

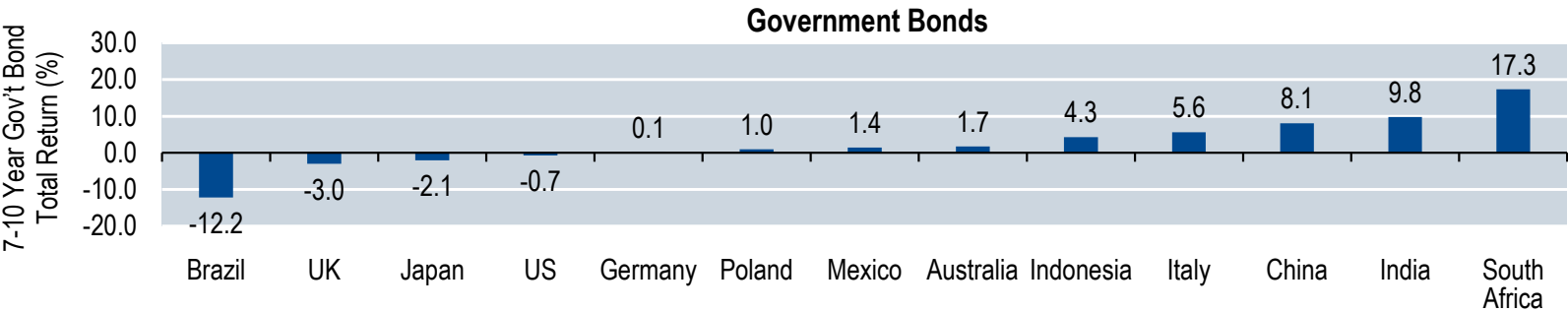
1Q25 Market & Strategy Update

January 8, 2025

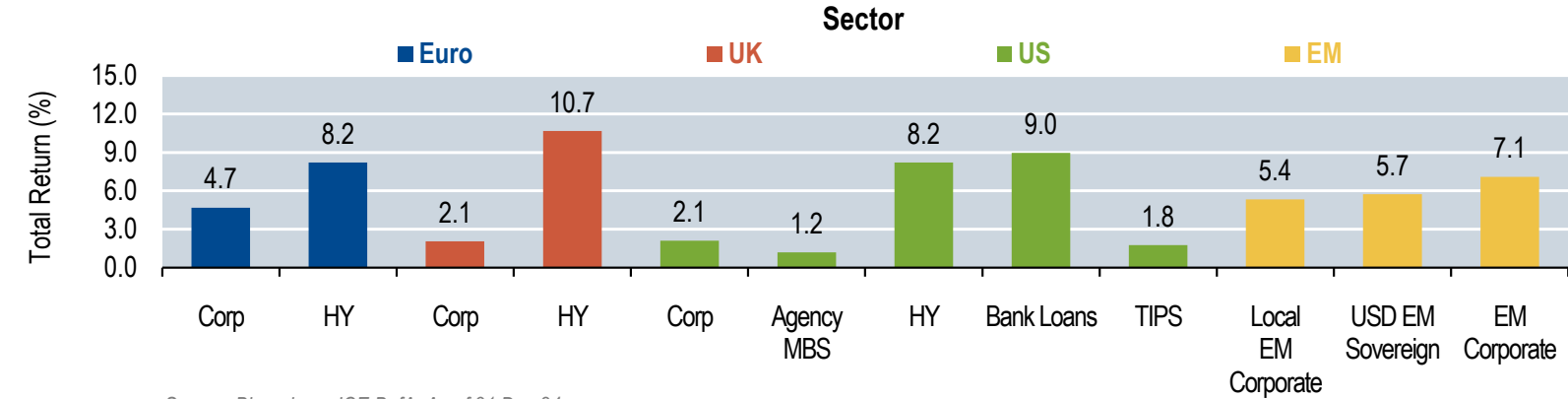
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Chief Investment Officer

Catherine Matthews
Global Product Specialist

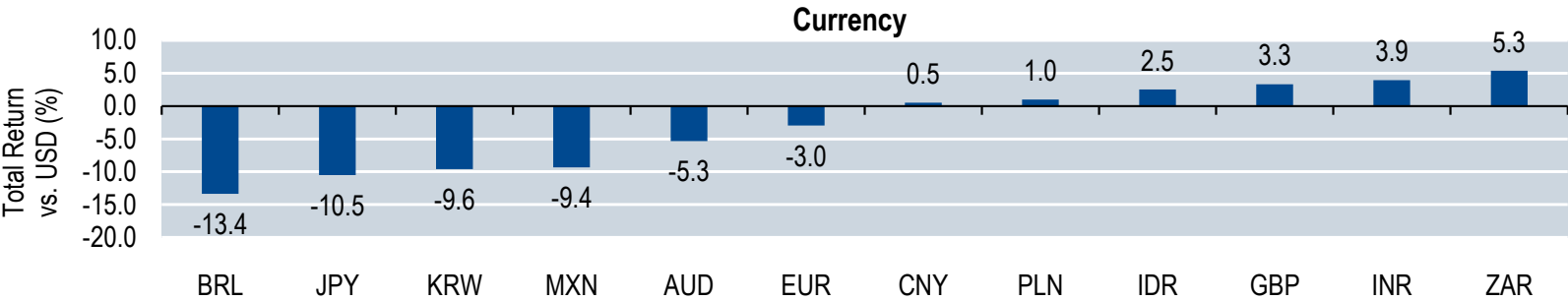
2024 Global Fixed-Income Returns



Source: Bloomberg, J.P. Morgan. As of 31 Dec 24
Country returns for China, Indonesia and South Africa are of the all maturity country index.



Source: Bloomberg, ICE BofA. As of 31 Dec 24



Source: Bloomberg. As of 31 Dec 24

Global Outlook

Global growth is moderating

Inflation is gradually moving toward central bank targets

Services inflation remains sticky

Policy rates will trend lower

US growth will continue to outpace other developed markets, supported by solid real income growth

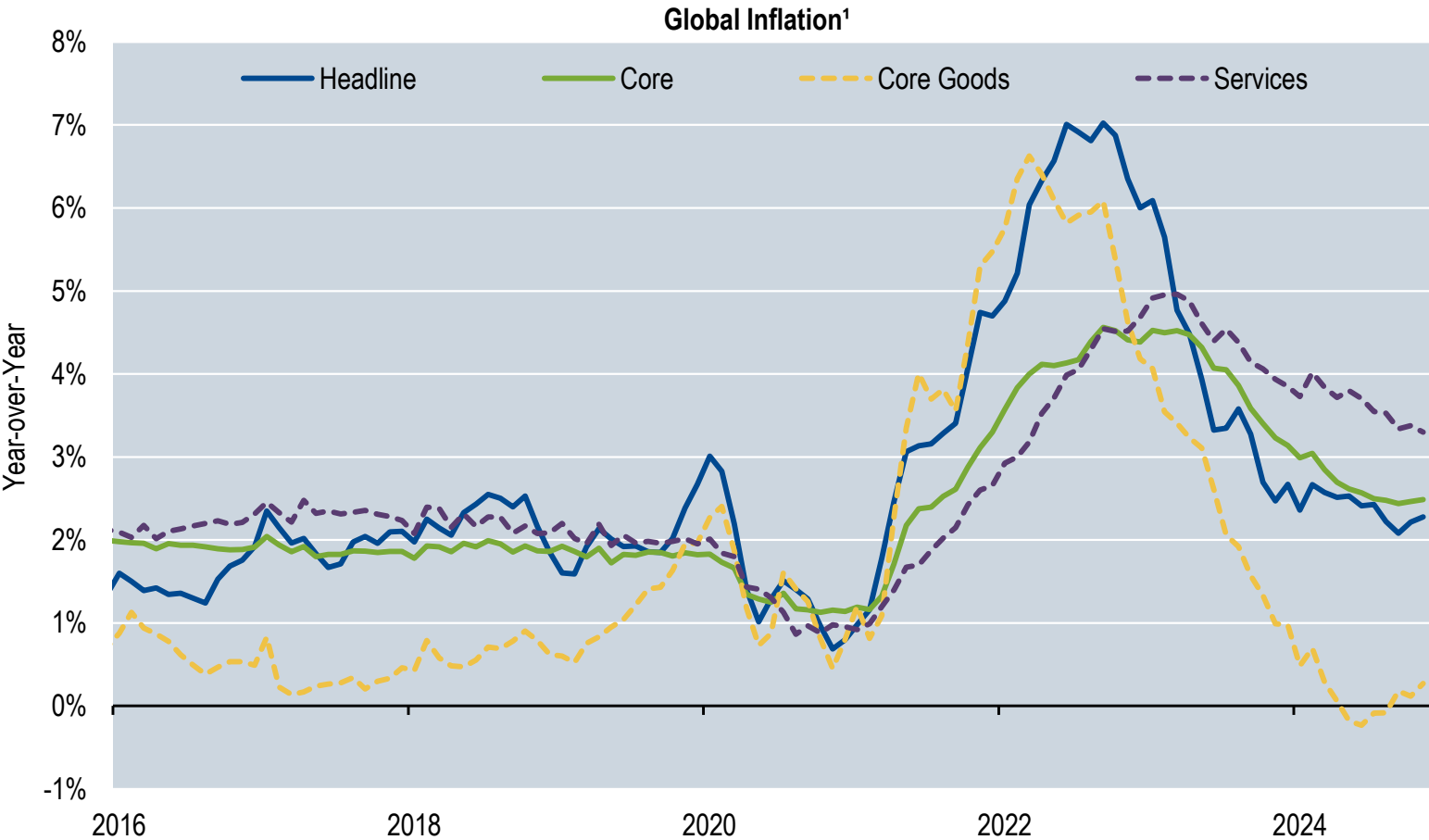
US policy initiatives may lead to bouts of volatility and opportunities

Fixed-income implications

- Real interest rates remain restrictive, which will give most global central banks room to cut rates further
- Yield curves may steepen given fiscal concerns
- Spread sector fundamentals are generally attractive
- Most spread sectors are trading rich vs. historical valuations. Little opportunity for incremental spread tightening
- Select opportunities in structured credit and emerging markets

Global Disinflation Is Broad-Based and Ongoing

Services inflation remains sticky but continues to trend lower

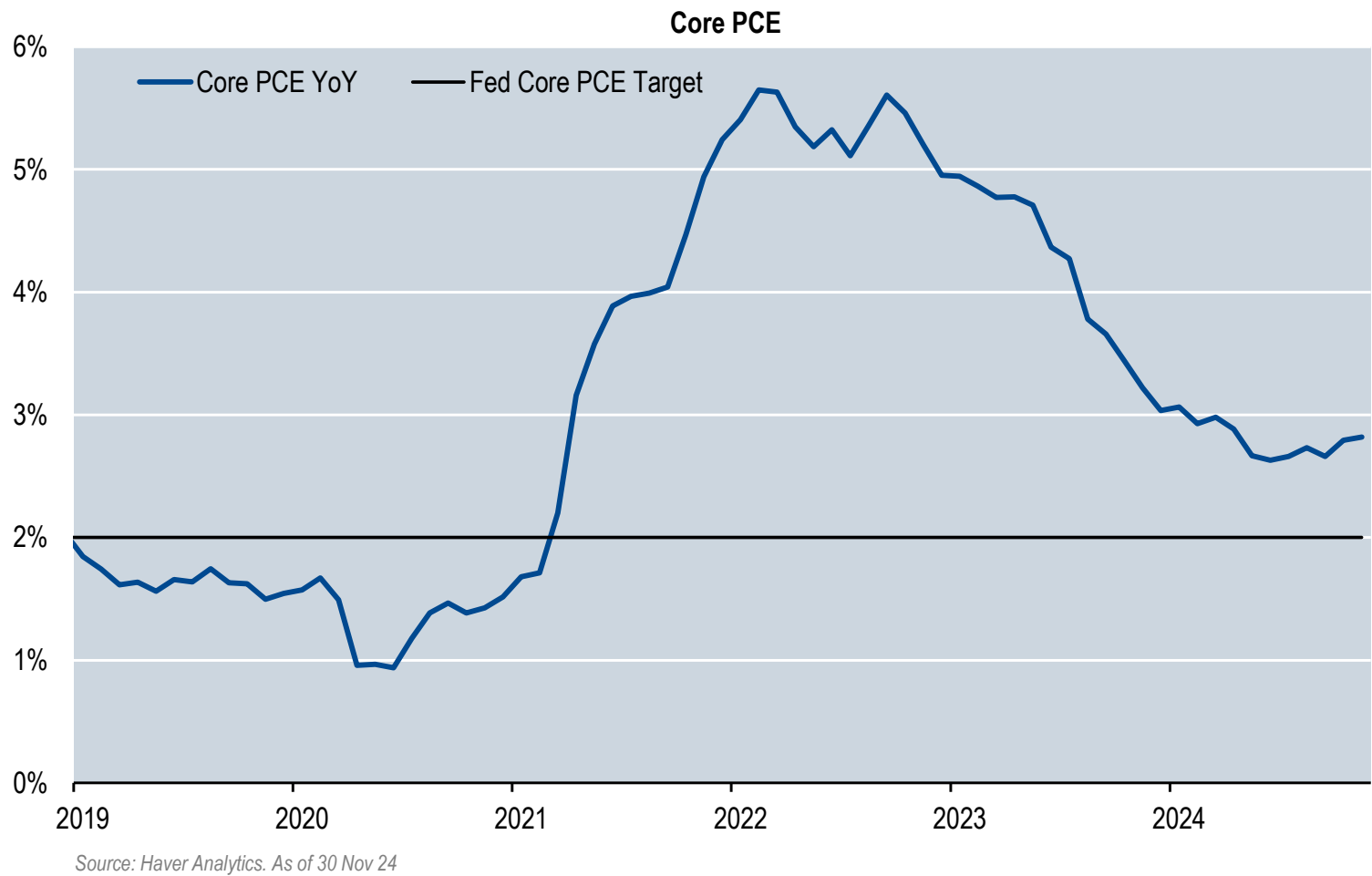


Source: Citigroup, Haver Analytics. As of 30 Nov 24
¹Headline and core cover 15 economies; goods and services cover 12 economies

The above reflects current opinions of Western Asset, which are subject to change with market conditions

US Inflation

The path to 2% core inflation has been slow and arduous

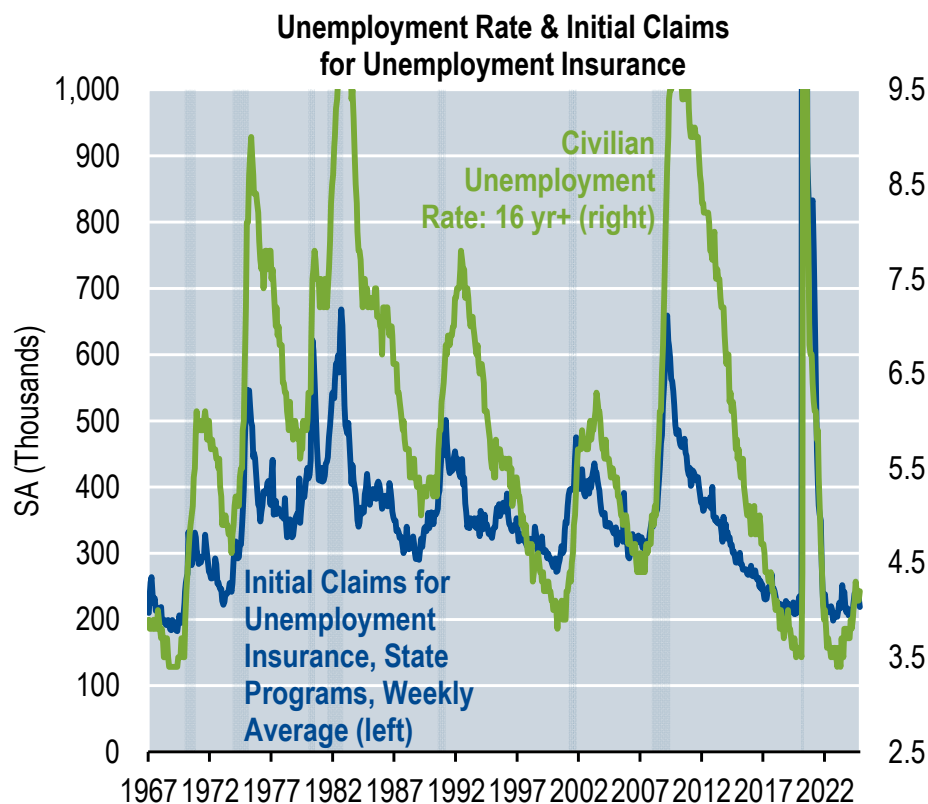


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US Labor Market

Labor market continues to rebalance across a broad swathe of measures

- Job Openings, Quits Rate and Hiring Rate have all declined to at or below pre-COVID levels



Source: Bureau of Labor Statistics, Department of Labor, Haver Analytics.

As of 30 Nov 24

Seasonally adjusted. Shaded areas indicate periods of recession.

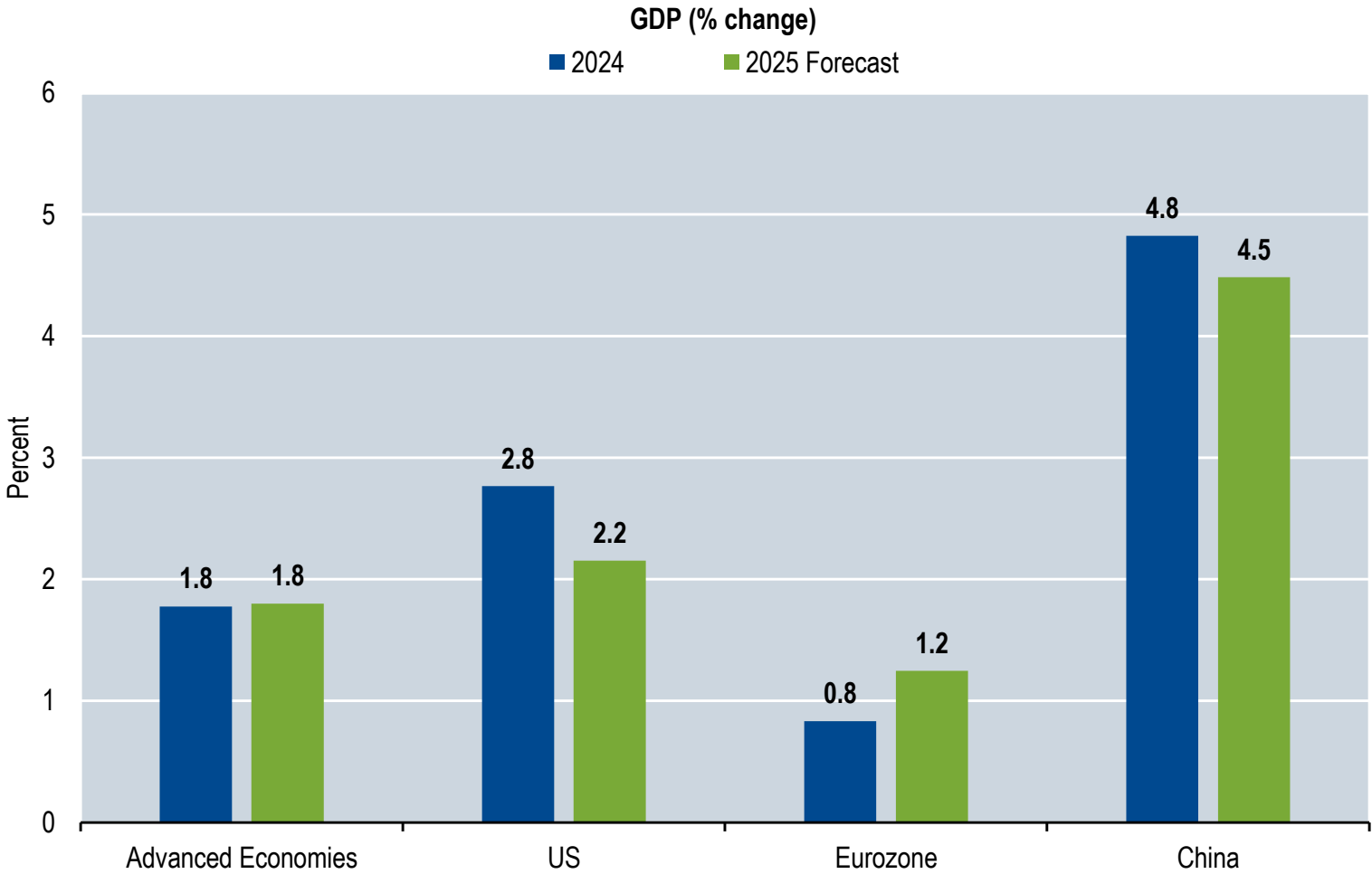


Source: Bureau of Labor Statistics. As of 30 Nov 24

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Global Economic Projections

Continued US resilience



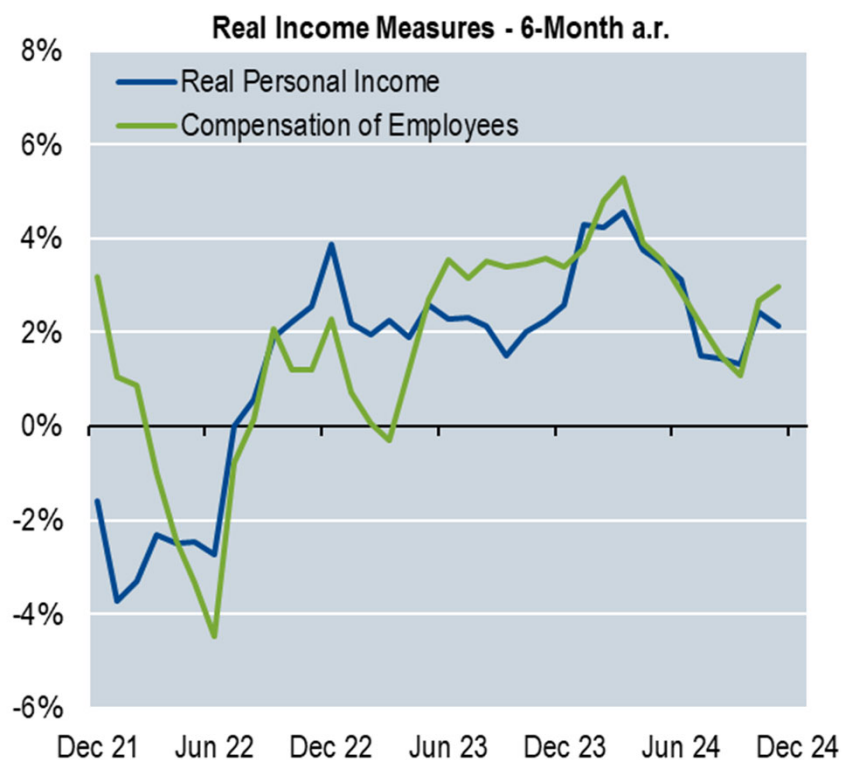
Source: International Monetary Fund. As of 30 Nov 24

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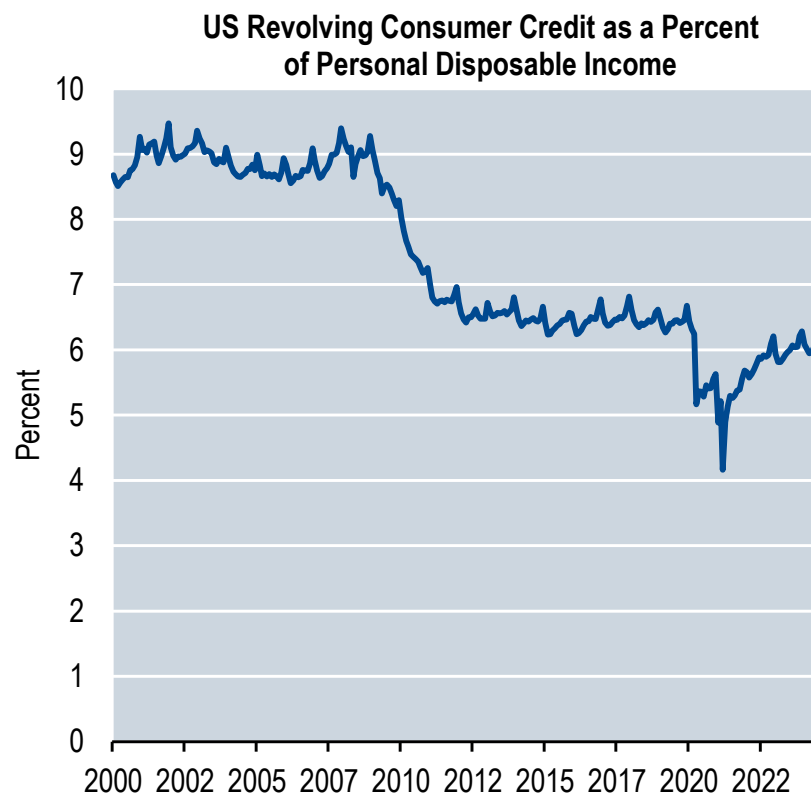
US Consumption

Growth outlook underpinned by strong personal income growth

- Real incomes have started to improve after early 2024 deceleration
- Wage compensation has picked up, but productivity has improved



Source: Bureau of Economic Analysis. As of 30 Nov 24

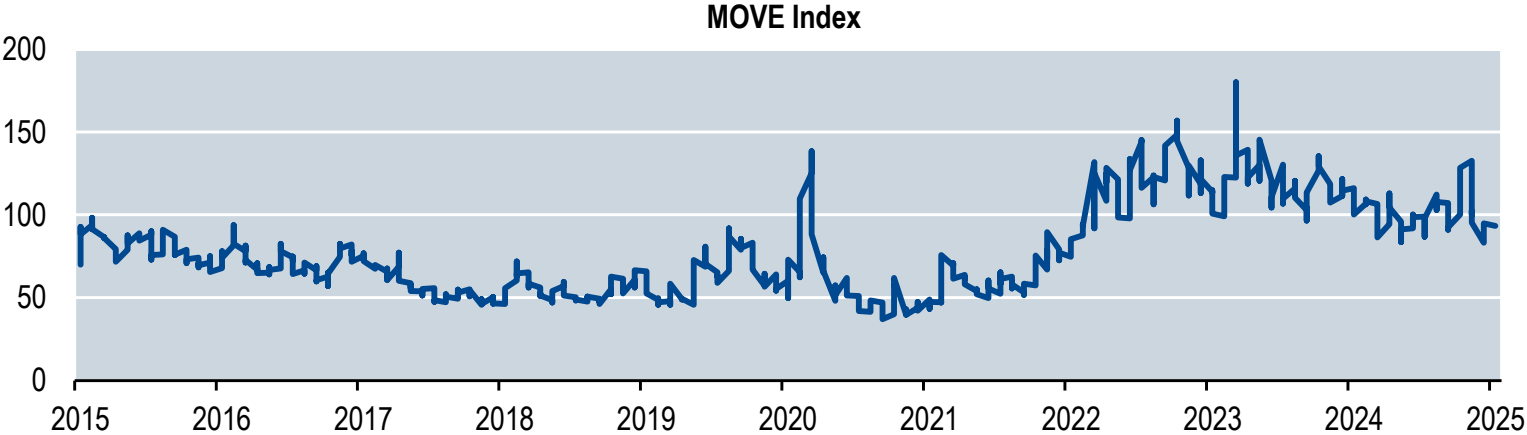


Source: Bloomberg. As of 31 Oct 24

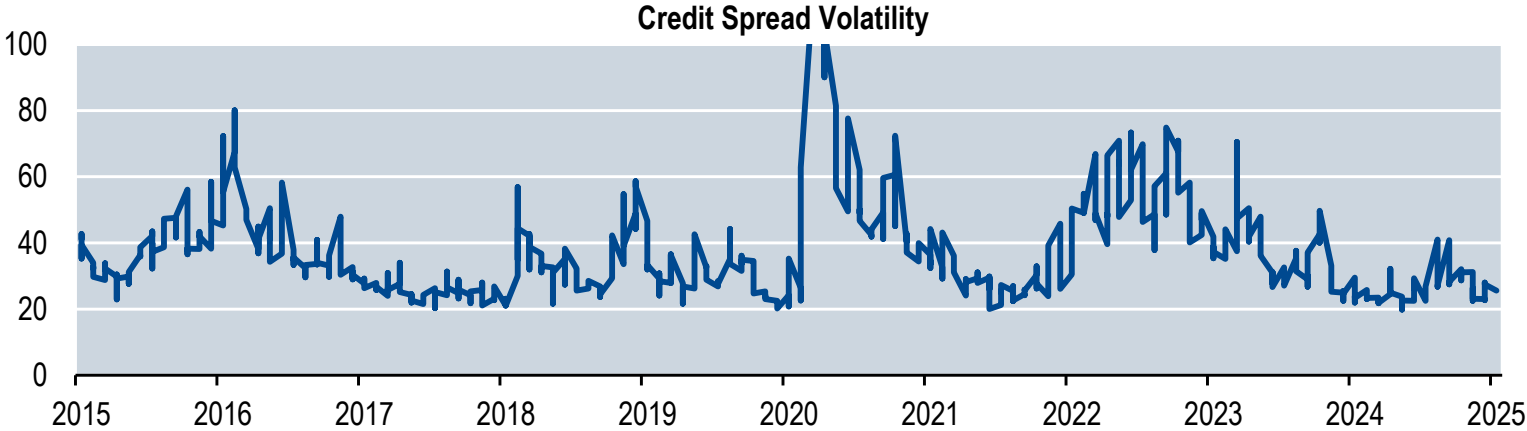
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Volatility Will Create Opportunities in 2025

Spread sector volatility remains subdued while interest rate volatility remains elevated



Source: Bloomberg. As of 31 Dec 24



Source: Bloomberg. As of 31 Dec 24

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US Trade Policy and Implications

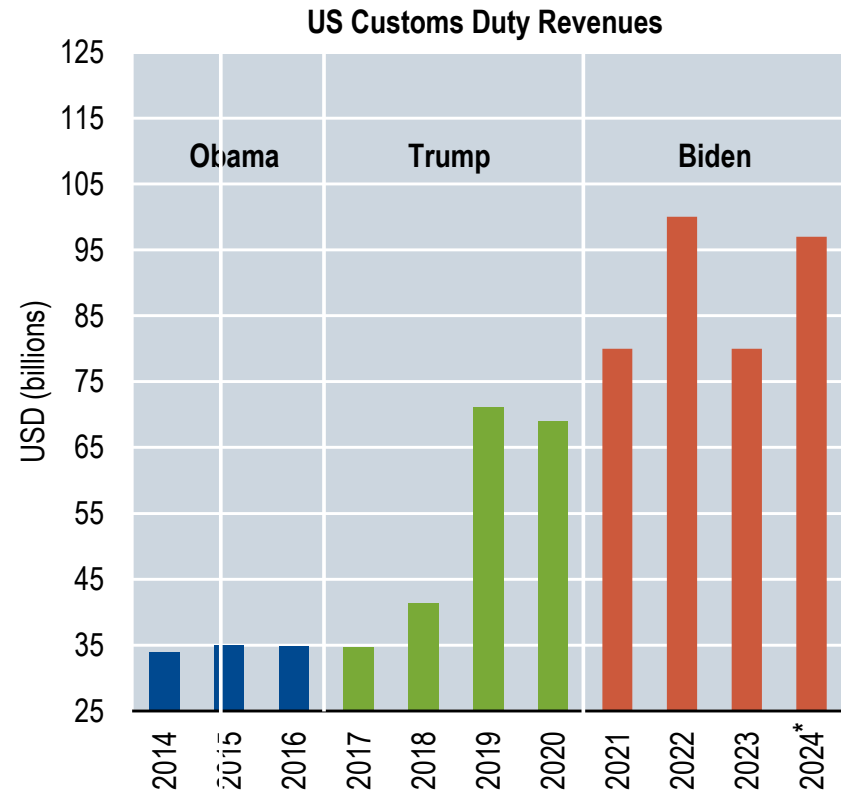
Protectionism on the Rise

Even before Trump 2.0, US trade policy has become increasingly protectionist

- Unlike fiscal policy, the Executive Branch can single-handedly drive trade policy
- Trump plans a blunt, broad-based approach versus Biden's sector-specific tariffs

Proposed 10% Trump tariffs risk a broader disruption to trade and markets

- Exchange rates, prices paid by consumers and exporter margins would likely absorb the brunt of across-the-board tariff increases
- Larger tariffs applied to China could divert some production to other countries, risking scrutiny on re-imports
- Expect reciprocal responses to US tariff increases and increased geopolitical tension

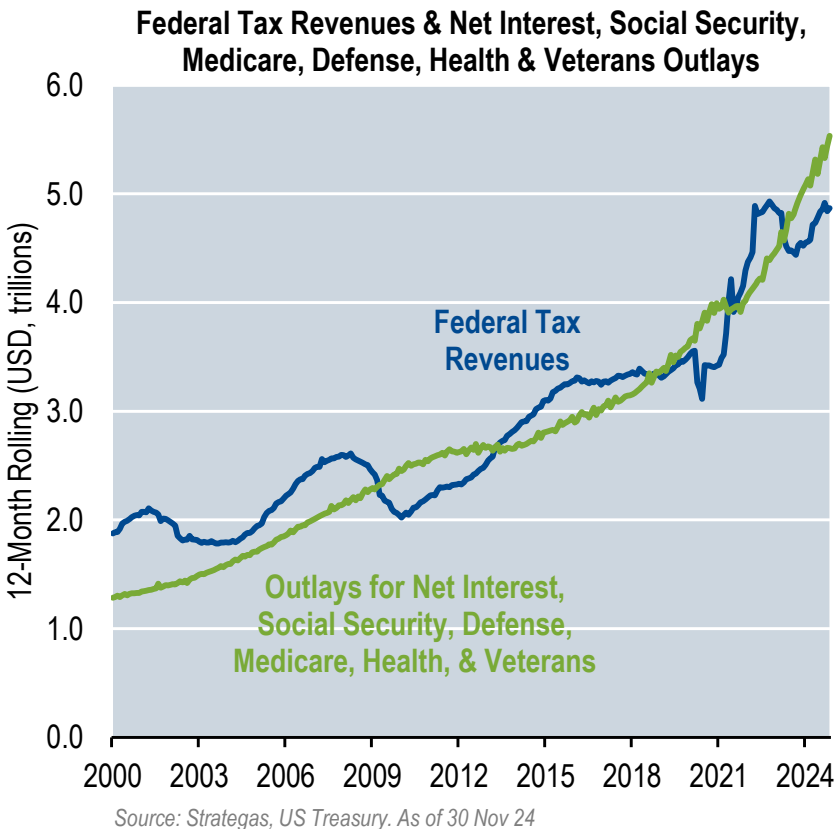
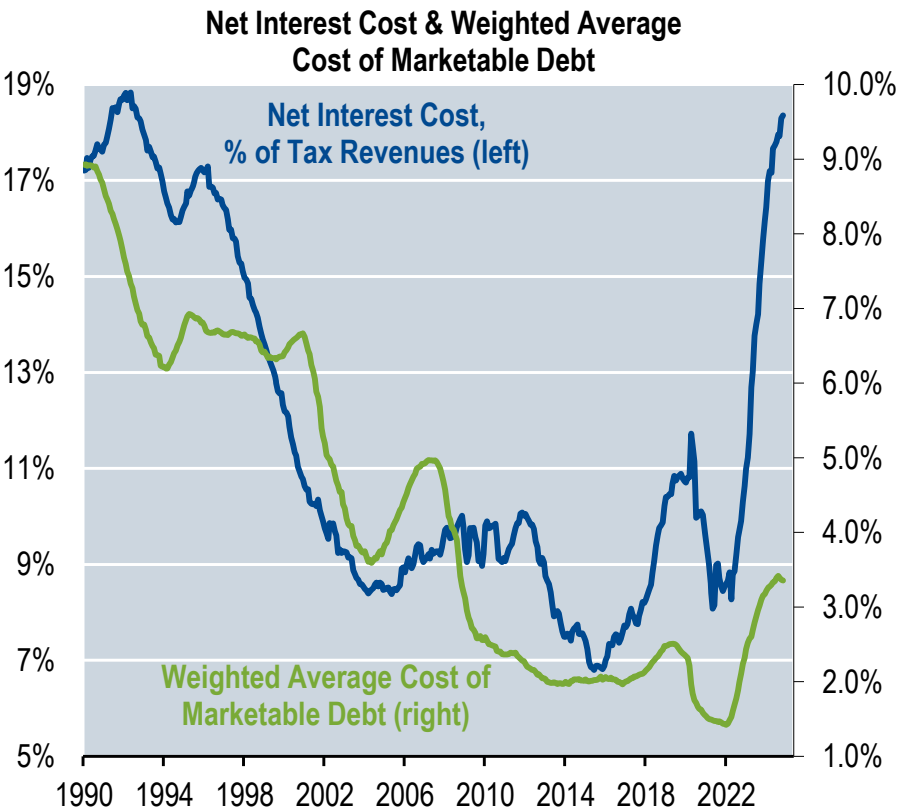


Source: Statista, November 2024

*Forecast

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Fiscal Concerns Continue to Weigh on the Market

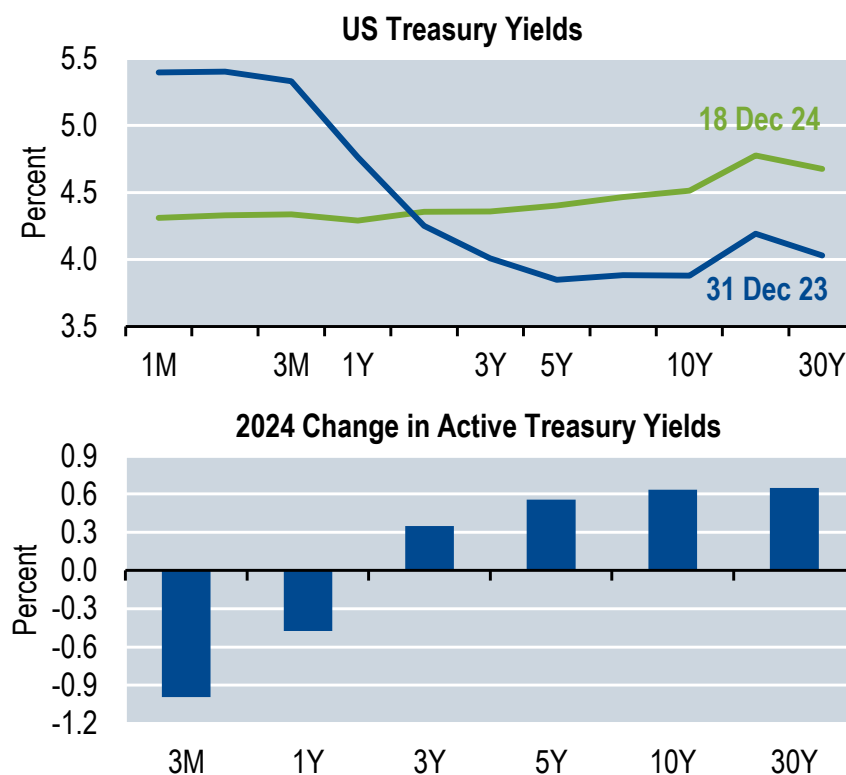
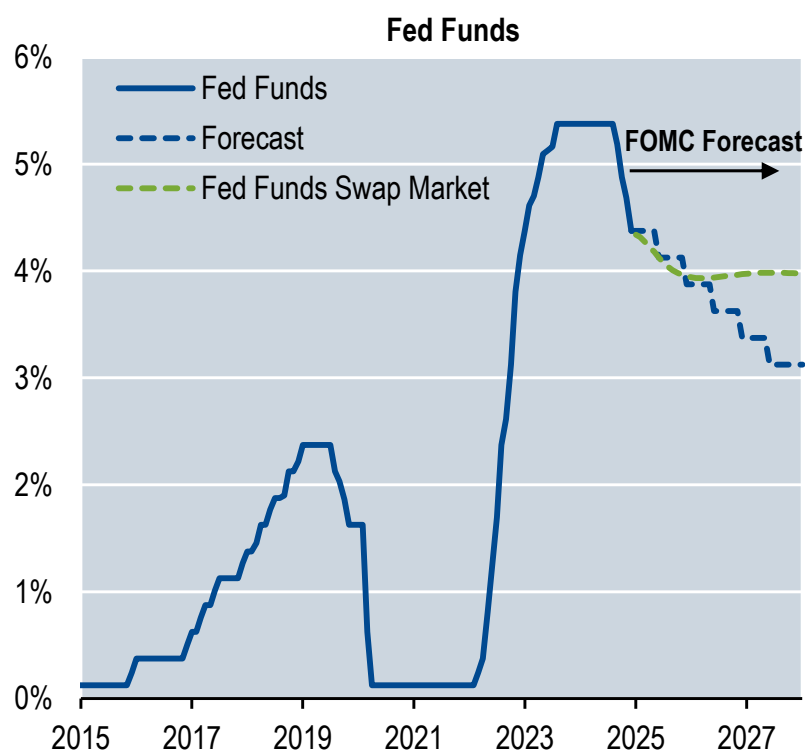


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US Interest Rates

The path for short rates is more reliable than the path for longer rates

- Less than two Fed rate cuts are currently priced in for 2025
- Resilient US growth, 100 bps of Fed rate cuts and prospective new US administration policy have removed the inversion of the yield curve



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Europe

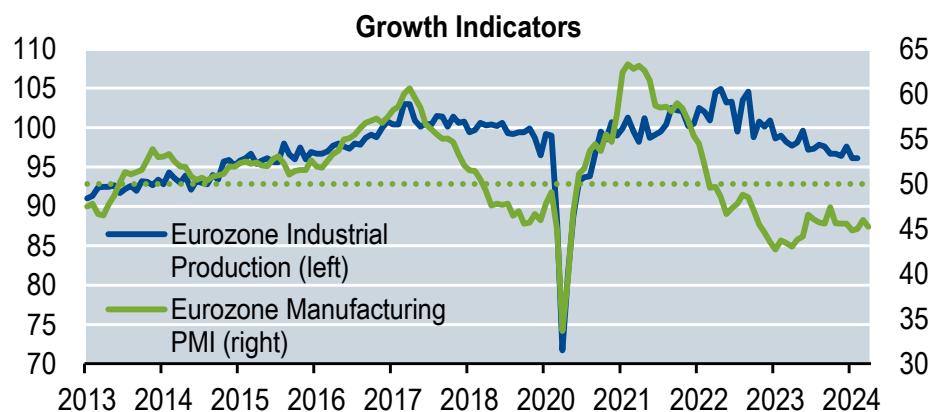
Lackluster growth with inflation near target

- Growth: Modest expansion at best
- Inflation: Lower services inflation key to ECB pace going forward
- ECB: Policy rate expected to be at 1.75% by the end 2025

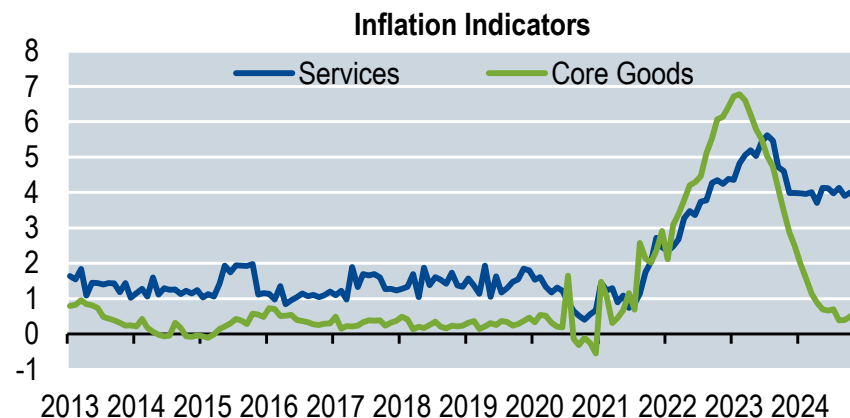
	Policy	HICP*	GDP
1999 to Current	1.50	2.10	1.40
Current	3.00	2.20	0.95

Source: ECB, Haver Analytics. As of 31 Dec 24

*Harmonized Index of Consumer Prices



Source: ECB, Haver Analytics. As of 31 Oct 24



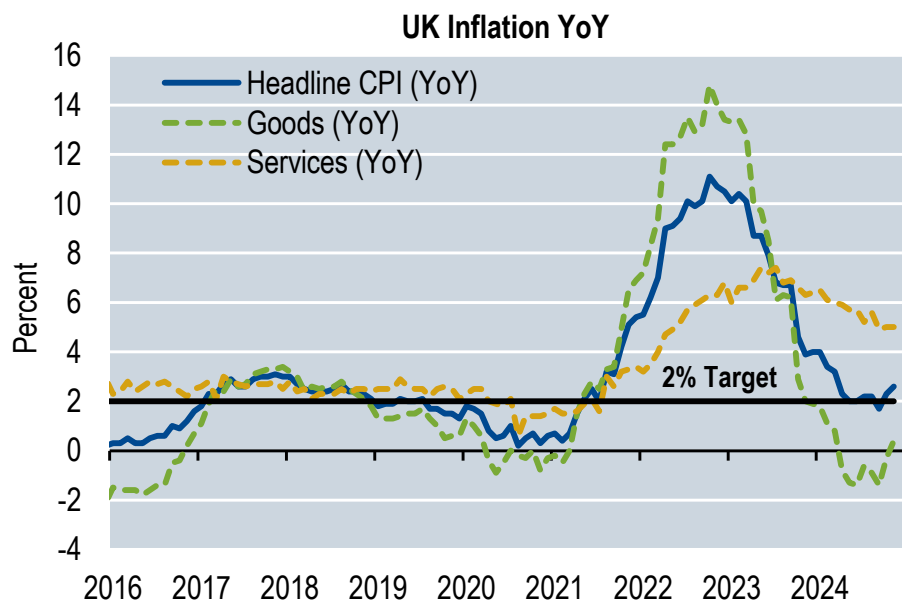
Source: ECB, Haver Analytics. As of 30 Nov 24

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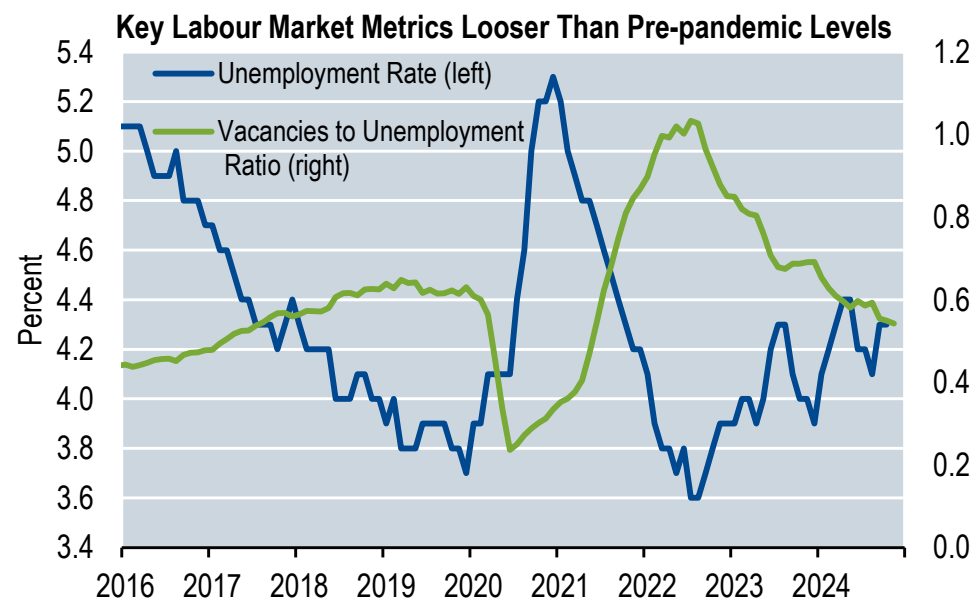
United Kingdom

“A gradual approach to removing policy restraint remains appropriate” – Bank of England, December 2024

- BoE monitoring budget impact
- Growth has been below forecasts
- Businesses expect to reduce hiring and wages, and raise prices modestly
- BoE likely to cut by more than the market is discounting in 2025



Source: Office for National Statistics, Bloomberg. As of 30 Nov 24



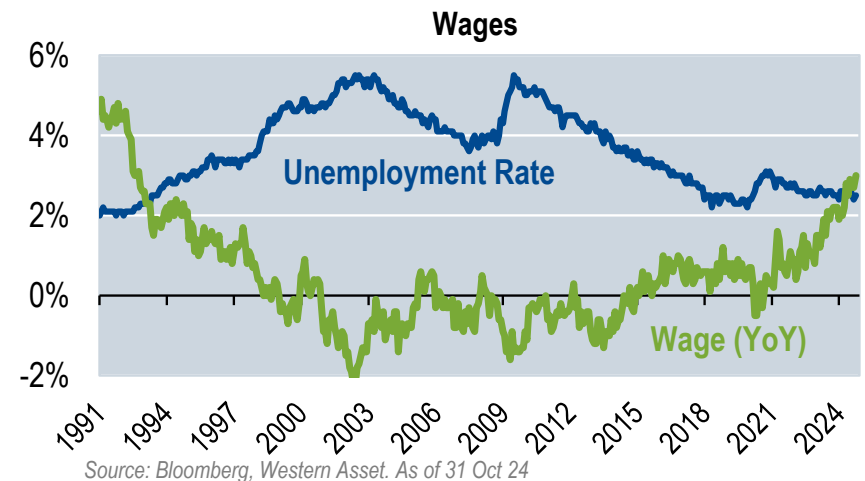
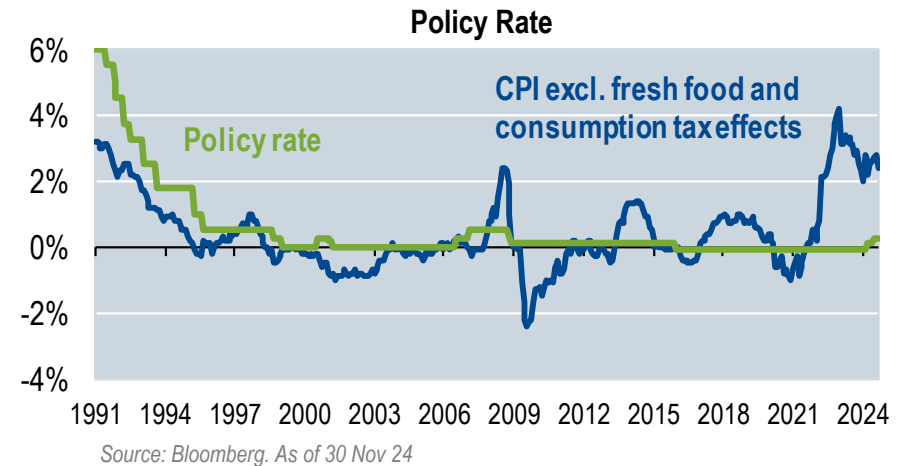
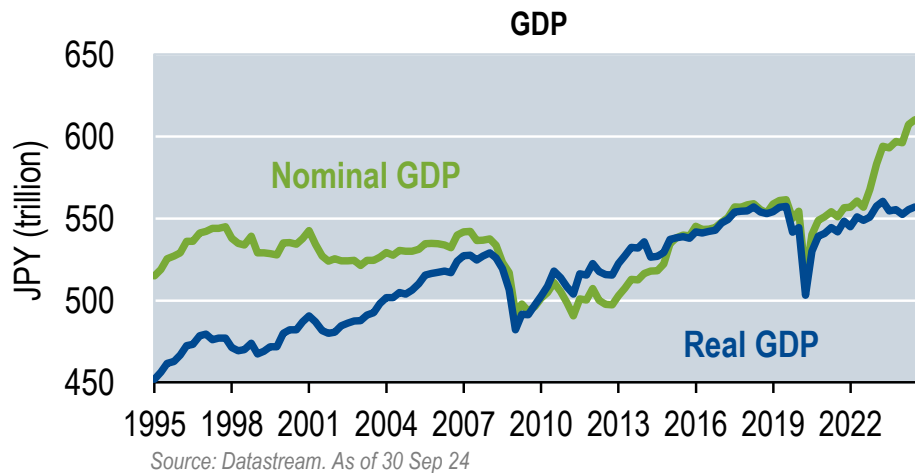
Source: Office for National Statistics, Bloomberg. As of 30 Nov 24

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Japan

Higher wages along with higher inflation forecasts strongly suggest Japanese yields need to rise

- The Japanese economy is expected to recover, driven by private consumption and business investments
- Inflation has been above the BoJ's target of 2% for almost three years due to rising wages stemming from structural labor shortages
- The Bank of Japan continues to hike policy rates at a moderate pace



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China

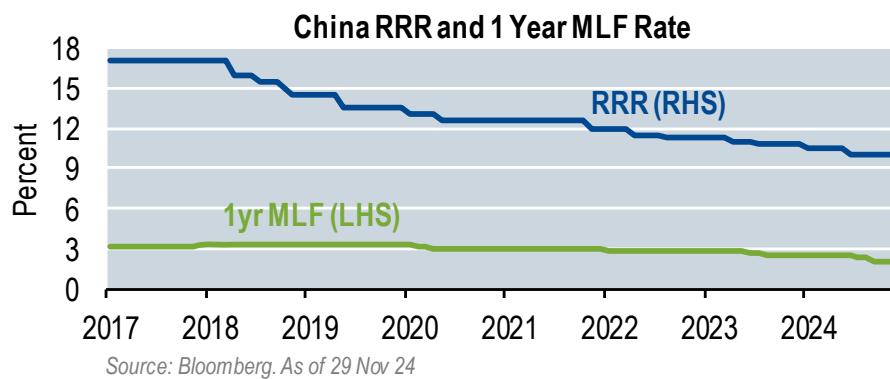
Endogenous structural challenges & exogenous headwinds

- Stimulus measures may be insufficient to bolster business confidence
- Heightened global pushback on Chinese industrial policies/exports

Due to structural challenges, as well as policy and property sector malaise, confidence remains weak ...



However, monetary policy has been supportive at the margin ...



And as a result, China is facing deflation not inflation.



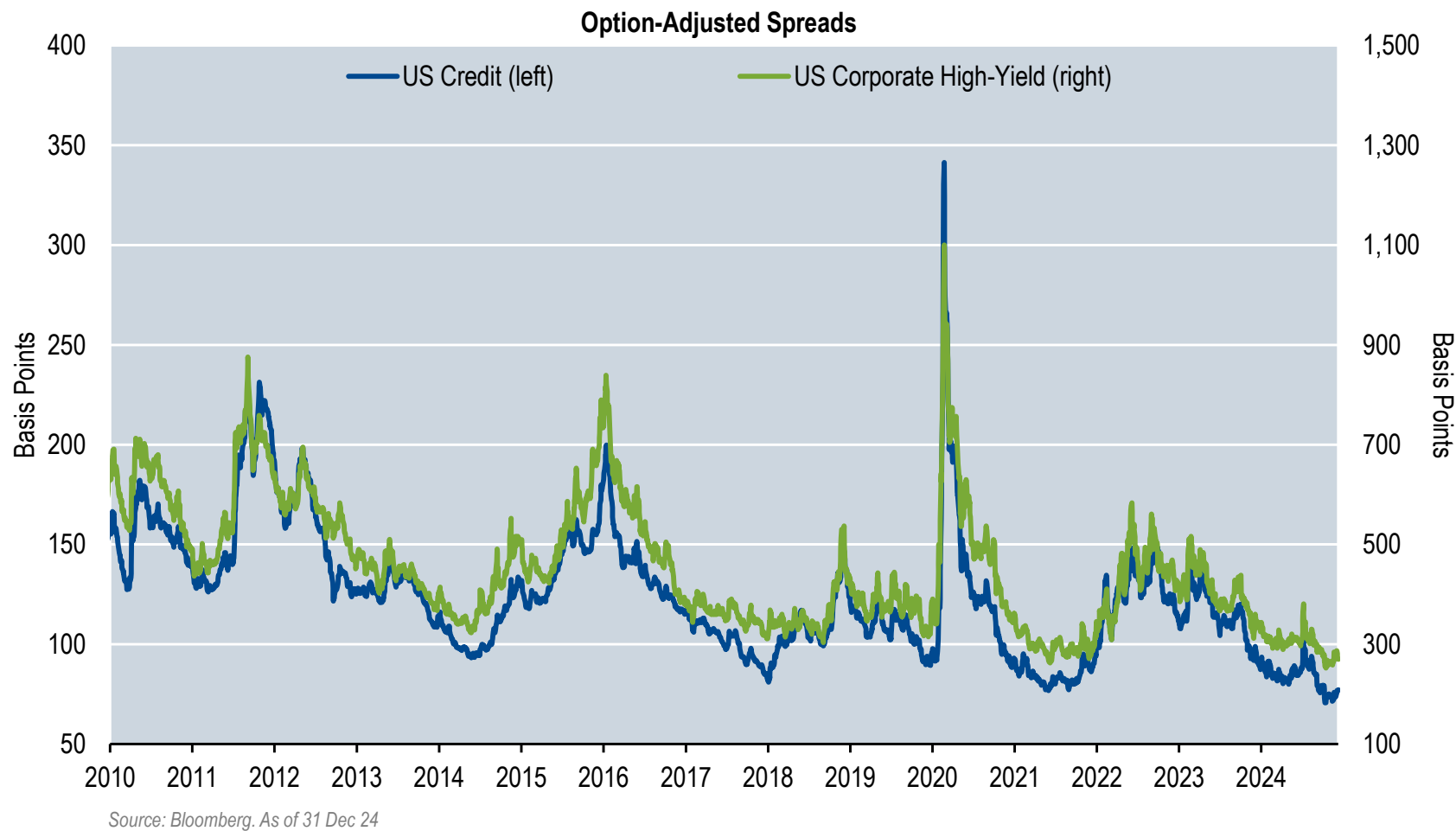
And Chinese buffers are more than adequate to stave off worst-case scenarios.



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Credit Valuations

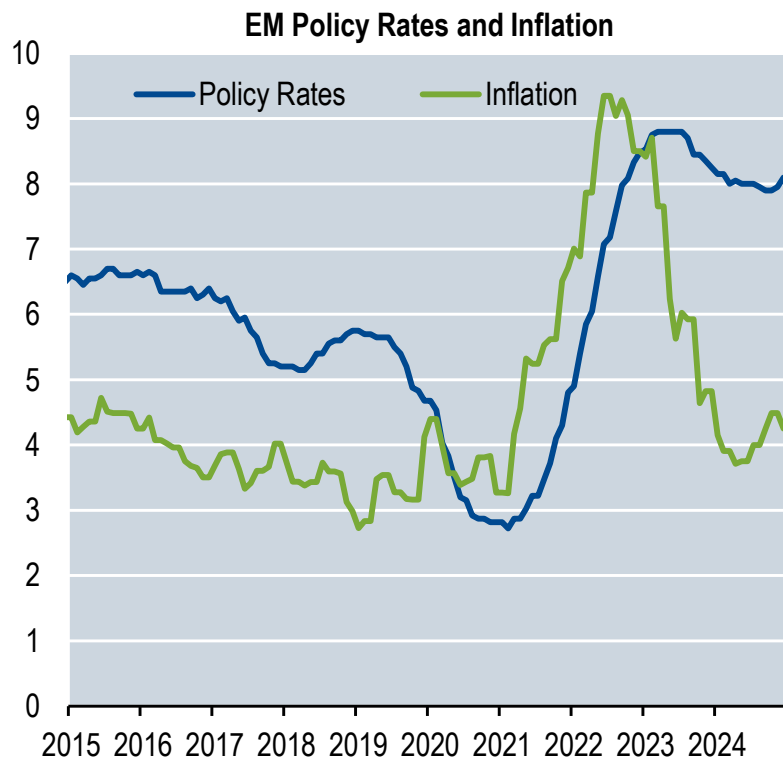
Trading well through historical averages anchored by strong fundamentals



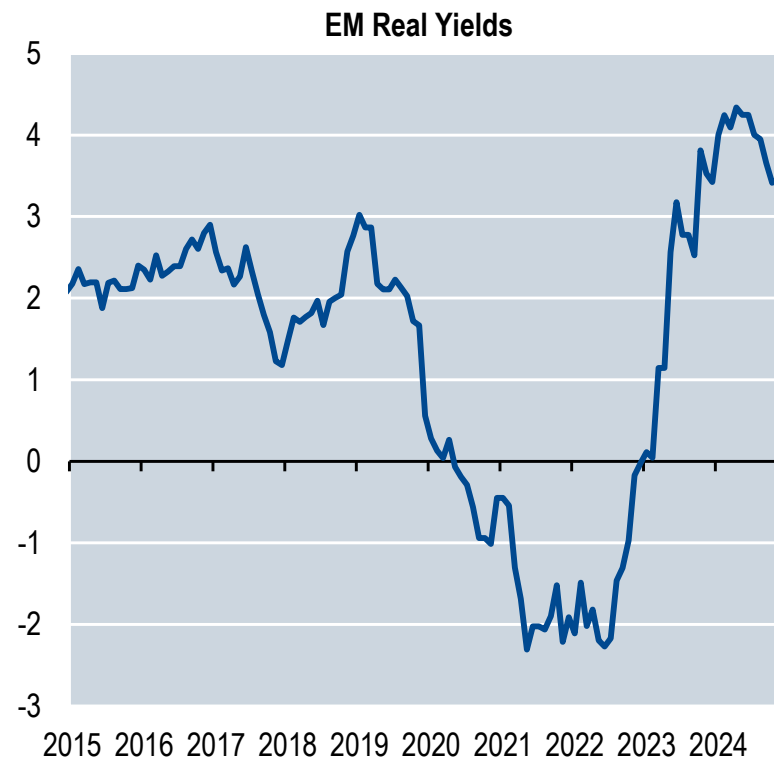
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Emerging Markets

EM inflation has normalized, and real yields remain high. Political and trade concerns are in focus.



Source: Bloomberg. As of 31 Dec 24



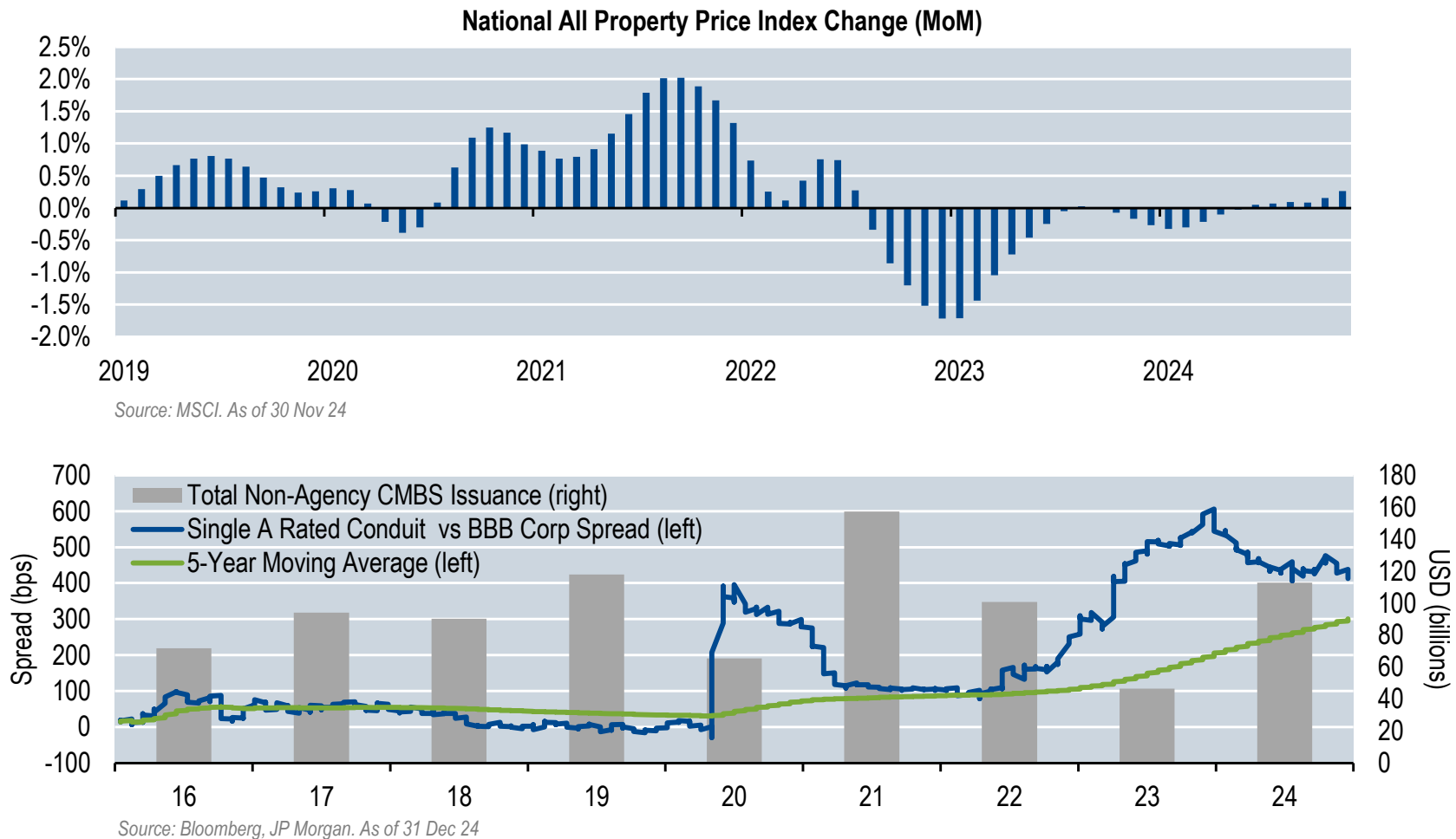
Source: Bloomberg. As of 31 Dec 24

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Commercial MBS

Commercial real estate asset prices are rebounding while spreads remain historically wide

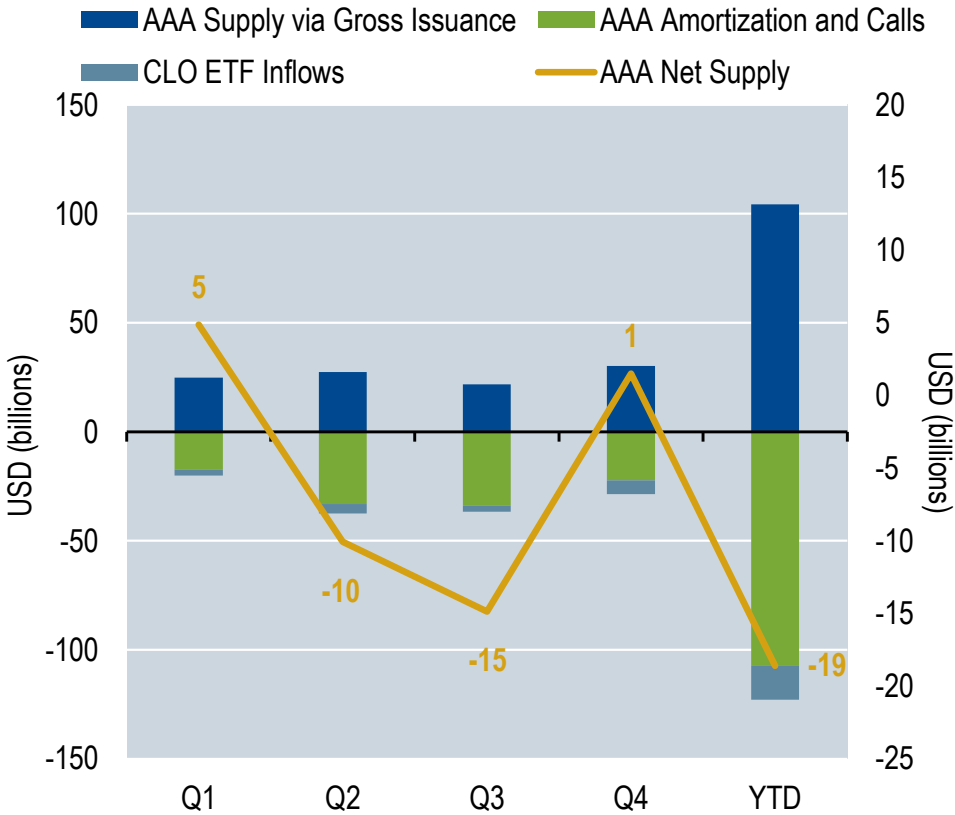
- Property prices have begun to rebound while CMBS spreads remain wide as compared to historical corporate credit relationships
- 2024 new-issue volumes were consistent with pre-Covid averages despite lower leverage. This trend is expected to continue in 2025



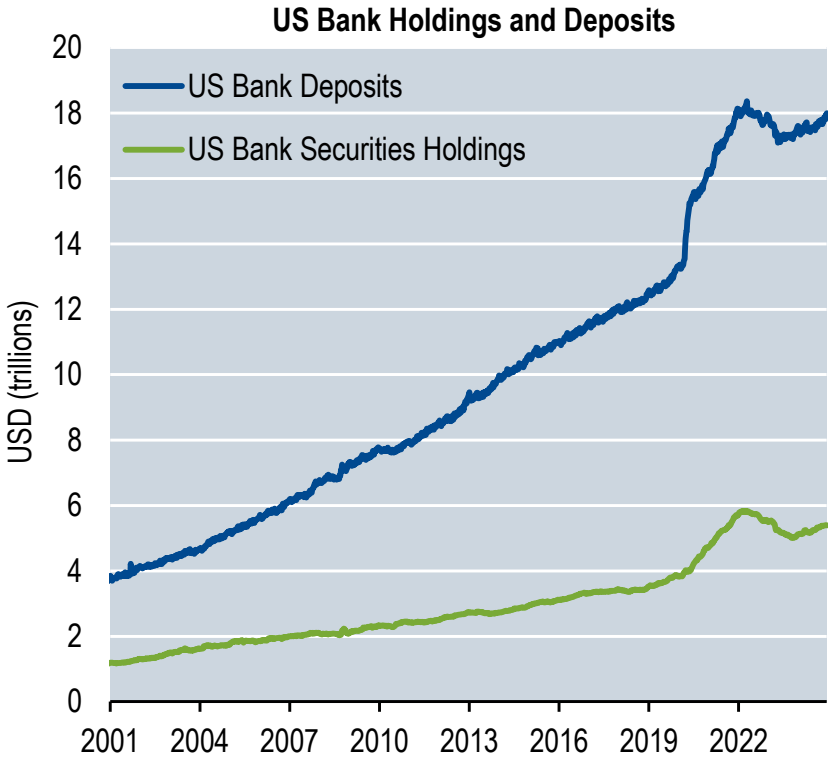
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AAA CLOs

Net negative supply in 2024 and attractive spread



Source: J.P. Morgan. As of 26 Dec 24



Source: BofA Securities. As of 11 Dec 24

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Thank you.

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