Investment Highlights

WESTERN ASSET
A Franklin Templeton Company

Oregon Local Government Intermediate Fund

Performance Review

The portfolio outperformed its benchmark, the Bloomberg 1-5 Year US Government/Credit Bond Index, by 6 basis points (bps) on a gross basis.

Fixed-income market volatility persisted in the fourth quarter of 2025 as investors and policymakers navigated mixed economic signals. The longest US government shutdown, which restricted data availability, ended in November after 43 days. The US Treasury (UST) yield curve steepened, with short and intermediate UST yields finishing the quarter lower, while long-term yields increased. Equities performed well, with the S&P 500 Index reaching new highs, while credit spreads were mixed.

Total nonfarm payrolls rose by 64,000 in November, significantly higher than the -105,000 jobs reported in October. The unemployment rate also rose to 4.6% in November, up from 4.4% in September. Inflation data continued to moderate in November, with headline Consumer Price Index (CPI) falling to 2.7% year-over-year (compared to 3.0% in September) and core CPI falling to 2.6% (from 3.0% in September).

The Federal Open Market Committee (FOMC) cut the Federal Reserve (Fed) policy rate twice over the quarter, by 25 basis points (bps) to a target range of 3.50% to 3.75%. In December, the committee added language to its statement linking “the extent and timing” of further policy actions to incoming data and the evolving outlook. The Fed also resumed reserve purchases to provide for ample liquidity and smoother policy transmission.

The European Central Bank (ECB) held policy rates unchanged. However, following hawkish comments from ECB member Isabel Schnabel that highlighted potential upside surprises to eurozone growth, markets moved to expect higher rates in 2026. S&P downgraded France’s sovereign credit rating from AA- to A+ citing slower than expected budgetary consolidation and deteriorating debt metrics. The Bank of Japan (BoJ) raised its policy rate by 25 bps to 0.75%, but forecast sluggish inflation and modest growth, while the yen weakened on expectations of slower rate hikes. Sanae Takaichi became Japan’s Prime Minister, launching a bold fiscal stimulus of ¥21.3 trillion and abandoning the single-year primary budget surplus target, which pushed Japanese government bond yields higher.

As of 30 Sep 25	Portfolio (gross)	Portfolio (net)	Index*
4Q25 Performance	1.24%	1.22%	1.18%

**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

Growth boosted by fiscal, monetary and regulatory policies: Our base case for 2026 anticipates improving economic growth, supported by Trump administration fiscal policies, additional Fed easing and regulatory changes. We believe inflation will trend lower toward the Fed’s 2% goal. Labor market conditions should improve as corporate hiring rebounds after 2025 tariff uncertainty. We expect 2026 to be a "carry" type of year but with tighter valuations, so we prefer higher-quality sectors to maintain a yield advantage over client benchmarks.

Western Asset’s outlook remains constructive, though we recognize that growth momentum is tempered by uncertainty in areas such as geopolitics and fiscal sustainability.

US financial conditions are largely supportive, which, alongside proposed fiscal loosening and solid household balance sheets, points toward a positive foundation for growth in 2026. Headwinds remain, including doubts over the state of the US labor market, core inflation lingering above target and the potential lagged impact of tariffs. Having cut rates at three successive meetings since September, the Fed may now moderate its pace of easing and await further signals from the post-shutdown data releases. 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” with growth remaining positive and inflation close to 2%. In Japan, above-trend growth is expected in 2026 with a more expansionary fiscal policy under the new prime minister. The gradual pace of BoJ policy rate hikes is expected to continue. In China, policy is expected to focus on reflation and improving domestic confidence with further fiscal and regulatory support.

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, Australia 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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