3Q 2018

Investment Report

Oregon Local Government Intermediate Fund

Performance Review

During the third quarter of 2018, the portfolio outperformed its benchmark, the Bloomberg Barclays 1-5 Year US Government/Credit Bond Index, by 18 basis points (bps) on a gross basis.

Exhibit 1
Oregon Local Government Intermediate Fund

	Portfolio	Index**
3Q18 Performance*	0.44%	0.26%

*As of 30 Sep 18. *Performance is gross of fees. **Bloomberg Barclays U.S. Government/Credit Bond Index (1-5 year).*

The portfolio's overweight to investment-grade credit was the largest contributor as spreads tightened from 116 bps to 100 bps, generating 157 bps of excess returns. Our overweight to emerging market (EM) corporate bonds was also a contributor as the sector returned 1.24% during the third quarter, according to the JPM CEMBI Broad Index.

The portfolio's overweight to duration detracted from performance as yields rose; the 10-year Treasury yield rose from 2.85% to 3.05%. Yield curve positioning, specifically our overweight to the 5-year and 10-year parts of the curve, did help to offset the negative impact from duration as short-term rates rose more than long-term rates during the quarter.

Investment Outlook

In the US, the economic picture has been better than we expected. Above-trend growth, subdued inflation and a cautious Federal Reserve (Fed) remain our base case. In the first half of 2018, growth came in at over 3%, while inflation flirted with finally hitting the Fed's target of 2% after eight years of expansion. Better growth with subdued inflation had provided a sturdy backdrop for the outperformance of most US spread assets.

For the second half of 2018, we expect much of the same. Growth may come in between 2.5% and 3.0% as the fiscal stimulus continues to provide incremental help. Meanwhile, the inflation outlook remains muted despite the improvement in the labor market. We believe the sluggish trajectory we have seen in rising inflation rates in the US and across the developed world will remain. With this backdrop in place, the Fed has acknowledged the need for a more pragmatic approach to thinking about interest rates.

Our outlook for a broad and sustained global recovery has been challenged on a wide variety of fronts given the underperformance of economic indicators relative to expectations in Europe, Japan, China and non-China EM. This growth downshift came from very high and, in our view, unsustainable levels. This leaves us with the crucial question of whether this downshift is the beginning of a more precipitous decline, or whether a return to the more moderate growth (3.5%-4.0%) of the last few years is in the offing. We are strong proponents of the latter camp, but we have to acknowledge that risks have risen.

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