QUARTERLY COMMENTARY

TCW Emerging Markets Local Currency

FOURTH QUARTER 2018

Performance

For the three months ended December 31, 2018, the TCW Emerging Markets Local Currency Income Strategy returned 1.52% gross (1.39% net of fees and expenses), versus the JP Morgan Global Bond Index Emerging Markets Global Diversified ("Index") which returned 2.11% for the same period. For 2018, the Strategy returned -7.23% gross (-7.70% net of fees and expenses) versus -6.21% for the Index.

Underweight positioning in Mexico and Turkey, which rebounded following a significant sell-off, drove underperformance for the quarter. We have shifted to a neutral position in each. In addition, overweight positioning in Indonesia hurt performance on the back of the oil sell-off. We are maintaining the overweight at current valuations, given a stable growth outlook and attractive carry versus other Asian peers. On the other hand, overweight positioning in Brazil, along with underweights in CEE[1] economies, and off-index positioning in Egypt, helped mitigate the quarter's underperformance.

Underperformance for the year was driven by our overweight to EMFX versus the U.S. dollar leading into a period of dollar strength earlier in 2018. From a country perspective, underweight positioning to Thailand, along with overweight positioning and security selection in Indonesia and South Africa hurt relative performance. Underweight positioning in Turkey as it rallied back later in the year also hurt performance. On the other hand, our EMFX exposure in off-index countries (Egypt, Nigeria, Serbia), which are more shielded from overall market volatility, helped mitigate this year's underperformance, in addition to overweight positioning and security selection in Brazil leading into the Presidential elections.

During the quarter, we added exposure to Brazil leading into the Presidential elections. In addition, we added exposure to Romania while reducing exposure to other Eastern European sovereigns (Serbia, Hungary). From a currency perspective, the Fund is overweight Latin America and several high yielders against neutral positions in Central Europe and Asia.

	Total	GBI-EM GD	Relative UW/OW*
Brazil	12.19	10.00	2.19
Indonesia	11.86	9.37	2.50
Mexico	10.58	10.00	0.58
South Africa	8.67	8.46	0.21
Colombia	8.24	7.14	1.10

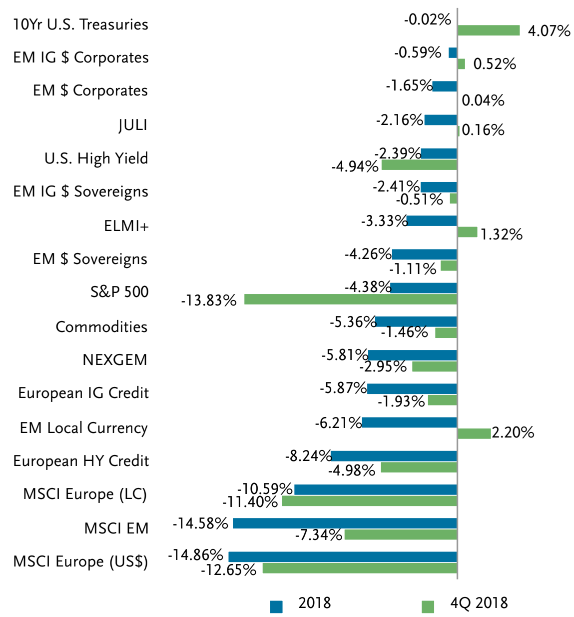
* Underweight/Overweight
Source: TCW

1. Central and Eastern Europe

Investment Environment

2018 was certainly a challenging year for global assets. Emerging Markets (EM) was no exception, with EM equities ending the year down 14.6%, EM local currency debt down 6.2% (in dollar terms), and EM dollar-denominated sovereign debt down 4.3%.

Total Returns Across Asset Classes



Source: Bloomberg, JP Morgan; Data as of December 31, 2018

EM debt generally outperformed Developed Markets (DM) debt in the fourth quarter and has had a strong start to the year. However, the market needs a catalyst for a meaningful turnaround. That being said, we believe some of the headwinds that hurt in 2018 are starting to improve.

- **Slower U.S. growth/U.S. dollar weakness:** In early 2018, stronger U.S. growth fueled by tax cuts and fiscal spending, along with perceptions of a more aggressive Fed[2] led to a stronger dollar. We believe U.S. growth has peaked and as fiscal stimulus wanes, growth will slow and lead to a less aggressive Fed in 2019. As we have seen, recently released Fed minutes suggest a dovish tilt, given growth concerns and market volatility. Furthermore, as the market starts to focus more on structural issues facing the U.S. economy – a rising U.S. current account and fiscal deficit – the dollar should come under downward pressure. As such, we believe that 2019 could present opportunities to add EM local currency exposure; note that EMFX is down around 35% on average since the 2013 taper tantrum, with the spread between EM and DM real rates near the wider end of the range.

- **Stable but slower Chinese growth:** Deleveraging, and to a lesser extent, trade headwinds have weighed on Chinese growth. In our view, growth in China will continue to slow in 2019 to around 6% (with the possibility of a quarter or two of growth below 6% early in the year). However, we believe that the impact of past, and forthcoming, China stimulus should stabilize demand around mid-2019. With banks reluctant to lend due to rising credit risks, fiscal policy is likely to play a bigger role in supporting growth.

2. Federal Reserve

- **EM/DM growth differential widening:** Against this backdrop of slower global, and Chinese, growth, our forecast for EM growth remains relatively stable, but less uniform than before, with several large countries accelerating (Brazil, Indonesia and South Africa), and/or relatively unchanged (e.g. India, Russia). As such, the spread between U.S. and EM growth in our view will widen marginally, which could result in flows out of U.S. assets and into international assets (not just EM).

- **China/U.S. trade war:** The Trump-Xi[3] dinner in late 2018 went better than expected, with the U.S. holding off on raising tariffs and expanding them to more products. Given the negative market and economic impact of higher tariffs, and with China taking some actions to address U.S. concerns, we believe chances are rising that further tariffs will be put off again. As negotiations continue, we expect broad CNY stability, helping to anchor other EM currencies, particularly in Asia. While the markets have responded constructively to the January negotiations, we believe that the chances of a broad agreement, and rollback of existing tariffs, remain low and the U.S. is likely to tighten restrictions on U.S. exports of, and Chinese investment in, U.S. technology. Uncertainty over the extent of trade and investment restrictions is likely to continue to weigh on business confidence and capex in both the U.S. and China and divert some investments into other emerging markets.

- **The idiosyncratic stories of Argentina and Turkey** that unraveled in early 2018 also hurt EM. Both of these countries have started to address their issues: Argentina via a large IMF[4] program and Turkey via slightly better policy. Both countries will experience significant growth declines in 2019, in our view. But importantly, Argentina and Turkey, which were punished for having large external financing gaps, do not represent the norm. Average debt/GDP is around 50% for EM countries – well below the developed world, which is over 100%. In addition, the bulk of EM sovereign debt is denominated in local currency, rather than dollars, making the asset class less vulnerable to periods of dollar strength such as we experienced in 2018.

In the near term, we believe markets globally are likely to remain volatile and without direction until there is more clarity on the U.S. economy, the direction of U.S. interest rates, trade policy and Chinese stimulus. Nonetheless, we think 2019 could be a better year for EM. Our local currency forecasts are driven by carry of 6.5%, enhanced by EMFX appreciation of 1-2%, if as suggested above, structural issues begin to exert downward pressure on the USD later in the year.

From a technical perspective, investors remain underweight despite the fact that institutional/strategic investors with zero to minimal allocations to EMD took advantage of the 2018 downtrade to add exposure (keep in mind that EM debt now comprises close to 20% of global fixed income).

We see the primary risk factors – which do not represent our base case – as follows:

1) A notable slowdown in China, in the low 5% area, below what we are expecting, with a more material downturn in property adding to deleveraging and trade headwinds, as well as reducing local government funds to finance infrastructure investment. Lower rated corporate borrowers could come under stress as they seek to refinance large amortizations in both domestic and external markets.

3. Chinese President Xi Jinping ; 4. International Monetary Fund

2) A dysfunctional political environment in the U.S. or a recession in the U.S. later in the year. In either of these scenarios, we would envision an extended U.S. equity sell-off that would weigh on risk assets more broadly.

3) A stagflation scenario, where the Fed gets behind the curve through accelerated rate hikes. Investment flows and liquidity would be at risk.

Sincerely,

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Source: TCW

Data based upon a representative account.

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The full composite performance for the strategy is available on the strategy detail page on TCW.com. Annualized returns can be found in the Performance and Approach table, and calendar year returns are contained in the Performance Disclosure document. You may also contact your TCW Client Relations Officer at 213 244 0000.

This material includes a partial list of past specific recommendations, reflecting the three largest new buys and the three largest sales (complete sales) for the calendar quarter. For a complete list of all representative buys and sells for a given time period, please contact TCW at contact@tcw.com.

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