3Q 2024

Investment Highlights

WESTERN ASSET
A Franklin Templeton Company

Oregon Local Government Intermediate Fund

Performance Review

In the third quarter, US Treasury (UST) bond yields drifted lower, and the 10-year yield hit its lowest level in over a year; the yield curve bull-steepened and the 2s-10s segment disinverted and turned positive for the first time since mid-2022. US economic data increasingly showed the balance of risks shifting more convincingly in favor of a Federal Reserve (Fed) rate cut, which culminated in the Fed initiating a long-awaited rate normalization cycle and delivering its first rate cut since March 2020. Despite a dramatic but short-lived risk-off episode in early August—which saw the VIX Index rising to an intraday high of nearly 60—risk assets ultimately rallied as credit spreads tightened and the S&P 500 Index hit a new record high toward the end of the quarter.

In the US, data releases reinforced the trend of a softening job market and continued disinflation. Nonfarm payrolls rose by 142,000 in August, which fell short of consensus expectations. Revisions to the prior months' additions pushed the three-month average to its lowest level since mid-2020. The unemployment rate crept higher—rising to 4.3% in July, which triggered debate over the "Sahm Rule" and whether the jobless rate indicated that the economy is already in a recession—before ticking lower to 4.2% in August. Meanwhile, inflation continued to decelerate with core and headline Consumer Price Index (CPI) falling to 3.2% and 2.5% year-over-year (YoY), respectively, from 3.4% and 3.3% at the end of the second quarter, respectively.

As of 30 Sep 24	Portfolio (gross)	Portfolio (net)	Index*
3Q24 Performance	3.48%	3.46%	3.50%

**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

Despite a decline in both job growth and income gains, the US economy should expand well into 2025, buoyed by housing and consumer demand. Monthly core inflation should continue to run near Federal Reserve (Fed) target levels, helped by modest goods deflation and declining shelter and services inflation. US bond yields remain high relative to pre-pandemic growth and inflation.

Our base case calls for further weakening in global growth and further declines in inflation with a greater emphasis on services disinflation. Goods price inflation is running modestly below pre-pandemic levels, but with ongoing deflationary pressures from Asia, it's hard to see a meaningful persistent uptick moving forward. Services inflation remains elevated, but wage pressures are abating as job markets soften and service sector demand is slowing. Headline inflation is close to target in most advanced economies. This has allowed central banks to reduce policy rates as inflation concerns lessen growth concerns. Growth is slowing in the US and remains moribund in the rest of the world. At the same time, lower policy rates and the recent Chinese stimulus package should lessen recessionary fears. We remain overweight to interest rate duration, but less so as rates have fallen, and markets have moved closer to our base case. Spread sectors have performed well and we expect this to continue if the downward growth trajectory remains gentle and services disinflation continues. However, valuations now have less yield advantage to offset potential macro and political risks going forward. Emerging market debt appears to remain fundamentally attractive, but both internal and external political risks have hampered performance in some countries.

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