

Western Asset

Current Market Muni Portfolios

Market overview

While the recession hasn't officially been declared over, economic data released during the fourth quarter indicated that the lengthiest recession since the Great Depression has likely concluded. Looking back, the Commerce Department reported that U.S. gross domestic product ("GDP")¹ growth was -6.4% during the first quarter of 2009. The economy then contracted a more modest 0.7% during the second quarter. After declining for four consecutive quarters, GDP in the third quarter was a positive 2.2%.² A variety of factors helped the economy to expand, including the government's \$787 billion stimulus program and its "Cash for Clunkers" car rebate program, which helped spur an increase in car sales. While the Commerce Department's initial estimate for fourth-quarter GDP won't be released until late January 2010, it's possible that economic growth accelerated during that period.

In terms of Federal Reserve Board ("Fed")³ monetary policy, it continued to hold short-term interest rates at an historic low of zero to 0.25% during the fourth quarter. The Fed has now kept short-term rates steady for more than a year. In conjunction with its December 2009 meeting, the Fed said that it "will maintain the target range for the federal funds rate at 0 to 0.25% and continues to anticipate that economic conditions – including low rates of resource utilization, subdued inflation trends, and stable inflation expectations – are likely to warrant exceptionally low levels of the federal funds rate for an extended period."

As one would expect given overall positive news regarding the economy, both short- and long-term U.S. Treasury yields rose over the quarter, with the yield on the 2-year Treasury moving from 0.95% to 1.13% and the yield on the 10-year Treasury rising from 3.31% to 3.83%.⁴ The yield curve⁵ steepened

during the period, as long-term rates moved higher than their short-term counterparts given expectations for higher inflation down the road. Continuing the trend that began earlier in the year, the taxable spread sectors (non-U.S. Treasuries) outperformed equal-duration U.S. Treasuries during the fourth quarter. Over the three-month period, lower-quality securities generated solid results, as investor risk appetites remained strong as they searched for higher yields given the relatively low interest rate environment.

After posting exceptional returns over the first nine months of the year, the municipal bond market took a small step backward during the fourth quarter. The tax-free market sold off in October, as a large new issuance calendar was met with moderating investor demand. While municipal bonds prices rose in November and December, it was not enough to overcome their earlier weakness. During the quarter, shorter-term municipal bonds outperformed longer-term securities and higher quality issues generated relatively better results than their lower-quality counterparts. As was the case with Treasuries, the municipal yield curve steepened during the last three months of the year. During that time, the yield on 1-year AAA municipal securities moved from 0.37% to 0.28% and the 30-year segment rose from 3.87% to 4.15%.⁶

Portfolios highlights

The portfolios lagged their benchmark during the fourth quarter. Our yield curve positioning was a negative, as we employed a barbell strategy, emphasizing both long- and short-term securities. This approach was not beneficial, as using a bulleted strategy in the five-year portion of the curve produced better results. An out-of-index exposure to longer-term bonds also detracted from performance as they lagged shorter-term municipal securities. In addition, the portfolios' cash position was a drag on their results given the low yields available from short-term instruments. Positively contributing to performance was the portfolios' overweight to state and local general obligation bonds. In addition, the portfolios' quality bias was

¹ Gross domestic product ("GDP") is the market value of all final goods and services produced within a country in a given period of time.

² Source: Bloomberg, 12/09.

³ The Federal Reserve Board ("Fed") is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.

⁴ Source: Bloomberg, 1/10.

⁵ The yield curve is the graphical depiction of the relationship between the yield on bonds of the same credit quality but different maturities.

⁶ Source: Bloomberg, based on the performance of the Barclays Capital Municipal Bond Index and the Barclays Capital U.S. Aggregate Index for the three-month period ended December 31, 2009.

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rewarded, as higher rated municipal bonds outperformed their lower rated counterparts.

Current Market Muni Portfolios - Retail

Annualized returns gross and net of fees

(%) as of December 31, 2009

	Q409	YTD	1-yr	3-yr	5-yr	7-yr	10-yr
Net of fees	-0.39	4.91	4.91	4.04	2.74	2.23	3.28
"Pure" gross of fees	-0.02	6.48	6.48	5.60	4.27	3.76	4.82
Barclays Capital 5-Year Muni Bond Index	0.55	7.40	7.40	6.11	4.50	4.19	5.24

Quarterly and YTD numbers are not annualized. Please see the GIPS® Endnotes on the back page of this document for important additional information. **Past performance is no guarantee of future results.**

Outlook

Looking ahead, while the recession may be over, we don't expect to see a resumption of robust growth in 2010. Consumer spending, which makes up approximately two-thirds of GDP, could continue to be strained given the headwinds associated with the weak job market and slowly recovering housing prices. Given this, we expect inflation to remain benign and the Fed to be sensitive to the impact associated with raising short-term interest rates. We have a somewhat cautious near-term outlook for the municipal market, as state and local governments continue to experience budgetary challenges. However, we have a positive view on the long-term prospects for the municipal bond market. Demand for tax-exempt bonds should remain solid given the demographic trends in the U.S. and the likelihood that state and federal tax rates will move higher.

Western Asset Current Market Muni Portfolios

All opinions and data included in this market commentary are as of the date indicated and are subject to change. The opinions and views expressed herein are those of the portfolio managers specified and may differ from those of other managers or the firm as a whole, and they are not intended to be relied upon as predictions or forecasts of actual future events or performance, or a guarantee of future results or investment advice. The information contained should not be used as the sole basis to make any investment decision. The statistics have been obtained from sources believed to be reliable, but the accuracy and completeness of this information cannot be guaranteed. **Past performance is no guarantee of future results.** All investments involve risk, including possible loss of principal amount invested. There is no guarantee that investment objectives will be met. An investor cannot invest directly in an index. Investments are not FDIC insured or guaranteed by any government agency. Values may fluctuate due to market conditions and other factors.

Risks

For tax-exempt securities, certain investors may be subject to the Federal Alternative Minimum Tax, and state and local taxes may apply. Capital gains, if any, are fully taxable. Please see "Important tax information" that follows. Fixed-income securities are subject to interest rate risk. As interest rates rise, the price of fixed-income securities declines."

There is also a risk that an issuer will be unable to make principal and/or interest payments.

State-specific and state-biased portfolios within Western Asset Current Market Muni Portfolios focus on individual states and are more vulnerable to losses caused by adverse developments in those states than are national portfolios, which diversify investments across multiple states.

Definitions

The Barclays Capital 5-Year Municipal Bond Index is a market-value-weighted index representative of the medium term (four to six years) tax-exempt bond market. Please note that an investor cannot invest directly in an index.

U.S. Treasuries are direct debt obligations issued and backed by the "full faith and credit" of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity.

General obligation municipal bonds are backed by the credit and taxing power of the issuing jurisdiction rather than the revenue of a given project.

Professional money management may not be suitable for all investors.

Important tax information

Legg Mason, Inc, its affiliates, and its employees are not in the business of providing tax or legal advice to taxpayers. These materials and any tax-related statements are not intended or written to be used, and cannot be used or relied upon, by any taxpayer for the purpose of avoiding tax penalties. Tax-related statements, if any, may have been written in connection with the "promotion or marketing" of the transaction(s) or matter(s) addressed by these materials, to the extent allowed by applicable law. Any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.

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Client portfolios are managed based on investment instructions or advice provided by one or more of the following Legg Mason-affiliated investment management firms, as indicated in portfolio names or otherwise: ClearBridge Advisors, LLC, Western Asset Management Company, Brandywine Global Investment Management, LLC, Global Currents Investment Management, LLC, and Legg Mason Capital Management, Inc. ("LMCM"). Management is implemented by Legg Mason Private Portfolio Group, LLC or, in the case of certain programs, by the program sponsor or its designee

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WESTERN ASSET CURRENT MARKET MUNI-SCHEDULE OF INVESTMENT PERFORMANCE RESULTS –GIPS® Endnote
(January 1, 1999 through December 31, 2008)

Year	Net return (%)	"Pure" gross return (%)	Benchmark total return (%)	% of bundled fee portfolios in the composite	No. of Portfolios	Composite dispersion (%)	Composite assets (\$mm)	% Of firm assets
1999*	-1.44	0.04	0.73	100	607	0.56	-	-
2000*	7.23	8.81	7.71	100	555	0.75	-	-
2001*	3.69	5.23	6.21	100	619	0.45	-	-
2002*	6.43	8.00	9.27	100	680	0.99	-	-
2003*	1.65	3.17	4.13	100	709	0.40	-	-
2004*	0.32	1.82	2.72	100	791	0.25	-	-
2005*	-0.31	1.19	0.95	100	2,248	0.23	1,951	-
2006	1.93	3.46	3.34	100	2,059	0.20	2,000	0.39
2007	3.40	4.95	5.15	100	1,864	0.24	1,995	0.32
2008	3.82	5.37	5.78	100	1,961	0.79	1,954	0.39

Western Asset has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). A complete list and description of the firm's composites is available upon request. Western Asset has been verified for the periods January 1, 1993 through December 31, 2007. A copy of the verification report is available upon request.

Western Asset, the firm, is a fixed-income investment manager composed of Western Asset Management Company, Western Asset Management Company Limited, Western Asset Management Company Pte. Ltd, Western Asset Management Company Ltd, and Western Asset Management Company Pty Ltd, with offices in Pasadena, New York, London, Singapore, Melbourne and Tokyo. Each Western Asset company is a wholly owned subsidiary of Legg Mason, Inc. ("Legg Mason"), but operates autonomously. Western Asset is held out to the public as a separate firm. Western Asset Management Company was founded in 1971. Western Asset's retail separately managed account (SMA) business was integrated into the firm in January 2006.

Western Asset – Current Market Muni portfolios are discretionary fixed-income portfolios that offer tailored municipal bond management to individual and taxable institutional investors. Western Asset's retail separately managed account business was integrated into the firm in January 2006, and it is currently managed by Western Asset. Effective April 2007, Western Asset manages these portfolios as subadvisor to its affiliate, Legg Mason Private Portfolio Group, LLC. From January 2006 through March 2007, Western Asset portfolio managers managed these portfolios as dual employees of ClearBridge Advisors, LLC, and ClearBridge Asset Management Inc. (each a Western Asset affiliate), following Western Asset's investment process and having access to Western Asset's investment resources, expertise and investment outlook. Previously, these portfolios were managed by an unaffiliated business that was acquired by Legg Mason in December 2005 and subsequently integrated into Western Asset. Net and gross composite returns for periods prior to January 1, 2006* (i) were achieved by this business and not by Western Asset and (ii) do not comply with GIPS. All or substantially all of the individuals responsible for security selection for the portfolios at the unaffiliated business immediately prior to December 2005 joined Western Asset as part of the above-noted integration.

The Western Asset – Current Market Muni composite is composed of accounts that are separately managed accounts (SMAs) managed in accordance with the Western Asset – Current Market Muni strategy. For periods after 2005, all such SMAs without client-imposed restrictions are included. For prior periods, the composite is composed of a majority of such SMAs, except that for periods prior to 2004, certain SMAs with client-imposed restrictions are also included. Terminated accounts are included through the last month of

management (last quarter prior to 2003). Portfolio returns of included SMAs are weighted according to asset size for periods after 2005 (equal-weighted for prior periods). Additional information about composite returns is available upon request. For comparison purposes, composite returns are shown against returns of the Barclays Capital Municipal Bond Index 5 Year (4-6), which is composed of 35% state general obligation bonds, 50% revenue debt and 15% pre-refunded bonds. Please note that an investor cannot invest directly in an index. The composite was created on January 1, 2006.

Before-tax composite returns are presented "Pure" Gross and Net of fees, are calculated in U.S. dollars, and assume reinvestment of dividends, interest, capital gains and other earnings. "Pure" gross returns do not reflect the deduction of any fees, transaction costs or expenses, and they are presented only as supplemental information to net returns. Net returns reflect the deduction of the anticipated maximum investment management SMA fee of 1.5% applied quarterly. Investment management SMA fees may vary across different financial firms and across different accounts based upon account size and other factors. The SMA fee applied includes custodial, trading, and investment management. Fee schedules of financial firms that offer the portfolios should be requested from such firms. All returns are gross of withholding tax on interest and capital gains, as are benchmark returns.

The dispersion of annual returns is measured by the standard deviation of the asset-weighted portfolio returns represented within the composite. Dispersion for periods during which the composite had five or fewer accounts is not statistically significant and is not presented.

The management fee schedule is as follows: 1.50% on all assets. Actual investment advisory fees incurred by clients may vary.

To receive a complete list and description of Western Asset's composites and/or a presentation that adheres to the GIPS standards, please contact Donny Killian at 212-601-6209 or dkillian@westernasset.com.

Risk

The program manager(s) may, to a limited extent, invest in other securities entailing additional risks beyond those highlighted in this profile. All investments involve risk, including possible loss of principal. An investor cannot invest directly in an index. Past performance is no guarantee of future results. All investments involve risk, including possible loss of principal