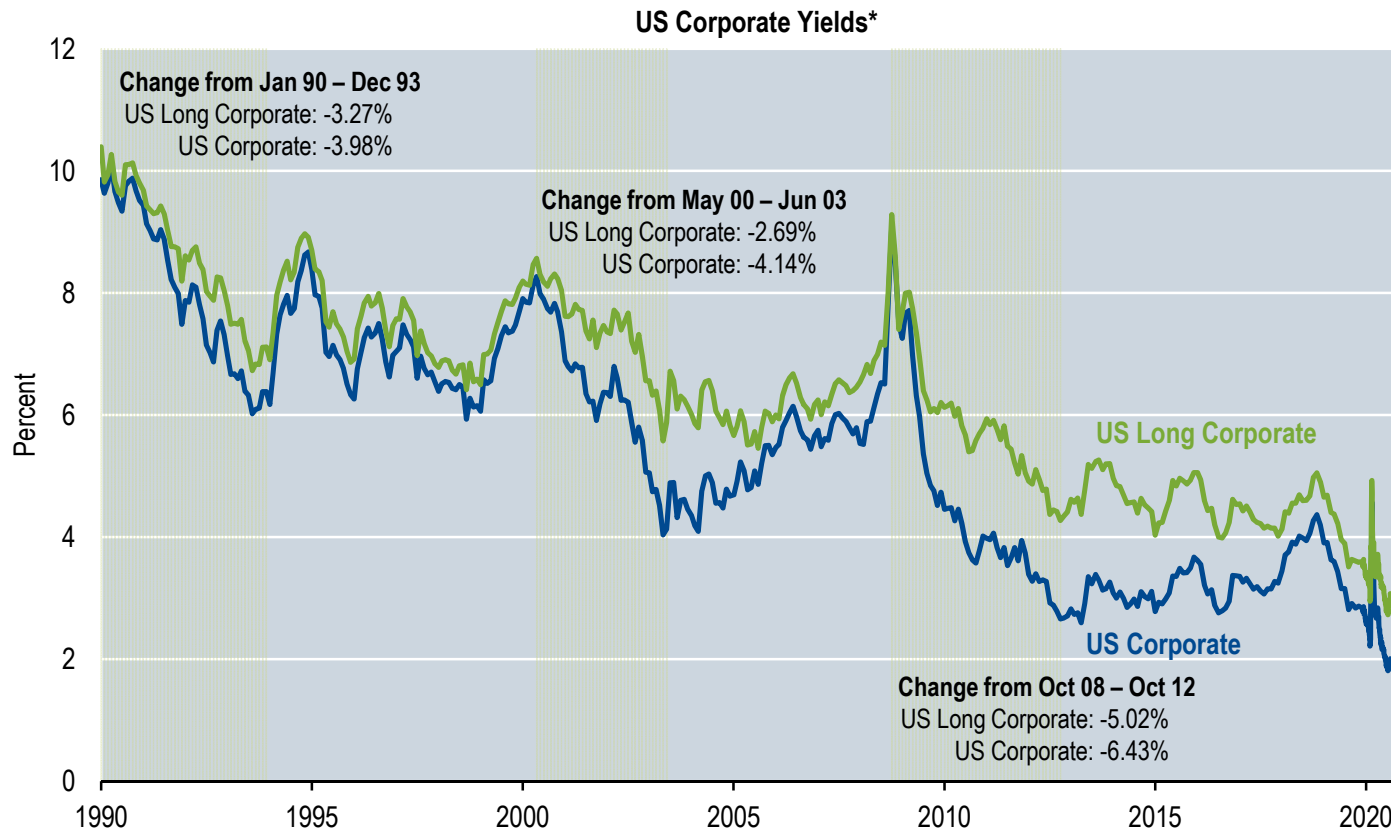


Source: Bloomberg Barclays, J.P. Morgan, S&P Global Market Intelligence, a division of S&P Global Inc, Western Asset

¹S&P/LSTA Performing Loans Index excess return vs. 3-Month LIBOR

²Non-Agency RMBS returns for 3Q20 are preliminary

In Every Post-War Recession — Investment-Grade Yields Have Declined



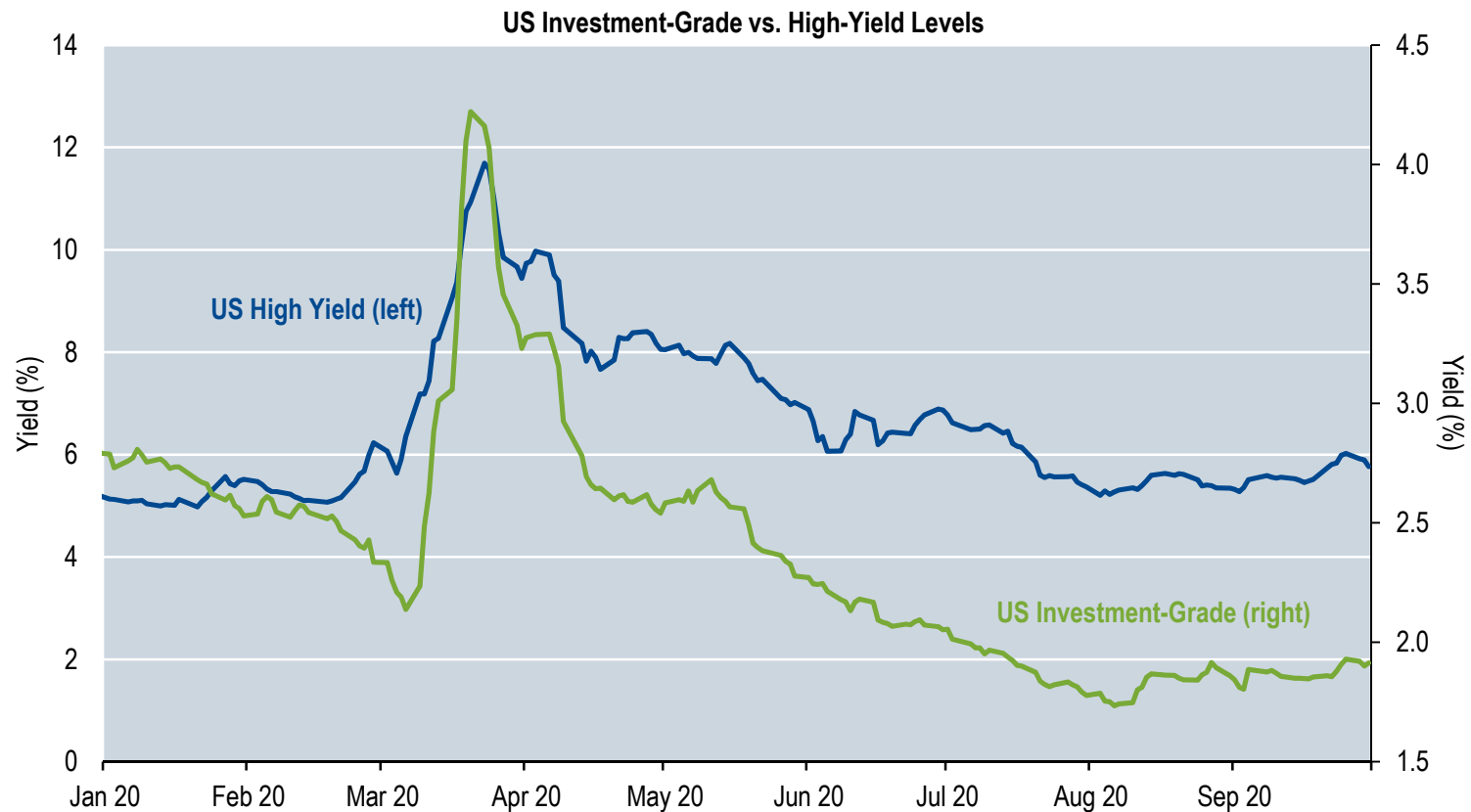
Source: Bloomberg Barclays. As of 30 Sep 20

*Represented by Bloomberg Barclays U.S. Corporate Investment Grade and Bloomberg Barclays Long U.S. Corporate Investment Grade indices

Investment-Grade as “Cornerstone Investment”

“The pace of purchases is based upon an array of measures of corporate bond market functioning ... If these measures indicate sustained improvement **to levels at or near those prevailing prior to the COVID-19 dislocation**, SMCCF purchases are expected to slow notably and, in some cases, could pause entirely. If those measures subsequently indicate a deterioration in market functioning, however, SMCCF purchases would be expected to increase.”

– NY Federal Reserve, Corporate Credit Market Facility FAQ, June 29, 2020



Source: Bloomberg Barclays. As of 30 Sep 20

Corporates Acting Conservatively: Tendering and Extending Debt

Notable Tenders

Date	Ticker	Name	Sector	Rating	Maturity Range	MMs
13 Apr 20	GE	GE Capital Intl Funding	Finance Companies	BBB	*20s	5,500
13 Apr 20	GE	General Electric Co	Diversified Manufacturing	BBB	*20s-24s	4,200
04 May 20	KHC	Kraft Heinz Foods Co	Food/Beverage	BB+	21s-26s	2,100
06 May 20	GE	General Electric Co	Diversified Manufacturing	BBB	*21s-23s	4,400
07 May 20	DISCA	Discovery Communications	Media Entertainment	BBB-	21s-23s	1,500
11 May 20	LLOYDS	Lloyds Bank Plc	Banking	A-	*20s-25s	2,100
12 May 20	VIAC	ViacomCBS Inc	Media Entertainment	BBB	21-23s and hybrids	1,500
28 May 20	HSBC	HSBC Holdings PLC	Banking	A	21s	3,400
10 Jun 20	ACGCAP	Aviation Capital Group LLC	Finance Companies	BBB-	20s	205
17 Jun 20	SLB	Schlumberger Investment SA	Oil Field Services	A	21s	935
25 Jun 20	ABIBB	Anheuser-Busch InBev SA/NV	Food/Beverage	BBB+	21s and 23s	3,000
25 Jun 20	OXY	Occidental Petroleum Corp	Independent	BB	21s-22s	2,000
13 Jul 20	AER	AerCap Ireland Cap/Global	Finance Companies	BBB-	21s	1,500
13 Jul 20	FCX	Freeport-McMoRan Inc	Metals and Mining	BB	22s-24s	1,300
27 Jul 20	T	AT&T Inc	Wirelines	BBB	21s-25s	6,000
03 Aug 20	APA	Apache Corp	Independent	BB+	across the curve	635
11 Aug 20	HSBC	HSBC Holdings PLC	Banking	A	21s and 22s	3,300
12 Aug 20	CVS	CVS Health Corp	Healthcare	BBB	23s and 25s	6,000
12 Aug 20	OXY	Occidental Petroleum Corp	Independent	BB	21s-23s	2,100
02 Sep 20	BHP	BHP Billiton Finance USA Ltd	Metals and Mining	BBB+	Hybrids	**1,900
08 Sep 20	AALLN	Anglo American Capital PLC	Metals and Mining	BBB	22s	**600
08 Sep 20	SFD	Smithfield Food Inc	Food/Beverage	BBB-	21s-22s	**800
08 Sep 20	ABIBB	Anheuser-Busch InBev SA/NV	Food/Beverage	BBB+	*24s-25s	2,100
08 Sep 20	ADM	Archer-Daniels-Midland Co	Food/Beverage	A	27s-97s	**600
14 Sep 20	JPM	JPMorgan Chase & Co	Banking	A	21-22s	6,810
14 Sep 20	KO	Coca-Cola Co/The	Food/Beverage	A+	*21s-50s	3,600
14 Sep 20	NWG	Natwest Group PLC	Banking	BBB-	22-23s & pref/T1	2,000
15 Sep 20	HSBC	HSBC Holdings PLC	Banking	A	21s and 22s	1,700
22 Sep 20	BATSLN	BAT Capital Corp	Tobacco	BBB	*21s-22s	**2,000
23 Sep 20	TGT	Target Corp	Retailers	A-	28s-46s	**1,750
23 Sep 20	AER	AerCap Ireland Cap/Global	Finance Companies	BBB-	21-22s	**1,500
					Total:	77,035

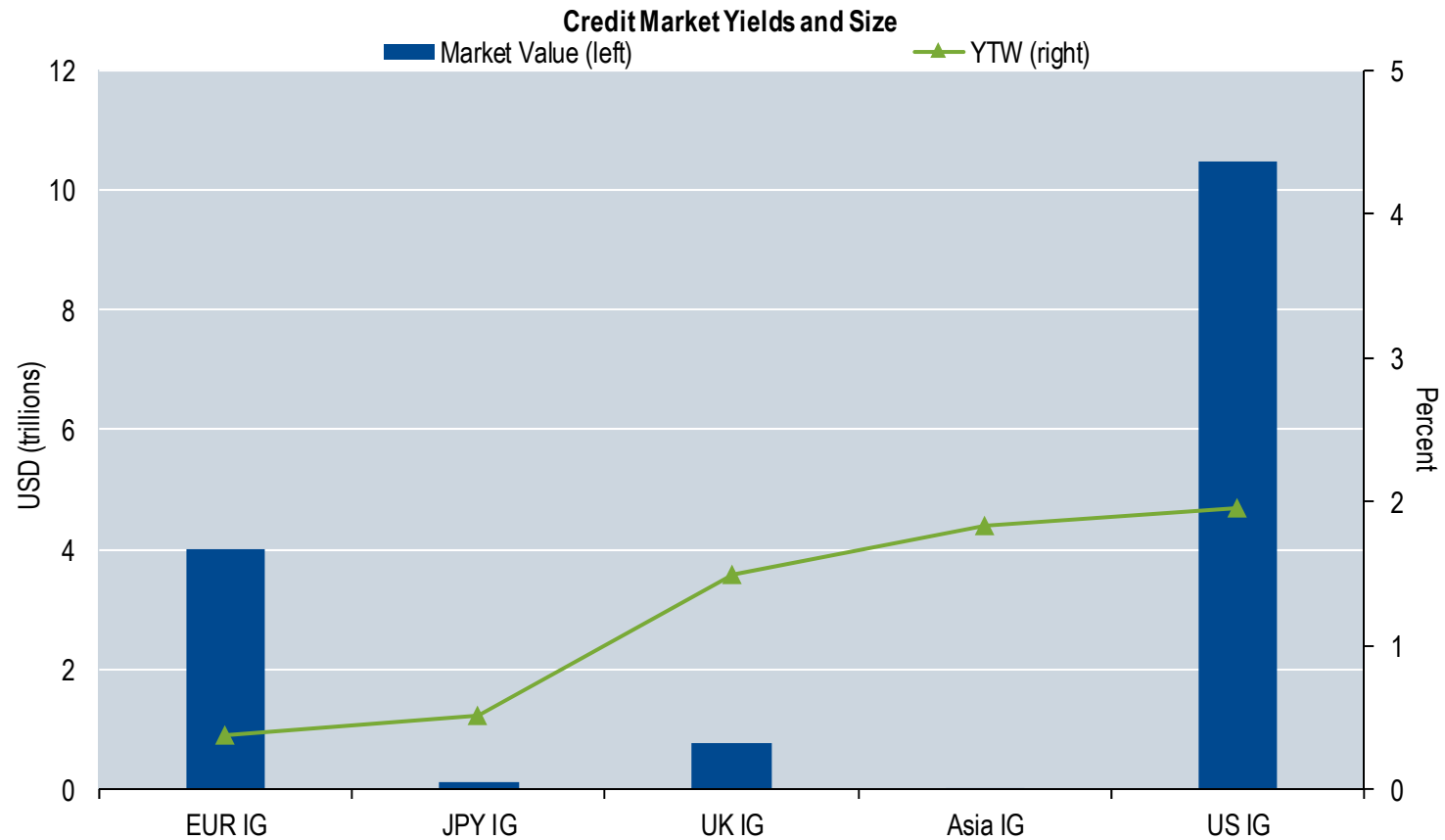
*Multi-currency

**Announced only

Source: Bloomberg. As of 30 Sep 20

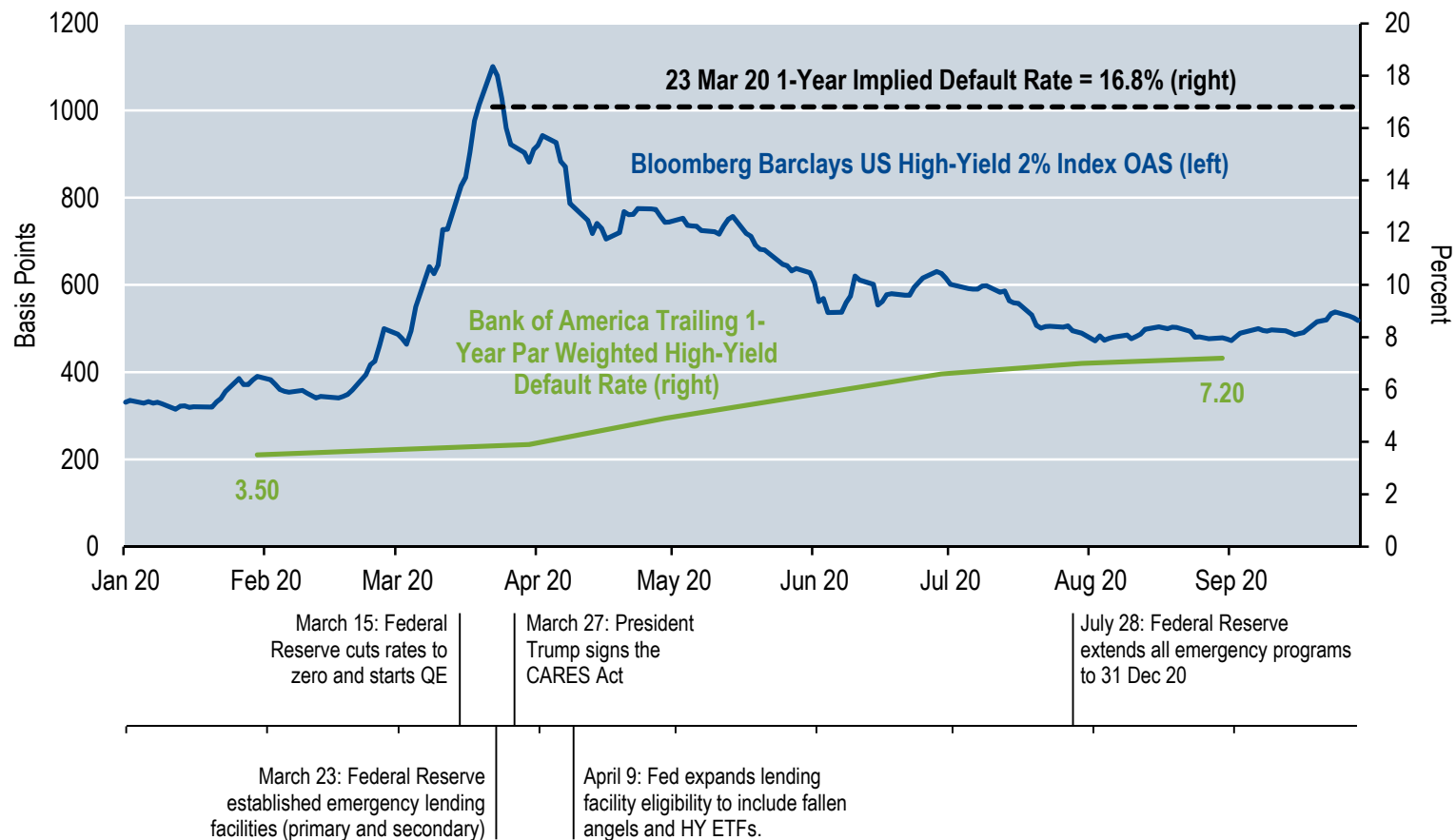
US Credit Markets Offer Both Attractive Yield and Size

Relative to other mature markets, US credit markets are attractive to a global investor.



Source: Bloomberg Barclays. As of 30 Sep 20
Barclays Global Credit Index by Currency

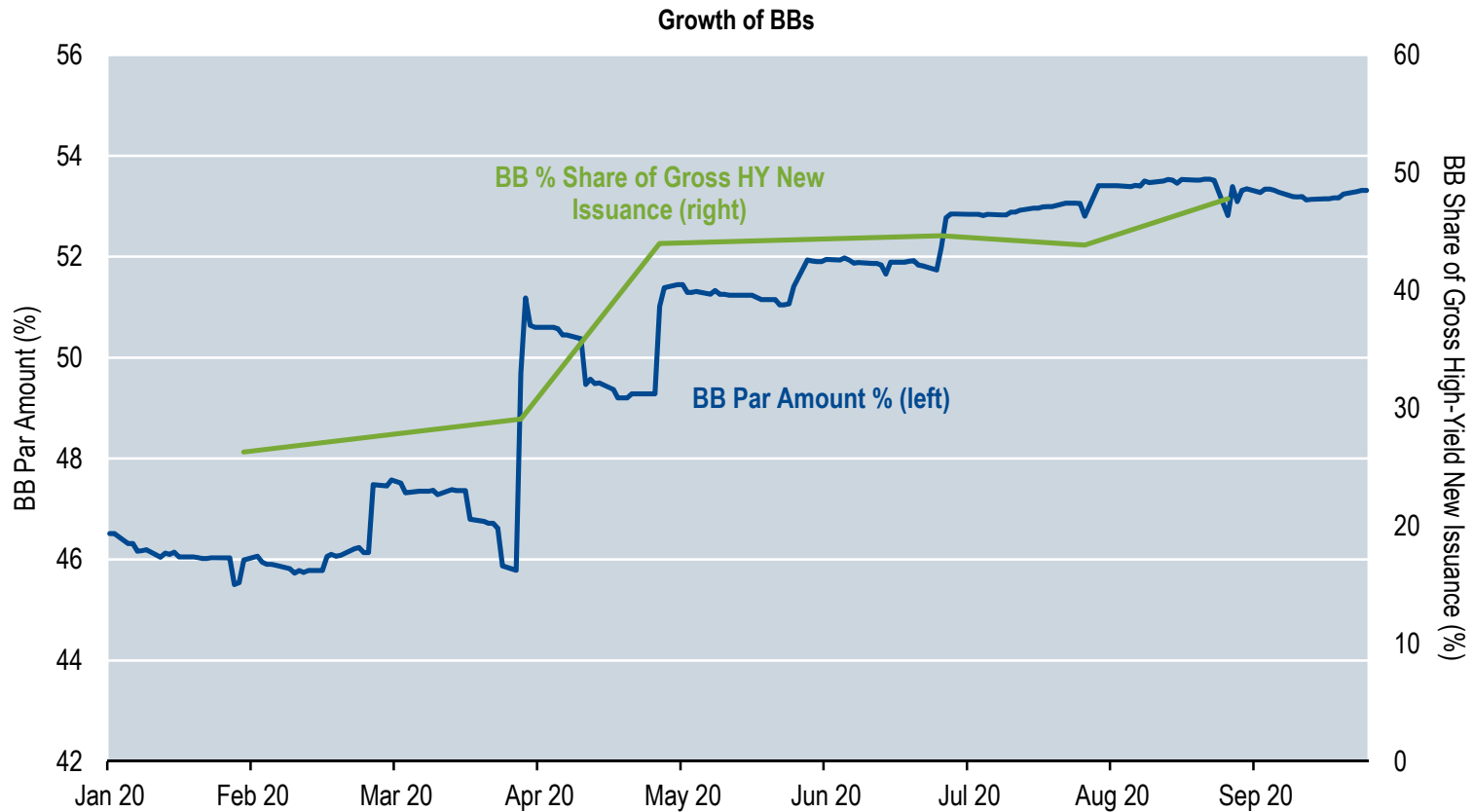
Today's High-Yield Valuations Better Reflect Market Expectations



Source: Bloomberg Barclays, Moody's, Western Asset. As of 30 Sep 20

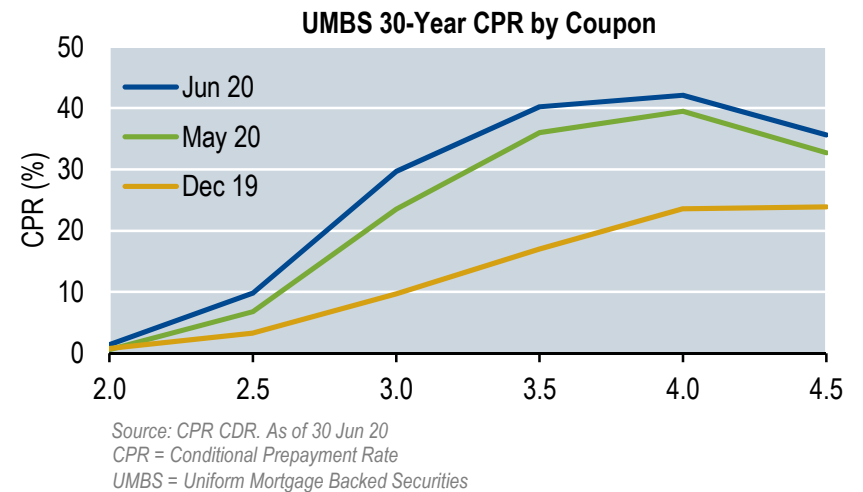
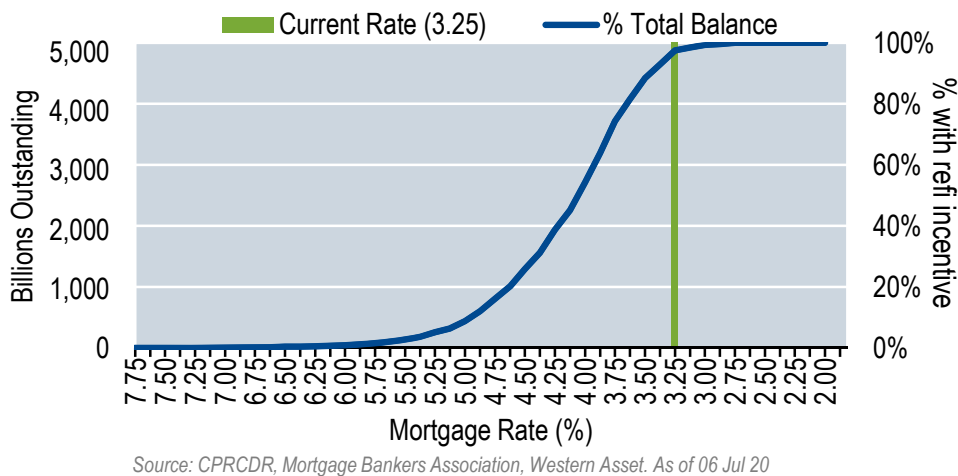
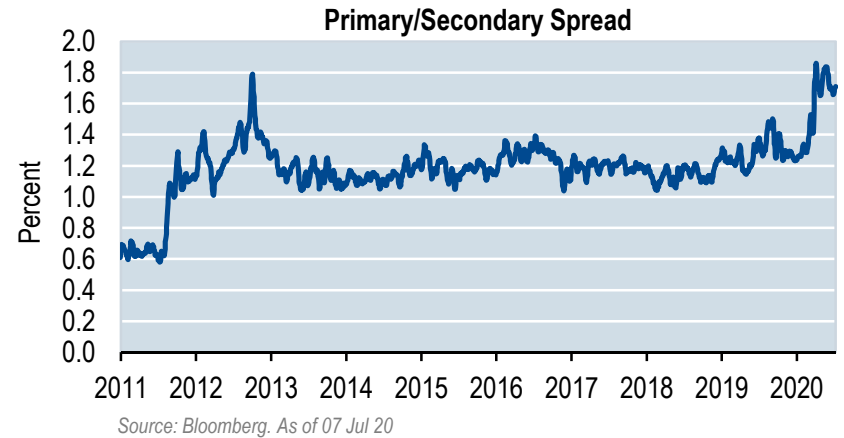
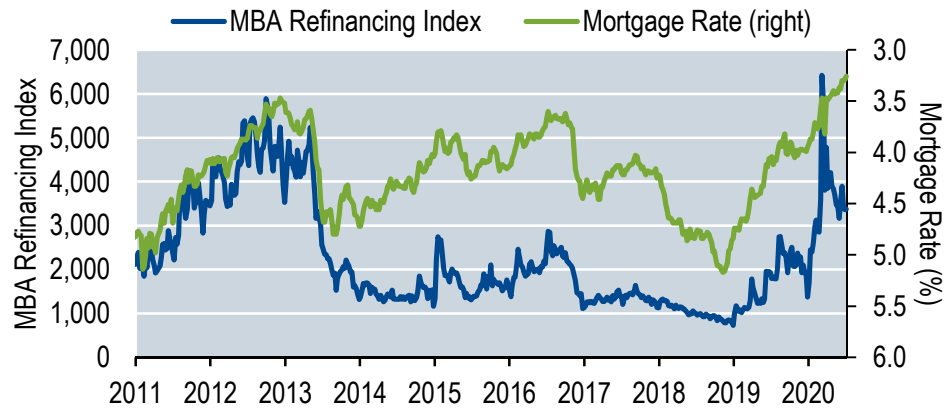
The High-Yield Asset Class is Now Higher-Quality and More Liquid

Growth of BBs Measured by Par Value



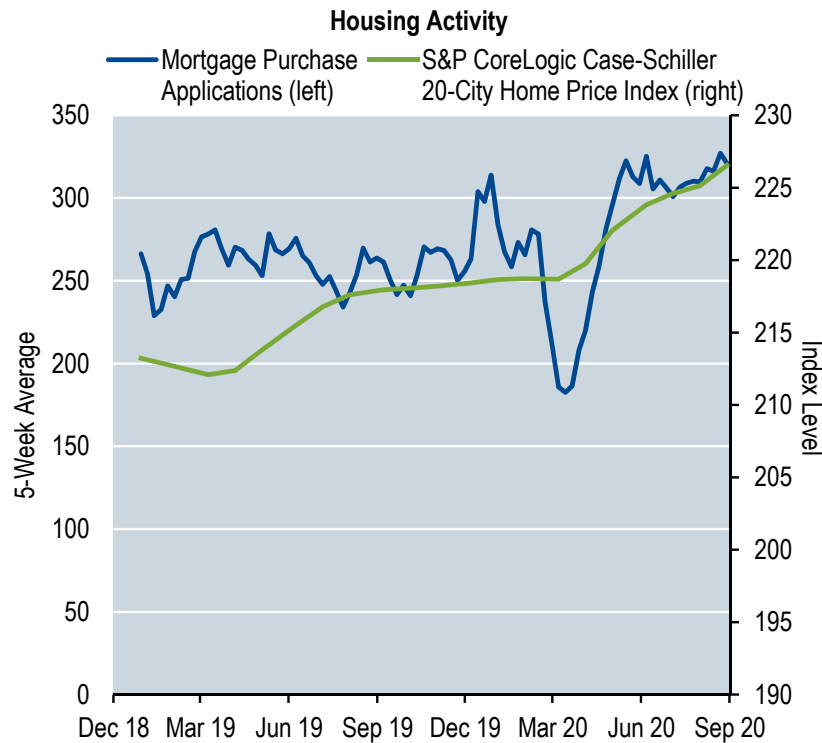
Source: Bloomberg Barclays. As of 30 Sep 20

Prepayment Risk Is Accelerating

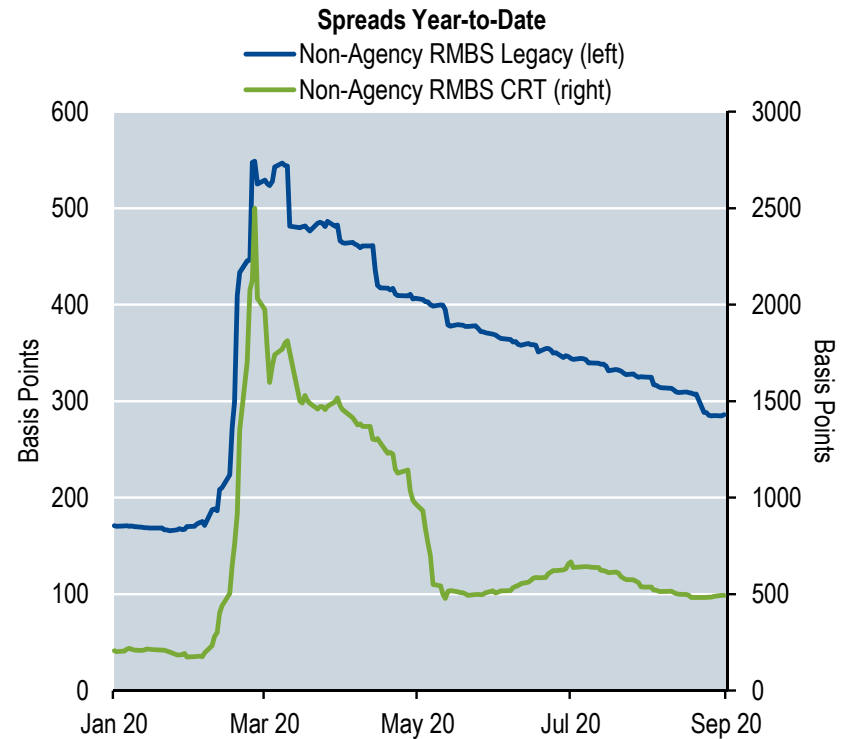


Housing Market Recovery Path

Housing has experienced a V-shaped recovery but credit spreads have lagged due to continued uncertainty and less direct Fed intervention.

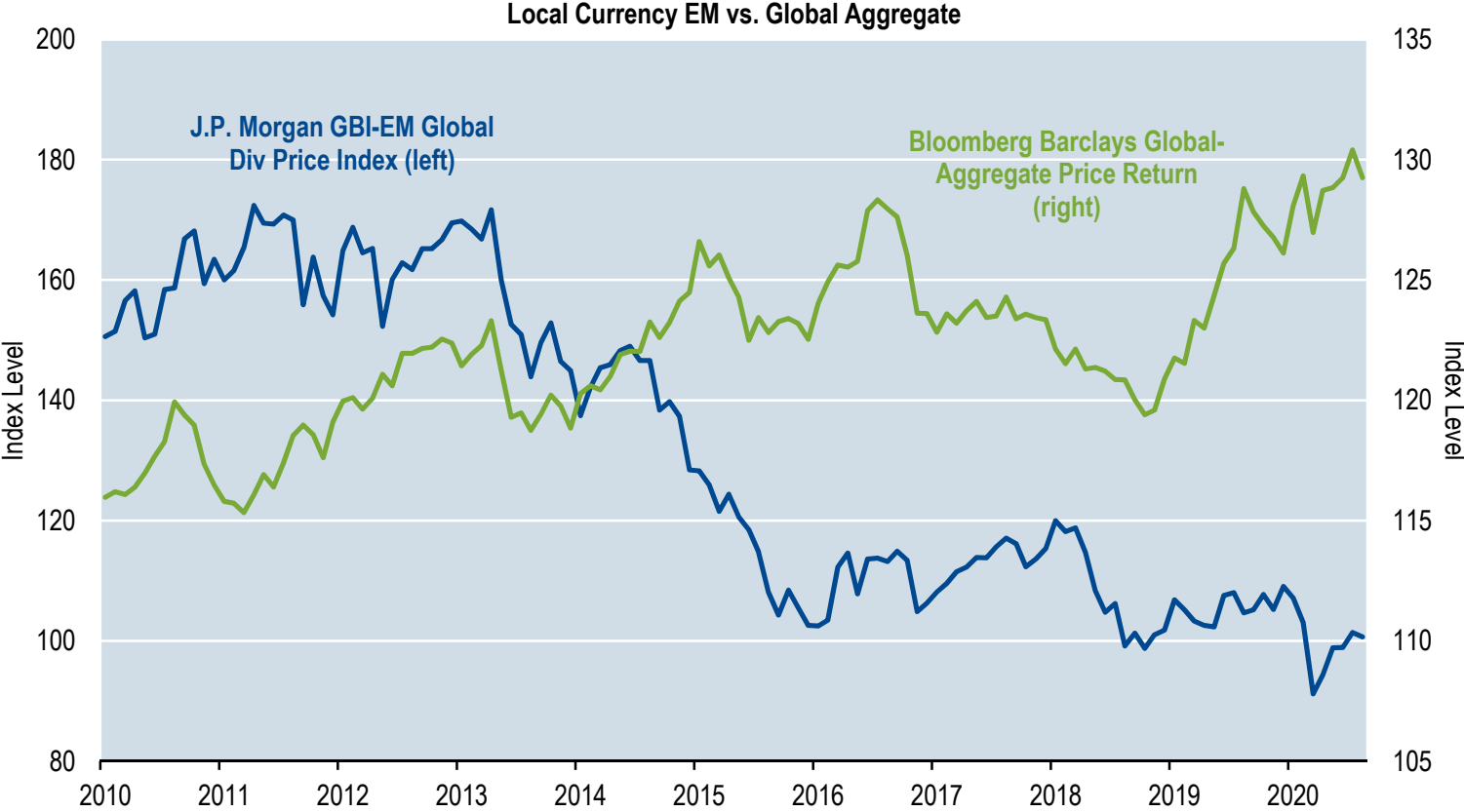


Source: Bloomberg, MBA, S&P CoreLogic Case-Schiller. As of 25 Sep 20



Source: Bloomberg Barclays, J.P. Morgan. As of 29 Sep 20

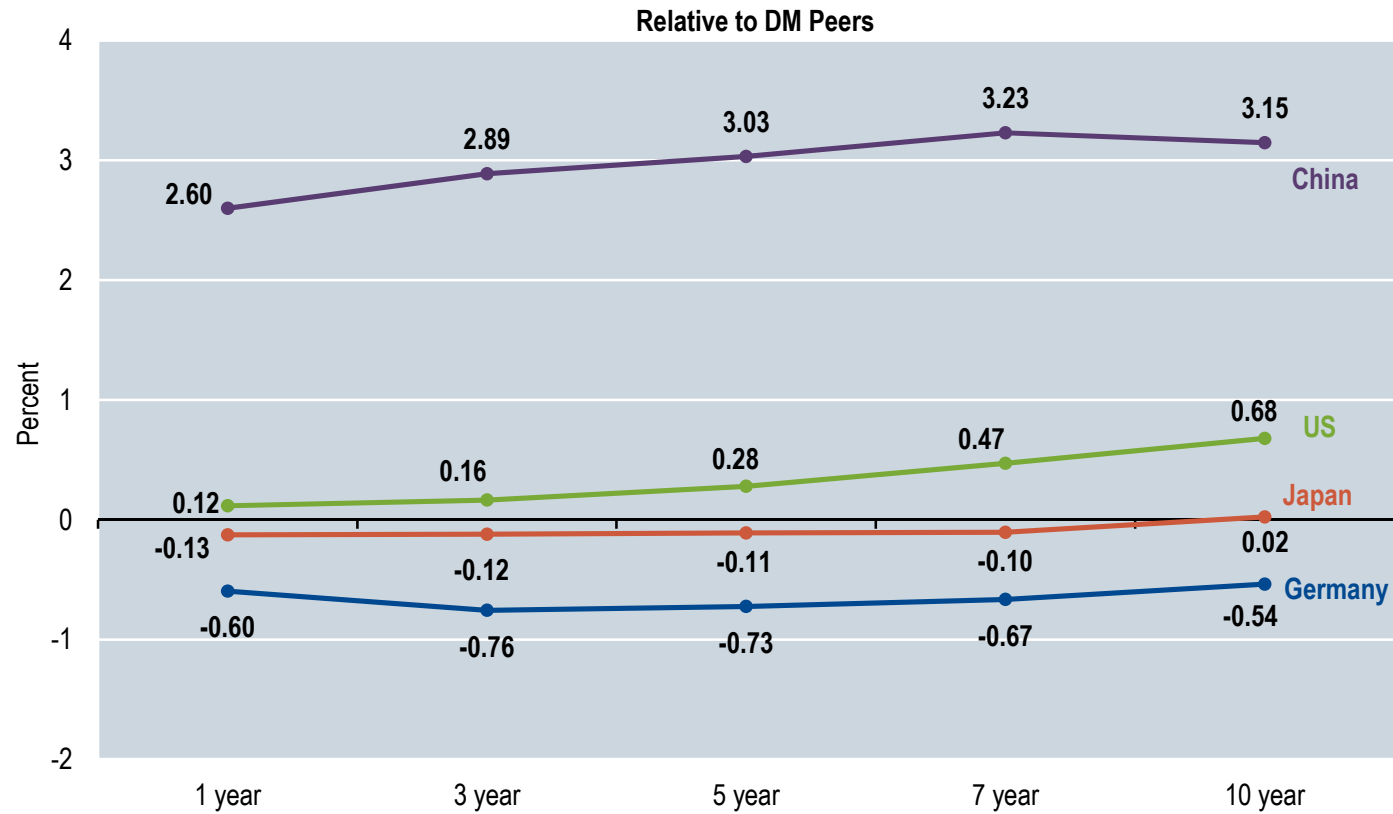
Local Currency Emerging Market Debt Prices Are Very Distressed



Source: Bloomberg Barclays, J.P. Morgan. As of 31 Aug 20



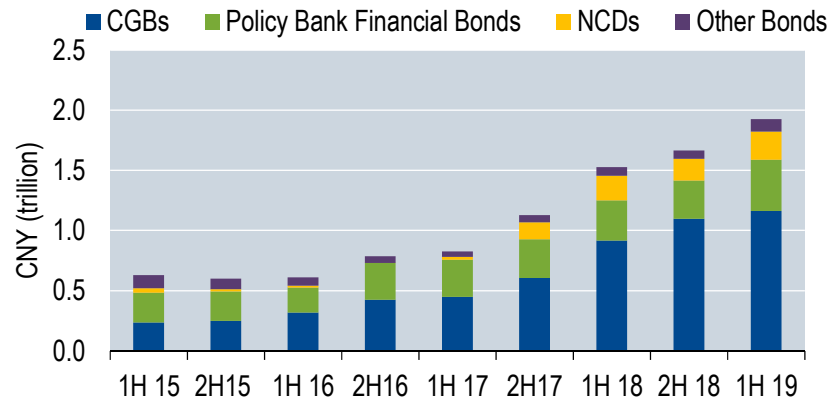
China Local Onshore Bonds Offer Attractive Valuations



Source: Bloomberg. As of 30 Sep 20

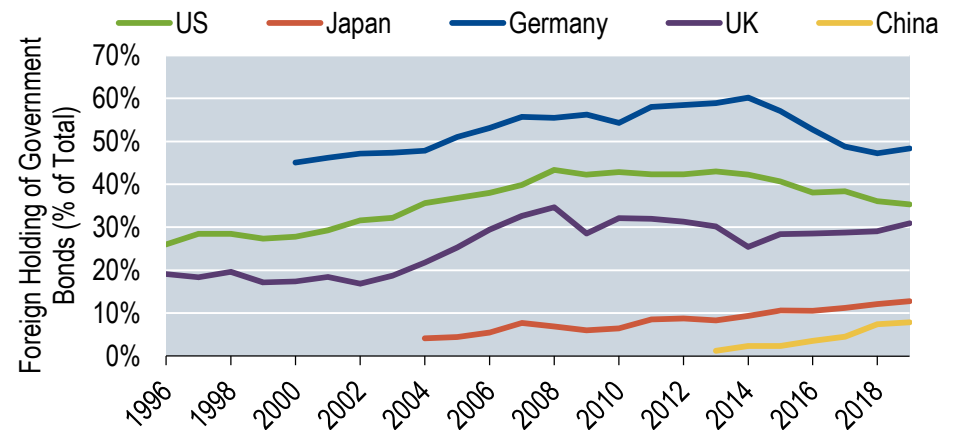
China Onshore Bond Market: Room For Foreign Ownership to Grow

Foreign Ownership in China Onshore Bonds Reaches CNY 1.9 trillion (USD 280 billion)



Source: Western Asset, Bloomberg, As of 22 May 19

But It Remains Low, Compared to Other Major Economies



Source: Standard Chartered, As of 31 Dec 19

It Provides Diversification Within a Global Bond Portfolio

5-Year Correlation of China Government Bonds

	China	Global Treasury	US	UK	Japan	EM
China	1.00	0.40	0.20	0.31	0.24	0.50
Global Treasury		1.00	0.58	0.42	0.86	0.66
US			1.00	0.21	0.49	0.21
UK				1.00	0.12	0.32
Japan					1.00	0.43
EM						1.00

Source: Western Asset, Bloomberg, As of 31 Jan 19

4th Quarter 2020 – 2021 Outlook

The Road Ahead Will Be a Long Hard Slog

Coronavirus-related growth setbacks have meaningfully reduced global and US growth

Incipient global recovery appears to be gaining traction

The medical battle will take time and prolonged efforts; recent developments are encouraging

US and global inflation rates are expected to be very subdued

Central banks will need to remain extraordinarily accommodative

Fiscal policy will have to remain very supportive

Even after recovery begins, central banks are expected to keep rates ultra low

Spread products ultimately should be beneficiaries of recovery

The timing and slope of eventual recovery remains the largest uncertainty

As of 05 Oct 20. Outlook concerning financial market trends are based on current market conditions, which will fluctuate

Questions & Answers



Thank you.

Risk Disclosure

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