Brandywine GLOBAL
A LEGG MASON COMPANY

2Q 2019 | Product Commentary

BWG - BrandywineGLOBAL - GLOBAL INCOME OPPORTUNITIES FUND INC.

Team-managed

Average annual total returns (%)

as of June 30, 2019

	3-mo	YTD	1-yr	3-yr	5-yr	10-yr	Since Incept. (3/28/12)
NAV	7.33	14.06	11.69	3.28	-0.08	-	3.61
Market Price	7.12	16.76	10.87	4.57	0.41	-	1.68

Performance shown represents past performance and is no guarantee of future results. *Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, so shares, when sold, may be worth more or less than the original cost. Returns are based on Market Price or NAV and assume the reinvestment of all distributions at the Dividend Reinvestment Plan Price or NAV, respectively. All returns include the deduction of management fees, operating expenses and all other Fund expenses, and do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares. Performance data of less than one year are cumulative figures and are not annualized. For current month-end performance, visit www.lmcef.com.*

Executive summary

- The growth divergence between the U.S. and rest of world no longer exists. Based on front-leading indicators, the U.S. economy has ratcheted down in line with the rest of the world economy.
- According to Brandywine, the escalation of an all-out trade war between the U.S. and China, Fed policy, a rise in global protectionism, and slower Chinese growth remain key risks.
- Within emerging markets, Brandywine Global prefers the high real-yielding bonds of Brazil, India, Indonesia, Mexico and Egypt. However, they have grown more selective in their currency decisions and overall exposure to emerging markets, given the macroeconomic backdrop.
- Brandywine Global has marginally increased the portfolio's foreign currency exposure by initiating exposure to the Australian dollar and euro, while decreasing allocations to the Japanese yen, British pound sterling and U.S. dollar.
- Brandywine Global will maintain a healthy allocation to U.S. Treasurys until credible signs of global economic stability take hold. The Treasury position is also a relative value opportunity versus German bunds and Japanese government bonds, both of which still have negative nominal and real yields.
- Brandywine Global remains constructive on U.S. dollar-denominated corporate debt, especially relative to European and emerging market corporate debt markets. In particular, Brandywine Global favors higher-quality, shorter-duration credits.

Global macro review

Global growth has continued to slow, and the June global Purchasing Manager Index (PMI) data is about as bad as it gets without a major recession. Importantly, a Federal Reserve Board ("Fed") policy pivot has continued to gain traction, which would support liquidity and eventually growth. The Fed and European Central Bank (ECB) have abandoned normalization and turned dovish. Elsewhere, China continues to dial up more policy stimulus, and central banks in Australia, Chile, India, Malaysia, the Philippines and Russia have cut rates. Money supply measures are basing out in most regions of the world, and Brandywine Global expects more to come. The bull market in the U.S. dollar has been checked—at least for now—with the broad dollar index roughly where it was in November 2018. The trade war between the U.S. and China appears to be on hold, possibly until the U.S. general elections.

Global liquidity is still the major driver of risk because of its effect on growth rates and market returns, both of which were in retreat in 2018 and spilled into international markets. This, in turn, dampened global liquidity and strengthened the U.S. dollar. At the midway point of 2019, the manufacturing slowdown may be on the precipice of turning into a manufacturing recession.

The Fed has ended tightening and is expected to ease, while

INVESTMENT PRODUCTS: NOT FDIC INSURED • NO BANK GUARANTEE • MAY LOSE VALUE

China's leaders will add incremental stimulus, if needed. The policy pivot is moving in the right direction. The real issue is that the scale of counter-stimulus seems modest in comparison with previous downturns. Central banks are globally trying to assess the risk of the manufacturing slump spilling over into other sectors of the economy. Simply stated, central banks do not want manufacturing PMIs to descend even further, yet the Fed is still balking. Meanwhile, China wants to avoid a big credit push, and the temporary agreement between the U.S. and China was to defer extra tariffs, not unwind the old ones. Meanwhile, Europe is embarking on another policy initiative to stabilize the surprising growth slump in the region. Brandywine Global believes the bottoming-out process is under way in order to stabilize the slowdown in global growth, and eventually provide a soft economic landing.

One important development in global data trends is the relative outperformance of emerging countries (ex-China). Emerging market manufacturing PMIs have been relatively flat since early 2018 and persistently above 50, while the same metric for advanced economies has trended to just below 50. (A reading below 50 indicates a contraction, while a reading above 50 indicates an expansion.) The reason for this relative performance is not perfectly clear. The collection of countries that have cut rates in recent weeks has been mainly emerging markets. In addition, there is considerable latitude for more easing, given steadily falling inflation and stable currencies. Meanwhile, there is anecdotal evidence of companies reconsidering production in countries outside of China. Stimulus and growth from the emerging area of the world could turn out to be a major component of the soft landing outlook which seems embedded in asset prices.

Key themes and risks

- The growth divergence between the U.S. and rest of world no longer exists. Based on front-leading indicators, the U.S. economy has ratcheted down in line with the rest of the world economy. Brandywine Global advanced the hypothesis some time ago that the U.S. might trade places with the rest of the world this year and into next—the U.S. softening, while the rest of the world picks up. Signs of stabilization in China, along with relative outperformance in emerging economies, support this thesis.
- Unfortunately, central banks in the major economies are still the only game in town when it comes to counter-cyclical economic policy. Fiscal policy is tapped out, as budget deficits are already large in the U.S. and China, and neither Europe nor Japan want their deficits bigger. Credit ratings agencies encourage emerging countries to balance their budgets. But central banks do not have much ammunition left, and many, including the Bank for International Settlements, warn that further rate cuts are counter-productive.
- The result could be that policy impotence drives politics toward increasingly radical attempts to stir up economic activity. There are plenty of signs of this pressure building. Populist uprisings in Europe are tilting toward better growth at the expense of balanced budgets. President Trump's musings about firing the Fed Chair is more than simple presidential exasperation with the stance of monetary policy—it is a sign of increased political pressure to drive growth.
- Populism and its effect on policymaking has been an overarching theme over the last few years. The economic drivers behind this sentiment have yet to be resolved. As such, geopolitical risk may resurface in 2019, precipitating periods of market volatility.
- While a weaker U.S. dollar will be a key factor in reviving global liquidity to support a longer global growth cycle, policymakers—namely the Fed and Chinese officials—will determine whether there is a global soft landing later this year.
- Brandywine Global continues to believe that emerging markets could be the net beneficiaries of global economic stability, which will be aided by unencumbered trade flows, a weaker U.S. dollar, stable commodity prices, and an improving Chinese economy. Real yields remain compelling, especially as inflation expectations remain too high in emerging markets.
- U.S. corporate and securitized credit markets will continue to present selective opportunities, although Brandywine Global will be cautious, given the business cycle's later stage relative to other countries. If the Fed begins an easing cycle, additional investment opportunities within the U.S. credit markets could be unlocked.
- The escalation of an all-out trade war between the U.S. and China, Fed policy, a rise in global protectionism, and slower Chinese growth remain key risks.

Fund positioning

Emerging market bonds: Brandywine Global prefers the high real-yielding bonds of Brazil, India, Indonesia, Mexico and Egypt. However, they have grown more selective in their currency decisions and overall exposure to emerging markets, given the macroeconomic backdrop.

Developed market currencies: After generating significant momentum last year, Brandywine Global believes the U.S. dollar should continue to stabilize in 2019. Brandywine Global has marginally increased the portfolio's foreign currency exposure by

initiating exposure to the Australian dollar and euro, while decreasing allocations to the Japanese yen, British pound sterling and U.S. dollar.

Developed market sovereign debt: Brandywine Global will maintain a healthy allocation to U.S. Treasurys until credible signs of global economic stability take hold. The Treasury position is also a relative value opportunity versus German bunds and Japanese government bonds, both of which still have negative nominal and real yields.

Corporate credit: Brandywine Global remains constructive on U.S. dollar-denominated corporate debt, especially relative to European and emerging market corporate debt markets. In particular, Brandywine Global favors higher-quality, shorter-duration credits.

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Portfolio allocations, holdings and characteristics referenced in this commentary are as of June 30, 2019 and are subject to change at any time.

Asset allocation (%):	
Government	43.0
Global High Yield Corporate Bonds	24.7
Global Investment Grade	14.1
Mortgage-Backed Securities	13.1
Bank Loan	1.1
Cash & Other Securities	4.1

Top currency exposure (%); includes currency hedging:	
US Dollar	71.6
Egyptian Pound	7.9
Australian Dollar	6.8
Brazilian Real	4.7
Colombian Peso	4.2
Indonesian Rupiah	2.3
Euro	2.0
Mexican Peso	0.6
Indian Rupee	0.4
British Pound	-0.5

Top 5 countries (%):	
United States	51.5
Brazil	11.8
Egypt	7.9
Mexico	7.8
Indonesia	7.0

Distribution rates (%):	
Market price	6.29
NAV	5.30

Distribution rate is calculated by annualizing the most recent distribution amount paid, excluding special distributions, divided by the closing market price or NAV as of 6/30/19. The Fund estimates that the distributions will be paid from: 100.00% investment income; 0.00% realized capital gains; and 0.00% return of capital. These estimates are not for tax purposes and a 1099 will be issued following year end. The distribution rate is subject to change and is not a quotation of Fund performance. The board of directors may terminate or suspend the managed distribution policy at any time. Any such termination or suspension could have an adverse effect on the market price of the Fund’s shares. A return of capital is not taxable and results in a reduction in the tax basis of a shareholder’s investment. For more information about a distribution’s composition, refer to the Fund’s distribution press release or, if applicable, the Section 19 notice located in the press release section of our website.

Glossary

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