

Oregon Local Government Intermediate Fund

Performance Review

The portfolio outperformed its benchmark, the Bloomberg 1-5 Year US Government/Credit Bond Index, by 13 basis points (bps) on a gross basis.

During the third quarter, volatility in both equity and Treasury markets remained relatively subdued. The US Treasury yield curve bull-steepened, reflecting market expectations for slower growth, moderation in economic data and potential rate cuts. Risk assets performed well, with the S&P 500 Index reaching new highs and credit spreads tightening.

US job growth weakened in August, with nonfarm payrolls rising by 22,000 jobs—lower than July's upwardly revised figure of 79,000 (from 73,000). The unemployment rate edged up to 4.3% from 4.2% over the quarter. Over the last three months, headline CPI increased to 2.9% year-over-year (YoY) from 2.4%. Core Personal Consumption Expenditures (PCE), the Federal Reserve's (Fed) preferred inflation measure, which excludes food and energy, rose to 2.9% YoY, up from 2.7% over the previous three months.

For the first time since December 2024, the Federal Reserve Open Market Committee (FOMC) lowered its policy rate by 25 basis points (bps) at its September meeting, setting the target range for the fed funds rate at 4.00% to 4.25%. While the move itself was not surprising, a recent string of significantly weaker labor market data, alongside mounting political pressure for a larger cut, made communication particularly important for a market already pricing in a series of additional rate reductions. In the Summary of Economic Projections (SEP), the median committee member anticipated a total of 75 bps of cuts in 2025 (including the September rate cut), compared to 50 bps projected in the June SEP. Notably, seven of the 19 members now foresee no further rate reductions this year, indicating a stark division within the committee.

During the third quarter, the Bank of England (BoE) cut its policy rate by 25 bps to 4.0%, as expected. However, a hawkish vote split and a forecast for a higher peak in inflation later in the year led the market to price in a slower pace of future easing. In its annual decision on quantitative tightening, the 12-month envelope for balance sheet reduction was lowered to £70 billion from £100 billion last year, with active sales skewed away from longer-dated maturities. The European Central Bank (ECB) held its policy rate unchanged at 2.0%, as expected. ECB President Christine Lagarde reiterated that the current policy setting is "in a good place," with inflation close to the ECB's 2% target and an upward revision to this year's growth forecast as uncertainty around US trade tariffs has declined.

As of 30 Sep 25	Portfolio (gross)	Portfolio (net)	Index*
3Q25 Performance	1.40%	1.38%	1.27%

**Bloomberg 1-5 Year US Government/Credit Bond Index*

Past investment results are not indicative of future investment results. Gross-of-fees returns are presented before management fees, but after all trading expenses. Net-of-fees performance returns are an estimate of time-weighted rate of return. The effective fee, based on a fee schedule, is deducted from the monthly gross return.

Investment Outlook

Labor Market Weakening but Policy Tailwinds Expected in 2026: The Fed and investors are focused on the weakening labor market and its impact on growth. We believe subtrend growth in 2025 is the likely outcome with reasons for optimism as we enter 2026. Fiscal and monetary policies should boost growth toward trend in 2026. With inflation still above the Fed's 2% target we are holding duration near neutral in broad market portfolios with a steepening bias. We have reduced exposure to select spread sectors given rich valuations.

Western Asset's outlook remains constructive, though we recognize that growth momentum is tempered by uncertainty in areas such as inflation, central bank policy, geopolitics and fiscal sustainability. US financial conditions are largely supportive, which, alongside fiscal loosening and solid household balance sheets, points toward a positive foundation for growth. Headwinds remain, including doubts over the state of the US labor market, core inflation lingering close to 3% and the potential lagged impact of tariffs. This backdrop should keep the Fed on a rate-cutting path, albeit with a cautious view of the inflation outlook. Fiscal vulnerabilities and persistent inflation may see the yield curve steepen further. European growth is expected to benefit from German and EU fiscal support with the ECB judging the eurozone economy to be "in a good place." The EU's trade deal with the US has not boosted confidence, however, and unemployment is rising in Germany and France. The French government's inability to agree and ratify a budget is likely to have a significant bearing on risk-sentiment toward French and peripheral European assets. Japanese politics are also in sharp focus, with the new leader of the LDP expected to be elected prime minister and shift toward more expansionary fiscal policy. Chinese GDP growth is marginally below the prescribed 5% target, but with inflation rebounding from the 2024 lows and the government offering fiscal and regulatory support, monetary policy is not expected to be loosened further in the near term. While we retain a modest overweight to interest-rate duration, we are concentrated in shorter maturities and biased to select countries and regions such as core Europe and the UK. While fundamentals remain positive, spreads are at the tight end of historical ranges in many sectors and warrant caution. We will continue to look for further periods of volatility to add to spread risk.

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