

For Immediate Release

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WESTERN ASSET: CREDIT SPREADS TO NARROW FURTHER; CORPORATE BONDS TO OUTPERFORM RISK-FREE GOVERNMENT COUNTERPARTS

London – 25 June 2009 – Despite stabilising economic activity and improving lending conditions, the path to recovery remains fragile, warns Western Asset Management, the global fixed income manager wholly-owned by Legg Mason, Inc. Central banks should stay vigilant for signs of slippage as there are forceful headwinds that will limit consumer spending growth.

“Savings rates in the U.S. still must rise farther. Consumption patterns in Germany and Japan still must rebalance away from external absorption toward domestic absorption. This will take time and limit upside potential well into next year,” said Mike Zelouf, Director of International Business at Western Asset.

Longer-term concerns notwithstanding, Western Asset is confident that economic activity should stabilise and resume growth in the near term, albeit at more subdued rates. The inventory liquidation cycle, which had been magnified by the credit crunch and has been the primary drag on economic growth, is nearing completion.

“Ongoing disinflation across much of the globe remains our base-case scenario. We will continue to look for signs that productive capacity has been destroyed, which could result in rising pricing pressures. Until we see evidence of that, we would expect the large negative output gap to justify both lower real yields and modest disinflation,” Zelouf continued.

Due to extreme yield curve steepening and extra duration being a relatively inexpensive diversifier, Zelouf said the firm is looking at extending duration out along the curve but will do so tactically in an attempt to take advantage of market volatility.

The global fixed income manager recently closed out currency strategies by bringing portfolio exposures back in line with their benchmarks. “The sharp U.S. dollar depreciation had been advantageous for our positioning, but the scope for additional gains in such a volatile marketplace is no longer compelling. We have therefore reduced currency risk to negligible levels until clearer opportunities emerge for either tactical trades or longer-term trend strategies,” explained Zelouf.

In terms of primary allocation strategy, Western Asset will continue to focus on credit markets and underweight in government debt. “We eliminated our long-standing overweight to agency mortgage-backed securities and now stand neutral to slightly underweight. The strategy had worked well since mid-November but, despite ongoing Fed purchases of agency debt, we feel the yield advantage has shrunk and is close to being offset by underlying pre-payment risks,” said Zelouf.

He said the firm has instead shifted allocation into the investment-grade corporate sector and will continue to hold select high-yield issues. Despite the recent narrowing, spreads still offer tremendous protection against default risks, especially in the financial subsector and some of the non-cyclical industries, including healthcare, telecommunications and utilities.

“We have been pleasantly surprised by the strength of the rally over the past two and a half months. We had expected spreads to converge toward fundamental value at a slower pace and are pleased to see market prices rising toward what we have long felt are more accurate valuations,” he added.

Despite the outperformance of the past two months, Western Asset still believes that credit spreads have further to decline and that these riskier markets will outperform their risk-free counterparts for the remainder of 2009 and possibly beyond. Spreads on U.S. investment-grade debt are still more than 100 bps wider than their 2002 peak, a time when corporate balance sheets were in far poorer condition. There is a massive amount of cash that had fled for the safety of prime money market funds and is currently earning close to 0% interest.

“As that cash is slowly redeployed, we believe credit spreads will continue to grind tighter over coming months and quarters,” Zelouf concluded.

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Note to Editors

About Western Asset

Western Asset is one of the world's leading fixed income managers with over US\$473.4 billion (March 31, 2009) under management. With offices in the United States, London, Tokyo, Singapore, Hong Kong, Melbourne and Sao Paulo, the company offers clients a full range of local and cross-border fixed income products. By devoting all of its resources to fixed income, Western Asset can provide a full commitment to clients in every area. This focused approach has generated positive long-term returns in a variety of products with varying risk disciplines. Western Asset's long performance track record and global presence has positioned the company to continue its commitment to excellence in fixed income investment management and client service.

About Legg Mason

Legg Mason, Inc., headquartered in Baltimore, USA, is a global investment management firm with assets under management totaling US\$632.4 billion as of March 31, 2009. Serving clients in 180 countries, Legg Mason is the 10th largest asset manager in the world¹. Legg Mason's wholly-owned, independently-operated investment subsidiaries manage equity and fixed income assets across the world's major markets. Collectively, they offer a broad spectrum of asset management styles.

¹ Legg Mason is the 10th largest asset manager in the world based on worldwide assets under management as of 31 December 2008. Source: Pensions & Investments May 2009 ranking.

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