1Q 2020

Investment Highlights

Oregon Local Government Intermediate Fund

WESTERN ASSET

Oregon Local Government Intermediate Fund

	Portfolio	Index**
1Q20 Performance*	1.52%	2.17%

As of 31 Mar 20
**Performance is gross of fees*
*** Bloomberg Barclays 1-5 Year US Government/Credit Bond Index*

Performance Review

During the first quarter of 2020 the portfolio underperformed its benchmark, the Bloomberg Barclays 1-5 Year US Government/Credit Bond Index, by 65 basis points (bps) on a gross basis.

The first quarter of 2020 brought drastic changes to both capital markets and the global economic outlook. Solid estimates for 2020 growth persisted at the onset of the year, only to be abruptly undone by quarter-end as the outbreak of COVID-19 upended global economies and ways of life. The greatest contributor to performance during the quarter was the portfolios allocation to IG Credit. The primary detractor over the quarter was emerging markets exposure, detracting 34 bps as spreads widened and all currencies depreciated materially versus the US dollar. High-yield exposure was the second largest detractor as spreads on all credit sectors widened considerably but closed somewhat tighter from their mid-March levels.

Investment Outlook

The rapid spread of not only of the coronavirus, but also of radical economic measures intended to slow it down have significantly changed the economic environment from what it was just a month ago. Previous recessions have invariably started in manufacturing or construction markets and spread from there to the rest of the economy. In contrast, the economic response to the virus started in the leisure-oriented service industries, and these will likely remain the hardest hit. Meanwhile, it seems the virus has spread into the industrial sectors of the economy and consumer demand for big-ticket items is understandably depressed. Economic weakness at present is largely coming from the supply side, as those services are simply not available, and as a range of important merchandise has disappeared from store shelves. However, as shutdown-forced layoffs spread, resulting in sustained income losses, there is also the risk of sharply reduced demand for a range of goods and services beyond big-ticket items.

Given the enforced measures of supply disruptions and their prevalence in cyclically insensitive services industries, possible declines in US GDP growth could be much more severe than even what was observed during the late stages of the global financial crisis (GFC). The unknowns are how severe such shutdowns will become across the whole country and how long the economy will remain at such low levels of utilization. This, of course, will depend partly on the arc of infections. However, it will also depend on the state of consumer and business demand when and as the virus has subsided, and return-to-work advisories are provided by the government to households and businesses.

Considering the very healthy financial shape of both businesses and households on the eve of the crisis (we disagree with claims that businesses were highly leveraged and households were clearly not so), and given the breadth and timeliness of government and central bank measures to sustain private-sector finances, we believe that the economic bounce-back can be strong and relatively quick. Also, we believe that central bank efforts to intervene directly in credit markets—with capital backing from the government—will be successful in forestalling widespread bankruptcies, so that firms will be able to survive and participate in the recovery. Finally, we are also inclined to think that the impact of the virus on national health and national health systems will be much less severe than some are predicting.

Of course, even if we are correct in these assumptions, the challenge will be in sustaining investment positions through what might be very rough times in the weeks and months ahead before a more hospitable market environment returns.

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