Webcast Summary

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Macro Opportunities Strategy Update: The Impact of Global Optimism

The improving macro backdrop in 2023 positively impacted the Macro Opportunities strategy's performance. Notably, the recent market sentiment shift toward likely central bank monetary easing in 2024 has lifted risk assets and tightened credit spreads, creating a favorable return environment. Going into the new year, the strategy is favorably positioned across sovereign bonds, credit sectors and other fixed-income areas to capitalize on Western Asset's global outlook, including our expectation that disinflationary trends should continue. The strategy provides concentrated exposure to our highest-conviction themes, including EM sovereign debt, especially in Latin America and Asia, DM rates, particularly USTs, and select opportunities in US investment-grade and high-yield corporate credit.

Global Outlook

- We think global disinflation is broad-based and ongoing, albeit uneven.
- Overall tight credit conditions and negative savings rates affecting consumer spending contribute to our view that the slowing of global growth is likely to continue.
- While US energy and goods prices have come down, rents and services remain sticky, but we believe we could see declines in the coming months.
- In the US labor market, we believe that downward pressure on wages, lower job openings and decreasing quit rates all lead to labor slack going forward.
- We continue to believe US rates will rally because they still look cheap versus other economies.
- Emerging markets (EM) have started cutting rates in the latter half of last year as inflation has declined, lending a boost to sovereign debt across EM countries.
- In China, we believe the country's disappointing growth metrics could be a source of disinflation for the rest of the global economy.

Investment Themes

- The US has turned away from China and towards trading more with USMCA partners and other Asian economies. This will not only benefit Mexico, but also Latin America as a whole, as well as Asian economies like India and Indonesia.
- Rates still look cheap in the US, where real yields are far higher than those of other economies. As that begins to weigh on US growth, we feel that that should allow for US Treasury (UST) nominal yields to move lower.
- US corporate profits and earnings remain fairly robust and do not show signs of an impending recession.

- Credit continues to shows promise and fundamental soundness, though spreads are not screamingly cheap currently. As a result, we have cut our allocation to investment-grade and high-yield corporate spreads.
- EM sovereign debt should benefit from global central banks' rate cuts in 2024 and the US dollar is likely to continue to decline, which is a tailwind for EM.
- We believe commodities will continue to drive EM economies and benefit net commodity (metals and energy) exporters such as Brazil and Indonesia.
- We have increased our allocation to EM and developed market (DM) rates, which look very attractive from both a fundamental and valuation perspective, demonstrating how our team continues to dynamically navigate markets over time by shifting risk allocations.

Portfolio Positioning

- EM has our largest risk allocation, mainly in Mexico, Brazil, India and Indonesia.
- We also hold overweights in investment-grade and high-yield credit, particularly in financials and industrials.
- We are short the euro and British pound to act as a hedge in case the global economy slows down faster than we expect.
- We are also short the Taiwanese dollar and hold a short Chinese renminbi trade to protect against a continued slowdown in the Chinese economy and geopolitical unrest between China and Taiwan.
- We recently increased our allocation to agency mortgage-backed securities (MBS) within structured products.
- We are long the Japanese yen for tail protection purposes.

Q&A Highlights

- The strategy has remained long duration due to our long-term view that rates look cheap and there is more room for yields to compress. We try to mitigate the risk of a protracted selloff by rotating into call options.
- We believe we are seeing a change in the dynamic of EM economic performance and its ties to China. We think this is due to China become increasingly driven by internal growth and consumption, as well as because of the sizeable US trade rotating away from China and toward Mexico and other EM countries.
- Despite our base case for a soft landing in the US, we still project for a possible recession and mitigate the risk by having hedges in place on the currency side as well as holding a fair amount of duration.

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