

Macro Opportunities Strategy Update: Navigating Rate Cuts and Election Volatility

July 25, 2024

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Macro Opportunities

Why Now?

We believe that the Macro Opportunities marketplace is favorably positioned to realize attractive absolute and excess returns in the year ahead.

- **Over time, as the backdrop of receding inflation continues, short rates should eventually be reduced.**
- **The prospect of lower rates supports our favorable outlook for a broad variety of fixed-income sectors.**
- **Overall long-duration positioning should benefit as the disinflationary process accelerates.**
- **Concentrated themes of short USD versus select developed and emerging market countries as well as financial and industrial credit exposure support a base case of slower but positive US and global growth with decelerating inflation.**
- **Current positive carry of 5.2% aids in the ability to maintain overweight positions to high-conviction themes.**
- **In the event of a Fed policy error, the long-dated duration of Macro Opportunities is favorably positioned if the Fed needs to cut rates to stimulate growth.**

Source: Western Asset.
The above reflects current opinions of Western Asset and are subject to change with market conditions. As of 30 Jun 24

2024 Global Outlook

Disinflation ongoing but uneven

Central banks will ease policy to normalize real interest rates

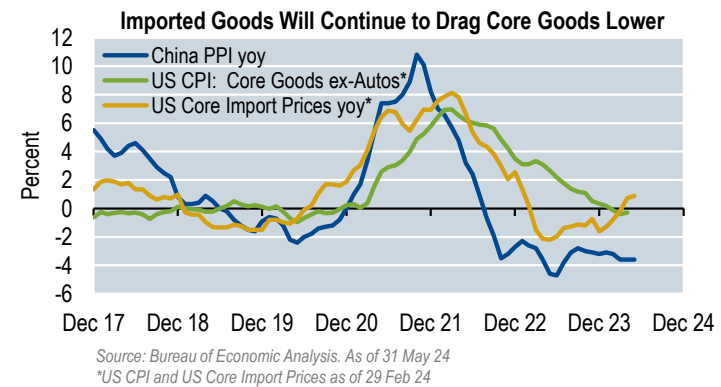
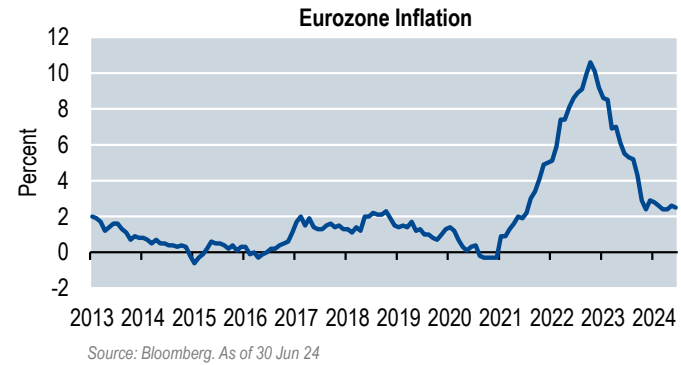
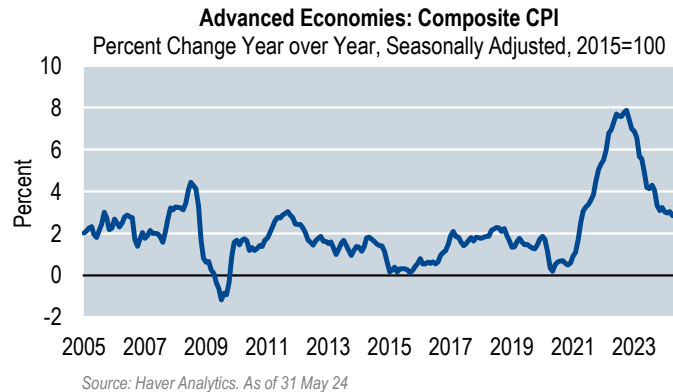
Economy has remained resilient, but is set to slow

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

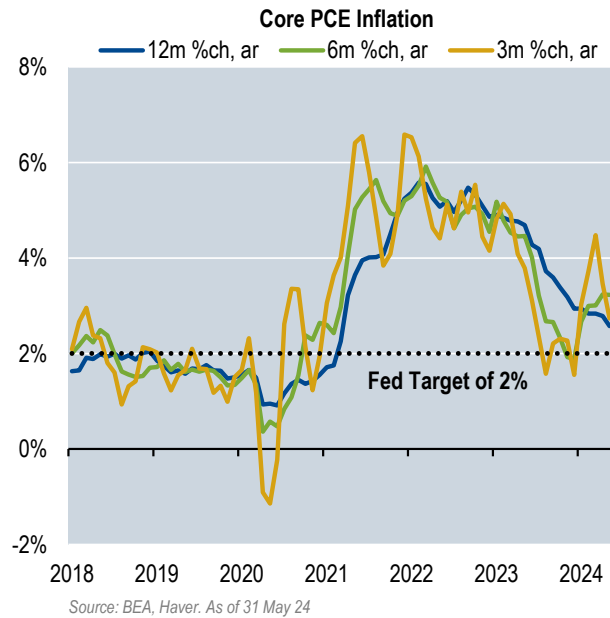
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Global Disinflation Is Broad-Based and Ongoing



US Inflation: More Disinflation Ahead

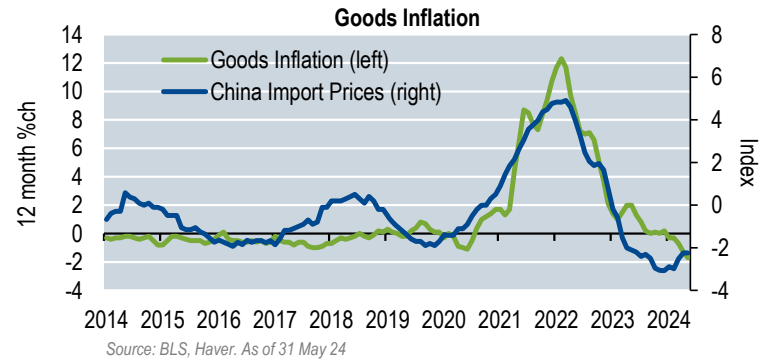
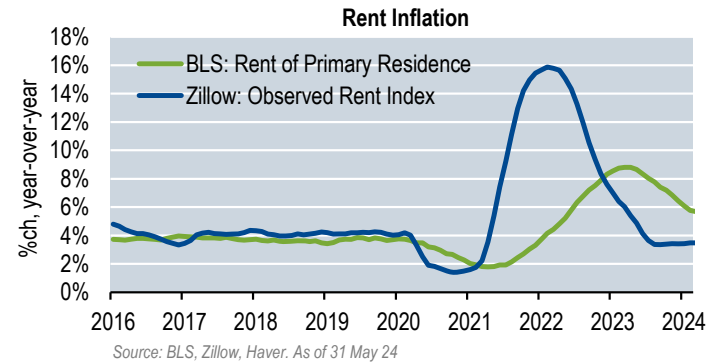
CPI housing inflation measures still elevated relative to surveys; goods prices can stay in deflation



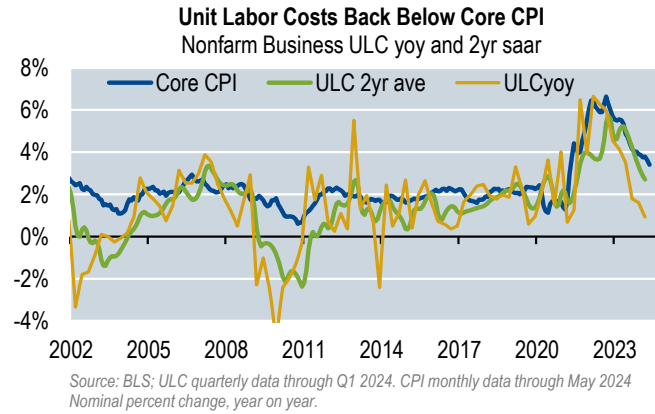
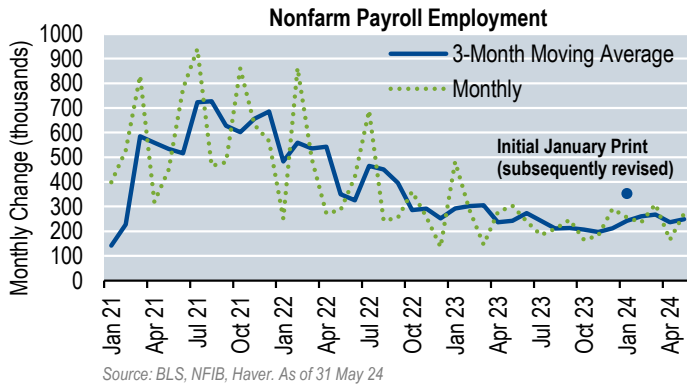
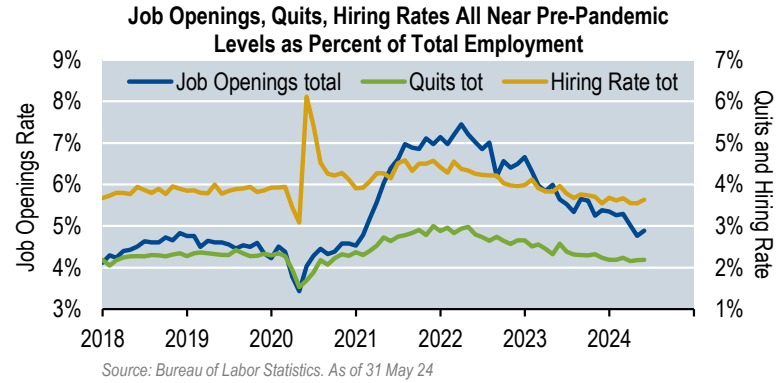
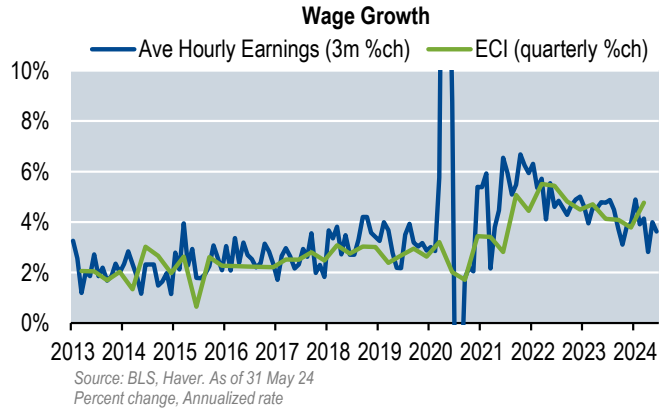
“The most recent inflation readings, however, have shown some modest further progress, and more good data would strengthen our confidence that inflation is moving sustainably toward 2%.”

“If we see that the labor market was unexpectedly weakening, then we could also respond to that, because we have a dual mandate and we now see the two mandates more in balance than they were a year ago.”

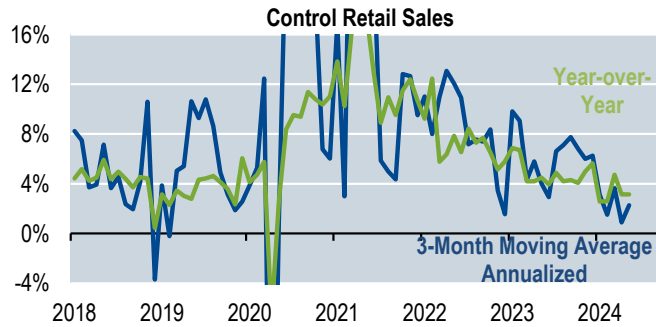
— Chair Powell, July 9, 2024



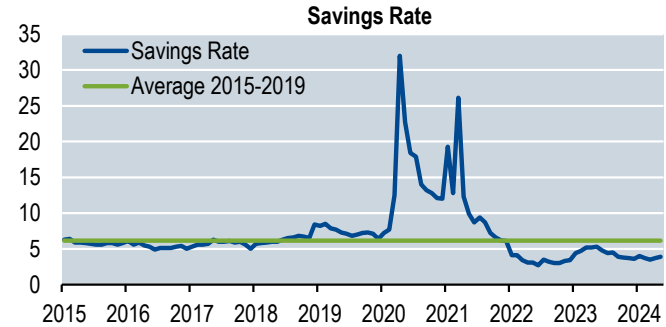
Labor Market May Have Fully Normalized



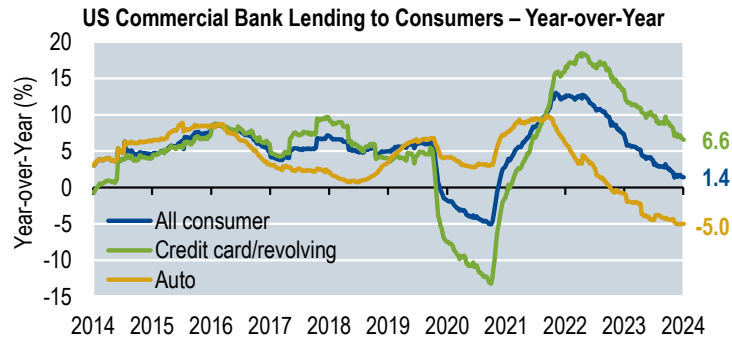
Consumer Spending Continues to Downshift



Source: US Census Bureau. As of 31 May 24



Source: BEA, Federal Reserve, Haver. As of 31 May 24

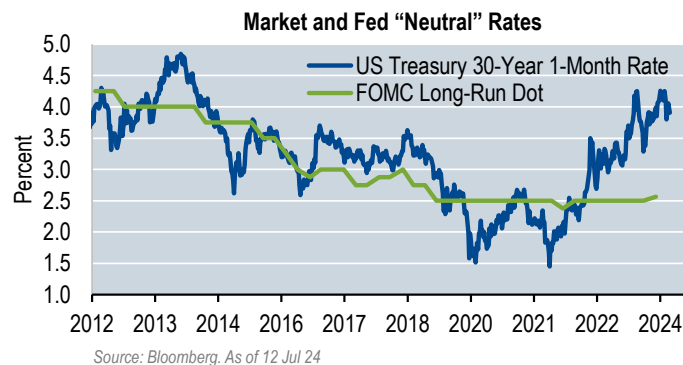
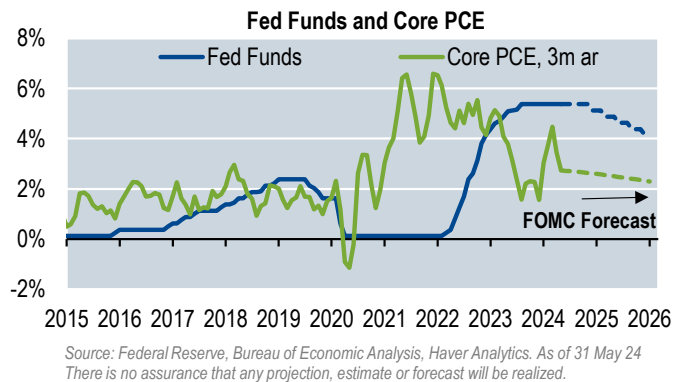
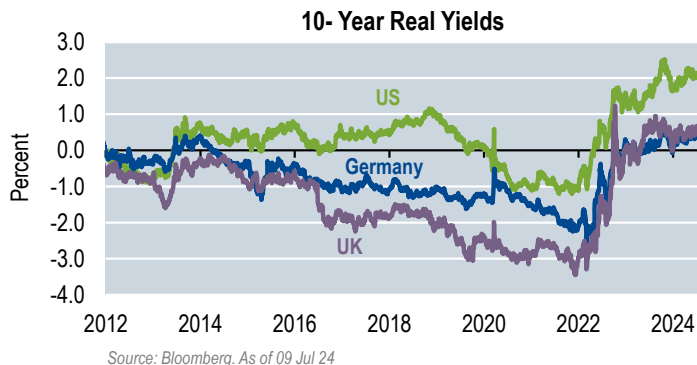
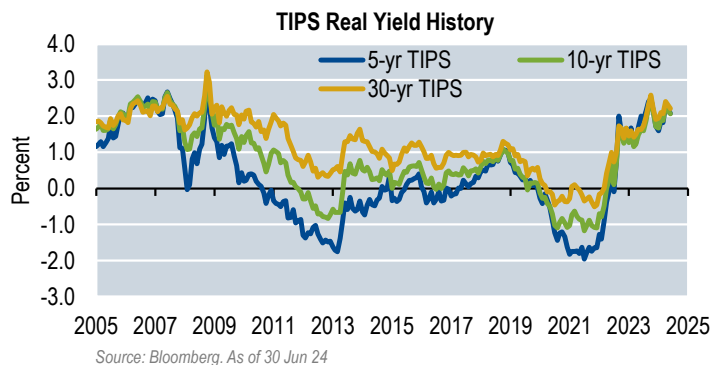


Source: Bloomberg, Federal Reserve, Morgan Stanley. As of 19 Jun 24



Source: Bloomberg. As of 08 Jul 24

Interest Rates Remain Elevated



Rest of World

Europe: Low to stagnant growth, inflation closing in on target with wages moderating

- ECB: Two more 25 bp cuts expected this year for a total of three in 2024

UK: Inflation at target, wage growth slowing and unemployment rate above pre-pandemic, continued depressed growth

- BoE: Should cut more than current market pricing, more than two 25-bp cuts now priced in for 2024

Japan: Firming up of growth and wages leading to higher inflation forecasts

- BoJ, FinMin: Further rate hikes possible if trend continues – core CPI expected above 2%, currency weakness problematic

China: Secular headwinds from debt, demographics, and de-globalization—likely constrains pace of future growth

- 2024 growth target achievable, Third Plenum likely expresses support for housing sector
- Risks to outlook include 60% tariffs under Trump 2.0 scenario and global pushback on Chinese industrial policies
- PBoC: Room to cut RRR further, \$3.28 trillion of FX reserves, relatively closed capital account, lack of systematic leverage

EM: Investors focused on China policy mix and growth, geopolitics and global growth, G10 monetary policy

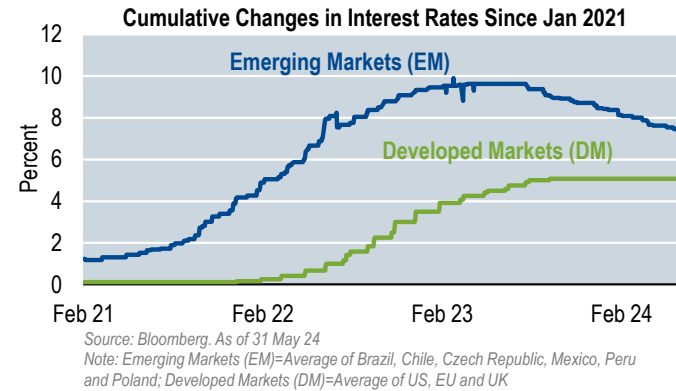
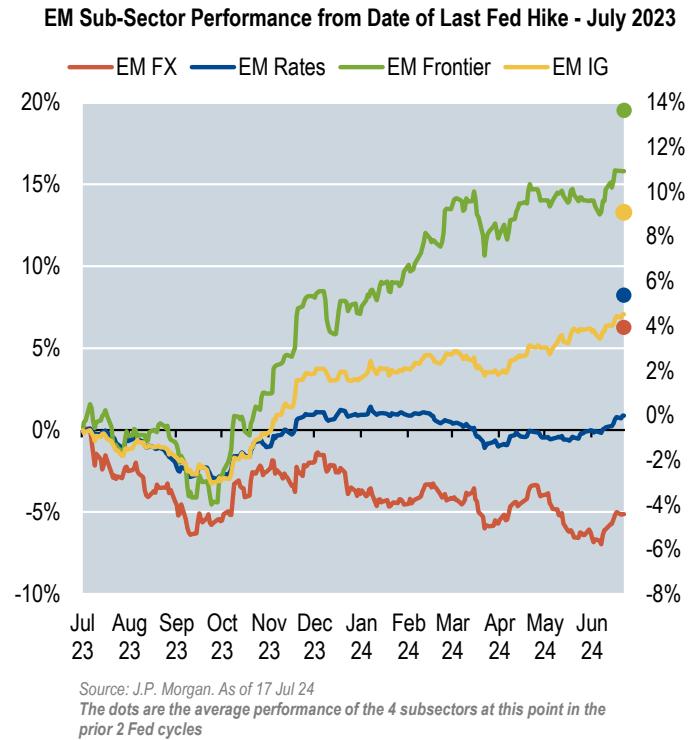
- EM FX relatively stable and local yields attractive, despite recent election-related volatility
- Nearshoring and geopolitics to benefit Mexico, Brazil, India, Indonesia – Trump 2.0 scenario a possible concern to Mexico
- CBs: Trying to stay ahead of the curve by cutting across many CBs amid falling inflation after spending most of 2021-22 raising rates. Had to pause as G10 cuts got pushed back, but should start cutting rates again later in 2024.

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The USD and Commodities: Key Emerging Market Drivers

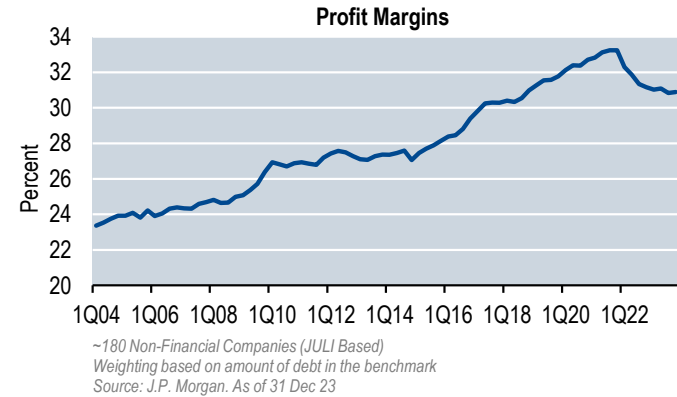
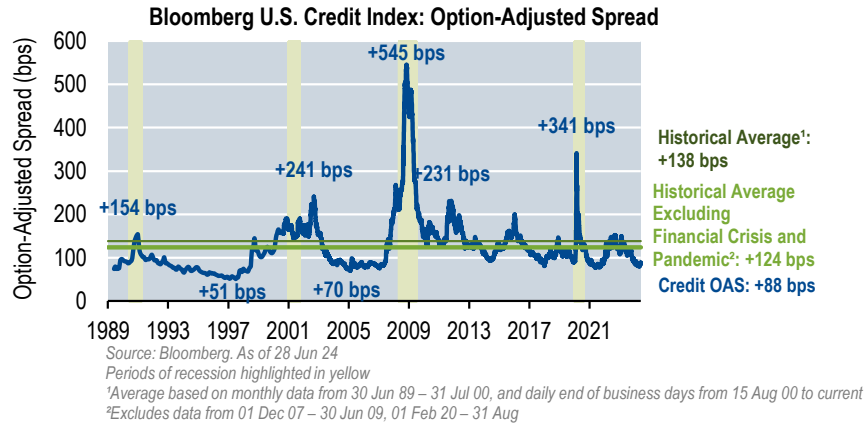
**EM local markets have underperformed previous cycles—
US exceptionalism has weighed on returns**

- EM central banks are further into the easing cycle than DM
- A Fed pause coupled with moderate economic growth bodes well for EM
- USD weakness going forward should provide a tailwind to EM FX



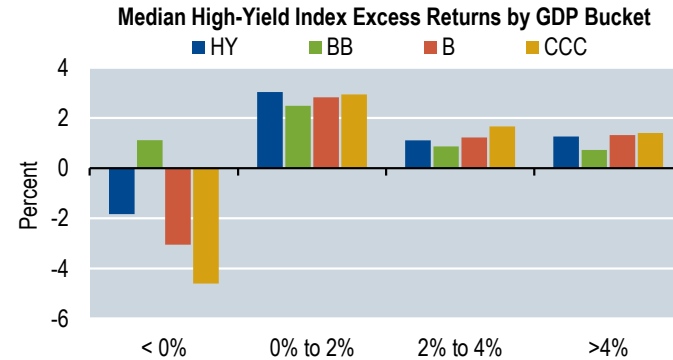
Investment-Grade and High-Yield Credit

- US investment-grade credit at +87 OAS is “richly valued,” but cash flow and debt metrics are healthy
- Foreign demand remains elevated, has helped absorb record net supply
- High-yield default rate off record lows, but debt maturity wall meaningful only in 2028 - low refinancing needs



Large Cap Banks – A Better Investment

	Regulatory Scrutiny	Balance Sheet Strength	Deposit Mix	Interest Rate Risk	Vulnerability to Confidence Erosion
Large US Banks	High	Very High	Diversified, Low Risk	Low	Low
Regional US Banks	Moderate	Moderate	Narrow, Medium Risk	Medium	High

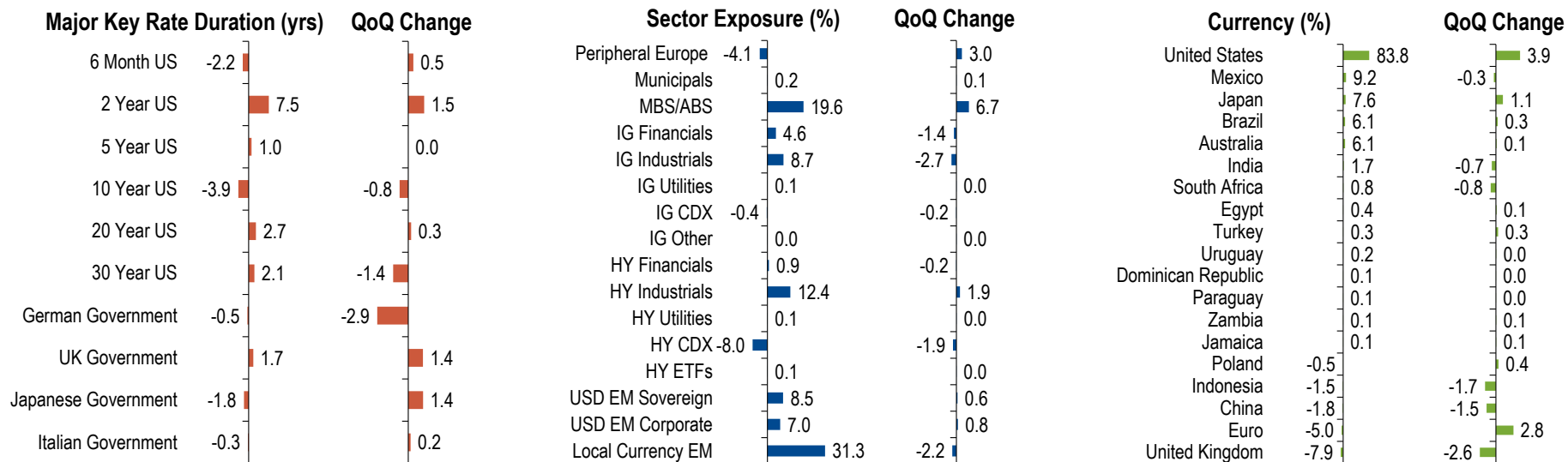


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Sector Exposure

Macro Opportunities

June 30, 2024



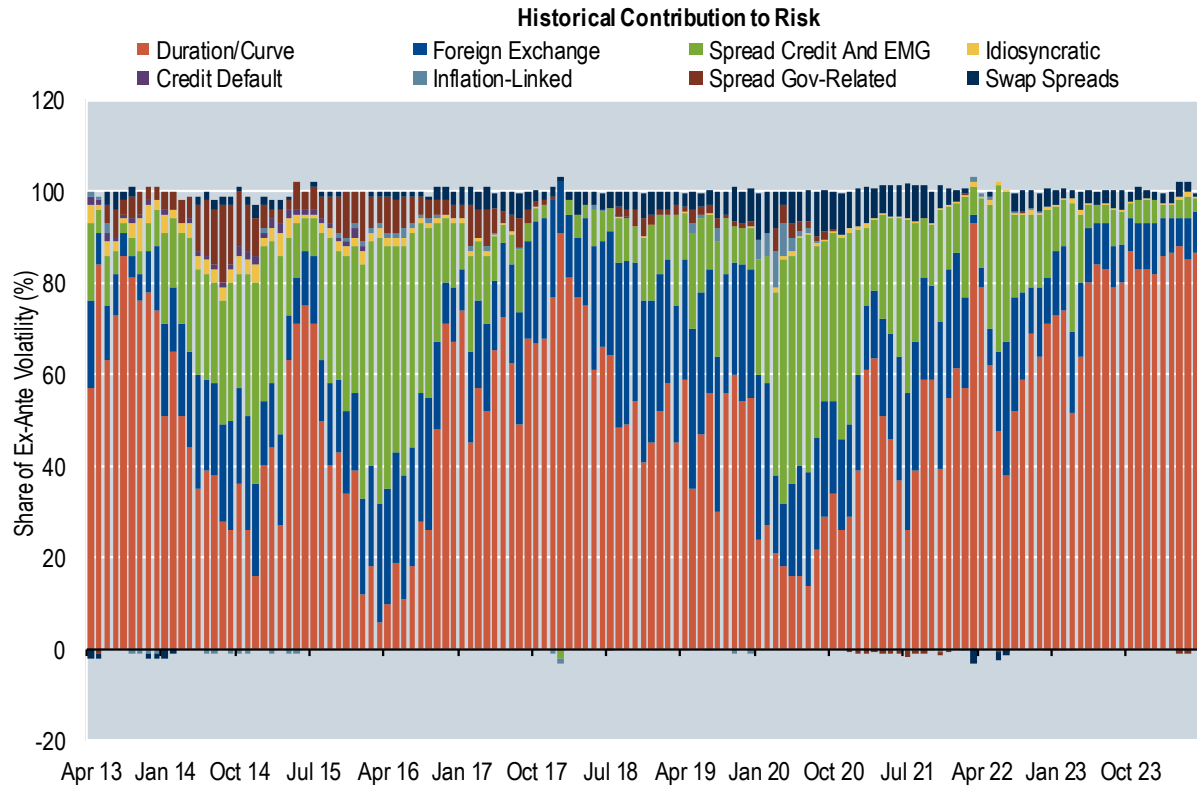
Statistics	
Effective Duration (yrs)	9.59
Average Rating ¹	BBB

Source: Western Asset
 Past performance does not predict future returns.
 Sectors subject to change. Data may not sum to total due to rounding.
¹Higher Of ratings

Historical Contribution to Risk

Macro Opportunities Ex-Ante Volatility

April 30, 2013 – June 30, 2024



Source: Bloomberg, Western Asset
Barclays POINT through 31 Jan 16 and Western Asset from 01 Feb 16 to present
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Questions & Answers



Thank you.

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