Western Asset Management- Core Full Discretion
Global Fixed: Barclays Aggregate Benchmark

For the month of: September 2016

Manager Performance Calculations

** Annualized returns*

	Last Month	Last 3 Months	Last 1 Year	Last 3 Years*	Last 5 Years*
Western	0.21%	1.86%	9.00%	6.03%	5.47%
BC Aggregate	-0.06%	0.46%	5.19%	4.03%	3.08%

Performance Attribution & Strategy Comments

Performance Review - The portfolio outperformed its benchmark in September. The portfolio returned 0.21% while its benchmark, the Bloomberg Barclays U.S. Aggregate Bond Index, returned -0.06%. High-yield exposure, where held, was a contributor to performance. Yield curve positioning was a detractor as long-term yields rose and the curve steepened.

Outlook Summary - Recently, there have been conflicting comments from different Fed members which have raised questions about the direction of US monetary policy. Our view is that the Fed would like to raise rates but it is unlikely to do so unless and until 1) economic growth is in line with the Fed's forecast, 2) financial conditions improve significantly and 3) inflation expectations rise. We acknowledge the reasonable argument that financials conditions have improved, and perhaps sufficiently to satisfy the Fed, but they still face two main challenges. First, growth continues to come in lower than Fed expectations. This year's growth rate has been only 1% and it has averaged 1.2% over the last four quarters. The Fed has been looking for growth to come in solidly above 2%. We believe its optimism on growth is misplaced, as it has been for the last five years. We believe the US economy is running at roughly 1.5%, but with risks to the downside. We have been emphasizing the softening manufacturing sector as a major drag on GDP growth, a factor that we believe is underappreciated by the market. The second challenge is that the market signals for inflation expectations are lower than the Fed's projection for inflation and have been steadily declining. We believe there are two particularly important reasons for ever-lower inflation expectations. First, the global inflation outlook remains subdued. Developed markets are struggling to generate positive inflation due to either significant slack in resource markets (Europe) or due to sluggish demand and high savings rates (Japan). The second reason is that wage growth in the US has failed to move up, even as the unemployment rate has fallen below 5%. This weak wage growth is most likely tied to declining trends in productivity and downward labor compensation pressure due to competition from foreign workers, a shift from manufacturing to retail and service jobs, etc. We acknowledge recent excess returns for spread sectors have been remarkable, particularly following the low mark in February, and value has become more challenging to find in this market. We have therefore reduced risk on the margin, but we still see areas that represent attractive opportunities. Our client's portfolios are positioned for an economic recovery and we are still overweight spread sectors. Our central theme remains that favorable valuations, strong fundamentals, reasonable growth and accommodative monetary policies are a powerful backdrop for spread sectors. We continue to be cautiously optimistic that growth will hold up. We expect that the US economy can continue to expand at roughly 1.5% and the global economy at approximately 3%. This expectation will require that global central banks remain accommodative but it suggests that spread sectors should outperform USTs and other developed country sovereign bonds; however, the downside risks to growth and inflation are real. We continue to maintain an overweight to the back end of the yield curve. We believe having extra-long-maturity UST duration is an important portfolio asset in conjunction with overweights to spread product. We believe growth is slow yet sustainable, but a flattening yield curve has historically been a harbinger of economic weakness. We believe we need to heed the message of the yield curve and protect against downside risks.

Manager Style Summary

Western manages a customized portfolio for PERSI, which falls outside of their traditional product offerings. While the product is called, "Core Full Discretion" (one of their traditional products), Western has the flexibility to invest in global inflation-linked bonds and to take bigger bets where they see the opportunity. As such, this portfolio is more volatile than the traditional underlying product. This global mandate allows Western to hold foreign, non-dollar denominated securities, take currency positions, and enter into futures, options and swaps contracts.

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Portfolio Guideline Compliance — September 2016

Portfolio Guideline:	Western	Min	Max	Compliance
C. Weighted average duration including futures positions	6.13	-30.00	30.00	ok
C4 (2): Sector Allocation				
a. Non-dollar denominated securities		0%	40%	ok
Un-hedged non-dollar denominated securities		0%	20%	ok
b. U.S. securities rated below investment grade (BIG)		0%	40%	ok
c. Non-dollar, Non-U.S. securities rated BIG		0%	20%	ok
d. Non-dollar denominated+emerging mkt+high yield		0%	50%	ok
C4 (3): Issuer				
a. Guaranteed by US gov, agencies, gov-sponsored corp or G-7		0%	100%	ok
b. Other national governments - limit per issuer		0%	10%	ok
c. Private MBS/ABS - limit per issuer		0%	10%	ok
If collateral is credit-independent of issuer & security's credit enhancement is generated internally - limit per issuer		0%	25%	ok
d. Obligations of other issuers subject to per issuer limit		0%	5%	ok
C4 (5): Credit				
No more than 40% of portfolio below Baa3 or BBB-/A2 or P2		0%	40%	ok
C4 (7): Derivatives				
Original futures margin and options premiums, exclusive of any in-the-money portion of the premiums		0%	5%	ok
F2. Annual Turnover	82%	100%	200%	check
The portfolio is in compliance with all other aspects of the Portfolio Guidelines			☑ Yes	☐ No

Manager Explanations for Deviations from Portfolio Guidelines

Annual Turnover: percentages are based off market values that have not yet been reconciled

Other: (94132LAA5) - WATERFALL COMMERCIAL MORTGAGE TRUST 2015 SBC5 A was deemed illiquid as of July 13, 2016. We will continue to hold unless instructed otherwise.

E5. Derivatives:

Organizational/Personnel Changes

Account Turnover

Gained: Number of Accounts: Total Market Value ($m):

Lost: Number of Accounts: Total Market Value ($m):

Reason(s):