2Q 2019 | Product Commentary

WESTERN ASSET CORE PLUS BOND FUND

Team-managed

Average annual total returns and fund expenses (%)

as of June 30, 2019

	3-mo	1-yr	5-yr	10-yr	Since Incept.*	Expenses Gross	Expenses Net
Class A Excluding sales charges	3.81	9.06	3.87	N/A	3.95	0.84	0.82
Class A Including effects of maximum sales charges	-0.57	4.43	2.97	N/A	3.33	0.84	0.82
Class I	3.91	9.46	4.28	6.70	6.06	0.52	0.45
Bloomberg Barclays U.S. Aggregate Bond Index	3.08	7.87	2.95	3.90	N/A	-	-

Performance shown represents past performance and is no guarantee of future results. *Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than the original cost. Class A shares have a maximum front-end sales charge of 4.25%.Total returns assume the reinvestment of all distributions at net asset value and the deduction of all Fund expenses. Total return figures are based on the NAV per share applied to shareholder subscriptions and redemptions, which may differ from the NAV per share disclosed in Fund shareholder reports. Performance would have been lower if fees had not been waived and/or reimbursed in various periods. Returns for less than one year are cumulative. For the most recent month-end information, please visit* www.leggmason.com.

Effective June 1, 2017, the Fund changed its security pricing methodology to now use the mean value of the bid and ask prices (of underlying fund holdings) to calculate the NAV. Funds may show a one-time increase of the NAV, which is due to this change in pricing methodology.

* The inception date for Class A is April 30, 2012. The inception date for Class I is July 8, 1998.

Gross expenses are the Fund's total annual operating expenses for the share class(es) shown.Net expenses are the Fund's total annual operating expenses for the share classes indicated and would reflect contractual fee waivers and/or reimbursements, where these reductions reduce the fund's gross expenses. These arrangements cannot be terminated prior to December 31, 2020 without the Board's consent.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is a broad-based bond index consisting of government, corporate, mortgage and asset-backed issues rated investment grade or higher and having at least one year to maturity. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

Market overview

U.S. Treasurys generated a positive return during the second quarter, as both short- and long-term yields declined (yields and prices move in the opposite direction). The spread sectors (non-U.S. Treasurys) also rallied over the quarter. After yields generally moved higher in April, trade concerns dominated May and led to a risk-off environment for much of the month. Yields then moved sharply lower as the Federal Reserve Board ("Fed")[1] indicated it was getting closer to lowering interest rates. Similar accommodative messaging by the European Central Bank (ECB)[2] also contributed to falling global bond yields.

Looking at the U.S. economy, according to the Commerce Department, first quarter 2019 gross domestic product (GDP)[3] annualized growth was 3.1%. In contrast, the economy expanded 2.2% during the fourth quarter of 2018. The

[1] 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.

[2] The European Central Bank is responsible for the monetary system of the European Union and the euro currency.

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

acceleration in GDP growth during the first quarter of 2019 was attributed to positive contributions from exports, personal consumption expenditures, nonresidential fixed investment, private inventory investment, and state and local government spending. These movements were slightly offset by a negative contribution from residential fixed investment. Imports, which are a subtraction in the calculation of GDP, decreased.[4]

The labor market remained tight during the second quarter. The unemployment rate was 3.6% in both April and May—equaling the lowest rate since December 1969. The unemployment rate then ticked up to 3.7%. However, this was partially due to an increase in the workforce participation rate, as it rose from 62.8% in May to 62.9% in June.[5]

The manufacturing sector continued to expand, but the pace moderated during the second quarter. According to the Institute for Supply Management's Purchasing Managers Index (PMI),[6] the manufacturing sector expanded for the 34th consecutive month in June, with a reading of 51.7, versus 52.8 in April. (A reading below 50 indicates a contraction, while a reading above 50 indicates an expansion.) Twelve of the 18 industries measured by the PMI expanded in June.[7]

According to the National Association of Realtors (NAR), existing-home sales rose 2.5% on a seasonally adjusted basis in May versus the previous month's sales. The NAR also reported that the median existing-home price for all housing types was $277,700 in May 2019, up 4.8% from May 2018. Finally, the inventory of homes available for sale in May was at a 4.3-month supply at the current sales pace. In contrast, there was a 4.2-month supply in the previous month.[8]

The Fed kept its target rate unchanged in a range between 2.25% and 2.50% during the second quarter. However, at its meeting in June, the Fed said, "The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, but uncertainties about this outlook have increased." In his press conference after the meeting Fed Chair Powell stated, "The case for somewhat more accommodative policy has strengthened."[9]

Both short-term and longer-term Treasury yields fell sharply during the second quarter. When the period began, the yield on the two-year Treasury was 2.27%, and it ended the quarter at 1.75%. Its low for the period of 1.71% occurred on June 25, and it rose as high as 2.41%, on April 16. The yield on the 10-year Treasury began at 2.41% and it ended the quarter at 2.00%, equaling its low for the period. Its peak of 2.60 occurred on April 16.[10]

The overall taxable bond market, as measured by the Bloomberg Barclays U.S. Aggregate Index,[11] gained 3.08% during the second quarter. The spread sectors also moved higher, as the Fed and a number of other central banks leaned toward introducing more accommodative monetary policies. In addition, signs of moderating global growth and uncertainties over U.S.-China trade negotiations triggered several flights to quality. Higher-yielding spread sectors also generated positive results during the quarter. The Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index[12] returned 2.50%, whereas the emerging market debt asset class, as represented by the JPMorgan Emerging Markets Bond Index Global ("EMBI Global"),[13] gained 3.76%.[14]

Contributors/detractors

The Fund's Class A (excluding sales charges) and Class I shares generated a positive return (gross of fees) and outperformed its benchmark, the Bloomberg Barclays U.S. Aggregate Index, during the quarter. Duration[15] positioning meaningfully contributed to returns. Having a long U.S. duration was beneficial, as rates moved lower across the curve. Our emerging market exposure contributed to results, as sovereign and corporate spreads narrowed, and a number of currencies

[4] Source of data in this paragraph: Bloomberg, 7/19.

[5] Source of data in this paragraph: Bloomberg, 7/19.

[6] The Institute for Supply Management's composite PMI Index (formerly the National Association of Purchasing Managers Index) is based on a survey of purchasing executives who buy the raw materials for manufacturing at more than 350 companies. It offers an early reading on the health of the manufacturing sector. Please note an investor cannot invest directly in an index.

[7] Source of data in this paragraph: Bloomberg, 7/19.

[8] Source of data in this paragraph: Bloomberg, 6/19.

[9] Source of data in this paragraph: Bloomberg, 6/19.

[10] Source of data in this paragraph: Bloomberg, 7/19.

[11] The Bloomberg Barclays U.S. Aggregate Index is a broad-based bond index composed of government, corporate, mortgage- and asset-backed issues rated investment grade or higher and having at least one year to maturity.

[12] The Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index is an index of the 2% Issuer Cap component of the Bloomberg Barclays U.S. Corporate High Yield Index, which covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market.

[13] The JPMorgan Emerging Markets Bond Index Global Diversified ("EMBI Global") tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds and local market instruments.

[14] Source of data in this paragraph: Bloomberg, 7/19.

[15] Duration is a measurement that signals how much the price of a bond is likely to fluctuate when there is a change in interest rates. The higher the duration number, the more sensitive a bond will be to interest rate changes.

appreciated versus the U.S. dollar. In particular, long positions in the Mexican peso, Russian ruble and Brazilian real were additive for returns, as they all strengthened versus the U.S. dollar. Overweights to investment-grade and high-yield corporate bonds were beneficial, as their spreads also narrowed over the quarter. Individual investment-grade corporate bonds that were beneficial for results included Goldman Sachs, Wells Fargo and Citigroup. Examples of high-yield corporate bonds that aided performance were Petrobras and Dish Corp. The portfolio's exposure to the Canadian dollar was rewarded, as it appreciated versus the U.S. dollar. Finally, the portfolio's exposure to structure product, including commercial mortgage-backed securities (CMBS)[16]and non-agency mortgage-backed securities ("NAMBS")[17], was additive for results, as their spreads generally narrowed.

On the downside, yield curve positioning detracted from performance, as the curve steepened. Elsewhere, an allocation to Treasury Inflation-Protected Securities ("TIPS")[18] was a headwind for returns, as breakeven inflation rates fell during the quarter. Elsewhere, an exposure to agency mortgage-backed securities (MBS)[19] was slightly negative for results, as their spreads widened. An individual investment-grade corporate bond that hurt results was Occidental Petroleum. High-yield corporate bonds that were headwinds for returns included Range Resources and Chesapeake Energy Corp.

A number of adjustments were made to the portfolio during the quarter. We added to the portfolio's exposures to U.S. Treasurys and cash. We increased our allocation to longer-term TIPS, as we felt that real yields of close to 1% were attractive. In contrast, we reduced our allocations to investment-grade corporate bonds and agency MBS. Finally, we pared our allocation to high-yield corporate bonds and increased our bank loan exposure.

Outlook

Global growth concerns have intensified since last quarter, as an initial trade spat between the U.S. and China has morphed into a broader conflict with the risk of expanding on new fronts. Markets have also been rattled by the prospect of a U.S. recession, a sustained slowdown in eurozone growth, and higher oil price volatility on escalating tensions in the Middle East. Despite these concerns, we expect global growth to remain resilient on the back of steady U.S. growth, improving domestic conditions in Europe, and signs that sustained monetary and fiscal stimuli across Asia are gaining traction. We acknowledge that trade friction will be an ongoing drag on investor and business confidence, but central banks globally have become much more explicit in their commitment to unleash additional policy accommodation to truncate downside risks.

[16] Commercial mortgage-backed securities (CMBS) are a type of mortgage-backed security that is secured by loans on commercial property. A CMBS can provide liquidity to real estate investors and to commercial lenders.

[17] Non-agency mortgage-backed securities are securities issued by non-governmental issuers, such as trusts and other special purpose entities.

[18] U.S. Treasury Inflation-Protected Securities ("TIPS") are bonds that receive a fixed, stated rate of return, but they also increase their principal by the changes in the CPI-U (the non-seasonally adjusted U.S. city average of the all-item consumer price index for all urban consumers, published by the Bureau of Labor Statistics). TIPS, like most fixed income instruments with long maturities, are subject to price risk.

[19] Agency mortgage-backed securities are securities issued by government-sponsored enterprise issuers, such as Fannie Mae, Freddie Mac and Ginnie Mae.

Top 10 fixed income holdings (%)	
US TREASURY N/B 2.8750% Mat 08/15/2045	2.0
GNMA 3.5% TBA MBS 30yr Mat 07/20/2049	1.9
U.S. Treasury Bonds 3.0000% Mat 05/15/2045	1.8
US TREASURY BOND 3.7500% Mat 11/15/2043	1.7
US TREASURY N/B 08/47 2.75 2.7500%	1.4
U.S. Treasury Bonds 2.5000% Mat 02/15/2045	0.9
FNMA 3.5% 06/01/49	0.9
GNMA II 4.5% 01/20/49	0.9
UNITED STATES TREASURY NOTE/BO 2.8750% Mat 05/15/2049	0.9
UNITED STATES TREASURY INFLATI 1.0000% Mat 02/15/2049	0.8

Sector allocation (%)	
Residential Mortgage Backed	35.5
Investment Grade Corporate Bonds	27.3
Government	13.5
Emerging Market	9.1
Commercial Mortgage Backed	4.4
Bank Loans	3.2
Inflation-Linked	2.2
High Yield Corporate Bonds	1.8
Asset Backed	1.7
Foreign Exchange	0.2
Cash & Cash Equivalents	1.1

Percentages are based on total portfolio as of quarter end and are subject to change at any time. For informational purposes only and not to be considered a recommendation to purchase or sell any security

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What should I know before investing?

Fixed income securities involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls. High-yield bonds are subject to greater price volatility, illiquidity and possibility of default. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets. Asset-backed, mortgage-backed or mortgage-related securities are subject to prepayment and extension risks. Potential active and frequent trading may result in higher transaction costs and increased investor liability. Active management does not ensure gains or protect against market declines.

U.S. Treasurys 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. Treasurys when the securities are held to maturity.

Definitions and other terms:

An **investment grade** is a rating that indicates that a municipal or corporate bond has a relatively low risk of default.

The **yield curve** shows the relationship between yields and maturity dates for a similar class of bonds.

Any information, statement or opinion set forth herein is general in nature, is not directed to or based on the financial situation or needs of any particular investor, and does not constitute, and should not be construed as, investment advice, forecast of future events, a guarantee of future results, or a recommendation with respect to any particular security or investment strategy or type of retirement account. Investors seeking financial advice regarding the appropriateness of investing in any securities or investment strategies should consult their financial professional.

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