**Performance Review**

During the fourth quarter of 2020 the portfolio outperformed its benchmark, the Bloomberg Barclays 1-5 Year US Government/Credit Bond Index, by 16 basis points (bps) on a gross basis.

The final quarter of 2020 was ultimately a strong one for risk assets, which rallied despite a number of short-term headwinds, including a sharp rise in Covid case counts. Ultimately, markets chose to remain forward-looking as a number of significant breakthroughs occurred in the final two months of the year, which provided some measures of relief from key macro risks. The greatest contributors to performance during the quarter were emerging markets (EM) exposure, and investment-grade and high-yield credit positioning, all contributing 5 bps as bond spreads tightened. Tactical changes to US long duration positioning contributed to performance as yields fluctuated. Yield-curve positioning was a detractor over the quarter.

**Investment Outlook**

For the most part, economic recovery has continued in the US in recent months, and we expect that to be the case in the months to come. Growth has slowed from the spectacular pace seen last year, but that is only to be expected as activity in most sectors re-approach pre-Covid levels and activity in other sectors continues to be restrained by sustained strictures on businesses and by consumer fears.

Aggregate demand has regained or surpassed pre-Covid levels in most goods-producing and construction sectors. Output and employment in these sectors have not yet fully recovered, but are in the process of doing so. In those sectors still operating under ongoing strictures—as well as the renewed shutdowns imposed in recent weeks—recovery has been more problematic, and a more robust pace of recovery there is not likely to emerge until a large proportion of the population has been vaccinated and something resembling herd immunity has been attained.

In the meantime, Federal Reserve (Fed) policy will likely remain very accommodative. There is little reason to argue or believe that current woes are monetary in nature or that monetary policy can help assuage them. However, that is not likely to sway the Fed’s hand. Meanwhile, we take some solace in the fact that Fed actions in 2020 look to have been about as inconsequential for growth and inflation as those of 2008 and after. In other words, there is no indication that any Fed excesses seen in 2020 or at present are working to generate inflation pressures. However, among financial market participants, inflation expectations do appear to have risen.

The Democratic sweep of the US presidency and both houses of Congress will give incoming President Biden a relatively free hand in legislating for the next year or so. However, Covid concerns are likely to hold center stage in Washington, and it also has never been clear to us whether tax increases were a major legislative aim of Biden’s campaign (apart from being used to energize portions of his base). The more likely fiscal action from Washington this year would be a package of infrastructure projects. We doubt that such a package will work to stimulate economic growth—or raise interest rates—as much as some corners appear to believe.

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