Western Asset

Western Asset Diversified Income Fund

WDI

Multi-Sector
December 31, 2024

Product Commentary

Performance Review

- With interest rates rising sharply, the U.S. fixed income market generated weak results during the fourth quarter and posted a modest gain for the year. The economy remained largely resilient and inflation continued to moderate, although it remained higher than the Federal Reserve's ("Fed") 2% target. While the U.S. central bank lowered interest rates twice during the quarter, it moderated its expectations for rate cuts in 2025. All told, both short- and long-term Treasury yields rose sharply and the overall U.S. bond market, as measured by the Bloomberg U.S. Aggregate Index, returned -3.06% during the quarter, paring its 2024 gain to a modest 1.25%.
- For the quarter, the fund returned -0.80% at NAV, while the benchmark, the Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index, returned 0.17%.

QUARTERLY KEY PERFORMANCE DRIVERS

- The Fund's exposure to high-yield (HY) bonds, bank loans and collateralized loan obligations contributed to performance. We maintain the view that HY credit spreads reflect balance sheet strength, the prudent behavior of management teams, and supportive demand for higher yielding securities relative to supply. We continue to see value in service-related sectors that are still recovering from the pandemic-era recession (i.e., reopening trades including cruise lines and lodging). We are also constructive on the energy sectors, specifically exploration and production issuers, as well as potential "rising stars." Sectors where we are more cautious include consumer products, retailers and home construction.
- Securitized credit was a modest contributor to returns during the quarter. In non-agency residential mortgage-backed securities (MBS), residential housing fundamentals remain supportive of securitization as the supply of both existing and new homes is expected to remain low for the coming year. Collateral performance continues to be robust, with delinquencies and losses at very low levels and underwriting standards stringent. We like new issue deals at the top of the credit stack, as well as seasoned credit bonds with ratings upgrade potential as deals continue to de-lever. In non-agency commercial mortgage-backed securities (CMBS), new-issue underwriting offers the best quality in over a decade, with low leverage, in-place cash flow and lender-friendly structures, as well as low exposure to non-trophy office properties. We view mezzanine and subordinate credit as offering the best relative value. Seasoned bonds priced at a discount also offer intriguing total return opportunities for short, event driven trades.
- Emerging markets (EM) debt was a modest detractor from performance. At present, all-in yields on EM sovereign and corporate debt appear to be attractive relative to other classes, such as U.S. credit. In the EM local debt space, we acknowledge that the prospect of fewer developed market (DM) and EM central bank rate cuts and a stronger U.S. dollar will weigh on EM foreign exchange and rates markets. With Donald Trump poised to enter the White House on January 20, 2025, markets will be on edge, and rightly so given the market volatility observed during the first Trump's administration. However, we believe the EM asset class has discounted plenty of the potential headline risk. This, combined with much cleaner technical positioning and resilient asset class fundamentals, supports our view that EM may continue to perform well, driven by high carry and the potential for strong outperformance in the near term on any positive surprise regarding the new Trump trade policy, economic stimulus from China or a reduction in geopolitical tensions.
- The Fund's duration stance was also a detractor from quarterly returns. Despite a decline in both job growth and income gains, the U.S. economy should expand near trend well into 2025, buoyed by housing and consumer demand. Monthly core inflation should continue to run near Fed target levels, helped by modest goods deflation and declining shelter and services inflation. U.S. bond yields remain high relative to pre-pandemic growth and inflation. Trump administration tariffs should have only a short-term impact on the disinflation trend, though market uncertainty about the extent and timing of policy changes may lead to market volatility in early 2025.

Outlook & Strategy

- Our base case calls for further weakening in global growth and further declines in inflation with a greater emphasis on services disinflation. Goods price inflation is running modestly below pre-pandemic levels, but with ongoing deflationary pressures from Asia, it's hard to see a meaningful persistent uptick moving forward. Services inflation remains elevated, but wage pressures are abating as job markets soften and service sector demand is slowing. Headline inflation is close to target in most advanced economies, which has allowed central banks to reduce policy rates as their inflation concerns lessen while growth concerns rise.
- Growth is slowing in the U.S. and remains moribund in the rest of the world. At the same time, lower policy rates and the recent Chinese stimulus package should lessen recessionary fears. We remain overweight to interest rate duration, but less so as rates have fallen and markets have moved closer to our base case. Spread sectors have performed well and we expect this to persist if the downward growth trajectory remains gentle and services disinflation continues. However, valuations now have less yield advantage to offset potential macro and political risks going forward. EM debt appears to remain fundamentally attractive, but both internal and external political risks have hampered performance in some countries.

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]	-1.30	-0.80	9.10	1.59	1.70
Western Asset Diversified Income Fund (Market Price Return)[a]	-3.57	-6.37	13.78	2.87	0.77
Bloomberg U.S. Corporate High Yield - 2% Issuer Cap Index	-0.43	0.17	8.19	2.92	3.02

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.

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.

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

What Are The Risks?

All investments involve risks, including possible loss of principal. The fund is newly organized, with a limited history of operations. **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.

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.

Distributions are not guaranteed and are subject to change. The Closed-End Funds are not sold or distributed by Franklin Distributors, LLC, or any affiliate of Franklin Resources, Inc. Unlike open-end funds, shares are not continually offered. Like other public companies, closed-end funds have a one-time initial public offering, and once their shares are first issued, are generally bought and sold through non-affiliated broker/dealers and trade on nationally recognized stock exchanges. Share prices will fluctuate with market conditions and, at the time of sale, may be worth more or less than your original investment. Shares of exchange-traded closed-end funds may trade at a discount or premium to their original offering price, and often trade at a discount to their net asset value. Investment return, market price and net asset value will fluctuate with changes in market conditions. The Funds are subject to investment risks, including the possible loss of principal invested.

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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