

The Big Picture

Western Asset's latest insights on economic drivers and credit markets for fixed-income investors

3Q25 HIGHLIGHTS

- US growth remains resilient with inflation fairly contained, though tariffs may lift goods prices later in 2025, while the Fed stays data dependent.
- Eurozone and UK growth are subdued but supported by easing inflation, fiscal stimulus and expected further rate cuts.
- China's growth is propped up by policy support and exports, but structural challenges persist, while Japan faces higher rates due to persistent inflation.
- Canadian and Australian outlooks are improving as domestic cost pressures ease and central banks maintain flexibility on further rate moves.
- Investment-grade and high-yield corporate credit fundamentals are steady globally, with opportunities in global banks, select sectors and strong demand supporting spreads.
- Securitized credit, including MBS and CLOs, offers attractive yields, though consumer credit and some commercial real estate segments face headwinds.
- We currently favor global banks, copper-focused metals, and select energy and transportation names, while remaining cautious on retail, utilities and lower-quality consumer credit.

OVERVIEW

Amid ongoing uncertainty related to trade and tariff policy, Western Asset's outlook remains measured yet constructive. Global economic growth is decelerating, challenged by the unresolved trade tensions, complex geopolitical dynamics and deteriorating fiscal conditions. In the US, growth is moderating but remains positive with recession risks having receded in recent months. Europe's outlook is supported by expected increases in defense and infrastructure spending while China continues to face structural and policy-related headwinds. Inflation is generally trending toward central bank targets worldwide though US inflation has proven somewhat more persistent. Following the July Federal Open Market Committee meeting, the Fed announced it was holding rates steady and reiterated its "wait-and-see" approach, emphasizing that future decisions will remain data dependent. Meanwhile, central banks in Europe and Asia have continued to ease policy. Despite these crosscurrents investor sentiment has rebounded sharply. Yield curves have steepened notably as a result of higher term premiums amid rising fiscal concerns.

Michael Buchanan, CFA

Chief Investment Officer



"In a landscape of policy divergence and shifting global growth trends, Western Asset continues to identify attractive opportunities across fixed-income as we navigate episodes of fluctuating volatility. As an active manager, we maintain a disciplined approach. We remain somewhat constructive on current market conditions, favoring resilient credit sectors, selectively positioning portfolios to ensure appropriate diversification and remaining committed to our long-term, value-driven investment philosophy."





Anthony Kirkham

Deputy CIO & Head of
Investment Management,
Asia Pacific

“As global economies navigate divergent trajectories, with resilience in the US, policy-driven recovery in China and easing pressures in Europe, our regional positioning is guided by both caution and conviction. We are strategically focusing on markets where strong fundamentals, evolving policy environments and valuation dynamics converge to present the most compelling relative value opportunities.”

KEY DRIVERS AND RELATIVE VALUE BY REGION

	Economic Resiliency Supports Our Soft-Landing Scenario	<p>Despite uncertainty around Trump's tariffs and fiscal and immigration policies, the US economy has remained resilient. The Federal Reserve (Fed) and investors are closely watching The One Big Beautiful Bill Act's impact on growth and inflation. We expect inflation to be contained with likely tailwinds from lower prices for shelter and services, but tariff pass-through to goods to increase prices in 2H25.</p>
	Growth Expected to Improve with Inflation Likely Below Target	<p>The Eurozone is balancing soft near-term growth and stronger forward-looking growth. The near-term negative is predicated on tariffs and heightened overseas competition, but as we move into 2026 and 2027 we expect fiscal stimulus tailwinds to strengthen, the impact of previously higher policy rates to fade and lower energy costs to support industry. We expect the European Central Bank to cut once more by year-end.</p>
	Domestic Inflationary Pressures Are Easing	<p>As investors debate whether UK businesses will pass on the cost of higher wages to consumers, we expect tepid growth to limit pricing power, weakening employment demand instead. Recent data has validated that view, and wage growth has slowed. We expect this to continue, allowing the Bank of England to continue to lower rates.</p>
	Growth Outlook Is Improving	<p>The Bank of Canada (BoC) has cut rates to the middle of its projected long-term neutral range, though both inflation and growth risks point in opposite directions. While US tariff uncertainty persists, the growth outlook is a bit better and we see a case to delay further monetary policy stimulation. Domestic wage and housing cost pressures appear to be lessening, giving the BoC leeway to ease.</p>
	Inflation at Target Brings RBA to the Table	<p>Falling inflation is driving real wages to improve. We expect this trend, the 2024 tax cuts and the Reserve Bank of Australia (RBA) easing monetary policy—with two to three more cuts expected before year end—to lead to greater consumer spending and a 2H25 recovery in growth despite global headwinds.</p>
	Higher Rates Ahead	<p>We expect the Bank of Japan to hike rates again as inflation has been above target for three years running and there is a substantially negative real policy rate.</p>
	Cyclical Shift, Structural Challenges Persist	<p>The absence of further escalation of tariff conflicts and a reprieve since the Geneva talks affirm that the US and China broadly intend to avoid full economic decoupling. China's growth remains supported by various policy measures and broadly accommodative fiscal and monetary policy. Most of the resilience is due to stronger-than-expected exports this year and the ongoing consumer goods trade-in program. Growth challenges will likely persist into 2H25.</p>
	Fiscal and Growth Challenges Abound	<p>Mexico avoided a technical recession in Q1 despite further fiscal consolidation from President Sheinbaum. Fiscal balances have improved, but spending cuts were at the expense of infrastructure spending, limiting medium-term growth prospects. We see headwinds such as ongoing support for PEMEX, US tariff uncertainty and a slowing US economy. We remain cautious on the peso and favor receiving local rates as we expect Banxico to maintain a dovish stance.</p>
	RBI Surprises with a Jumbo Cut	<p>The Reserve Bank of India (RBI) surprised the market with a 50-basis point (bp) cut, setting its rate to 5.5%, and moved its policy from “accommodative” to “neutral.” Liquidity was enhanced with lower cash reserve ratio rates, but reverse repos were also announced resulting in some policy uncertainty. We see India as a great carry play, but we favor trimming any duration overweight.</p>
	Political Fighting Inside and Out	<p>President Lula's fiscal agenda still concerns many investors, especially ahead of the 2026 elections. Growth has remained resilient despite tight monetary policies. We expect that Brazil's central bank has concluded its hiking cycle with no cuts priced in through 2025. We are modestly positive on the real given its carry and prefer receiving local rates in the 5- to 7-year part of the curve.</p>



Annabel Rudebeck

Deputy CIO & Head of
Investments, London

“Among all credit sectors, we maintain our strong conviction in global banks. Their robust capital buffers, sound regulatory frameworks and disciplined management have consistently reinforced their resilience through various market cycles. As a result, we believe banks are well-equipped to navigate ongoing policy changes, and current valuations present compelling opportunities in the sector.”

WESTERN ASSET SECTOR THEMES	FUNDAMENTALS	TECHNICALS	VALUATIONS
Investment-Grade (IG) Corporate Credit			
US: Fundamentals are steady as we await Q2 earnings with a focus on margin resilience and tariff pass-through commentary. IG has rallied from April's widening but subsector dispersion remains: cable, aerospace and banking are outperforming (we see opportunities in global banks), while media, utilities and autos lag. Technicals are strong as supply is absorbed by steady yield-focused demand.	●	●	●
Europe: Fundamentals remain resilient, especially in banking. We continue to be overweight financials, utilities and select property companies. Some sectors are facing cyclical headwinds and tariff-related uncertainty. Spreads feel well supported but now have less margin for safety. However, due to robust demand, we expect spreads to grind a bit tighter in the near term as issuance recedes through the summer.	●	●	●
Australia: Through uncertainty, IG credit has remained well bid with primary markets healthily oversubscribed and grinding tighter. Issuance from first-time issuers has been a value add. Balance sheets remain strong with sensible leverage levels. Focus remains on shorter tenors for carry in regulated utilities and infrastructure, as well as National Champion Banks, with selective exposure across the capital stack.	●	●	●
High-Yield (HY) Corporate Credit			
US: HY credit spreads reflect balance sheet strength, the prudent behavior of management teams and supportive demand for higher-yielding securities relative to supply. We continue to see selective opportunities in service-related sectors, transportation, energy (E&P) and potential rising stars. We are more cautious on consumer products, retailers and home construction sectors.	●	●	●
Europe: Fundamentals continue to be positive overall. Net supply remains manageable as most bond issuance is aimed at refinancing. We continue to focus on short-dated, seasoned BB/B rated issues with a bias toward telecom/cable, select consumer and capital goods companies. Given fairly tight valuations, we think investors can generally expect an income-type return in the near term.	●	●	●
Bank Loans			
Valuations remain attractive with the index spread of approximately 450 bps and total yield currently approaching double-digits. With the BB to B spread relationship wide of historical averages, we anticipate single-B loan compression and favor higher quality single-B names in defensive sectors. We favor BB loans for portfolio ballast, but favor adding some single-B exposure for incremental yield and price convexity.	●	●	●
Collateralized Loan Obligations (CLOs)			
CLO primary issuance has started up again with both US and overseas demand expected to remain consistent through year end. Current CLO arbitrage remains attractive enough to warrant new CLO creation and bank loan net issuance has increased as of late, which should help managers effectively ramp up new deals. While underlying bank loan fundamentals remain, we are mindful of the potential for tail risks.	●	●	●
Mortgage and Consumer Credit			
Agency MBS: Agency mortgage-backed securities' (MBS) yields and spread levels appear attractive, given limited mortgage refinancing activity and low prepayment risk. We favor 20- and 30-year MBS and non-benchmark subsectors, focusing on active coupon and collateral management to enhance total returns.	●	●	●
NARMBS: For non-agency residential MBS (NARMBS), we are cautious on home prices as supply has increased meaningfully in 2025 and demand at current mortgage rates of 7% remains weak. Conversely, tariff implications may stoke home price increases given higher input costs and fewer new homes. Collateral performance measures remain positive, providing strong fundamentals to residential securitized credit.	●	●	●
CMBS: While lagging other sectors, non-agency commercial MBS (CMBS) has now nearly retraced the Q2 widening. Risk appetites for on-the-run deals (e.g., in hospitality) have improved. The sector exhibits little after-effects from recent volatility except for higher leverage, shorter-term deals, which suffer from higher-for-longer rate moves due to perceived inability to refinance low-coupon/high-leverage loans.	●	●	●

WESTERN ASSET SECTOR THEMES <i>continued</i>		FUNDAMENTALS	TECHNICALS	VALUATIONS
ABS: For asset-backed securities (ABS), we expect consumer fundamentals to deteriorate due to changes in economic policy and rising costs, with lower-end consumers facing the greatest headwinds. We expect the end of the Saving on a Valuable Education (SAVE) Plan moratorium to put pressure on borrowers with delinquent student loans. We have a strong preference for higher-quality consumer credit.		●	●	●
Inflation-Linked				
US: Treasury Inflation-Protected Securities (TIPS) real yields remain attractive at near-two-decade highs, and breakeven inflation (BEI) levels are only modestly above Fed targets. We expect real yields to decline to between pre-GFC and pre-Covid levels, closer to 1.5% than 2.5%. TIPS might underperform nominal US Treasuries but may still be useful should the market question the focus of future monetary policy.		●	●	●
Japan: The current level of 10-year BEI at 1.5% looks cheap given the structural problems of a labor shortage and elevated inflation.		●	●	●
Municipals				
Record municipal supply has contributed to improved income opportunities and attractive after-tax relative value versus comparable taxable fixed-income sectors. Credit fundamentals remain favorable, but are largely reflected by historically tight municipal credit spreads. We expect US growth and inflation to ebb and longer-duration and mid-grade credit components to contribute to 3Q performance.		●	●	●
Emerging Market (EM) Debt				
Sovereigns: IG-rated EM sovereigns have continued to tighten and valuations look rich. We still favor frontier market sovereigns over their IG-rated counterparts, with key idiosyncratic credit stories built on a fundamental turnaround and IMF support. Frontier markets continue to show attractive total return opportunities via relatively cheap valuations and a strong tailwind from carry.		●	●	●
Local EM: We are monitoring the tariff landscape and its impact on local inflation and trade balances. With high real yields even as inflation continues to decline, we favor Latin American local rates where central banks have room to cut if there's a global slowdown. We anticipate a gradual weakening of the US dollar and continued inflows into local EM economies to add a tailwind to the subsector's performance potential.		●	●	●
EM Corporates: EM corporates continue to maintain strong balance sheets, especially compared to their developed market (DM) peers. But valuations remain at historical tightness, prompting us to seek value in the primary markets and in shorter-dated EM HY corporates.		●	●	●

René Ledis

Research Analyst



"In the metals and mining sector, the continued global push toward energy transition and electrification (albeit at a slower pace) is providing sustained longer-term support for commodity demand, while industry-wide underinvestment has deferred future development delaying supply growth. This is particularly true for copper. Based on our analysis, we favor producers exposed to the secular trend that are well-capitalized and maintain sufficient liquidity to take advantage of growth opportunities."

WESTERN ASSET INDUSTRY THEMES	
Industry	Key Observations
Auto & Related	We favor market weight positioning in the global automotive sector in IG and HY, as the risk/reward opportunity has become more balanced over the last several months since the initial Liberation Day scare. We expect to see ongoing margin pressure for most OEMs and suppliers, which could result in more rating agency downgrades.
Banks	We maintain a large overweight position to top-quality global banks given resilient performance, as banks have lower risk profiles due to stringent regulations, heightened oversight and improved risk management following the GFC.
Energy	We favor remaining market weight for energy overall but overweight the midstream subsector. Disciplined capital allocation, continued balance sheet strength and strong liquidity anchor the industry. The supply side is driving oil markets; the demand side drives the outlook for natural gas. We are biased to natural gas focused E&P companies.
Food & Beverage	We expect tariffs to pressure consumer purchasing power but not food costs as more than 85% of food consumed in the US is grown or produced domestically. We remain mostly underweight due to rich valuations but have found attractive value in the poultry producer segment that has benefited from higher pricing and lower input costs.

WESTERN ASSET INDUSTRY THEMES *continued*

Gaming	Fundamentals in the US and Asia-based gaming markets remain sound but we are monitoring signs of consumer weakness, particularly in Las Vegas. Trips to several regions suggest that softness to date has only been felt in the lower-income tiers. Outside the US, we view the long-term growth stories in both Singapore and Macau favorably.
Health Care	The One Big Beautiful Bill Act removes near-term headline risk and the rural hospital fund could be a net benefit for HY hospitals before the revised Medicaid provisions are effective. We are underweight IG and equal weight HY health care, as we expect to see elevated utilization over the interim period, benefitting providers while pressuring managed care costs.
Metals & Mining	We remain overweight and biased to copper-focused producers. Tariffs are under watch as disrupted trade flows lead to arbitrage opportunities. China remains the largest consumer, still focused on executing policies to stabilize and grow. Prices have yet to reach sustained higher levels needed to incentivize necessary investment.
Pharmaceuticals	We are underweight IG and market weight HY due to continued sector headwinds and policy risk. We expect the industry to commit to more US-based manufacturing during the 2Q25 earnings reporting season. In HY, we are focused on names with visible credit catalysts (i.e., rising stars, liability management, M&A, etc.) and downside protection.
Retailing	We expect tariff-related demand uncertainty and supply chain challenges to pressure margins. Retailers are shifting production out of China, negotiating with suppliers to share and offset costs. We are underweight this sector, expecting tariff effects to be felt more fully later this year; retailers may raise certain prices while absorbing higher costs.
Telecommunications & Media	Despite increasing market competition, we believe that telecom/cable remains well positioned given defensive characteristics with monthly recurring revenue and strong free cash flow prospects. Within media, we remain selective, as legacy linear TV remains challenged, and advertising is vulnerable to macroeconomic weakness.
Transportation	We expect airlines to keep benefiting from consumers' willingness to prioritize experiences and pay a premium. Lower fuel costs are a tailwind for operating margins, and ultimately debt reduction. We remain overweight airlines, expecting credit metrics to improve with unencumbered assets increasing as airlines opportunistically issue unsecured debt.
Utilities	We are underweight and have strategically reduced positions with the new-issue market. Load growth has turned positive from anemic. Capital budgets are high and growing with increased need for external capital markets to fund amid companies operating closer to downgrade thresholds. Regulatory support is an increasingly significant factor to watch.

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