



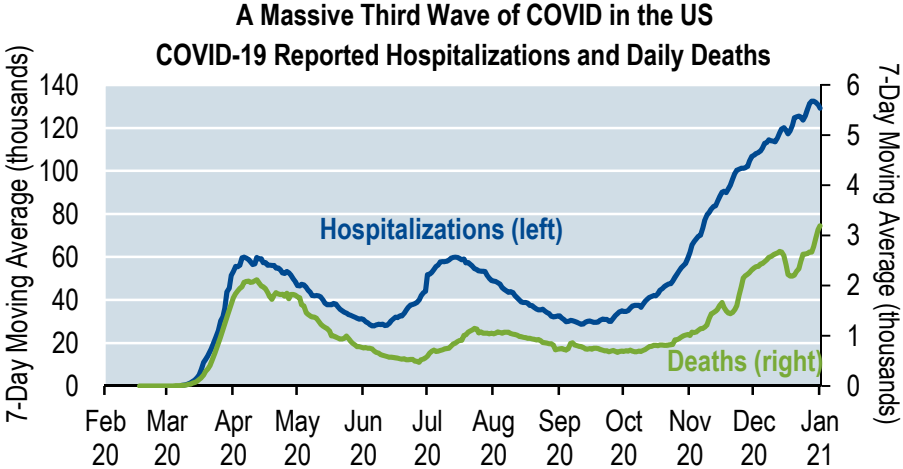
1Q21 Market and Strategy Update

January 14, 2021

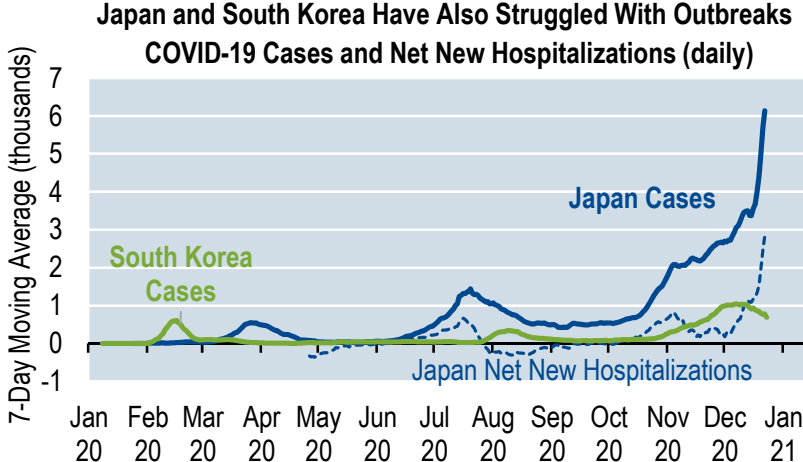
Ken Leech
Chief Investment Officer

I'd like to cancel my
subscription to 2021.
I've experienced the free
7-day trial and I'm not
interested.

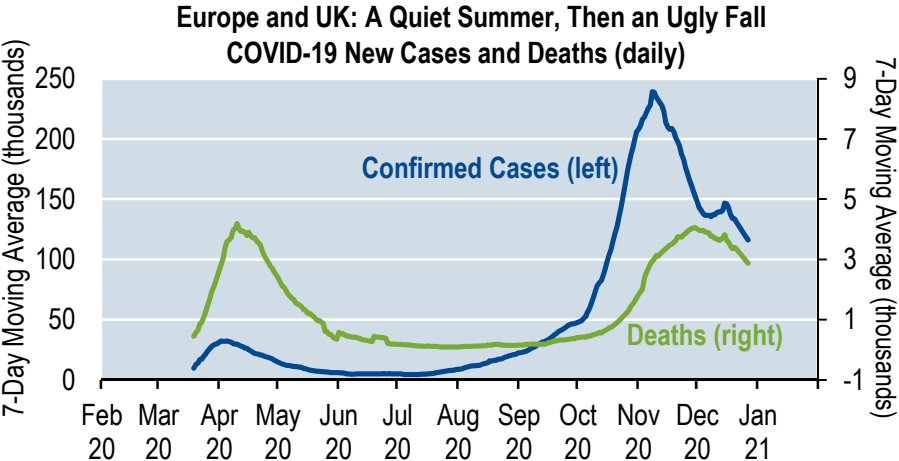
Darkness: The Winter COVID-19 Wave Has Been Severe and Is Not Over



Source: Gavekal. As of 10 Jan 21



Source: Gavekal. As of 11 Jan 21



Source: Gavekal. As of 27 Dec 20

COVID-19

Humanity will win this war, although it is losing the current battle

Cases surging everywhere

- US, UK and South Africa amongst places of greatest concern

Virus is evolving and has spawned new, more infectious variants first detected in the UK and South Africa

- Existing vaccines are effective against the new variants

Vaccine supply exceeds vaccine administration

- Vaccine administration will improve; it is easier to get that right than creating the vaccine

Vaccine supply increasing

- In addition to the mRNA vaccines other efforts are producing vaccines
- Sinovac 78% Effective 600 Million doses in 2021 Can be stored in refrigerator
- AstraZeneca 60% Effective 3 billion doses in 2021 Can be stored in refrigerator

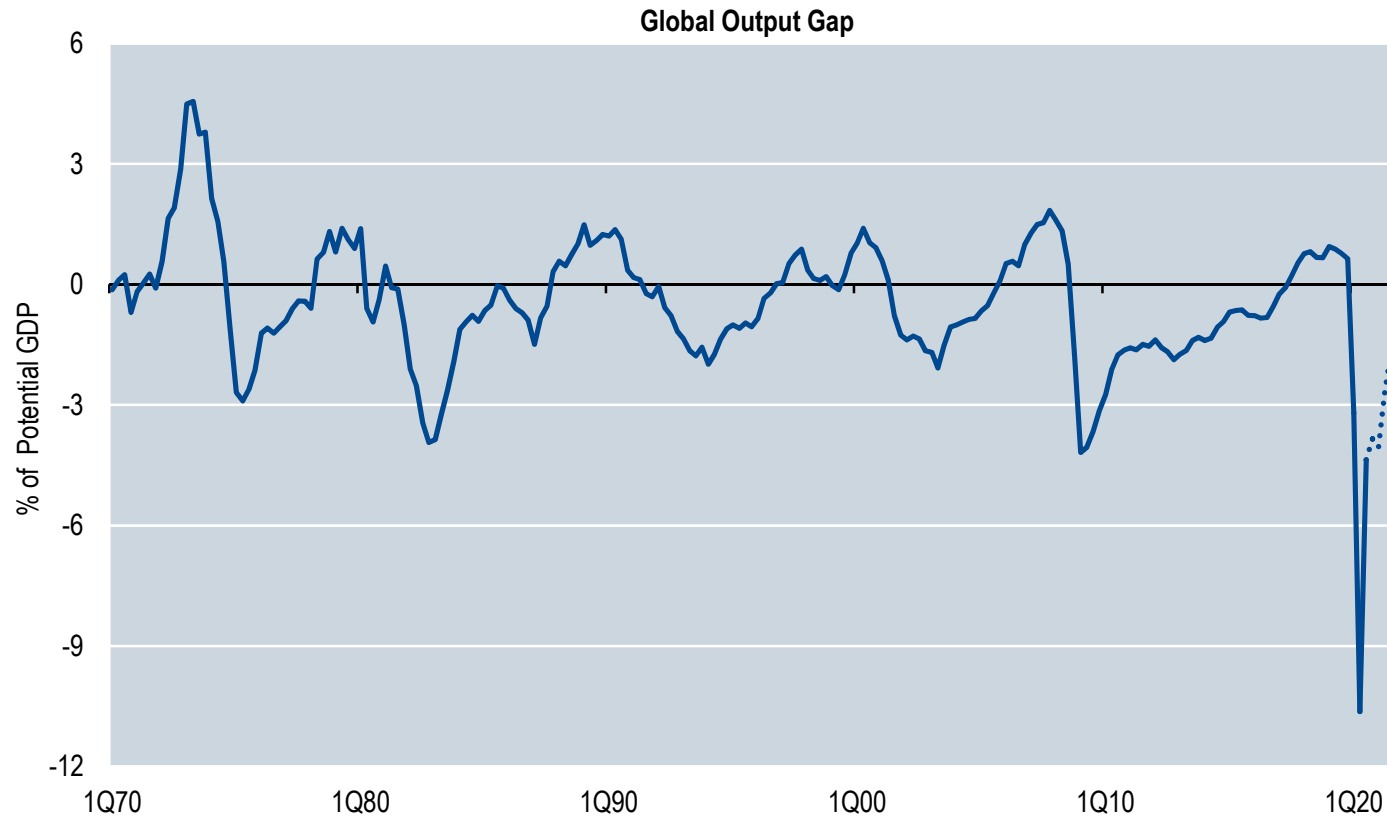
Vaccines are proving to be safe and effective

- mRNA “Gold Standard” vaccines; cause severe side effects in only 0.001% of injections; has a 95% efficacy rate

The Global Economy Is Gaining Traction But Faces a Protracted Period of Output Slack

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

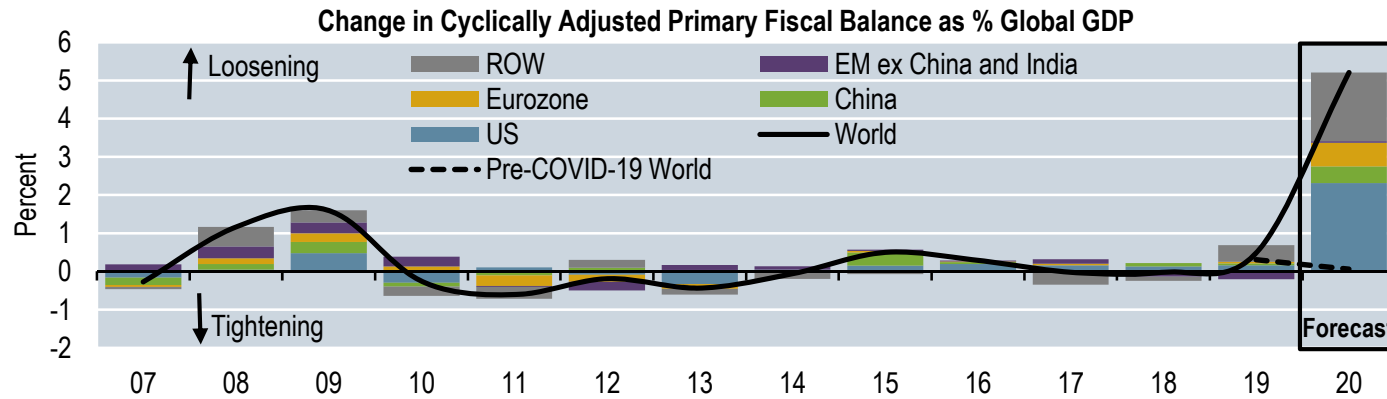
The fall-off in global aggregate demand is by far the steepest in recent history



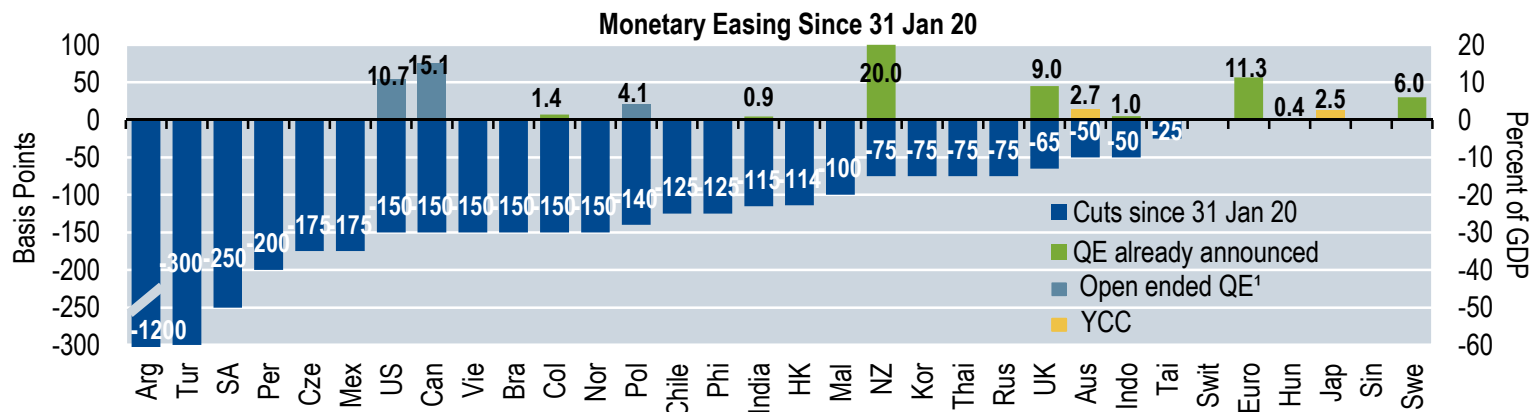
Source: J.P. Morgan. As of 30 Sep 20

Global Governments Have Provided Enormous Amounts of Stimulus

While the stimulus to date has been substantial, the question remains if current stimulus will be sufficient in mitigating permanent damage to global economies or if more will be required.



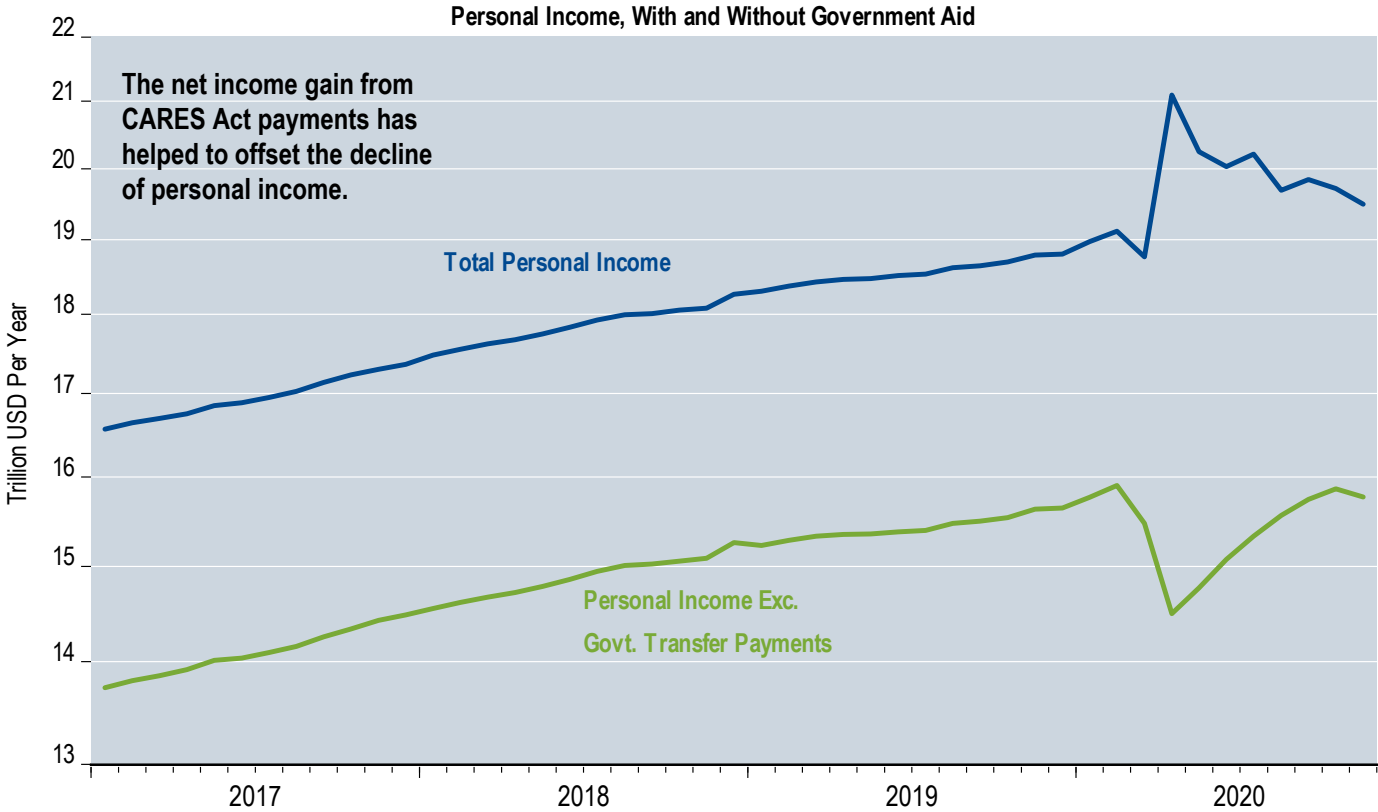
Source: UBS, Haver, European Commission, CBO. AS of 29 Jul 20



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

Government Support to Households Has Already Been Massive

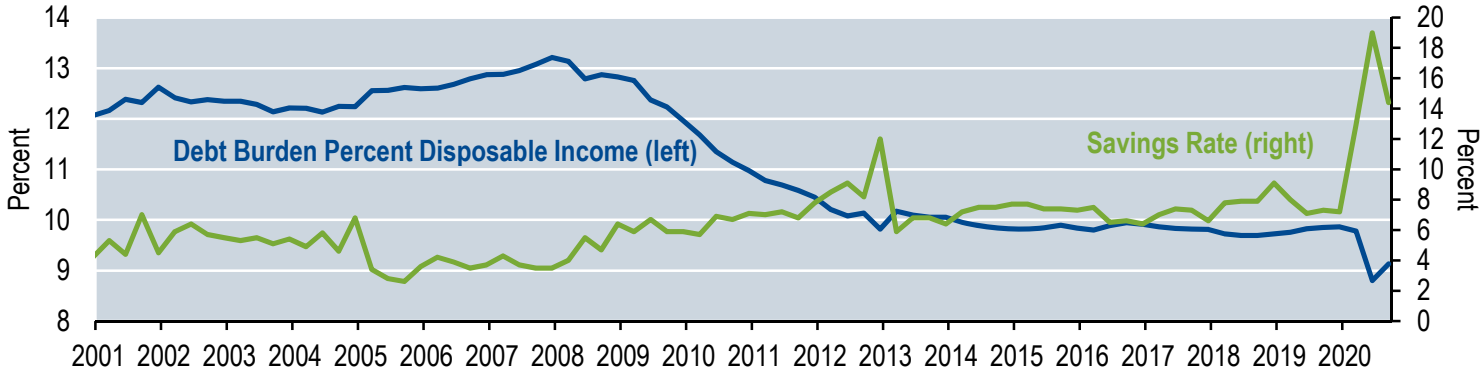
Government direct support to households via the CARES Act and extended unemployment compensation to turn personal income growth positive



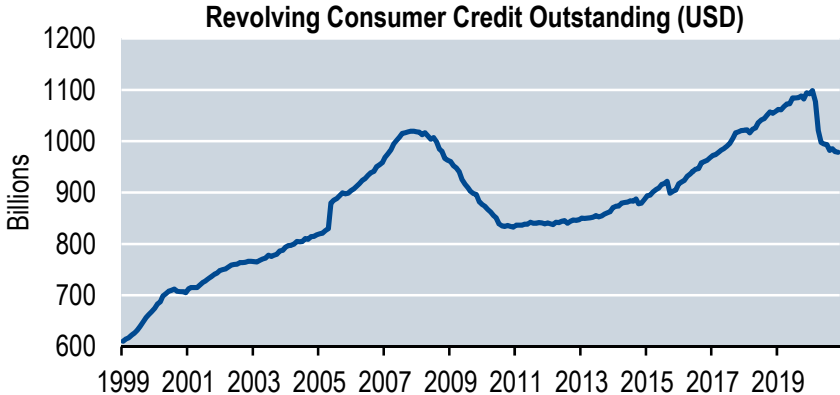
Source: Bureau of Economic Analysis. As of 30 Nov 20

Consumer Fundamentals Have Improved Post-COVID-19

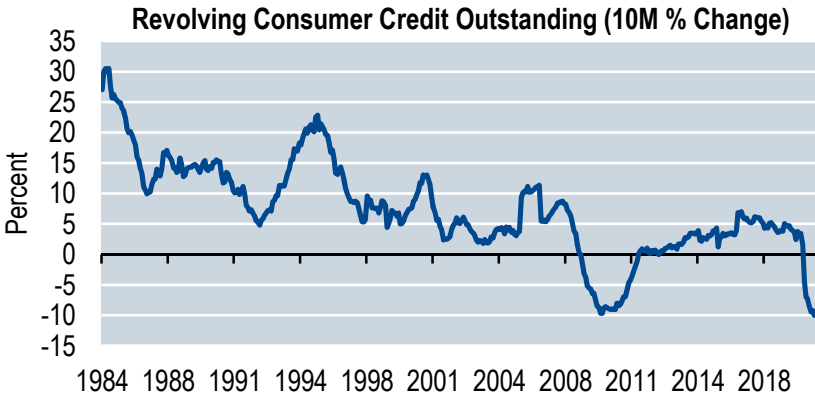
- Increased savings rate has gone to reduce debt
- Lower interest rates have decreased debt burden levels to the lowest in 20 years



Source: New York Fed Consumer Credit Panel/Equifax. As of 30 Sep 20



Source: Bloomberg, Rosenberg Research. As of 30 Nov 20



Source: Bloomberg, Rosenberg Research. As of 30 Nov 20

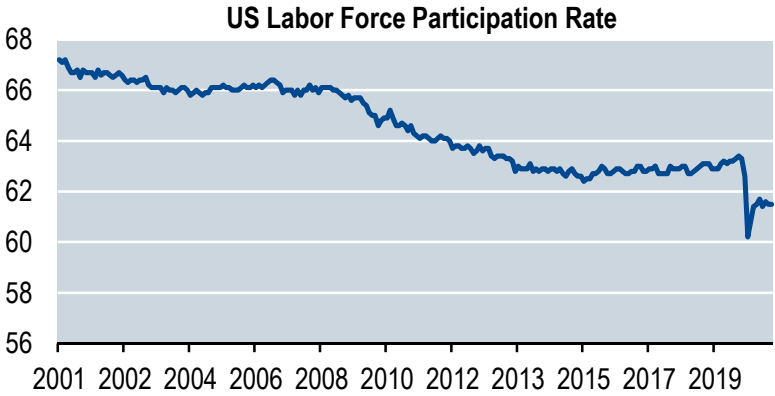
Labor Markets Have Been Severely Wounded



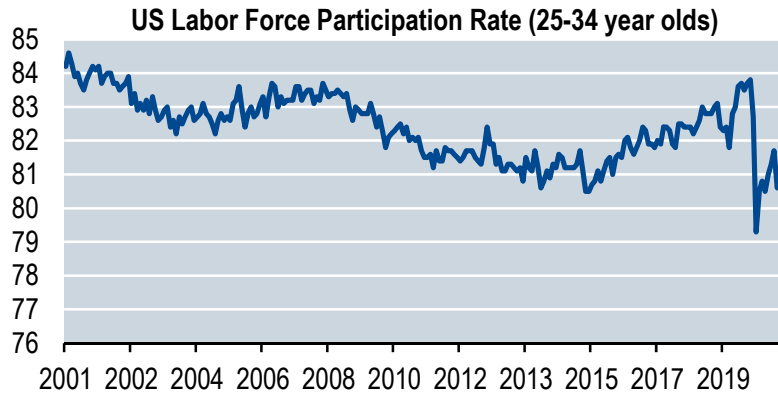
Source: Bloomberg. As of 31 Dec 20



Source: Bloomberg. As of 31 Dec 20



Source: Bloomberg. As of 31 Dec 20

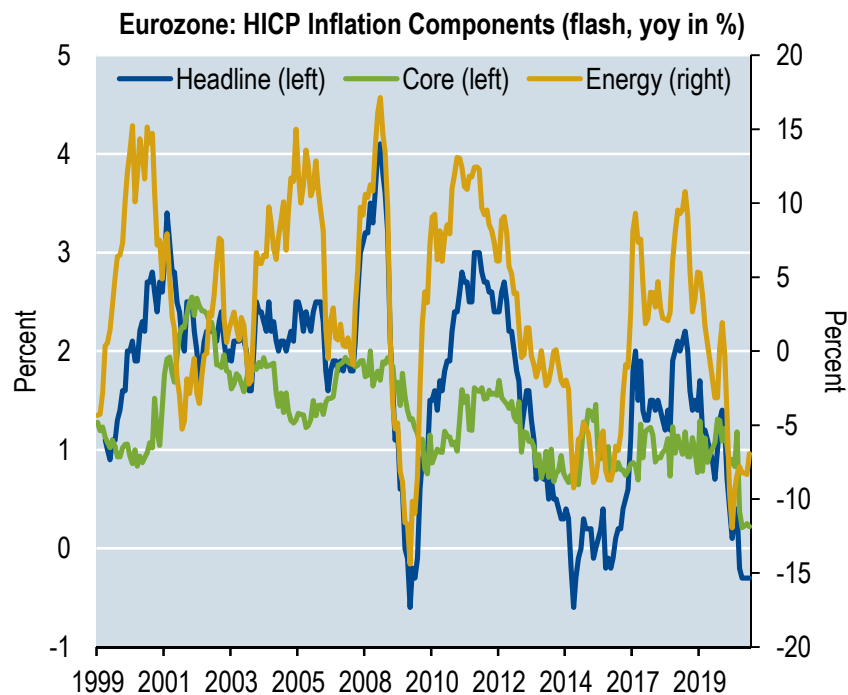


Source: Bloomberg. As of 31 Dec 20

The Road Ahead for Europe Also Appears Challenging

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

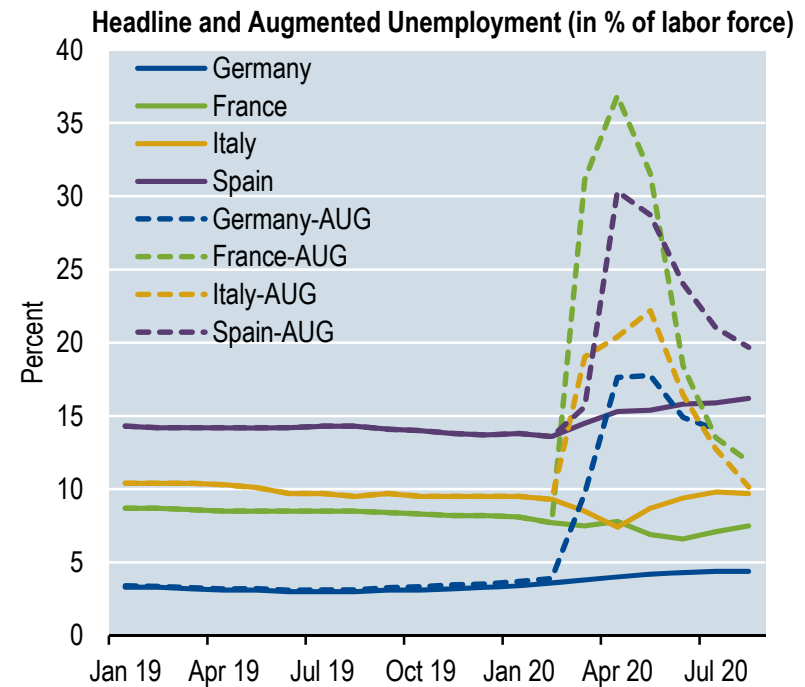
- Core inflation has been around 1 percent for a few years but has now fallen to 0.2 – an all-time low. The actual data – both headline and core – are starting to drift below the ECB macro projections from mid-September



Source: Statistical Office of the European Communities, Haver. As of 31 Dec 20

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



Source: Haver, National Ministries of Labor and Social Security. As of 31 Aug 20

2021 European Outlook

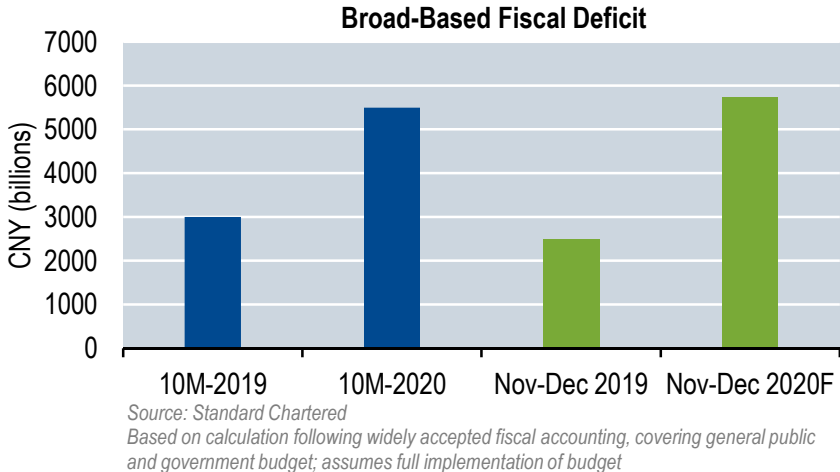
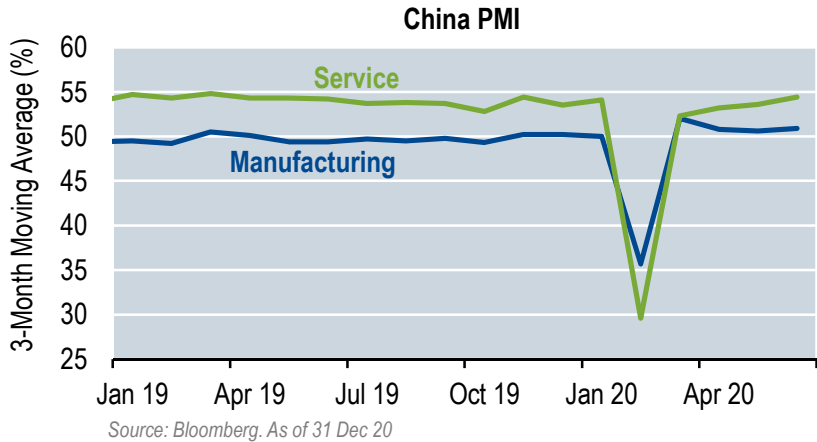
We expect Europe to recover to pre-crisis activity levels, but not before the end of 2022

Inflation in the eurozone is likely to remain muted for an extended period, abstracting from significant base effects in 2021 due to tax changes

This will allow the ECB to focus its interventions on ensuring favorable financing conditions, in line with its commitment last December

China Outlook: Nascent Signs of Economic Normalization

- Despite abating coronavirus outbreak, China maintains systematic control
- Leading indicators are encouraging
- Financial market conditions continue to be growth-supportive
- Fiscal policy is also becoming supportive

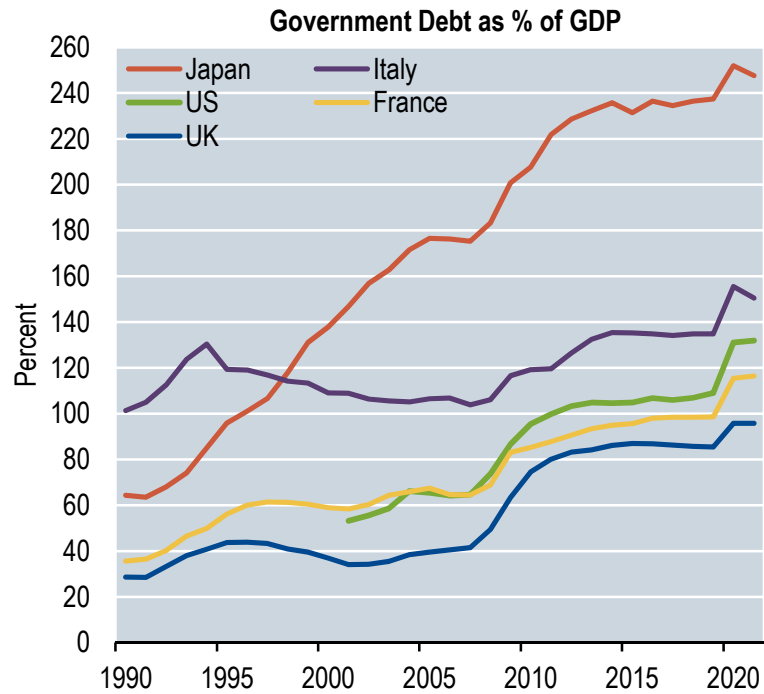


Our Current Thoughts on Japan's New PM Suga's Economic Policy ("Suganomics")

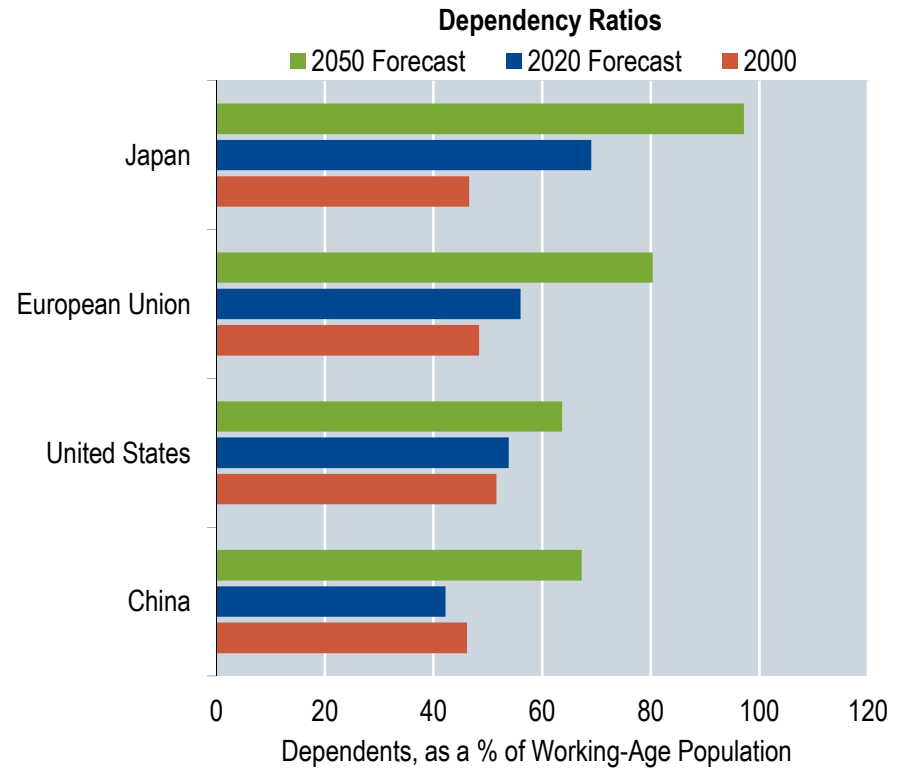
More than Abenomics, Rather than More Abenomics

- 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. The 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 being a reform-oriented pragmatist with a successful track record, for actions 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 had greater hope than overseas investors with Suganomics
- 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

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

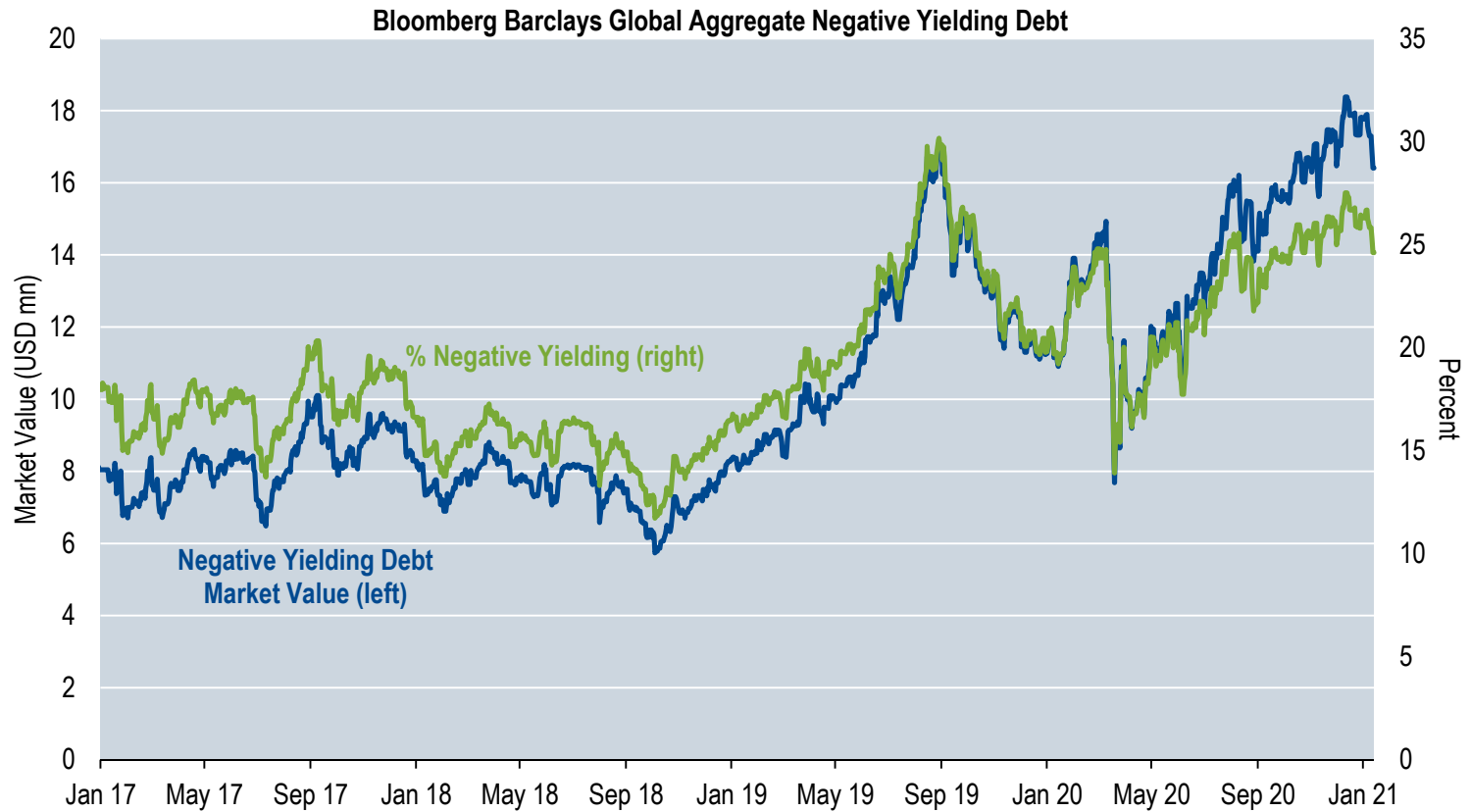


Source: IMF. As of 08 May 20



Source: World Bank. As of 09 Sep 20

The Prevalence of Negative Yielding Debt Globally Continues to be Remarkable



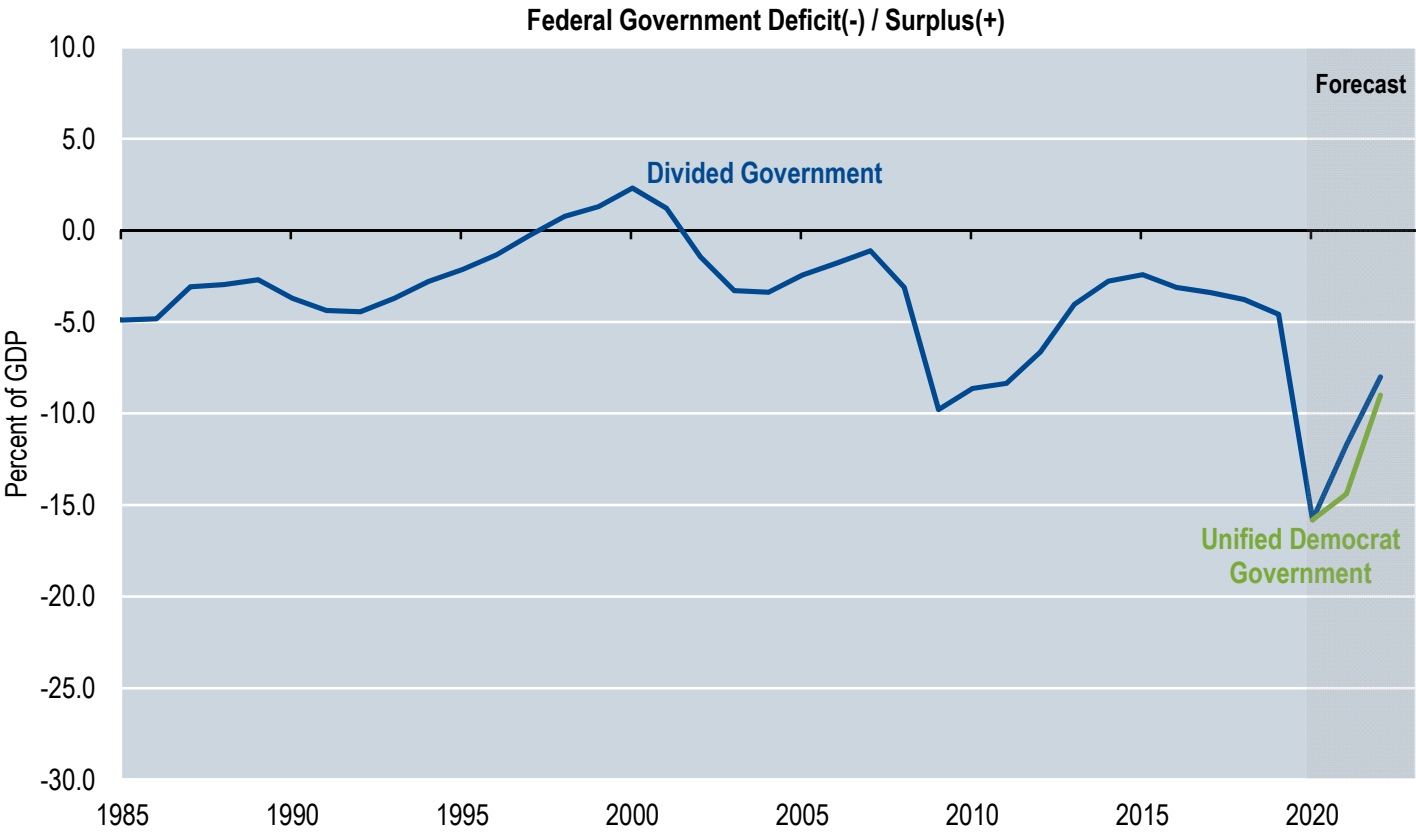
Source: Bloomberg Barclays, Western Asset. As of 13 Jan 21

Democrats Control Government; Continued Spending Likely

Budget Reconciliation: Pass legislation with 50 votes in the Senate; there will be three chances in 2021-2022

Razor Thin Margins: 50-50 in Senate, 6 vote margin in the House; legislation must be acceptable to all factions of Democratic party

Expectations: Additional stimulus in 1Q21 (state and local, unemployment insurance); other Dem priorities for H2?



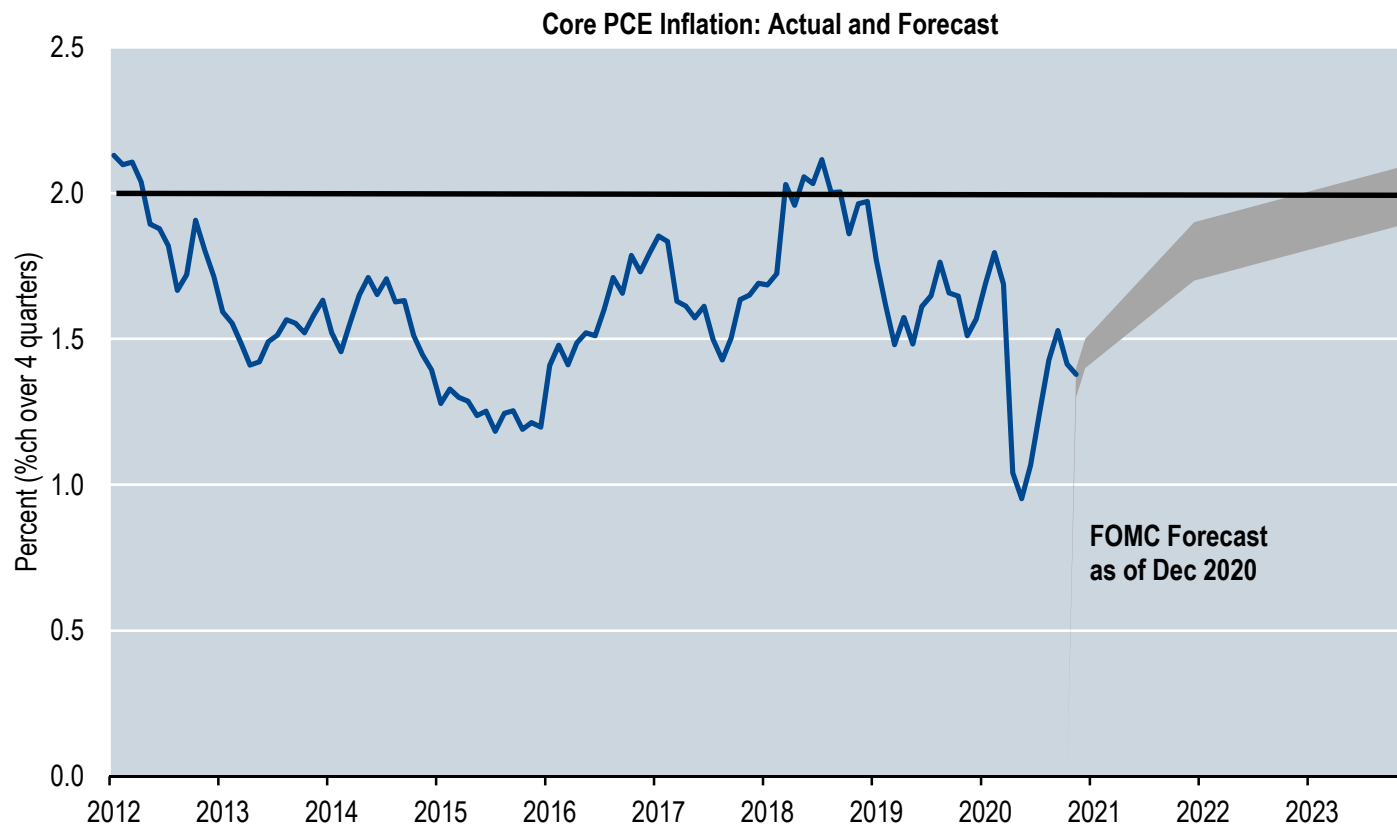
Source: Office of Management and Budget, Western Asset. As of 08 Jan 21



Fed Expects Only a Gradual Rise in Inflation

“Looking at everything we know about inflation dynamics in the United States and around the world over recent decades, **we expect it will take some time**... There will be slack in the economy... The economy will be below maximum employment, below full demand. And that will tend to wear—to put downward pressure on inflation”

- Chair Powell, September 16, 2020 FOMC Press Conference



Source: Bureau of Labor Statistics, Federal Reserve. As of 16 Dec 20

Recent Fed Quotes

Vice Chair Clarida, Jan 8, 2021

Discussion about base effects:

“I do believe that because of some year-over-year base effects, we will see some move up in inflation, perhaps above 2 percent, in the Spring and the Summer... But, I would expect that to be transitory. Indeed our view is that by the end of the year inflation will be higher than it is today, but somewhat below our two percent objective.”

Discussion about looking through reopening pressure on prices:

“... If that does play out this year, I would tend to look through that as a one-time relative price adjustment that is needed to get people back in and employed in the service sector ... My inclination now is that, if we see that, it is not something we should lean against or tighten policy as a bad development. It’s just the price system working to reallocate resources back towards services, and to get supply in line with demand ... There will be enough demand in the economy this year, and supply and demand will come into balance. But for me that would not cause any adjustment in the policy that we have communicated.”

Governor Brainard, Jan 13, 2021

“Overall, **payroll employment is still nearly 10 million jobs below its February level**. If we adjust the 6.7 percent headline unemployment rate for the decline in participation since February and the Bureau of Labor Statistics estimate of misclassification, the **unemployment rate would be 10 percent**, similar to the peak following the Global Financial Crisis...”

... The recovery thus far has been uneven, and the path ahead is uncertain. We remain far from our goals, with **core PCE inflation only at 1.4 percent and payroll employment nearly 10 million below** its pre-pandemic level.”

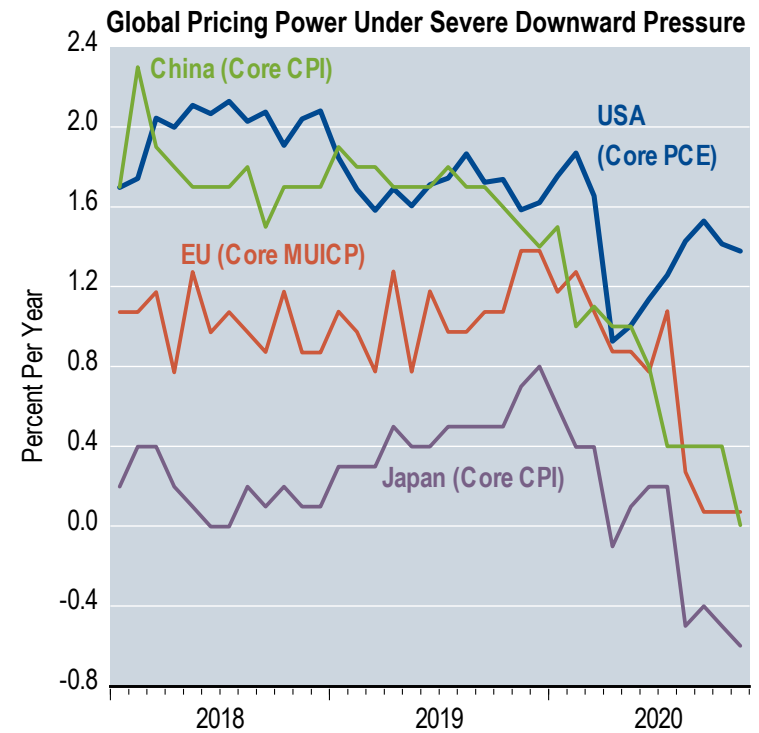
Market Confidence in Renewed Inflation May Be Misplaced

Breakeven Inflation Rates Near Beginning of the Year Levels

10-Year Breakeven Inflation (%)

| | 31 Dec 19 | 23 Mar 20 | 11 Jan 21 |
|-----------|-----------|-----------|-----------|
| Australia | 1.41 | 0.09 | 1.82 |
| Canada | 1.39 | 0.04 | 1.50 |
| Germany | 0.99 | 0.23 | 0.99 |
| Japan | 0.16 | -0.15 | 0.06 |
| US | 1.79 | 0.81 | 2.06 |

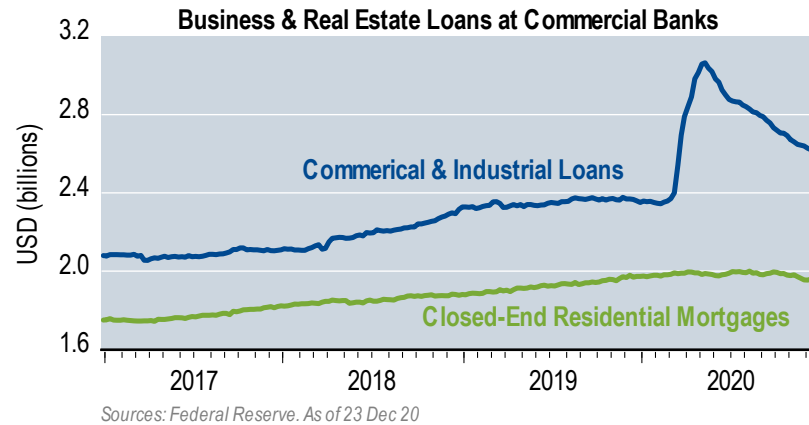
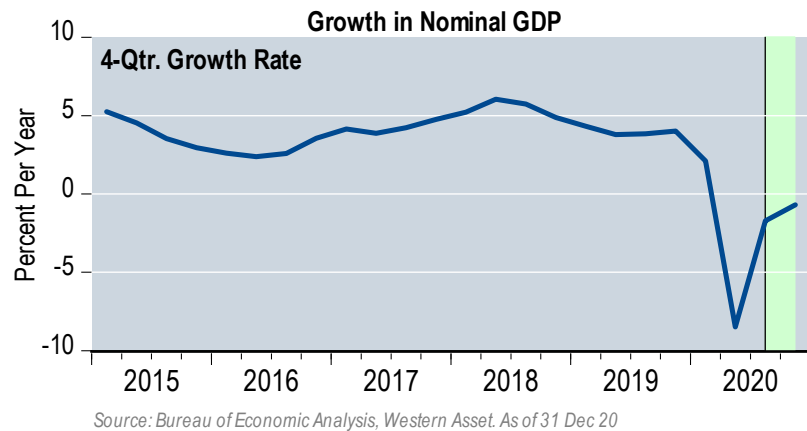
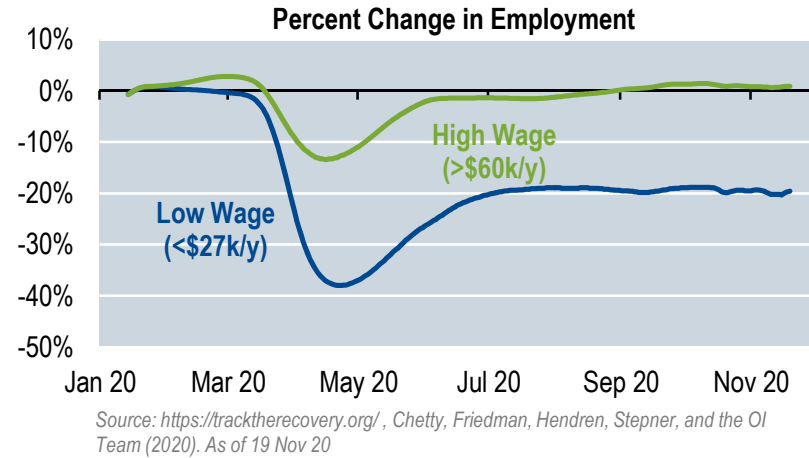
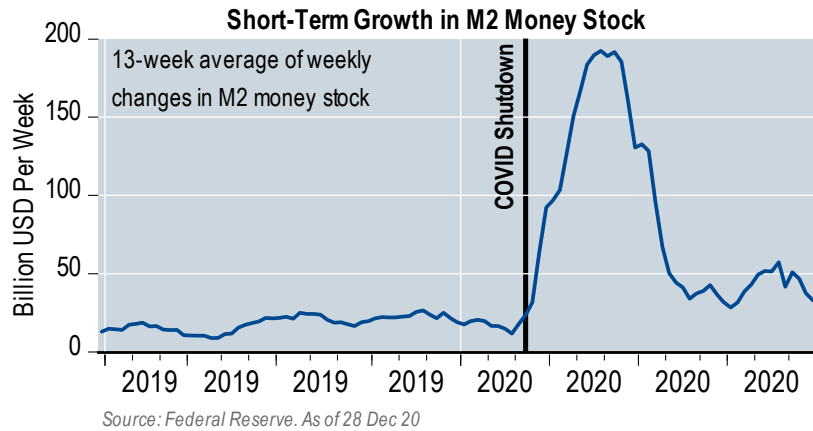
Source: Bloomberg. As of 11 Jan 21



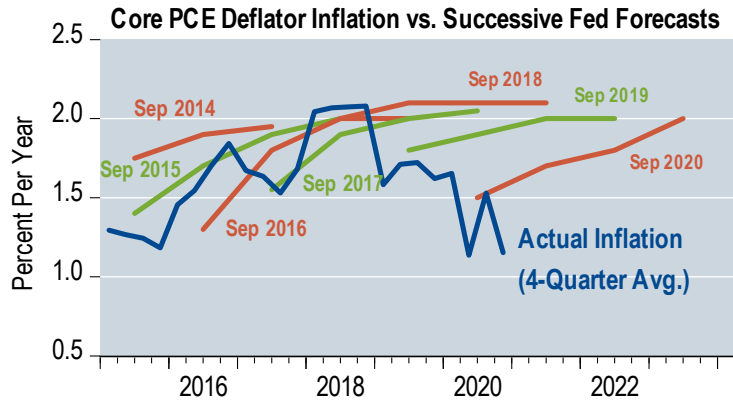
Source: US Bureau of Economic Analysis, Bloomberg. As of 30 Nov 20

Year-on-year (12 Month) change in core consumer prices

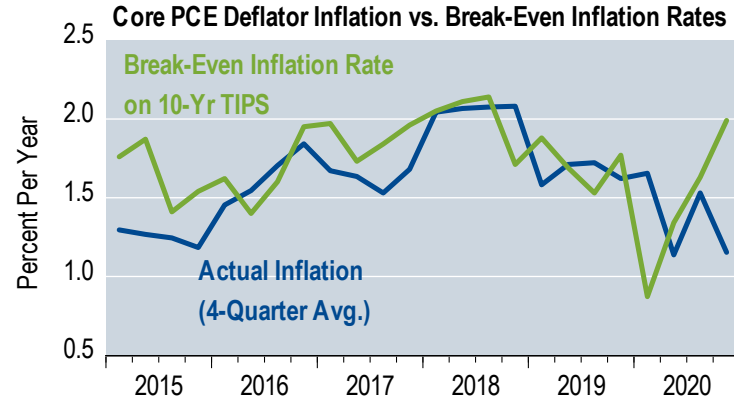
Inflation — Keeping an Open Mind



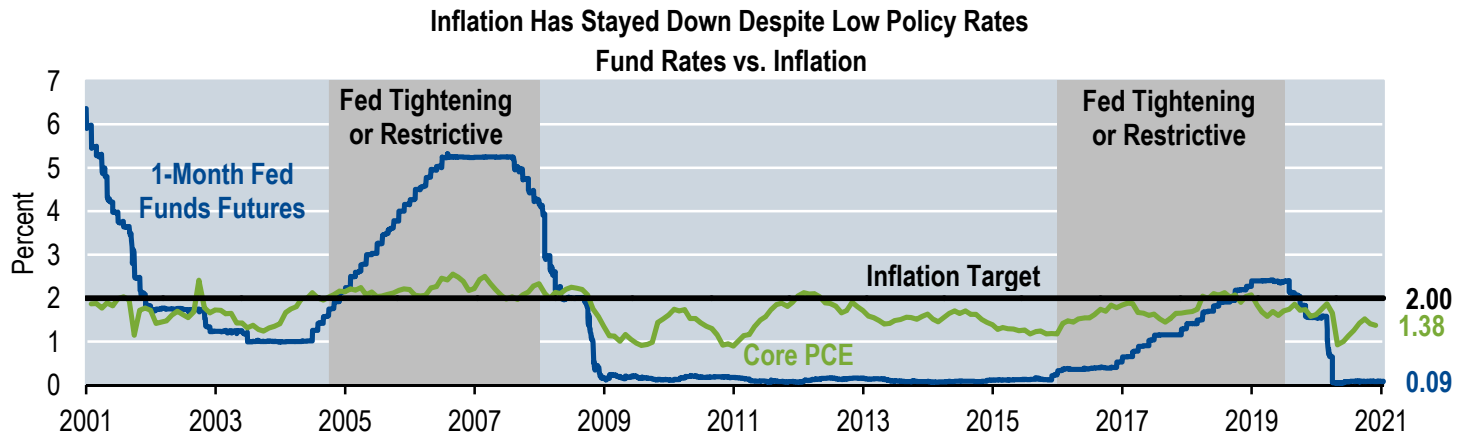
Market and Fed Expectations for Rising Inflation Have Been Seen Before



Source: Bureau of Economic Analysis, Federal Reserve. As of 31 Dec 20
Plotted are midpoints of forecast ranges.

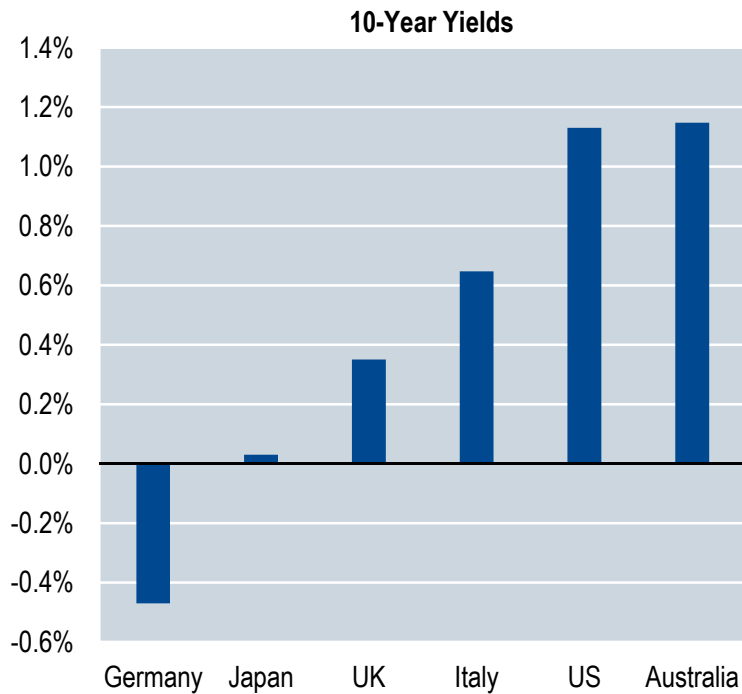


Source: Bureau of Economic Analysis, Federal Reserve. As of 31 Mar 18



Source: Bloomberg, HSBC. As of 13 Jan 21

US Rates Are Relatively Attractive on Both Hedged and Unhedged Relative to Other Developed Countries



Source: Bloomberg. As of 12 Jan 21

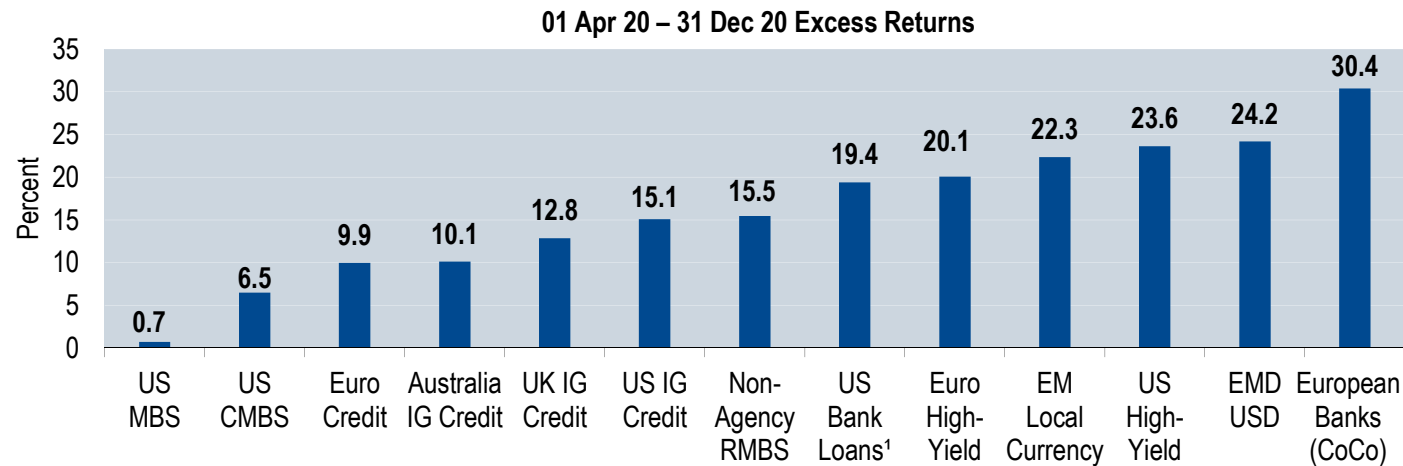
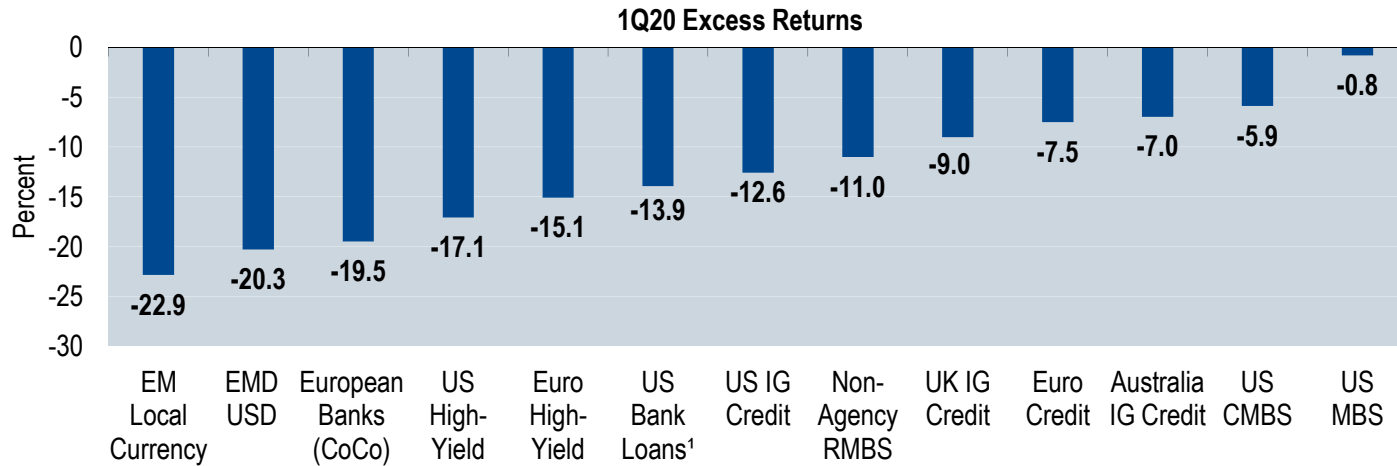
Government Bond Yields, JPY-hedged

| | Local Yield (%) | JPY-Hedged Yield (%) | Hedged-Yield Advantage Over 10-Year JGBs |
|-------------------|-----------------|----------------------|--|
| 10-Year Japan | 0.04 | 0.04 | |
| 10-Year US | 1.16 | 0.76 | 0.72 |
| 10-Year UK | 0.35 | 0.17 | 0.13 |
| 10-Year Australia | 1.15 | 1.00 | 0.96 |
| 10-Year Germany | -0.47 | -0.06 | -0.10 |
| 10-Year France | -0.26 | 0.16 | 0.11 |
| 10-Year Belgium | -0.31 | 0.11 | 0.06 |
| 10-Year Spain | 0.11 | 0.52 | 0.48 |
| 10-Year Italy | 0.65 | 1.06 | 1.02 |

Source: Bloomberg, As of 12 Jan 21

A Tale of Two Markets

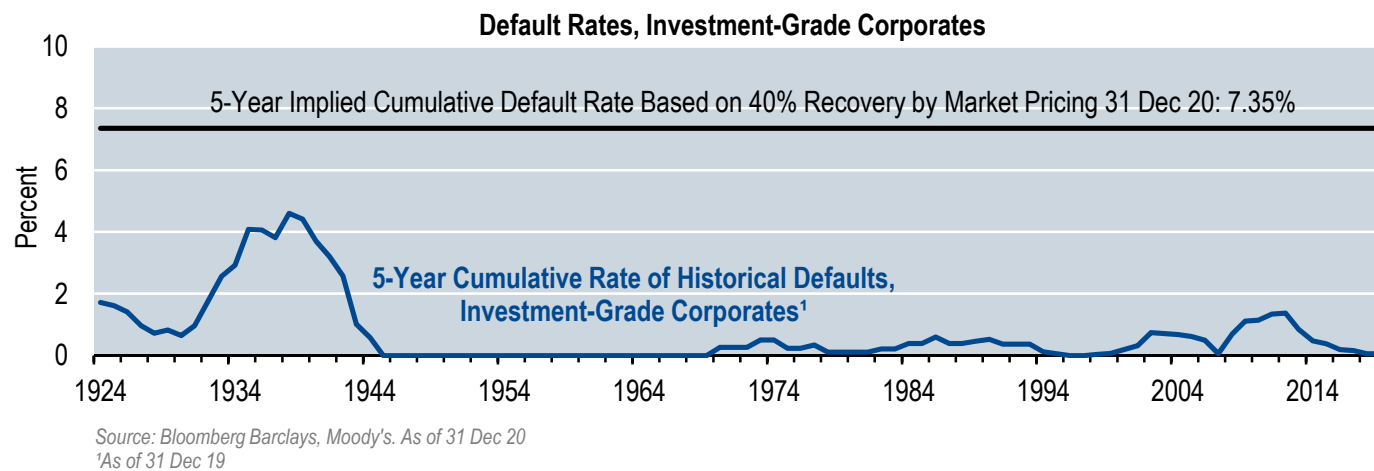
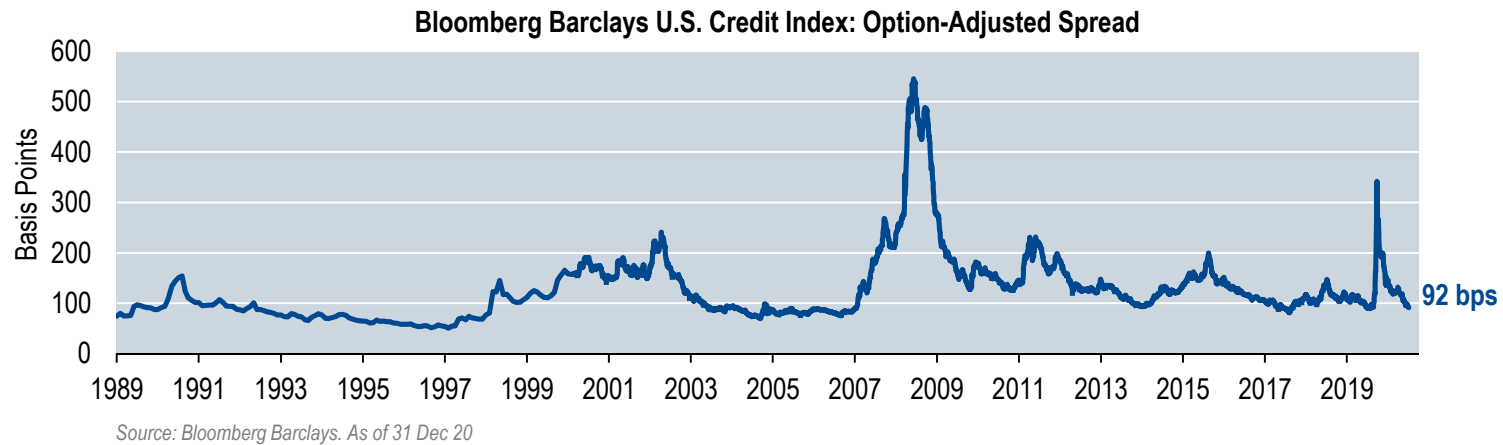
Spread Sector Excess Returns — 1Q20 vs. April 1 to December 31, 2020



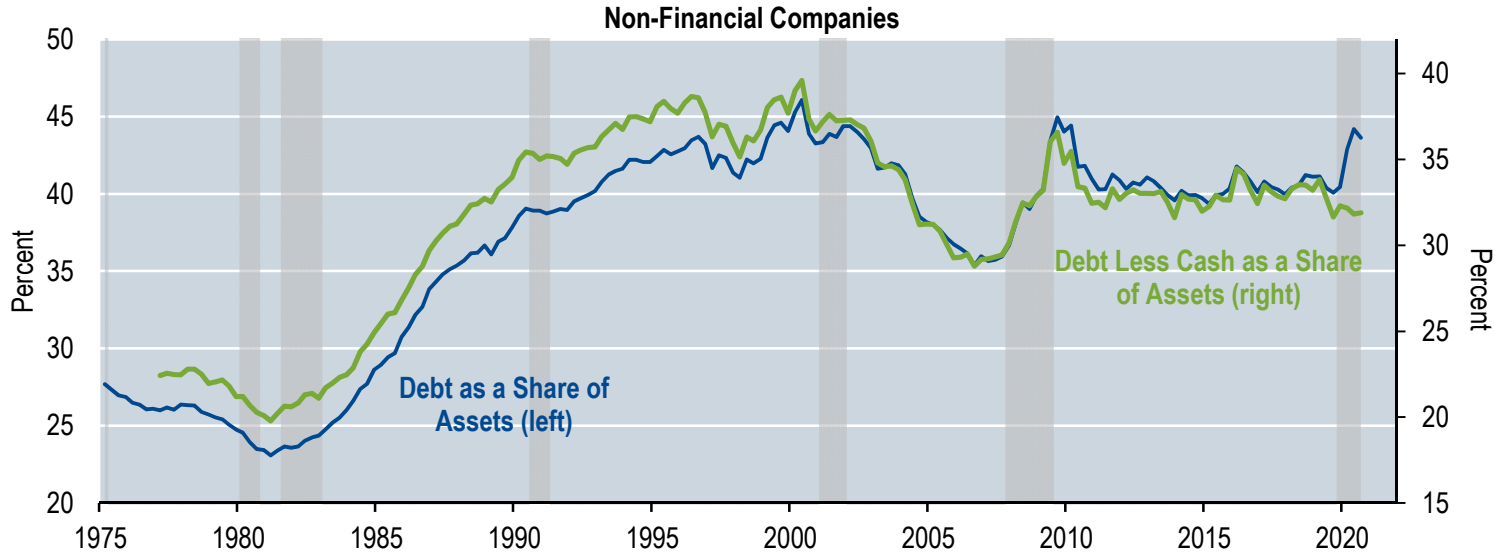
Source: Bloomberg Barclays, J.P. Morgan, S&P Global Market Intelligence, a division of S&P Global Inc, Western Asset
 ¹S&P/LSTA Performing Loans Index excess return vs. 3-Month LIBOR

US Investment-Grade Credit

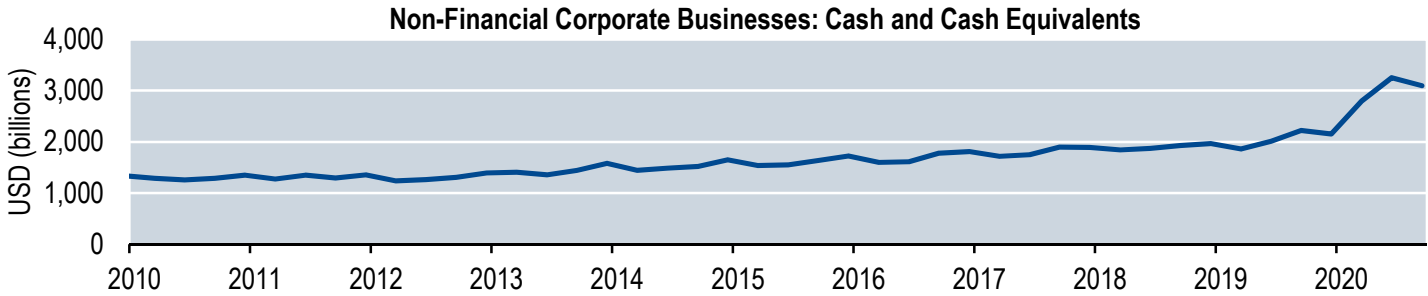
Spreads and Default Rates



Record Debt Issuance Over the Last Year Is Less Concerning Because Corporates Used Almost All the Funds Raised to Bolster Cash Positions



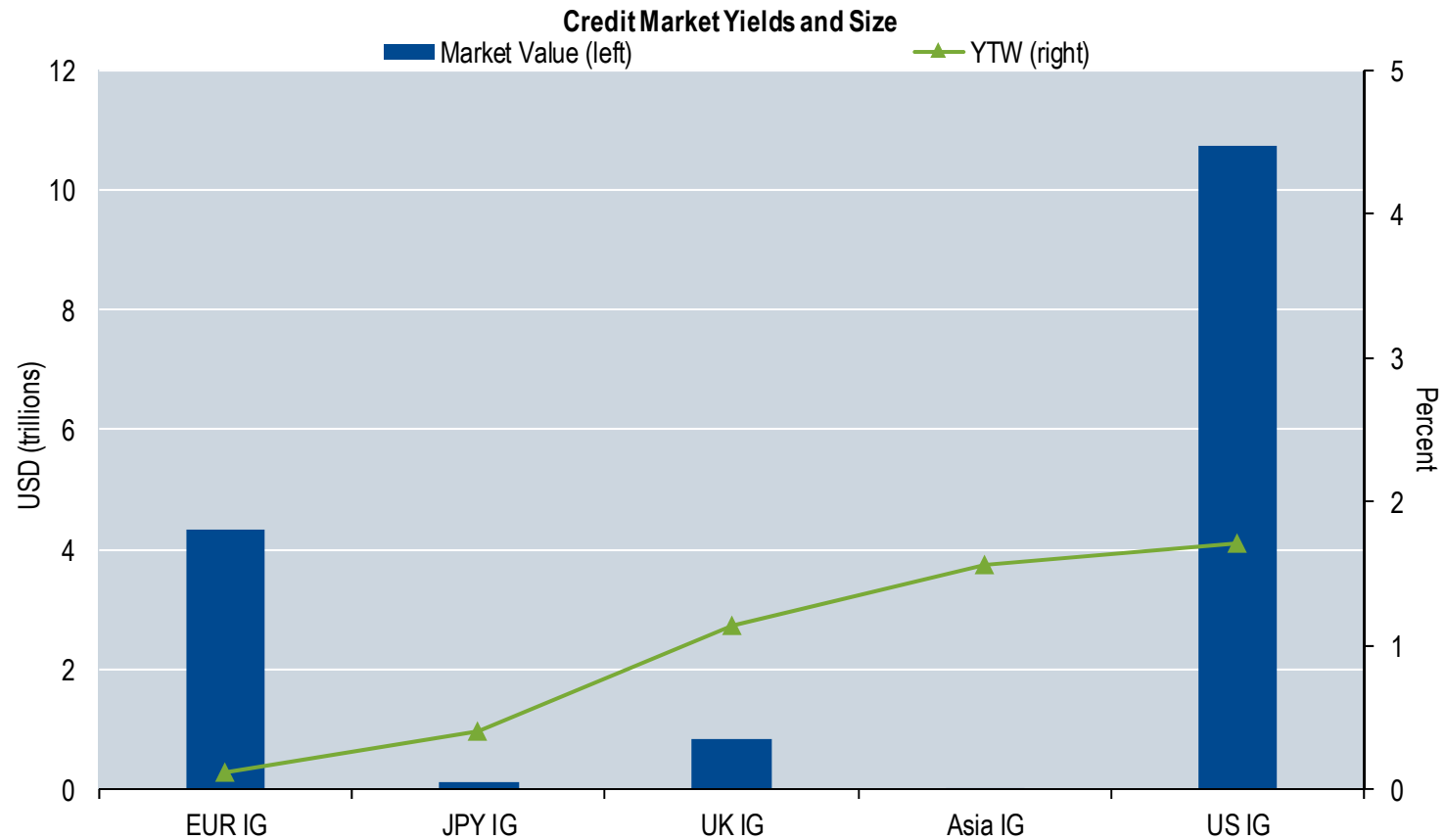
Source: Federal Reserve, Goldman Sachs. As of 30 Sep 20
Shaded areas indicate recessions.



Source: Goldman Sachs, Federal Reserve. As of 30 Sep 20

US Credit Markets Offer Both Attractive Yield and Size

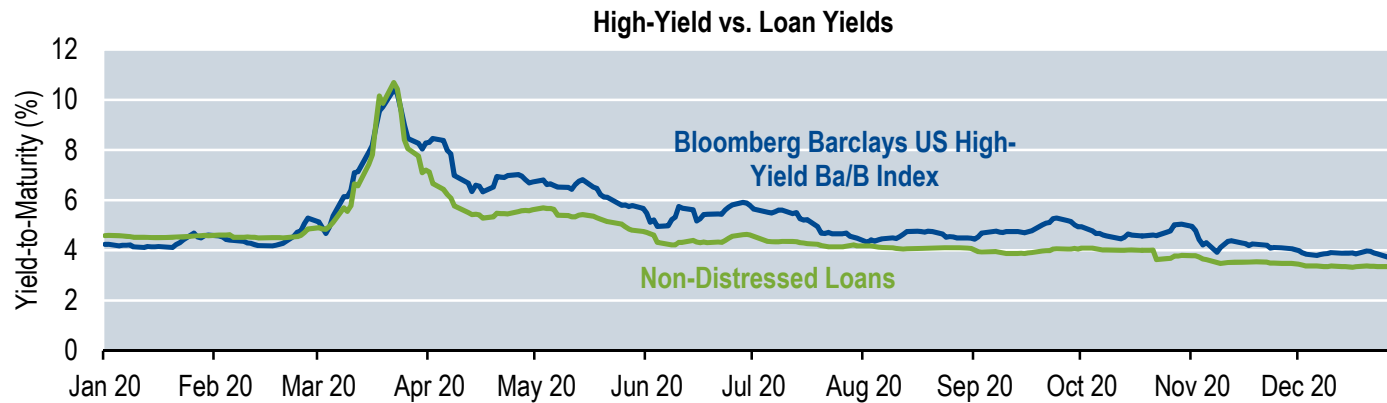
Relative to other mature markets, US credit markets are attractive to a global investor.



Source: Bloomberg Barclays. As of 31 Dec 20
Barclays Global Credit Index by Currency

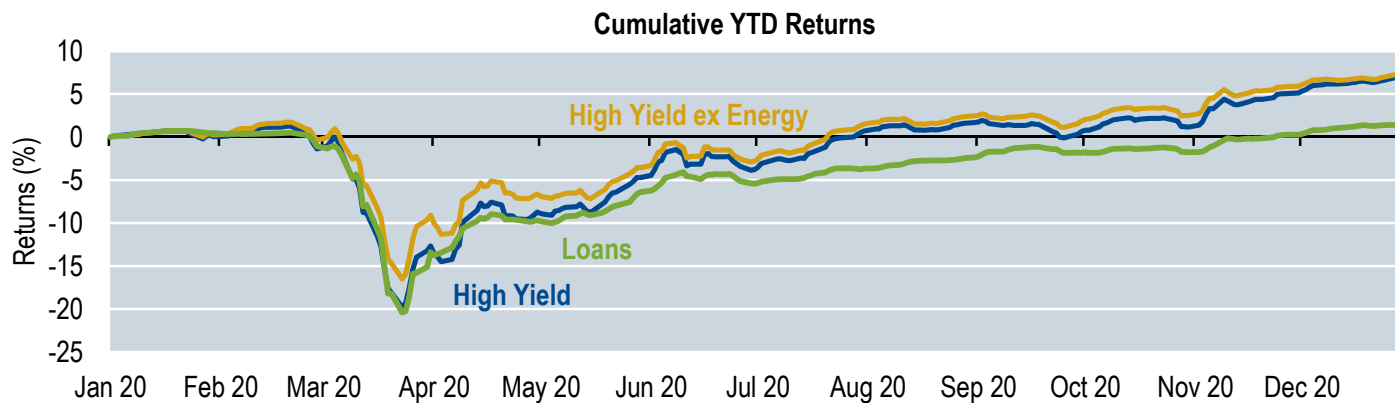
High-Yield Strategy –Term Loans Offer Better Relative Value Post HY Outperformance

HY unsecured bond vs. secured term loan yields have compressed from +200 bps in March 2020 to roughly flat



Source: Bloomberg Barclays, S&P LCD. As of 31 Dec 20
Non-distressed loans represented by the BB Loan Index

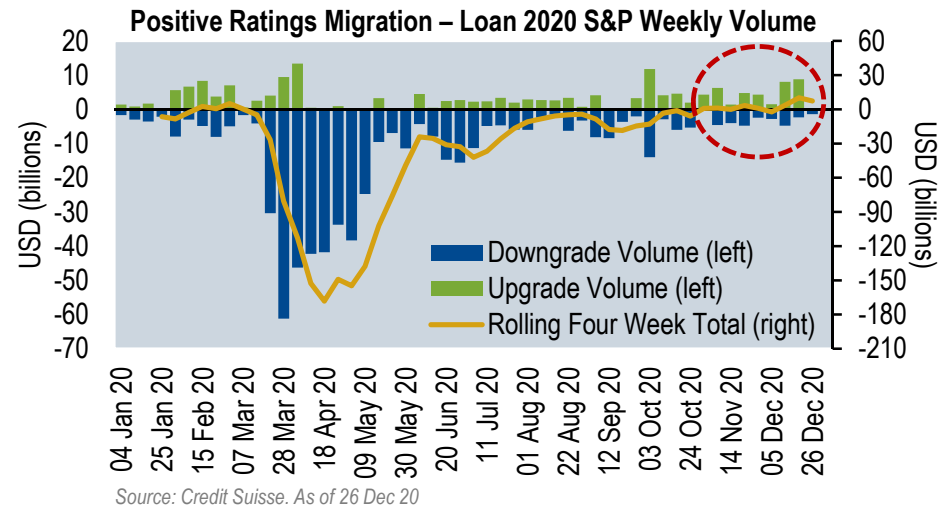
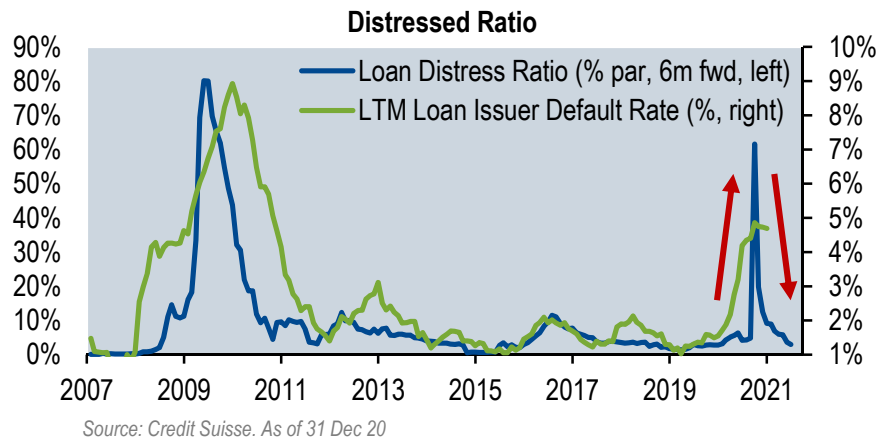
Secured loans underperformed HY in 2020 by several hundred basis points



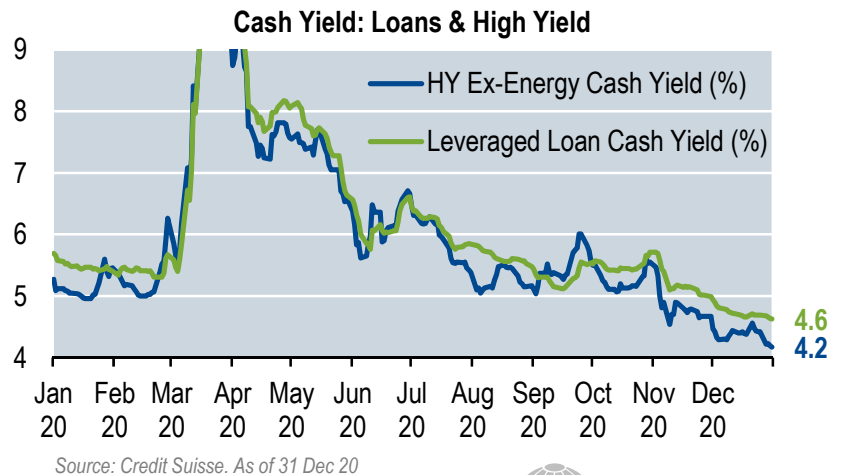
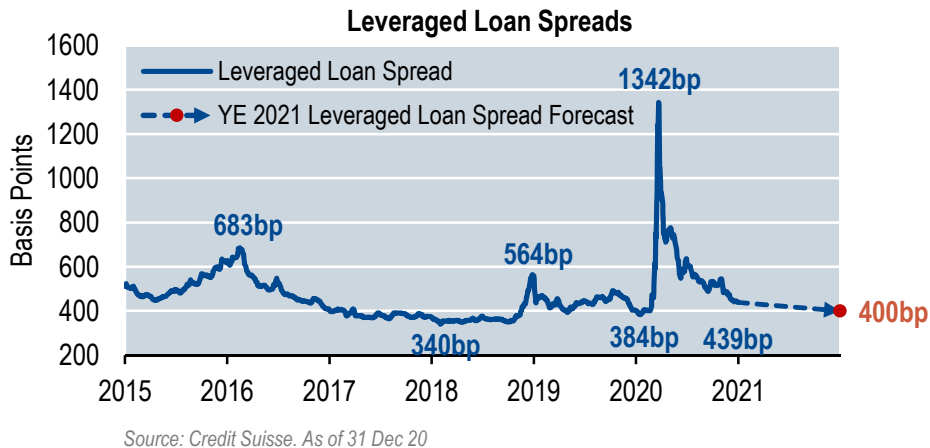
Source: Bloomberg Barclays, S&P LCD. As of 31 Dec 20

Loan Fundamentals Remain Intact and Improving While Yields Remain Attractive

Loan asset class distress ratio below pre-Covid levels with improving fundamental profiles and positive outlook

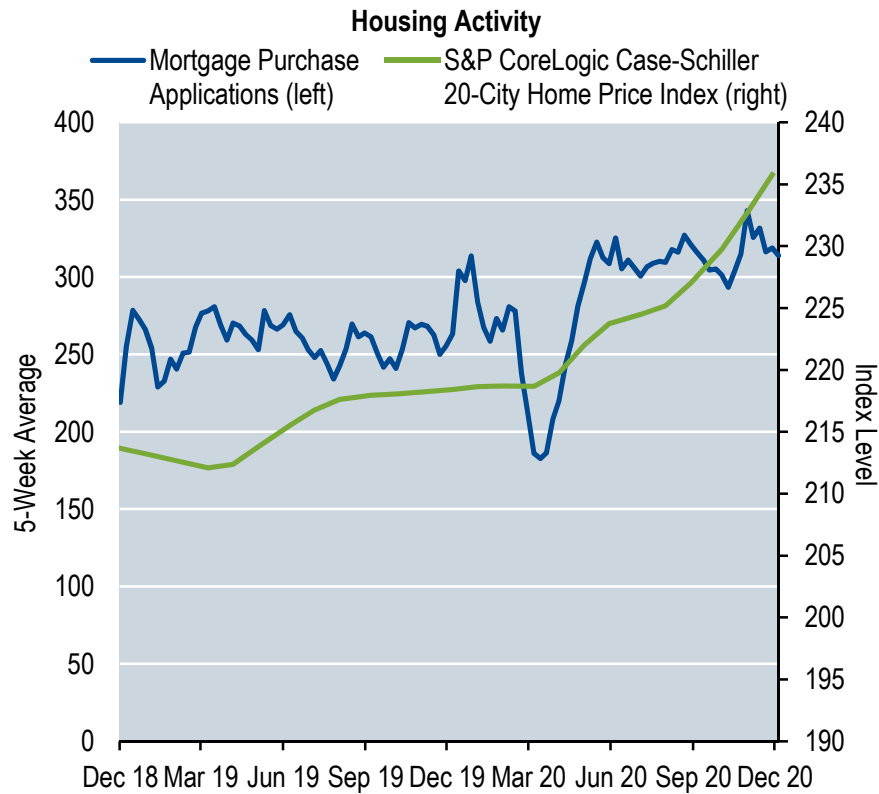


Loan yields are attractive and remain wide of pre-Covid levels as the asset class has lagged high yield and investment grade recovery

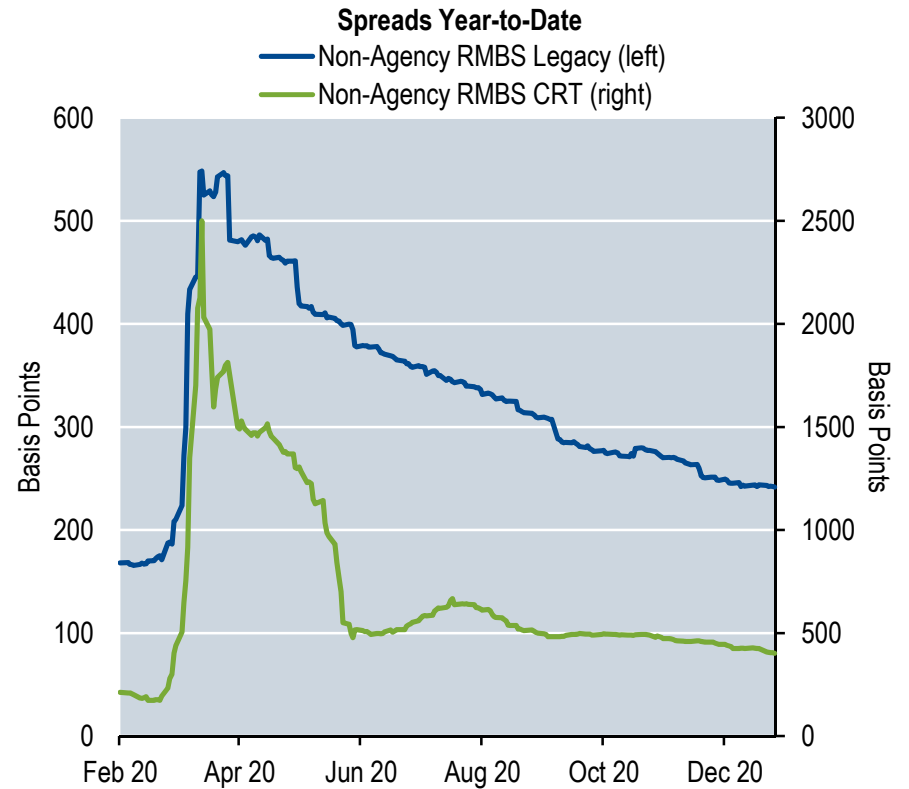


Housing Market Recovery Path

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



Source: Bloomberg, MBA, S&P CoreLogic Case-Schiller. As of 01 Jan 21



Source: Bloomberg Barclays, J.P. Morgan. As of 08 Jan 21

Mortgage Credit Offers Attractive Relative Value

Mortgage credit (both residential and commercial) has lagged in the post-Covid recovery as there has not been explicit stimulus from the US Federal Reserve (Fed)

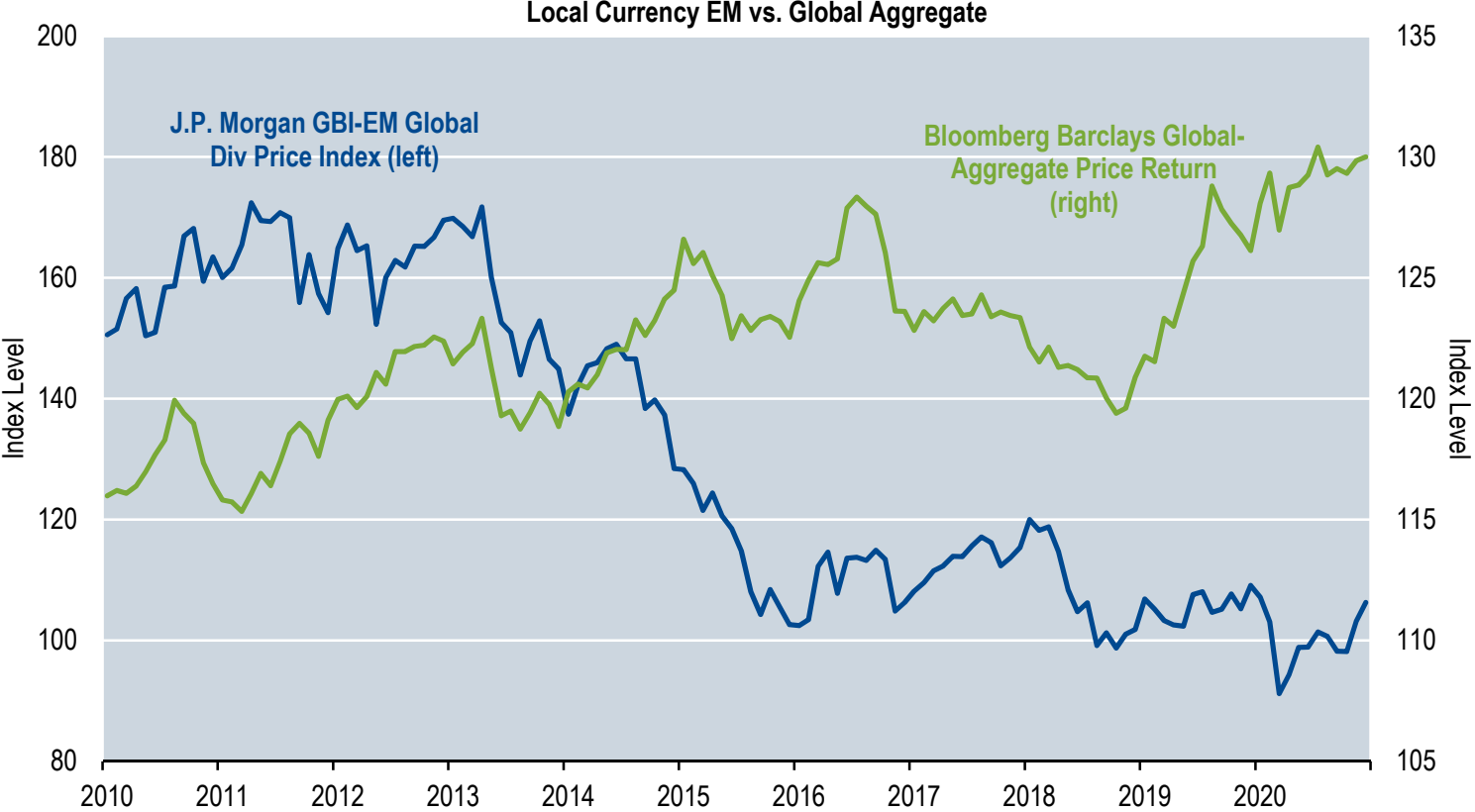
| Spreads | Sectors Without FED Support | | | Sectors With FED Support | | |
|-----------------------------------|---------------------------------------|--|--|--|----------------------------------|---|
| | J.P. Morgan Non-Agency RMBS CRT | J.P. Morgan Non-Agency RMBS Legacy | Bloomberg Barclays Non-Agency CMBS BBB | Bloomberg Barclays US Agency MBS | Bloomberg Barclays ABS AAA | Bloomberg Barclays US Non-Agency CMBS AAA |
| 3-Year Average | 385 | 205 | 527 | 42 | 45 | 88 |
| 31 Jan 20 | 201 | 170 | 331 | 48 | 26 | 67 |
| 31 Dec 20 | 425 | 244 | 717 | 39 | 24 | 82 |
| Difference Since 31 Jan 20 | 224 | 74 | 386 | -9 | -2 | 15 |
| Difference from 3-Year Average | 40 | 39 | 190 | -3 | -21 | -6 |

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

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situations or needs of investors.

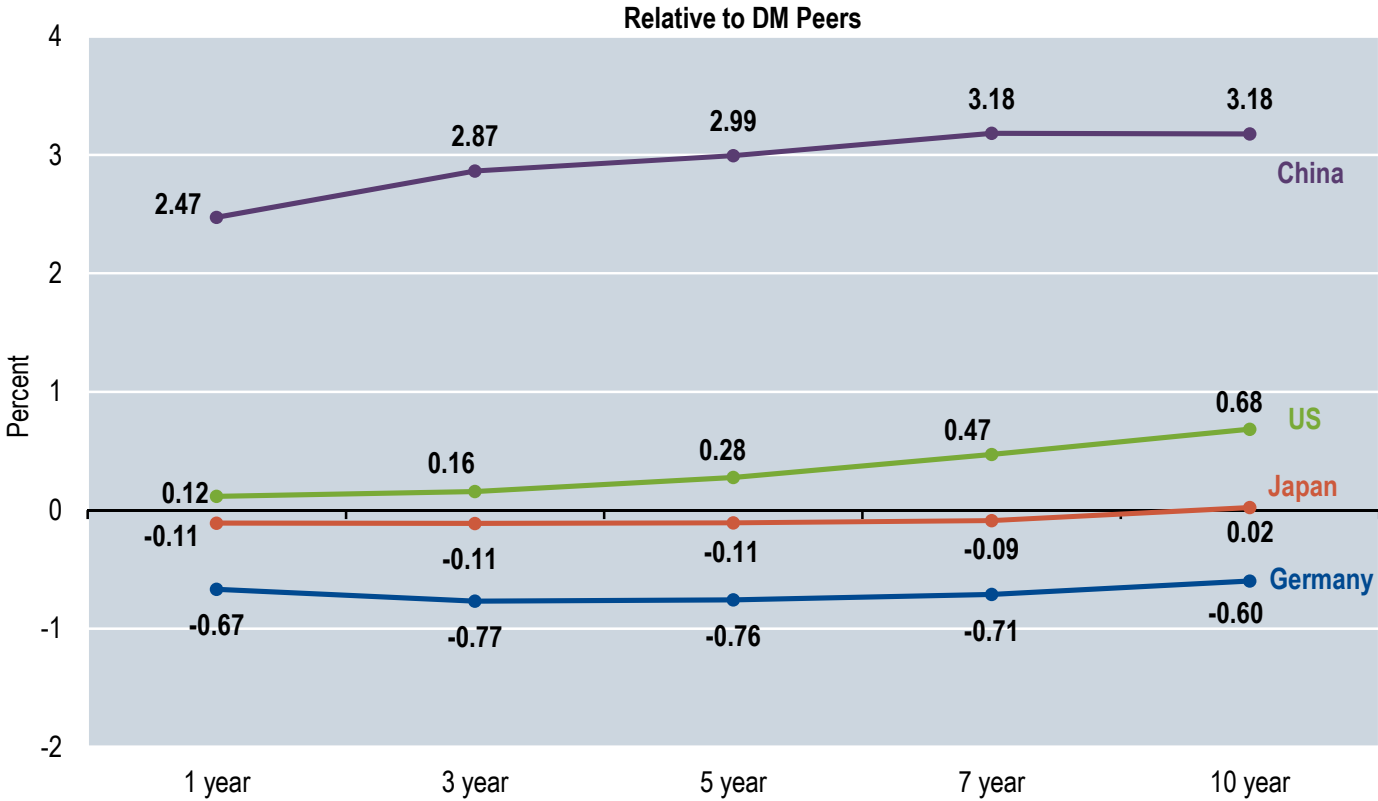
Past performance is not a reliable indicator of future results.

Local Currency Emerging Market Debt Prices Are Very Distressed



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

China Local Onshore Bonds Offer Attractive Valuations



Source: Bloomberg. As of 31 Dec 20

2021 Outlook

Economic

- Global economy is recovering
- Fiscal and monetary policy should stay supportive
- Second half should see meaningful pick-up in growth—as economy “Reopens”
- Global economic slack, debt burdens, labor market scarring, and SME destruction will take years to absorb
- Central bank policy rates will be very low for very long
- Re-ignition of inflation is still years away

Investment implications

- Reopening spread products should outperform Treasury and Sovereign bonds
- Emerging markets should particularly benefit
- The dollar should weaken only mildly
- Interest rates should be broadly range bound

Questions & Answers



Thank you.

Risk Disclosure

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