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News Release

For Immediate Release

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WESTERN ASSET CIO CONTINUES TO BE MODERATELY OPTIMISTIC ABOUT PROSPECTS FOR GLOBAL ECONOMIC GROWTH

FIXED-INCOME INVESTMENT OPPORTUNITIES FOR 2015 WILL VARY WIDELY ACROSS MARKETS AND SECTORS

(Pasadena, CA, December 11, 2014) – In his latest webcast on the prospects for worldwide fixed-income markets, **S. Kenneth Leech, Chief Investment Officer of Western Asset Management**, a Legg Mason affiliate, made the case that weak global economies continue to make forecasting difficult.

“I think we all recognize as we come into the close of 2014 that it has been a pretty interesting year,” Ken Leech told the audience. “Maybe an interesting year in the Chinese curse of that sense, both opportunity and risk pretty apparent.”

“It’s really best characterized as a two steps forward, one step back kind of process. And I think 2014 broadly conformed to that. We’ve had some positives. Growth has been moderate in the U.S.; it’s been moderate abroad.”

The webcast can be accessed via this link:
http://www.westernasset.com/us/en/research/viewwebcasts.cfm?mvar=120414

“When we look back at 2014, I think the year really reinforced the importance of attacking your fixed-income portfolio design,” Mr. Leech advised. “Not just from a sector and issue-specific basis, which is obviously crucial, but also using macroeconomic strategies that help provide balance for the portfolio during those times when you have the ‘one step back’ scenario. This is obviously very important in maintaining the ability to provide return while mitigating risk.”

Prospects for 2015 feature much the same starting point, in Mr. Leech’s view.

“When we look at the year coming up, we think that while global growth is slow, it’s going to improve very, very mildly from last year — that’s a pretty low bar, to be fair. But when we look around the world, the US is the real bright spot. It still has an ongoing recovery and moderate growth remains in place. Our rough starting forecast is 2.5 percent for next year. That might be a little bit less than the Federal Reserve’s (Fed’s) 3 percent optimism, but not as much difference as we’ve had in other years. So, that’s a pretty good story for the recovery. It should be a pretty good year for spread product.”

Europe, on the other hand, should be more problematic.

“European growth has been faltering. We’ve been very pessimistic on the outlook for European growth,” Mr. Leech said. “The challenge there is that growth is just very, very, very slow. So, our growth forecast of under 1 percent next year is still less than the consensus.”

"Where we are a little more optimistic probably is in China," he observed. "China's obviously a tough place to read; the data's a little bit opaque; you can't be overly confident. But our feeling is that they're managing the process of a transition to slower rates of growth over time. For 2014, it looks like they're going to hit their target. We think in 2015, something like a 7 percent growth rate would be achievable."

"Japan is a really tough one," Mr. Leech continued. "That recovery has downshifted—perhaps even into technical recession … So, that is not going to be a major contributor to global growth."

"Then we look at emerging markets," he said. "From a growth perspective, this still is the fastest growing segment and is contributing to global growth."

In terms of the macroeconomic impact on bond markets, Mr. Leech was strong and direct.

"The big story, as we all know, is Europe. The change in expectations in Europe has been really pretty spectacular. We've had to go all the way to negative interest rates in the European Central Bank (ECB). We've had quantitative easing (QE) with the covered bonds. We believe it will have sovereign QE early next year. The ECB has really had to change policy pretty aggressively and the expectation is that those rates will be in place for quite some time. And to be fair, that's actually one of the reasons why the US bond market rally has been as strong as it is."

Mr. Leech went on to discuss markets and sectors that fixed-income investors should consider. The energy sector, with specific reference to oil (the price of which, he observed, has declined 35 percent in recent months), provided much of his focus.

"Our investment in the energy sector, we're about 50 percent underweight, has been a positive for us," he reported. "We've been over two times invested in cable and satellites, and our biggest overweight, of 240 percent of the index, has been in senior bank paper. So from our perspective, it's still extremely important what sectors of the market you're in."

"One of the things we have done is put together an oil task force to look at all the different risks and scenario analyses of how sectors, whether in emerging corporates, emerging markets, stand-alone sovereigns, high-yield or investment-grade, will perform to changes in the energy price … The dramatic decline in some of these sectors actually presents an opportunity. There are many companies that we believe can be very, very strong performers, even with energy prices at the current level or even below, that have been hit unduly hard. And so, you should expect to see us increasing our exposure to this sector modestly."

"One of the unseen challenges, which could develop over the next three months if oil prices don't move, is the possibility of challenges with respect to loans to some companies that might've needed a higher price of oil to break even. There could also be banking challenges—even in some of the countries that are dependent on oil exports. We need to be very thoughtful about those kinds of shortfalls. We expect to see some curtailment of capital expenditure in that and then in the oil sector, et cetera."

Mr. Leech concluded his overview on an upbeat note.

"While we do see that there's been a modest downshift in global growth and we do think that global inflation is very subdued, we expect monetary accommodation and the same kind of slow-but-steady process of this recovery to continue," he said. "And that gives us the basic thrust of our portfolio, which continues to be overweight in the spread product sectors, taking advantage of the higher yields than Treasuries, but occasionally using opportunistic views of duration to try and mitigate any downside risks."

Asked during the Q&A session about the ECB's recent pronouncements, including the possibility of QE, Mr. Leech was hopeful.

"Our basic premise continues to be that they will need to do QE on a sovereign basis. We do believe that the politics will come together for that and, our best guess is that we will see QE late in the first quarter of next year. We think that it is true that there are structural impediments to the ECB's moving forward, but we think that it's moving very, very aggressively or as aggressively as it can within the constraints it faces to expand its balance sheet. And we think it'll be successful in doing that."

Questioned about the Fed becoming more hawkish, and the possibility that it may tighten monetary policy more quickly than signaled, Mr. Leech sounded a cautionary tone.

"It doesn't take a lot of arithmetic to understand that the US Treasury market is overpriced. And I think that has given investors a desire to be very short this year, and that's been unsuccessful."

Of the Fed he continued, "On the one hand, they want to get the funds rate off zero; on the other hand, they don't want to impede the forward progress of the recovery. It's that latter point that we focus on because that's what's important to the portfolio as a whole. Whether it's a quarter later or in June or September is not as important, I think, for a long-term investor as the construct that they will do nothing to impede the US recovery."

Mr. Leech said he doubts that the decline of German bonds will lead to problems in Europe that will be as significant as Japan's have been over the past 20 years.

"When you look at some of the monetary signals – forward-looking signals – there's actually some rays of hope," he said. "It's going to take time; you have to be patient. But no, we do not think Europe is going the way of Japan."

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About Kenneth Leech

As Chief Investment Officer, Ken Leech oversees the firm's interest rate strategy and leads the long duration effort. Mr. Leech joined Western Asset Management in 1990. In 1998, he was named CIO and spearheaded the performance and product development efforts that helped underpin Western Asset's global growth and success. After taking medical leave for much of 2008, Mr. Leech resumed investment duties in early 2009 and was named chairman of the global strategy committee. In this position, he directed global portfolio management and the macro-strategy alternative efforts. In 2013 he became Co-CIO as part of the transition process, before fully resuming the CIO role in April 2014.

From 2002 to 2004, Mr. Leech served as a member of the U.S. Department of Treasury's Borrowing Committee. Prior to joining Western Asset, he spent much of his career focusing on proprietary trading, including with Greenwich Capital (1988–1990) and the First Boston Corporation (1980–1988). In his four years at the University of Pennsylvania's Wharton School, Mr. Leech obtained three degrees while graduating summa cum laude.

Mr. Leech and Western Asset were named US Fixed-Income Core and Core Plus Managers of the Year by Institutional Investor in 2013 and Morningstar's Fixed-Income Manager of the Year in 2004. Together Mr. Leech and the firm were among four finalists for Morningstar's award in 2003 and 2006. In 2007, Mr. Leech was named to the Fixed-Income Analysts Society's (FIASI) Hall of Fame.

About Western Asset Management

Western Asset Management is one of the world's leading fixed-income managers with $472 billion in assets under management as of September 30, 2014. The firm is a wholly owned, independently operated subsidiary of Legg Mason, Inc. (NYSE: LM) From offices in Pasadena, Hong Kong, London, Melbourne, New York, São Paulo, Singapore, Tokyo and Dubai, the company provides investment services for a wide variety of global clients, across an equally wide variety of mandates.

About Legg Mason

Legg Mason is a global asset management firm, with $707 billion in AUM as of November 30, 2014. The Company provides active asset management in many major investment centers throughout the world. Legg Mason is headquartered in Baltimore, Maryland, and its common stock is listed on the New York Stock Exchange (symbol: LM).

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