1Q

2018

Investment Report

Oregon Local Government Intermediate Fund

Performance Review

For the first quarter of 2018, the portfolio underperformed the Bloomberg Barclays US Government/Credit Bond Index (1-5 year) by 11 basis points (bps) gross.

Interest rate positioning had no net impact on performance for the first quarter as a small negative duration impact was cancelled out by a small positive yield curve positioning impact.

The portfolio's overweight position to investment-grade corporate bonds was the primary detractor to performance as spreads widened and generated negative excess returns. Spreads for the Bloomberg Barclays Credit Index widened from 89 bps to 103 bps. Overweight positions to USD-denominated emerging market (EM) corporate bonds, predominately from Latin American issuers, was also a negative contributor as spreads widened.

We continue to believe that opportunities exist for high-quality carry in investment-grade corporate bonds, and we added approximately 1.5% in select industrial names to the portfolio.

Oregon Local Government Intermediate Fund

	Portfolio	Index**
1Q18 Performance*	-0.61%	-0.50%

*As of 31 Mar 18. *Performance is gross of fees. **Bloomberg Barclays US Government/Credit Bond Index (1-5 year).*

Investment Outlook

Our core theme has been that the process of inflation normalization, and hence interest-rate normalization, would be very slow to develop. Markets, on the other hand, have shifted quickly and sharply to higher inflation expectations. The change in US fiscal policy in combination with already full employment conditions has led many to extrapolate that current improvements in the inflation data mean that interest rates will have to move up meaningfully. Our view is that the short-term pickup in cyclical inflation doesn't remove the long-term secular challenges to this bottoming process.

We are steadfast believers that the low inflation world we inhabit is not going to change quickly. Portfolios need buffers against adverse events, and Treasury securities remain the best diversifying hedge. During the long recovery since 2009, there have been several periods of market optimism that the economy had accelerated sufficiently (escape velocity) to bring about a surge in inflation. There have been other periods when market pessimism has led to concerns over portfolios with insufficient holdings in sovereign and Treasury debt, as well as strategies offering downside protection. We believe the global economies are mending, and that central bankers should finally but gradually be able to withdraw stimulus. It is not a sure thing by any stretch. If this outlook proves broadly correct, spread sectors should do well. If there are any meaningful wobbles, Treasury bond gains should help provide a cushion.

For more information on Western Asset visit www.westernasset.com.