

# Unconstrained Fixed Income Summit

Chicago: February 10 | New York: February 12

## US Economic and Fixed-Income Outlook

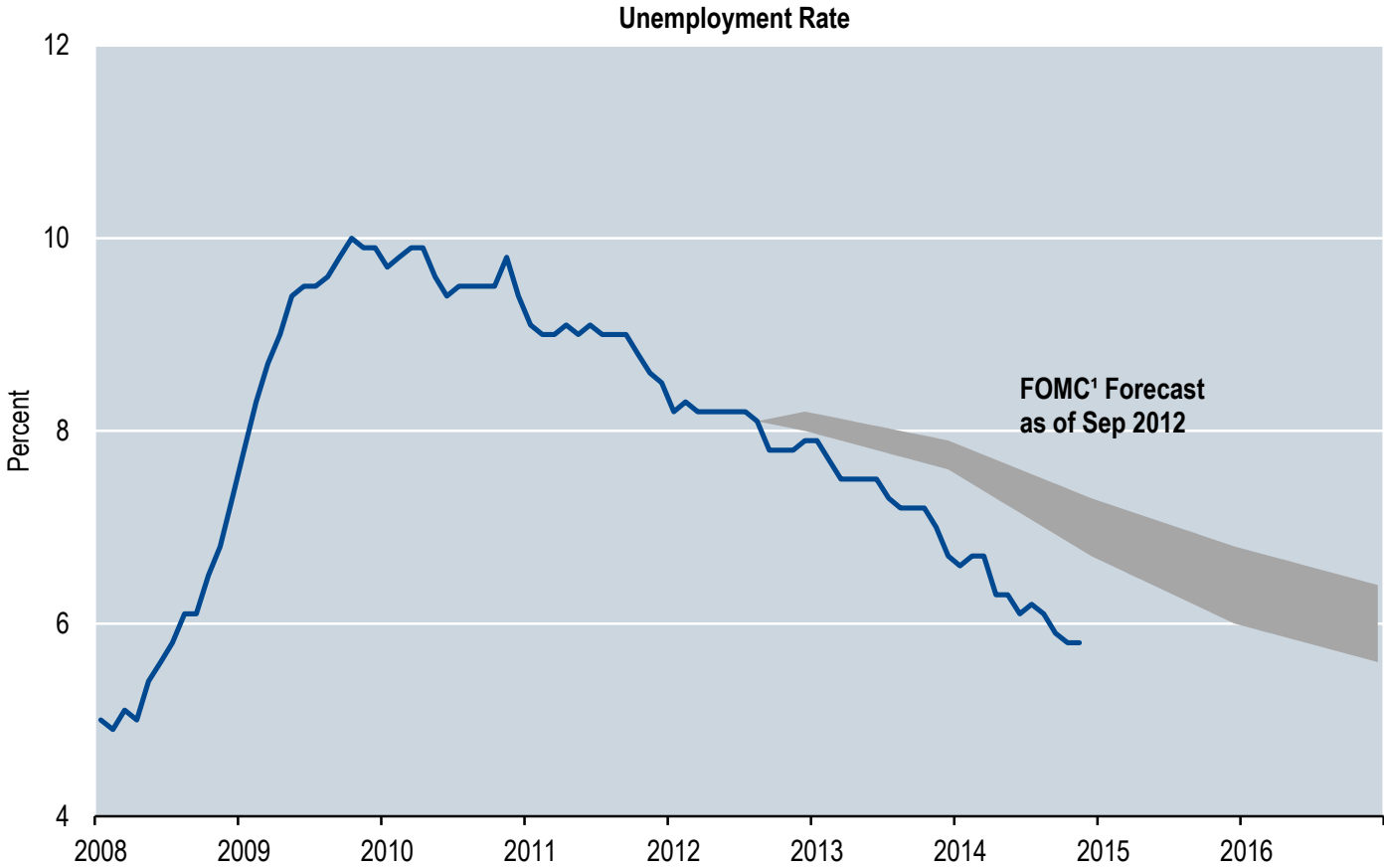
John L. Bellows, Portfolio Manager  
Western Asset Management

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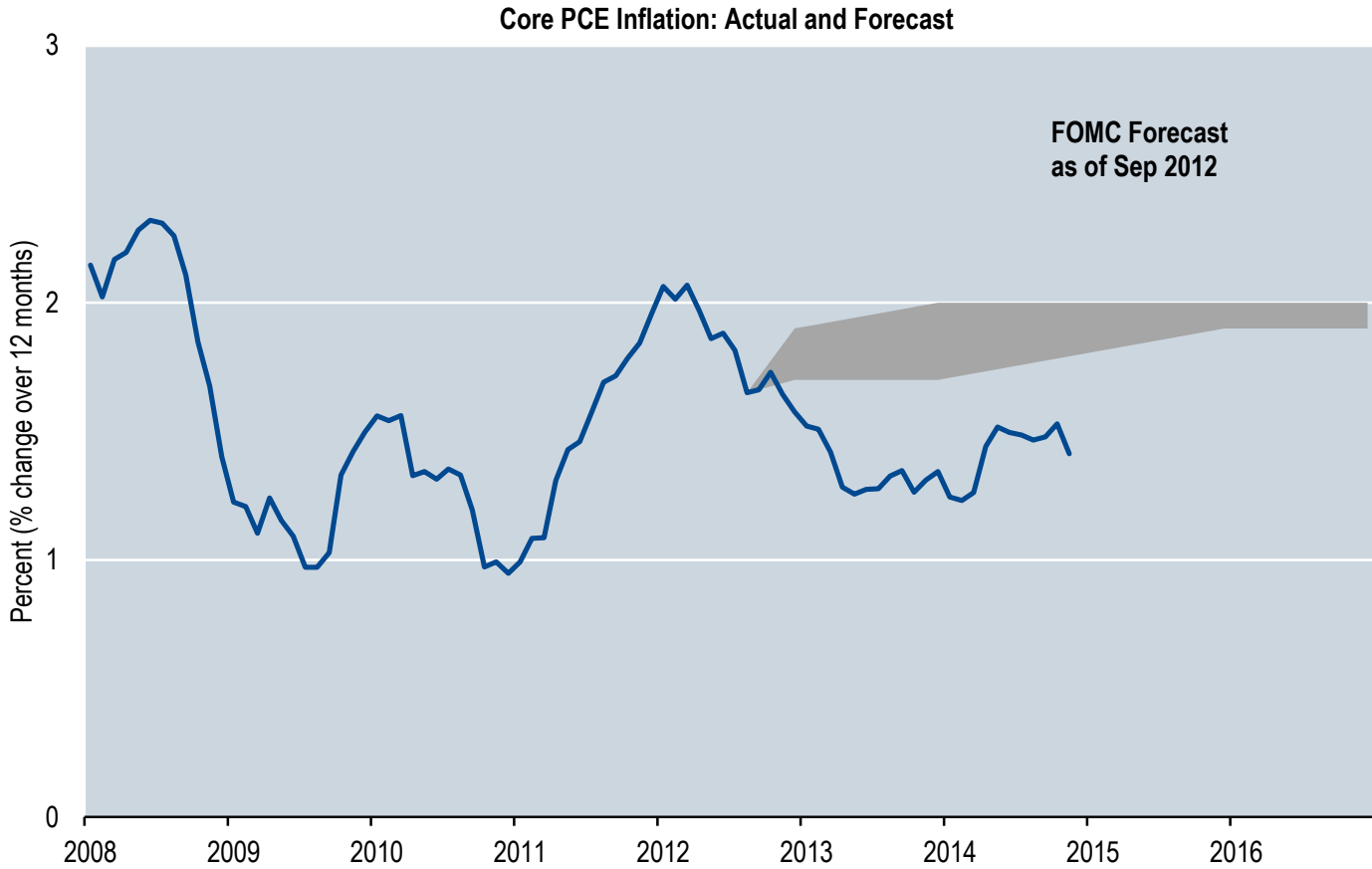
- I. Fed Outlook
- II. The Risks for the Fed in 2015 – It's Mostly Global
- III. Advantages of Unconstrained Bond Management
- IV. Appendix

# US Unemployment Rate



Source: Federal Reserve, Bureau of Labor Statistics. As of 30 Nov 14

# US Core Inflation



Source: Federal Reserve, Census Bureau. As of 30 Nov 14

# The Fed's Reaction Function

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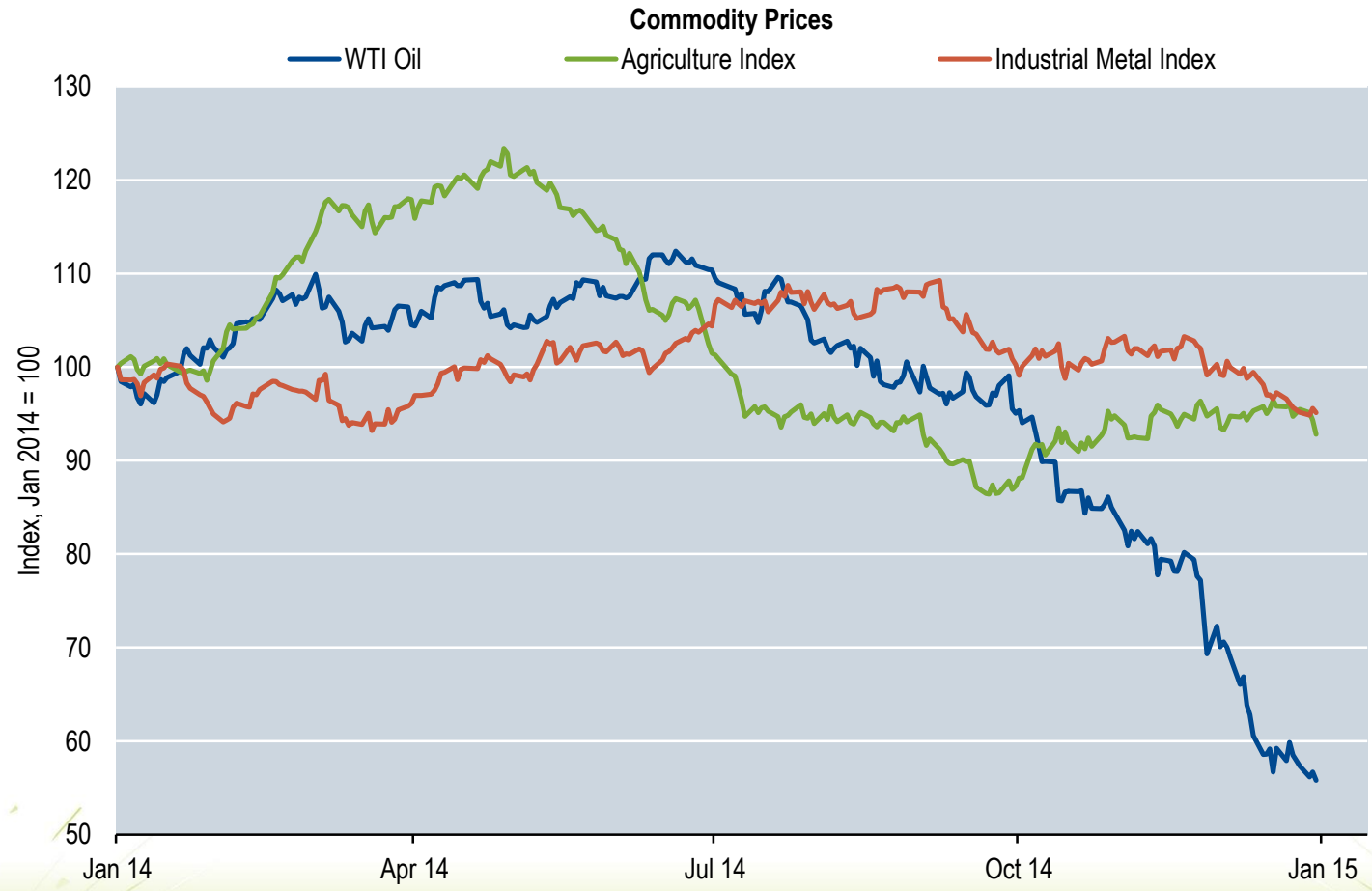
**“By the time of lift off, participants expect core inflation to be running near current levels, but foresee being reasonably confident in their expectation that inflation will move back toward our 2 percent longer-run inflation objective over time”**

*- Janet Yellen, Dec 17, 2014*

# Risk #1: Falling Oil Prices

Outlook: Lower oil prices due to supply shock, boosts growth and temporarily lowers inflation

Risk: Lower oil prices due to demand shock

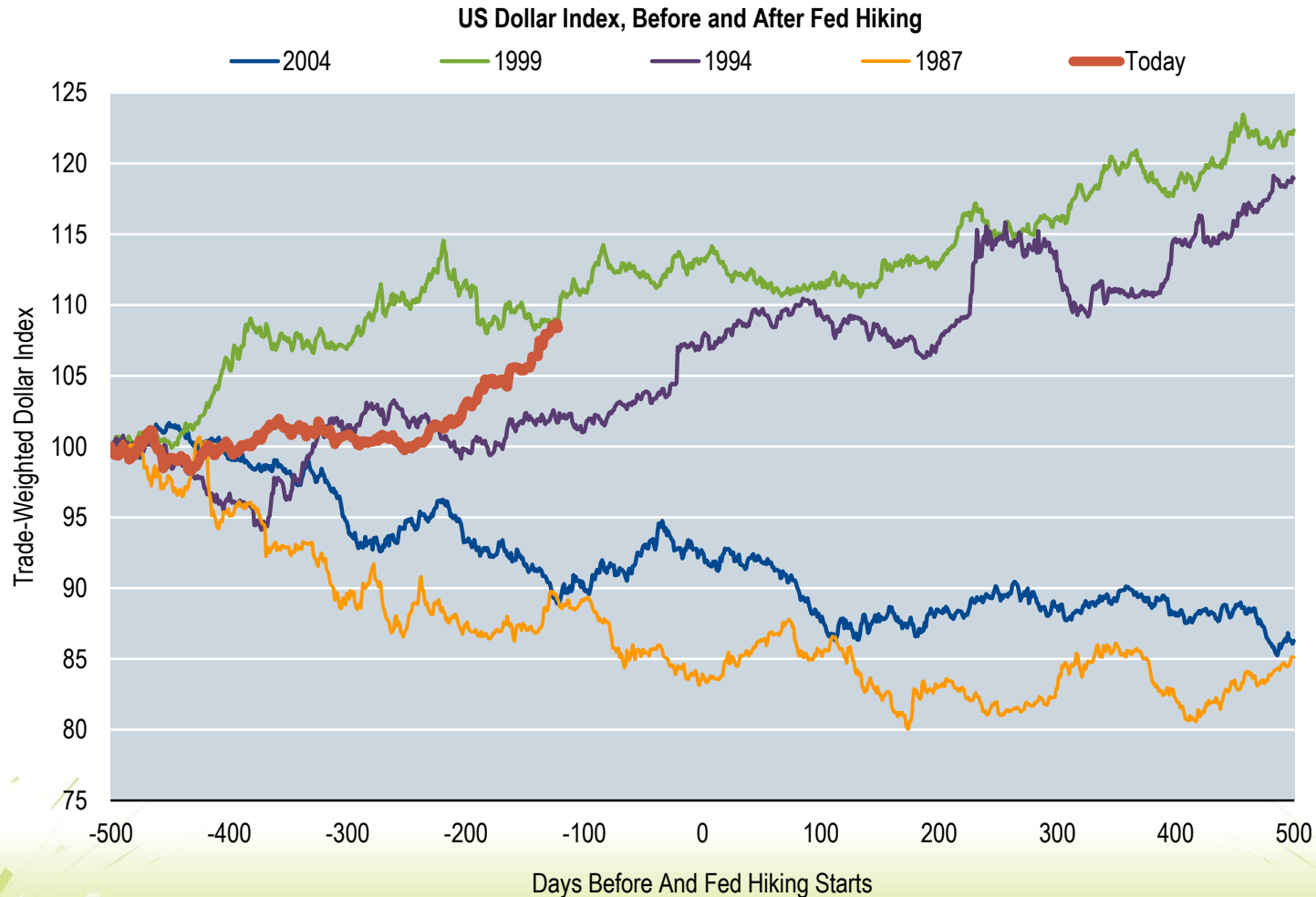


Source: Bloomberg. As of 31 Dec 14

# Risk #2: The US Dollar Appreciation

Outlook: USD appreciation reflects healthy US economy

Risk: USD appreciation lowers inflation, or reflects “flight-to-safety” capital flows

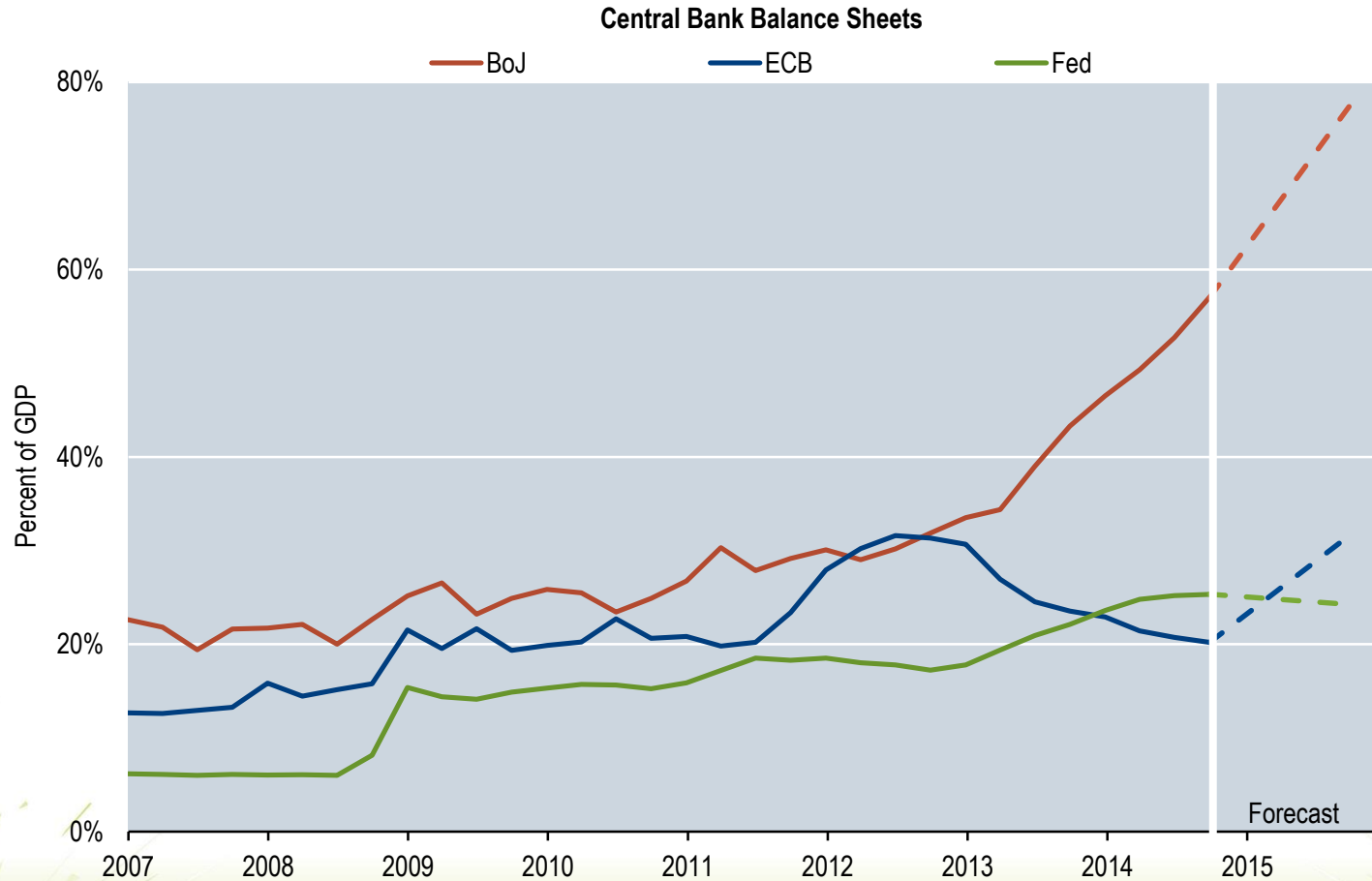


Source: Bloomberg As of 31 Dec 14

# Risk #3: Global Central Bank Easing

Outlook: ECB and BoJ easing boosts financial conditions, allowing the Fed to tighten

Risk: Further CB easing fails to support risk markets and / or growth



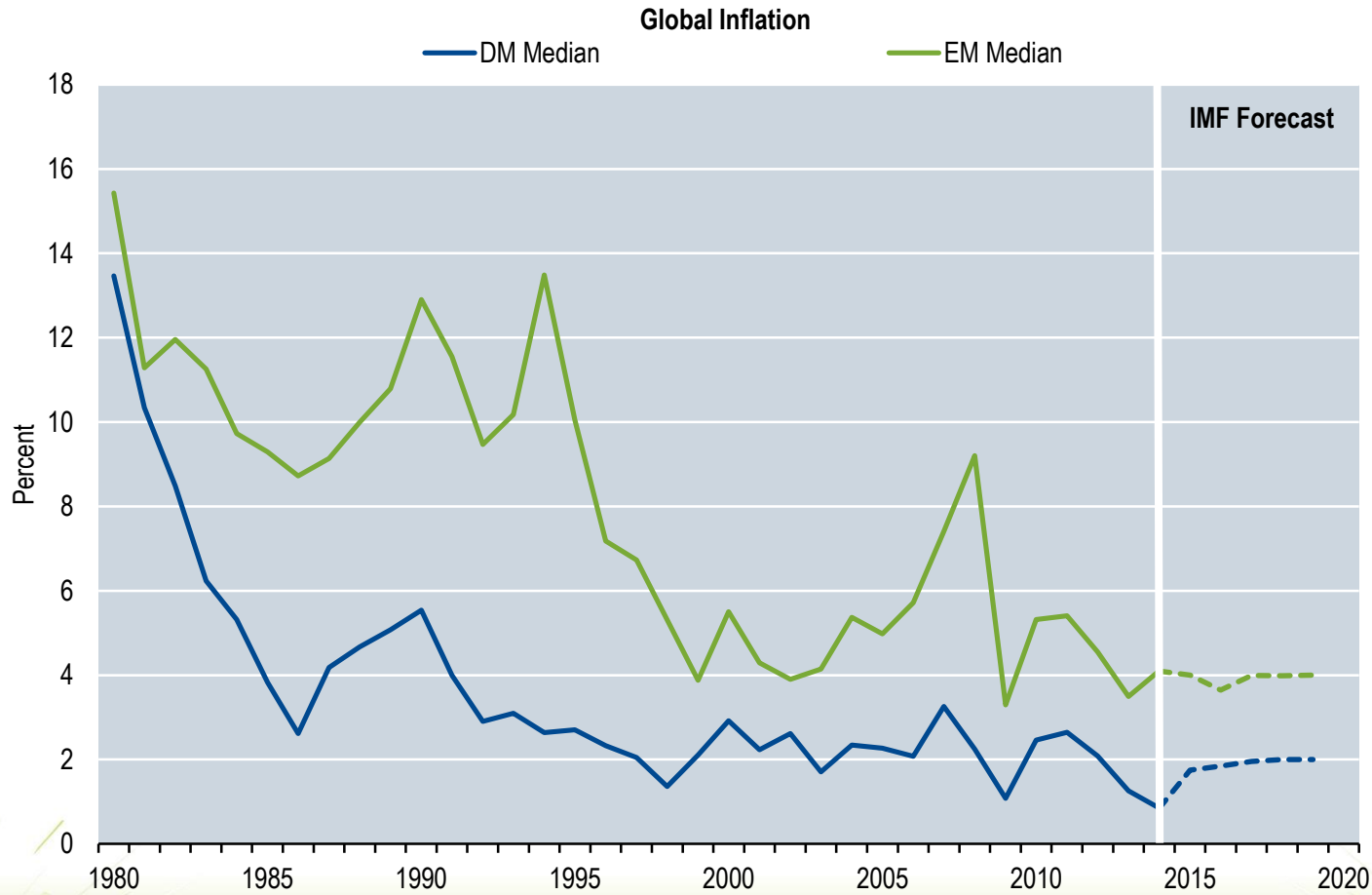
Source: Bloomberg. As of 30 Sep 14



# Risk #4: Global Inflation is Falling

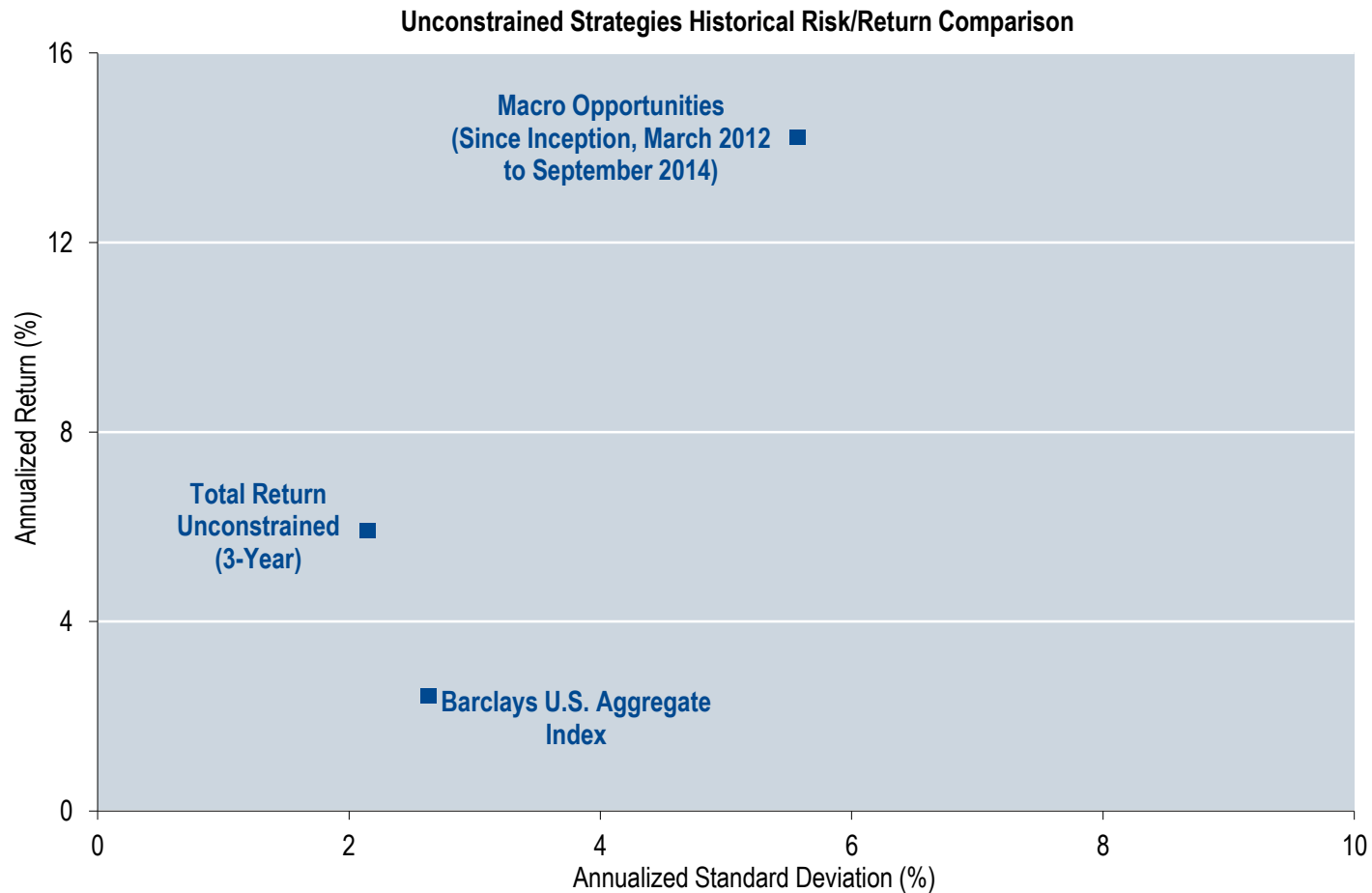
Outlook: Low inflation supports growth and easy monetary policy abroad

Risk: US may import deflation from other countries



Source: IMF. As of 31 Dec 14

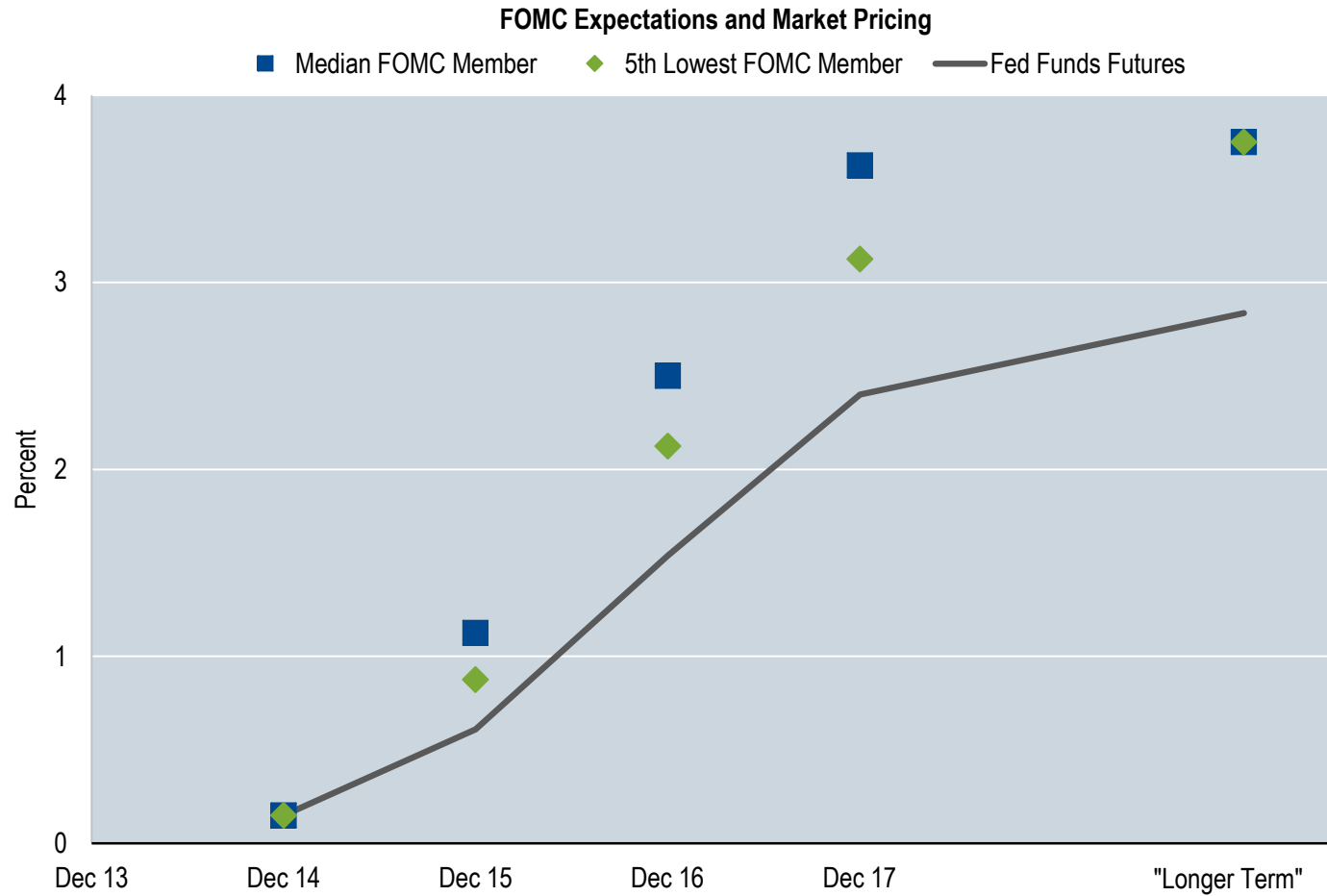
# Unconstrained Strategies Historical Risk/Return Comparison



Source: Western Asset. As of 30 Sep 14

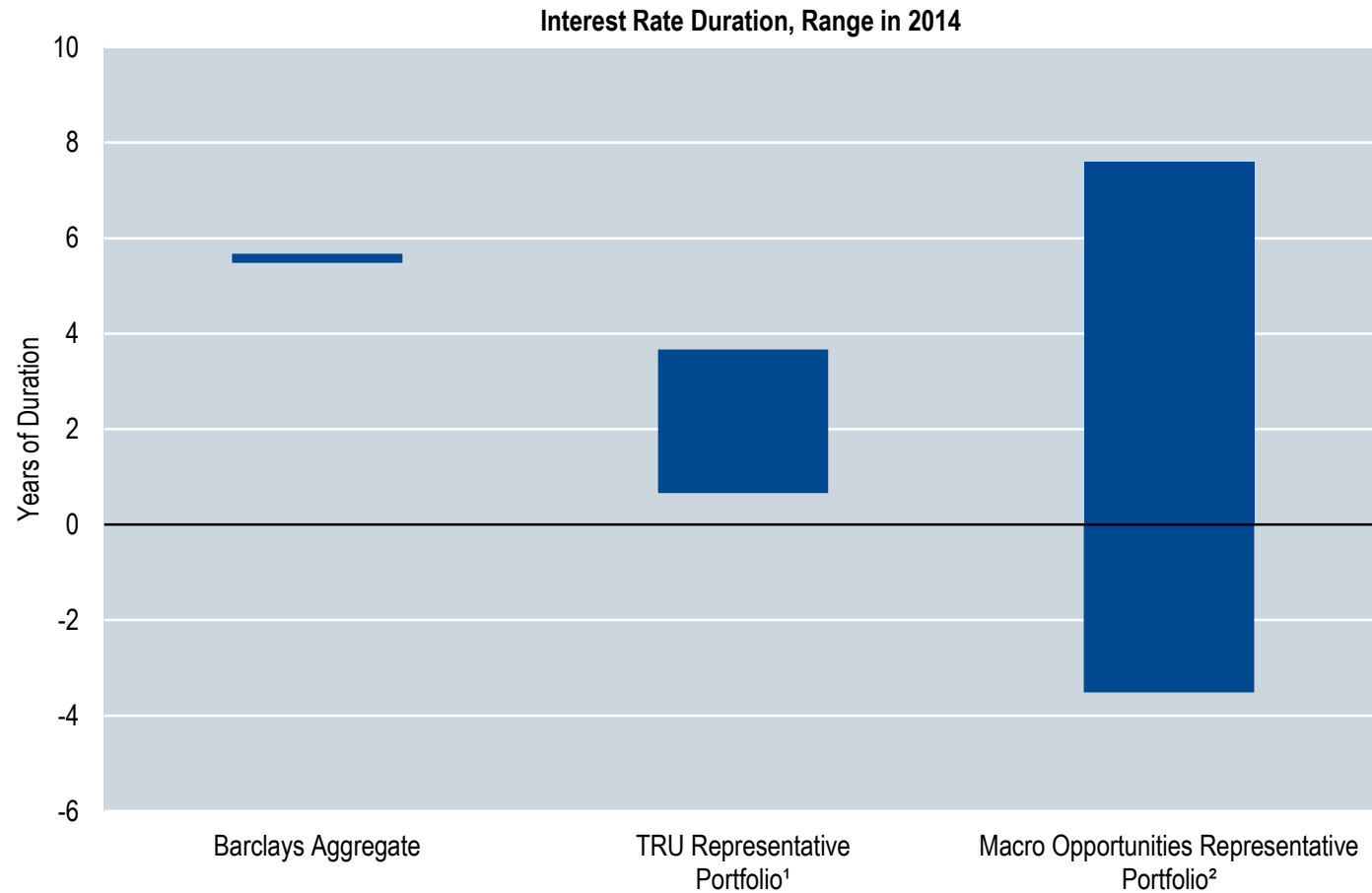
Performance shown is gross of fees. Returns for periods greater than one year are annualized. Please see the Performance Disclosure in the Appendix for more information.

# US Yields Lower than Fed Guidance



Source: Federal Reserve, Bloomberg. As of 31 Dec 14

# Duration Exposure in Western Asset's Unconstrained Portfolios

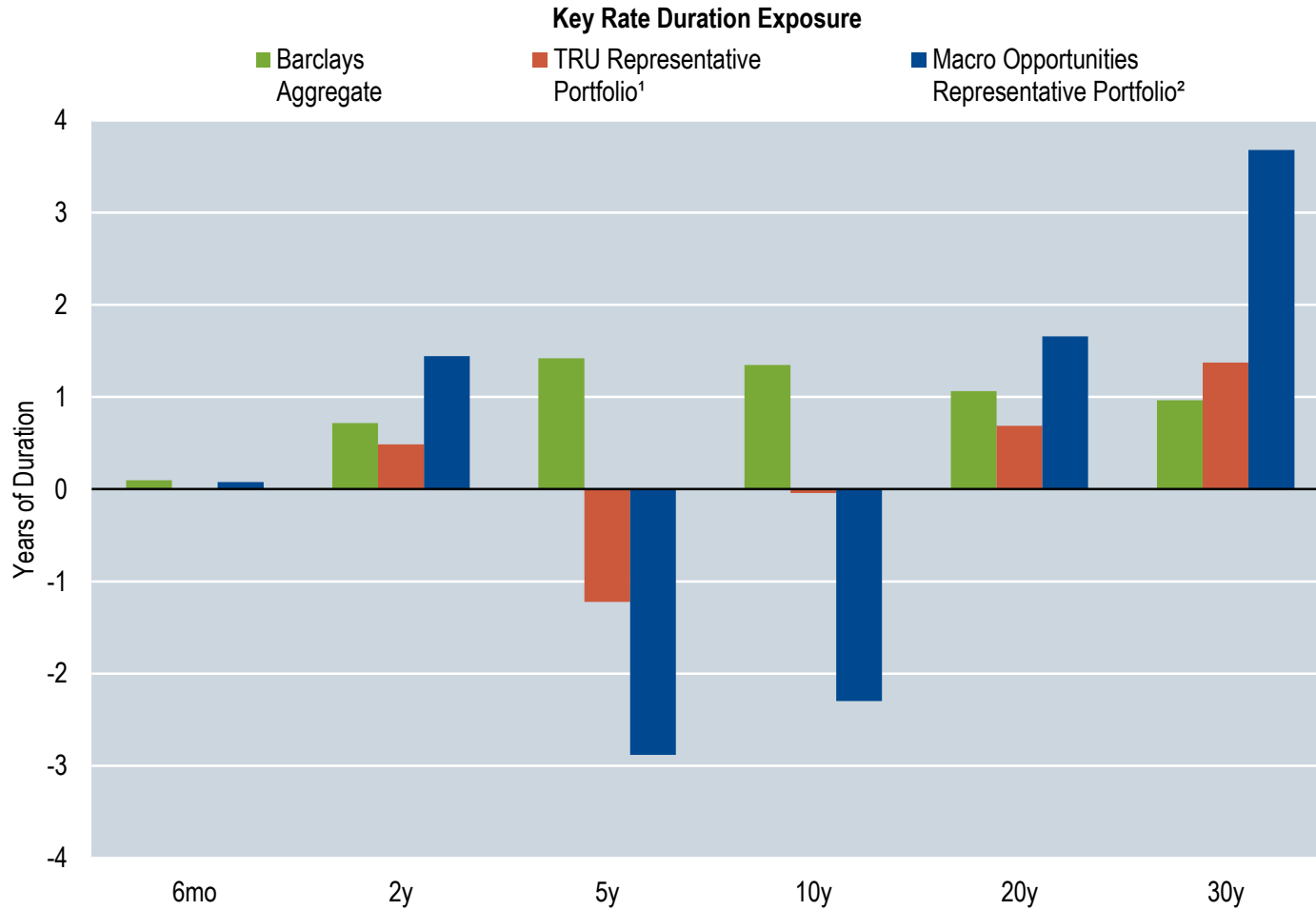


Source: Barclays, Western Asset

<sup>1</sup>The information provided is supplemental to the Total Return Unconstrained (TRU) Bond Composite. Please see performance disclosure in the appendix.

<sup>2</sup>The information provided is supplemental to the Macro Opportunities Composite. Please see performance disclosure in the appendix.

# Curve Exposure in Western Asset's Unconstrained Portfolios



Source: Barclays, Western Asset. As of 30 Jun 14

<sup>1</sup>The information provided is supplemental to the Total Return Unconstrained (TRU) Bond Composite. Please see performance disclosure in the appendix.

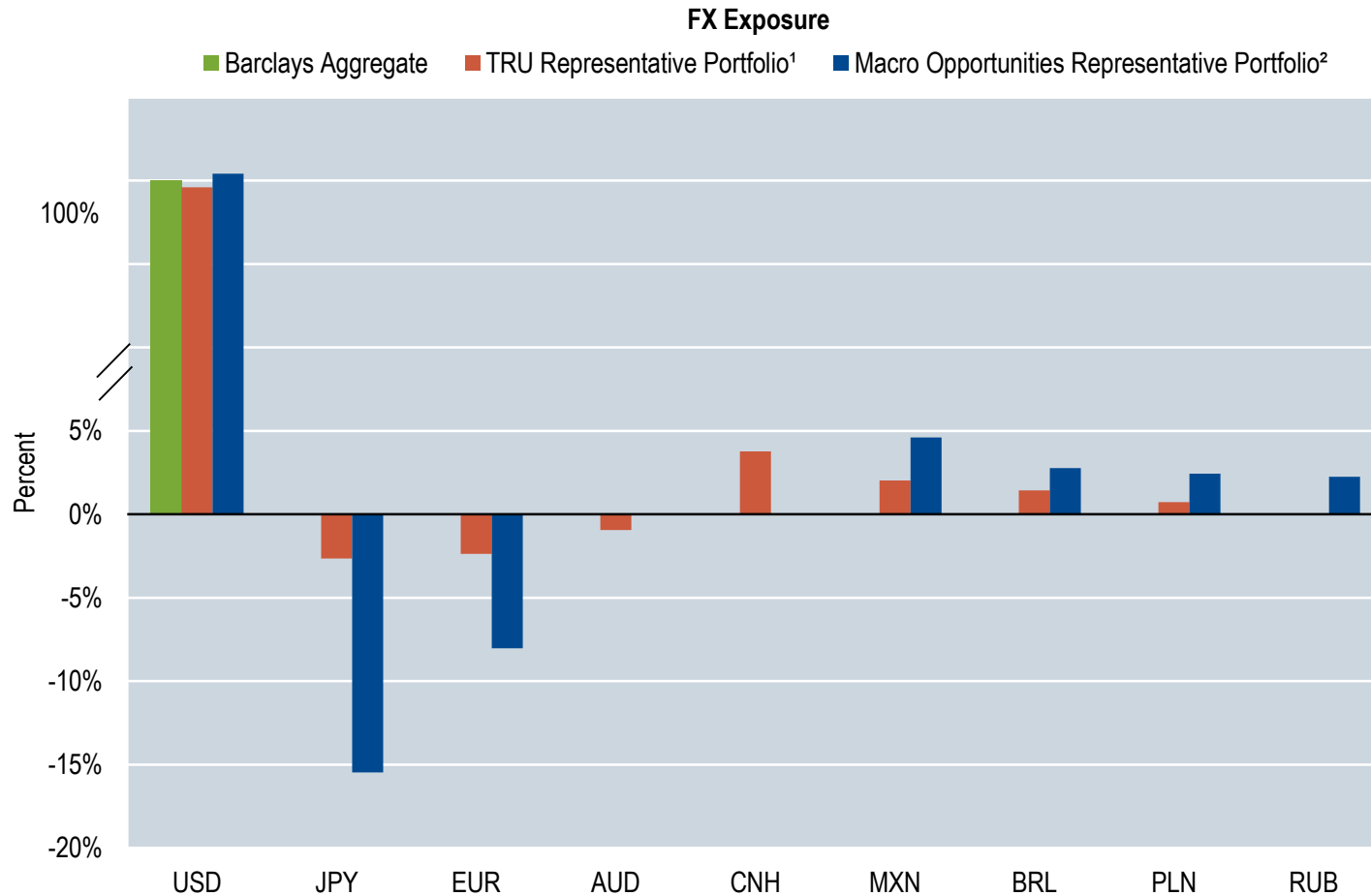
<sup>2</sup>The information provided is supplemental to the Macro Opportunities Composite. Please see performance disclosure in the appendix.

# Business Cycles Not Coordinated Across Countries



Source: Bloomberg As of 31 Oct 14

# Foreign Currency Exposure in Western Asset's Unconstrained Portfolios

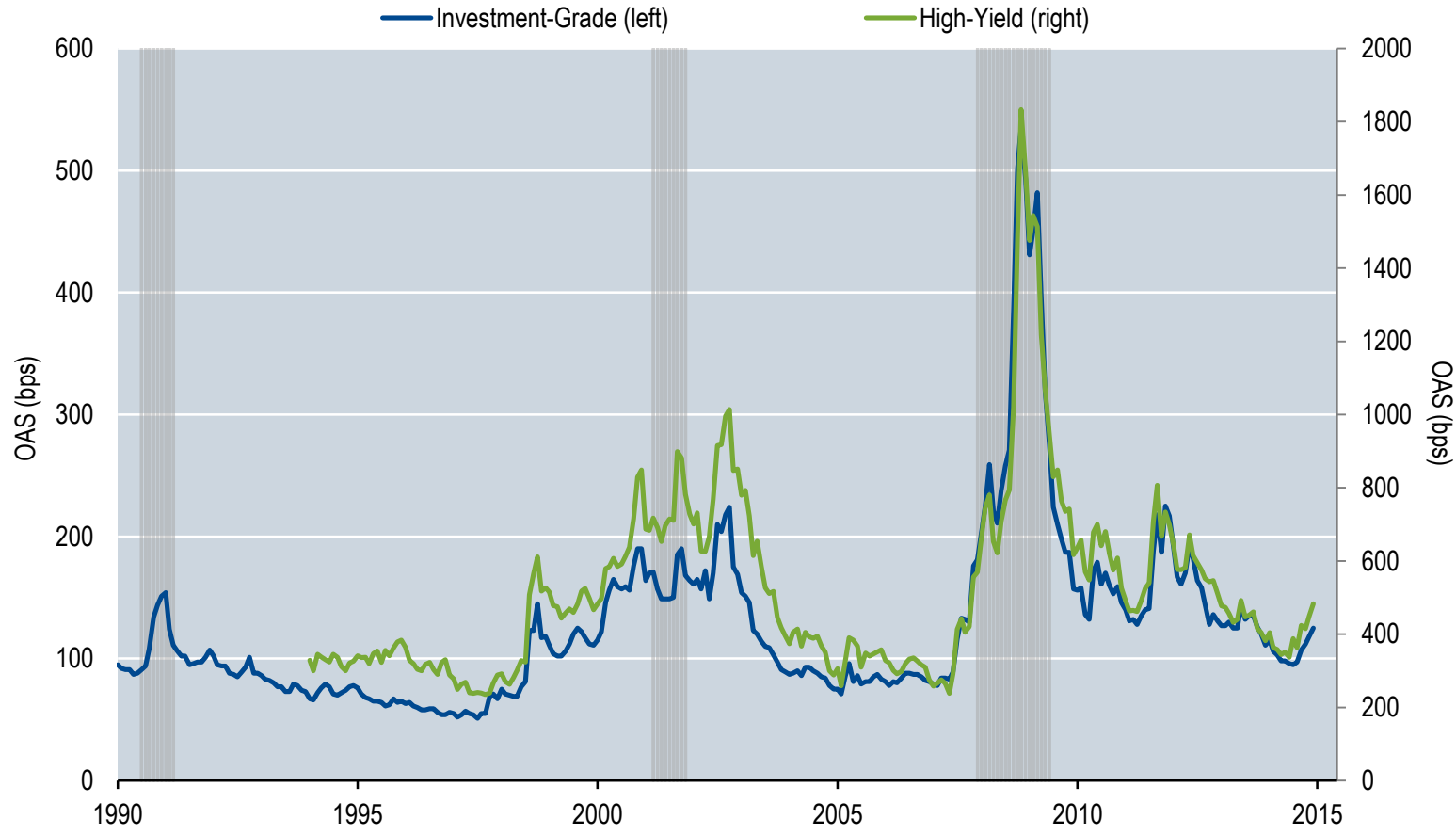


Source: Western Asset. Exposures as of 30 Jun 14

<sup>1</sup>The information provided is supplemental to the Total Return Unconstrained (TRU) Bond Composite. Please see performance disclosure in the appendix.

<sup>2</sup>The information provided is supplemental to the Macro Opportunities Composite. Please see performance disclosure in the appendix.

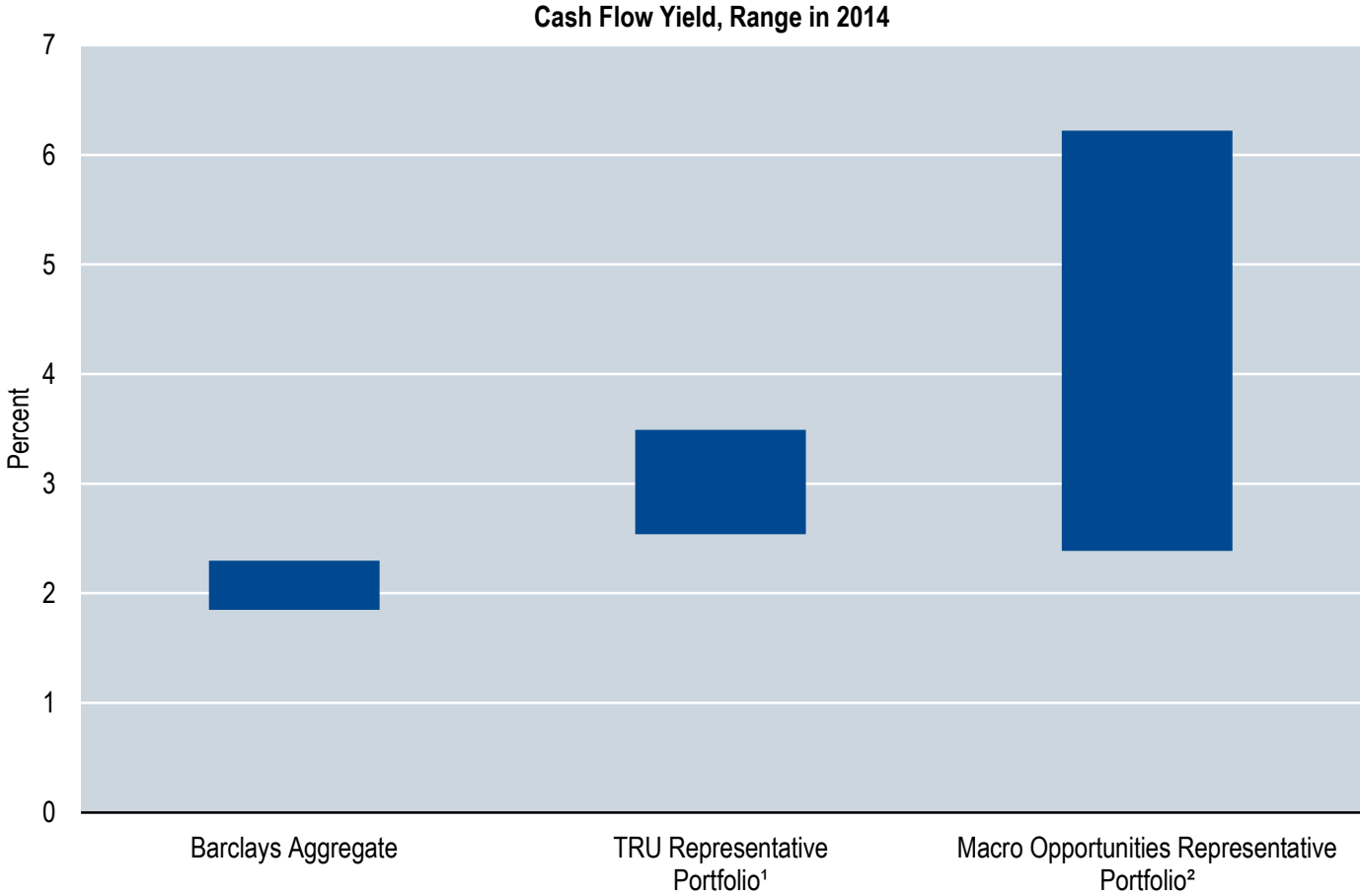
# Spread Product Likely to Remain Attractive



Source: Bloomberg, Barclays. As of 31 Dec 14



# Spread Product in Western Asset's Unconstrained Portfolios



Source: Barclays, Western Asset

<sup>1</sup>The information provided is supplemental to the Total Return Unconstrained (TRU) Bond Composite. Please see performance disclosure in the appendix.

<sup>2</sup>The information provided is supplemental to the Macro Opportunities Composite. Please see performance disclosure in the appendix.

# Summary

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Fed's guidance is Inherently subjective; essentially making a judgment call

Risks to the Fed's outlook are all global

- Oil prices
- US dollar appreciation
- Global Central Bank easing
- Global inflation is falling

Potential advantages of unconstrained bond management

- Interest rate duration and curve flexibility
- Non-US exposures
- Enhanced yield and income

# Appendix

# Performance Disclosure

December 31, 2014

**Western Asset claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Western Asset has been independently verified for the periods from January 1, 1993 to December 31, 2013. The verification report is available upon request.**

Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The verification does not ensure the accuracy of any specific composite presentation.

For GIPS® purposes, the Firm is defined as Western Asset, a primarily fixed-income investment manager comprised of Western Asset Management Company, Western Asset Management Company Limited, Western Asset Management Company Pte. Ltd., Western Asset Management Company Ltd, Western Asset Management Company Pty Ltd, and Western Asset Management Company Distribuidora de Títulos e Valores Mobiliários (DTVM) Limitada, with offices in Pasadena, New York, London, Singapore, Tokyo, Melbourne, São Paulo, Hong Kong, and Dubai. Each Western Asset company is a wholly owned subsidiary of Legg Mason, Inc. ("Legg Mason") but operates autonomously, and Western Asset, as a Firm, is held out to the public as a separate entity. Western Asset Management Company was founded in 1971.

The Firm is comprised of several entities as a result of various historical acquisitions made by Western Asset and their respective performance has been integrated into the Firm in line with the portability requirements set forth by GIPS.

The Composite is valued monthly. The Composite returns are the asset-weighted average of the performance results of all the accounts in the Composite. Gross-of-fees returns are presented before management fees, but after all trading expenses. Net of fees results are calculated using a model approach whereby the current highest tier of the appropriate strategy's fee schedule is used. This model fee does not reflect the deduction of performance based fees. The portfolios in the Composite are all actual, fee-paying and performance fee-paying, fully discretionary accounts managed by the Firm for at least one full month. Investment results shown are for taxable and tax-exempt accounts and include the reinvestment of all earnings. Any possible tax liabilities incurred by the taxable accounts have not been reflected in the net performance. Composite performance results are time-weighted net of trading commissions and other transaction costs including non-recoverable withholding taxes. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The returns for the accounts in the Composite are calculated using a time-weighted rate of return adjusted for weighted cash flows. The returns for commingled funds in the Composite are calculated daily using net value (NAV), adding back the funds' total expense ratio or equivalent. Trade date accounting is used since inception and market values include interest income accrued on securities held within the accounts. Performance is calculated using asset values denominated in a base currency. Composite market value at year-end presented in the schedule are translated to U.S. dollars using end of year exchange rates.

Composite returns are measured against a benchmark. The benchmark is unmanaged and provided to represent the investment environment in existence during the time periods shown. For comparison purposes, its performance has been linked in the same manner as the Composite. The benchmark presented was obtained from third party sources deemed reliable but not guaranteed for accuracy or completeness. Benchmark returns and benchmark three-year annualized ex-post standard deviation are not covered by the report of independent accountants.

Internal dispersion is calculated using the asset-weighted standard deviation of annual gross returns of those portfolios that were included in the Composite for the entire year. For each annual period, accounts with less than 12 months of returns are not represented in the dispersion calculation. Periods with five or fewer accounts are not statistically representative and are not presented. The three-year annualized ex-post standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. Any gross total three-year annualized ex-post standard deviation measures prior to 2011, included within the "Examination Period" identified above, are not covered by the report of independent accountants.

Past investment results are not indicative of future investment results.

Western Asset's list of composite descriptions is available upon request. Please contact Jan Pieterse at 626-844-9977 or [jan.pieterse@westernasset.com](mailto:jan.pieterse@westernasset.com). All returns for strategies with inception prior to January 1, 2005 are available upon request.

# Performance Disclosure

December 31, 2014

## Total Return Unconstrained (TRU) Bond Composite

Composite Inception Date: 07/01/2004 | Composite Creation Date: 10/01/2004

|      | No. of<br>Accts | Gross Total<br>Return | Net Total<br>Return | Benchmark<br>Total Return | Gross Total<br>3-Yr St Dev | Benchmark Total<br>3-Yr St Dev | Internal<br>Dispersion | Mkt. Value<br>(US\$mil) | Percentage of<br>Firm Assets | Firm Assets<br>(US\$mil) |
|------|-----------------|-----------------------|---------------------|---------------------------|----------------------------|--------------------------------|------------------------|-------------------------|------------------------------|--------------------------|
| 2005 | 1               | 3.86%                 | 3.24%               | -na-                      | -na-                       | -na-                           | -na-                   | \$1,487                 | 0.60%                        | \$249,233                |
| 2006 | 3               | 7.25%                 | 6.62%               | -na-                      | -na-                       | -na-                           | -na-                   | \$3,472                 | 0.68%                        | \$510,172                |
| 2007 | 4               | 2.53%                 | 1.92%               | -na-                      | 2.19%                      | -na-                           | -na-                   | \$5,410                 | 0.87%                        | \$621,493                |
| 2008 | 4               | -14.62%               | -15.14%             | -na-                      | 7.18%                      | -na-                           | -na-                   | \$5,294                 | 1.05%                        | \$505,660                |
| 2009 | 4               | 32.41%                | 31.64%              | -na-                      | 9.37%                      | -na-                           | -na-                   | \$4,585                 | 0.95%                        | \$482,218                |
| 2010 | 4               | 9.42%                 | 8.77%               | -na-                      | 9.45%                      | -na-                           | -na-                   | \$4,442                 | 0.98%                        | \$453,909                |
| 2011 | 4               | 1.74%                 | 1.14%               | -na-                      | 5.97%                      | -na-                           | -na-                   | \$4,019                 | 0.91%                        | \$443,140                |
| 2012 | 3               | 9.91%                 | 9.26%               | -na-                      | 2.99%                      | -na-                           | -na-                   | \$4,113                 | 0.89%                        | \$461,891                |
| 2013 | 4               | 2.20%                 | 1.59%               | -na-                      | 2.63%                      | -na-                           | -na-                   | \$4,968                 | 1.10%                        | \$451,632                |
| 2014 | 5               | 3.46%                 | 2.84%               | -na-                      | 2.07%                      | -na-                           | -na-                   | \$5,709                 | 1.23%                        | \$466,036                |

**Description:** Western Asset's Total Return Unconstrained (TRU) Bond Composite includes portfolios that employ actively managed, diversified fixed-income portfolios. Portfolio construction is based on Western Asset's fundamental view of the fixed-income markets and is independent of broad market benchmarks. The approach is to construct a portfolio in which the manager intends to actively manage sector, duration and term structure exposure.

**Objective:** Maximize return consistent with the current market environment and outperform the broad market over the course of a market cycle.

**Benchmark Description:** The Composite is not measured against a benchmark as accounts that may comprise the Composite are measured on an absolute return basis. There is no benchmark available that appropriately reflects the guidelines of all accounts within the Composite.

**Base Currency:** USD | **Composite Minimum:** No minimum asset size requirement.

**Current Fee Schedule:** .60 of 1% on first US\$100 million, .40 of 1% on amounts over US\$100 million.

**Examination Period:** The Composite has been examined for the period from July 1, 2004 to December 31, 2013.

# Performance Disclosure

December 31, 2014

## Macro Opportunities Composite

Composite Inception Date: 04/01/2012 | Composite Creation Date: 05/14/2012

|                   | No. of<br>Accts | Gross Total<br>Return | Net Total<br>Return | Benchmark<br>Total Return | Gross Total<br>3-Yr St Dev | Benchmark Total<br>3-Yr St Dev | Internal<br>Dispersion | Mkt. Value<br>(US\$mil) | Percentage of<br>Firm Assets | Firm Assets<br>(US\$mil) |
|-------------------|-----------------|-----------------------|---------------------|---------------------------|----------------------------|--------------------------------|------------------------|-------------------------|------------------------------|--------------------------|
| 2005              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$249,233                |
| 2006              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$510,172                |
| 2007              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$621,493                |
| 2008              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$505,660                |
| 2009              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$482,218                |
| 2010              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$453,909                |
| 2011              | -na-            | -na-                  | -na-                | -na-                      | -na-                       | -na-                           | -na-                   | -na-                    | -na-                         | \$443,140                |
| 2012 <sup>1</sup> | 1               | 17.28%                | 16.77%              | -na-                      | -na-                       | -na-                           | -na-                   | \$112                   | 0.02%                        | \$461,891                |
| 2013              | 2               | 7.57%                 | 6.85%               | -na-                      | -na-                       | -na-                           | -na-                   | \$745                   | 0.16%                        | \$451,632                |
| 2014              | 7               | 9.66%                 | 8.67%               | -na-                      | -na-                       | -na-                           | -na-                   | \$5,157                 | 1.11%                        | \$466,036                |

**Description:** Western Asset's Macro Opportunities Composite is an unconstrained, global macro strategy that focuses on long-term value investing and active management of duration, yield curve and volatility. It does this primarily by identifying relative value among securities and sectors in global fixed-income markets.

**Objective:** Maximize total return.

**Benchmark Description:** The Composite is not measured against a benchmark as accounts that may comprise the Composite are measured on an absolute return basis. There is no benchmark available that appropriately reflects the guidelines of all accounts within the Composite.

**Base Currency:** USD | **Composite Minimum:** US\$1 million

**Current Fee Schedule:** 1% on all assets.

**Examination Period:** The Composite has been examined for the period from April 1, 2012 to December 31, 2013.

<sup>1</sup>Partial period return (April 1, 2012 to December 31, 2012).

# Risk Disclosure

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