WESTERN ASSET
A LEGG MASON COMPANY

2Q 2019 | Separately Managed Accounts | Product Commentary

WESTERN ASSET CORE PORTFOLIOS

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 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 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

[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.

[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.

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.[12]

Core Portfolios

Annualized returns net and gross of fees - PRELIMINARY

(%) as of June 30, 2019

	QTR	YTD	1-yr	3-yr	5-yr	7-yr	10-yr
Net of fees	2.54	6.03	6.59	1.49	2.16	1.97	3.58
"Pure" gross of fees	2.92	6.82	8.18	3.01	3.69	3.50	5.13
Bloomberg Barclays U.S. Aggregate Index	3.08	6.11	7.87	2.31	2.95	2.62	3.90
FTSE 3-Month U.S. Treasury Bill Index	0.61	1.21	2.30	1.36	0.84	0.62	0.46

The strategy returns are preliminary composite returns, subject to future revision (downward or upward). Please visit www.leggmason.com for the latest performance figures. YTD numbers are not annualized.

Quarterly and YTD data are not annualized. **Past performance is no guarantee of future results.** Please see the Western Asset Core Composite Disclosure – GIPS® endnotes on the back page of this document for important additional information and for effects of fees. Management and performance of individual accounts may vary for reasons that include the existence of different implementation and model requirements in different investment programs. The Core Portfolios are available as separately managed accounts that utilize both individual securities and no-fee mutual funds. These mutual funds were created specifically for, and are made available exclusively through, these separately managed accounts. The Fund's prospectus is available from your financial professional and includes information on Fund investment objectives, strategies and risks.

Fees: Gross performance shown does not reflect the deduction of investment management fees and certain transaction costs, which will reduce portfolio performance shown. Net performance includes the deduction of a 1.5% annual wrap fee, which is the maximum anticipated wrap fee for fixed income portfolios. Actual fees may vary. For fee schedules, contact your financial professional, or if you enter into an agreement directly with Legg Mason Private Portfolio Group, LLC (LMPPG), refer to LMPPG's Form ADV disclosure document.

Returns reflect the reinvestment of dividends and other earnings.

Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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

Contributors and detractors

The Portfolio generated a positive return (gross of fees) but underperformed its benchmark, the Bloomberg Barclays U.S. Aggregate Index, during the quarter. Yield curve positioning was the largest detractor from performance, as the curve steepened. An allocation to Treasury Inflation-Protected Securities ("TIPS")[13] was a headwind for returns, as breakeven inflation rates during the quarter. Elsewhere, an exposure to agency mortgage-backed securities (MBS)[14] was slightly negative for results, as their spreads widened.

On the upside, an overweight to investment-grade corporate bonds was the largest contributor to results, as their spreads narrowed during the quarter. The Fund's investment-grade emerging market exposure was beneficial for returns, as sovereign and corporate spreads also narrowed during the period.

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.

Important information

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.

Past performance is no guarantee of future results.

Diversification does not assure a profit or protect against market loss.

Separately managed accounts (SMAs) are investment services provided by Legg Mason Private Portfolio Group, LLC (LMPPG), a federally registered investment advisor. Client portfolios are managed based on investment instructions or advice provided by one or both of the following Legg Mason-affiliated subadvisors: ClearBridge Investments, LLC and Western Asset Management Company. Management is implemented by LMPPG, the designated subadvisor or, in the case of certain programs, the program sponsor or its designee.

These materials are being provided for illustrative and informational purposes only. The information contained herein is obtained from multiple sources that are believed to be reliable. However, such information has not been verified, and may be different from the information included in documents and materials created by the sponsor firm in whose investment program a client participates. Some sponsor firms may require that these materials be preceded or accompanied by investment profiles or other documents or materials prepared by such sponsor firms, which will be provided upon a client's request. For additional information, documents and/or materials, please speak to your financial advisor.

Risks

All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met.

Fixed income securities are subject to interest rate and credit risk, which is a possibility that the issuer of a security will be unable to make interest payments and repay the principal on its debt. As interest rates rise, the price of fixed income securities falls.

Fixed income securities may be subject to extension risk, which is the risk that the issuer will repay their obligations more slowly than the market anticipates, in the event market interest rates rise. Issuers also have the right to pay their payment obligations ahead of schedule, in the event market interest rates fall, subjecting investments to prepayment risk.

Investments may also be made in mortgage-backed and asset-backed securities and taxable municipal securities. Asset-

[13] 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.

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

backed securities generally decrease in value as a result of interest rate increases, but they may benefit less than other fixed income securities from declining interest rates, principally because of prepayments. Mortgage-backed securities involve additional risk over more traditional fixed income investments, including: interest rate risk; implied call and extension risks; and the possibility of premature return of principal due to mortgage prepayment, which can reduce expected yield and lead to price volatility.

U.S. Treasurys are direct debt obligations issued by the U.S. government and backed by its “full faith and credit.” The U.S. government guarantees the principal and interest payments on U.S. Treasurys when the securities are held to maturity. Unlike U.S. Treasurys, debt securities issued by the federal agencies and instrumentalities and related investments may or may not be backed by the full faith and credit of the U.S. government. Even when the U.S. government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting from declines in the market value of these securities.

Foreign securities, where permitted, are subject to the additional risks of fluctuations in foreign exchange rates, changes in political and economic conditions, foreign taxation, and differences in auditing and financial standards. These risks are magnified in the case of investments in emerging markets.

Tapering of the Federal Reserve Board's quantitative easing program and a general rise in interest rates may lead to increased portfolio volatility.

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 such taxpayer for the purpose of avoiding tax penalties or complying with any applicable tax laws or regulations. 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 such taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

Investments are not FDIC insured or guaranteed by any government agency. Values may fluctuate due to market conditions and other factors.

Where LMPPG implements, Western Asset selects broker/dealers to execute trades; and certain Western Asset employees, acting as dual employees of LMPPG, may perform all or some of LMPPG's implementation services. LMPPG and Western Asset are subsidiaries of Legg Mason, Inc.

Definitions and additional information

Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

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.

The **FTSE 3-Month U.S. Treasury Bill Index** is an index based on the average monthly yield of the 90-day Treasury bill. U.S. Treasury bills are secured by the "full faith and credit" of the U.S. government and offer a fixed rate of return. The portfolio composition typically varies from that of the above-noted, unmanaged indexes.

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.

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

Institute for Supply Management (ISM), formerly known as the National Association for Purchasing Management, is an association representing more than 48,000 purchasing and supply management professionals. It conducts regular surveys of purchasing and supply managers to determine industry trends.

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

National Association of Realtors (NAR) is a national organization of real estate brokers. The National Association of Realtors was created to promote the real estate profession and foster professional behavior in its members.

PMI is the Institute for Supply Management's composite PMI Index (formerly the National Association of Purchasing Managers Index), which 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.

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

Professional money management may not be suitable for all investors.

Western Asset Core SMA – GIPS® endnotes ($USD)

Schedule of investment performance results – December 31, 2018

Year	Net total return	"Pure"[1] gross total return	Benchmark total return	Gross total 3 Yr. Standard Deviation	Benchmark total 3 Yr. Standard Deviation	Number of portfolios	% of bundled fee portfolios in the composite	Internal dispersion	Composite assets ($mm)	% of firm assets
2009	10.96%	12.61%	5.93%	-n/a-	-n/a-	28	100	0.16%	28	0.01%
2010	7.54%	9.14%	6.54%	-n/a-	-n/a-	26	100	0.09%	28	0.01%
2011	5.71%	7.29%	7.84%	3.08%	2.82%	25	100	0.09%	27	0.01%
2012	4.92%	6.49%	4.21%	2.59%	2.42%	60	100	0.14%	51	0.01%
2013	-3.34%	-1.89%	-2.02%	2.94%	2.75%	48	100	1.39%	74	0.02%
2014	5.79%	7.37%	5.97%	2.97%	2.67%	101	100	0.14%	83	0.02%
2015	-0.08%	1.41%	0.55%	3.20%	2.92%	207	100	0.19%	163	0.04%
2016	2.22%	3.75%	2.65%	3.15%	3.02%	333	100	0.31%	258	0.06%
2017	3.41%	4.96%	3.54%	2.94%	2.81%	417	100	0.31%	331	0.08%
2018	-2.04%	-0.57%	0.01%	3.07%	2.88%	459	100	0.37%	355	0.08%

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, 2018. 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, LLC; Western Asset Management Company Limited, authorised and regulated by the Financial Conduct Authority ("FCA"); Western Asset Management Company Pte. Ltd. Co. Reg. No. 200007692R, holder of the Capital Markets Services Licence for fund management and regulated by the Monetary Authority of Singapore; Western Asset Management Company Ltd, a registered Financial Instruments Business operator and regulated by the Financial Services Agency of Japan; Western Asset Management Company Pty Ltd ABN 41 117 767 923, holder of the Australian Financial Services Licence 303160; and Western Asset Management Company Distribuidora de Títulos e Valores Mobiliários (DTVM) Limitada, authorised and regulated by Comissão de Valores Mobiliários and Banco Central do Brazil, with offices in Pasadena, New York, London, Singapore, Tokyo, Melbourne, São Paulo, Hong Kong, and Zürich. 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.

Western Asset – Core portfolios are discretionary fixed-income portfolios that offer – to individual and taxable institutional investors – tailored bond management which seeks to maximize total return and has the flexibility to invest across a range of fixed-income sectors, including the U.S. government, federal agency, domestic corporate, mortgage and money market/cash equivalent sectors. Exposure to certain fixed income sectors represented in the strategy are achieved by investing in shares of one or more mutual funds managed by Western Asset. The composite is comprised of accounts that are separately managed accounts (SMAs), managed in accordance with the strategy with an account minimum of US $150,000. The composite employs a 10% significant cash flow policy. The composite was created on January 1, 2007.

Effective January 1, 2013, the number of portfolios reflects a change from prior periods due to an aggregation of accounts as reported by one sponsor. For periods prior to 2013, the firm excluded accounts designated by the sponsor as client-restricted.

For comparison purposes, composite returns are shown against returns of the Bloomberg Barclays U.S. Aggregate Bond Index. An investor cannot invest directly in an index.

1"Pure" gross returns are presented as supplemental information to the net returns. The current fee schedule is 1.50% on all assets. Net returns are calculated by deducting the anticipated maximum annual bundled fee applied on a monthly basis from the "pure" gross monthly return. The bundled fee includes all charges for trading costs, portfolio management, custody, and other administrative fees. Bundled fees may vary across different financial firms and across different accounts based upon account size and other factors. Returns and market values are expressed in USD.

Dispersion is calculated using the asset-weighted standard deviation of annual returns of those portfolios that were included in the composite for the entire year (equal-weighted prior to 2014). 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. Standard deviation is not presented for periods where 36 monthly returns are not available for the composite or the benchmark.

Past investment results are not indicative of future investment results. Information contained herein is believed to be accurate, but cannot be guaranteed. Employees and/or clients of Western Asset may have a position in the securities mentioned.

Western Asset's list of composite descriptions and policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. Please contact Ellen Cammer at 212-601-6064 or Ellen.Cammer@westernasset.com.