

For Immediate Release

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WESTERN ASSET: LABOUR MARKETS HOLD THE KEY TO SUSTAINABLE RECOVERY

Singapore – 21 April 2010 – While labour markets are traditionally a lagging indicator, they may at present offer strong predictive power for the future path of economic activity, according to global fixed income manager Western Asset. Until a clear trend of rising employment is established, the likelihood of a double-dip recession will remain the primary threat to the firm's base-case scenario of modest growth, gradual disinflation and supportive monetary policy.

The latest US payrolls report indicated respectable job growth for the first time in nearly three years, while the unemployment rate in some of the stronger European countries looks to be near a plateau as well. Concerns remain about whether the wider G7 will suffer through a jobless recovery as did the US following its last two recessions.

"Lost jobs do not necessarily return during an economic recovery, as the composition of growth often shifts. Today, for example, real estate, financial services and the construction sector appear to have suffered a permanent decline. It will take time, possibly years, for former employees in these sectors to retrain and find jobs elsewhere," says Mike Zelouf, Director of International Business at Western Asset.

The heightened degree of uncertainty surrounding the recovery has also discouraged some businesses from hiring until greater clarity is reached. This validates concerns about a double-dip recession further down the road in a number of economies, especially as fiscal stimulus is scaled back in response to the perception of binding sovereign debt burdens.

Strong job creation over the next few quarters would not necessarily assuage these concerns either, as this may be more a one-off, partial retracement following the panicky plunge in payrolls in the wake of Lehman Brothers' collapse. A temporary bounce in hiring seems more likely for the US than Europe or the UK, where unemployment spiked more violently and could therefore display more noticeable rehiring.

Fixed income investors should take account of this factor when managing their portfolios, Western Asset argues.

"Given our base-case scenario of modest growth and a disinflationary bias, we are comfortable running more duration than the benchmark, both because we feel nominal yields will not rise meaningfully in the near term and because of its value as a hedge should our primary risk scenario of slower than expected growth become more likely," says Zelouf.

The UK and Japan are two exceptions where the scope for rising yields is much larger, he adds. Western Asset has prepared for flatter yield curves (especially in the US) which the firm expects to be realized as current rate hike expectations are not met. Western Asset has also chosen to reallocate

modestly toward a number of peripheral economies where interest rates compensate investors well for given risks, such as Australia and Poland. The firm maintains its bias away from the euro but has been reducing the underweight position given recent weakness. Economies with much stronger growth prospects and healthier government balance sheets, including the Polish zloty, the Norwegian krona, Brazilian real and Korean won appear to offer better value in the current environment.

Spread sectors remain the most attractive part of the fixed-income universe in Western Asset's view. The firm's expectation that central banks will remain focused on stimulating growth, in combination with the weak bargaining position of labour, should help keep profit margins healthy for the corporate sector and reduce risk premiums further. In stark contrast to sovereign balance sheets, corporate balance sheets continue to improve. For example, net cash flows are near an all-time record share of corporate GDP in the US.

"Our focus remains the financial sub sector. As spreads continue to compress, we are actively managing the composition. We recently shifted exposure up the capital structure and would expect to conduct similar risk-reduction operations should pricing continue to improve as we expect. The overweight to the corporate sector is partially funded by an underweight to the US mortgage-backed sector, which we feel will come under pressure now that the Fed has completed its buying program and spreads have reached a 20-year low. Should spreads widen meaningfully to attract alternative buyers, we may look to begin moving back toward neutral," says Zelouf.

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Note to Editors

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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.

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