Global Fixed Income Perspectives

Brandywine GLOBAL

Global Market Outlook

- The quarter began with uncertainty and ended with muted optimism after policymakers contained a banking and debt ceiling crisis. Focus returned to inflation and concerns that economic momentum may stall.
- Central banks made progress on inflation; however, they remain hawkish as they battle "core" CPI. U.S. labor markets largely remain strong while there appears to continue to be excess savings in the system. Bond markets were volatile as a result.
- Credit spreads were supported by stronger than expected economic activity and equity markets. We anticipate corporate earnings to be revised lower and credit to remain subject to economic momentum and underlying rates, making for continued volatility until the hard vs. soft landing debate is resolved.
- The reopening in China has been disappointing. Other emerging markets, especially in Latin America, have seen growth and lower inflation.

About this Publication

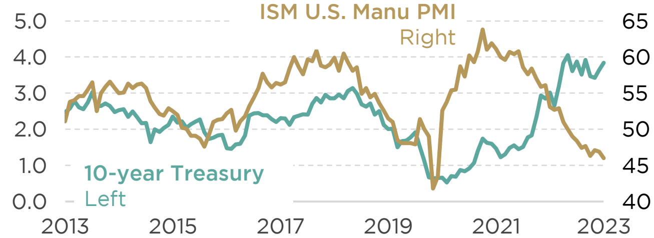
The Global Fixed Income Perspectives discusses performance and opportunities for global fixed income markets by segment.

DM	Developed Market Rates	We expect global bond yields to head lower in the second half of 2023 for an array of reasons. Among them, both U.S. and European current manufacturing PMI levels point to an economic slowdown. In spite of current bond yields predicting a more sanguine outcome, we think PMIs' suggestion of economic deterioration is convincing.
IG	Investment Grade	Spreads have remained rangebound for the year but have rallied since March 2023 in conjunction with the U.S. Economic Surprise Index. U.S. investment grade has returned 3.2% YTD, and we expect it to have positive returns for the rest of the year if rates rally.
HY	High Yield	We remain cautious with high yield allocations coming into the second half of the year. We prefer to remain up in quality and short in duration. Underlying corporate fundamentals remain healthy, but the question remains how long these can hold while the Federal Reserve (Fed) signals more hikes ahead.
EM	Emerging Markets	Local currency sovereign markets have outperformed hard currency emerging markets. We believe there is scope for yields to fall further as inflation remains on the decline allowing central banks to start cutting in 2H23 and into 2024. We will be following China's policy response to a lackluster reopening in addition to Fed policy.
SC	Structured Credit	The macro backdrop has been more constructive than feared, coupled with stable fundamentals and favorable technical factors, this should support further performance. However, we remain wary of economic and geopolitical risks, preferring to position up in credit and adding risk selectively.

DM Developed Market Rates

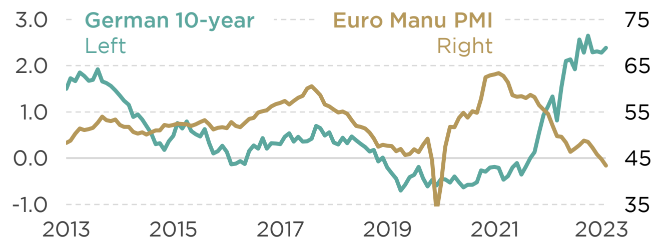
- In both the U.S. and Europe, manufacturing PMIs are at their lowest levels since the depth of the COVID-19 crisis, while Treasury yields and German bond yields remain near decade highs. (FIGURES 1 AND 2)
- Elevated global inflation has a major influence on why these two metrics deviate; however, we believe inflation is set to fall meaningfully in the next number of quarters removing that major caveat.
- Naysayers will also point to service level PMI, fiscal influences, and deglobalization as reasons to discredit what businesses are reporting, but investors should be careful not to dismiss what's been one of the foremost indicators of lower bond yields over the past decades.
- While time lags are difficult to determine, we believe PMIs and other leading indicators support global bond yields heading lower.

1 U.S. PMI vs. 10-year Treasury
As of 6/30/2023



Source: Bloomberg (© 2023, Bloomberg Finance LP)

2 Europe PMI vs. German 10-year
As of 6/30/2023



Source: Bloomberg (© 2023, Bloomberg Finance LP)

IG Investment Grade

- The Bloomberg Barclays U.S. Corporate Total Return Index has returned 3.21% as of June 30, 2023, and spreads have been fairly rangebound this year, tightening somewhat since the Bloomberg U.S. Economic Surprise Index bottomed in March (FIGURE 3).
- Looking forward to the second half of the year, we use a simple total return calculator based on spreads and rates to identify potential total return scenarios (FIGURE 4). If spreads and rates remain where they are, one would expect a total return for the remainder of the year of an additional 2.7%. We expect some spread widening and for Treasury yields to decrease, giving a potential positive total return for the second half of the year (see left hand side of FIGURE 4).
- Risk-adjusted returns in investment grade look attractive, although highly subject to Treasury moves. While on an index level basis, short-dated investment grade, T-Bills, and 12-month forward earnings yield on S&P 500 look similar (5.2%) the ability to add low-priced, high-quality names adds to their attractiveness. We remain cautious and nimble on our allocation given cash and short-dated government bonds are so attractive.

3 U.S. Corporate Credit OAS and U.S. Economic Surprise Index
As of 6/30/2023, Basis Points (bps)

Source: Bloomberg (© 2023, Bloomberg Finance LP)

4 Potential Remaining Total Returns for Bloomberg U.S. Corporate Index
As of 7/5/2023, %

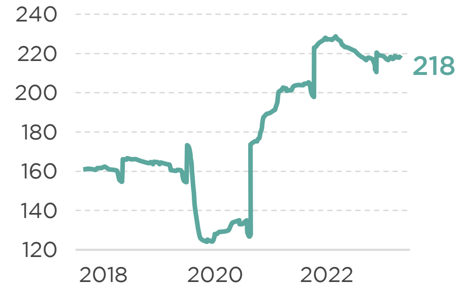
Spread (bps)	Interpolated US Treasury Yield to match index duration (%) 3.7%	4.0%	4.3%	4.6%	4.9%	5.2%
83	10.0%	7.9%	5.6%	3.5%	1.3%	-1.0%
95	9.1%	7.0%	4.8%	2.7%	0.5%	-1.7%
108	8.0%	6.0%	3.8%	1.7%	-0.4%	-2.5%
124	6.9%	4.8%	2.7%	0.7%	-1.4%	-3.5%
139	5.7%	3.7%	1.7%	-0.3%	-2.3%	-4.4%
156	4.5%	2.5%	0.5%	-1.4%	-3.4%	-5.4%
176	3.1%	1.2%	-0.8%	-2.6%	-4.5%	-6.4%
198	1.6%	-0.3%	-2.1%	-4.0%	-5.8%	-7.6%

Source: Bloomberg (© 2023, Bloomberg Finance LP)

HY High Yield

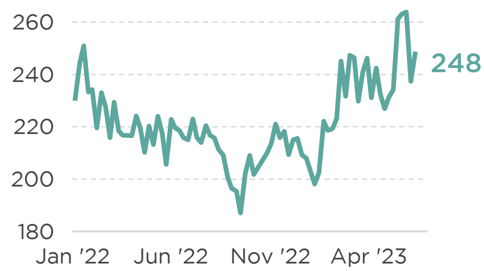
- Corporate profits (FIGURE 5) remain near all time highs and fundamental credit metrics (leverage and interest coverage) are the healthiest they have been in over 10 years.
- Although we have leaned on these metrics to maintain an overweight high yield allocation, we have shifted our asset mix into shorter duration and higher-quality bonds given concerns over the macro outlook. While EBITDA margins spiked considerably during the 21/22 fiscal response to COVID-19, these have started to trend back to more normal levels, and as such, we think credit metrics will begin to follow.
- Our preferred economic data to support our high yield thesis continues be the labor market. Absent a material change to labor, we don't see a clear catalyst that would send high yield spreads materially wider.
- Employment data, to date, have been strong. That said, initial jobless claims (FIGURE 6) has started to show a small uptick in the previous few months. We've also started to see Job Openings and Labor Turnover Survey (JOLTS) retreat from record high prints posted early last year. Neither of these metrics are at dangerous levels yet, but if recent trends continue, it may suggest an overall slowdown in economic activity, which would be a negative for high yield.

5 **S&P 500 EPS**
As of 06/30/2023, $/Shr



Source: Bloomberg (© 2023, Bloomberg Finance LP)

6 **U.S. Initial Jobless Claims**
As of 06/30/2023, Thousands

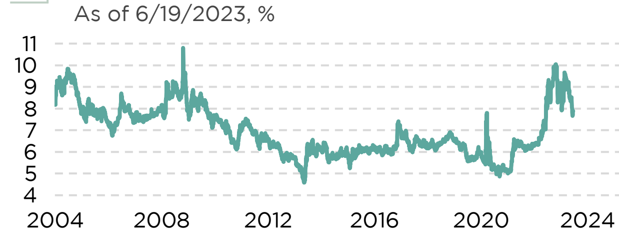


Source: Bloomberg (© 2023, Bloomberg Finance LP)

EM Emerging Markets Debt

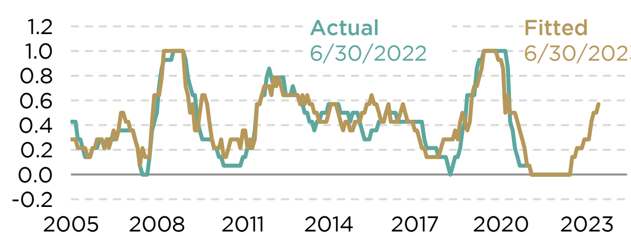
- Emerging markets have performed well year to date despite a number of headwinds. Local currency sovereign markets have outperformed hard currency emerging markets, with a number of higher-yielding local sovereign markets generating double-digit returns so far this year.
- While we are no longer at the 10% local currency nominal yields (see FIGURE 7) we saw in 2022, we believe there is scope for yields to fall further as inflation remains on the decline. Falling inflation should allow emerging market central banks to start rate-cutting cycles in the second half of 2023 and into 2024, leaving duration as a possible driver of returns over the coming months (see FIGURE 8).
- Over the second half of the year, we will be following China's policy response to a lackluster reopening in addition to Fed policy. We believe the Fed is likely ending its tightening cycle, and we see a number of signs that U.S. inflation will continue to decelerate back toward target. The draw on liquidity from the U.S. Treasury rebuilding its general account and debt issuance following the debt ceiling deal is another situation we are following given the potential for draining of liquidity.

7 **Emerging Market Nominal Yields***
As of 6/19/2023, %



*JPM GBI-EM country yield to maturity (YTM) for each market, including Brazil, Colombia, Czech Republic, Hungary, Indonesia, Mexico, Poland, Thailand, and South Africa.
Source: Bloomberg (© 2023, Bloomberg Finance LP), Brandywine Global

8 **Falling Inflation Should Allow More Central Banks to Start Cutting Rates**
As of 6/15/2023, Ratio, Share of Countries Cutting over the Next 12-Months**



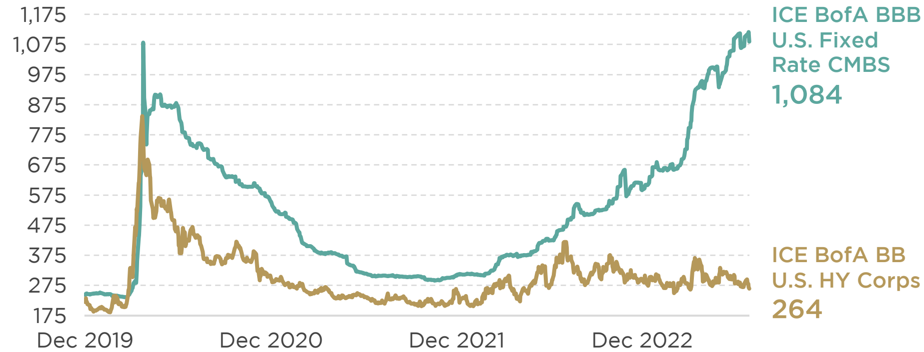
**Brazil, Colombia, Czech Republic, Hungary, Indonesia, Mexico, Poland, Thailand, and South Africa
Source: Bloomberg (© 2023, Bloomberg Finance LP), Brandywine Global

SC Structured Credit

- While we see opportunities across structured credit, we are cautious given the continued potential for economic deterioration, leading us to be selective and focus on higher credit quality.
- Credit-risk transfer (CRT) securities remain the most attractive segment based on steady collateral performance and lower supply. Floating coupons protect from risk of further interest rate increases.
- Commercial mortgage-backed securities (CMBS) offer attractive spreads, but they reflect considerable risks in the office sector. We remain up in credit and seek opportunities selectively (FIGURE 9).
- Asset-backed securities (ABS) held steady in spite of rising delinquencies, and their short durations help to mitigate interest rate risk. We maintain exposure while closely watching consumer credit performance.
- Collateral loan obligations (CLOs) have seen a notable drop in issuance due to worsening arbitrage economics while the leveraged loan fundamentals deteriorate. We remain wary of liquidity and credit rating downgrade risks (FIGURE 10).

9 BBB- CMBS vs. BB HY Corporate Credit Spreads to U.S. Treasury Curve

As of 6/30/2023, in Basis Points (bps)



Source: : ICE Data Indices, LLC., BofA Global Research

10 CLO 2.0 BB vs. CLO 2.0 AAA Spreads to SOFR

As of 6/30/2023, in Basis Points (bps)

Source: BofA Global Research

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Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, and a fixed coupon schedule. The ICE BAML AA Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated AA1 through AA3, inclusive. The ICE BAML Single-A Global Corporate Index is a subset of the ICE BAML Global Corporate Index, including all securities rated A1 through A3, inclusive. The ICE BAML BBB Global Corporate Index is a subset of The ICE BAML Global Corporate Index, including all securities rated BBB1 through BBB3, inclusive. The ICE BAML U.S. Corporate Index tracks the performance of U.S. dollar-denominated investment grade corporate debt publicly issued in the U.S. domestic market. 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The ICE BAML U.S. High Yield Index tracks the performance of USD-denominated below investment grade corporate debt publicly issued in the major U.S. markets. The ICE BAML European High Yield index tracks the performance of below-investment grade corporate bonds publicly issued in Europe. The Credit Suisse Leveraged Loan Index tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest-rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries. The ICE BAML U.S. Mortgage-Backed Securities Index tracks the performance of U.S. dollar-denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market. The ICE BAML U.S. Fixed Rate CMBS Index tracks the performance of U.S. dollar-denominated investment grade fixed rate commercial mortgage-backed securities publicly issued in the U.S. domestic market. The JP Morgan Corporate Emerging Market Bond Index (CEMBI) Broad is a global, liquid corporate emerging markets benchmark that tracks U.S. denominated corporate bonds issued by emerging markets entities. The JPM EM Bond Index Global Diversified is composed of U.S. dollar-denominated Brady bonds, eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities. The JPM Government Bond Index-Emerging Markets (GBI-EM) Broad Diversified is a comprehensive emerging market debt benchmark that tracks local currency bonds issued by emerging market governments. The unique diversification scheme ensures that weights among the index countries are more evenly distributed by reducing the weight of large countries and redistributing the excess to the smaller-weighted countries with a maximum weight per country of 10%. All data current as of the date at the top of the page unless otherwise noted. This information should not be considered a solicitation or an offer to provide any Brandywine Global service in any jurisdiction where it would be unlawful to do so under the laws of that jurisdiction.

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Brandywine GLOBAL

Brandywine Global Investment Management, LLC

1735 Market Street
Suite 1800
Philadelphia, PA 19103

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