Western Asset Diversified Income Fund

WDI

Multi-Sector
March 31, 2025

Product Commentary

Performance Review

- Economic uncertainties triggered a flight to quality during the first quarter of 2025, driving U.S. Treasury yields lower and their prices higher. The economy continued to expand, while inflation remained higher than the Federal Reserve's ("Fed") 2% target. Meanwhile, President Trump's plans for new reciprocal tariffs on U.S. imports led to concerns of rising inflation. All told, both short- and long-term Treasury yields declined and the overall U.S. bond market, as measured by the Bloomberg U.S. Aggregate Index, returned 2.78% during the first quarter.
- For the quarter, the fund returned 1.13% at NAV, while the benchmark, the Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index, returned 1.00%.

QUARTERLY KEY PERFORMANCE DRIVERS

- The Fund's duration positioning contributed to performance. Despite a glimmer of hope that the Trump administration tariff proposals might be manageable for both the U.S. and global economies, potentially supporting spread sectors, global financial market uncertainty has skyrocketed. Trump's tariffs have become more aggressive and credible than anticipated, clouding economic forecasts and thickening the left-hand tail of macro distribution curves. We continue to view duration as an effective risk-off ballast against spread risk and are now closely monitoring potential shifts in U.S. Treasury and equity correlations, especially with rising inflation expectations on the horizon. Given the increased likelihood of this risk, along with growing fears of recession and stagflation, we are currently favoring U.S. steepener trades and focusing more on the belly, rather than the long end of the curve.
- The Fund's exposure to securitized credit was also a contributor to returns. In non-agency residential mortgage-backed securities (MBS), residential housing fundamentals remain strong, with low supply of both existing and new homes expected to persist. We prefer new-issue deals at the top of the credit stack and seasoned credit bonds with upgrade potential as deals de-lever. We believe the impact of tariffs will be minimal, potentially reducing new home construction and thereby supporting higher home prices. In non-agency commercial mortgage-backed securities (CMBS), we believe the market's trajectory will likely be influenced by credit and equity market performance. Higher goods costs may challenge rents in consumer-oriented sectors like lodging, retail, and multifamily housing. Industrial sectors might see reduced demand for space due to decreased foreign trade. If tariffs delay rate cuts, it could negatively impact commercial real estate credits and values, pressuring refinancing success rates and further constraining lending. Despite these concerns, we believe the CMBS market has many mispriced credits but will approach near-term volatility cautiously. Collateralized loan obligations (CLOs) are likely to follow macro sentiment, especially in lower-rated segments However, most CLOs are backed by diversified loan baskets, insulating the investment-grade portions. Tail risks for BB-rated CLOs and equity tranches can increase, particularly in deals with significant exposure to sectors impacted by tariffs. We're selective, avoiding below-investment-grade CLOs that are less diversified or heavily exposed to autos, chemicals, and building products. We prefer shorter spread durations within each rating category and aim to add or rotate positions on any widening, given the already attractive yields in the CLO space.
- The Fund's exposure to high-yield (HY) bonds and bank loans detracted from returns. Although HY spreads have widened since mid-February, we remain confident that strong credit fundamentals will prevent significant declines in valuations. We don't foresee a substantial increase in default rates in the near term, given the current leverage profiles, the absence of imminent maturities, and liability management strategies that often favor bondholders. Unless a recession occurs, we view current spreads as an attractive entry point to increase exposure to select higher quality, high-yield issuers. However, sectors that warrant caution include consumer products, retail, and home construction. In the bank loan space, we've reduced exposure to cyclical sectors like autos, chemicals, and building products due to tight spreads and moderating growth. Additionally, we've avoided auto companies with supply chains in Mexico due to aggressive Trump tariffs. Beyond autos, we've ensured our portfolio holdings lack significant manufacturing exposure in Mexico, particularly in industrials, building products, or consumer products. Despite these adjustments, we expect bank loans to perform well, supported by attractive yields and a favorable CLO issuance environment driving demand.
- Emerging markets (EM) local currency-denominated sovereigns and corporates, as well as U.S. dollar-denominated corporate debt, modestly contributed to performance. In the EM space, fundamental performance has been relatively stable, as reflected in current spreads. With the Fed in an easing cycle, we expect EM central banks to follow suit, leading to a decline in local sovereign yields over the medium term. While we anticipate some near-term volatility, we believe tariff uncertainty will create attractive opportunities in EM. In frontier markets, we continue to hold select exposures and find value in select new issues. EM corporates remain a core holding, benefiting from conservative financial policies and strong duration-adjusted carry. However, we've adopted a more cautious approach in EM local markets due to the uncertainty surrounding Trump tariffs.

Outlook & Strategy

- Proposed tariffs and other policy changes from the new U.S. administration have created uncertainty and volatility in financial markets. Global growth is expected to slow given the heightened uncertainty but should remain solidly in positive territory. U.S. growth is downshifting due to a myriad of factors: uncertainty over tariffs, waning benefits from immigration and reduced government spending, among others. A significant fiscal boost from European defense and Germany infrastructure spending should support eurozone confidence and growth, providing some relief from tariff-related uncertainty. In China, deflationary pressures remain and confidence is weak amid property market concerns, but sentiment is improving with fiscal stimulus and policy easing.
- The disinflationary trend may be interrupted as tariffs and retaliatory actions are implemented, but we expect inflation to move lower again over the longer term. Monetary policy remains restrictive. We expect central banks will continue to cut rates further in 2025. The Fed remains well positioned to provide support if the U.S. economy falters. Public debt levels continue to rise and yield curves may steepen given concerns over fiscal policies globally. We see pockets of opportunity in developed market rates in Europe, the UK and Australia. While the overall uncertainty in the market

environment necessitates caution, we see some longer-term value opportunities in EM local currency debt. Spread sector fundamentals remain supportive, but valuations reflect those fundamentals and credit spreads persist at below historical averages. We continue to find opportunities within spread sectors and related securities while remaining tactical. Developed market duration provides useful diversification.

Product Details

Inception Date	06/24/2021
Benchmark	Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index

Ticker	WDI
CUSIP	95790K109

Product Description

Diverse opportunity set: Anticipates investing in a wide range of fixed income securities, seeking to go beyond traditional bond benchmarks to access a broad range of opportunities for income and capital appreciation.

Income-focused: Potential access to fixed income sectors and private debt not typically available through traditional mutual funds.

Flexible and dynamic: Anticipates rotating sectors and securities in response to market conditions, focusing on what we believe are undervalued securities with attractive fundamentals.

Deep experience: Will draw on Western Asset's 50 years as an active fixed income manager.

Limited Term: The Fund intends to dissolve as of the first business day following the twelfth anniversary of the effective date of the Fund's initial registration statement (the "Dissolution Date"), provided that the Board may extend the Dissolution Date for up to two years. Within 6-18 months of the liquidation date the Board may approve a tender offer for 100% of the shares outstanding. If, upon expiration of the tender offer, the Fund has in excess of $200 million aggregate net assets the Board may remove the Fund's termination date.

Performance Data

Average Annual Total Returns[1] (%)

	1 Mth	3 Mths	1 Year	3 Year	Since Inception (06/25/2021)
Western Asset Diversified Income Fund (NAV Returns)[a]	-1.79	1.13	6.23	3.42	1.89
Western Asset Diversified Income Fund (Market Price Return)[a]	-2.68	4.49	12.62	7.98	1.90
Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index	-1.02	1.00	7.69	4.98	3.09

***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 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. When applicable, performance would have been lower if fees had not been waived in various periods. The index is unmanaged and includes reinvestment of any income or distributions. It does not reflect any fees, expenses or sales charges. One cannot invest directly in an index, and an index is not representative of the fund's portfolio. Index data is provided for comparison purposes only. The fund is not managed against an index. Returns for periods of less than one year are not annualized. Please visit franklintempleton.com for the most recent month-end performance.*

The total annual operating expenses are as of the fund's annual report available at the time of publication. Actual expenses may be higher and may impact portfolio returns. **NAV** is total assets less total liabilities divided by the number of shares outstanding. **Market Price**, determined by supply and demand, is the price an investor purchases or sells the fund. The Market Price may differ from a fund's NAV. **Premium** / **Discount** reflects the difference between the NAV and the Market Price of the fund, and represents the amount that the fund is trading above or below its NAV, expressed as a percentage of the NAV.

The **Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index** measures the performance of U.S. dollar-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. The Index limits the maximum exposure to any one issuer to 2%. Source: Bloomberg Indices.

1. Periods shorter than one year are shown as cumulative total returns.

Investment Team

Western Asset is one of the world's leading active fixed-income managers, delivering long-term fundamental value investment solutions to clients for over half a century. Founded in 1971, Western Asset offers clients deep expertise across the range of global fixed-income sectors from nine offices located in key financial markets.

What Are The Risks?

All investments involve risks, including possible loss of principal. Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **Low-rated, high-yield bonds** are subject to greater price volatility, illiquidity and possibility of default. **Asset-backed**, **mortgage-backed or mortgage-related securities** are subject to prepayment and extension risks. **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. Derivative instruments** can be illiquid, may disproportionately increase losses, and have a potentially large impact on performance. **Leverage** increases the volatility of investment returns and subjects investments to magnified losses and a decline in value. **Diversification** does not assure against market loss.

Important Legal Information

The information provided is not a complete analysis of every material fact regarding any country, market, industry, security or fund. Because market and economic conditions are subject to change, comments, opinions and analyses are rendered as of the date of this material and may change without notice. A portfolio manager's assessment of a particular security, investment or strategy is not intended as individual investment advice or a recommendation or solicitation to buy, sell or hold any security or to adopt any investment strategy; it is intended only to provide insight into the fund's portfolio selection process. Holdings are subject to change.

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Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, or summary prospectus, if available, at www.franklintempleton.com. Please read it carefully.

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a. The total annual operating expenses are as of the fund's annual report available at the time of publication. Actual expenses may be higher and may impact portfolio returns.

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