

**For Immediate Release**

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**Western Asset more convinced rates will stay low following Greek crisis**

**Singapore – 31 May 2010** – The Greek funding crisis has made it more likely for central banks to keep policy rates at low levels for some time, according to Western Asset, Legg Mason-owned fixed income manager with over US\$482 billion of assets under management.

Western Asset argues that, while reining in sovereign balance sheets is occupying policymakers' and investors' minds, other concerns are that disinflationary pressures remain strong across most major economies and that extreme excess capacity in labour markets may result in subdued wage growth.

"We have always considered quantitative easing a necessary policy response that mitigated an extreme deflationary shock to one of mere disinflation. Today, as sovereign solvency concerns rise along with debt-to-GDP ratios, we believe the burden on monetary authorities will only increase. Rate hikes are likely a distant event," said Mike Zelouf, Director of International Business at Western Asset.

While sovereign solvency concerns have taken their toll on investors' risk appetite, the combination of economic recovery and official rates anchored at historically low levels should continue to support credit spreads. Default rates are declining and corporate profitability is rebounding faster than expected.

As most financial firms have beaten optimistic earnings expectations in the past two quarters, Western Asset expects companies to enjoy ongoing profitability, given steep yield curves and a wide opportunity to generate trading profits. This, together with central bank liquidity provisions, should reduce the risks of system-wide credit contraction even during periods of market volatility.

Western Asset has recently shifted exposure up the capital structure into more senior ranked issues that are less sensitive to profits and more dependent on cashflows and balance sheet metrics. It is running closer to neutral positions in the industrial and utility sectors, favouring U.S. over European markets in the belief that spreads in these sectors offer far less compensation given the impressive rally of last year.

"We remain comfortable with extra duration. We anticipate yields to continue to fluctuate within their current range and expect curves in the U.S. and Europe to flatten from historically steep positions. Rate hikes should not occur as early as the market expects and terminal policy rates may now be much lower than historic levels," said Mike Zelouf.

“We have chosen to emphasise countries that we believe will have little trouble funding deficits in coming years. We prefer the U.S. over the U.K.. The U.S. economic rebound should be sharper, longer-term trend growth should be higher and dollar markets should benefit from the reserve currency status of the U.S. dollar. The U.K. faces a more daunting task in reducing its government budget deficit in the face of greater political uncertainty, although early signs from the new coalition government point to a determined commitment to reducing the deficit. We don’t believe U.K. yields will rise meaningfully,” he added.

Western Asset feels comfortable with modest additional duration in Europe, particularly on longer-dated issues, and believes intra-country risk differentiation is crucial. It will maintain a reduced allocation to the periphery, primarily through large underweight positions to Italy, Spain and Portugal.

While Greek fundamentals are weak, the amount of compensation Greek debt offers is considerably higher than the rest of peripheral Europe. As such, Western Asset has partly covered the underweight to peripheral European markets with Greek five-year notes and inflation-linked issues. It also prefers regional countries that are not part of the currency union and therefore have the advantage of competitive currencies, better growth potential or superior debt metrics. These countries include Poland, Norway and Australia.

For the same rationale that governs its peripheral European underweight, a significant short euro position is also an important strategy for Western Asset.

In the case of extreme turmoil, Zelouf expects the European Central Bank (ECB) to initiate another round of liquidity measures and conduct further outright asset purchases should Greek contagion spread. This could be severely damaging for the euro. The ECB risks facing a dilemma should a struggling, deflationary periphery stand in stark contrast to a resurgent German economy.

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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\$482.2 billion (December 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 US\$685.3 billion assets under management, as of April 30, 2010. Serving clients in 180 countries, Legg Mason is the 10th largest asset manager in the world<sup>1</sup>. 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.

<sup>1</sup> Legg Mason is the 10<sup>th</sup> 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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