

ClearBridge

Investments

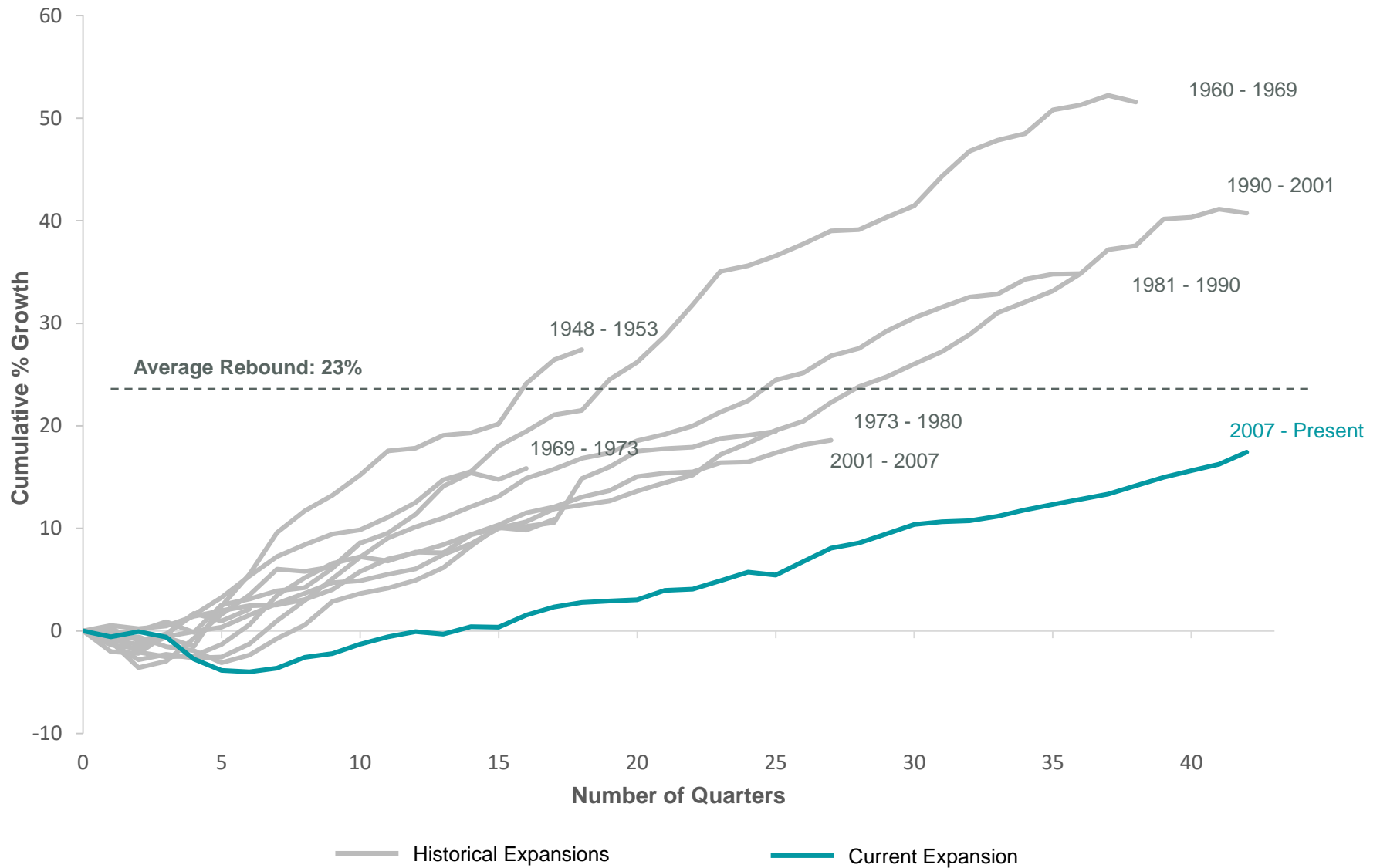
Economic and Market Outlook

Fourth Quarter 2018

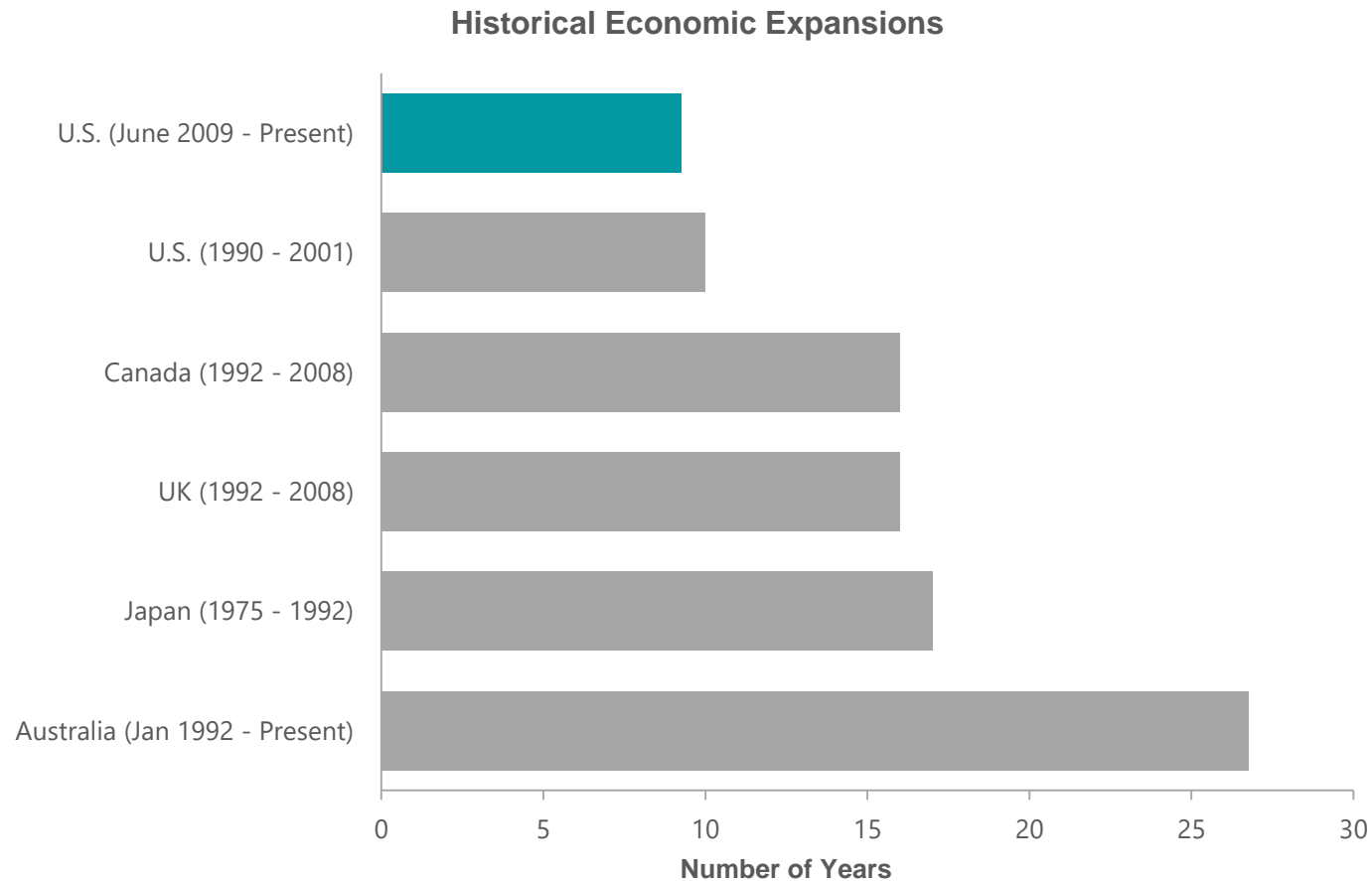
Investment Products: Not FDIC Insured • No Bank Guarantee • May Lose Value

Past performance is no guarantee of future results. Financial term and index definitions are available in the appendix.

Strength of Economic Expansions



Just How Long Can The Cycle Continue?



▶ **Extended economic expansions are more common outside of the U.S.**

U.S. Recession Risk Indicators

- 12 variables have historically foreshadowed a looming recession
- Only money supply signals risk right now

		Third Quarter 2018	Second Quarter 2018
Financial	Yield Curve	↑	↑
	Credit Spreads	↑	↑
	Money Supply	●	↑
Inflation	Wage Growth	↑	↑
	Commodities	↑	↑
Consumer	Housing Permits	↑	↑
	Jobless Claims	↑	↑
	Retail Sales	↑	↑
	Job Sentiment	↑	↑
Business Activity	ISM New Orders	↑	↑
	Profit Margins	↑	●
	Truck Shipments	↑	↑
Overall Signal		↑	↑

↑ Expansion ● Caution × Recession

U.S. Recession Risk Indicators

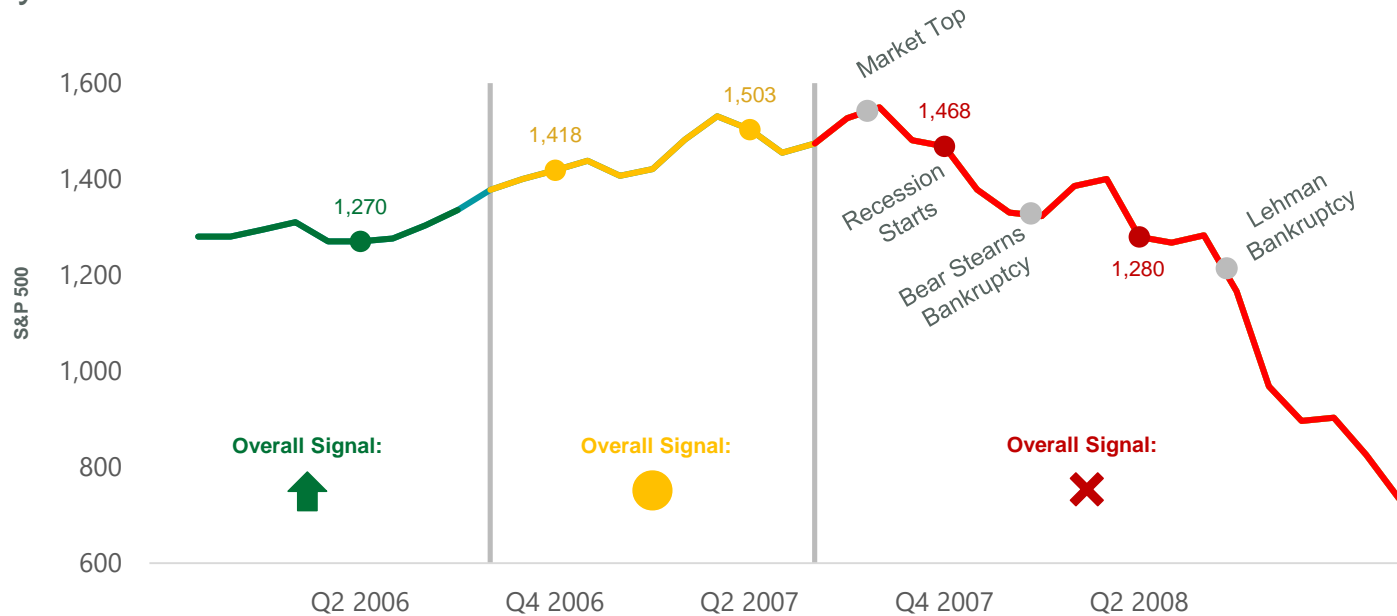
- 12 variables have historically foreshadowed a looming recession
- Only money supply signals risk right now

		Recession							
		Current	2007-2009	2001	1990-1991	1981-1982	1980	1973-1975	1969-1970
Financial	Yield Curve	↑	×	×	×	×	×	×	×
	Credit Spreads	↑	×	×	×	×	×	↑	●
	Money Supply	●	×	×	×	×	×	×	×
Inflation	Wage Growth	↑	×	×	×	×	×	×	×
	Commodities	↑	×	×	×	×	●	●	●
Consumer	Housing Permits	↑	×	●	×	×	×	×	×
	Jobless Claims	↑	●	×	×	×	×	↑	×
	Retail Sales	↑	×	×	×	×	×	●	×
	Job Sentiment	↑	×	×	×	×	●	●	●
Business Activity	ISM New Orders	↑	×	×	×	×	×	×	×
	Profit Margins	↑	×	×	×	×	×	●	×
	Truck Shipments	↑	●	×	×	×	×	n/a	n/a
Overall		↑	×	×	×	×	×	●	×

↑ Expansion ● Caution × Recession

U.S. Recession Dashboard

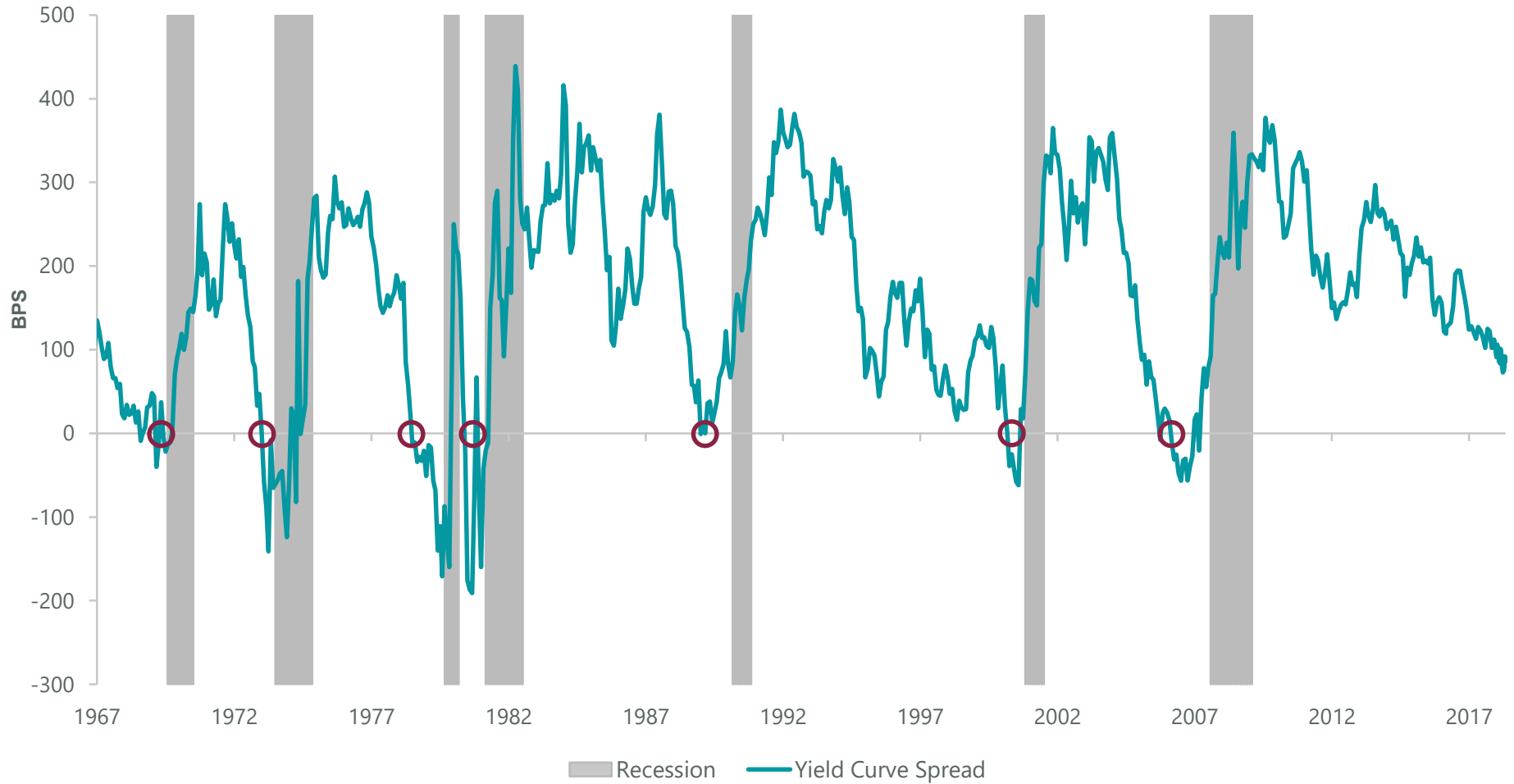
Case Study: 2006-2009



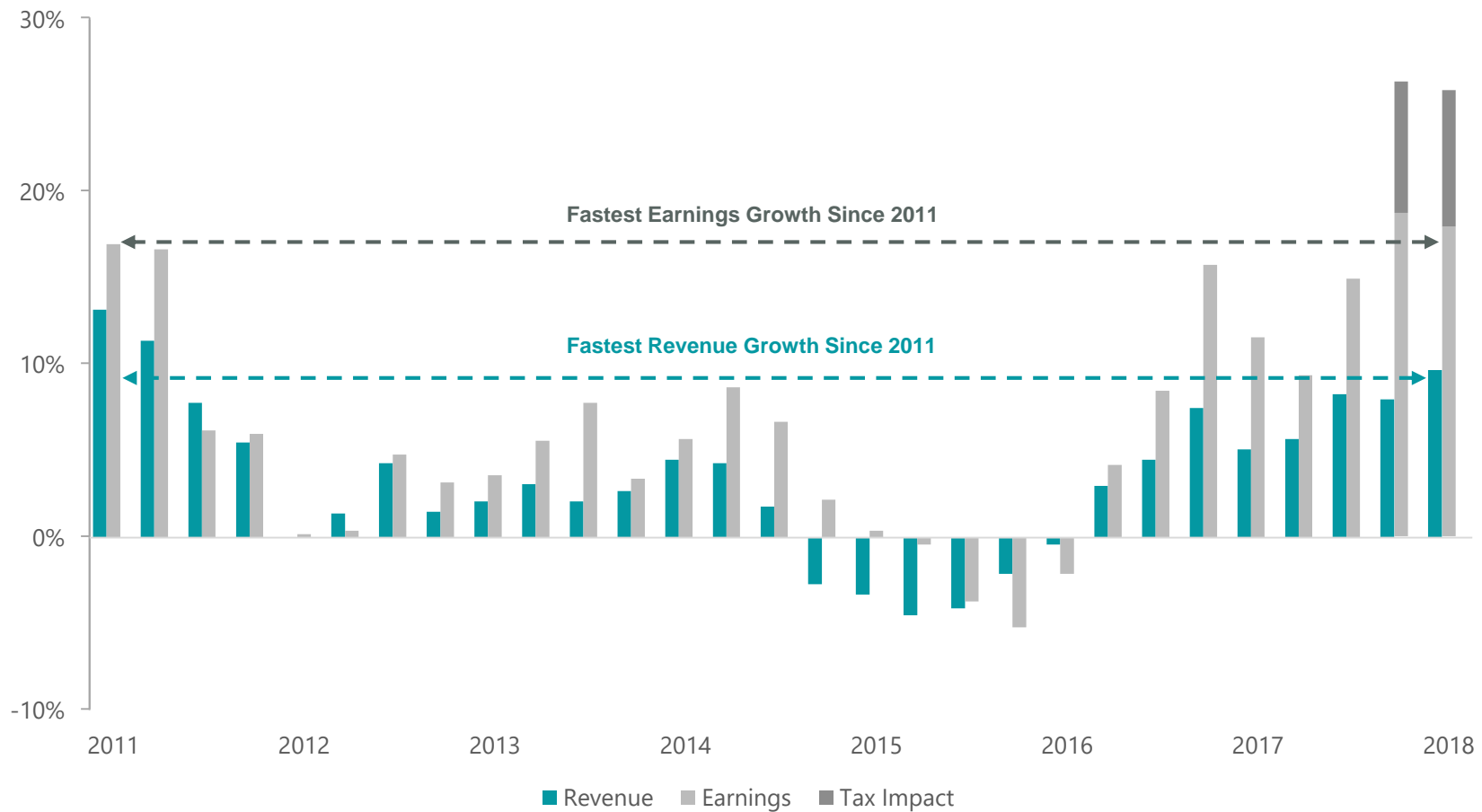
		Q2 2006	Q4 2006	Q2 2007	Q4 2007	Q2 2008
Financial	Yield Curve	●	×	×	×	×
	Credit Spreads	↑	↑	↑	×	×
	Money Supply	×	×	×	×	×
Inflation	Wage Growth	×	×	×	×	×
	Commodities	↑	↑	↑	×	×
Consumer	Housing Permits	●	×	×	×	×
	Jobless Claims	↑	↑	●	●	×
	Retail Sales	↑	●	●	×	×
	Job Sentiment	↑	●	●	×	×
Business Activity	ISM New Orders	↑	●	●	×	×
	Profit Margins	●	●	●	×	×
	Truck Shipments	●	●	●	●	●

Yield Curve Spread

Yield curve spread less than zero (inverted)
occurs prior to recessions.



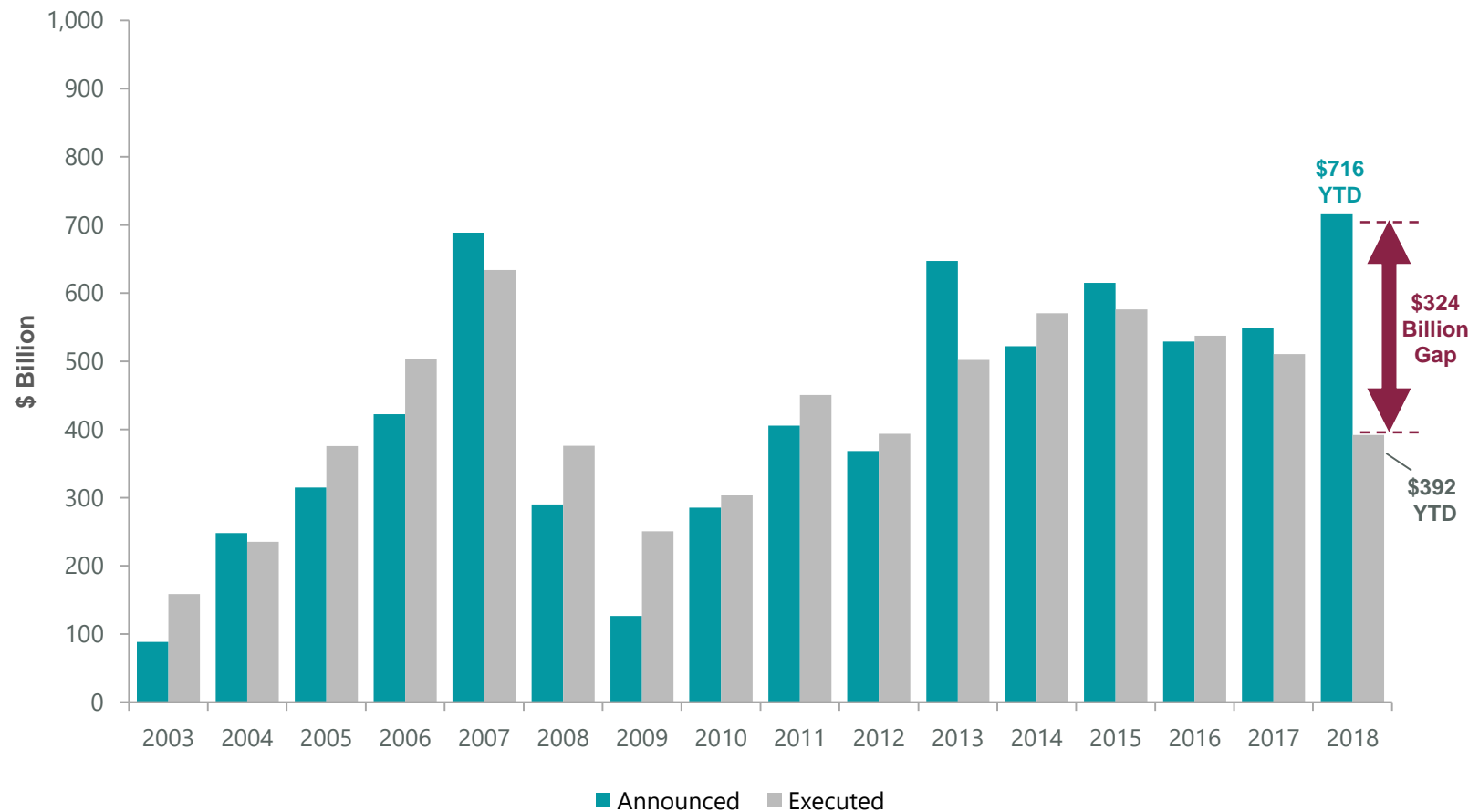
S&P 500 Revenue & Earnings Growth



- ▶ Revenue and earnings growth are at the strongest level since the early part of the recovery.
- ▶ Earnings growth is quite robust, even excluding the 8% boost from tax reform.

Buybacks Should Drive Markets Into Year-End

S&P 500 Companies



▶ **The \$324 billion gap between announced and executed buybacks YTD should help drive markets higher over the next several months.**

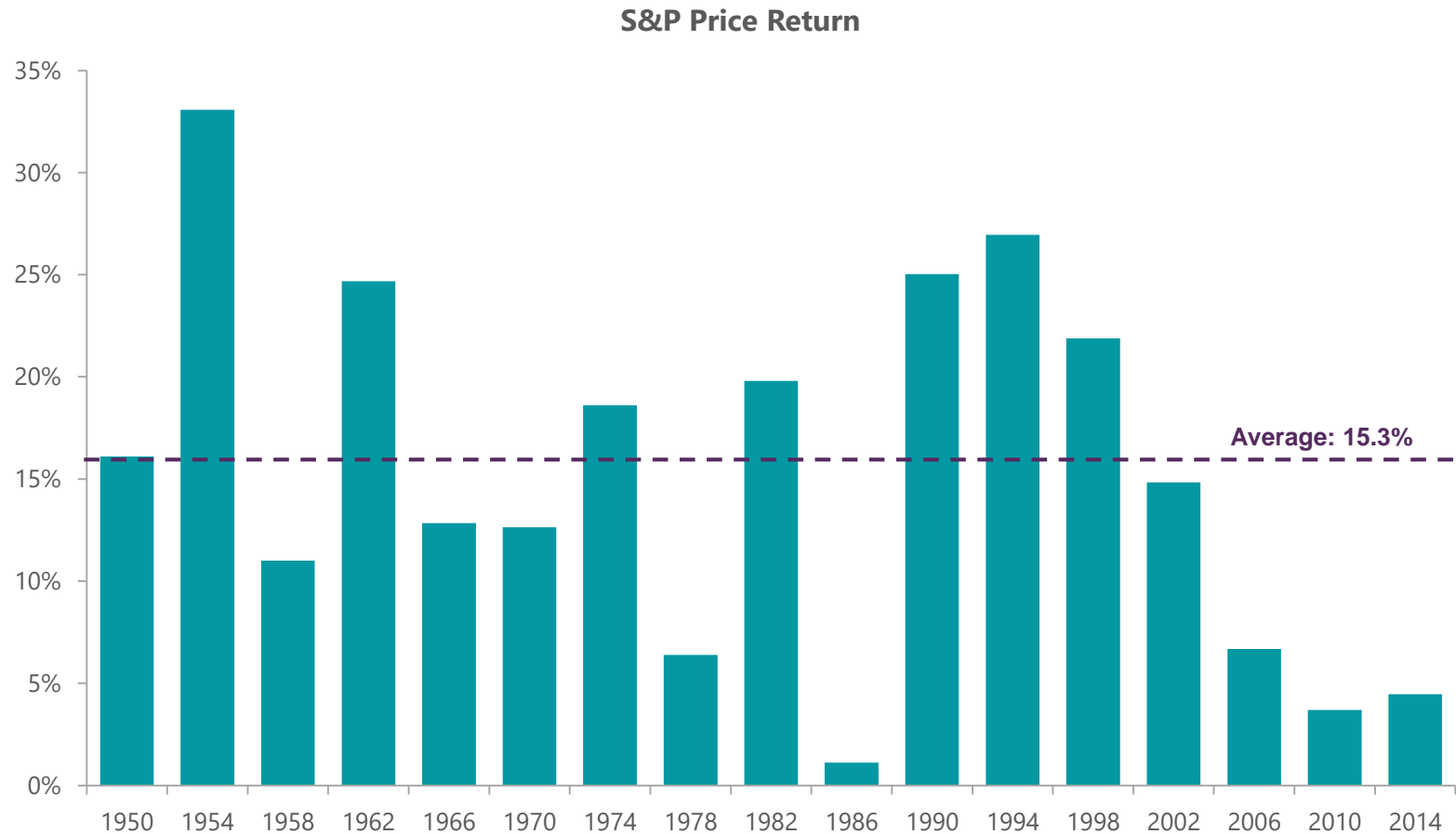
Midterm Election Year Performance

Average S&P 500 Performance in Midterm Years Since 1950



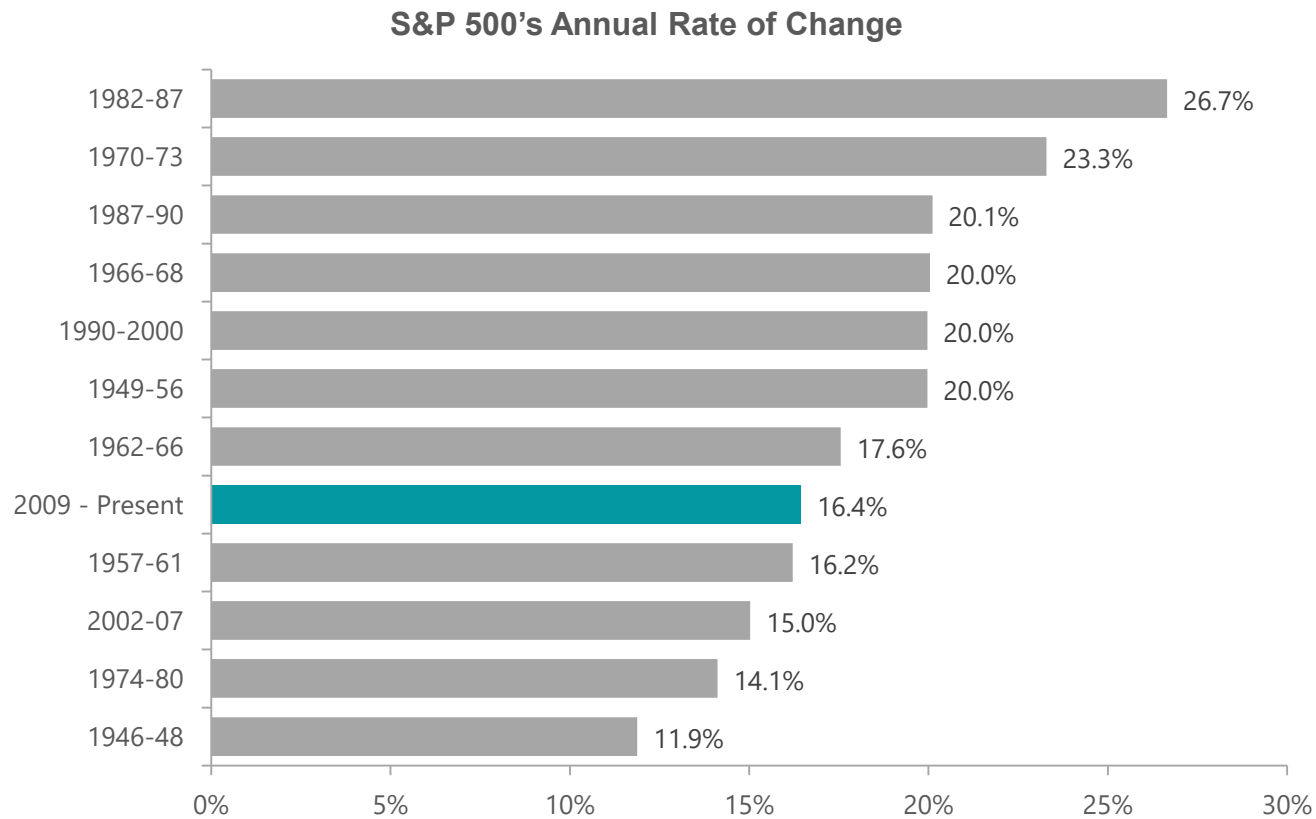
Post-Midterm Election Performance

Midterm Year Since 1950



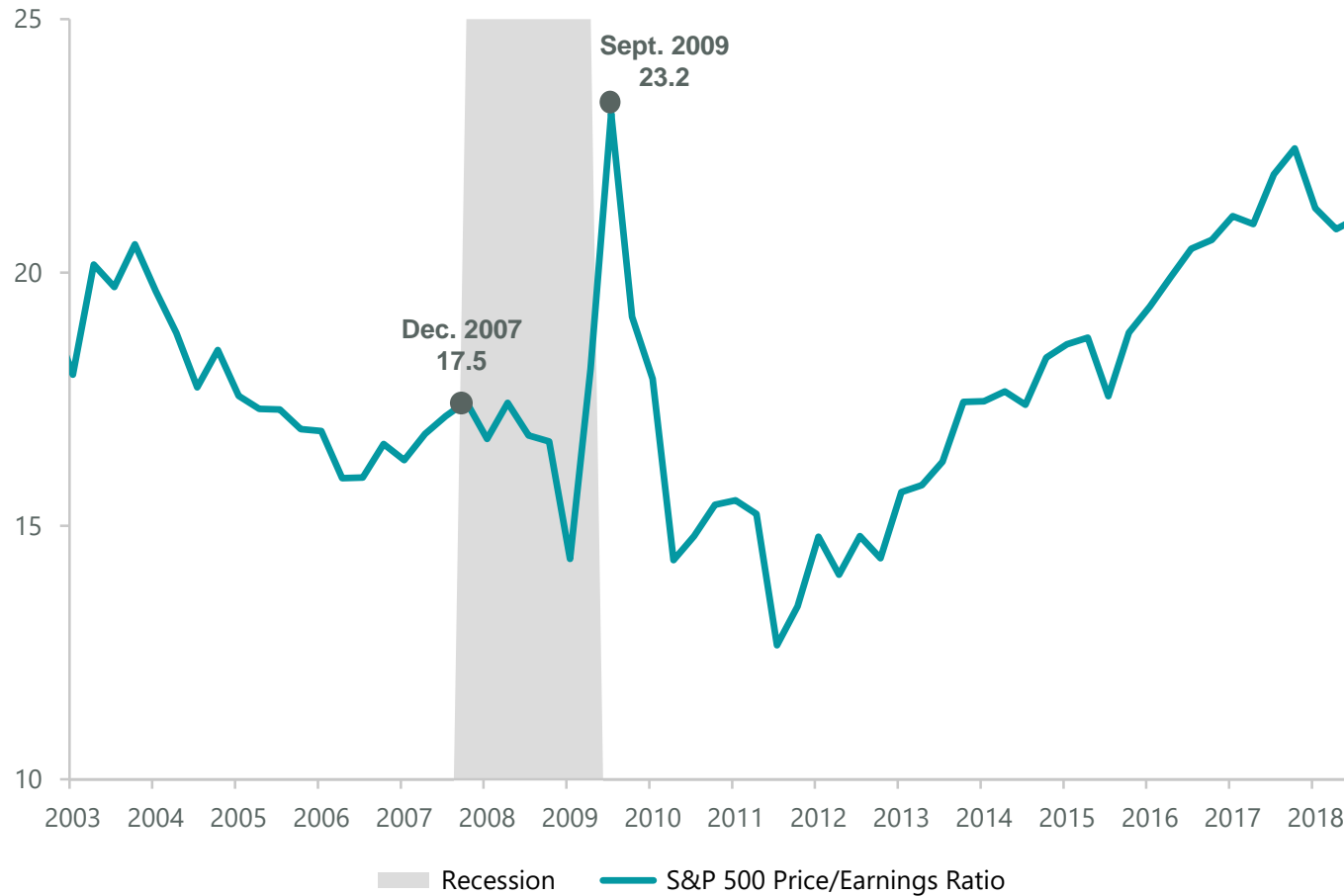
- ▶ **In the 12 months following a midterm election, the S&P 500 has been up 15.3% on average, historically.**
- ▶ **Every period historically has had a positive return.**

Strength of U.S. Bull Markets



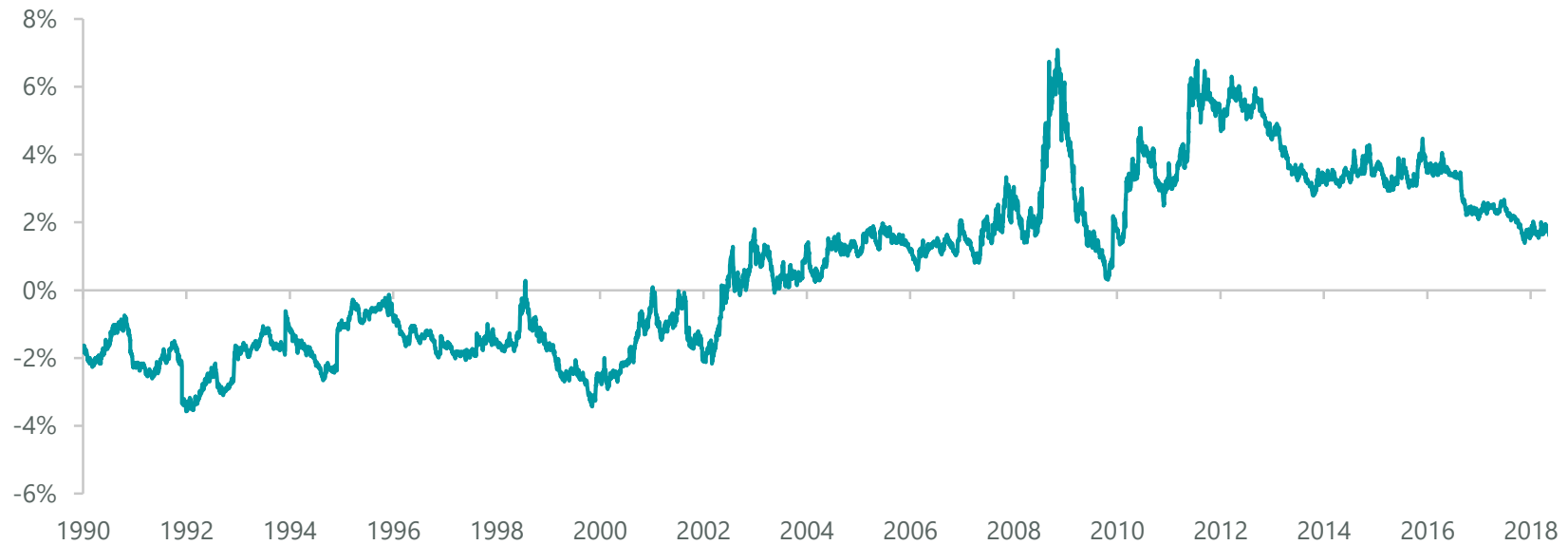
► **The current bull market is the eighth strongest since WW2.**

Price/Earnings Is Not The Only Indicator To Watch



Earnings Price Yield

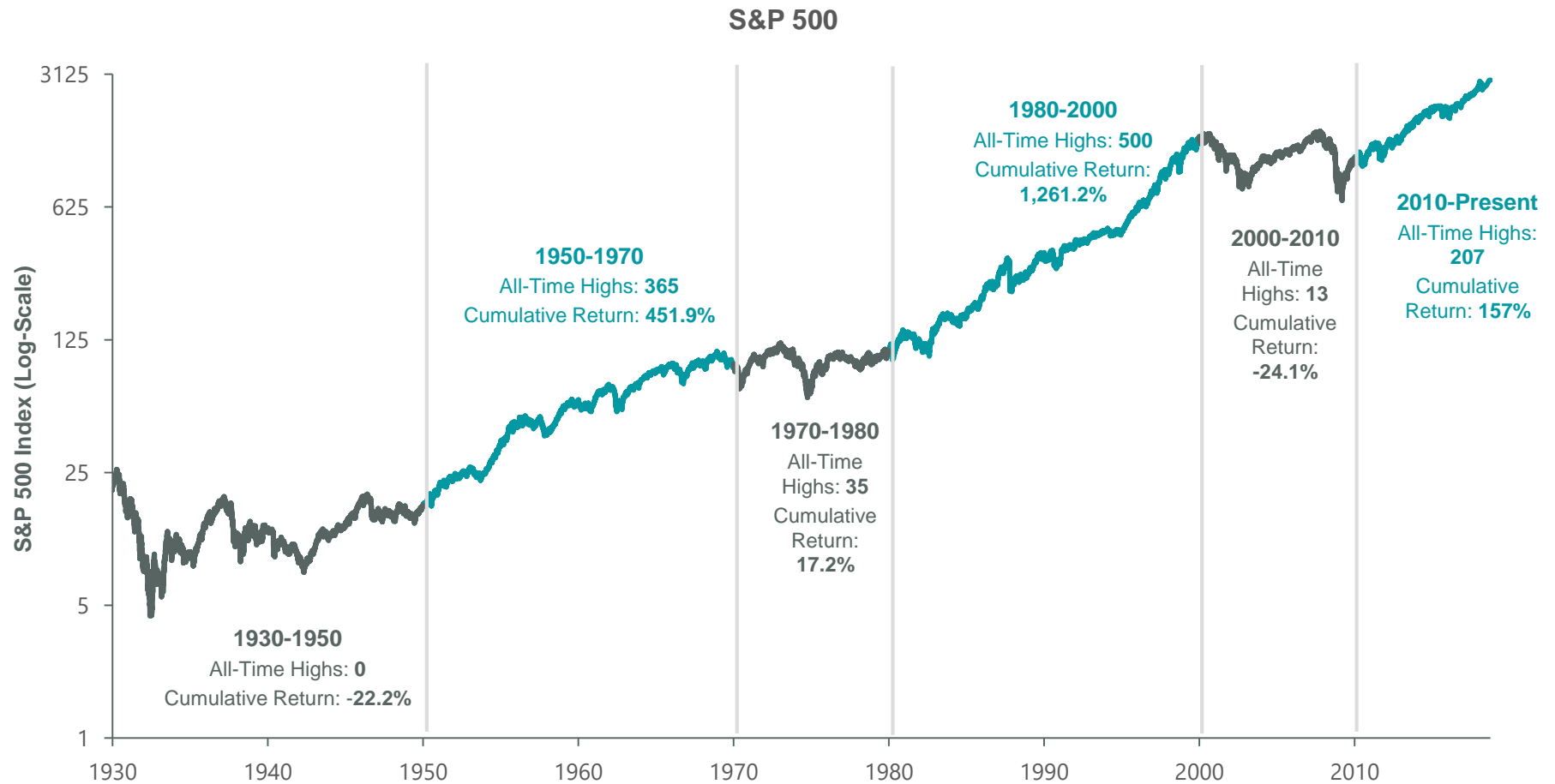
Interest Rates: S&P 500 Minus YTM of 10-Year Treasuries



Valuation levels at end of the three longest U.S. economic cycles based on quarter end values:

Quarter	E/P Yield	YTM 10-Year Treasuries	Spread
Q4 1968	5.5%	6.2%	-0.7
Q2 1990	6.4%	8.4%	-2.0
Q1 2000	3.6%	6.0%	-2.4
Current	4.7%	3.1%	1.6

New Secular Bull Market?



Bull Market Top Checklist

	2000	2007	Current	Comments
Blow-off top	√	√	x	Few signs of panic buying or speculative excess in public equity markets. S&P is currently only 6% above 200-day MA after peaking in January.
Heavy inflows into equity market funds	√	√	x	Net inflows into equity mutual funds and ETFs is underwhelming while inflows into bond funds remain robust.
Big pick-up in M&A activity	√	√	√	M&A activity has picked up significantly this year from years in the past. In absolute dollar terms, activity is near historical highs but within the context of overall market cap we wouldn't be surprised to see further increases.
IPO activity	√	√	x	Despite some high-profile new issues in 2017, deal volume and assets raised remain far below the pace exhibited in 2015.
Rising real interest rates	√	√	x	Real rates have moved higher, but relative to historical levels they are low.
Weakening upward earnings revisions	√	√	x	Upward earnings revisions remain at elevated levels.
Erosion in number of stocks making new highs	√	√	x	The numbers of companies making 52-week highs peaked in January.
Shift towards defensive leadership	√	√	x	Since the February 2016 low, cyclical shares have outperformed for the past two years. Changes here is an item to watch going forward.
Widening credit spreads	√	√	x	High-yield and investment grade credit spreads remain compressed and are not worrisome at the moment.

International

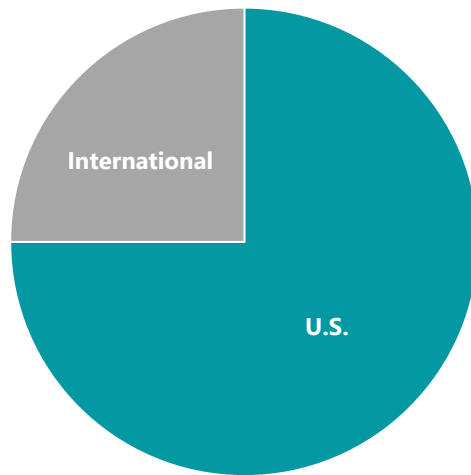


International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets.

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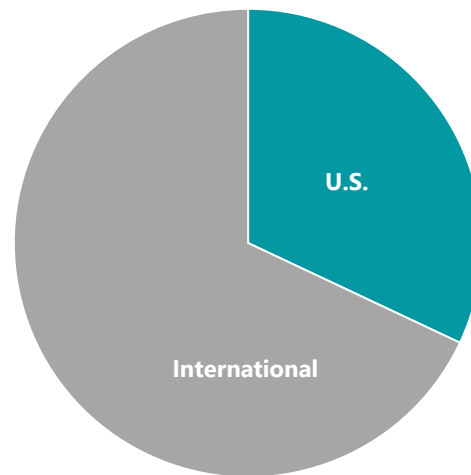
Home Country Bias

% Assets



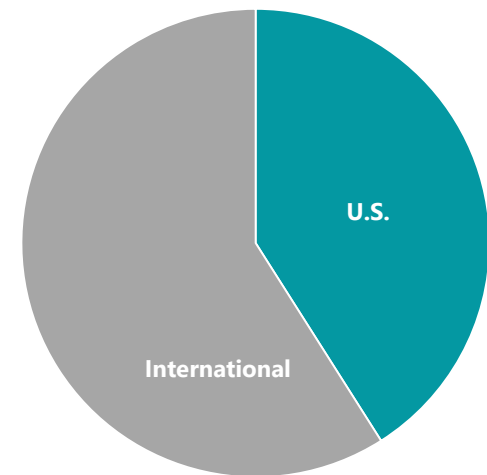
The U.S. represents 75% of U.S. investor portfolios

% GDP



The U.S. represents only 32% of Global GDP

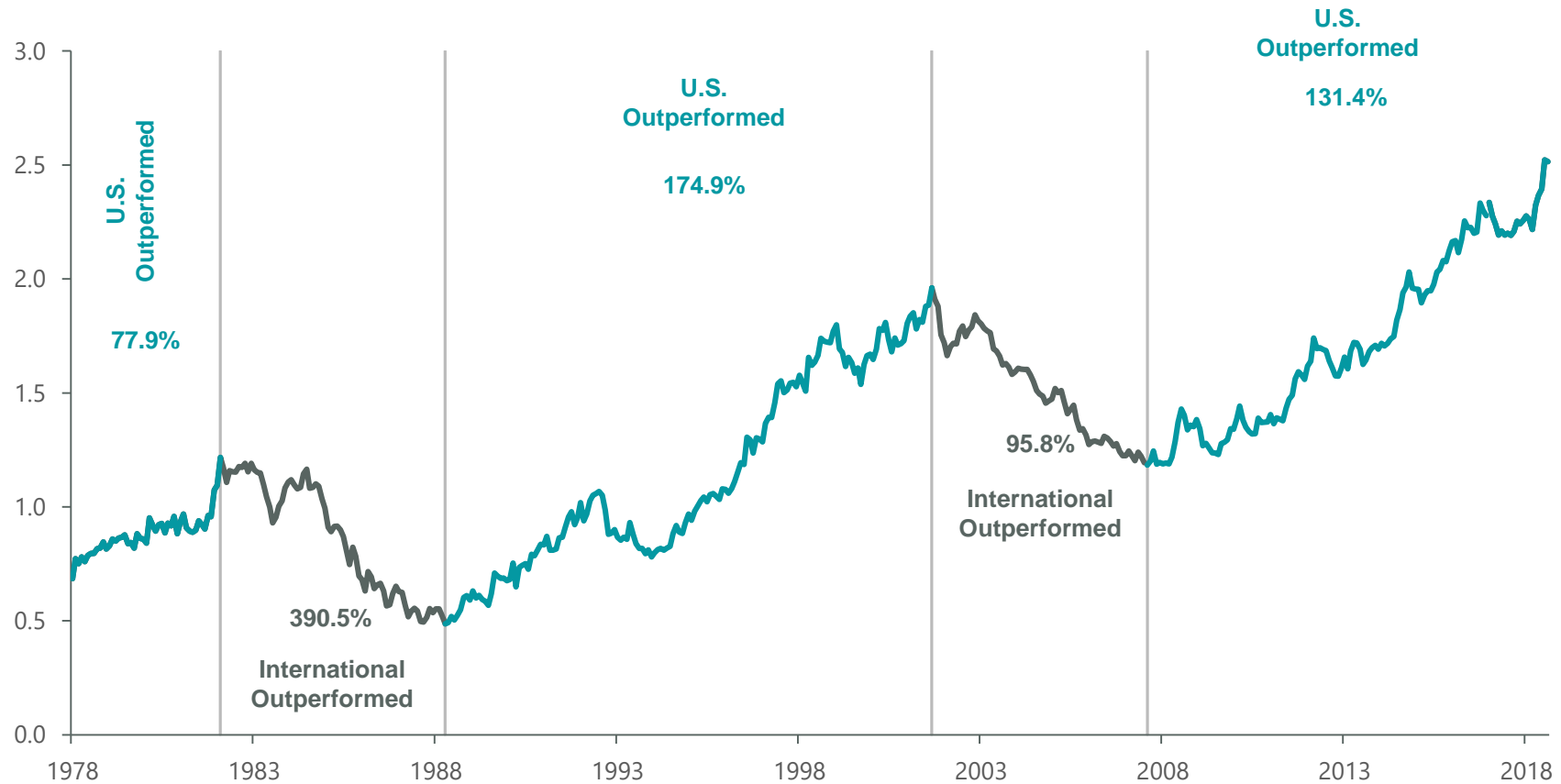
% Market Cap



The U.S. represents only 41% of Global Market Cap

► **Investors tend to over-allocate to their home country.**

U.S. vs. International Equity Performance



► Geographic leadership tends to persist for multiple years.

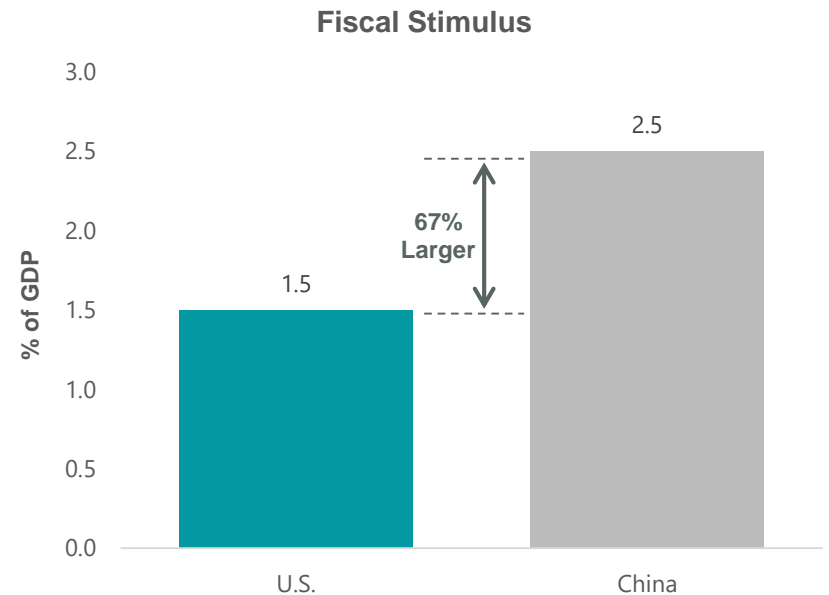
International Roadmap

		Economic		Government		Financial		Currency
		GDP Growth (% YoY)	Economic Momentum	Central Bank Policy	Sovereign Credit Rating	P/E Ratio (x)	EPS Growth (% YoY)	
Neutral	North America	41.	Accelerating	Neutral & Hiking	AAA	16.7	12.8	Strengthening
Positive	Europe ex-UK	2.2	Decelerating	Easy & Stable	AA-	13.8	8.9	Weakening
Neutral	United Kingdom	1.2	Decelerating	Easy & Hiking	AA	12.7	8.7	Weakening
Positive	Asia ex-Japan	3.5	Accelerating	Easy & Stable	AAA	11.7	9.8	Weakening
Positive	Japan	3.0	Accelerating	Easy & Stable	A	13.4	5.4	Weakening
Neutral	Emerging Markets	5.4	Stable	Neutral & Hiking	BBB+	11.1	10.3	Weakening

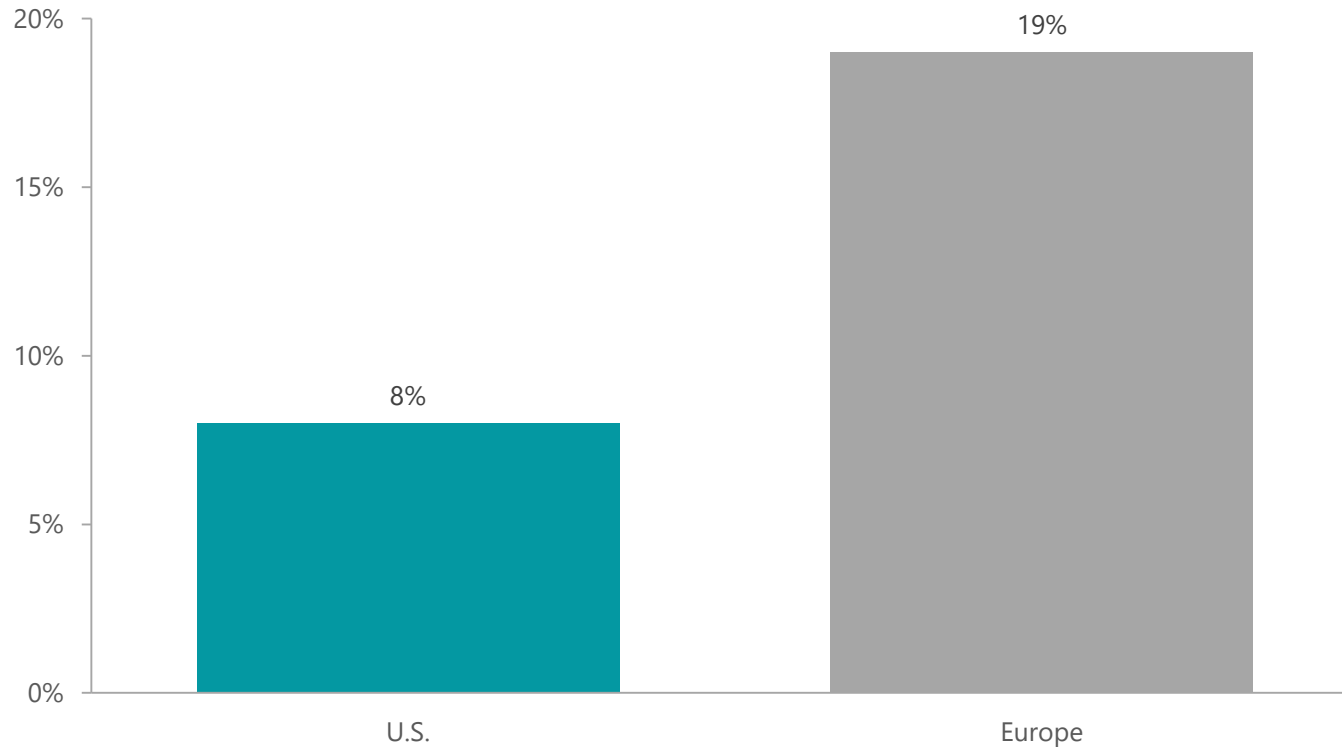
Chinese Stimulus

Similar to 2015-16, China is taking steps to stimulate their economy including:

- Lower interest rates (Shibor -200bps, 150 bps cuts of RRR)
- Yuan devaluation
- Looser credit standards: New bank loans up 75% y/y in July
- Fiscal stimulus (Government spending, tax cuts)
- Approximately \$100 billion capital injection via medium term lending facility

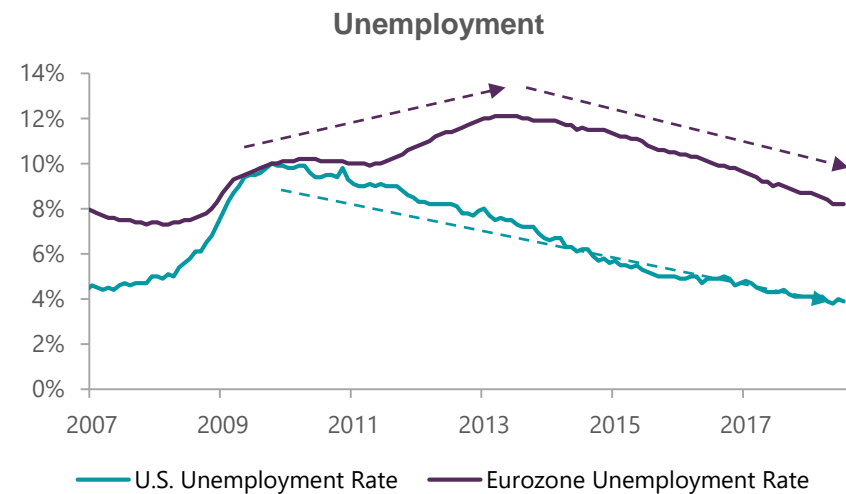


Proportion of Revenues from EM



▶ **European equities are more exposed to EM than U.S. equities.**

Europe vs U.S. Retail Sales and Unemployment



► Europe is earlier in their economic cycle than the U.S.

Additional Important Information

Past performance is no guarantee of future results.

Forecasts are inherently limited and should not be relied upon as indicators of actual or future performance.

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