

4Q24 Market & Strategy Update

October 2, 2024

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Global Outlook

Global disinflation process ongoing

Global growth has downshifted

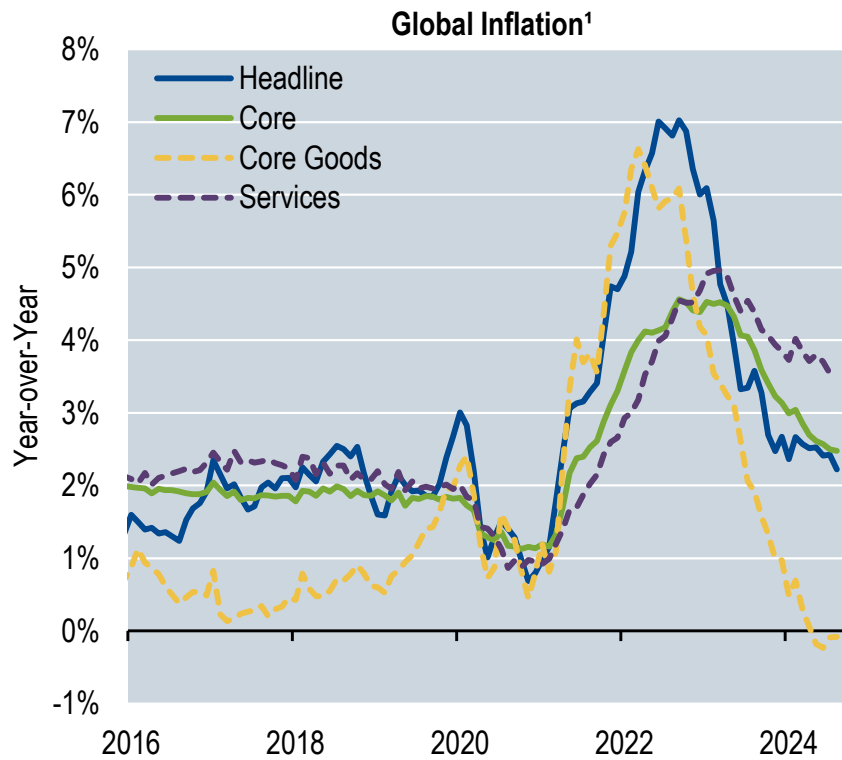
Central banks have begun to ease policy

Fixed-income outlook

- Global inflation will continue to recede
- Global growth has downshifted, led by China and the eurozone
- US growth will slow but should avoid recession
- China policy stimulus should help mitigate hard-landing scenario
- US core PCE already near Fed target
- Central banks have started policy easing to normalize real interest rates
- The US dollar will weaken moderately
- Select emerging markets should outperform, particularly those with high real yields
- Spread sector fundamentals are generally attractive, valuations are not
- Geopolitical uncertainty continues to add to volatility

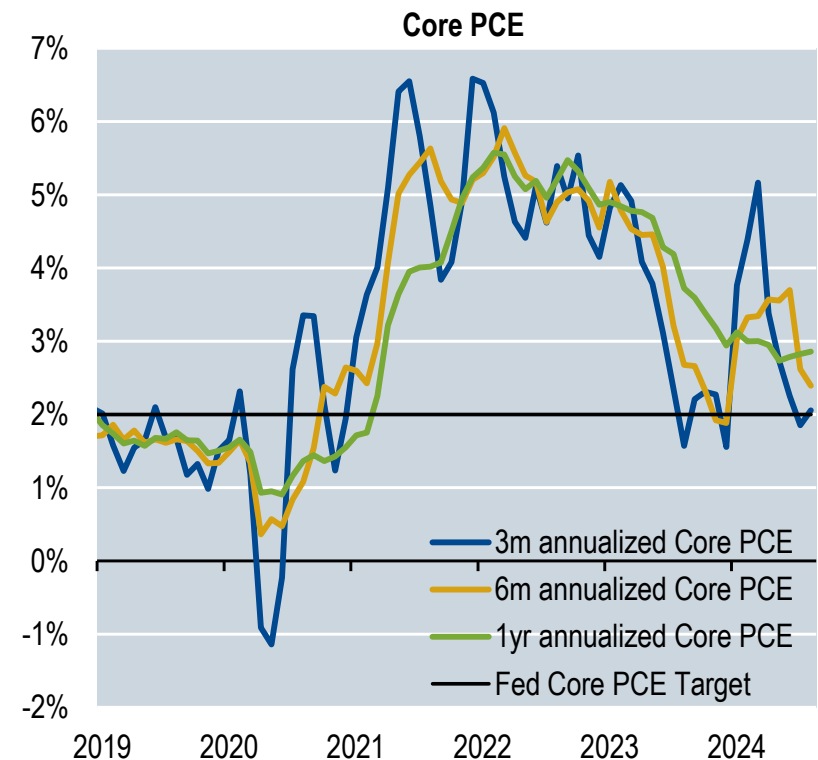
Global Disinflation Is Broad-Based and Ongoing

US Core PCE Nears Fed Target



Source: Citigroup, Haver Analytics. As of 31 Aug 24

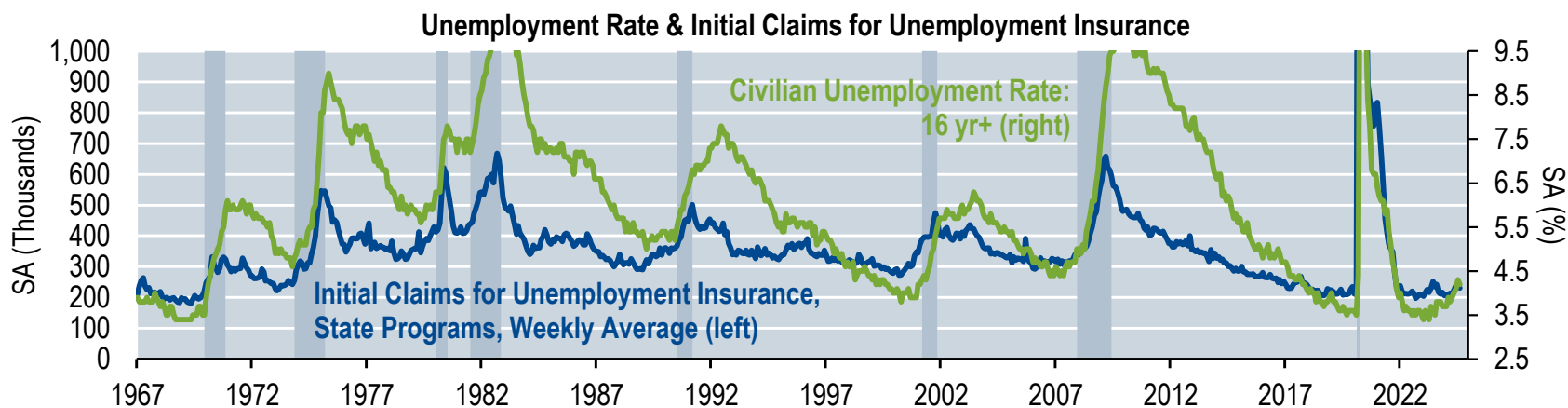
¹Headline and core cover 15 economies; goods and services cover 12 economies



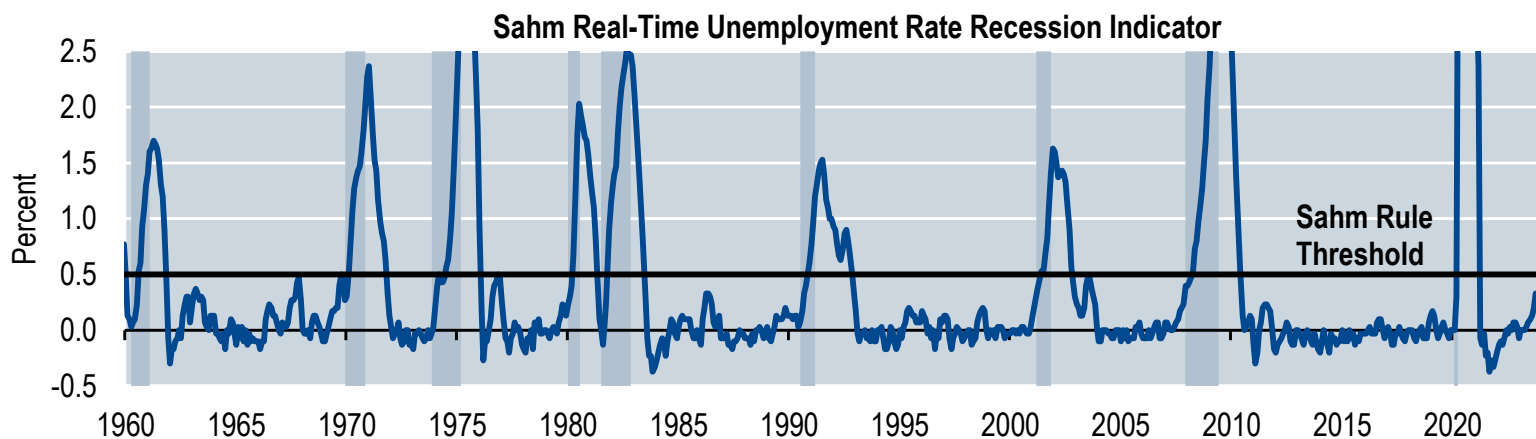
Source: Haver Analytics. As of 31 Aug 24

The US Unemployment Rate Has Ticked Higher to 4.2% but Layoffs Remain Low

The “Sahm Rule” has been triggered, but is this time different?



Source: Bureau of Labor Statistics, Department of Labor, Haver Analytics. As of 31 Aug 24

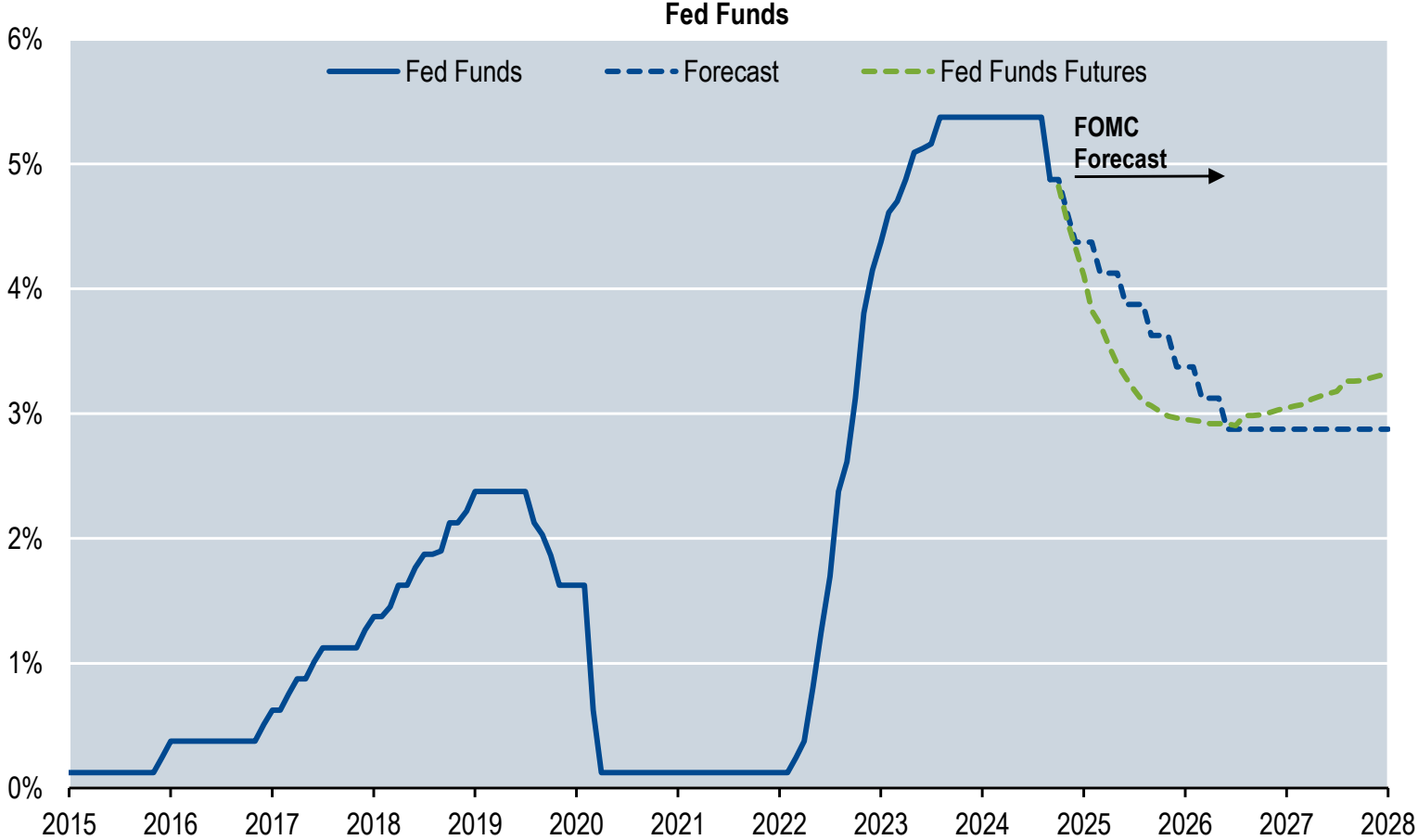


Source: Haver Analytics, National Bureau of Economic Research. As of 31 Jul 24

If the 3-month average unemployment rate moves more than 0.50% above the lowest 3-month average unemployment rate from the previous 12 months, then the Sahm Rule will be triggered.

US Federal Reserve

Fed now cutting, but by how much?

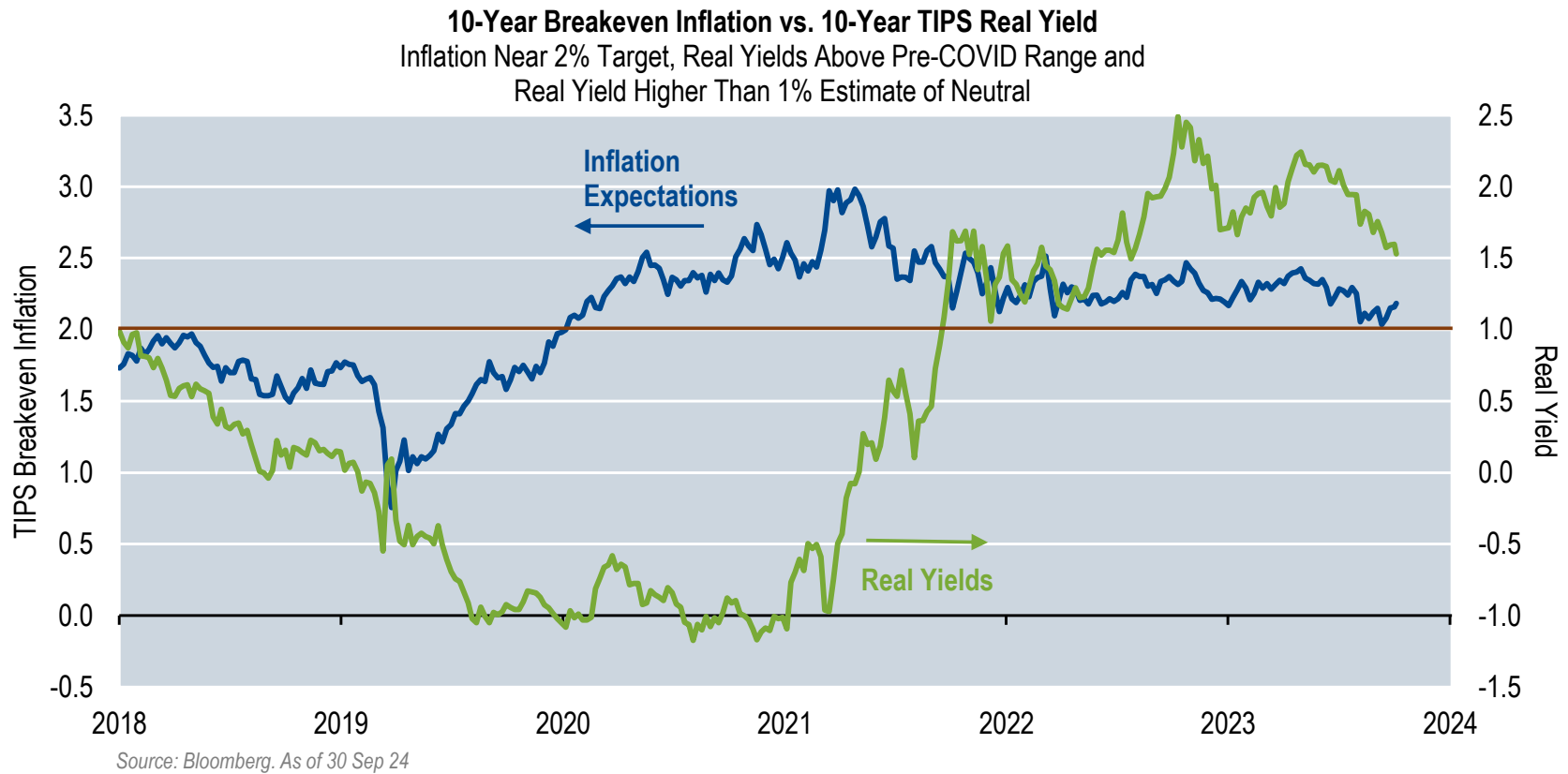


Source: Federal Reserve, Haver Analytics. As of 30 Sep 24
There is no assurance that any projection, estimate or forecast will be realized.

US TIPS

Real yields attractive

- Inflation expectations have fallen along with actual inflation
- 10-year expected inflation close to Fed targets (TIPS breakeven inflation)
- Real yields remain high relative to past periods when inflation was at target
- Red line is a relatively high estimate of the neutral real rate (right-hand scale) and target inflation (left-hand scale)



Ballots, Bonds & Beyond

	Harris	Trump
Taxes/Fiscal	<p>Increase corporate tax rate to 28% from current 21%.</p> <p>Allow TCJA expiration for individuals earning > \$400,000.</p> <p>Expand Child Tax Credit (CTC) with larger credit for newborns.</p> <p>Expand green energy credits.</p>	<p>Cut corporate tax rate to 15% from current 21%.</p> <p>Extend all individual TCJA rates.</p> <p>Roll back green energy credits.</p>
Trade	<p>Maintain existing tariffs, focused on key sectors like technology, electric vehicles, and defense.</p>	<p>60% tariffs on imported Chinese goods.</p> <p>10% broad tariffs on all imported goods.</p> <p>Incentives for US domestic production.</p>
Regulation	<p>Tighter regulations, especially in areas of environmental protection, labor rights and consumer protections.</p> <p>Emphasis on climate initiatives, renewable energy projects and antitrust enforcement; increased enforcement of the technology sector to continue.</p>	<p>Less stringent regulatory policies aimed at stimulating economic growth.</p> <p>Reduction of regulatory burdens across multiple sectors, including energy, finance and health care.</p>

China: Structural Issues Remain but Risk of Hard Landing Scenario Has Been Mitigated

Market Concerns Over the Sustainability of Chinese Growth:

- Stimulus measures announced in late September may not be sufficient to address structural issues and bolster confidence
- Lack of demonstrated fiscal support for the weak consumer and slowing economy
- Heightened global pushback on Chinese industrial policies/exports
- Potential 60% tariffs under a Trump 2.0 scenario could exacerbate trade tensions

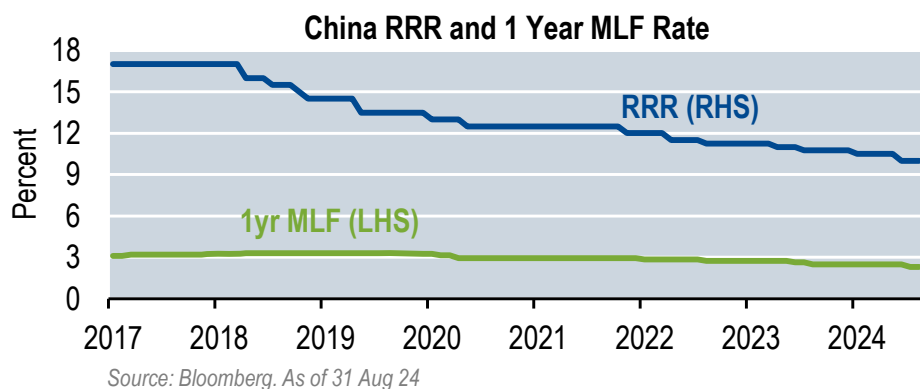
Due to regulatory policy and property market struggles, confidence remains challenged...



And as a result, the Chinese are facing deflation not inflation.



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



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



Europe: Lackluster Growth With Inflation Near Target

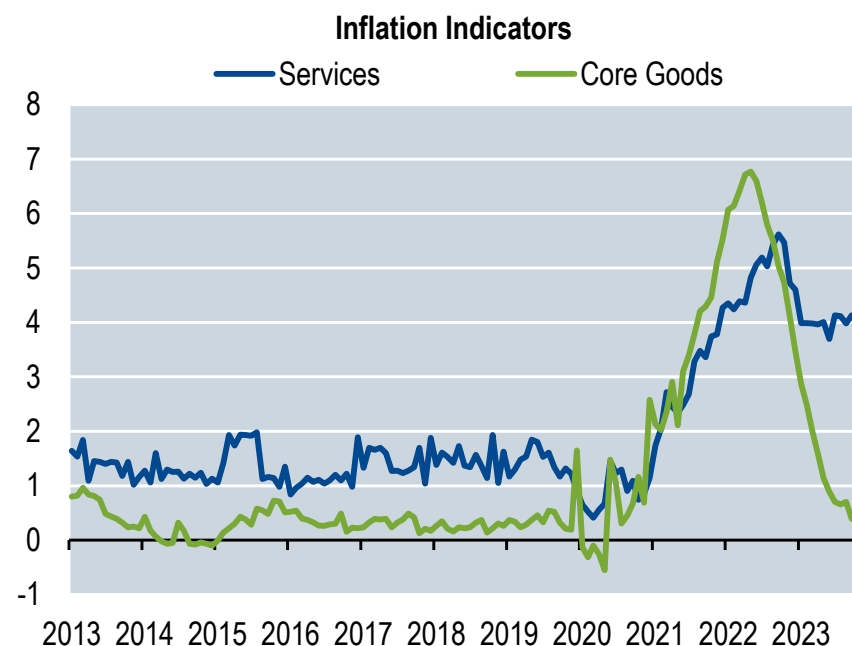
- Growth: Modest expansion still challenged
- Inflation: Lower services inflation key to ECB pace going forward
- ECB: One or potentially two further cuts expected this year
- ECB: Policy historically tight given growth and inflation

	Policy	HICP	GDP
1999 to Current	1.50	2.09	1.40
Current	3.50	2.20	0.60

Source: ECB, Haver Analytics. As of 23 Sep 24



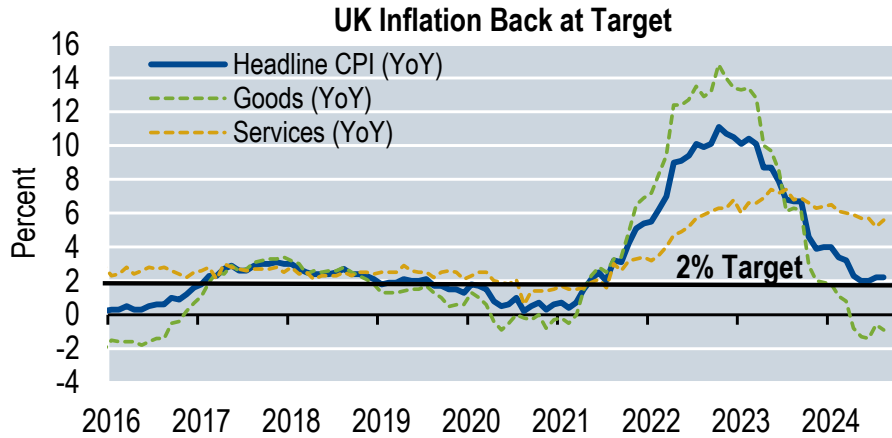
Source: S&P Global, Hamburg Commercial Bank, Haver Analytics. Industrial production as of 31 Jul 24. Manufacturing PMI as of 23 Sep 24



Source: Haver Analytics. As of 31 Aug 24

United Kingdom

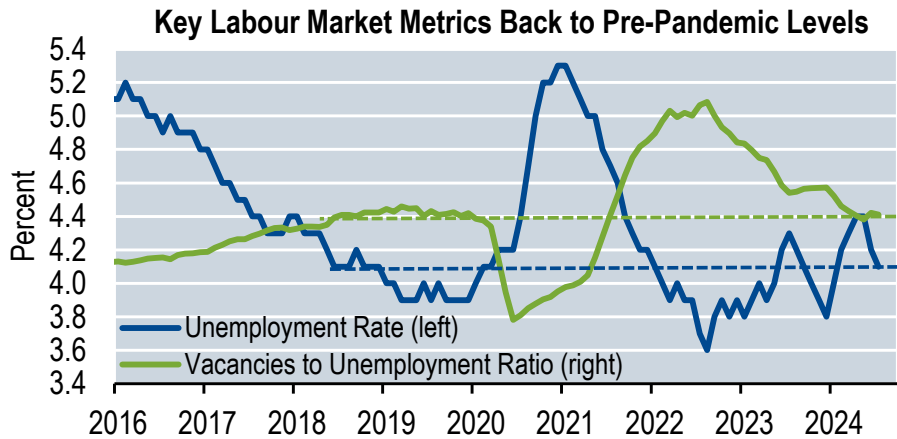
“A gradual approach to removing policy restraint remains appropriate” – Bank of England, September 2024



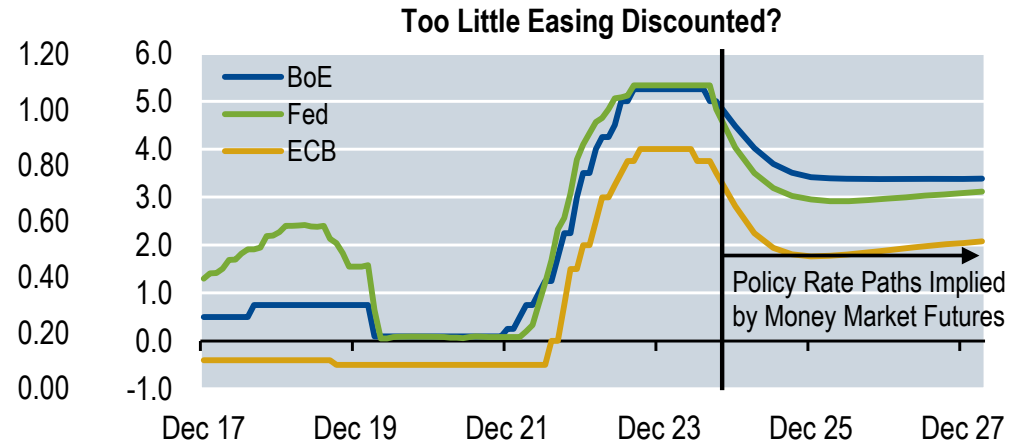
Source: Office for National Statistics, Bloomberg. As of 30 Sep 24



Source: Office for National Statistics, BoE Decision Maker Panel. As of 30 Sep 24



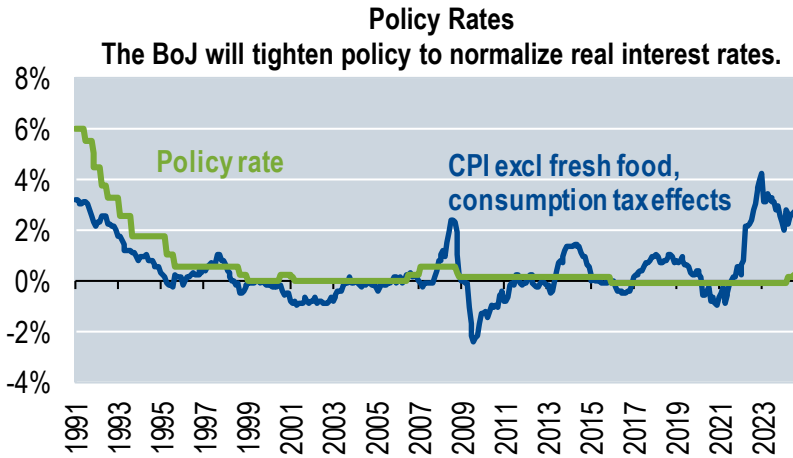
Source: Office for National Statistics, Bloomberg. As of 30 Sep 24



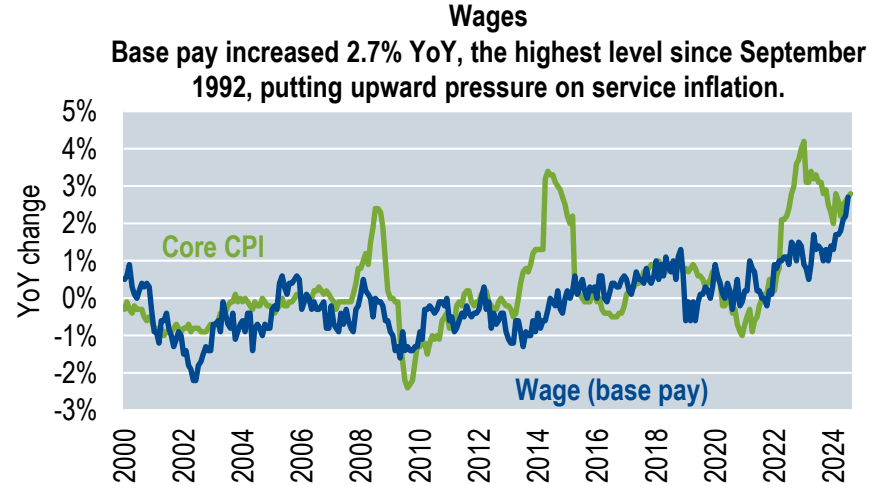
Source: Bloomberg, Western Asset. As of 20 Sep 24

Japan

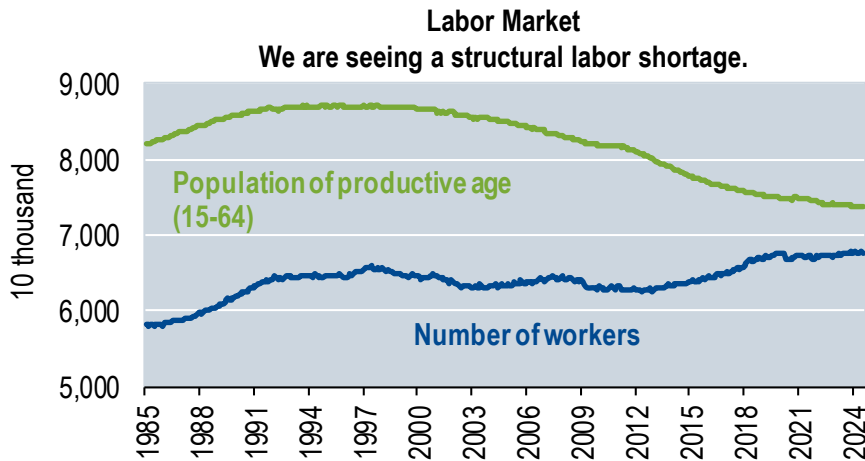
Higher wages along with higher inflation forecasts strongly suggest Japanese yields need to rise



Source: Bloomberg, Western Asset. As of 31 Aug 24

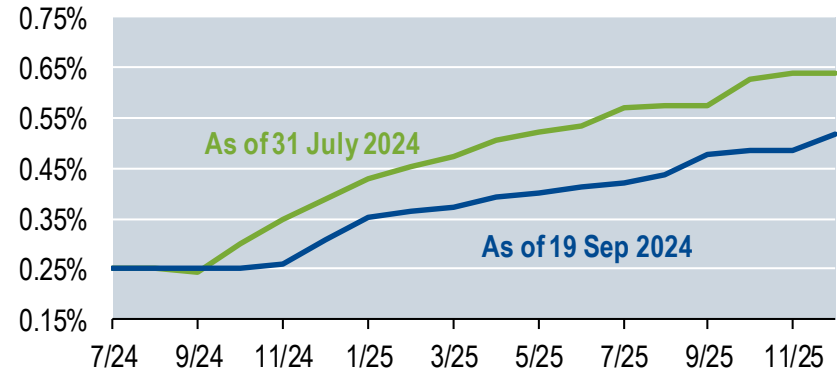


Source: Bloomberg. As of 31 Aug 24



Source: Datastream. As of 31 Jul 24

Policy Rate Path
The market is pricing in a 5-bps hike in December 2024 and another 5-bps hike in March 2025, suggesting that the next rate hike is not fully priced in right now.

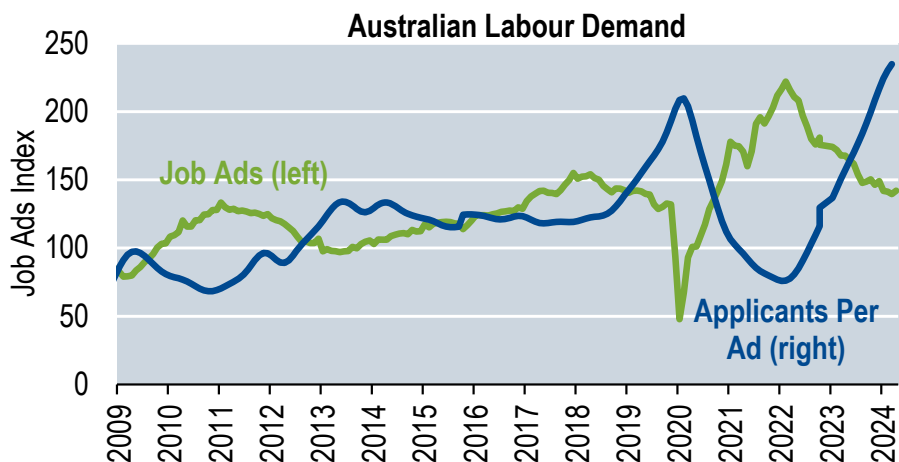


Source: Bloomberg, Western Asset. As of 31 Aug 24

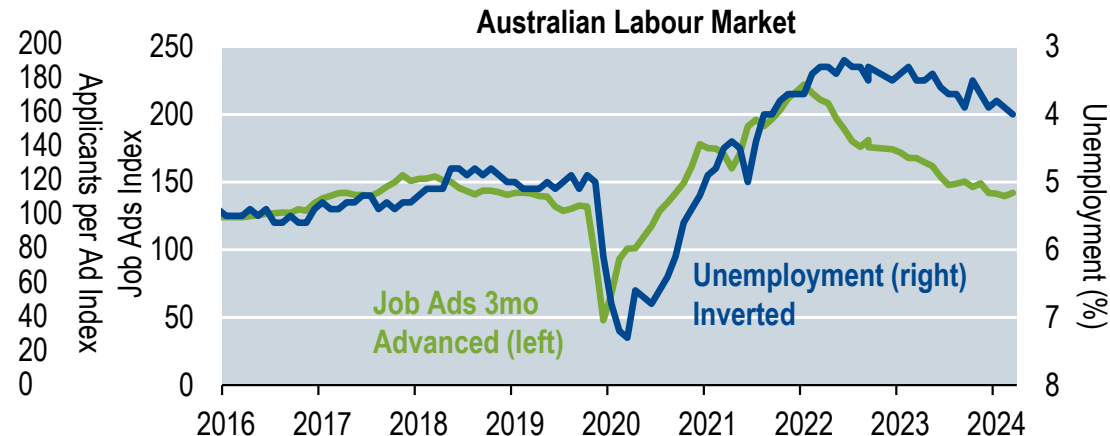
Australia: Job Market Loosening as Inflation and Growth Wane

RBA on hold until core inflation makes further progress.

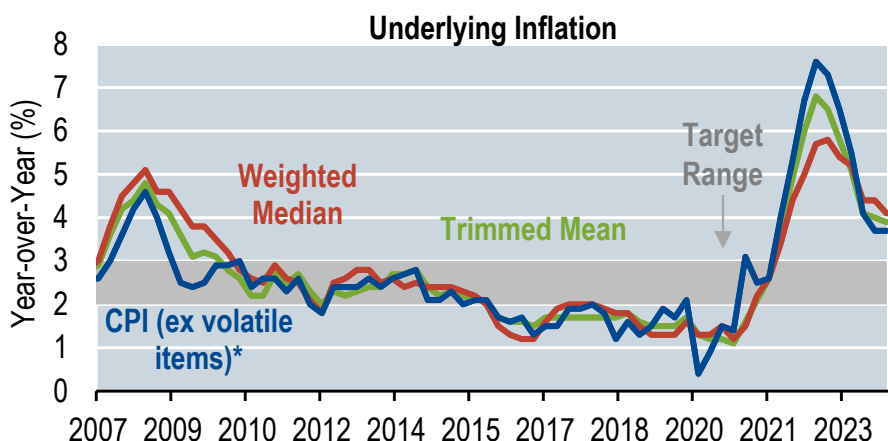
- Headline inflation to retreat as government implements energy subsidies, but core inflation remains the key
- Loosening job market has seen wages turn lower
- Improved labor market gives RBA scope to ease by 2Q25



Source: Seek. As of 31 Jul 24



Source: ABS, Seek. As of 31 Jul 24



Source: RBA, Bloomberg. As of 30 Jun 24

*Excluding volatile items; excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999-2000.

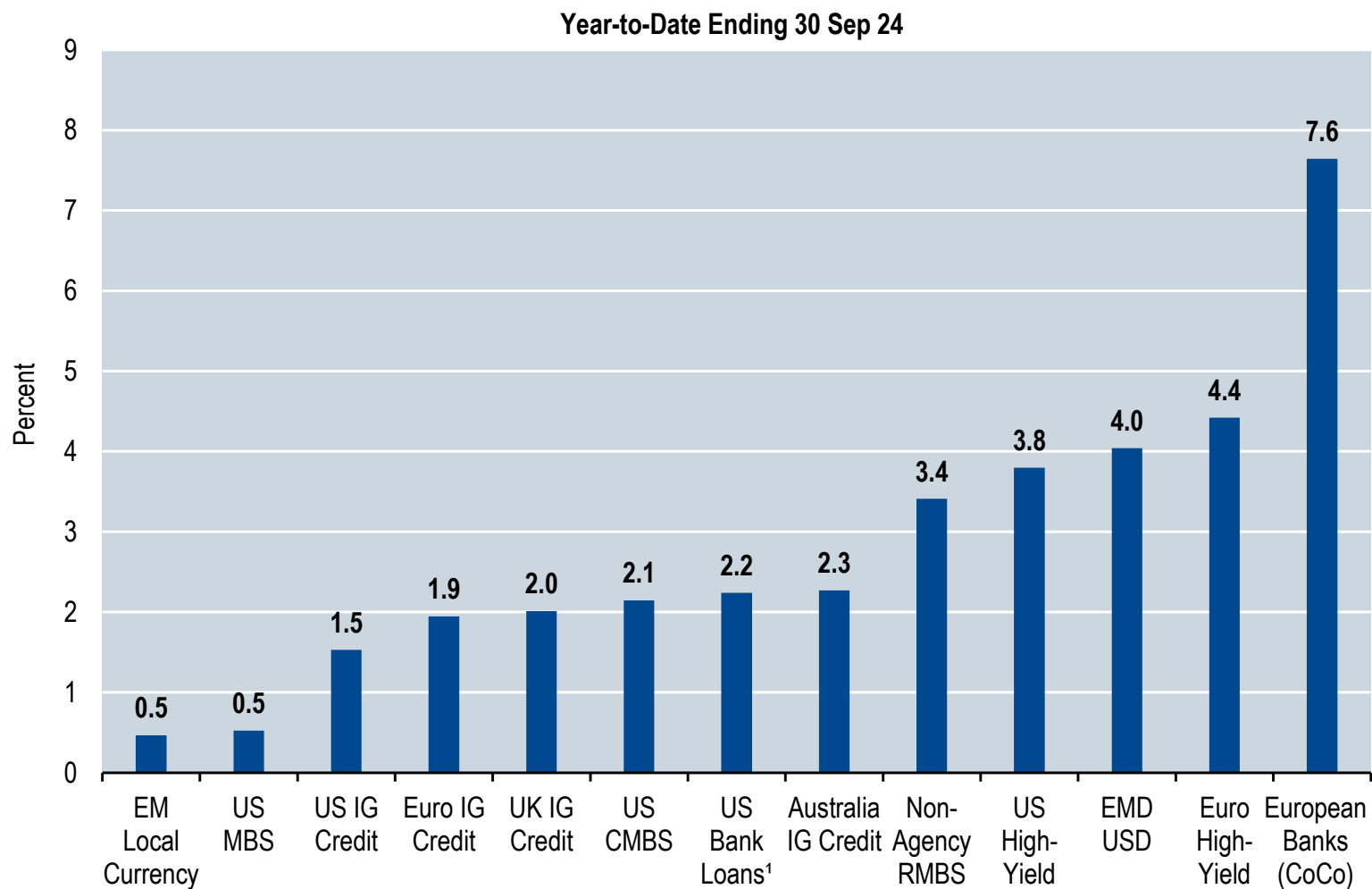


Source: Bloomberg. As of 30 Jun 24

*Not seasonally adjusted

Spread Sector Excess Returns

Spread sectors have outperformed.



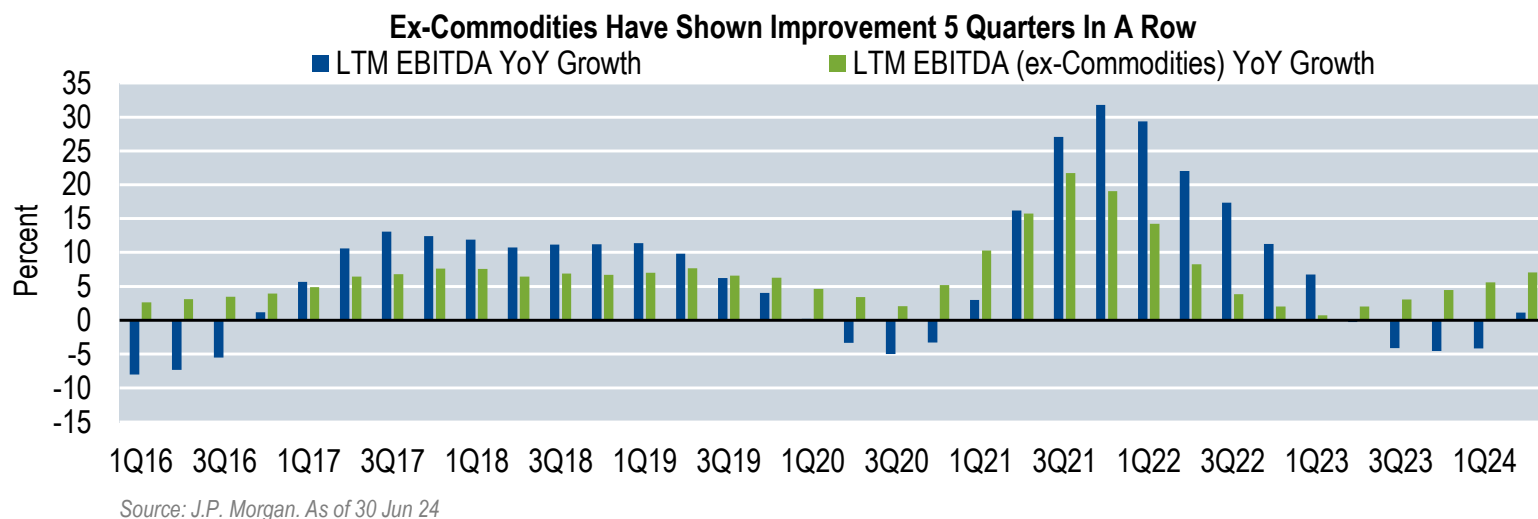
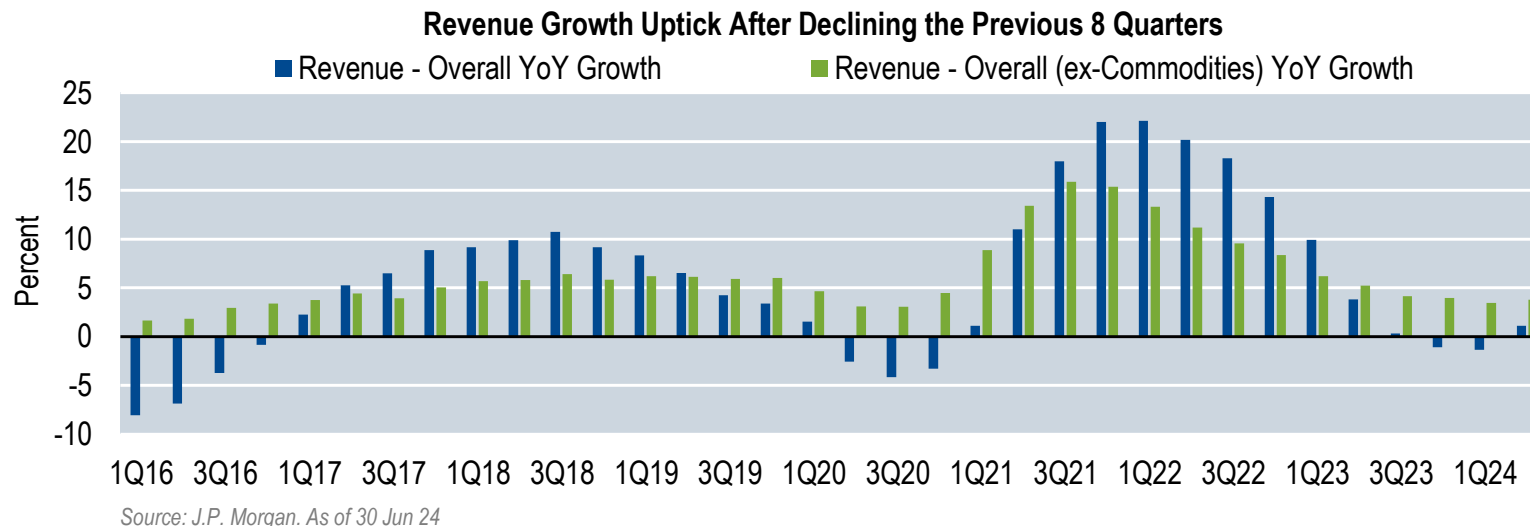
Source: Bloomberg, Citi, J.P. Morgan, Morningstar LSTA, Western Asset. As of 30 Sep 24

¹Morningstar LSTA US Leveraged Loan Total Return Index excess return vs. SOFR - Secured Overnight Financing Rate USD Unhedged Index.

Past performance is not a reliable indicator of future results.

Corporate Bond Fundamentals

Fundamentals remain strong.

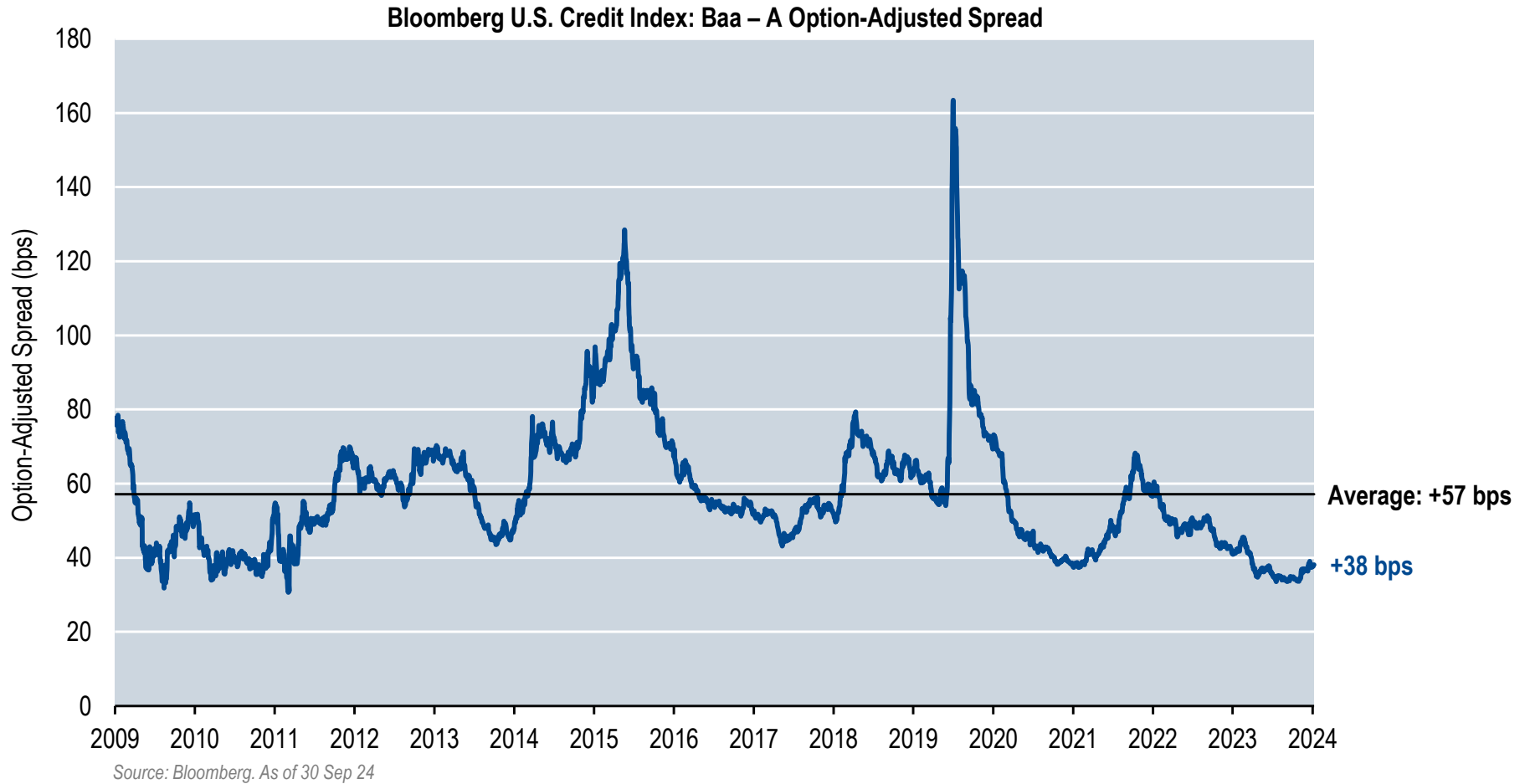


Methodology:

The analyses in this report are based on about 210 non-Financial High Grade bond issuers. For balance sheet and income statement data such as Revenue and Cash, the figures shown are a simple sum of each company in the analysis. Financial ratios are calculated by taking each issuer's ratio and weighting it by its debt in relationship to the total debt of all issuers or of all issuers in the sector. In this process, the top and bottom 10% of each ratio (weighted by debt) is eliminated from the calculations, to avoid distortion from outliers. Note that for all charts a constant composition methodology is used. This means when a company falls to high yield its current and all prior data from the company is eliminated from the analysis. We use the same list of companies with the same weights for all the history. The benefit of this approach is that it removed distortions from changes in composition. The downside is that the data over time are not comparable to bond indices, as indices rebalance regularly. The data sources for the analysis is primarily J.P. Morgan analysts.

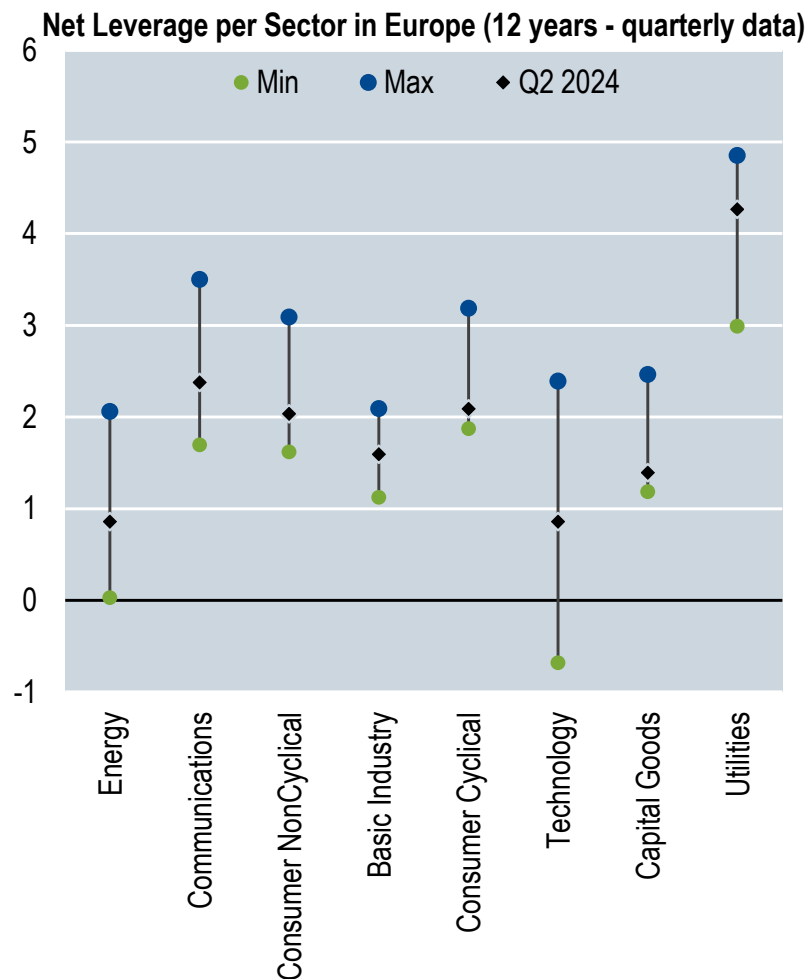
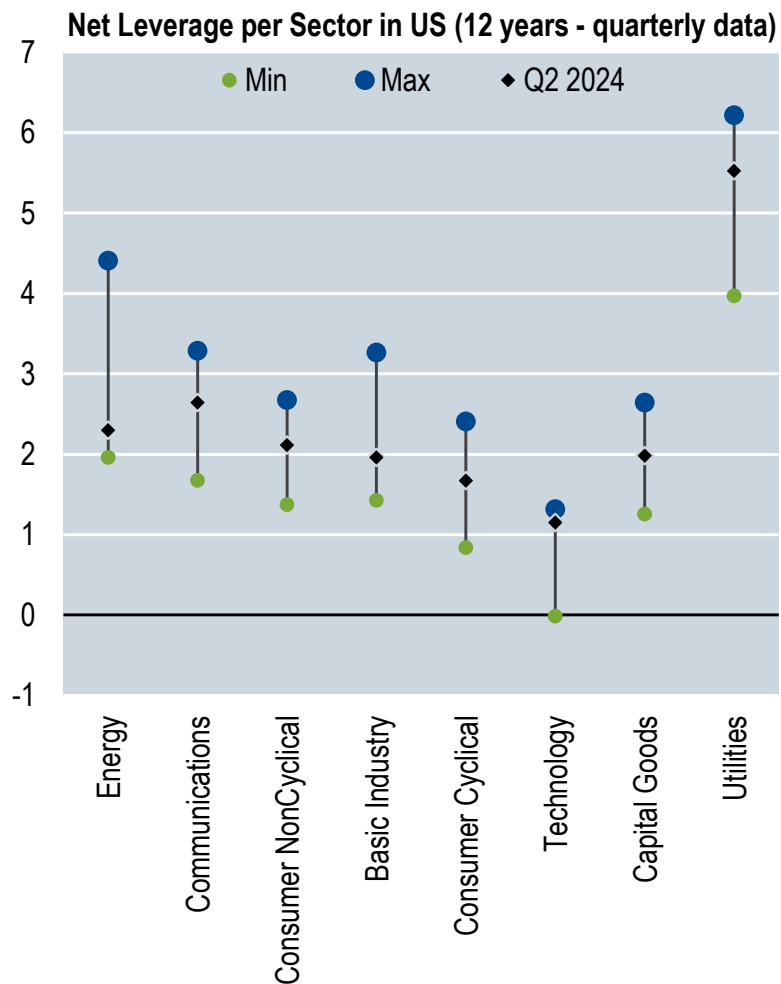
Corporate Bond Valuations

US Credit OAS - BBB vs. A near 15-year tights



Sector Cyclicity May Look Different Than in the Past

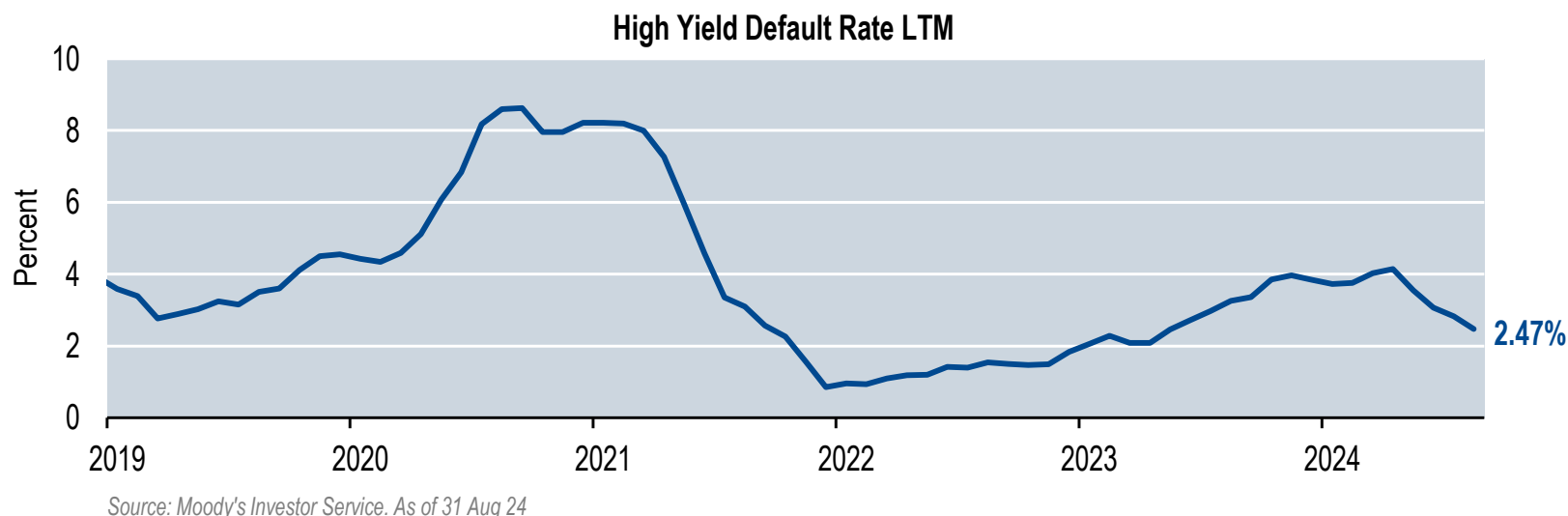
- Some traditionally cyclical sectors (e.g., energy) have lower leverage than in the past...
- ...while some noncyclical sectors have higher leverage (e.g., US utilities).



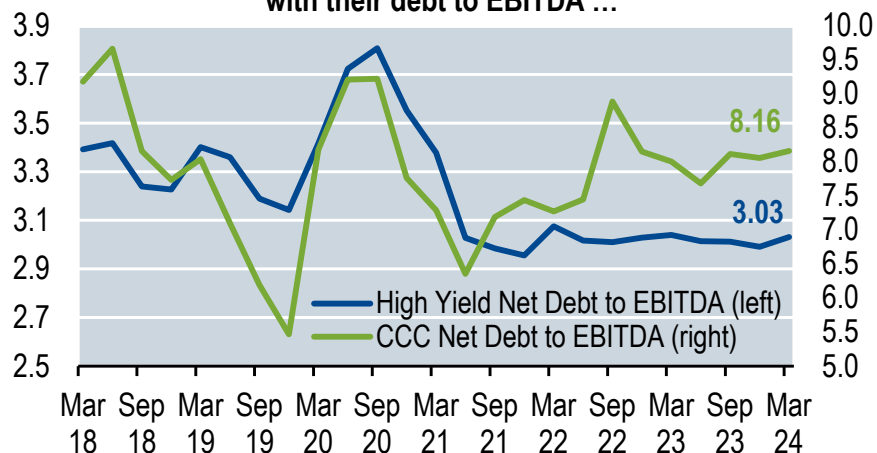
Source: S&P Capital IQ, Western Asset. As of 30 Jun 24

High-Yield Corporate Bonds: Fundamental Dispersion Supports an Active Approach

...and default rates are moderating

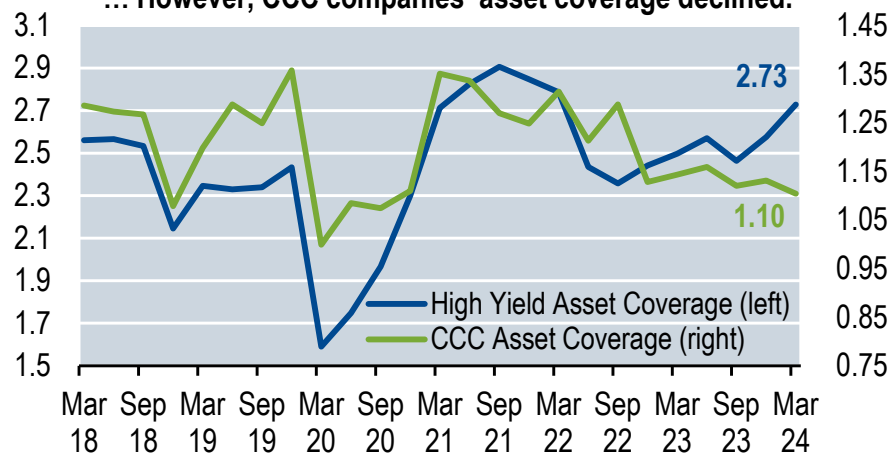


Many companies have maintained discipline with their debt to EBITDA ...



Source: Morgan Stanley. As of 31 Mar 24

... However, CCC companies' asset coverage declined.

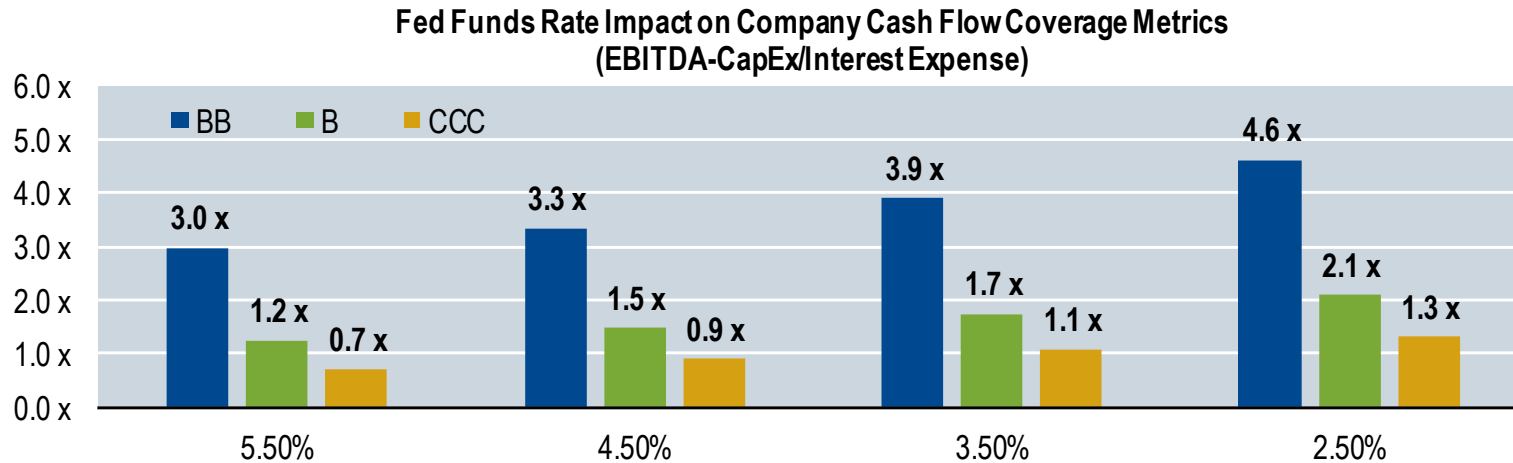


Source: Morgan Stanley. As of 31 Mar 24

Bank Loans: Impact of Fed Rate Cut Cycle

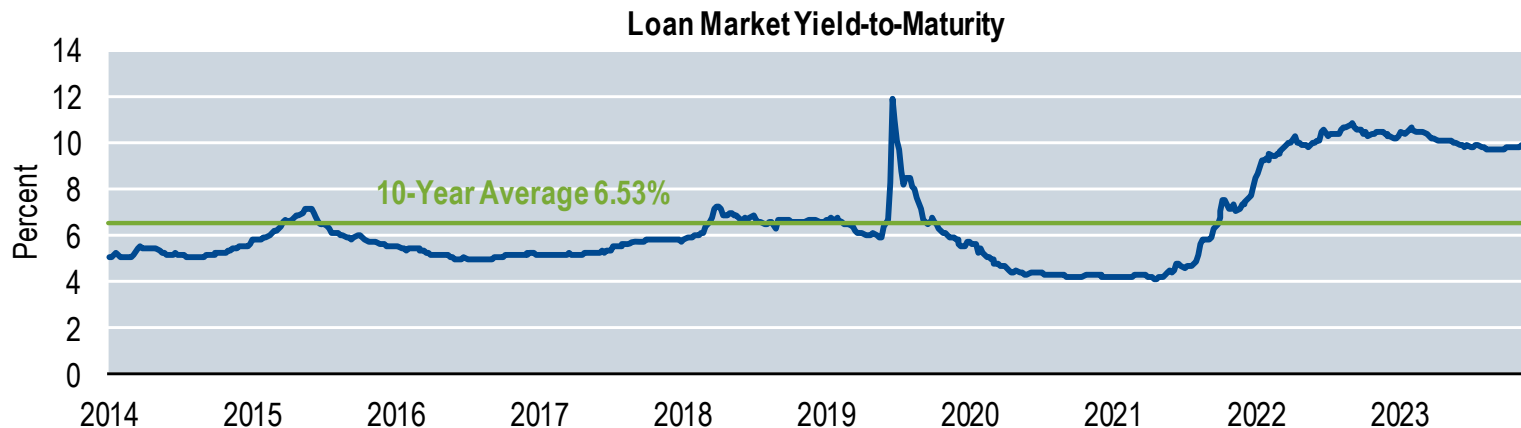
The Fed's rate-cutting cycle will reduce bank loan total yields and drive significant reduction in companies' interest costs

Bank loan issuers will benefit significantly from lower rates and lower interest costs.



Source: BofA Global Research, LCD, Bloomberg, Bixby. As of 16 Sep 24

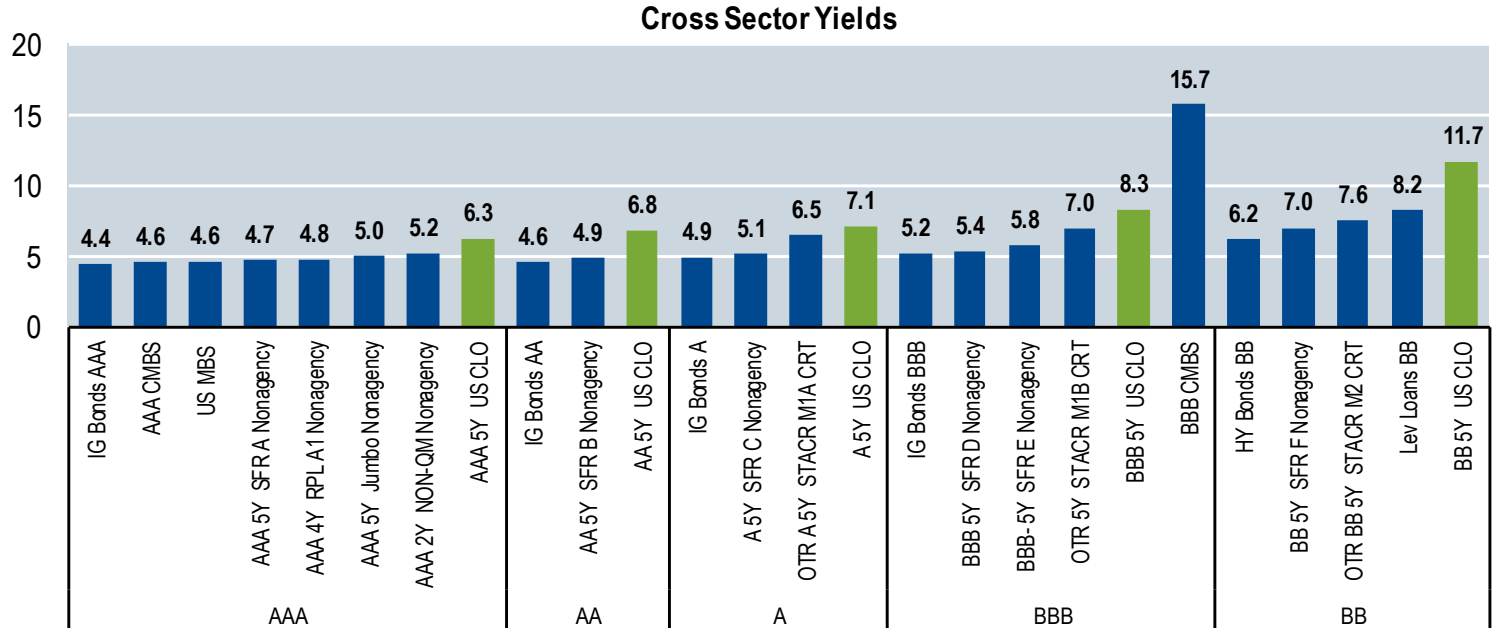
Loan yields remain attractive and significantly above 10-year averages with carry remaining compelling in a cutting cycle. Given the expected improvement in capital structures, we anticipate compression between BB-B relationship.



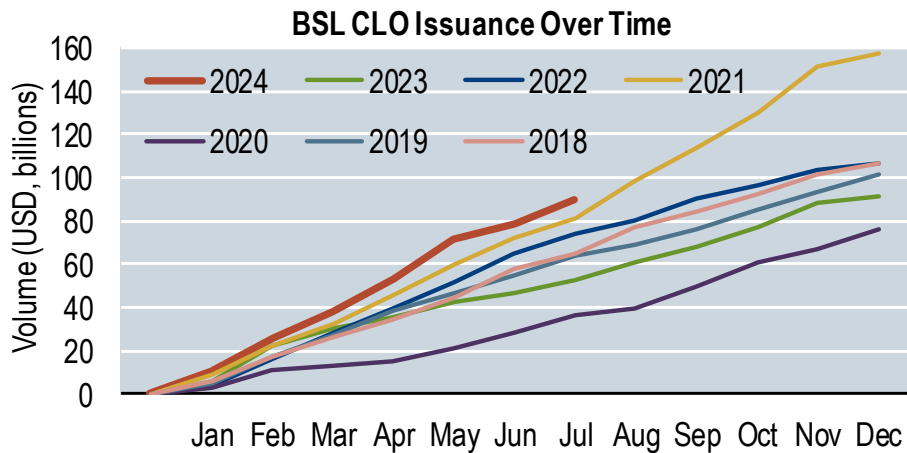
Source: Morningstar LSTA. As of 13 Sep 24

CLO Market and Technicals

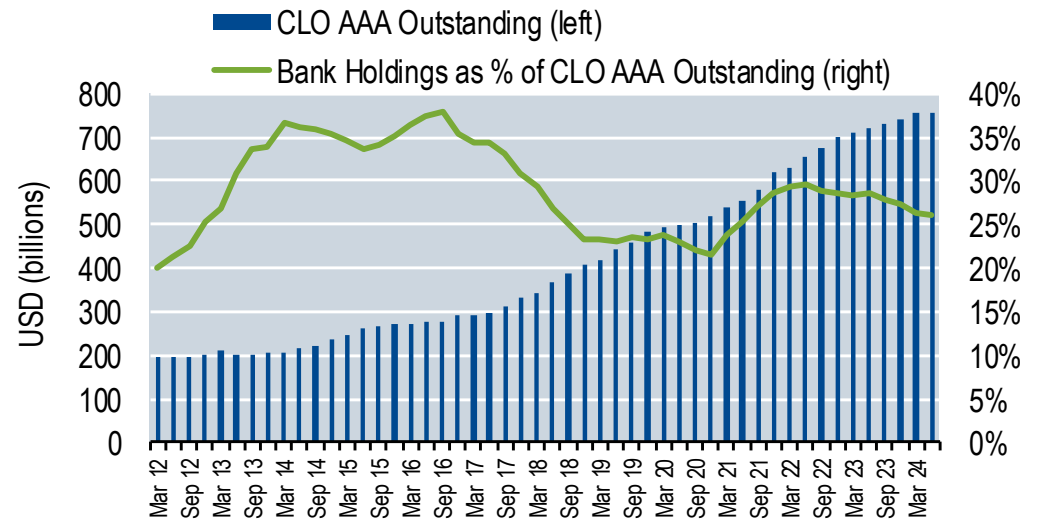
Attractive current yields across most rating categories. AAA CLO spreads offer value vs. comparably rated sectors



Source: BofA Global Research, Palmer Square CLO Indices, Bloomberg. As of 23 Aug 24



Source: BofA Global Research, S&P LCD, Bloomberg, Intex. As of 31 Jul 24



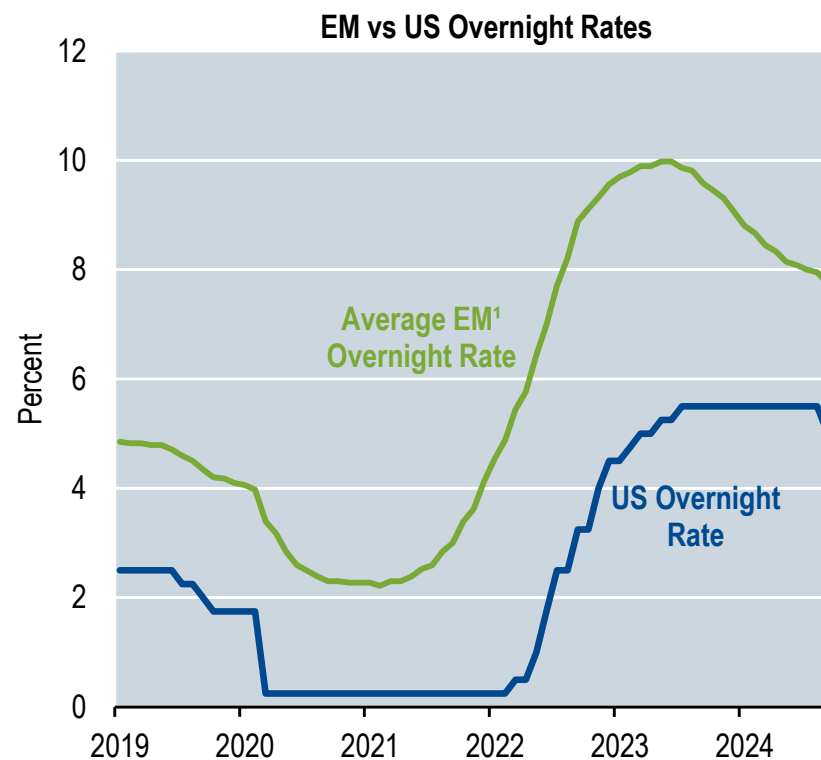
Source: BofA Global Research, SNL, Intex, LCD. As of 30 Jun 24

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 EM and DM inflation having peaked, EM central banks were only able to tepidly cut rates in front of the Fed.

With the Fed having finally initiated its easing cycle, look for EM monetary policymakers to accelerate/continue/reinitiate easing cycles. This rate-cutting environment provides a constructive backdrop for EM rate trades.



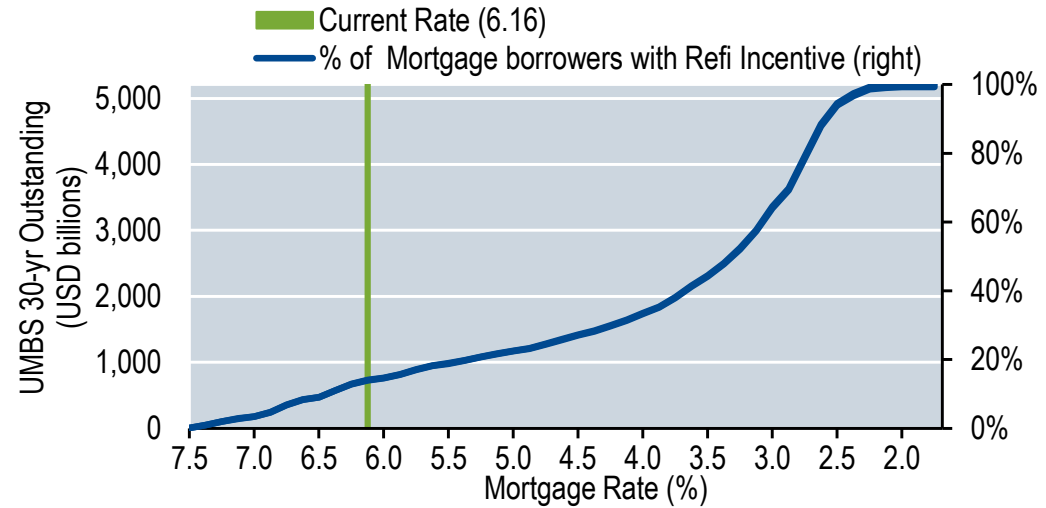
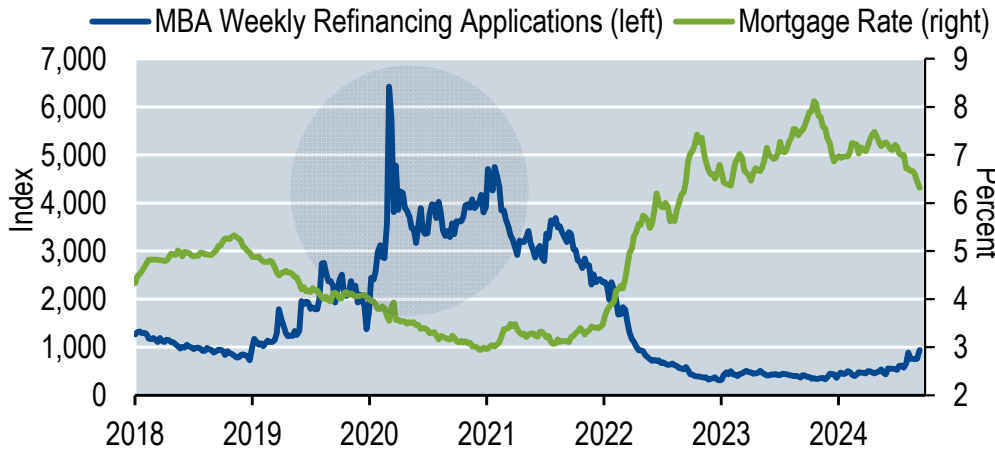
Source: Western Asset. As of 30 Sep 24

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

US Agency Mortgages Offer Attractive High-Quality Yields

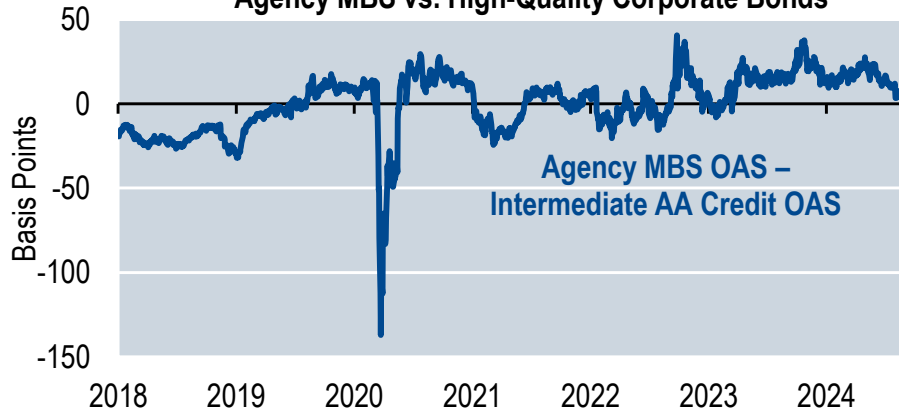
- Most US mortgage borrowers have locked in sub-4% mortgage rates during Covid and have limited refinancing incentives at current or lower rates

Limited Refinancing Risk

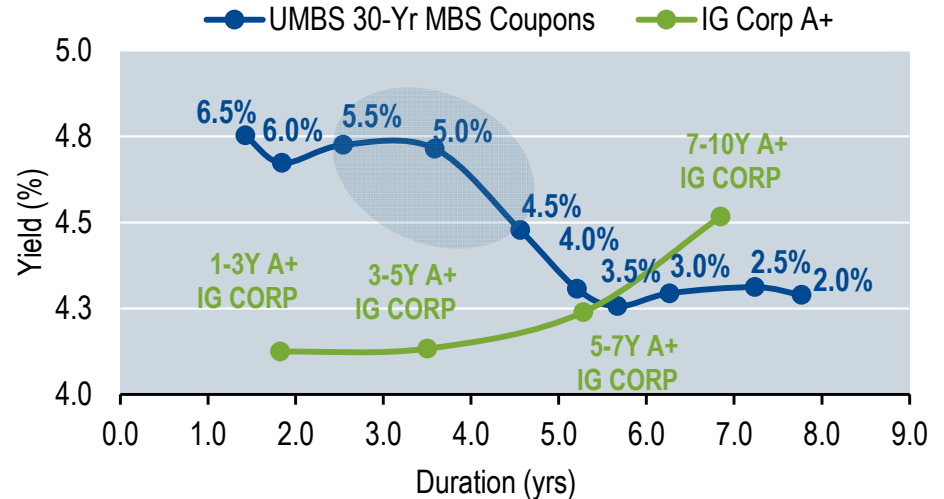


- Agency MBS spreads look attractive relative to high-quality corporate bonds, offering potential for higher risk-adjusted yields in higher coupons

Agency MBS vs. High-Quality Corporate Bonds

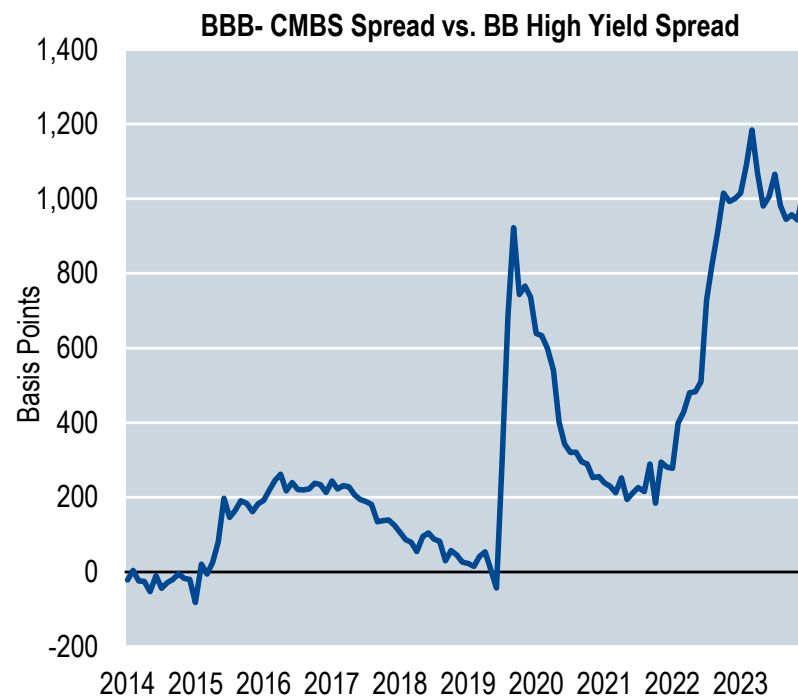
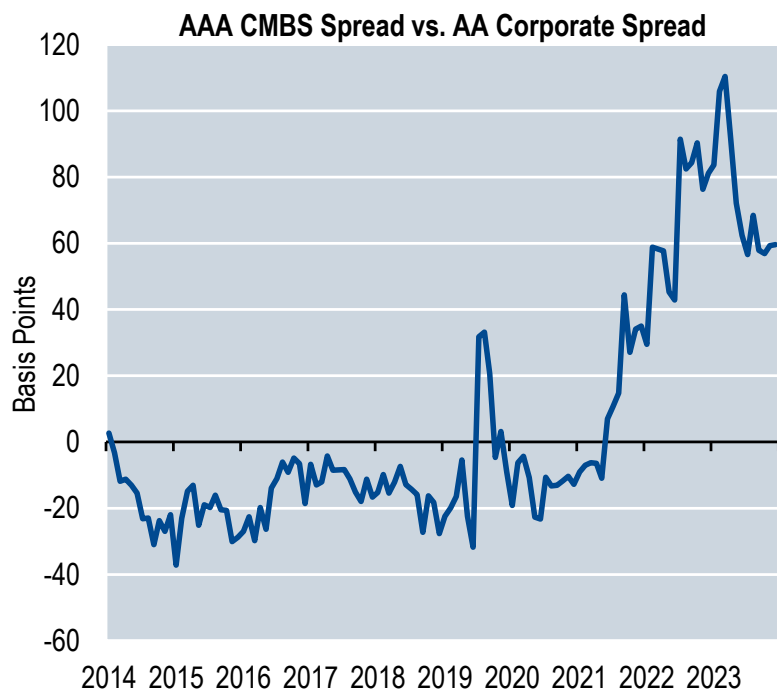
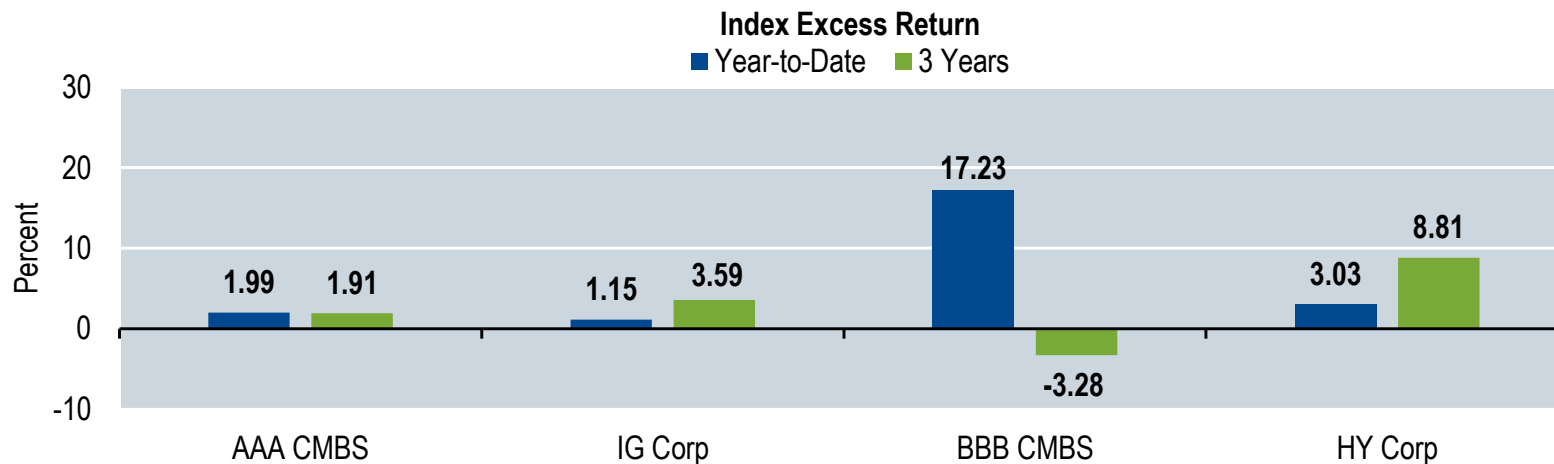


Yield vs. Duration



Source: Bloomberg, CPRCDR, Western Asset. As of 20 Sep 24

CMBS Has Outperformed Corporate Credit YTD but Remains Historically Cheap



Source: Bloomberg, JP Morgan. As of 31 Aug 24

AAA CMBS: Bloomberg Non-Agency Investment Grade CMBS: AAA Total Return Unhedged Index. **BBB CMBS:** Bloomberg Non-Agency Investment Grade CMBS: BBB Total Return Unhedged Index. **IG Corp:** Bloomberg U.S. Corporate Investment Grade Index. **HY Corp:** Bloomberg U.S. Corporate High Yield Index.

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- Geopolitical uncertainty continues to add to volatility



Thank you.

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