Investment Highlights

Western Asset
A Franklin Templeton Company

Oregon Local Government Intermediate Fund

Performance Review

In the second quarter of 2025, the portfolio outperformed its benchmark, the Bloomberg 1-5 Year US Government/Credit Bond Index, by 10 basis points (bps) on a gross basis.

During the second quarter, increased volatility was marked by geopolitical shocks and macro crosscurrents. The market saw bouts of risk-off sentiment, most notably following the "Liberation Day" tariff announcement on April 2 and the brief US, Iran and Israel conflict. Markets subsequently rebounded as most tariffs were delayed, and Iran and Israel agreed to a tentative ceasefire. Despite these shocks, US Treasury (UST) yields twisted steeper as the front end of the yield curve declined while long-end yields rose on concerns of rising deficits and potential inflation reacceleration. Risk assets had a strong performance as the S&P 500 Index broke a new record and fixed-income credit spreads tightened.

US job growth accelerated in May. Nonfarm payrolls rose by 139,000 jobs, stronger than April's downwardly revised gain of 120,000 (from 185,000). However, the unemployment rate remained steady at 4.2%. Inflation data continued to soften over the quarter. Over the last three months, the year-over-year (YoY) core Consumer Price Index (CPI) data fell from 3.10% to 2.80%. Core Personal Consumption Expenditures (PCE), which excludes food and energy prices and is the Federal Reserve's (Fed) preferred measure of inflation, declined from 2.80% YoY to 2.70% YoY.

The Fed kept its policy rates unchanged at both the May and June Federal Open Market Committee (FOMC) meetings at 4.25%-4.50%. The latest Summary of Economic Projections (SEP) indicated that the median FOMC committee member expects two 25-bp cuts by the end of 2025 and one further cut in 2026. May inflation data proved slightly weaker than expected, which, combined with a downward revision to the 1Q25 GDP reading, saw UST yields fall and investors discount additional easing from the Fed. By the end of June, markets expected 67 bps of policy rate cuts by year end, up from 55 bps at the beginning of the month.

The Bank of Japan (BoJ) announced it would slow the pace of its bond purchases as BoJ Governor Kazuo Ueda suggested that more progress was needed before inflation expectations were anchored at 2%. The Japan Ministry of Finance announced it would reduce long-term Japanese government bond debt issuance in favor of shorter maturities. This followed a sharp steepening of the local yield curve as the BoJ reduced its bond purchases.

As of 30 Jun 25	Portfolio (gross)	Portfolio (net)	Index*
2Q25 Performance	1.60%	1.58%	1.50%

**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

Economic Resilience Supports Our Soft-Landing Scenario: Despite uncertainty around Trump's tariffs as well as his fiscal and immigration policies, the US economy remained resilient. The One Big Beautiful Bill Act has the Fed and investors alike closely watching its impact on growth and inflation. Inflation is expected to be contained with likely tailwinds from lower prices for shelter and services, but tariff pass-through to goods should increase prices in the second half of 2025.

US government policy has caused severe volatility in fixed-income markets over the last several months. Global growth is expected to slow given heightened unpredictability but should remain positive. US growth is downshifting due to a myriad of factors including tariff uncertainty, waning benefits from immigration and reduced government spending in recent years. A significant fiscal boost from European defense and German infrastructure spending should support eurozone growth and provide relief from tariff-related uncertainty. Deflationary pressures in China persist and confidence is weak amid property market concerns, but sentiment is improving with fiscal stimulus and policy easing. Overall monetary policy remains restrictive, and we believe that central banks will continue to cut rates. The Fed remains well positioned to provide support if the US economy falters. Public debt levels continue to rise and yield curves may steepen further given concerns over fiscal policies. 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 some sectors and warrant caution. We will continue to look for further periods of volatility to add to spread risk.

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