

4Q  
2017

Investment Report

## Oregon Local Government Intermediate Fund



### Performance Review

For the fourth quarter of 2017, the portfolio outperformed the Bloomberg Barclays 1-5 Year Government/Credit index by 20 basis points (bps). For the year ending December 31, 2017, the portfolio has outperformed the same index by 39 bps.

Interest rate positioning had a positive net impact on performance for the fourth quarter. The portfolio's slightly long duration position during most of the quarter was a minor detractor as most interest rates rose. This was more than offset by a positive contribution from the portfolio's yield curve flattening positioning as 2s to 10s flattened from 86 bps to 51 bps.

The portfolio's overweight position to investment-grade corporate bonds was a positive contributor as spreads tightened. Overweight exposure to certain industries, such as financials, energy, and metals and mining were particularly beneficial. We continue to believe that opportunities exist for high-quality carry in investment-grade corporate bonds and added approximately 2% in select financial and industrial names to the portfolio.

Overweight positions to dollar-denominated emerging market (EM) corporate bonds, predominately from Latin American issuers, and an overweight position to high-quality structured products, focused on government-guaranteed student loan ABS, were both positive contributors to performance.

### Investment Outlook

The US growth outlook for 2018 looks to be another 2%+ growth year, and with many of the new tax bill provisions taking effect

almost immediately, perhaps better. Does such cyclical strength presage a meaningful pickup in longer-term interest rates? We think not. Our view has always been that the story of long-term interest rates is little more than the story of long-term inflation. In many past recoveries, inflation has risen in line with cyclical strength, and basing longer-term rate forecasts on cyclical forecasts worked out reasonably well. But in a highly disinflationary world, which we have been in since the turn of the century, inflation dynamics have not readily followed cyclical forces. Add the burden of global debt into this picture, and a sharp rise in developed-market interest rates does not seem likely.

With global growth picking up, EM in particular healing readily and European optimism growing, there should be few headwinds from abroad to impede US growth. We believe that in this environment spread products should still continue to outperform government bonds. While we may not get the meaningful benefit from spread compression that we did in 2016 and 2017, this environment remains supportive of successfully clipping coupons. That is the challenge of a low-growth, low-inflation environment. Returns in high-quality fixed-income products should be expected to be modest. The demand for income and yield—with diminishing prospects for an imminent, significant rise in interest rates—provides the possibility of spreads tightening further.

For more information on Western Asset visit [www.westernasset.com](http://www.westernasset.com).

### Oregon Local Government Intermediate Fund

	Portfolio	Index**
4Q17 Performance*	0.10%	0.30%
Year-to-Date	1.66%	1.27%

As of 31 Dec 17. \*Performance is gross of fees. \*\*Bloomberg Barclays Capital US Government/Credit Bond Index (1-5) year.

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