



# Fresno County Employees' Retirement Association

May 4, 2016

Frances L. Coombes

Kurt D. Halvorson, CFA



# Table of Contents

---

- I. Organizational Update
- II. Investment-Grade Credit Overview
- III. Portfolio Review
- IV. Investment-Grade Credit Market Review
- V. Appendix

## Organizational Update

# Western Asset Management

---

*Western Asset is a global investment management firm committed to  
understanding the needs of each client,  
identifying investment solutions and  
delivering superior long-term investment results*

# Investment Philosophy

These are the core beliefs that drive our investment decision-making

## Long-term fundamental value

- **Markets often misprice securities.** Prices can deviate from fundamental fair value, but over time, they typically adjust to reflect inflation, credit quality fundamentals and liquidity conditions. Consistently investing in undervalued securities may deliver attractive investment returns.
- **We can systematically identify mispricings.** We believe we can identify and capitalize on markets and securities that are priced below fundamental fair value. We do this through disciplined and rigorous analysis, comparing prices to the fundamental fair values estimated by our macroeconomic and credit research teams around the globe.
- **Our portfolios emphasize our highest convictions.** The greater the difference between our view of fair value and markets' pricing, the bigger the potential value opportunity. The greater the degree of confidence in our view of fundamentals, the greater the emphasis of the strategies in our portfolios.

## Multiple diversified strategies

- **We seek diversified sources of returns.** Our objective is to meet or exceed our investors' performance objectives within their tolerances for risk. We seek to diversify investments and add value across interest rate duration, yield curve, sector allocation, security selection, country and currency strategies. We deploy multiple diversified strategies that benefit in different environments so no one strategy dominates performance, helping to dampen volatility.

# Global Breadth and Local Depth

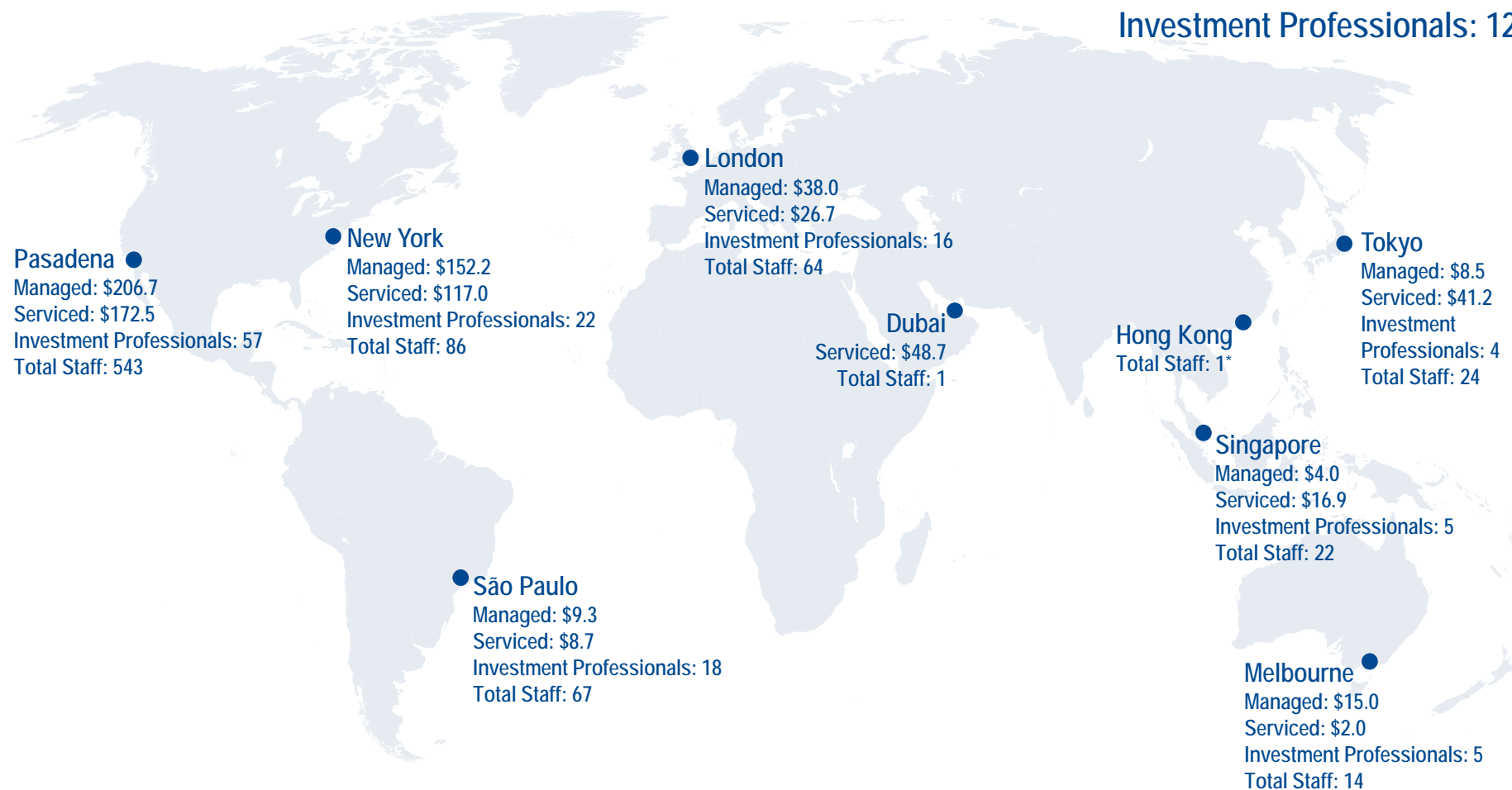
December 31, 2015

Total AUM: \$433.7 billion

8 Countries (9 Offices)

Total Staff: 821

Investment Professionals: 127



Assets under management in USD (billions)

\*Splits time between Hong Kong and Singapore offices

# Committed to Excellence in Client Service

## Representative Client List

Corporate	Public	Multi-Employer / Union	Eleemosynary
AGL Resources, Inc.	Arkansas Local Police and Fire Retirement System	1199 SEIU Health Care Employees Pension Fund	Abilene Christian University
Alcoa Inc.	Baltimore County (MD) Employees Retirement System	Alaska Electrical Trust Funds	Baha'i World Centre
Allergan, Inc.	California State Teachers' Retirement System	Automotive Machinists Pension Trust	Bill & Melinda Gates Foundation Trust
Alliant Techsystems Inc.	City of Grand Rapids	Bert Bell / Pete Rozelle NFL Player Retirement Plan	Commonfund
Allied Domecq Pension Fund	City of Orlando	Boilermaker Blacksmith National Pension Trust	Creighton University
American Cast Iron Pipe Company	compenswiss	Carpenters District Council of Kansas City	Domestic & Foreign Missionary Society ECUSA
ArcelorMittal USA Inc.	East Bay Municipal Utility District	Directors Guild of America-Producer Pension and Health Plans (DGA - PPHP)	E. Rhodes & Leona B. Carpenter Foundation
AT&T Investment Management Corporation	Employees' Retirement System of the State of Rhode Island	Heating, Piping and Refrigeration Local 602 Pension Fund	Indiana University
Atmos Energy Corporation	Fife Council Pension Fund	Heavy & General Laborers' Locals 472/172	Saint Louis University
Bayer Corporation	Fresno County Employees' Retirement Association	IBEW Local 25	Salk Institute for Biological Studies
Campbell Soup Company	Gloucestershire County Council	IBEW Local No. 9	United Negro College Fund
Chrysler LLC	Government of Bermuda Public Funds	IUOE Employers Construction Industry Retirement Plan, Locals 302 and 612	University of Southern California
Clark Enterprises, Inc.	Hampshire County Council	Iron Workers Local #11 Benefit Funds	University of Wisconsin Foundation
Consolidated Edison Company Of New York, Inc.	Indiana State Treasurer's Office	Line Construction Benefit Fund	Voelcker Foundation
Consolidated Rail Corporation	Iowa Public Employees' Retirement System	Major League Baseball Players Benefit Plan	Washington College
Energy Transfer Partners LP	Kansas Public Employees Retirement System	National Asbestos Workers	Washington State University
FairPoint Communications, Inc.	Los Angeles County Employees Retirement Association	National Education Association of the United States	
Flowers Foods	Marin County Employees' Retirement Association	New England Healthcare Employees Union, District 1199, AFL-CIO	<b>Insurance</b>
Graphic Packaging International Incorporated	Minnesota State Board of Investment	Operating Engineers Local #428 Trust Funds	AAA of Northern California, Nevada, & Utah
Hawaiian Telcom	New Jersey Transit	Retail Wholesale & Department Store Union	American Contractors Insurance Group
Highbury Pacific Capital Corp.	North Dakota State Investment Board	Southern Nevada Culinary & Bartenders Pension Trust Fund	Anthem, Inc.
International Paper Company	Ohio Police & Fire Pension Fund	UAU Local No. 290 Plumber, Steamfitter & Shipfitter Industry Pension Trust	Blue Cross Blue Shield of Massachusetts
John Lewis Partnership Pensions Trust	Orange County Transportation Authority	United Food and Commercial Workers Union Local 919	Catalina Holdings (Bermuda) Ltd
Lennox International, Inc.	Oregon Investment Council	Western Washington Laborers Employers Pension Trust	Great-West Life & Annuity Insurance Company
Macy's, Inc.	Phoenix City Employees' Retirement System		Health Care Service Corporation
National Grid USA	Public Employee Retirement System of Idaho	<b>Healthcare</b>	Maryland Automobile Insurance Fund
Nestle USA, Inc.	Public School Teachers' Pension and Retirement Fund of Chicago	Abington Memorial Hospital	Oil Investment Corporation Ltd.
Nisource, Inc.	Salt River Project Agricultural Improvement and Power District	Ascension Investment Management	United Services Automobile Association
PCS Administration (USA), Inc	School Employees Retirement System of Ohio	Baptist Healthcare System, Inc.	
Pensioenfond Horeca & Catering	Seattle City Employees Retirement System	Baylor Scott & White Holdings	<b>Sub-Advisory</b>
PPG Industries	State of Ohio Bureau of Workers Compensation	Catholic Health Initiatives	AXA
Southern California Edison	Surrey County Council	CHRISTUS Health	Contassur
Stichting Pensioenfond DSM-Nederland	Tennessee Valley Authority	Kaiser Permanente	Delphi Capital Management Company
The Dun & Bradstreet Corporation	Ventura County Employees' Retirement Association	LCMC Health	DIAM Co., Ltd.
ThyssenKrupp North America, Inc	Virginia Retirement System	Lehigh Valley Hospital	GuideStone Capital Management, LLC
Unilever United States, Inc.	Washington Metro Area Transit Authority	NorthShore University HealthSystem	Legg Mason, Inc.
Unisys Corporation	Wichita (KS) Retirement Systems	Pinnacle Health System	Morgan Stanley
Vidanova Pension Management	Wyoming Retirement System	Sisters of Charity of St. Augustine Health System, Inc.	Russell Investment Group
		St. George Corporation	SEI Investments Management Corporation
			Shinko Asset Management Co., Ltd.
			Sumitomo Mitsui Asset Management Company, Limited

As of 29 Feb 16. Please see the Representative Client List Disclosure in the Appendix for more information. All have authorized the use of their names by Western Asset for marketing purposes. Such authorization does not imply approval, recommendation or otherwise of Western Asset or the advisory services provided.

# Relationship Summary

March 31, 2016

Fresno County Employees' Retirement Association	
Portfolio Inception	May 2005
Market Value	\$210,376,669
Mandate	US - Credit IG*
Investment Objective	Exceed the return of the Index over the long term (5 years).
Benchmark	Barclays U.S. Credit
Alpha Target	50 bps
Tracking Error Budget	100 bps
Diversification	Min 95% investment grade (Barclays Method); Max 20% in Non-USD securities (fully hedged back to USD); Max 25% in global sovereign bonds (ex UST and Agency bonds)

*\*Mandate changed from US Core Plus to UG Credit IG effective September 2014.*



## Investment-Grade Credit Overview

# Western Asset Credit Assets Under Management

December 31, 2015

**Total Firm Assets** **\$433.7 billion**

**Investment-Grade Credit** **\$97.2 billion**

- Investment-Grade Credit-Only Assignments \$40.6
  - 78 US Credit \$35.1
  - 24 Non-US Corporate \$5.5
- Broad Market Assignments \$58.6

**High-Yield** **\$18.3 billion**

**Bank Loan** **\$8.6 billion**

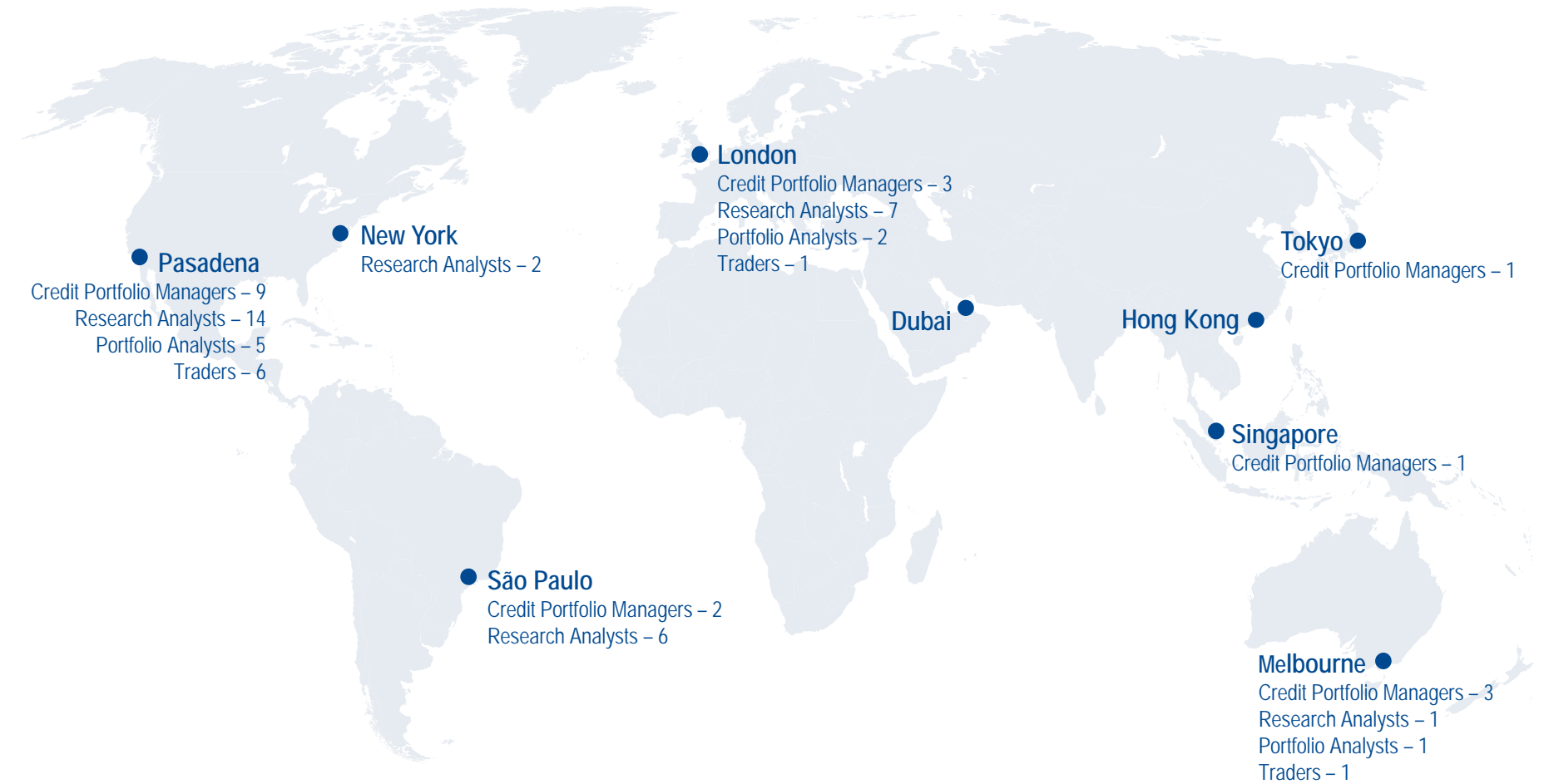
**Emerging Market** **\$9.1 billion**

**Total Credit AUM** **\$133.1 billion**

*Assets under management by Western Asset and its supervised affiliates, in USD (billions).  
Data may not sum to total due to rounding.*

# Global Credit Platform

## By Region



As of 31 Mar 16

# Global Credit Team

S. Kenneth Leech (39 yrs) – Chief Investment Officer

Michael C. Buchanan, CFA (26 yrs) – Deputy Chief Investment Officer

Portfolio Managers	Investment-Grade Credit	High-Yield Credit/Bank Loans	Emerging Markets Credit
	<p>Ryan K. Brist, CFA (22 yrs) – US            Matthew D. Jackson (14 yrs) – UK            Craig Jendra, CFA (20 yrs) – Australia            Blanton Keh, CFA (16 yrs) – US            Hiroyuki Kimura (29 yrs) - Japan            Anthony Kirkham, CFA (26 yrs) – Australia            Paul Shuttleworth (30 yrs) – UK</p>	<p>Michael C. Buchanan, CFA (26 yrs) – US            Ian R. Edmonds (26 yrs) – UK            Christopher N. Jacobs, CFA (28 yrs) – US            Walter E. Kilcullen (19 yrs) – US            Christopher Kilpatrick (19 yrs) – US            Timothy J. Settel (23 yrs) – US            Damon Shinnick, CFA (17 yrs) – Australia</p>	<p>Chia-Liang Lian, CFA (23 yrs) – US            Jean-Pierre Cote Gil (17 yrs) – Brazil            Sergio Evangelista (27 yrs) – Brazil            Swee-Ching Lim (17 yrs) – Singapore            Kevin Ritter, CFA (18 yrs) – US</p>
Research	<p>Sebastian Angerer (7 yrs) – UK            Credit Analyst            Nathalie Cuadrado, CFA (16 yrs) – UK            Industrials            Ian Justice (18 yrs) – UK            Whole Business Securitization            Rene Ledis (23 yrs) – US            Basic Industries/Utilities/Energy            Miguel Molina (7 yrs) – UK            European Retail, Consumer Products/Services            Kathryn L. Montgomery (8 yrs) – US            Generalist, Liquidity            Paul S. Olsen (33 yrs) – US            Financial Institutions            DeAndre L. Parks, CFA (23 yrs) – US            Healthcare/Consumer Products/Retail            Gerald R. Rawcliffe (33 yrs) – UK            Financial Institutions            Sean Rogan (27 yrs) – Australia            Credit Analyst            Ivor Schucking (25 yrs) – US            Financial Institutions            Davis Smith (27 yrs) – US            Communications</p>	<p>Michael T. Borowski (15 yrs) – US            High-Yield Autos, Industrials, Gaming/Leisure, Utilities            J. Gibson Cooper, CFA (29 yrs) – US            Exploration &amp; Production, Oil Field Services, Midstream, Refining            William Cullinan (18 yrs) – US            High-yield paper, Packaging, Chemicals, Homebuilders, and Building Materials            Douglas Dieter, Dr.P.H (17 yrs) – US            Healthcare, Technology            Ruchi Gupta (18 yrs) – UK            European High-Yield Credit            John C. Hwang (15 yrs) – US            Structured Credit            Araceli M. Sibley (24 yrs) – US            Consumer Products, Entertainment, Restaurants, Consumer Services, Textiles            Suzanne M. Trepp, CFA (26 yrs) – US            Aerospace/Defense, Transportation, Retail, Food &amp; Beverage, Tobacco            Florent Vallespir (23 yrs) – UK            European High-Yield Credit</p>	<p>Daniel Araujo (32 yrs) – Brazil            Banking, Insurance, Telecom            Adriano Casarotto (20 yrs) – Brazil            Capital Goods, Chemicals, Energy, Metals &amp; Mining, Paper &amp; Forest, Infrastructure            Kevin Chang, CFA (16 yrs) – US            Emerging Markets Credit            Marcos Dal Collina (31 yrs) – Brazil            Education, Health Care, Specialized            Consumer Services, High Yield            Matthew Graves, CFA (11 yrs) – US            Emerging Markets Credit            Mark A. Hughes, CFA (18 yrs) – US            Emerging Markets Credit            Caio Magano (15 yrs) – Brazil            Auto Components, Transportation, Utilities            Willian Murayama (12 yrs) – Brazil            Securitization            Jie Peng, CFA (11 yrs) – Singapore            Asian (ex-Japan) Credit            Alex Tanaka (16 yrs) – Brazil            Building Products, Homebuilding, Real Estate Broker, Retailing</p>
Trading	<p>Osvaldo Acosta (17 yrs) – Australia            Daniel C. Alexander, CFA (12 yrs) – US            Oberto Alvarez (23 yrs) – US            Kurt D. Halvorson, CFA (15 yrs) – US            Chetna Mistry (19 yrs) – UK</p>	<p>Sophala Chhoeng (10 yrs) – US            Brandon C. Jacoby, CFA (13 yrs) – US</p>	<p>Wilfred Wong, CFA (15 yrs) – US</p>
Portfolio Analysts	<p>Lawrence Daly, CFA (17 yrs) – Australia            Jean Lee, CFA (11 yrs) – UK            Edward T. Ma, CFA (14 yrs) – US            Molly Schwartz, CFA (12 yrs) – US</p>	<p>Brendan A. Bowman, CFA (11 yrs) – US            Quentin Lafosse (9 yrs) – UK</p>	<p>Jacob Greenberg (3 yrs) – US            Andy Song (11 yrs) – US</p>
Product Specialists	<p>James J. So, CFA (20 yrs) – US            Catherine L. Matthews (29 yrs) – UK            Global Products</p>	<p>Thomas V. McMahon (37 yrs) – US</p>	<p>Steven T. Saruwatari, CFA (22 yrs) – US</p>

As of 31 Mar 16  
 Group heads

# Western Asset Credit Approach

---

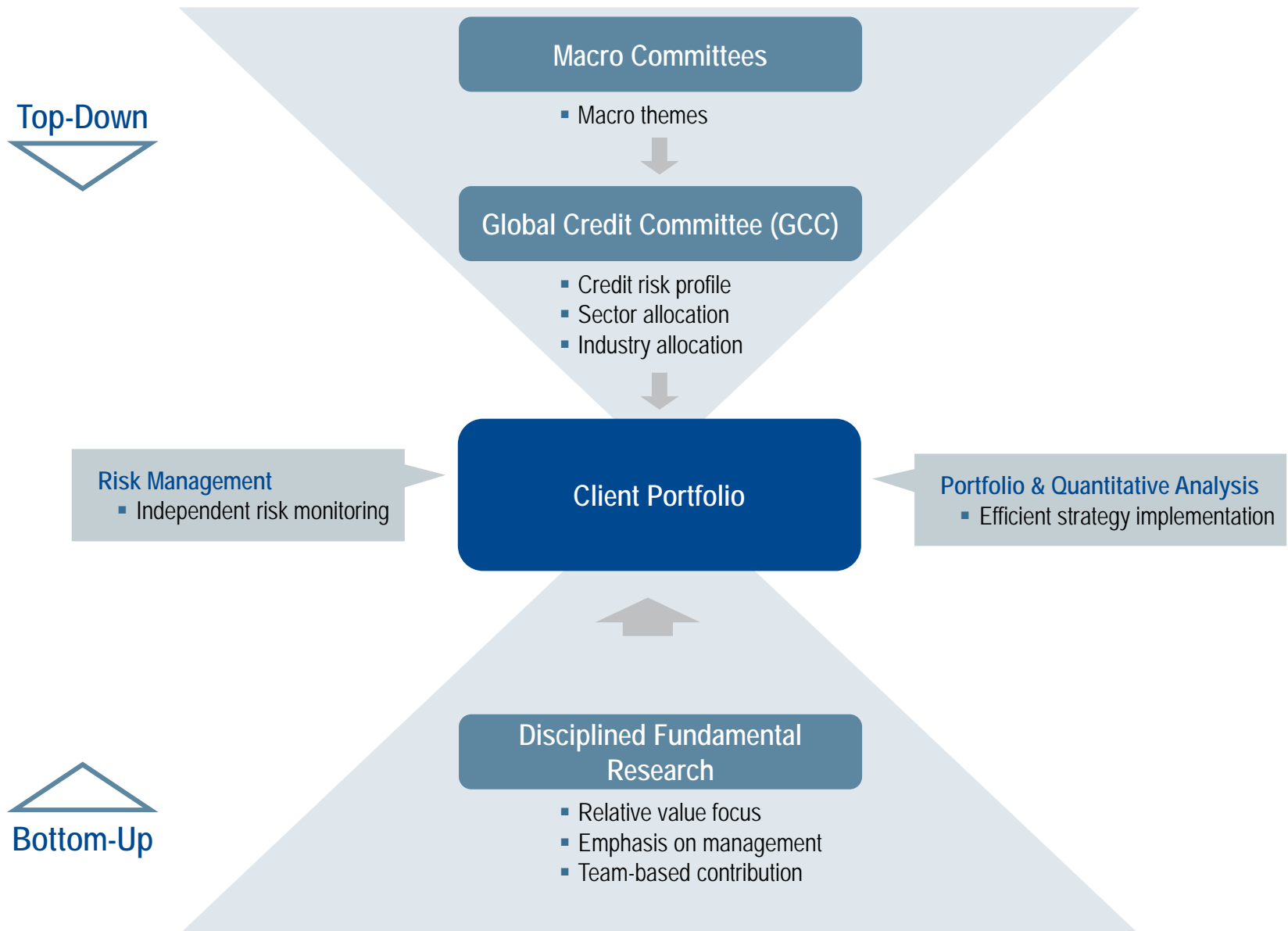
## Philosophy

- We believe the ability to integrate superior fundamental credit research with accurate relative-value analysis will generate relative outperformance over a market cycle when proper risk controls are applied

## Overview

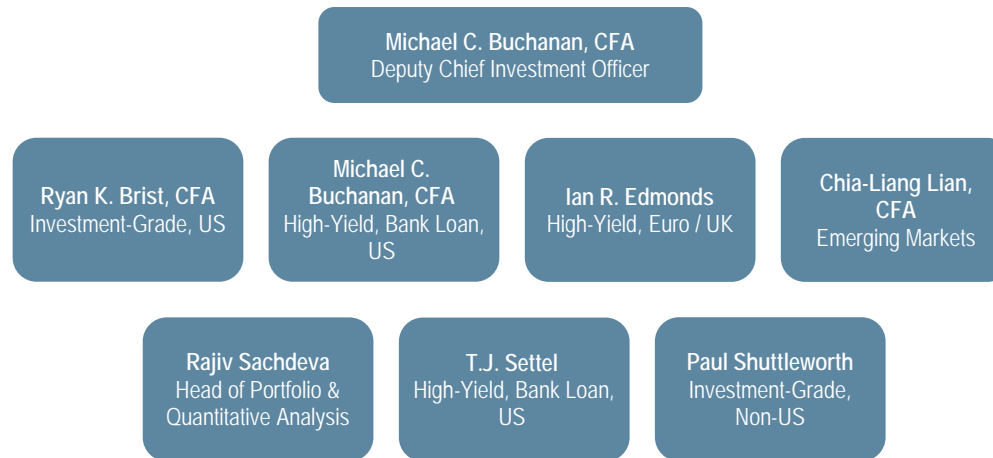
- Top-down
  - Consideration of Western Asset's economic assessment
  - Credit analysts provide industry insights
  - Global Credit Committee determines credit sector allocation
- Bottom-up
  - Dedicated sector teams direct industry/issuer position within allocation
  - Fundamental credit analysis
  - Relative-value assessment
- Risk oversight
  - Ensure resulting portfolio possesses prudent industry/issuer risks

# Credit Investment Process



# Global Credit Committee

## Top-Down



Committee meets monthly to discuss, debate and ultimately determine overall firm wide credit strategies

Topics include comprehensive assessment regarding outlook for credit, as well as relative-value analysis across all credit asset classes, industry biases and, at times, specific issuer review

Committee establishes sector allocation for all multi-sector credit accounts

# Global Credit Committee – Sector Allocation

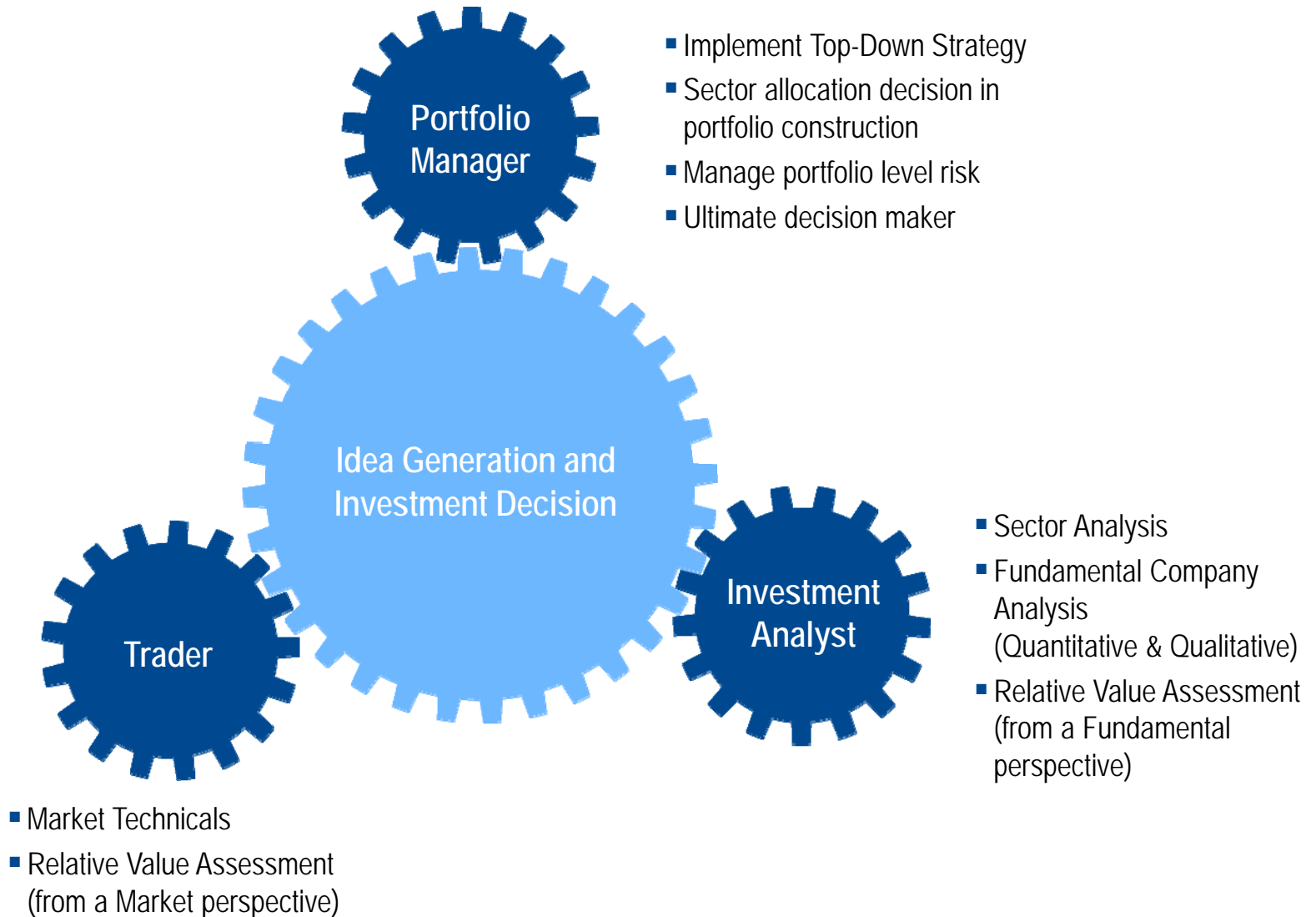
	Wt Rating	Quality Rating	Comment	Yield*
Overall Credit View	4	B	<ul style="list-style-type: none"> <li>▪ Fears of a global slowdown remain the primary concern in the credit markets and trading illiquidity is causing high volatility in both directions</li> <li>▪ Central bank policies remain accommodative and aided in improving investor sentiment</li> <li>▪ Fundamentals, ex-commodity related names, are still supportive for credit investing but the global credit markets are currently driven by technicals</li> <li>▪ While defaults should stay below historical averages, including energy. The market is pricing in a significantly higher default rate</li> <li>▪ Emerging market credits look attractive on a historical basis and improving technicals led to a more positive stance</li> <li>▪ We voted to increase our rating for European credit markets by one notch to a 4 given the ECB stimulus</li> </ul>	4.1%
US HY	4	B	<ul style="list-style-type: none"> <li>▪ Maintain a 4 (moderate overweight) based on disparity between supportive fundamentals contrasted with cheap valuations</li> <li>▪ Market liquidity remains challenging. However, this illiquidity is beginning to positively affect prices as buyers re-enter the market. Liquidity premiums are still excessive</li> <li>▪ Management teams remain cautious given an uncertain economic outlook. As such, balance sheet health is generally strong</li> <li>▪ M&amp;A activity has recently slowed down due to market volatility as well as regulatory obstacles that limit leveraged buyout activity. As prices begin to repair, we expect an increase in underwriting with the use of proceeds skewed toward refinancing</li> <li>▪ Sentiment surrounding energy and commodity sectors has turned positive given the rally in underlying commodities. Valuations are still cheap despite recent rally and leaves meaningful upside for the sectors if commodity prices hold</li> <li>▪ With a current yield above 8.25% and a spread of +640, the high-yield market remains attractive. Energy and CCCs are two segments of the market that currently offer excessive yields and upside potential for patient investors</li> </ul>	8.6%
Non-US HY	4	C	<ul style="list-style-type: none"> <li>▪ European high-yield volatility has continued into 2016. Yields have been in a 120-bps range and are currently back to the 5.6% area seen at the start of the year</li> <li>▪ The recently announced ECB corporate sector purchase program should have a positive knock on impact on European high-yield</li> <li>▪ Therefore move tactically to a 4 from a 3</li> <li>▪ Corporate fundamentals still supportive. Default rates remain benign, around 1%</li> <li>▪ Supply is expected to increase from low levels, initially higher quality issuance to start with. Refinancing also anticipated to be main use of proceeds</li> <li>▪ Use yield to call paper as a source of cash for new issues and focus on B rated issues for best risk/reward. Euro denominated BBs remain expensive</li> </ul>	2.3%
US IG	4	C	<ul style="list-style-type: none"> <li>▪ Remain cautiously optimistic on credit spreads while acknowledging that the market has rallied -40 bps tighter from the February 11 wides</li> <li>▪ Technicals continue to dominate; ECB's commitment to buy investment-grade-rated non-bank corporates creates a potential large tailwind for credit</li> <li>▪ Sharp rebound in crude oil has helped fuel a rally in energy spread, however, ratings downgrades remain a concern</li> <li>▪ EPFR data shows fund flows have turned positive and are close to flat for the year</li> </ul>	3.6%
Non-US IG	4	C	<ul style="list-style-type: none"> <li>▪ We move from a neutral to a tactical overweight bias to European credit given current valuations and the positive technical backdrop following the additional stimulus provided by the ECB</li> <li>▪ The ECB has over-delivered versus market expectations. The size of the QE program was not only increased by €20bn per month to €80bn but is to also include the purchase of non-bank European domiciled investment-grade credit</li> <li>▪ The European banking sector was also given a much needed boost with the introduction of a new series of T-LTROs at attractive interest rates to be set in the range of maximum 0% to a low of the deposit rate (-0.4%). This not only reduces the sectors funding cost but also eases the pressure on net interest margins. We retain an overweight to the sector</li> <li>▪ We are also positive on UK credit which has underperformed on Brexit fears but should be a beneficiary from attractive relative valuations, a spillover effect from ECB purchases and the improved risk appetite globally</li> </ul>	1.8%
Bank Loans	4	B	<ul style="list-style-type: none"> <li>▪ The loan market has rallied recently bringing the full year return to 0.46%. The rebound is being led by higher rated assets as BBs are up 1.1% while CCCs are down 2.36%</li> <li>▪ Even with the rally, loans continue to offer a compelling risk-adjusted return opportunity as loans currently trade close to two standard deviations wide of the long-term historical spread</li> <li>▪ Minimal CLO new issuance and retail outflows continue to be a headwind. New issues have been very light providing an offset to the weaker demand picture</li> <li>▪ We are using the rally in the market to reduce risk within the portfolio particularly within names that are less liquid</li> <li>▪ Even with the rally and risk reduction, we continue to like the loan market and wish to remain overweight. Loans can be an ideal option in the current environment given their floating coupon and senior secured status. In this environment loans hold value as a lower-volatility, high-yielding investment and as a portfolio diversifier</li> </ul>	5.0%
CEMBI	3	B	<ul style="list-style-type: none"> <li>▪ Recent spread widening has made EM corporate valuations look attractive on a historical basis, particularly for BBB/BB quasi-sovereigns, although relative value versus US investment-grade or high-yield does not look compelling</li> <li>▪ While Latin American corporates have been hit hard by the secular shift in the Chinese economy away from infrastructure-related spending, we believe that value exists in higher quality issuers and export-oriented credits currently benefiting from local currency-denominated cost structures</li> <li>▪ We continue to expect EM corporate fundamentals to deteriorate on an absolute basis and relative to DM, but valuations appear to have increasingly priced in the bad news and we do not believe national balance sheets will precipitate sovereign-wide corporate defaults</li> <li>▪ With the EM new issue market starting to show green shoots, we are watching for the opportunity to participate in attractively-priced transactions for issuers previously frozen out of the market. In order to move to a 4 rating we would need to have greater comfort about the resolution of the commodity and/or Brazilian political crises, both of which have caused a significant amount of the widening in EM corporates over the past 2 years</li> </ul>	6.2%

As of 12 Mar 16. Ratings shown should not be viewed as a proxy to any rating provided by a Nationally Recognized Statistical Rating Organization. Yields shown are not representative of any specific Western Asset product. Weight ratings are denoted 1 to 5. The scale is formulated in such a way that 5 is given to credit asset classes we feel offer the most compelling risk/reward opportunities and 1 is assigned to those credit asset classes where Western Asset sees little investment opportunity. Quality ratings indicate within an asset class where Western Asset believes investment opportunities do or do not exist and are denoted by A, B or C. The scale is formulated in such a way that A represents the highest-rated issuers and C represents the lower-rated issuers. \*The yield cited for the "Overall Credit View" reflects the average overall credit yield based on Western Asset's current weighting within the sectors shown. All quoted yields are drawn from the benchmark against which each credit asset class composite is measured.



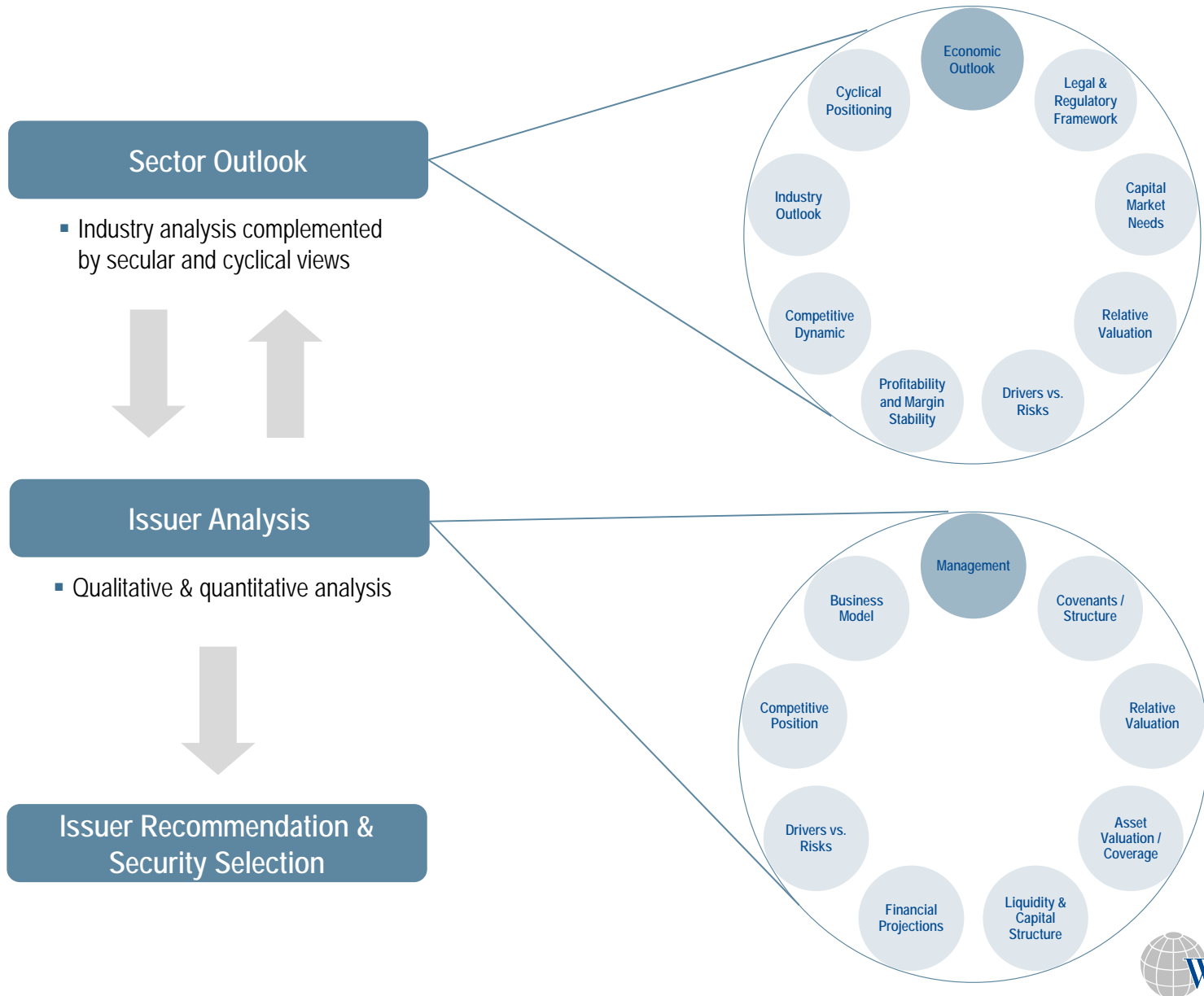
# Idea Generation

## A Three-Pronged Team Approach



# Sector Analysis: Top-Down Outlook Influences Sector Views

## Issuer Analysis: Bottom-Up Research Is Our Core Competency



# Credit Portfolio Construction

Top-Down

Portfolio Construction		Return Characteristic	Idea Generation	Investment Criteria	Holding Period
Portfolio	Opportunistic 5%–15%	Price	Trading ✓ Research Portfolio Manager	Liquidity Imbalance	Short-Dated
	Under Valued 25%–35%	Price and Income	Trading Research ✓ Portfolio Manager	Upgrade/ Downgrade	Intermediate
	Core Holdings 50%–70%	Income	Trading ✓ Research ✓ Portfolio Manager ✓	Stable Holding	Longer-Dated

# Sell Discipline and Willingness to Avoid Participation

---

## Revised credit opinion

- Relevant change to our original premise that affects our fundamental valuation

## Target valuation

- Security meets/exceeds our relative value target

## Avoiding the “losers” is as important as investing in the “winners”

- Risk associated with owning or holding the security does not justify the expected return

Material price change up or down will trigger a full team credit review

# Risk Management

---

## Areas of Focus

Market & Credit Risk Committee

Strategy and portfolio reviews

Dispersion analysis

Counterparty risk exposures (dollar-weighted, risk-weighted)

Liquidity analysis—portfolios tiered by liquidity class

Risk dashboards

Prediction/outcome analysis

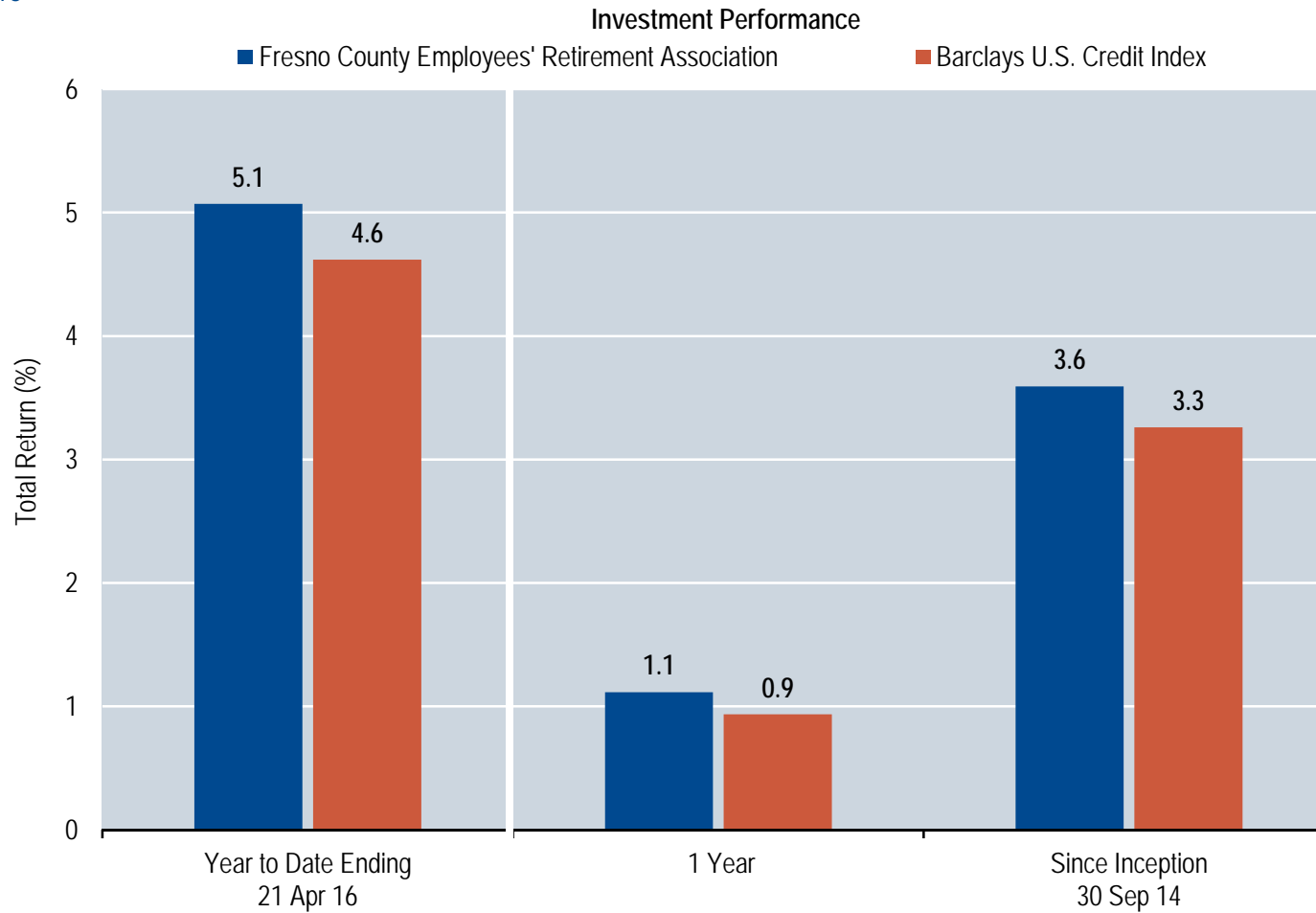
Systems review and enhancement

## Portfolio Review

# Investment Results

## Fresno County Employees' Retirement Association

March 31, 2016



*Performance shown is gross of fees. The account's actual return will be reduced by those fees and any other expenses chargeable to the account. The fee schedule for this strategy may be found in Part 2 of Western Asset's Form ADV. As fees are deducted quarterly, the compounding effect will be to increase the impact of the fees by an amount directly related to the gross account performance. For example, on an account with a 1% annual fee, if the gross performance were 10%, the compounding effect of the fees would result in a net performance of approximately 8.93%. Returns for periods greater than one year are annualized. Returns since inception are as of the indicated close of business day.*

## Portfolio Characteristics

### Fresno County Employees' Retirement Association vs. Barclays U.S. Credit Index

March 31, 2016

	Portfolio MV (%)	Index MV (%)
<b>Treasury</b>	<b>3.21</b>	<b>0.00</b>
<b>Agency</b>	<b>0.59</b>	<b>0.00</b>
<b>Financial Institutions</b>	<b>38.14</b>	<b>25.27</b>
Banking	28.39	17.88
Brokerage	0.97	0.72
Finance Companies	3.13	0.65
Financial Other	1.07	0.01
Insurance	4.38	4.03
REITS	0.21	1.98
Swap	-0.01	0.00
<b>Industrials</b>	<b>46.88</b>	<b>50.49</b>
Basic Industry	3.94	3.06
Capital Goods	4.20	4.39
Communications	6.74	8.22
Consumer Cyclical	6.49	6.26
Consumer Non-Cyclical	13.90	13.01
Energy	8.31	7.67
Technology	1.18	5.66
Transportation	2.12	1.90
Industrial Other	0.00	0.31
<b>Utilities</b>	<b>3.24</b>	<b>6.15</b>
Electric	3.24	5.63
Natural Gas	0.00	0.43
Other Utilities	0.00	0.09
<b>Non-Corporate</b>	<b>0.66</b>	<b>15.16</b>
<b>Municipal</b>	<b>0.32</b>	<b>2.93</b>
<b>High Yield</b>	<b>4.38</b>	<b>0.00</b>
<b>ABS</b>	<b>1.30</b>	<b>0.00</b>
<b>Cash</b>	<b>1.27</b>	<b>0.00</b>
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

Credit Quality	Portfolio MV (%)	Index MV (%)
<b>AAA</b>	<b>6.11</b>	<b>9.30</b>
<b>AA</b>	<b>4.45</b>	<b>11.06</b>
<b>A</b>	<b>38.07</b>	<b>36.64</b>
<b>BBB</b>	<b>46.47</b>	<b>43.00</b>
<b>&lt;BBB</b>	<b>4.89</b>	<b>0.00</b>
<b>NR</b>	<b>0.01</b>	<b>0.00</b>
<b>Total</b>	<b>100.00</b>	<b>100.00</b>

<b>YTW</b>	<b>3.43</b>	<b>3.10</b>
<b>Duration (yrs)</b>	<b>6.81</b>	<b>7.15</b>
<b>Average Quality</b>	<b>A-</b>	<b>A-</b>

Note: Sector exposure includes look-through to any underlying commingled vehicles if held. All weightings are a percentage of total market value. A negative cash position may be reported, which is primarily due to the portfolio's unsettled trade activity. Data may not sum to 100% due to rounding.



# US Investment-Grade Credit Portfolio Considerations

---

1H 2016

## Themes

- Growing pessimism in global growth outlook and credit metrics have peaked with M&A on center stage
- Persistent primary issuance continues to be a negative headwind; low dealer inventory/liquidity remains challenged
- Valuation has become attractive, but issuer selection key in the later stage of credit cycle

## Strategies

- Maintain overweight in financials at current valuation and strong technicals
  - “Back to Basics” banking, secular destination should be a more bondholder-friendly industry with lower growth, less risk and stronger capital and liquidity
  - Regulators continue to force banks to become Safer, Stronger, Simpler and Smaller
  - Near the end of balance sheet improvement; cyclical headwinds appear to be improving
- Near-term underweight in industrial sectors prone to shareholder activism and M&A activities
  - Chemicals, communications, pharmaceuticals, and technology
- Remain underweight electric utilities: Thesis unchanged as valuations tight amid headwinds
  - Capital expenditures remain high at \$95 billion+ per year through 2020
  - Regulatory risk potentially on the rise; lackluster electric load growth

## Investment-Grade Credit Market Review

# US Investment-Grade Credit Outlook

1st Half 2016

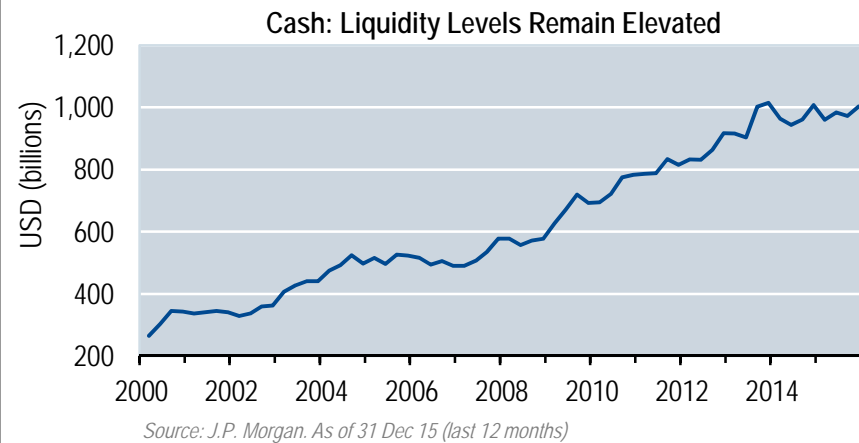
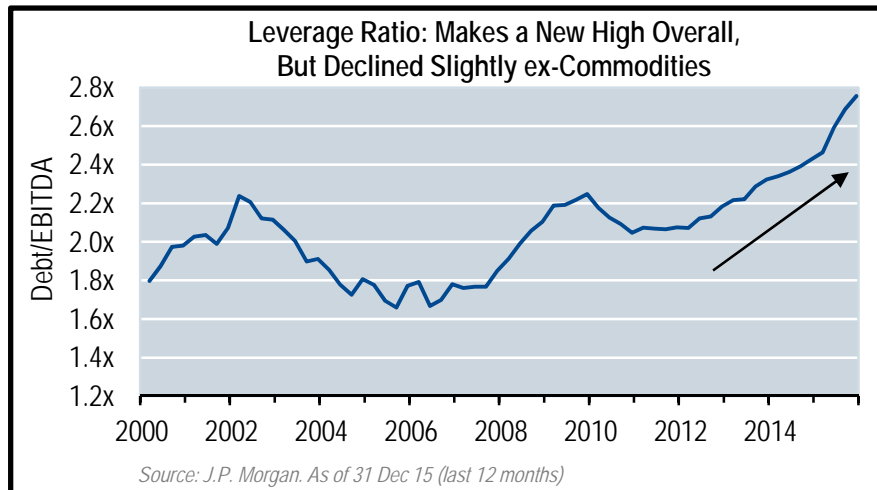
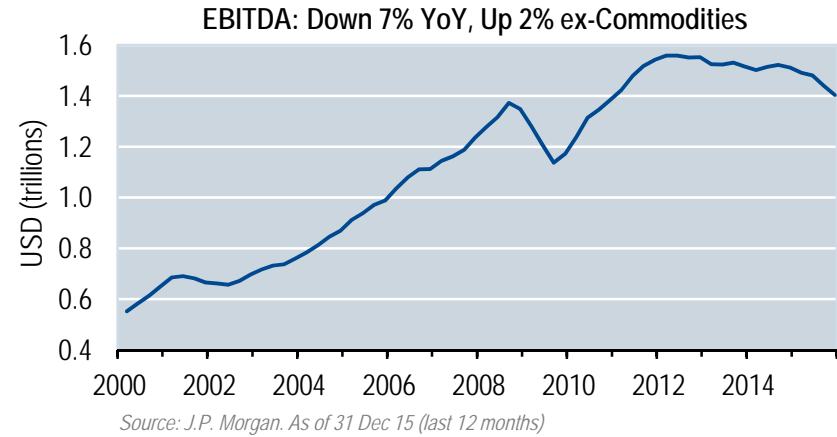
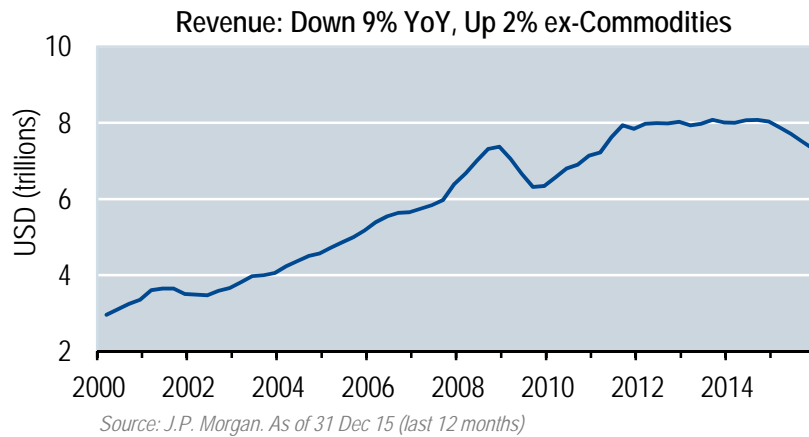
---

## Opinion: Mid-late credit cycle. Buy IG spreads

- **Fundamentals:** Q1 2016 revenue/earnings expectations are down YoY
- **Technicals:** Upgraded to “Fair”. Global inflows/ECB corporate debt purchases/M&A volume lower
- **Global issues:** Still affecting US IG credit market
  - Negative yields (Europe/Japan)
  - China growth estimates
  - Brexit a near-term hurdle
  - Oil Prices – Finding a bottom?
  - EM – Amazing comeback in Q1 2016
- **Valuations:** IG spreads appear attractive
- **Strategies in the current environment**
  - **Banks:** Still really favor Western Asset's long-term overweight
  - **Industrials:** Neutral. More favorably disposed to industrials. Focus on upgrade candidates.
    - Security selection most important in back half of the credit cycle
    - Healthcare: Moved to an underweight across our firm
    - Energy: Continue to reduce underweight
  - **Utilities:** Underweight. Be careful of leverage creep

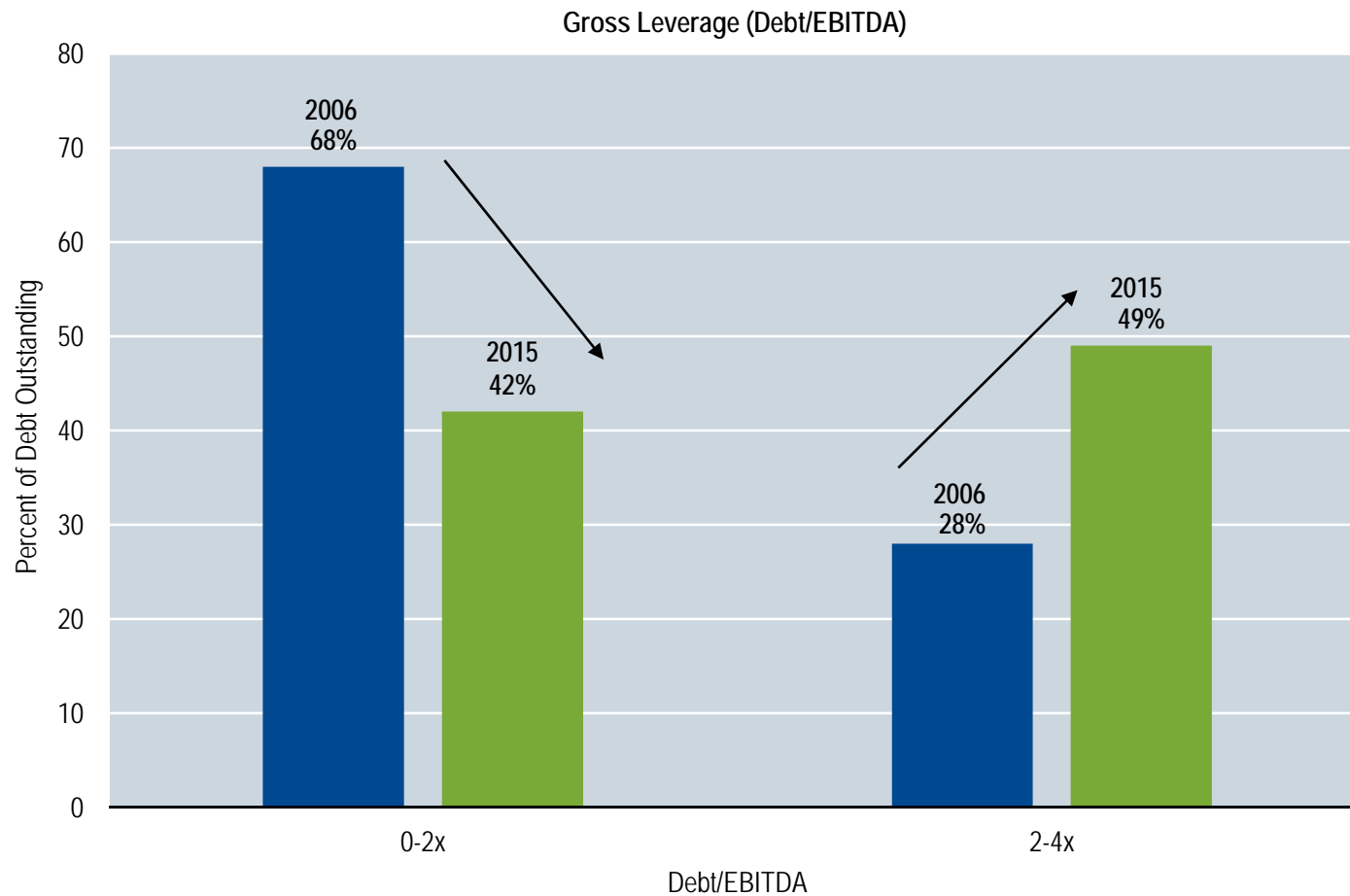
# IG Fundamentals: Revenues and Earnings Continue to Show Signs of Deterioration

4Q15



Fundamentals

# Increase in Leverage Mainly From Large, High Quality Companies



Source: J.P. Morgan. As of 31 Mar 15

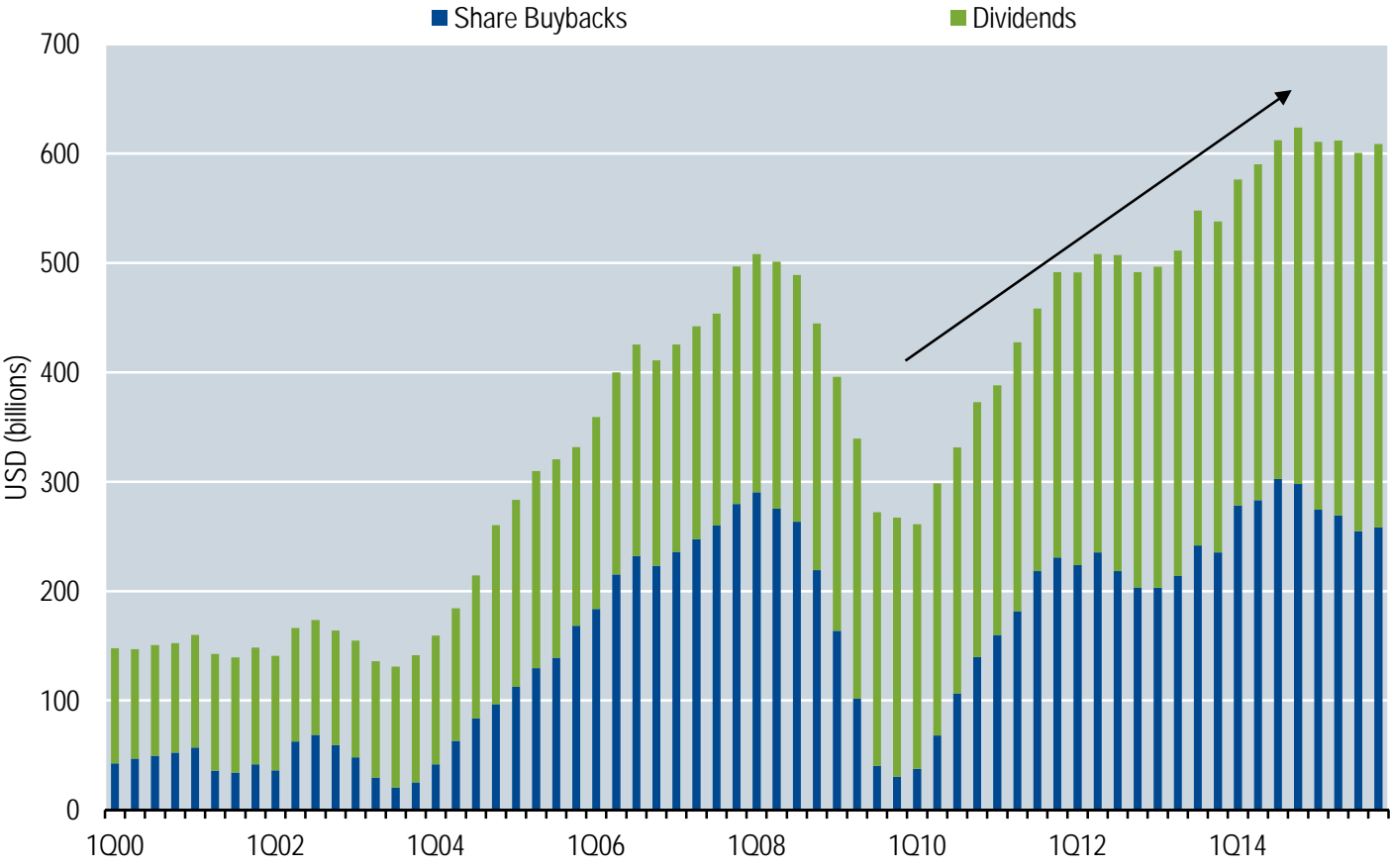
## Top 10 Companies Who Increased Leverage Since 2006

1. Verizon
2. AT&T
3. Merck
4. Target
5. BP
6. Pepsi
7. Coca-Cola
8. Medtronic
9. Siemens
10. Dow

Source: J.P. Morgan. As of 31 Mar 15

## Fundamentals

# Borrowing WITHOUT a Purpose: Share Buybacks and Dividends Remain Elevated



Source: J.P. Morgan. As of 31 Dec 15

Fundamentals



## Borrowing WITH a Purpose: “Plain Vanilla” M&A

Acquirer	Target	Sector	% Stock	Purchase Multiple	Premium	Pre-Acq Leverage	Post-Acq Leverage
Charter	Time Warner Cable	Cable	49%	9.8x	26%	5.0x	4.5x
H.J. Heinz	Kraft Foods Group	Food and Beverage	6%	24x	45%	4.8x	3.6x
Aetna	Humana	Health Insurance	46%	10x	14%	N/A	N/A
Becton Dickinson & Co	Carefusion	Healthcare	18%	15x	26%	2.0x	4.0x
Medtronic	Covidien	Healthcare	35%	17x	29%	2.3x	4.1x
Zimmer	Biomet	Healthcare	21%	15x	N/A	1.2x	4.2x
Halliburton	Baker Hughes	Oil Field Services	76%	9x	54%	1.1x	1.9x
ACE Ltd	Chubb	P&C	50%	N/A	30%	13% <sup>1</sup>	23% <sup>1</sup>
Merck & Co	Cubist	Pharmaceuticals	0%	38x	38%	1.8x	2.4x
Actavis	Allergan	Pharmaceuticals	59%	31x	15%	3.5x	5.0x
Abbvie	Pharmacyclics	Pharmaceuticals	72%	156x	43%	2.3x	4.4x
Reynolds American	Lorillard	Tobacco	43%	13x	8%	2.0x	3.6x
AT&T	DirectTV	Wirelines	72%	8x	17%	1.7x	2.7x
Anheuser-Busch InBev	SAB Miller	Food and Beverage	37%	21x	22%	2.3x	4.4x
		<b>Average<sup>2</sup></b>	42%	28x	28%	2.5x	3.7x

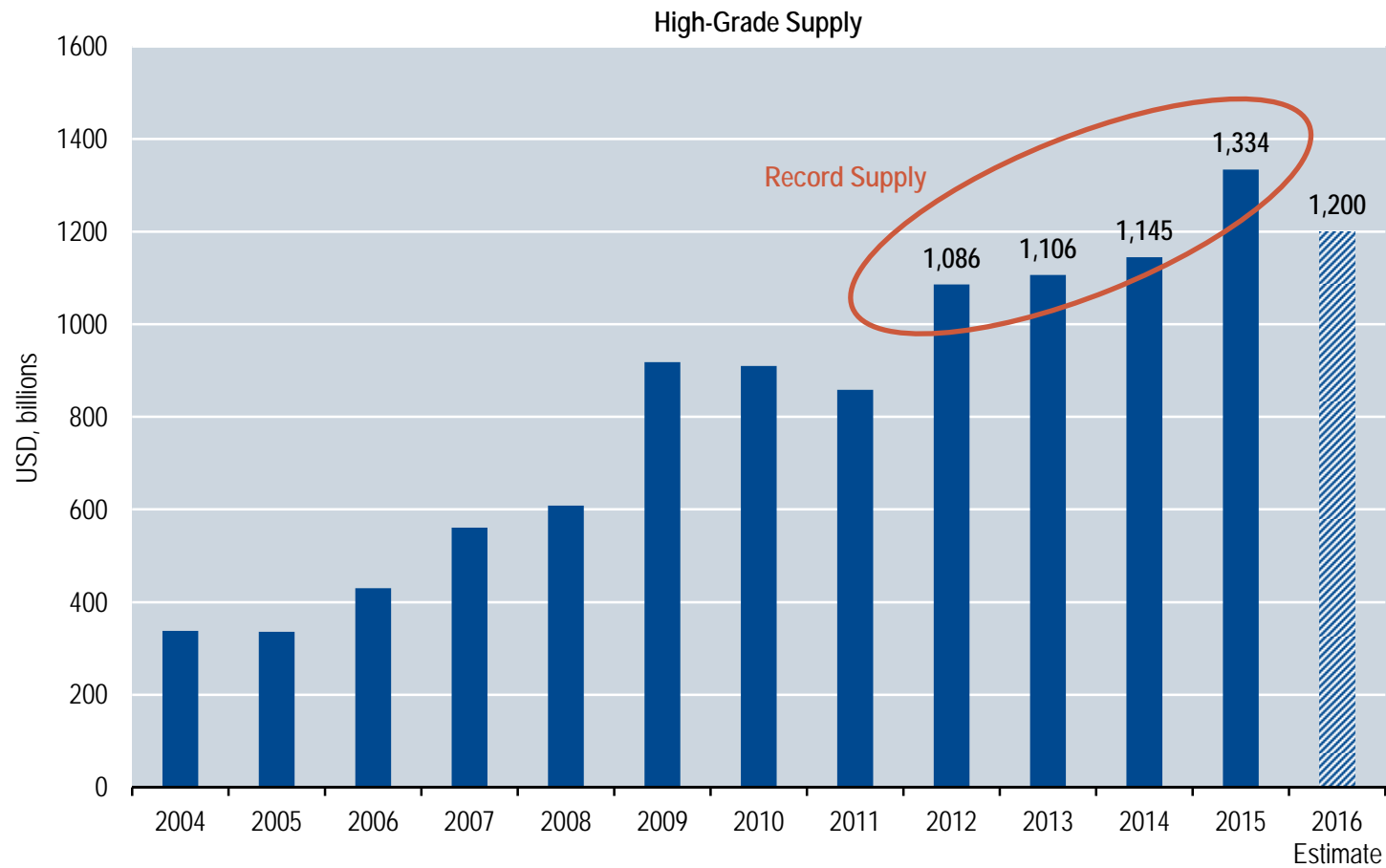
Source: Bloomberg, Western Asset. As of 24 Feb 16

<sup>1</sup>Debt/Cap

<sup>2</sup>Average excludes N/A and outliers.

### Fundamentals

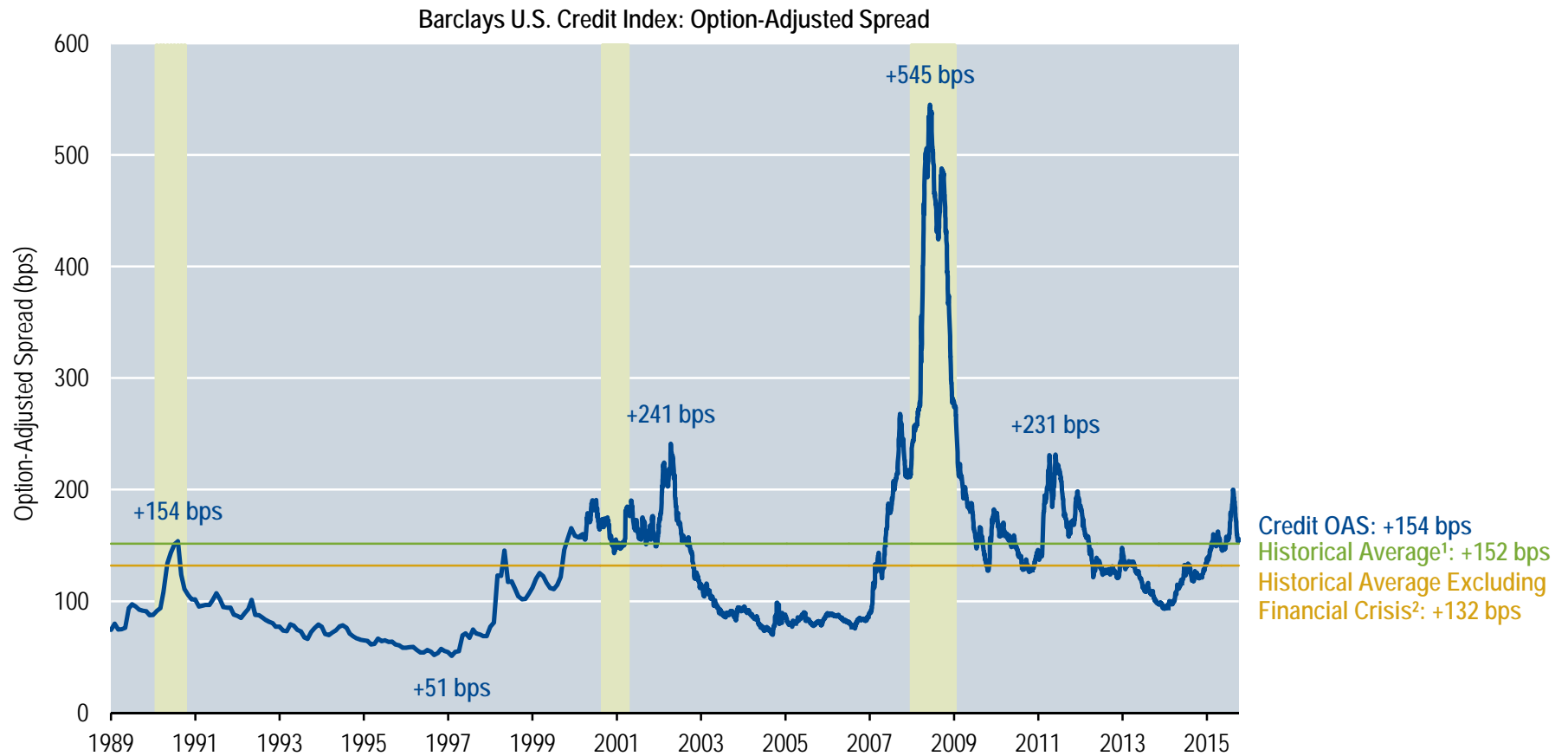
# Massive New-Issue Supply Continues to Weigh on High-Grade Corporates



Technicals

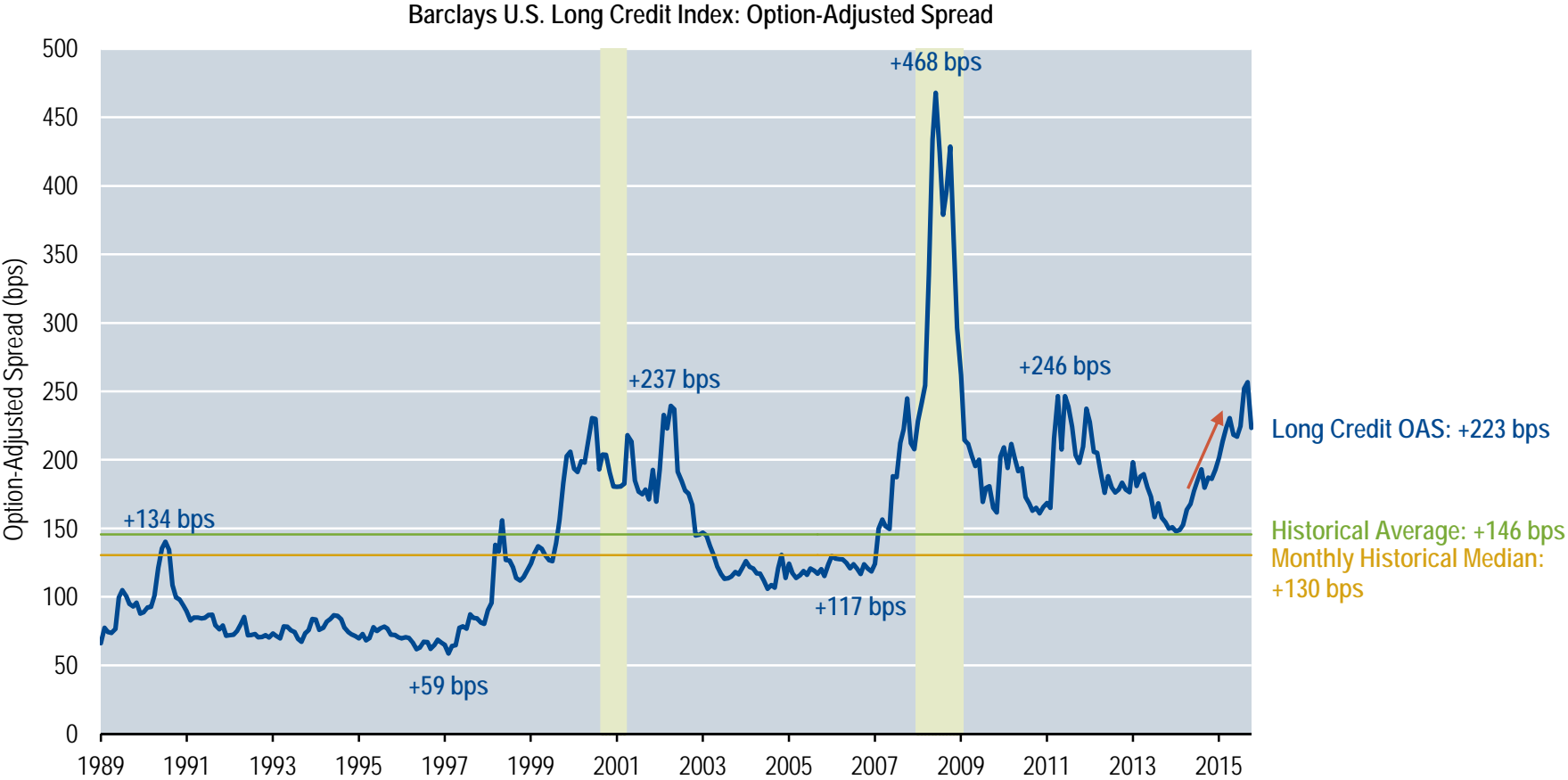


# IG Spreads Appear Attractive at Long-Term Average



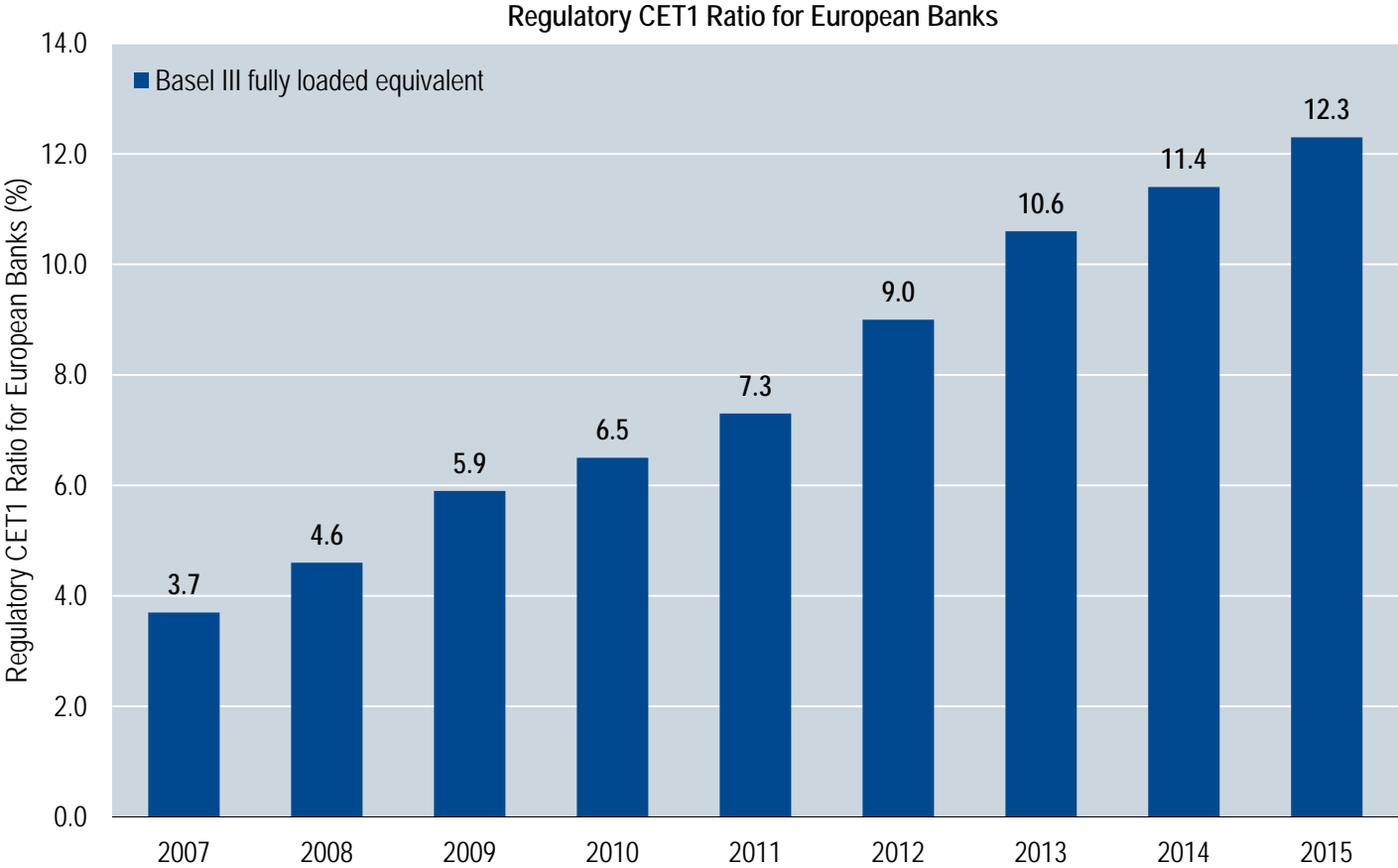
Source: Barclays. As of 31 Mar 16  
 Periods of recession highlighted in yellow.  
<sup>1</sup>Average based on monthly data from 30 Jun 89 – 31 Jul 00, and daily end of business days from 15 Aug 00 to current.  
<sup>2</sup>Excludes data from 01 Dec 07 – 30 Jun 09

# Long Spreads Remain Attractive



Source: Barclays. As of 31 Mar 16  
 Periods of recession highlighted in yellow.  
 \*Monthly average since June 1989

# Strategy 1: Both US and European Banks Have Dramatically Improved Their Capitalization



Source: BNP Paribas, 31 Mar 16

## Strategy 1 (continued): Why Bank Spread Underperformance in Q1 2016?

10-Year Senior Bank Spread History

		31 Dec 15 Year End	08 Apr 16 Today	Change from Year End
BAC	10yr	139	167	+28 bps wider
JPM	10yr	123	142	+19 bps wider
GS	10yr	144	175	+31 bps wider
MS	10yr	134	169	+35 bps wider
WFC	10yr	117	125	+8 bps wider
US Bank Avg:		131	156	+25 bps wider
IG Credit Index OAS (bps)		155	154	-1 bps tighter
IG Credit Index Yield		3.54%	3.02%	-52 bps lower in yield
HY Index Yield		8.74%	8.15%	-59 bps lower in yield

Source: Barclays, Bloomberg. As of 08 Apr 16

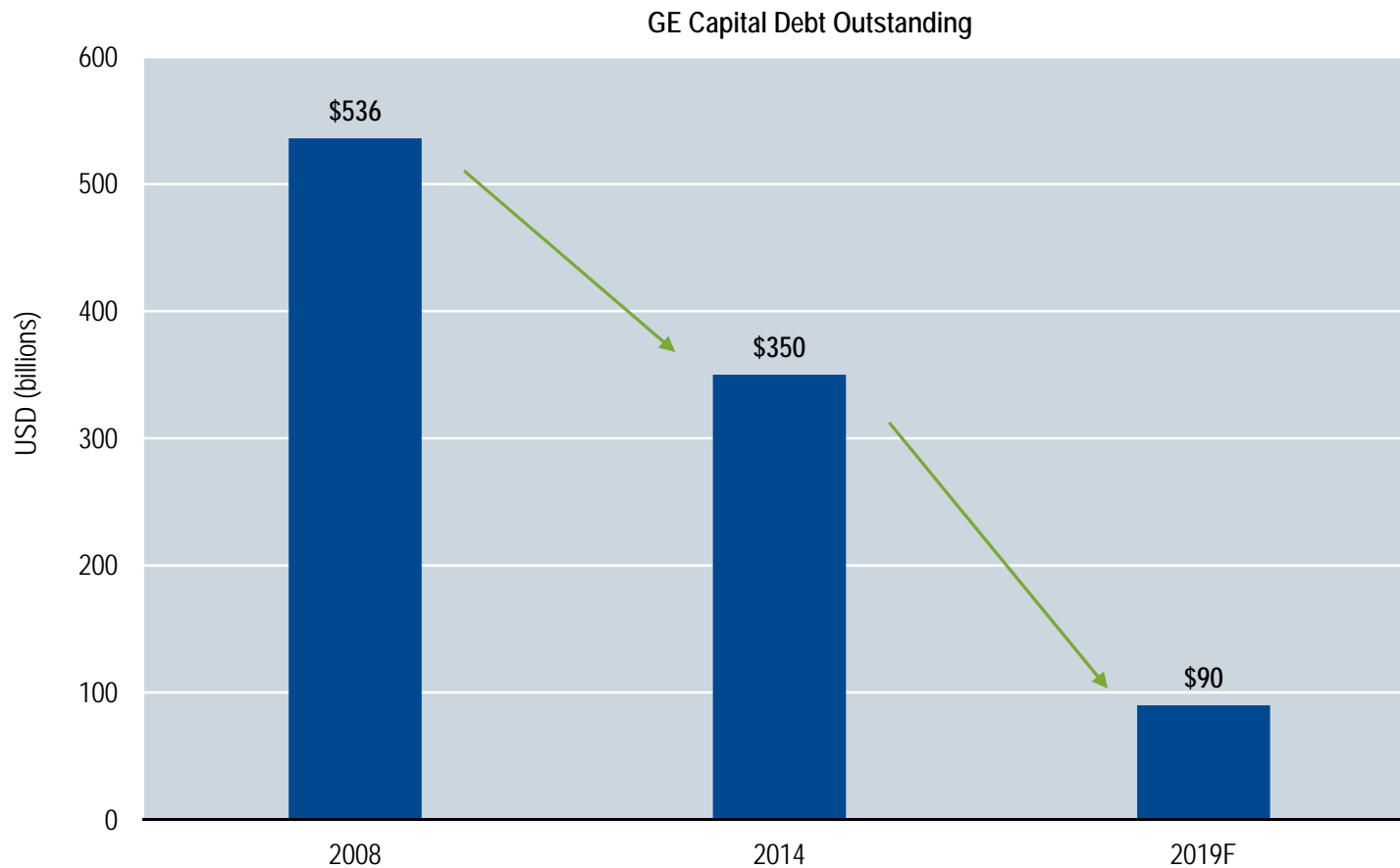
### Fundamental reasons

1. Global recession fears
2. Rate hikes now off the table, leading to lower net interest margin
3. Reduced sales, trading (volumes/liquidity)

### The "Noise"

4. Energy/Metals Loan Exposure
5. US Politics: "Break up the banks"

## Strategy 1 (continued): General Electric – A Structural Change in the Business Model



Source: General Electric Capital Corp

**Significantly Smaller Funding Footprint**

Fundamentals

## Strategy 2: Avoiding Landmines ...Healthcare Next?

---

Worst Performing Subsectors in 2015

Subsector	Excess Return (%)
Basic Industry	-8.37
Energy	-8.01
Electric Utility	-2.06
Communications	-2.05

All were largely Western Asset underweights on a duration contribution basis in 2015

## Strategy 3: Adding to Energy – Who Can Borrow at \$30 Oil?

Date	Issuer	Rating	Amount	10-Year Spread	10-Year Spread
				July 2014 (bps)	11 Apr 16 (bps)
Nov 15	Halliburton Co.	A2/A	7.5bn	77	208
Dec 15	Schlumberger Holdings Co.	A2/AA-	\$6.5bn	63	170
Dec 15	Devon Energy Co.	Ba2/BBB	\$1.6bn	71	455
Mar 16	Occidental Petroleum Co.	A3/A	\$2.75bn	83	148
Mar 16	Anadarko Petroleum Co.	Ba1/BBB*	\$3.0bn	88	325

*\*\$1bn Tender Announcement for 2bn outstanding 2017 note @ T+90 = \$106+*

### No HY Energy issuance during 4Q15 or 1Q16

Source: Barclays. As of 11 Apr 16

Technicals

## Strategy 4: Buy After the “Bad Deed”

Negative credit event risk and leveraging transactions are unfortunately on the rise

We like good companies with a clear, post-transaction deleveraging strategy and attractive new issue concessions

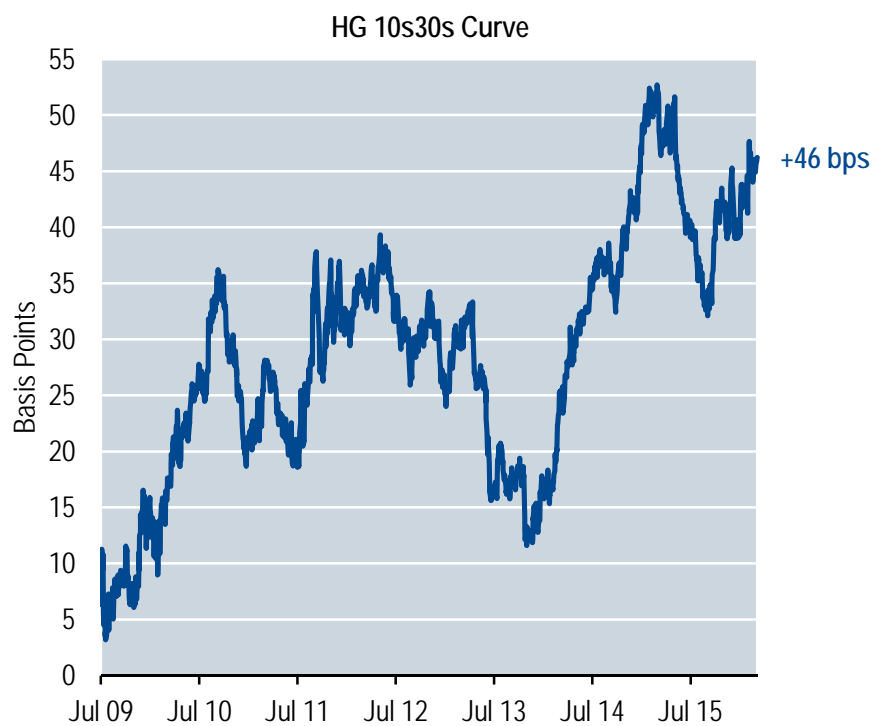
Date	Subsector	Acquirer/Issuer	Target/M&A	Rating	Issuance	10-Year Spread at Issue (bps)	Current 10-Year Spread (bps)
Sep '13	WIRELINES	VERIZON COMMUNICATIONS	VERIZON WIRELESS	BAA1	\$49 bn	+225	+139
Dec '14	HEALTHCARE	BECTON DICKINSON & CO	CAREFUSION	BAA2	\$6.2 bn	+150	+109
Dec '14	HEALTHCARE	MEDTRONIC INC	COVIDIEN	A3	\$17 bn	+140	+87
Feb '15	PHARMACEUTICALS	MERCK & CO.	CUBIST	A2	\$8 bn	+95	+65
Mar '15	PHARMACEUTICALS	ACTAVIS FUNDING SCS	ALLERGAN	BAA3	\$21 bn	+175	+168
Mar '15	HEALTHCARE	ZIMMER HOLDINGS INC	BIOMET	BAA3	\$7.65 bn	+145	+155
Apr '15	WIRELINES	AT&T INC	DIRECTV	BAA1	\$17.5 bn	+150	+153
May '15	PHARMACEUTICALS	ABBVIE INC	PHARMACYCLICS	BAA1	\$16.7 bn	+145	+117
June '15	TOBACCO	LORILLARD	REYNOLDS AMERICAN	BAA2	\$9 bn	+205	+130
Nov '15	OIL_FIELD_SERVICES	HALLIBURTON CO	BAKER HUGHES	A2	\$7.5 bn	+160	+210
Nov '15	P&C INSURANCE	ACE	CHUBB	A	\$6 bn	+135	+103
Dec '15	CON_CYC_SERVICES	VISA	VISA EUROPE	BAA2	\$16 bn	+97	+83
Jan '16	FOOD_AND_BEVERAGE	ANHEUSER-BUSCH INBEV	SABMILLER	A3	\$46 bn	+160	+124
Mar '16	CONSUMER PRODUCTS	NEWELL RUBBERMAID INC	JARDEN CORP	BAA3	\$8 bn	+235	+185
1H '16	HEALTH_INSURANCE	ANTHEM	CIGNA				
1H '16	HEALTH_INSURANCE	AETNA	HUMANA				
					\$227+ bn		

### Fundamentals

Source: Western Asset. As of 11 Apr 16



## Strategy 5: Credit Spreads – 30s Look Cheap vs. 10s



Source: J.P. Morgan. As of 31 Mar 16

### Corporate Credit 10/30 Curves

Industrials			
<i>Capital Goods</i>			
Diver. Manufacturing	General Electric 10yrs		82
Aa3/AA+	General Electric 30yrs		132
			50
<i>Communications</i>			
Wirelines	Verizon 10yrs		118
Baa1/BBB+/A-	Verizon 30yrs		192
			74
<i>Consumer Non-Cyclical</i>			
Pharmaceuticals	Gilead 10yrs		108
A3/A-	Gilead 30yrs		158
			50
Tobacco	Altria 10yrs		71
Baa1/BBB+/BBB+	Altria 30yrs		140
			69
Food & Beverage	Tyson 10yrs		355
Baa3/BBB/BBB	Tyson 30yrs		379
			24
<i>Transportation</i>			
Railroads	Burlington 10yrs		83
A3/BBB+	Burlington 30yrs		140
			57

Source: Bloomberg. As of 11 Apr 16

### Valuations

# Appendix

# Biographies

---

## FRANCES L. COOMBES

### *18 Years Experience*

- Western Asset Management Company – Client Service Executive, 1998–
- *Columbia University, School of International and Public Affairs, M.P.P.*
- *University of California, Berkeley, B.A.*

## KURT D. HALVORSON

### *15 Years Experience*

- Western Asset Management Company – Trader, 2010-
- Aegon USA Investment Management – Senior Corporate Bond Manager, 2006-2010
- 40/86 Advisors, LLC – Senior Trader, 2005-2006
- Banc of America Securities, LLC – Associate, Corporate Bond Trading, 2001-2005
- *Covenant College, B.A. Business*
- *Chartered Financial Analyst*

*Note: Western Asset experience reflects current position title and hire date.*

## Representative Client List Disclosure

---

The clients listed are invested in a wide range of mandates, and are located in a variety of countries or regions of the United States.

The clients listed in the Corporate company type have portfolios with an AUM of \$8(M) or greater.

The clients listed in the Public company type have portfolios with an AUM of \$80(M) or greater.

The clients listed in the Multi-Employer / Union company type have portfolios with an AUM of \$20(M) or greater.

The clients listed in the Healthcare company type have portfolios with an AUM of \$13(M) or greater.

The clients listed in the Eleemosynary company type have portfolios with an AUM of \$4(M) or greater.

The clients listed in the Insurance company type have portfolios with an AUM of \$5(M) or greater.

The clients listed in the Sub-Advisory company type have portfolios with an AUM of \$128(M) or greater.

Clients that have advised Western Asset of account terminations have been excluded from the lists.

## Risk Disclosure

---

© Western Asset Management Company 2016. This presentation is the property of Western Asset Management Company and is intended for the sole use of its clients, consultants, and other intended recipients. It should not be forwarded to any other person. Contents herein should be treated as confidential and proprietary information. This material may not be reproduced or used in any form or medium without express written permission.

Past results are not indicative of future investment results. This presentation is for informational purposes only and reflects the current opinions of Western Asset Management. Information contained herein is believed to be accurate, but cannot be guaranteed. Opinions represented are not intended as an offer or solicitation with respect to the purchase or sale of any security and are subject to change without notice. Statements in this material should not be considered investment advice. Employees and/or clients of Western Asset Management may have a position in the securities mentioned. This presentation has been prepared without taking into account your objectives, financial situation or needs. Before acting on this information, you should consider its appropriateness having regard to your objectives, financial situation or needs. It is your responsibility to be aware of and observe the applicable laws and regulations of your country of residence.