
GLOBAL FIXED INCOME REVIEW

- DM government yields rose as risk sentiment improved.
- The Fed raised rates by a further 0.25%.
- EM bonds and currencies stabilized as several EM central banks raised rates.
- The US imposed additional tariffs on imports from China.
- The new Italian government released budget proposals that indicated a higher than expected budget deficit



MARKET REVIEW

Developed market (DM) government yields rose over the month as risk sentiment improved. The US Federal Reserve (Fed) raised rates by a further 0.25% to a range of 2.0%–2.25%. The Fed’s forecast for the future path of interest rates was largely static but the characterization of monetary policy as being “accommodative” was removed from its statement. Despite the US imposing additional tariffs on imports from China, emerging market (EM) bonds and currencies stabilized as several EM central banks raised rates, including a surprise 6.25% rate hike in Turkey, and the International Monetary Fund’s (IMF) announcement of a new financing program for Argentina. Italian bonds outperformed, but spreads over Germany rose sharply at the end of the month as the new government released budget proposals that indicated a higher than expected deficit of 2.4% of GDP. Core eurozone yields also rose as European Central Bank (ECB) President Mario Draghi described underlying inflation as “vigorous”. High-yield corporate bonds and bank loans posted positive returns as demand remained strong and investment-grade corporate bonds outperformed government bonds.



MARKET OUTLOOK

Notwithstanding the improved near-term growth outlook in the US, we see little evidence that recent tax changes and government spending will materially improve the longer-term trajectory for the economy. US inflation has moved up to the Fed's 2% target, but has not shown any acceleration past it. The limited increase in inflation, even though growth has improved meaningfully, speaks to the magnitude and persistence of the long-term disinflationary pressures on the US economy. Absent any further acceleration in nominal GDP, we view the uptick in inflation as merely a move back to more normal levels as the economy heals; we believe this scenario is fully priced into the forward markets. Accordingly, we retain a long US duration bias which we also believe remains an effective hedge against risk exposures in global portfolios.

In Europe, we remain underweight 10-year German duration on our view that European data will stabilize in the second half of 2018, led predominantly by domestic consumption and investment. Overall, we expect growth of around 2.0% for 2018 and 2019. Core eurozone inflation is expected to move higher by the end of the year as spare capacity diminishes. As the market begins to look forward to a significant pick-up in net supply in 2019 with the end of the Public Sector Purchase Programme, we expect core European bond yields to move higher. While Italian yields are likely to remain volatile, ultimately we expect the Italian risk premium to recede and continue to retain a modest overweight to Italian bonds.

In line with recent forward guidance, we expect the Bank of Japan to maintain its accommodative monetary policy for some time to meet its 2% inflation goal. With 10-year nominal yields capped around 0.0%, we expect the nominal yield curve to steepen over time and real yields to decline and maintain exposure to Japanese inflation-linked bonds.

We remain modestly overweight in investment-grade corporate bonds. The largest sector bias remains in the financial sector, where deleveraging, capital build and regulatory constraint remain credit-positive. We also remain comfortable keeping a modest overweight in the energy and metals and mining sectors where many issuers remain in deleveraging mode. We continue to be cautious about the potential for further M&A and shareholder-friendly activities in certain industrial sectors such as healthcare/pharmaceuticals and telecommunications.

In currency markets, we continue to believe the long-term trend for the US dollar to weaken as Fed policy normalization is fully priced and growth expectations outside of the US are likely to improve over the coming quarters. Recent political developments in Italy have reignited concerns over the sustainability of the single currency. However, we remain constructive on this front and will look for opportunities to reinstate an overweight position in the euro.

EM bond markets remain volatile on global growth fears with a number of isolated stories further contributing to weakness. We remain mindful of the downside risks to growth from an escalation in global trade tensions, but over the longer term we are still constructive on EM debt and currencies given steady EM growth, improved external accounts, prudent fiscal policy and advantageous positive real rates.

We continue to look for opportunities to benefit from market anomalies. Our focus remains on longer-term fundamentals with diversified strategies to manage risk.

LEGG MASON

GLOBAL ASSET MANAGEMENT

Brandywine Global
Clarion Partners
ClearBridge Investments
EnTrustPermal
Martin Currie
QS Investors
RARE Infrastructure
Royce & Associates
Western Asset Management

Legg Mason is a leading global investment company committed to helping clients reach their financial goals through long term, actively managed investment strategies.

- Over US\$752 billion* in assets invested worldwide in a broad mix of equities, fixed income, alternatives and cash strategies
- A diverse family of specialized investment managers, each with its own independent approach to research and analysis
- Over a century of experience in identifying opportunities and delivering astute investment solutions to clients

* As of 31 August 2018.

IMPORTANT INFORMATION

Source: Western Asset Management. This document is issued by Legg Mason Asset Management Singapore Pte. Limited (Registration Number (UEN): 200007942R), in Singapore and by Legg Mason Asset Management Hong Kong Limited in Hong Kong and Macau ("**Legg Mason**"). This document is for information only and does not constitute an offer or invitation to the public to purchase any shares in any fund in Singapore, Hong Kong or Macau.

If this document is distributed in Macau, this may not be used other than by the Distributors.

This document is for information only and is not intended to provide investment advice. All data, opinions, estimates and other information are provided as of the date of this document and may be subject to change without notice. Where past performance is quoted, such figures are not indicative of future performance. Investors intending to subscribe for any units or shares of a fund should refer to the Fund's most current offering document. **INVESTMENT INVOLVES RISKS.** Please refer to the offering documents for further details, including the risk factors. Although information has been obtained from sources that Legg Mason believes to be reliable, no guarantee can be given as to its accuracy and such information may be incomplete or condensed and may be subject to change at any time without notice.

Any views expressed are opinions of the respective investment affiliates as of the date of this document and are subject to change based on market and other conditions without notice and may differ from other investment affiliates or of the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. The mention of any individual securities/ funds should neither constitute nor be construed as a recommendation to purchase or sell securities, and the information provided regarding such individual securities/funds is not a sufficient basis upon which to make an investment decision. Portfolio allocations, holdings and characteristics are subject to change at any time. Legg Mason, its affiliates, officers or directors, may have an interest in the acquisition or disposal of the securities mentioned herein. Distribution of this document may be restricted in jurisdictions, other than Hong Kong, Macau and Singapore. Any person coming into possession of this document should seek advice for details of, and observe such restrictions (if any).

Neither Legg Mason nor any officer or employee of Legg Mason accepts any liability whatsoever for any loss arising from any use of this document or its contents. The information in this document is confidential and proprietary and may not be used other than by the intended user. This document may not be reproduced, distributed or published without prior written permission from Legg Mason.

Issuer in Hong Kong and Macau:

Legg Mason Asset Management Hong Kong Limited.

This document has not been reviewed by the Securities and Futures Commission in Hong Kong or Monetary Authority of Macao in Macau.

Issuer in Singapore:

This material has not been reviewed by the Monetary Authority of Singapore in Singapore.

FOR PUBLIC IN SINGAPORE AND HONG KONG AND DISTRIBUTORS IN MACAU USE ONLY.