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## Markets


Photographer: Michael Nagle/Bloomberg

# This Bond Manager Isn't a Household Name, But He Beats 98% of His Peers

by **Charles Stein** and **John Gittelsohn**
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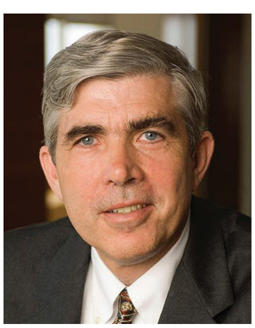
- Ken Leech bests rivals with spot-on forecasts, camera-shy ways
- Bet that inflation would rise slowly has helped drive results

Kenneth Leech isn't as well known as star bond managers like Jeffrey Gundlach and Bill Gross. Based on his performance, maybe he should be.


Kenneth Leech
Source: Western Asset Management

Leech, chief investment officer of Western Asset Management, has twice been part of a team that won Morningstar's fixed-income manager of the year award. This year, he and his colleagues are beating virtually all of their peers in the intermediate-term bond category thanks to savvy bets on interest rates, corporate debt and currencies.

"Ken doesn't emit the great man vibe that some bond managers do," Bill Miller, the legendary stock picker and a long-time colleague of Leech's, said in a telephone interview. "He is more interested in generating returns than in generating publicity."

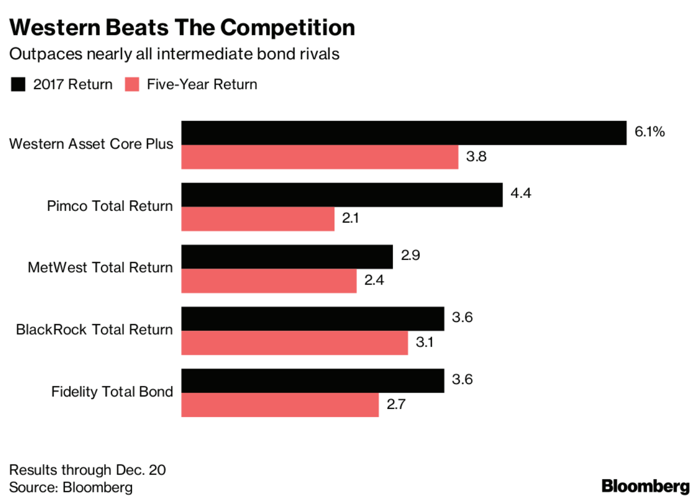
The upshot: the $21.9 billion Western Asset Core Plus Bond Fund, Leech's biggest, beat 98 percent of intermediate bond funds in 2017, and 98 percent over the past three years and five years, according to Morningstar. Along the way it outperformed intermediate-term competitors at Pacific Investment Management Co., TCW Group, BlackRock Inc. and Fidelity Investments.

The fund did well in 2017 because Leech and his team made several spot-on forecasts. They include correctly predicting that short-term interest rates would rise while long rates would move very little, that corporate bonds would make decent gains and that local currency debt in Mexico and Brazil was poised for a rebound.

"You've got better global growth and extremely subdued core inflation around the world," Leech, 63, in a telephone interview from his Pasadena, California, office. That backdrop, he said, proved ideal for investing in everything from mortgages, to corporate bonds to emerging market debt.

Leech shares management duties on 61 funds with about $100 billion of Western's $435 billion in assets. He joined Western in 1991 and rose to chief investment officer in 1998. In 2007 he was named to the Fixed-Income Analysts' Hall of Fame.

Leech is a Life Master at bridge, whose strong suit is playing the hands, which requires identifying and weighing multiple possible outcomes and risks, much like investing, according to



Dexter Senft, his bridge partner for 40 years.

"He knows how to play those cards like nobody I've ever seen," Senft, a retired fixed-income manager, said in a phone interview.

Leech rarely appears on television or radio, by design, say colleagues.

"There are only so many hours in the day and Ken wants to spend them evaluating investment ideas," said Western's deputy chief investment officer Michael Buchanan. Leech's boss, Joseph Sullivan, chief executive officer of Legg Mason Inc., said if Leech's profile was higher, it would probably help the firm attract more assets.

While the Core Plus fund attracted $2.6 billion in the first 10 months of the year, many other bond funds, most of which didn't perform as well, gathered more money, Morningstar data show. "The flows are nice, but we could always use more," Leech admitted.

In his quarterly commentaries Leech has emphasized what he calls the "two-steps forward-one step back" nature of the economic recovery and the persistence of low-inflation. That observation led to a bet that the yield curve would flatten -- that short-term rates would rise while longer-term rates would not. Yields on two-year Treasuries have climbed to about 1.88 percent from 1.2 percent in January. The yield on the 10-year, about 2.5 percent, is not far from where it was at the start of the year.

Leech is sticking with his long-held forecast that the U.S economy will grow at a moderate rate and that the Federal Reserve will push up rates gradually. Not everyone agrees.

Bob Michele, who oversees about $476 billion at J.P. Morgan Asset Management said in a recent Bloomberg interview, that the Fed could hike rates four times in 2018, more than the market is anticipating. Leech is expecting three rate increases.

"If rates really do go up in 2018 that will be a definite drag on the Western fund," said Morningstar analyst Maciej Kowara, who gives the fund his top rating.

Leech benefited this year from a January prediction that emerging market bonds from Mexico and Brazil would have a strong year. Local currency bonds from Mexico gained 14 percent and Brazilian debt returned 15 percent. Leech still favors emerging-market bonds on the theory that a better global economy will drive yields lower and prices higher.

A document Western produced for the first nine months of 2017 illustrates how good a year the Core Plus fund had. It shows positive contributions from about 10 different sources -- virtually the entire spectrum of potential bond investments.

Leech, who has been in the bond business for more than 40 years, knows how unusual that is. In September he was asked who has having a better year: his fund or the local baseball team, the first place Los Angeles Dodgers.

"It was a close call," he said, until the Dodgers lost 16 of 17 games late in the season. "Fortunately that hasn't happened to us."



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**Average Annual Total Returns and Expense Ratios (%) of Western Asset Core Plus Bond Fund Class I (WACPX), IS (WAPSX), and C (WAPCX) as of 12/31/17**

| | 1-year | 3-year | 5-year | 10-year | Since Inception | Expenses (Gross/Net)^ | Inception date |
|---|---|---|---|---|---|---|---|
| WACPX (incl./excl. sales charges) | 6.96 | 4.32 | 3.88 | 5.96 | 6.19 | 0.52/0.45 | 7/8/98 |
| WAPSX (incl./excl. sales charges) | 6.99 | 4.32 | 3.91 | - | 7.01 | 0.42/0.42 | 8/4/08 |
| WAPCX (incl. sales charges) | 5.82 | 3.19 | 2.76 | - | 3.22 | 1.52/1.52 | 4/30/12 |
| WAPCX (excl. sales charges) | 4.82 | 3.19 | 2.76 | - | 3.22 | 1.52/1.52 | 4/30/12 |
| Bloomberg Barclays U.S. Aggregate Bond Index | 3.54 | 2.24 | 2.10 | 4.01 | - | - | - |

***Performance shown represents past performance and is no guarantee of future results.*** *Current performance may be higher or lower than the performance shown. Investment return and principal value will fluctuate, so shares, when redeemed, may be worth more or less than the original cost. Class C shares have a one-year CDSC of 1.0%. If sales charges were included, performance shown would be lower. Performance for other share classes will vary due to differences in sales charge structure and class expenses. Total returns assume the reinvestment of all distributions at net asset value and the deduction of all Fund expenses. Total return figures are based on the NAV per share applied to shareholder subscriptions and redemptions, which may differ from the NAV per share disclosed in Fund shareholder reports. Performance would have been lower if fees had not been waived in various periods. Absent reimbursements and/or fee waivers, the Fund's 30-day SEC yield for Class C, I and IS, respectively, would have been 1.74%, 2.70% and 2.83%. Numbers may be the same due to rounding. To obtain the most recent month-end information, please visit www.leggmasonfunds.com.*

^Gross expenses are the Fund's total annual operating expenses for the share class(es) shown. Net expenses for Class I reflect contractual fee waivers and/or reimbursements, where these reductions reduce the Fund's gross expenses, which cannot be terminated prior to Dec 31, 2018 without Board consent.

**Sector Weights (% as of 12/31/17):** Residential Mortgage Backed 29.08, Government 23.57, Investment Grade Corporate Bonds 21.19, Emerging Market 7.45, Bank Loans 5.75, Commercial Mortgage Backed 4.38, Inflation-Linked 3.58, Asset Backed 2.63, High Yield Corporate Bonds 2.37, Cash & Cash Equivalents 0.07.

**Morningstar Fixed Income Manager of the Year:** Morningstar Fund Manager of the Year award recognizes portfolio managers who demonstrate excellent investment skill and the courage to differ from the consensus to benefit investors. To qualify for the award, managers' funds must have not only posted impressive returns for the year, but the managers also must have a record of delivering outstanding long-term performance and of aligning their interests with shareholders'. The Fund Manager of the Year award winners are chosen based on Morningstar's proprietary research and in-depth evaluation by its fund analysts.

Awarded to Ken Leech, Carl Eichstaedt, and Mark Lindbloom for Western Asset Core Bond Fund (WACSX) and Western Asset Core Plus Bond Fund (WAPSX) named Morningstar 2014 and 2004 U.S. Fixed Income Manager of the Year, United States of America. Morningstar Awards 2018 © Morningstar, Inc.

Morningstar percentile ranks and are based on a fund's total returns (including the effects of sales charges, loads and redemption fees) for the specified time period relative to all funds in the same category, the Intermediate-Term Bond category. The highest (or most favorable) percentile rank is 1 and the lowest (or least favorable) percentile rank is 100. The top-performing fund in a category will always receive a rank of 1. Ranks shown are for Class I and IS shares of the Western Asset Core Plus Bond Fund. For the period ending December 31, 2017, Class IS percentile ranks were 1% (5/986 funds) for the 1-year period, 2% (10/778 funds) for the 5-year period, and N/A for the 10-year period. Class I percentile ranks were 1% (6/986 funds) for the 1-year period, 2% (12/778 funds) for the 5-year period, and 1% (6/554 funds) for the 10-year period. Class C percentile ranks were 4% (42/986 funds) for the 1-year period, 15% (115/778 funds) for the 5-year period, and N/A for the 10-year period. Fund ranking based on institutional shares which are not broadly available to retail investors. Other share classes have different expense structures and performance characteristics. Classes have a common portfolio.

**Fixed Income Analysts Hall of Fame:** In 1995, the Fixed Income Analysts Society established a Hall of Fame to recognize the lifetime achievements of outstanding practitioners in the advancement of the analysis of fixed-income securities and portfolios. Inductees will have made major contributions to the advancement of fixed-income analysis and portfolio management. These contributions may be academic, business-related or FIASI-related. The Board of Directors determines the annual inductees.

**U.S. Treasuries** are direct debt obligations issued and backed by the "full faith and credit" of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity.

**Western Asset Core Plus Bond Fund Risks:** Fixed-income securities involve interest rate, credit, inflation, and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls. High yield bonds are subject to greater price volatility, illiquidity, and possibility of default. Derivatives, such as options and futures, can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets. Asset-backed, mortgage-backed or mortgage related securities are subject to prepayment and extension risks. Potential active and frequent trading may result in higher transaction costs and increased investor liability. Active management does not ensure gains or protect against market declines.

The **Bloomberg Barclays U.S. Aggregate Bond Index** is an unmanaged index that measures the performance of the investment-grade universe of bonds issued in the United States. The index includes institutionally traded U.S. Treasury, government sponsored, mortgage and corporate securities. Investors cannot invest directly in an index and unmanaged index returns do not reflect any fees, expenses or sales charges.

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