



1Q24 Market & Strategy Update

January 11, 2024

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2024 Global Outlook

Disinflation ongoing but uneven

Central banks will ease policy to normalize real interest rates

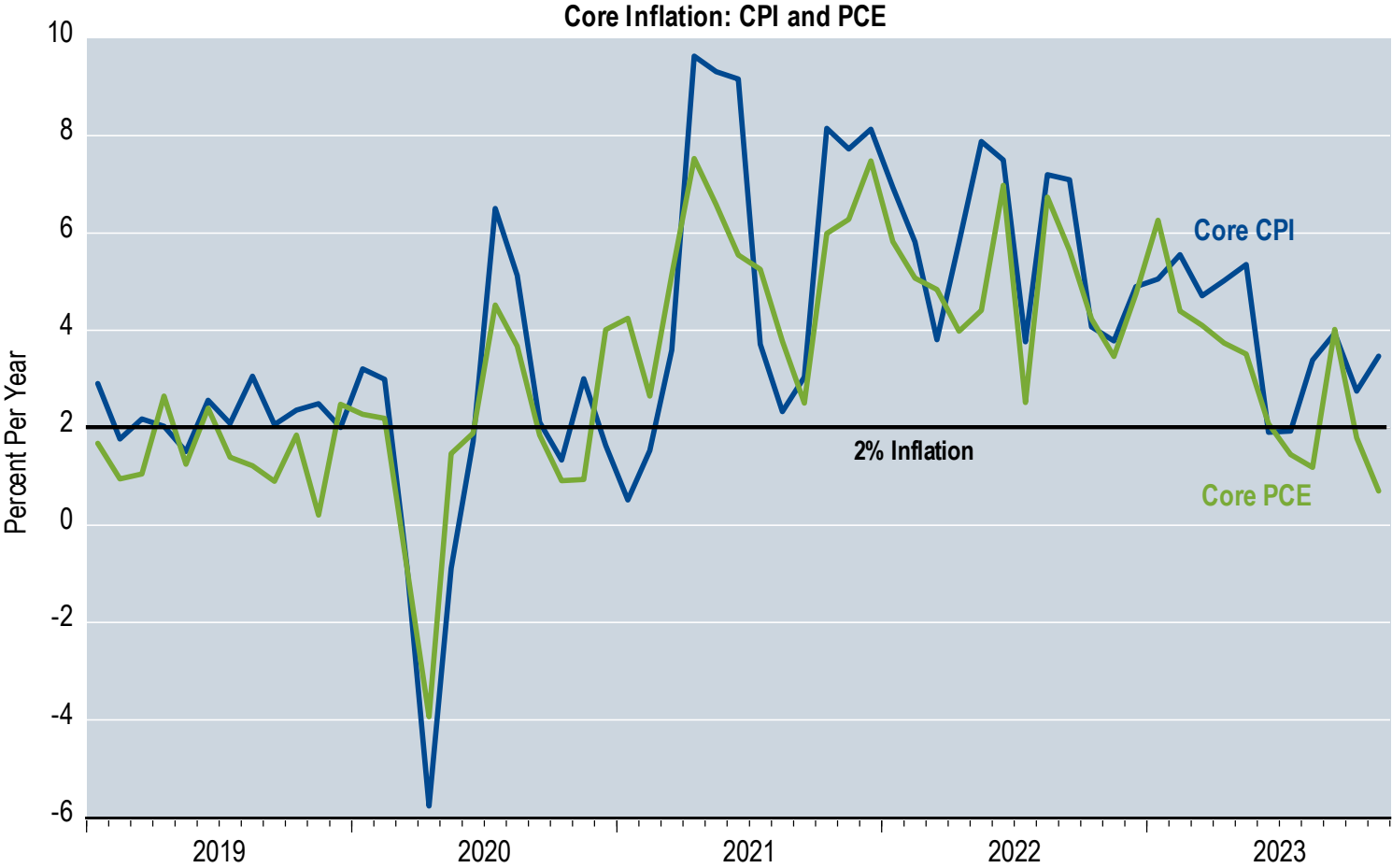
Economy has remained resilient, but is set to slow

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

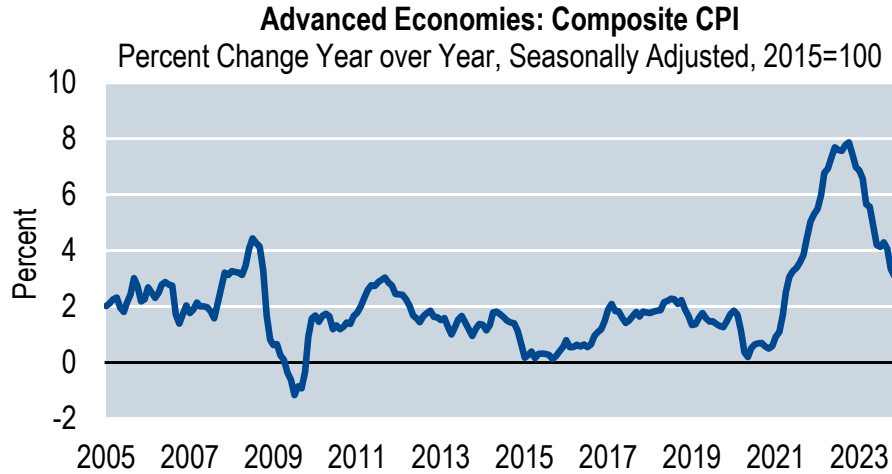
Core Inflation Right Around Fed's Target Recently

1.9% per year average over last 6 months

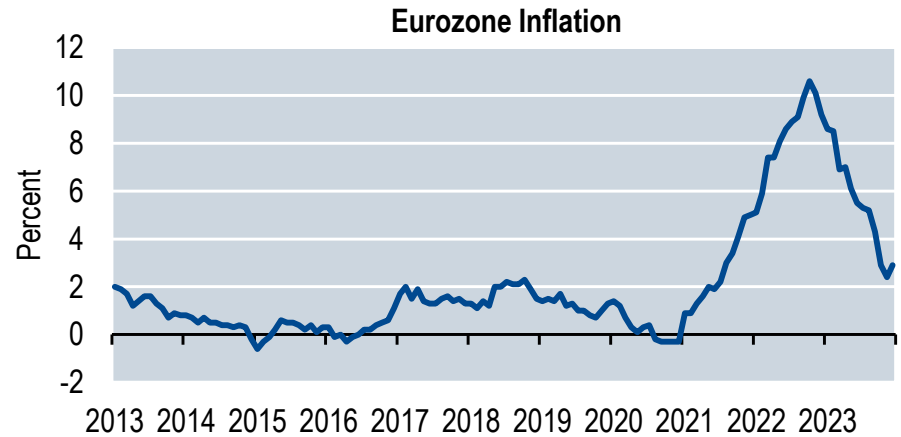


Source: Bureau of Labor Statistics, Bureau of Economic Analysis, JP Morgan
As of 30 Nov 23

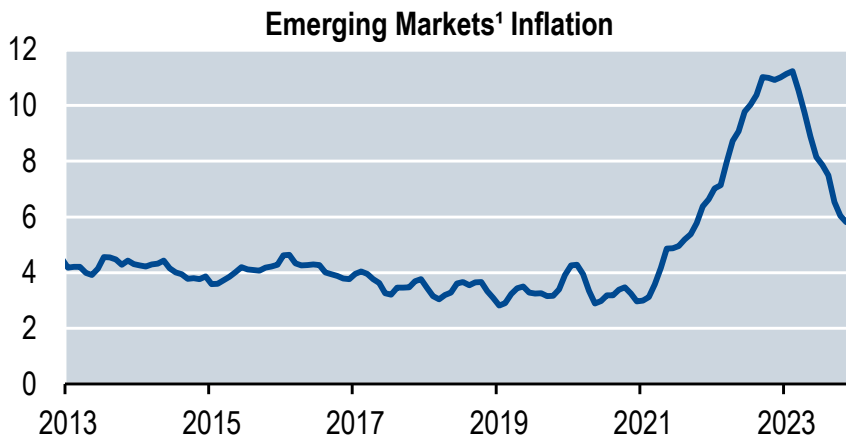
Global Disinflation Is Broad-Based and Ongoing



Source: Haver Analytics. As of 30 Nov 23

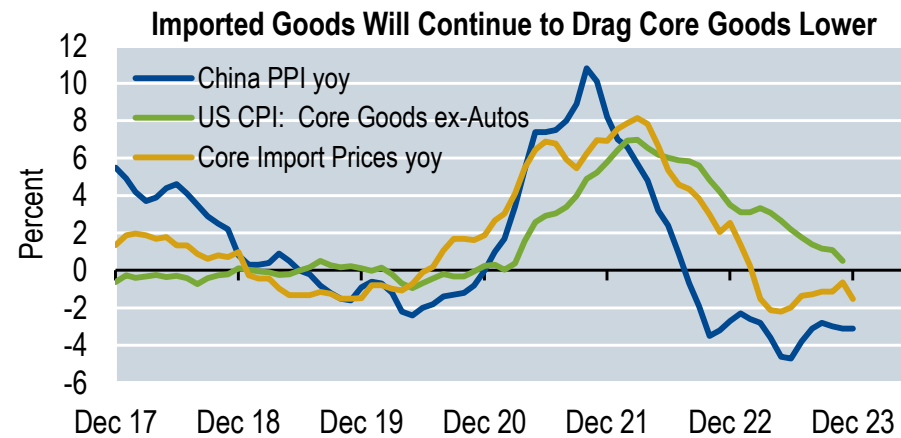


Source: Bloomberg. As of 31 Dec 23



Source: Bloomberg, Western Asset. As of 30 Nov 23

¹EM = Brazil, Mexico, Colombia, Chile, South Africa, India, Indonesia and Poland

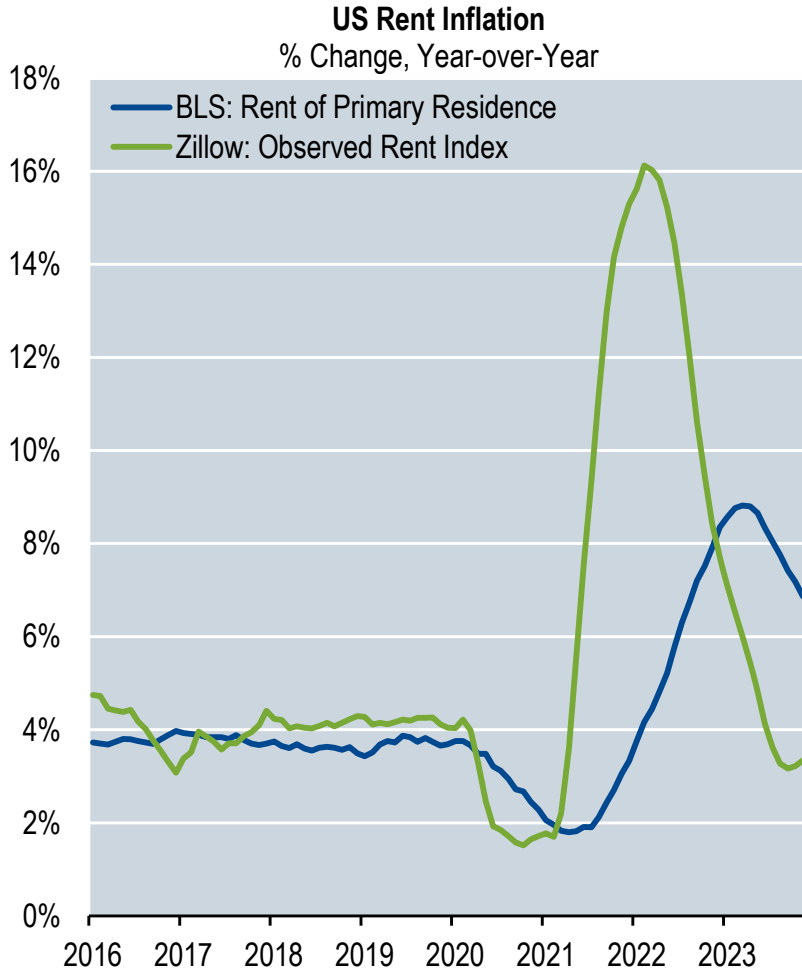


Source: Bureau of Economic Analysis. As of 31 Dec 23

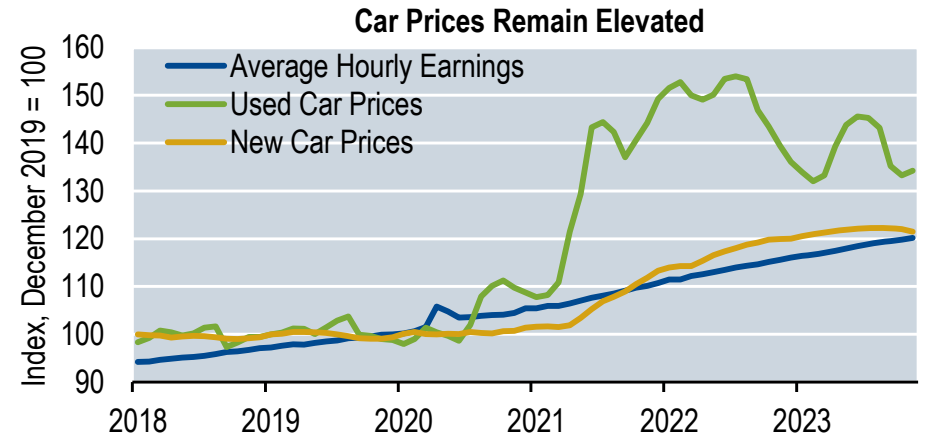
*US CPI as of 30 Nov 23

More Disinflation to Come in US

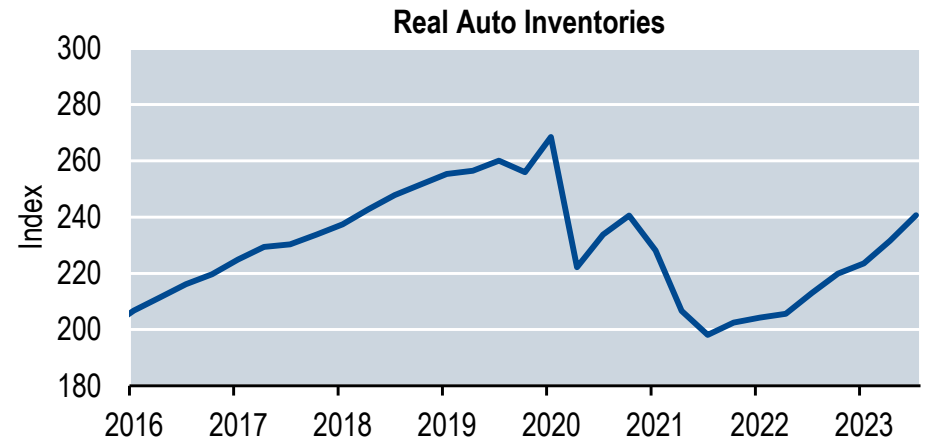
Rent disinflation not yet fully reflected; goods prices have further to fall



Source: Bureau of Labor Statistics, Haver Analytics, Zillow. As of 30 Nov 23



Source: Bureau of Labor Statistics, Haver Analytics. As of 30 Nov 23

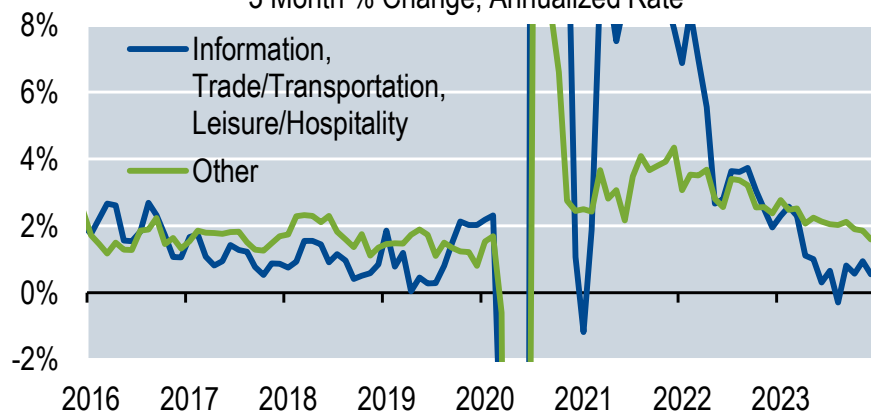


Source: Federal Reserve. As of 30 Jun 23

US Labor Market Moving Back Towards Balance

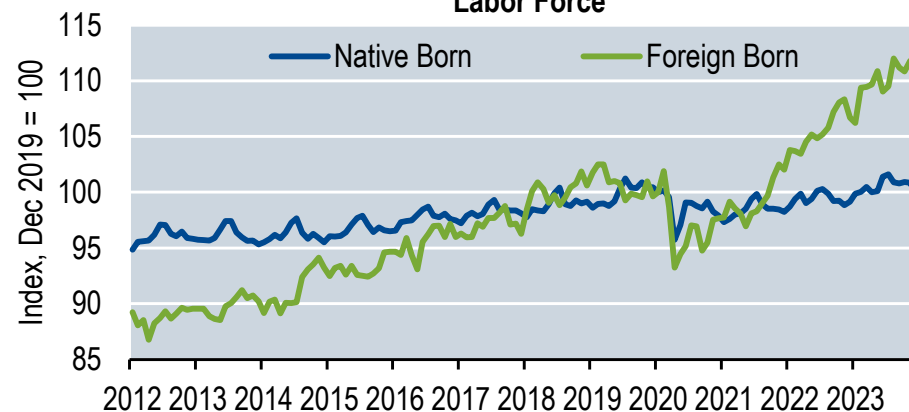
Demand moderating, supply improving

Employment Growth by Sector
3 Month % Change, Annualized Rate



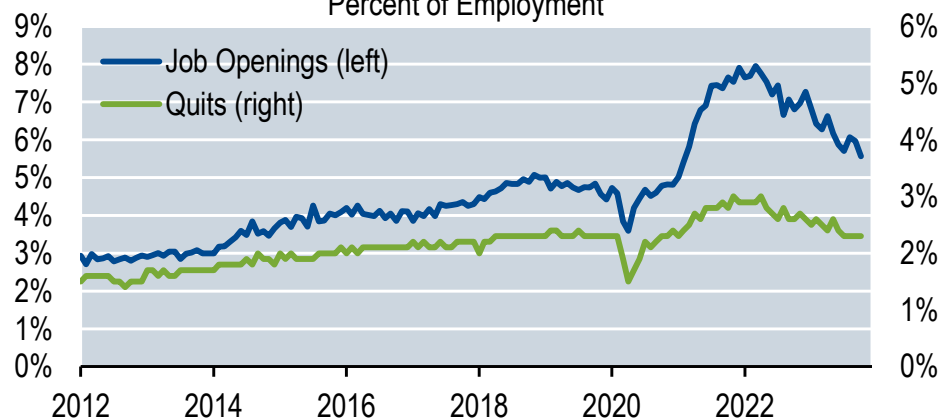
Source: Bureau of Labor Statistics, Haver Analytics. As of 31 Dec 23

Labor Force



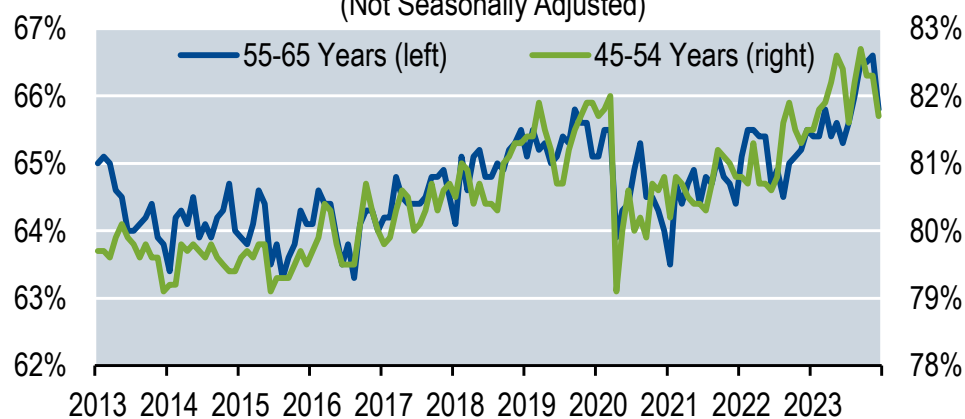
Source: Bureau of Labor Statistics, Haver Analytics. As of 31 Dec 23

Job Openings and Quits
Percent of Employment



Source: Bureau of Labor Statistics, Haver Analytics. As of 30 Nov 23

Labor Force Participation Rate
(Not Seasonally Adjusted)



Source: Bureau of Labor Statistics, Haver Analytics. As of 31 Dec 23

US Wage Growth Normalizing



Source: Bureau of Labor Statistics, Haver Analytics. As of 31 Dec 23



Source: Bureau of Labor Statistics, Atlanta Federal Reserve, Haver Analytics. As of 31 Dec 23

US Growth Moderation Likely to Continue

Tight Credit Conditions

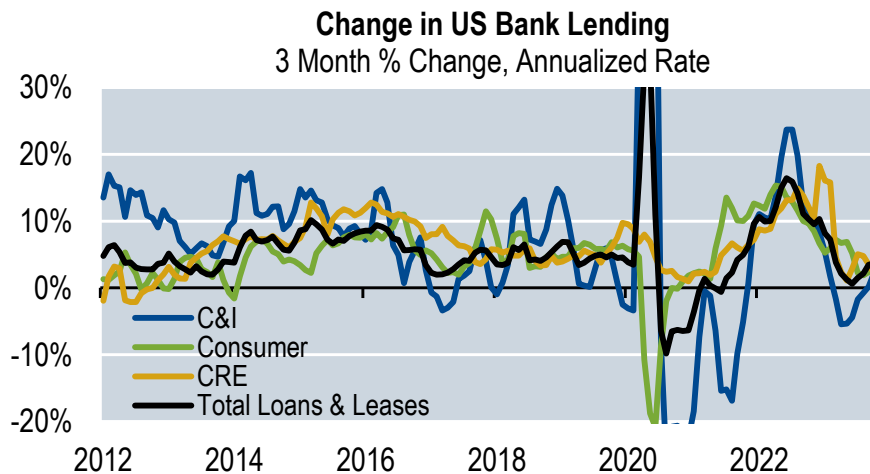
Savings Rate Likely to Rise

High Interest Rates Deter Investment

- Especially in Housing and Manufacturing

Fiscal Impulse a (Small) Drag

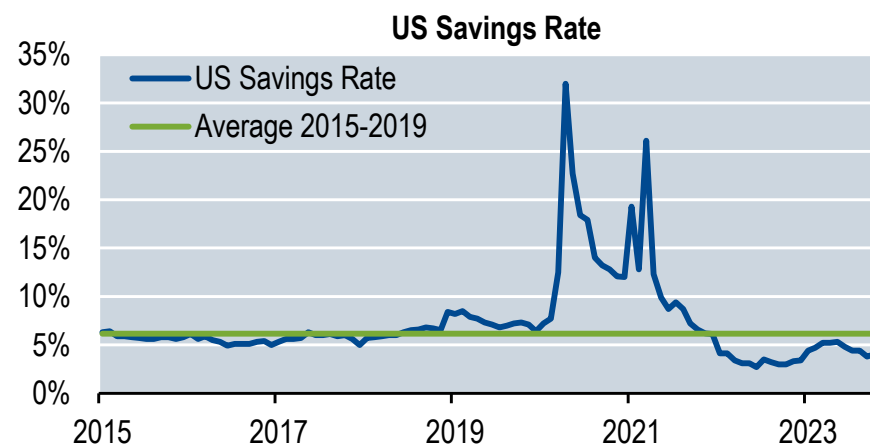
Reopening in Leisure/Hospitality Finished?



Source: Federal Reserve, Haver Analytics. As of 30 Nov 23



Source: Bloomberg. As of 09 Jan 24



Source: Bureau of Economic Analysis, Haver Analytics. As of 30 Nov 23

Powell Moves From “Pain” to “So Far, So Good”

“While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, **they will also bring some pain to households and businesses.**

These are the unfortunate costs of reducing inflation. But a failure to restore price stability would mean far greater pain.”

– Chair Powell, August 26, 2022
Jackson Hole Symposium

“Inflation keeps coming down. The labor market keeps getting back into balance. And you know, **it's so far, so good**, although we kind of assume that it will get harder from here, but so far, it hasn't.”

– Chair Powell, Dec 13, 2023
Post FOMC Meeting Press Conference

FOMC Discussion Turns Towards Cuts

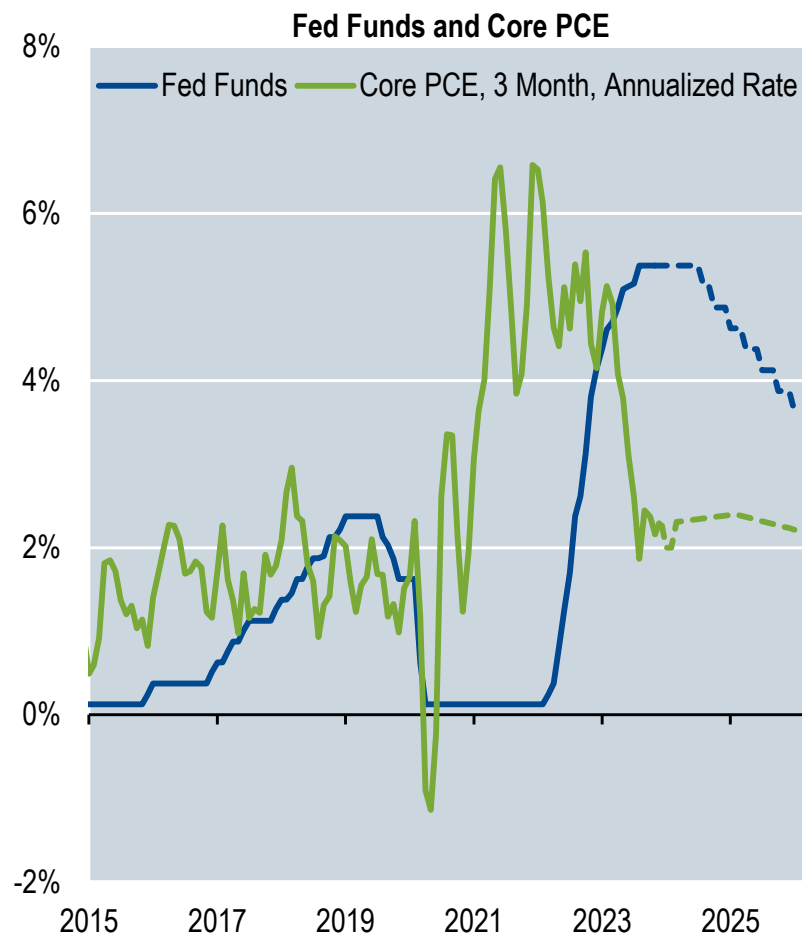
But FOMC also forecasts Fed funds remaining well above inflation rate

“The question of when will it become appropriate to begin dialing back the amount of policy restraint in place, that begins to come into view and is...**also a discussion for us at our meeting today**”

“**So, we're aware of the risk that we would hang on too long.** We know that that's a risk, and we're very focused on not making that mistake.”

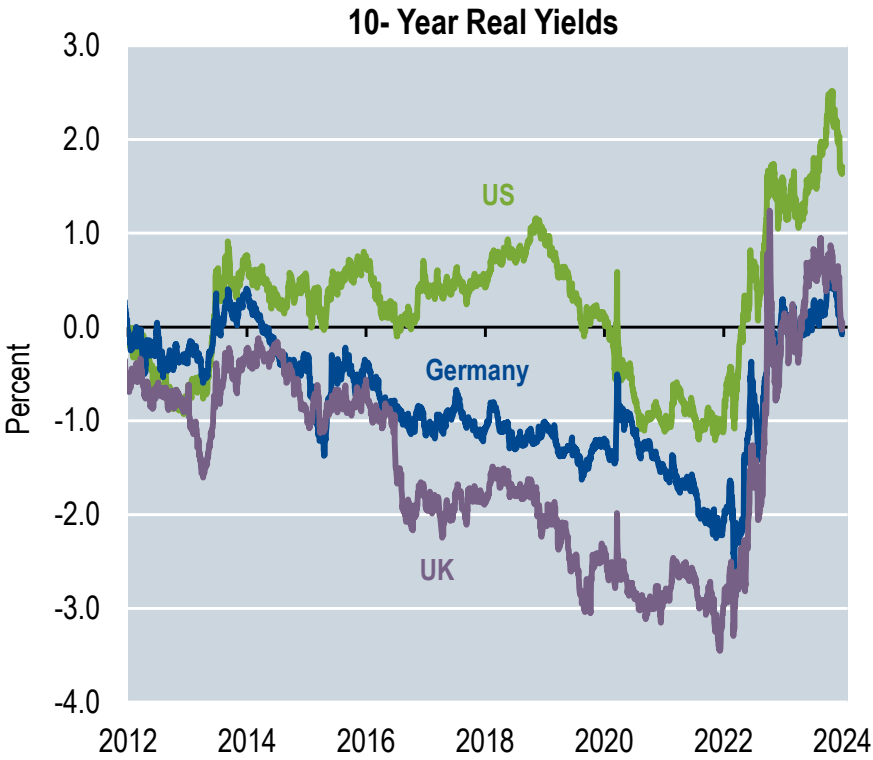
“We're getting now back to the point where **both mandates are important**, and they're more in balance, too.”

– Chair Powell, Dec 13, 2023

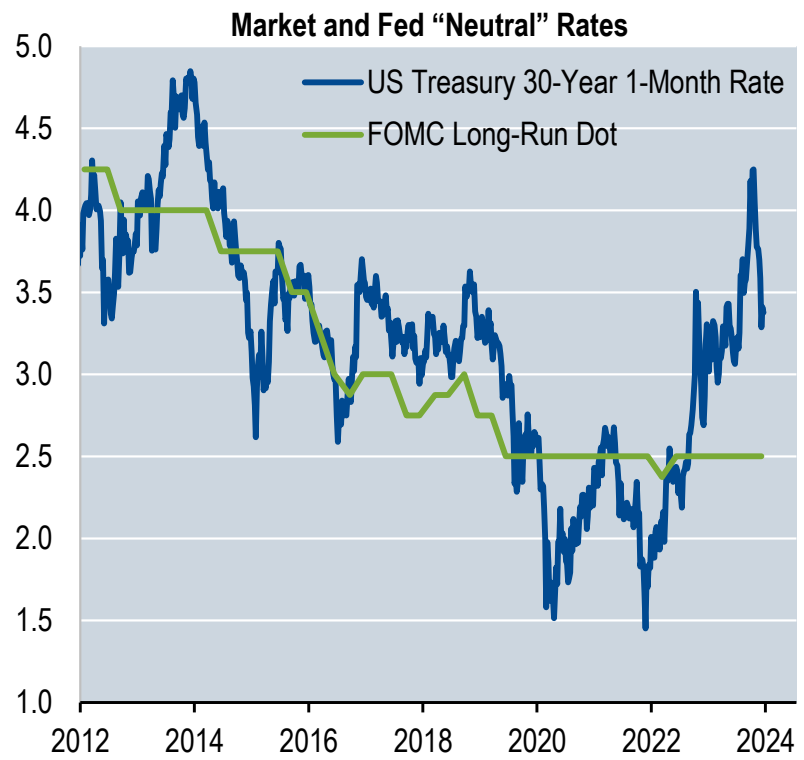


Source: Federal Reserve, Bureau of Economic Analysis, Haver Analytics
As of 31 Dec 23

Interest Rates Remain Elevated



Source: Bloomberg. As of 31 Dec 23

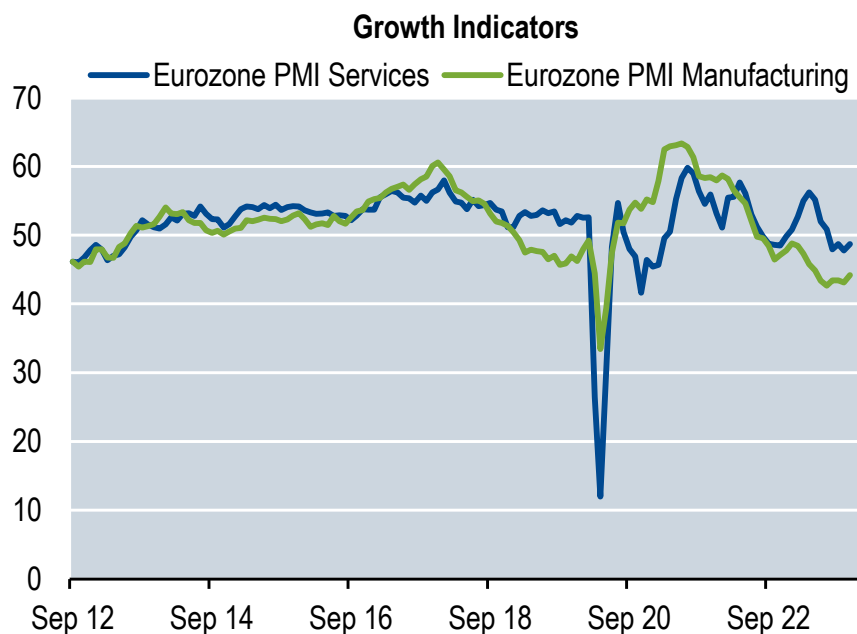


Source: Bloomberg. As of 31 Dec 23

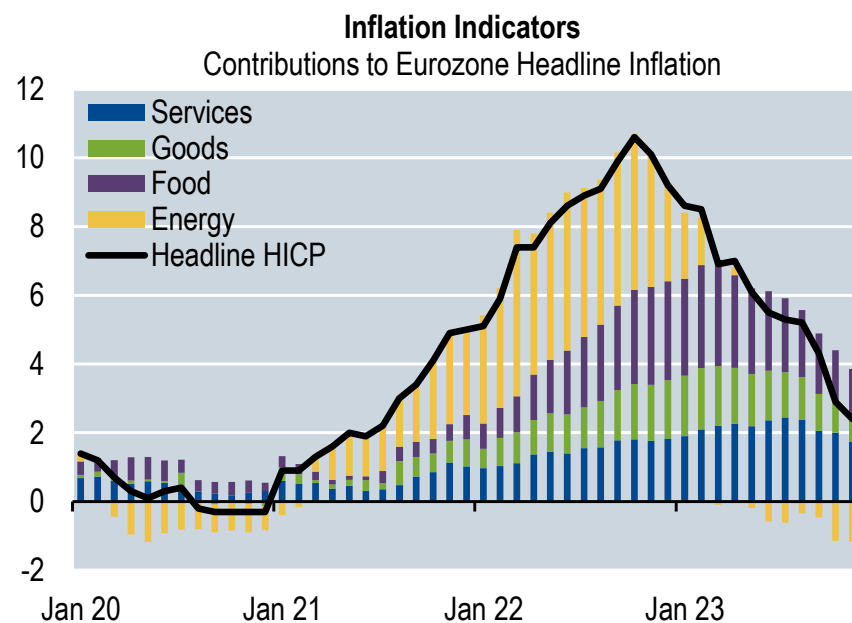
Europe: Stagnant Growth With Inflation Closing in on Target

- Growth: Stagnation to mild contraction
- Inflation: Continues to fall more quickly than ECB forecast
- ECB: Still more concerned about upside inflation risks (that assessment will change soon)
- ECB: Policy historically tight given growth and inflation

	Policy	HICP	GDP
1999 to Current	1.50	2.09	1.39
Current	4.00	2.40	0.10



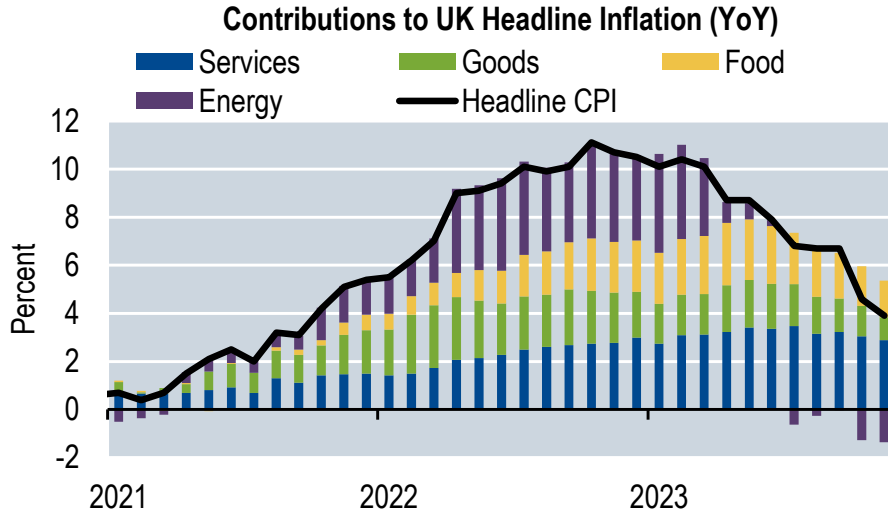
Source: S&P Global, Hamburg Commercial Bank, Haver Analytics. As of 30 Nov 23



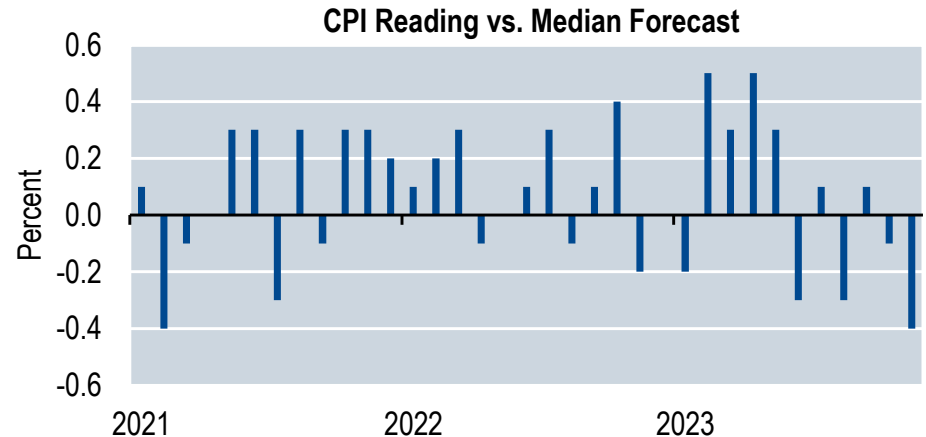
Source: S&P Global, Hamburg Commercial Bank, Haver Analytics. As of 30 Nov 23

United Kingdom: Less of an Outlier

- Base effects are finally reflecting in energy and food prices
- Slowing is being seen across all components and recent prints have surprised to the downside (sharp contrast to the early past of last year)



Source: Office for National Statistics, Bloomberg. As of 30 Nov 23

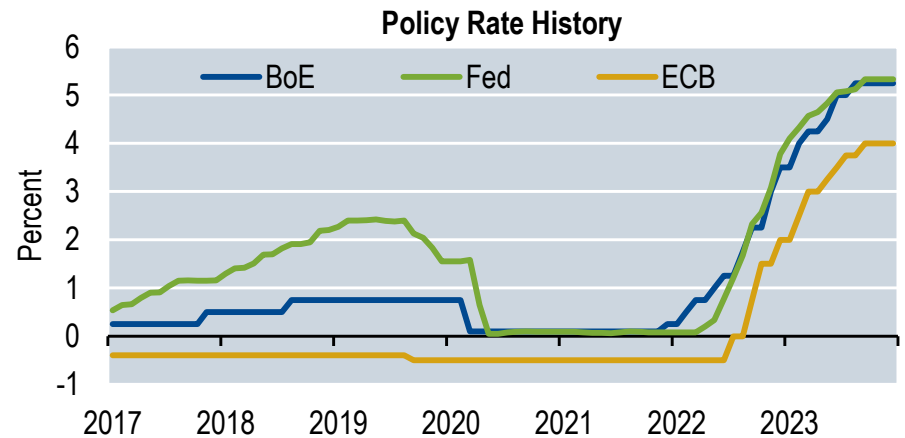


Source: Office for National Statistics, Bloomberg. As of 30 Nov 23

- More timely price measures show that inflation will continue to slow towards target, slack has returned to the labour market and growth remains subdued
- Given lags in the transmission of monetary policy, we expect a shift towards a less restrictive monetary policy stance

IMF Real GDP Forecasts			
	Projections		
	2022	2023	2024
US	2.1	2.1	1.5
Euro Area	3.3	0.7	1.2
UK	4.1	0.5	0.6

Source: International Monetary Fund. As of October 2023



Source: Bloomberg. As of 31 Dec 23

The above reflects current opinions of Western Asset and are subject to change with market conditions.

China: Underwhelming Post-Covid Economic Rebound

Government growth targets are achievable but consumer confidence is weak.

- The post-Covid economic rebound in 2023 disappointed the market, with external forecasters expecting 2024 growth below authorities' 5% target.
- In the face of continuing pressure on the property sector and local government funding, policymakers have increased measures to stabilize financial markets, including rate cuts, loan guarantees and FX intervention



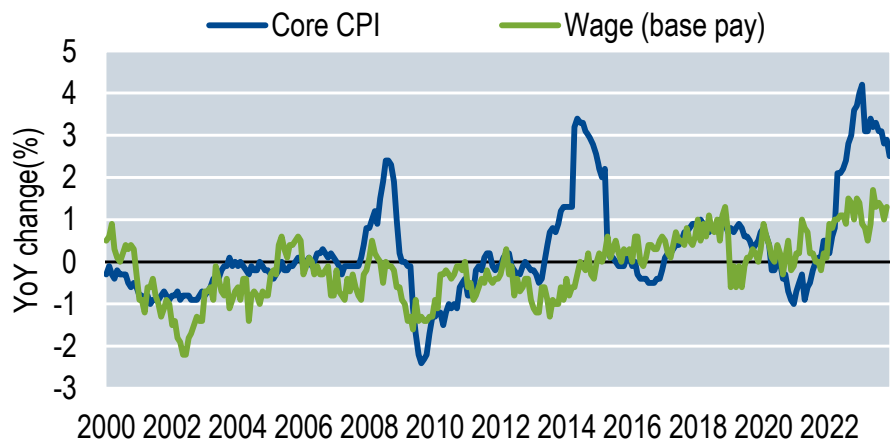
Source: Bloomberg, Citi. As of 31 Dec 23



Source: Bloomberg. As of 31 Dec 23

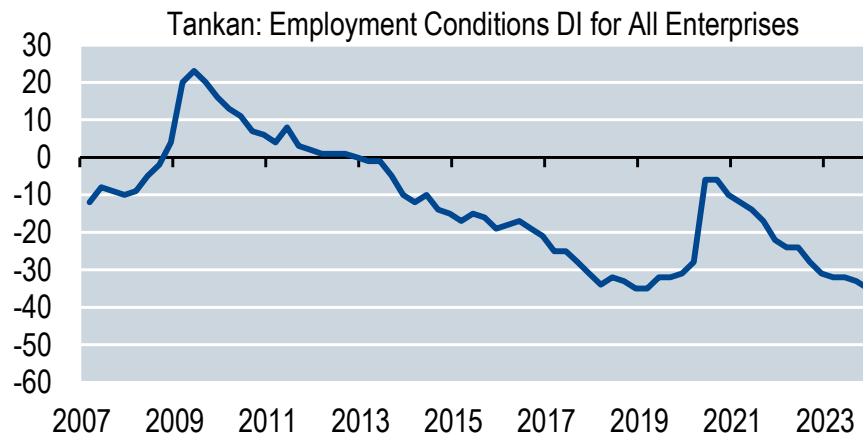
Japan: Wage Pressure Slowly Building as Employment and Growth Outlook Brightens

Wage increased following the results of spring wage negotiation and the tight labor market.



Source: Bloomberg. As of 30 Nov 23

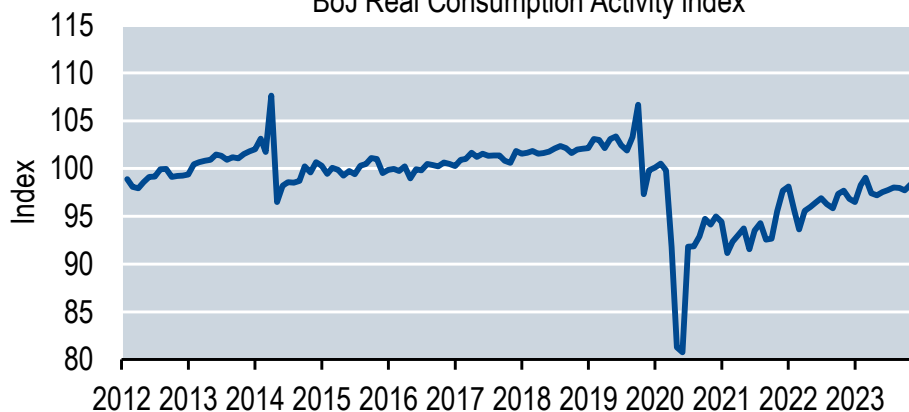
Employment Conditions Survey: BoJ Tankan survey: employment conditions DI suggests a deepening labor shortage.



Source: Bloomberg, Western Asset. As of 31 Dec 23

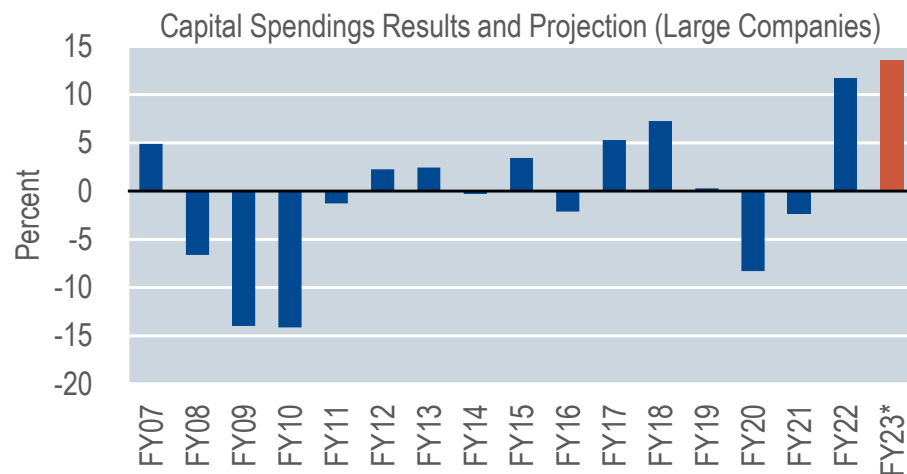
Employment Conditions DI: "excessive employment" minus "insufficient employment"

Consumer Activities
BoJ Real Consumption Activity index



Source: Bloomberg, Western Asset. As of 31 Oct 23

Capital Spending: BoJ Tankan survey: Capital spending projections are strong.



Source: Bank of Japan. Western Asset. As of 30 Sep 23

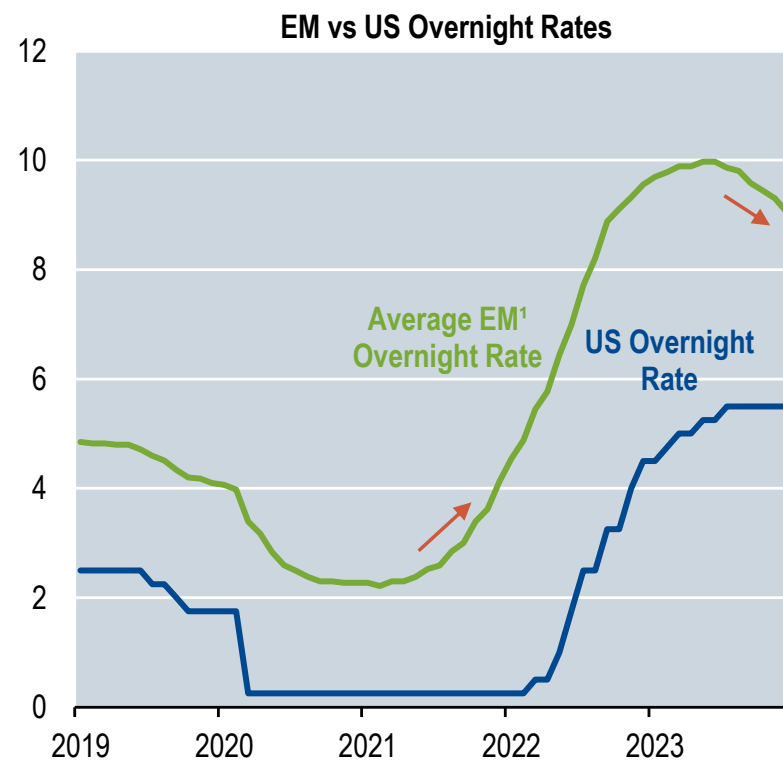
*FY2023 Projection

EM Central Banks Have Been Ahead of the Curve

EM policymakers tightened policy aggressively, starting in early 2021 well in front of the Fed.

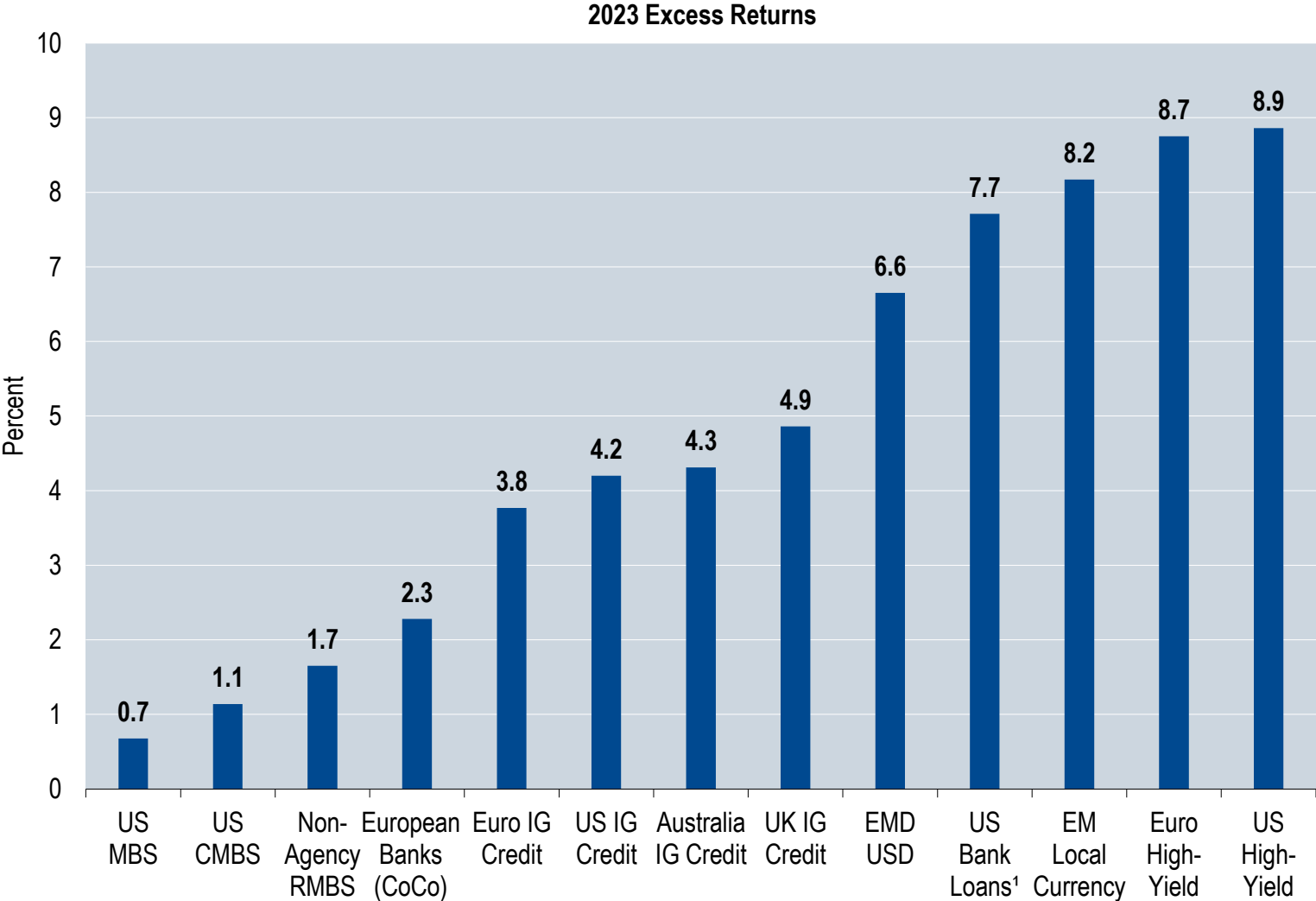
With both EM and DM inflation having peaked, EM central banks have already started to cut rates despite the Fed indicating no cuts in the US until late 2024.

EM central banks' response to the recent inflation scenario has provided stability for EM FX and the opportunity for investors to benefit from attractive local yields.



Source: Bloomberg, Western Asset. As of 31 Dec 23
*EM = Brazil, Mexico, Colombia, Hungary, Chile, South Africa, India, Indonesia and Poland

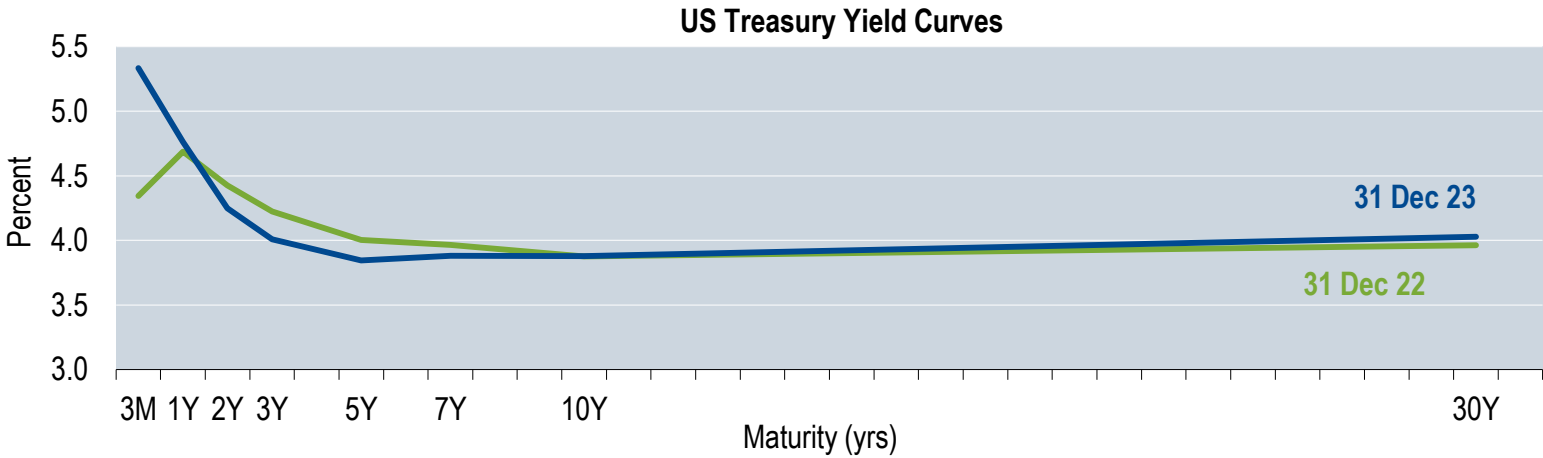
Spread Sector Excess Returns



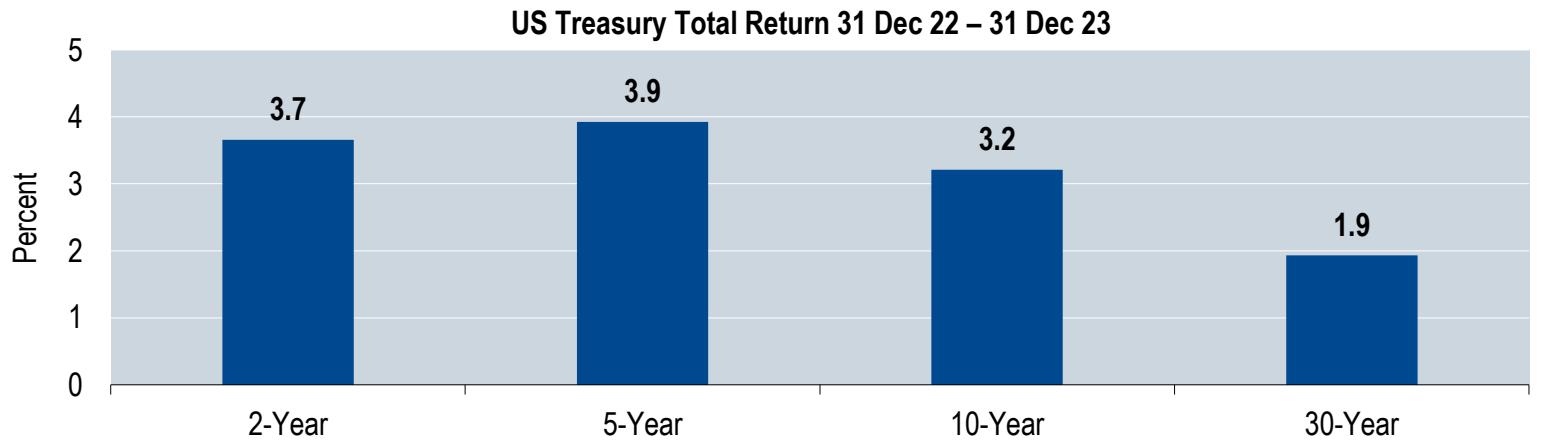
Source: Bloomberg, Citi, J.P. Morgan, S&P Global Market Intelligence, a division of S&P Global Inc, Western Asset. ¹S&P/LSTA Leveraged Loan Total Return Index excess return vs. 3-Month LIBOR. As of 31 Dec 23
 Past performance is not a reliable indicator of future results.



US Treasury Yield Curves

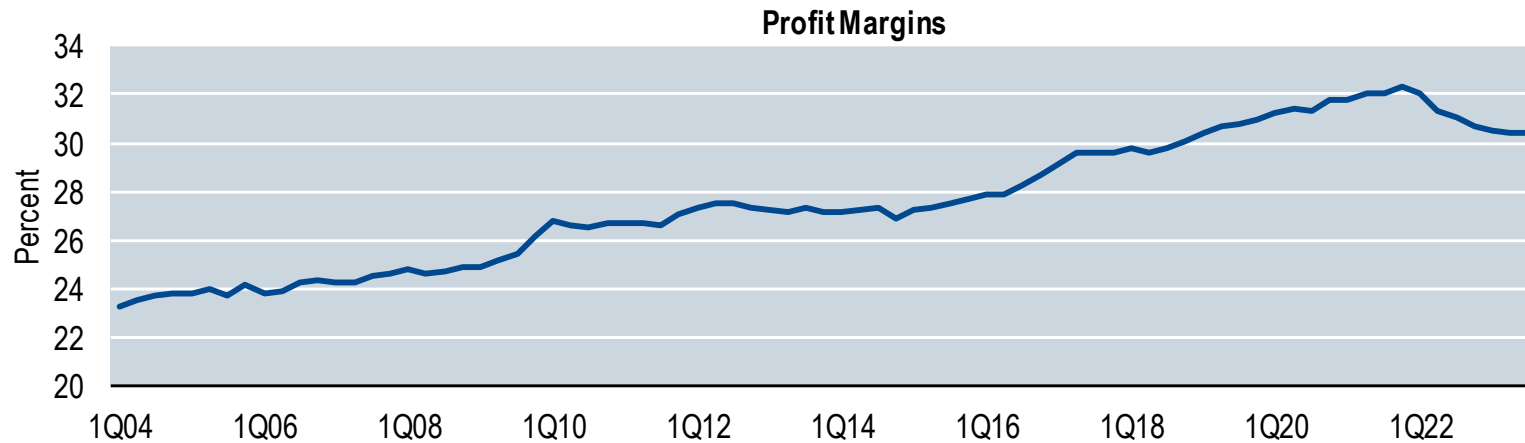


Source: Bloomberg. As of 31 Dec 23

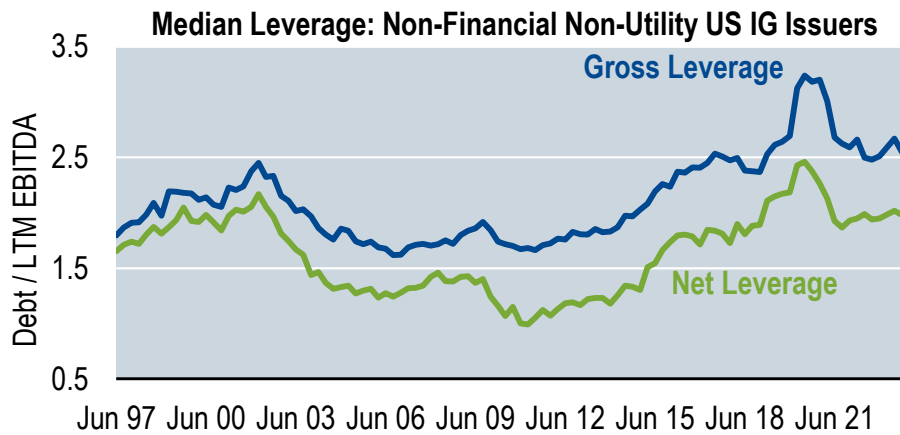


Source: Bloomberg

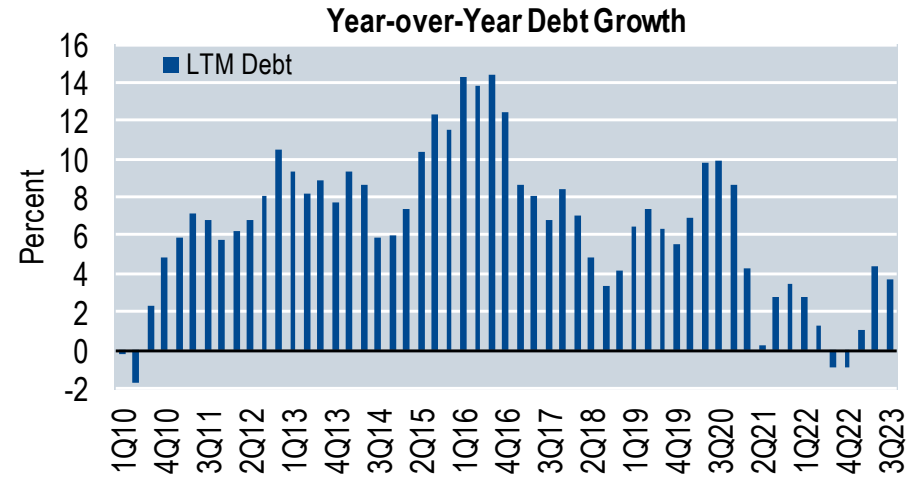
Corporates Have Solid Cash Flow and Debt Metrics



~180 Non-Financial Companies (JULI Based)
 Weighting based on amount of debt in the benchmark
 Source: J.P. Morgan. As of 30 Sep 23



Source: BofA Global Research*. As of 30 Sep 23

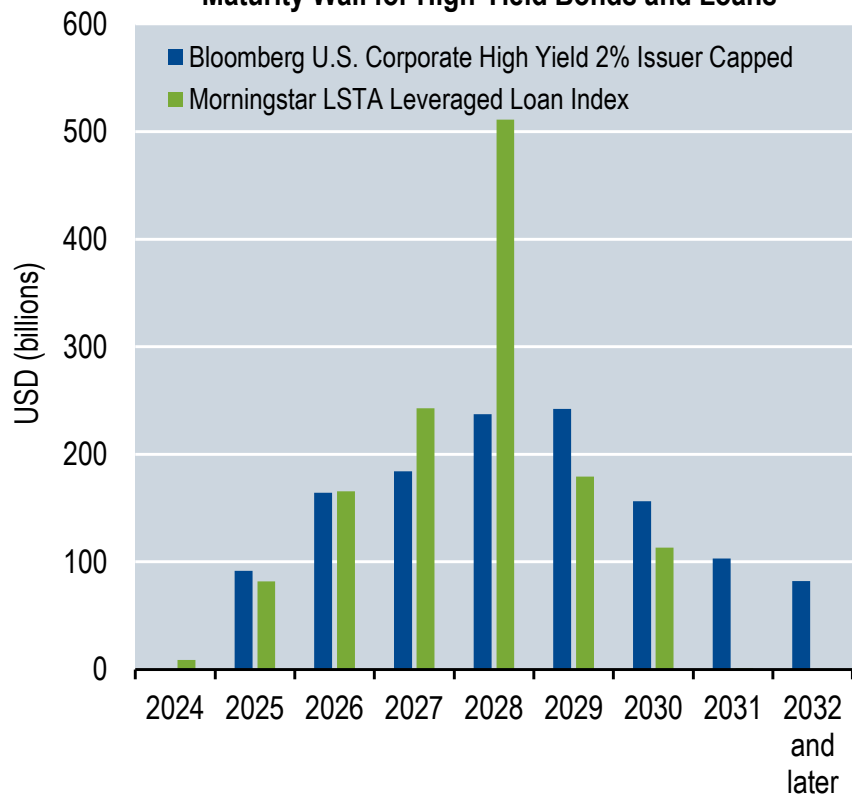


Source: J.P Morgan. As of 30 Sep 23

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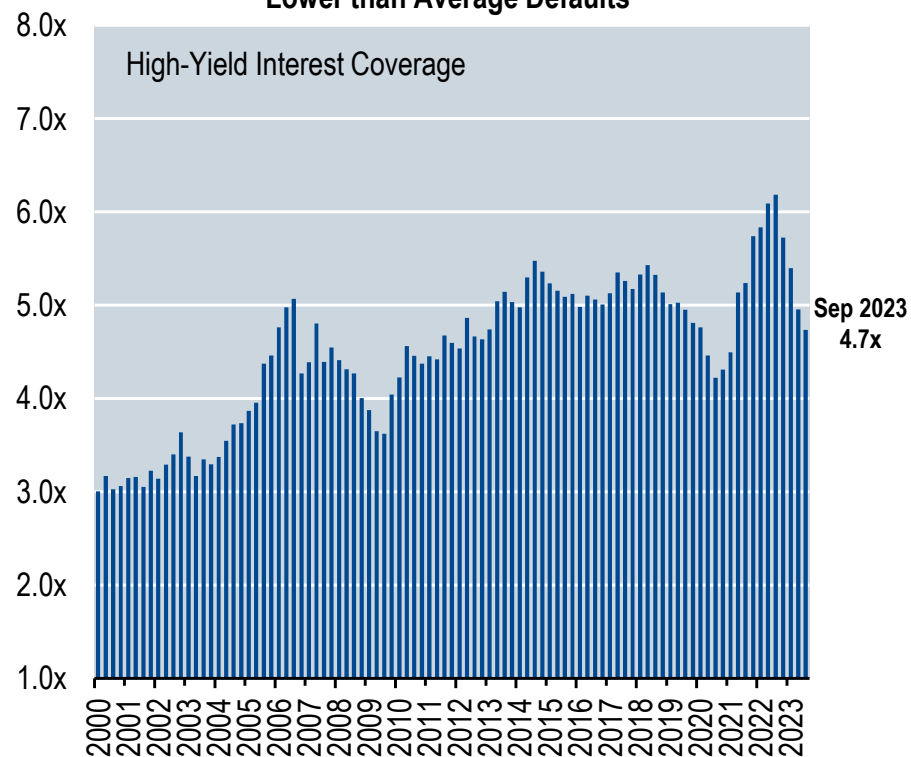
High-Yield Fundamentals

Maturity Wall for High-Yield Bonds and Loans



Source: Bloomberg, Morningstar. As of 31 Dec 23

Ability to Service Debt Also Supportive of Lower than Average Defaults

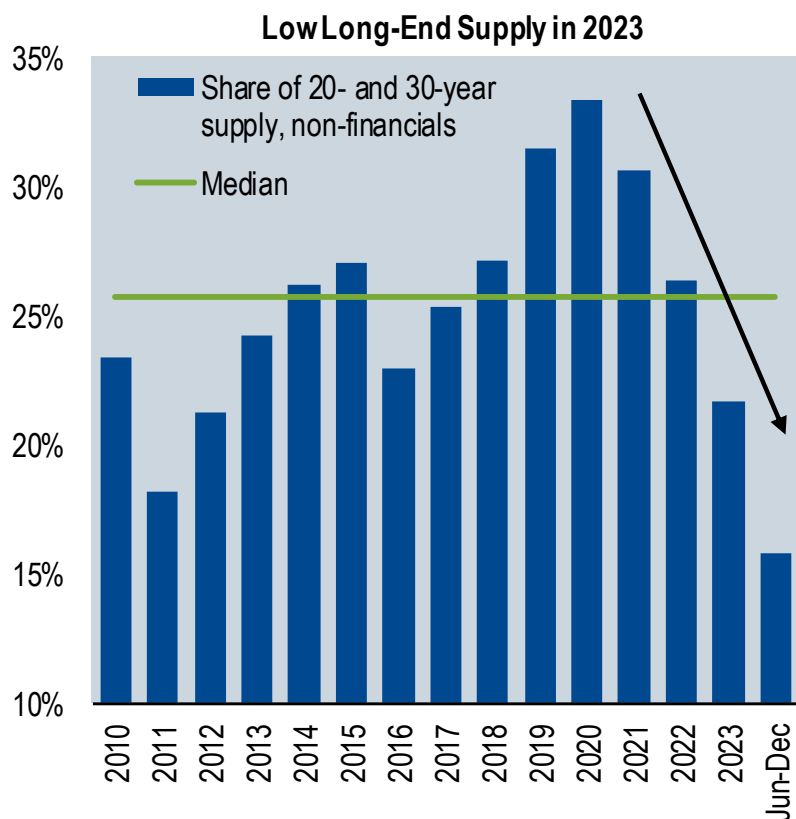


The sample is confined to public reporters for which we are able to retrieve four consecutive quarters of data from Bloomberg or S&P Capital IQ. New constituents are integrated quarterly based on additions to the Bloomberg US Corporate HY Bond Index).

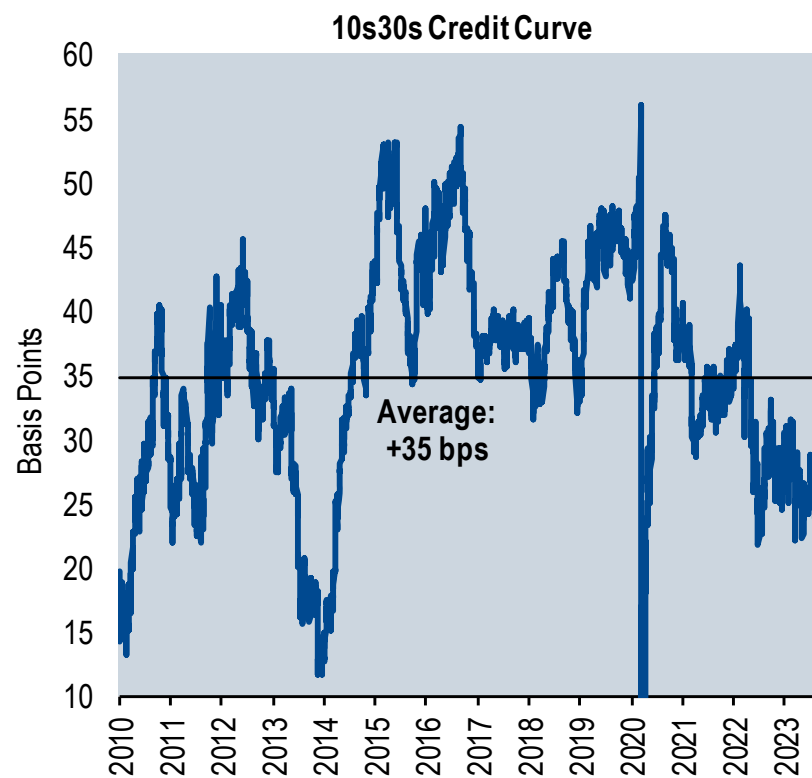
Source: Morgan Stanley Research, Bloomberg, S&P Capital IQ. As of 30 Sep 23

Dramatic Flattening of the Credit Curve in 2H23

Yield-based buyers locking in attractive all-in yields were met with dwindling long end supply.

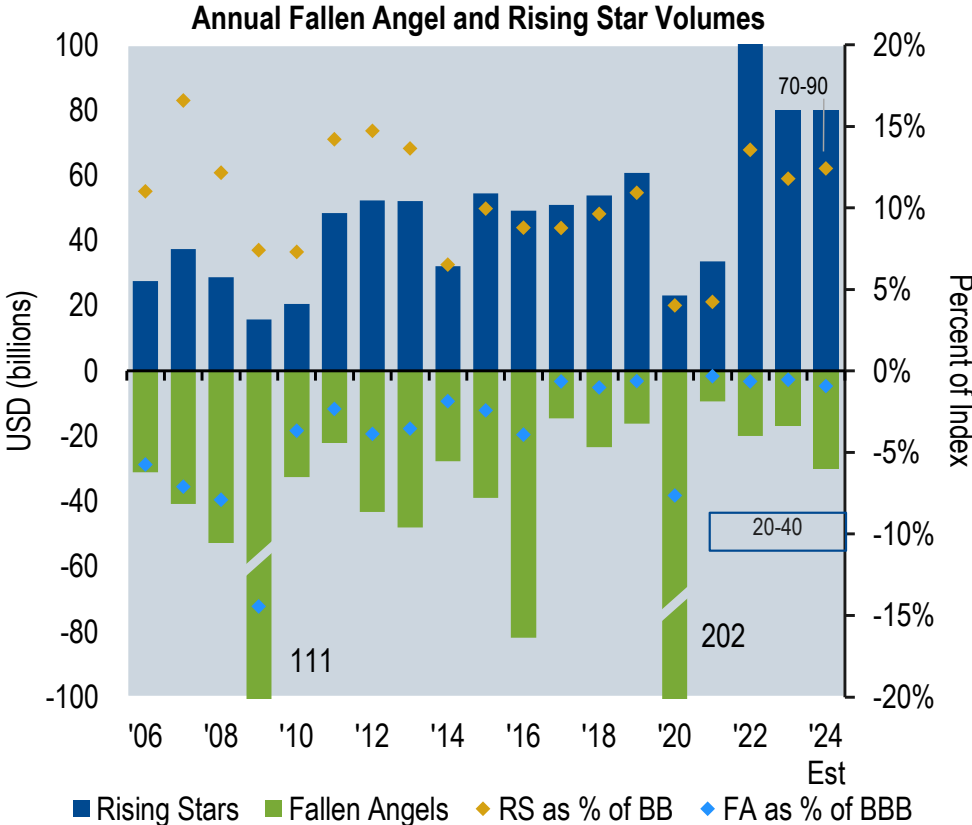


Source: BofA Global Research. As of 31 Dec 23

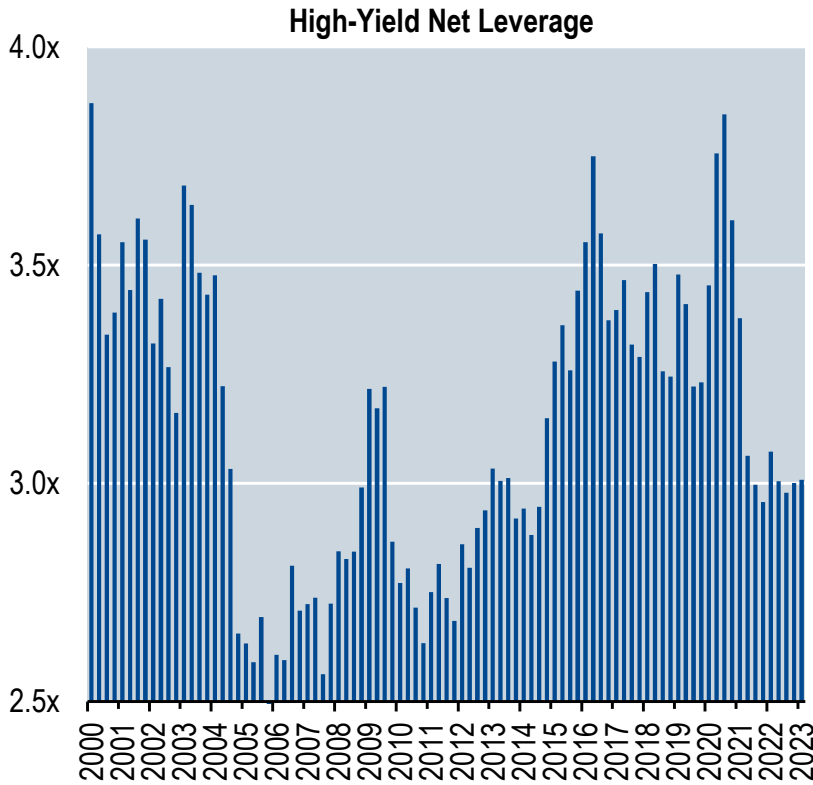


Source: J.P. Morgan. As of 18 Oct 23

Credit Rating Upgrade Opportunities Still Exist



Source: Bloomberg, Barclays Research. As of 31 Oct 23

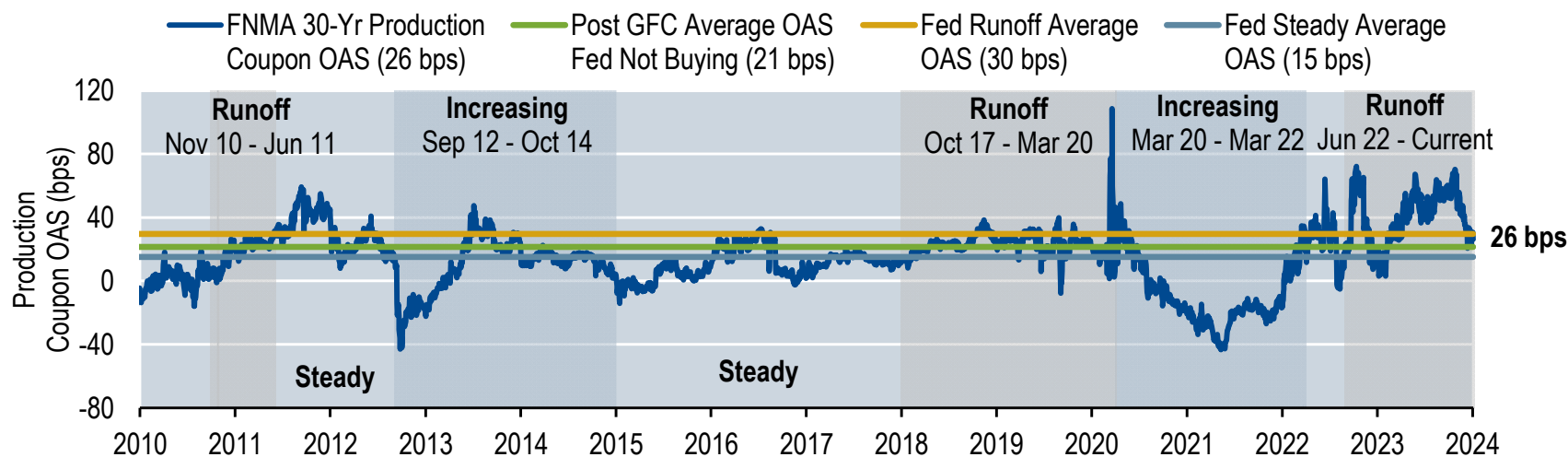


Source: Morgan Stanley Research, Bloomberg, S&P Capital IQ. As of 30 Sep 23

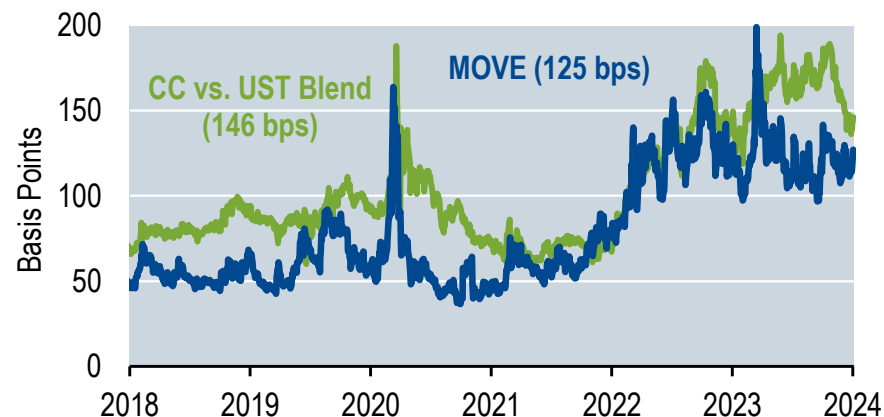
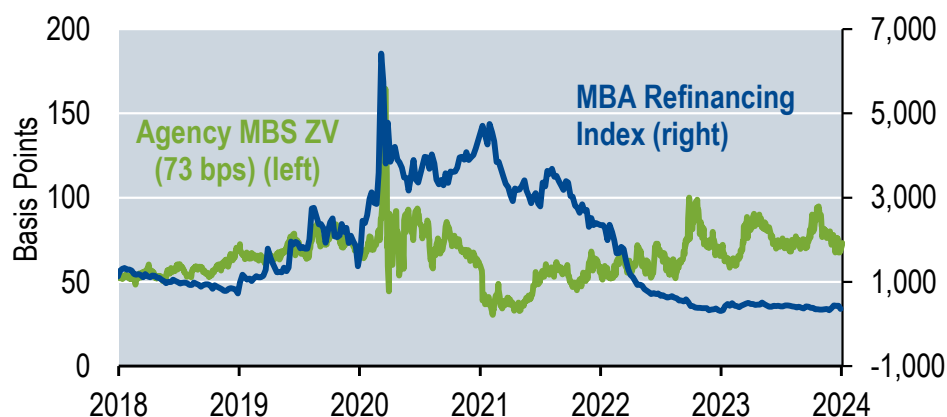


Agency Mortgage-Backed Securities Remain Fundamentally Attractive

- Agency MBS spreads widened as Fed and banks support diminished and volatility was elevated
- Prepayment risk remains muted as mortgage borrowers have little refinancing incentive



Source: Bloomberg, MS Research, Western Asset. As of 03 Jan 24



Source: Bloomberg, MS Research, Western Asset. As of 03 Jan 24

Mortgage Credit Offers Attractive Relative Value

- While real estate prices are expected to cool from the record increases, market spreads are elevated with increased risk premiums
- During the housing boom of Covid, lending stayed conservative and single family markets remain well supported by long-term fundamentals
- Commercial real estate sector has largely been able to pass on the cost of higher interest rates in rents at hotels, apartments, and industrial properties, while the office sector faces continued headwinds from Covid

Spreads	Representative RMBS CRT Below IG*	BAML RMBS Legacy Below IG	Bloomberg Non-Agency CMBS BBB	Bloomberg US IG Corporate	Bloomberg US High Yield
31 Jan 20	178	123	250	102	390
29 Dec 23	295	267	1,120	99	323
Difference Since 31 Jan 20	117	143	870	-3	-67
31 Dec 18	246	127	371	153	526
29 Dec 23	295	267	1,120	99	323
Difference Since 31 Dec 18	49	140	749	-54	-203

Source: Bloomberg, Bank of America, Western Asset. As of 29 Dec 23

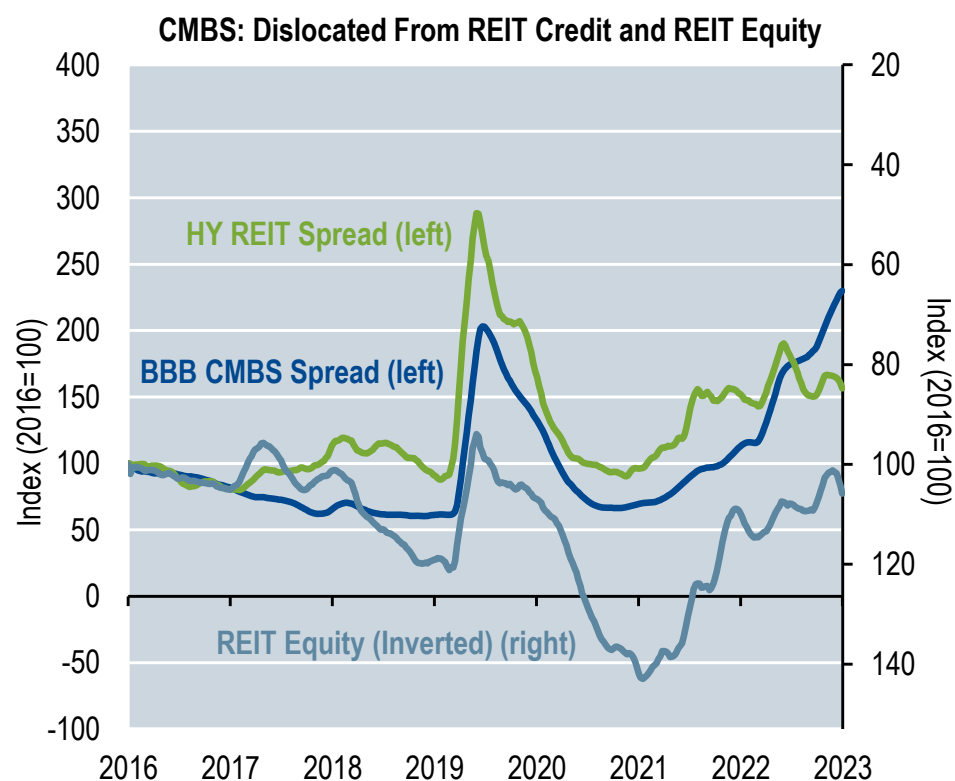
Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situations or needs of investors.

*Representative RMBS CRT Below IG: On-the-run speed adjust spread for below investment-grade rated CRT cohort

Past performance is not a reliable indicator of future results.

Commercial Mortgages (CMBS) are Widely Panned but Misunderstood

- Unfairly maligned, CMBS credit spreads remain wide of peak COVID 2020 distressed levels while spreads of similar commercial real estate exposures recover
- Office sector has been uniquely impacted by COVID; however, the 4 other primary commercial real estate sectors exhibit neutral to positive fundamental performance since 2019



Source: Bloomberg, Western Asset. As of 31 Dec 23
Indexed to 100 on 30 Dec 16

4 of 5 Commercial Real Estate Sectors Fundamentally Sound

	Office	Retail	Multifamily	Industrial	Hotel	
Change From 2019	Occupancy	-4.4%	0.3%	-0.9%	-0.9%	-2.9%
	Rent Growth*	0.7%	13.5%	16.1%	36.2%	16.2%
	Cap Rates	1.1%	-0.3%	0.2%	0.1%	0.1%
	Price Change 4-Year*	-4.9%	9.8%	17.9%	45.4%	20.7%
	Loan Payoff Rate	-34.7%	-5.1%	-2.4%	(NAV)	24.0%

Source: Costar, Deutsche Bank, Real Capital Analytics, Western Asset. As of 31 Dec 23

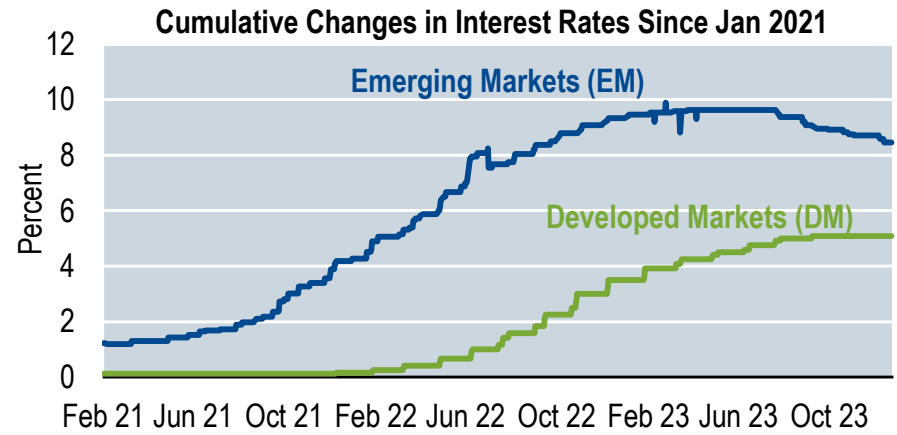
*Cumulative

The USD and Commodities: Key Emerging Market Drivers

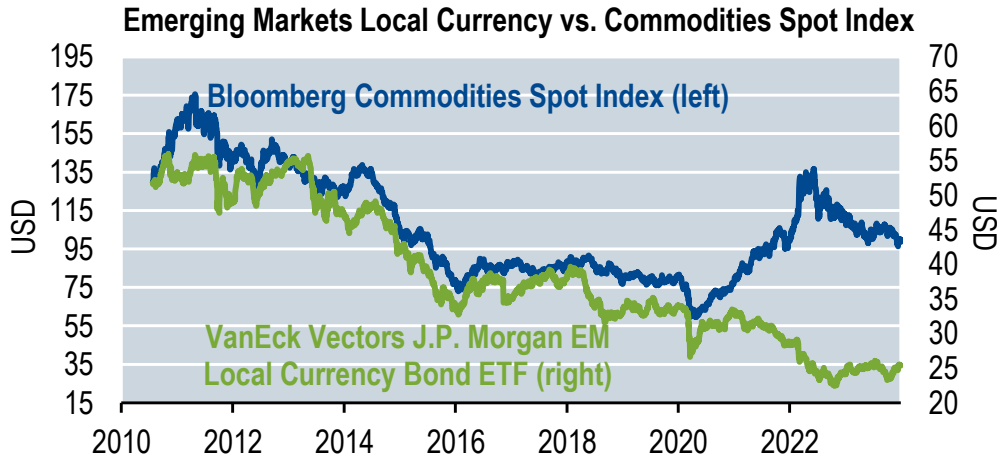
- EM central banks are closer to the end of the tightening cycle relative to the developed world
- USD relative strength and commodity prices are both inputs into EM economic conditions and returns
- A Fed pause coupled with moderate economic growth bodes well for EM



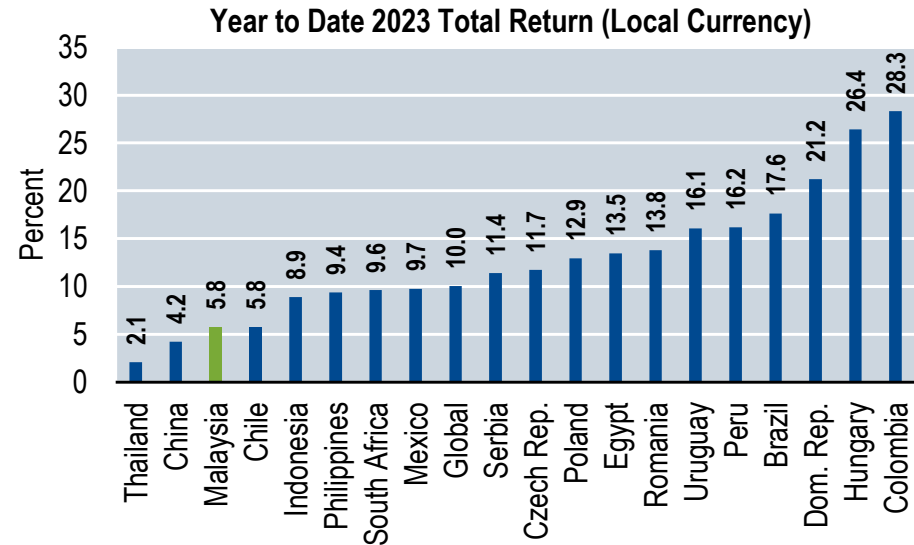
Source: Bloomberg. As of 31 Dec 23
 Note: The US Dollar Index is the value of the US dollar relative to a basket of foreign currencies



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



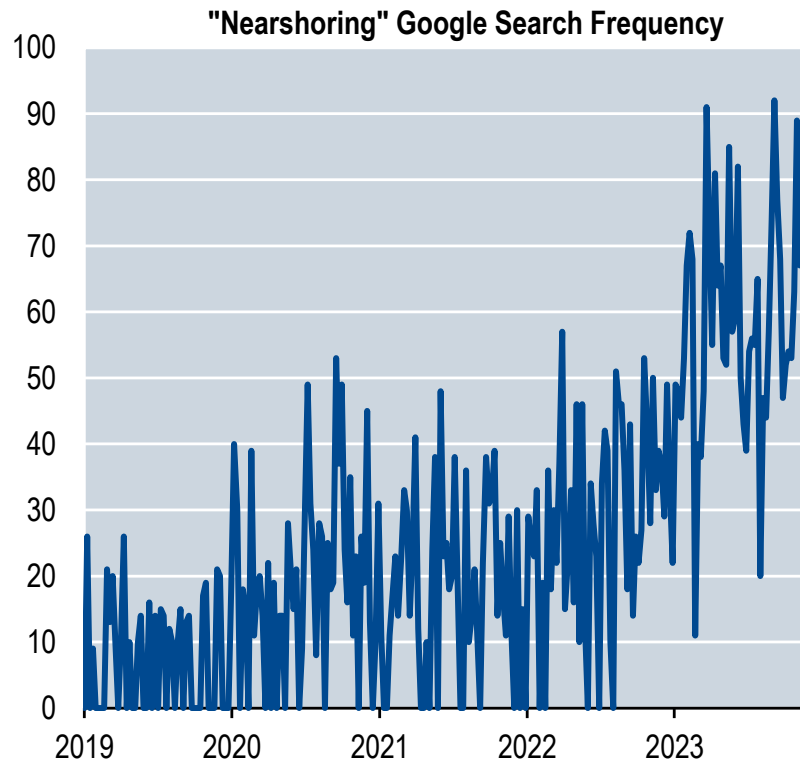
Source: Bloomberg. As of 29 Dec 23



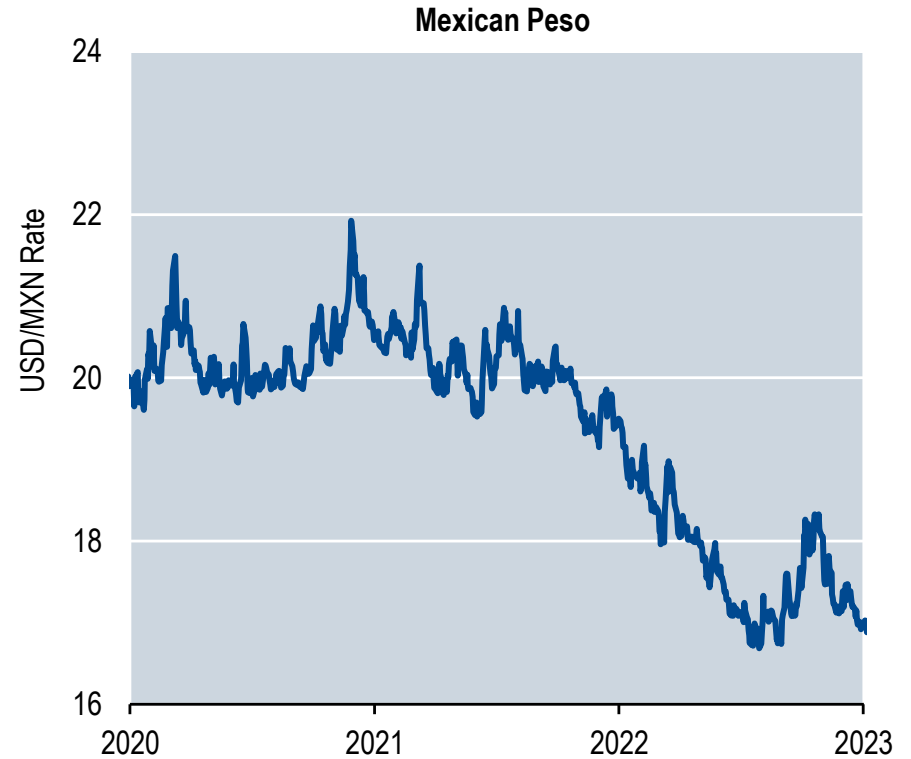
Source: J.P. Morgan. As of 31 Dec 23

Nearshoring Set to Benefit EM

- Some EM countries/regions are set to benefit from the evolution of global supply chains to reflect geopolitical considerations in addition to manufacturing costs
- We would highlight Mexico, Dominican Republic, Costa Rica, and India as potential beneficiaries of nearshoring



Source: Google. As of 26 Nov 23



Source: Bloomberg. As of 31 Dec 23

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

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- Geopolitical uncertainty continues to add to volatility



Thank you.

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