Western Asset Product Commentary

MACRO OPPORTUNITIES:
A FLEXIBLE APPROACH TO MACRO INVESTING
Macro Opportunities: A Flexible Approach to Macro Investing

Introduction

In 2012, Western Asset set out to develop an aggressive, unconstrained fixed-income strategy—Macro Opportunities (MO)—to offer our clients the opportunity to generate returns in a slow-growth, low-rate environment. It needed to be both opportunistic and defensive, yet offer a compelling risk/reward profile.

At that time, excessive monetary accommodation gave rise to the conundrum of zero interest-rate policies. If rates stayed “low for long,” it would remain difficult to generate positive fixed returns; if rates were to rise, however, it would be difficult to preserve capital. What was an investor to do?

With these investors in mind, we designed the MO strategy to provide concentrated and opportunistic exposure to Western Asset’s key themes, with an emphasis on active management of macro risk factors. The thought process centered on our belief that if we could provide meaningful macro offsets during periods when our spread product themes were out of favor, our value style of investing could provide compelling returns over the long run. Additionally, if actively managed macro themes could also provide an independent source of return, the combination could be powerful. We designed MO to be aggressive with a volatility limit not to exceed 10% over a market cycle.

Furthermore, our robust global platform would allow us to execute the strategy and showcase our strongest ideas. Over the past 40 years, our business has grown to include trading operations in seven countries—using our team-based approach we always know our best ideas across the globe.

Now, over five years later, MO has been successfully tested in challenging markets—both up and down. This paper lays out how the strategy responded to those challenges, using a flexible approach to seek diversified sources of return for our clients.

Dislocations Should Create Opportunities for Investors, Regardless of the Direction of Rates

We believe the interconnectedness of global markets and the increased importance of central bank policy will continue to fuel dislocations that create opportunities for MO investors—regardless of the direction of rates.

These dislocations are particularly suitable for a value investor like Western Asset. We believe markets misprice securities for three main reasons: 1) greed and fear, 2) supply and demand, including non-economic players like central banks and 3) lack of a long-term investment horizon. Due to any combination of these factors, prices can deviate from fundamental fair value, but over time, prices typically adjust to reflect inflation, credit fundamentals and liquidity conditions. We believe consistently investing in undervalued securities will deliver attractive investment returns over the long term.

But there are also economic opportunities that arise as the outlook for growth, inflation and liquidity conditions change. These macro factors have exerted tremendous influence in the markets since the crisis of 2008. Last year alone, 30-year Japanese government bond yields had declined nearly 60 basis points (bps) from historically low levels, with similar declines in many other G-10 countries. The ability to express meaningful views through positions in duration, yield curve placement and changes in volatility in global interest-rate markets affords directional as well as relative value opportunities. The strategy’s risk budget...
comes predominantly from these macro factors. As an example of how we express these views, Exhibit 1 shows MO’s duration flexibility since its inception. While we actively manage duration exposure, the analytic duration shown in the chart, is not considered in isolation. Because we hold corporate and emerging market bonds, we consider some portion of our portfolio duration to be “soft” duration. Soft duration is our reference to the reality that these instruments can have vastly different volatilities and opportunity sets, based on their sensitivity to risky cash flows or default expectations rather than solely to changes in interest rates.

A key aspect of the strategy centers on risk measurement and risk management—elements integral to our investment process. We seek to control risk through active risk management, evaluating and sizing the portfolio for what we believe the environment will be. Natural hedges combined with our value philosophy form the backbone of a tightly controlled risk process.

Source:  Western Asset.  As of 31 May 17
We Now Have a Five-Plus-Year Track Record for Clients to Assess the Success of the Strategy

Macro Opportunities has performed well on an absolute and risk-adjusted basis considering its realized volatility. In the 62 months since its inception, the strategy has returned a gross total of over 71% with an ex-post volatility of 6.1%. With the average annualized return of 10.9% it has a Sharpe Ratio of 1.6 and a Sterling Ratio (ratio of average annualized return to maximum drawdown) of 1.2.

Further, we believe the frequency, depth and length of drawdown are particularly attractive. Over the life of the strategy, MO has drawn down more than 5% four times, and each time has returned to make a new high water mark within 12 months or less. Exhibit 2 shows the periods of drawdown highlighting the event that initially moved the market.

Macro Opportunities Has Been Stress-Tested Through Some Very Turbulent Times

As an example, some of the more challenging times since 2012 have included accelerating bankruptcies in Spanish provinces, the beginning of the “taper tantrum” in summer 2013, the surprise China devaluation in 2015, and many others. All the while, due to active management, MO returns provided strong diversification to other broad segments of global markets. Exhibit 3 shows MO regressed against a broadly diversified global portfolio. Note the significance of the alpha component, which is the component of total return that cannot be ascribed to any of the index factors. We believe our style of investing and active management of macro factors help create these low correlations.

<table>
<thead>
<tr>
<th>Exhibit 3</th>
<th>Historical Beta and Contribution (21 Mar 12 - 31 May 17, Daily Log Returns)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beta Total</td>
<td>25.9%</td>
</tr>
<tr>
<td>Alpha Total</td>
<td>27.0% 2.4 46.0%</td>
</tr>
<tr>
<td>Macro Opportunities Total (Log Return)</td>
<td>52.9%</td>
</tr>
</tbody>
</table>

| Source: Bloomberg, Western Asset. As of 31 May 17  
Note: Log returns were used to show component contributions. These will not match the compound returns. |

A Flexible Strategy for Changing Market Conditions

An interesting example of the versatility of MO is the December 2013-January 2014 period. It was a period when interest rates moved meaningfully in opposite directions in back-to-back months with positive performance for MO in both instances.

In December 2013, the US Federal Reserve (Fed) decided to reduce the pace of its monthly purchases of US Treasury (UST) and mortgage securities in small but equal amounts, signaling its intention to wind down the quantitative easing (QE) program initiated in September 2012.

The response from the market was dramatic; global equity and credit markets rallied and the UST yield curve sold off, led by 5-and 10-year UST rates—10-year rates increased 28 bps—with an impressive flat-
tening in the long end. Although the reduction of purchases was small, it signaled the Fed’s intention to be out of the QE business as soon as possible and to manage future expectations solely through forward guidance. This was exactly what the market wanted to hear and it set the stage for a positive risk environment going forward.

Macro Opportunities was positioned with four years of duration with risk positions in investment-grade credit, emerging markets and peripheral European debt. Despite the 28 bps rise in 10-year rates, the strategy delivered 85 bps of performance.

January 2014 was a complete reversal of December 2013. Renewed concerns over a Chinese slowdown pressured emerging markets; foreign exchange selloffs in Turkey and India triggered reluctant rate hikes in those countries, creating a negative loop of growth fears, currency pressures and more rate hikes. Equity markets declined and 10-year UST rates declined 38 bps with the 10-to-30-year curve unchanged.

Macro Opportunities was positioned with three years of duration and similar risk positions, and with the 38 bps decline in US 10-year rates, the strategy delivered 82 bps of performance. While this is an example of a successful scenario, there are no guarantees that we will be “right” every time. Flexible investment guidelines with active duration management provided the ability to take advantage of these disparate opportunities.

The Strategy Serves Multiple Roles in Client Portfolios

With its flexibility and return potential, Macro Opportunities can serve different roles in client portfolios. We have clients who use it as a diversifier to a broad fixed-income portfolio and others who use it as a pure return source in their non-traditional or alternative portfolios. The flexibility, active management and focus on macro risk factors help reduce the correlations to broad financial markets. This is a key value proposition to investors, as the strong diversification impact can help lower the risk in client portfolios. Lower correlations and lower risk give clients flexibility to realize returns in changing market conditions.

Given Our Global Economic Outlook, We Believe Macro Opportunities Is More Relevant to Clients Now Than Ever Before

The current pattern of low growth and low inflation for the global economy poses a great challenge to fixed-income investors. The opportunity to generate large capital gains by passively riding falling market yields is
much lower now than the risk of capital losses that cannot be offset with coupon income over time. As can be seen in Exhibit 4, the broad global fixed-income market, here represented by the Bloomberg Barclays Global Aggregate, has a lower yield and a greater sensitivity to interest rate changes than ever before. Even in the case of slowly increasing global rates—Western Asset’s house view—this seems to provide investors with little return for the risk that they take. This allocation challenge requires strategies that are defensive, yet opportunistic, and that offer diversified, risk-adjusted returns in line with the opportunity set, which is always changing. We believe Macro Opportunities is one such strategy.
Macro Opportunities Composite

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

<table>
<thead>
<tr>
<th>No. of Accs</th>
<th>Gross Total Return</th>
<th>Net Total Return</th>
<th>Benchmark Total Return</th>
<th>Gross Total 3-Yr St Dev</th>
<th>Benchmark Total 3-Yr St Dev</th>
<th>Internal Dispersion</th>
<th>Mkt. Value (US$mil)</th>
<th>Percentage of Firm Assets</th>
<th>Firm Assets (US$mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$505,660</td>
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<tr>
<td>2009</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$482,218</td>
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<td>2010</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$453,909</td>
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<tr>
<td>2011</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$443,140</td>
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<td>2012</td>
<td>1</td>
<td>17.26%</td>
<td>16.77%</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$112</td>
<td>0.02%</td>
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<tr>
<td>2013</td>
<td>2</td>
<td>7.57%</td>
<td>6.85%</td>
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<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$745</td>
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<tr>
<td>2014</td>
<td>8</td>
<td>9.66%</td>
<td>8.67%</td>
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<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$5,184</td>
<td>1.11%</td>
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<tr>
<td>2015</td>
<td>8</td>
<td>2.86%</td>
<td>1.84%</td>
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<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$7,409</td>
<td>1.71%</td>
</tr>
<tr>
<td>2016</td>
<td>9</td>
<td>8.38%</td>
<td>7.31%</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>-na</td>
<td>$7,951</td>
<td>1.86%</td>
</tr>
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</table>

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 with less than 10% annualized volatility.

Benchmark Description: The Composite is not measured against 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: $40 million as of 1/1/16 (previously $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, 2015.

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 and performance examination reports are available upon request.

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 Titulos e Valores Mobiliarios (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 the commingled funds in the Composite are calculated daily using net asset values (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.

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. The three-year annualized ex-post standard deviation is not presented for periods where 36 monthly returns are not available for the composite or the benchmark. 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. All returns for strategies with inception prior to January 1, 2007 are available upon request.
IMPORTANT INFORMATION

There may be differences between the strategy composite and the Legg Mason Western Asset Macro Opportunities Bond Fund including differences in the amount of assets under management, cash flows, fees and expenses, and applicable regulatory requirements, including investment and borrowing restrictions.

The past performance and allocations of the strategy composite may not be indicative of the Legg Mason Western Asset Macro Opportunities Bond Fund over the same period. For more information on the strategy composite see the composite disclosure on the previous page.

This is a sub-fund of Legg Mason Global Funds plc ("LMGF plc"), an umbrella fund with segregated liability between sub-funds, established as an open-ended investment company with variable capital, organised as an undertaking for collective investment in transferable securities ("UCITS") under the laws of Ireland as a public limited company pursuant to the Irish Companies Acts and UCITS regulations. LMGF plc is authorised in Ireland by the Central Bank of Ireland.

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