

**WESTERN ASSET MANAGEMENT- US TIPS FULL DISCRETION
DOMESTIC FIXED: BARCLAYS TIPS BENCHMARK**

FOR THE MONTH OF: **AUGUST** **2016**

MANAGER PERFORMANCE CALCULATIONS

* Annualized returns

	Last <u>Month</u>	Last <u>3 Months</u>	Last <u>1 Year</u>	Last <u>3 Years*</u>	Last <u>5 Years*</u>
Western TIPS	-0.42%	2.31%	3.75%	1.81%	1.23%
Barclays TIPS	-0.45%	2.50%	5.37%	2.71%	1.77%

PERFORMANCE ATTRIBUTION & STRATEGY COMMENTS

Performance Review - The portfolio outperformed its benchmarks in August. We employed duration tactically, and duration was a small detractor over the month. Our curve bias was a positive contributor as the curve continues to flatten. We further reduced our underweight to tips during the month which was a small positive contributor to performance.

Outlook - The inflationary environment remains extremely mixed, with the moderate recovery in global demand led by Europe, balanced against a sluggish US economy and suspicion that China is slowing more rapidly than expected. Energy prices, which continue to be overshadowed by excessive inventory overhangs in both crude and products, managed to rebound into the mid \$40s, surrendering some of their gains into the end of August, and with an eye to the upcoming discussion of production freezes set for late September. In Europe, the economy continues to beat expectations supported by ECB policy, and the shock of the Brexit vote ebbed further in August, though we expect this to resurface as the UK Government is called to enact the wishes expressed in the vote, and enact the infamous "Article 50" that governs the UK relationship with Europe. The Italian referendum on constitutional reform in November begins a tough nine months within which we see elections in France and Germany, although recent stress in European bank stocks abated somewhat in August. Against this troubled backdrop we expect further Global Central Bank stimulus to support inflationary impulses, with an eye on the meetings in September. We remain convinced that inflation has bottomed and is on a firmer footing, and recent data adds to that confidence, supporting inflation linked assets. But the reversal in the Chinese currency, which revisited it's worst levels of 2016, has reignited concerns over the Chinese economy, undermining confidence that inflation is on the rise. Furthermore, the lack of US wage growth and weak US productivity continue to cast a heavy shadow over the US inflation outlook, though the strengthening labor market perhaps points to an end to these fears in the near future. So overall, the global inflation outlook remains extremely mixed, continuing to hamper the Fed's desires for normalization of interest rates, while challenging the success of the ECB and BoJ monetary stimulus efforts. Therefore we expect global Central banks to continue to add to stimulus at least until headline inflation rates begin to move in the right direction. As such, both real and nominal yields in the U.S. are low for current domestic conditions. However, we remain cautious due to still fragile global conditions and the attractive level of real (and nominal) U.S. yields relative to other developed markets. With so many turbulent cross-currents, expect us to remain tactical with our stance on US Tips, with a bias to own them. We added to energy-related investment grade corporates in the month, and expect us to add further in the future, to enhance the yield of the portfolio.

MANAGER STYLE SUMMARY

Western manages a Core Plus account in addition to this TIPS mandate. This is an expansion of our existing SSgA TIPS (Treasury Inflation Protected Securities) allocation in that this portfolio will be actively managed and will not employ a buy and hold strategy however, it will be more limited than what was our Bridgewater global TIPS portfolio. Western is limited to hold no more than 20% of the portfolio in non-inflation-linked bonds, but does have the latitude to hold foreign, non-dollar denominated securities, take currency positions, and enter into futures, options and swaps contracts, provided our daily pricing requirements are met..

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PORTFOLIO GUIDELINE COMPLIANCE

AUGUST 2016

Portfolio Guideline:	Barclays TIPS	Western	Min	Max	Compliance
C2. Weighted average duration including futures	8.19		5.73	10.64	ok
Weighted average duration with options			6.55	9.82	ok
C3. Credit Quality					
(1) Rated securities: % invested in investment grade			80%	100%	ok
C4. Diversification					
(2a) Sector: % invested in IPS and/or floating rate securities			80%	100%	ok
(2b) Sector: % invested in US TIPS and/or floating rate securities			80%	100%	ok
(2c) Sector: % invested in non-IL bonds and MBS			0%	20%	ok
(2d) Sector: % invested in extended sectors including emg mkts			0%	20%	ok
Max invested in any one of the extended sectors					check
(2e) Sector: % invested in un-hedged non-dollar exposure			0%	15%	ok
(3a) Issuer: Limit of obligations of non-benchmark issuers			0%	5%	ok
(4) Credit: % invested in issues rated below Baa3 or BBB- / A2 or			0%	20%	ok
(5) Derivatives: % invested in orig futures margin & option prem			0%	5%	ok
Max net credit derivative exposure (as % of mkt value)			0%	40%	ok
F2. Annual Turnover		63%	150%	250%	check
The portfolio is in compliance with all other aspects of the Portfolio Guidelines				<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No

MANAGER EXPLANATIONS FOR DEVIATIONS FROM PORTFOLIO GUIDELINES

F2. Annual Turnover: Please provide explanation.

ORGANIZATIONAL/PERSONNEL CHANGES

ACCOUNT TURNOVER

Gained:	Number of Accounts:	Total Market Value (\$m)
Lost:	Number of Accounts:	Total Market Value (\$m)
	Reason(s):	