

WESTERN ASSET HIGH INCOME FUND II INC.

Form N-CSRS

December 28, 2017

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED**

**MANAGEMENT INVESTMENT COMPANIES**

**Investment Company Act file number 811-08709**

**Western Asset High Income Fund II Inc.**

**(Exact name of registrant as specified in charter)**

**620 Eighth Avenue, 49<sup>th</sup> Floor, New York, NY 10018**

**(Address of principal executive offices) (Zip code)**

**Robert I. Frenkel, Esq.**

**Legg Mason & Co., LLC**

**100 First Stamford Place**

**Stamford, CT 06902**

**(Name and address of agent for service)**

**Registrant's telephone number, including area code: (888) 777-0102**

**Date of fiscal year end: April 30**

**Date of reporting period: October 31, 2017**

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ITEM 1. REPORT TO STOCKHOLDERS.

The **Semi-Annual** Report to Stockholders is filed herewith.

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Semi-Annual Report

October 31, 2017

WESTERN ASSET

HIGH INCOME FUND II INC.

(HIX)

INVESTMENT PRODUCTS: NOT FDIC INSURED NO BANK GUARANTEE MAY LOSE VALUE

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**Fund objectives**

The Fund seeks to maximize current income. As a secondary objective, the Fund seeks capital appreciation to the extent consistent with its objective of seeking to maximize current income.

Under normal market conditions, the Fund invests at least 80% of its net assets, plus any borrowings for investment purposes, in high-yield debt securities. In addition, the Fund may invest up to 35% of its total assets in debt securities of issuers located in emerging market countries.

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## Letter from the chairman

**Dear Shareholder,**

We are pleased to provide the semi-annual report of Western Asset High Income Fund II Inc. for the six-month reporting period ended October 31, 2017. Please read on for Fund performance information and a detailed look at prevailing economic and market conditions during the Fund's reporting period.

As always, we remain committed to providing you with excellent service and a full spectrum of investment choices. We also remain committed to supplementing the support you receive from your financial advisor. One way we accomplish this is through our website, [www.lmcef.com](http://www.lmcef.com). Here you can gain immediate access to market and investment information, including:

Fund prices and performance,

Market insights and commentaries from our portfolio managers, and

A host of educational resources.

We look forward to helping you meet your financial goals.

Sincerely,

Jane Trust, CFA

Chairman, President and Chief Executive Officer

November 30, 2017

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## Investment commentary

### Economic review

Economic activity in the U.S. improved during the six months ended October 31, 2017 (the reporting period). Looking back, the U.S. Department of Commerce reported that first quarter 2017 U.S. gross domestic product (GDP) growth, as revised, was 1.2%. Second quarter 2017 GDP growth then accelerated to 3.1%. Finally, the U.S. Department of Commerce's second estimate for third quarter 2017 GDP growth released after the reporting period ended was 3.3%. Stronger growth was attributed to a number of factors, including positive contributions from personal consumption expenditures, private inventory investment, nonresidential fixed investment and exports. These factors were partly offset by a decrease in imports.

Job growth in the U.S. was solid overall and a tailwind for the economy during the reporting period. When the reporting period ended on October 31, 2017, the unemployment rate was 4.1%, as reported by the U.S. Department of Labor. This represented the lowest unemployment rate since December 2000. The percentage of longer-term unemployed fluctuated during the reporting period. In October 2017, 24.8% of Americans looking for a job had been out of work for more than six months, versus 24.0% when the period began.

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### **Market review**

#### **Q. How did the Federal Reserve Board (the Fed) respond to the economic environment?**

A. Looking back, after an extended period of maintaining the federal funds rate<sup>iii</sup> at a historically low range between zero and 0.25%, the Fed increased the rate at its meeting on December 16, 2015. In particular, the U.S. central bank raised the federal funds rate to a range between 0.25% and 0.50%. The Fed then kept rates on hold at each meeting prior to its meeting on December 14, 2016, at which time, the Fed raised rates to a range between 0.50% and 0.75%.

After holding rates steady at its meeting that concluded on February 1, 2017, the Fed raised rates to a range between 0.75% and 1.00% at its meeting that ended on March 15, 2017. At its meeting that concluded on June 14, 2017, the Fed raised rates to a range between 1.00% and 1.25%. At its meeting that concluded on July 26, 2017, the Fed kept rates on hold, as expected. At its meeting that concluded on September 20, 2017, the Fed again kept rates on hold, but reiterated its intention to begin reducing its balance sheet, saying, "In October, the Committee will initiate the balance sheet normalization program." Finally, at its meeting that ended on November 1, 2017, after the reporting period ended, the Fed maintained the federal funds rate in the target range of 1.00% to 1.25%, but left open the possibility of another rate hike in December 2017.

#### **Q. Did Treasury yields trend higher or lower during the reporting period?**

A. Both short-term and longer-term Treasury yields moved higher during the six-month reporting period ended October 31, 2017. The yield for the two-year Treasury note began the reporting period at 1.28% and ended the period at 1.60%. The low for the period of 1.26% occurred on May 17, 2017 and the peak of 1.63% took place on October 26, 2017. The yield for the ten-year Treasury began the reporting period at 2.29% and ended the period at 2.38%. The low for the period of 2.05% occurred on September 7, 2017, and the peak of 2.46% took place on October 26, 2017.

#### **Q. What factors impacted the spread sectors (non-Treasuries) during the reporting period?**

A. The spread sectors posted mixed results during the reporting period. Performance fluctuated given shifting expectations for global growth, questions regarding future central bank monetary policy and several geopolitical issues. The broad U.S. bond market, as measured by the Bloomberg Barclays U.S. Aggregate Index<sup>iv</sup>, returned 1.58% during the six-month reporting period ended October 31, 2017.

#### **Q. How did the high-yield bond market perform over the reporting period?**

A. The U.S. high-yield bond market, as measured by the Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index<sup>v</sup> gained 3.44% for the six months ended October 31, 2017. The high-yield market rallied from May through July 2017. This was driven by overall robust demand from investors looking to generate incremental yield in the low interest rate environment. The high yield market was then relatively flat in August 2017, and again moved higher in September and October 2017.



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**Investment commentary (continued)**

**Q. How did the emerging market debt asset class perform over the reporting period?**

A. The JPMorgan Emerging Markets Bond Index Global (EMBI Global<sup>i</sup>) returned 3.15% during the six months ended October 31, 2017. The asset class posted positive results during the first two months of the reporting period. This was triggered by overall strong investor demand, less concern over a significant shift in U.S. trade policy and a weakening U.S. dollar. The asset class then modestly declined in June 2017, but moved higher from July through October 2017.

**Performance review**

For the six months ended October 31, 2017, Western Asset High Income Fund II Inc. returned 3.95% based on its net asset value (NAV<sup>ii</sup>) and 0.15% based on its New York Stock Exchange (NYSE) market price per share. The Fund's unmanaged benchmarks, the Bloomberg Barclays U.S. Corporate High Yield + 2% Issuer Cap Index and the EMBI Global, returned 3.44% and 3.15%, respectively for the same period. The Lipper High Yield (Leveraged) Closed-End Funds Category Average<sup>viii</sup> returned 3.67% over the same time frame. Please note that Lipper performance returns are based on each fund's NAV.

During this six-month period, the Fund made distributions to shareholders totaling \$0.30 per share. As of October 31, 2017, the Fund estimates that 99.27% of the distributions were sourced from investment income and 0.73% constitutes a return of capital.\* The performance table shows the Fund's six-month total return based on its NAV and market price as of October 31, 2017. **Past performance is no guarantee of future results.**

**Performance Snapshot as of October 31, 2017**  
(unaudited)

	6-Month
Price Per Share	Total Return**
\$7.78 (NAV)	3.95%
\$7.13 (Market Price)	0.15%

**All figures represent past performance and are not a guarantee of future results. Performance figures for periods shorter than one year represent cumulative figures and are not annualized.**

**\*\* Total returns are based on changes in NAV or market price, respectively. Returns reflect the deduction of all Fund expenses, including management fees, operating expenses, and other Fund expenses. Returns do not reflect the deduction of brokerage commissions or taxes that investors may pay on distributions or the sale of shares.**

**Total return assumes the reinvestment of all distributions, including returns of capital, if any, at NAV.**

**Total return assumes the reinvestment of all distributions, including returns of capital, if any, in additional shares in accordance with the Fund's Dividend Reinvestment Plan.**

\*These estimates are not for tax purposes. The Fund will issue a Form 1099 with final composition of the distributions for tax purposes after year-end. A return of capital is not taxable and results in a reduction in the tax basis of a shareholder's investment. For more information about a distribution's composition, please refer to the Fund's distribution press release or, if applicable, the Section 19 notice located in the press release section of our website, [www.lmcef.com](http://www.lmcef.com) (click on the name of the Fund).

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### Looking for additional information?

The Fund is traded under the symbol **HIX** and its closing market price is available in most newspapers under the NYSE listings. The daily NAV is available on-line under the symbol **XHGIX** on most financial websites. *Barron's* and the *Wall Street Journal's* Monday edition both carry closed-end fund tables that provide additional information. In addition, the Fund issues a quarterly press release that can be found on most major financial websites as well as [www.lmcef.com](http://www.lmcef.com) (click on the name of the Fund).

In a continuing effort to provide information concerning the Fund, shareholders may call 1-888-777-0102 (toll free), Monday through Friday from 8:00 a.m. to 5:30 p.m. Eastern Time, for the Fund's current NAV, market price and other information.

Thank you for your investment in Western Asset High Income Fund II Inc. As always, we appreciate that you have chosen us to manage your assets and we remain focused on achieving the Fund's investment goals.

Sincerely,

Jane Trust, CFA

Chairman, President and

Chief Executive Officer

November 30, 2017

***RISKS:** The Fund is a diversified closed-end management investment company designed primarily as a long-term investment and not as a trading vehicle. The Fund is not intended to be a complete investment program and, due to the uncertainty inherent in all investments, there can be no assurance that the Fund will achieve its investment objective. The Fund's common stock is traded on the New York Stock Exchange. Similar to stocks, the Fund's share price will fluctuate with market conditions and, at the time of sale, may be worth more or less than the original investment. Shares of closed-end funds often trade at a discount to their net asset value. Diversification does not assure against market loss. The Fund's investments are subject to a number of risks, such as credit risk, inflation risk and interest rate risk. As interest rates rise, bond prices fall, reducing the value of the Fund's holdings. The Fund may use derivatives, such as options and futures, which can be illiquid, may disproportionately increase losses, and have a potentially large impact on Fund performance. High-yield bonds, known as junk bonds, involve greater credit and liquidity risks than investment grade bonds. Foreign securities are subject to certain risks not associated with domestic investing, such as currency fluctuations and changes in political and economic conditions which could result in significant fluctuations. These risks are magnified in emerging markets. The Fund is also permitted purchases of equity securities. Equity securities generally have greater price volatility than fixed income securities. Leverage may result in greater volatility of NAV and the market price of common shares and increases a shareholder's risk of loss.*

All investments are subject to risk including the possible loss of principal. Past performance is no guarantee of future results. All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

The information provided is not intended to be a forecast of future events, a guarantee of future results or investment advice. Views expressed may differ from those of the firm as a whole.

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**Investment commentary (cont d)**

- <sup>i</sup> Gross domestic product ( GDP ) is the market value of all final goods and services produced within a country in a given period of time.
  
- <sup>ii</sup> The Federal Reserve Board (the Fed ) is responsible for the formulation of U.S. policies designed to promote economic growth, full employment, stable prices and a sustainable pattern of international trade and payments.
  
- <sup>iii</sup> The federal funds rate is the rate charged by one depository institution on an overnight sale of immediately available funds (balances at the Federal Reserve) to another depository institution; the rate may vary from depository institution to depository institution and from day to day.
  
- <sup>iv</sup> The Bloomberg Barclays U.S. Aggregate Index is a broad-based bond index comprised of government, corporate, mortgage- and asset-backed issues, rated investment grade or higher, and having at least one year to maturity.
  
- <sup>v</sup> The Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index is an index of the 2% Issuer Cap component of the Bloomberg Barclays U.S. Corporate High Yield Index, which covers the U.S. dollar-denominated, non-investment grade, fixed-rate, taxable corporate bond market.
  
- <sup>vi</sup> The JPMorgan Emerging Markets Bond Index Global ( EMBI Global ) tracks total returns for U.S. dollar-denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities: Brady bonds, loans, Eurobonds and local market instruments.
  
- <sup>vii</sup> Net asset value ( NAV ) is calculated by subtracting total liabilities, including liabilities associated with financial leverage (if any), from the closing value of all securities held by the Fund (plus all other assets) and dividing the result (total net assets) by the total number of the common shares outstanding. The NAV fluctuates with changes in the market prices of securities in which the Fund has invested. However, the price at which an investor may buy or sell shares of the Fund is the Fund's market price as determined by supply of and demand for the Fund's shares..
  
- <sup>viii</sup> Lipper, Inc., a wholly-owned subsidiary of Reuters, provides independent insight on global collective investments. Returns are based on the six-month period ended October 31, 2017, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 35 funds in the Fund's Lipper category.

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**Fund at a glance** (unaudited)

**Investment breakdown** (%) as a percent of total investments

The bar graph above represents the composition of the Fund's investments as of October 31, 2017 and April 30, 2017 and does not include derivatives, such as forward foreign currency contracts. The Fund is actively managed. As a result, the composition of the Fund's investments is subject to change at any time. Represents less than 0.1%.

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**Spread duration (unaudited)**

**Economic exposure** October 31, 2017

**Total Spread Duration**

HIX 3.91 years

Benchmark 4.41 years

Spread duration measures the sensitivity to changes in spreads. The spread over Treasuries is the annual risk-premium demanded by investors to hold non-Treasury securities. Spread duration is quantified as the % change in price resulting from a 100 basis points change in spreads. For a security with positive spread duration, an increase in spreads would result in a price decline and a decline in spreads would result in a price increase. This chart highlights the market sector exposure of the Fund's sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark 80% of Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index and 20% of JPMorgan Emerging Markets Bond Index Global  
 EM Emerging Markets  
 HIX Western Asset High Income Fund II Inc.  
 HY High Yield  
 IG Credit Investment Grade Credit

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## Effective duration (unaudited)

Interest rate exposure October 31, 2017

**Total Effective Duration**

HIX 4.19 years

Benchmark 4.42 years

Effective duration measures the sensitivity to changes in relevant interest rates. Effective duration is quantified as the % change in price resulting from a 100 basis points change in interest rates. For a security with positive effective duration, an increase in interest rates would result in a price decline and a decline in interest rates would result in a price increase. This chart highlights the interest rate exposure of the Fund's sectors relative to the selected benchmark sectors as of the end of the reporting period.

Benchmark 80% of Bloomberg Barclays U.S. Corporate High Yield 2% Issuer Cap Index and 20% of JPMorgan Emerging Markets Bond Index Global  
EM Emerging Markets  
HIX Western Asset High Income Fund II Inc.  
HY High Yield  
IG Credit Investment Grade Credit

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October 31, 2017

**Western Asset High Income Fund II Inc.**

	Rate	Maturity Date	Face Amount	Value
<b>Security</b>				
<b>Corporate Bonds &amp; Notes 106.4%</b>				
<b>Consumer Discretionary 20.2%</b>				
<i>Auto Components 1.6%</i>				
Adient Global Holdings Ltd., Senior Notes	4.875%	8/15/26	5,373,000	\$ 5,554,339 (a)(b)
Delphi Technologies PLC, Senior Notes	5.000%	10/1/25	760,000	767,600 (a)
IHO Verwaltungs GmbH, Senior Secured Bonds (4.750% Cash or 5.500% PIK)	4.750%	9/15/26	1,460,000	1,492,850 (a)(c)
ZF North America Capital Inc., Senior Notes	4.750%	4/29/25	3,116,000	3,283,485 (a)(b)
<i>Total Auto Components</i>				<i>11,098,274</i>
<i>Diversified Consumer Services 1.1%</i>				
Prime Security Services Borrower LLC/Prime Finance Inc., Secured Notes	9.250%	5/15/23	4,300,000	4,776,010 (a)(b)
Service Corp. International, Senior Notes	7.500%	4/1/27	2,090,000	2,515,837 (b)
<i>Total Diversified Consumer Services</i>				<i>7,291,847</i>
<i>Hotels, Restaurants &amp; Leisure 5.1%</i>				
1011778 BC ULC/New Red Finance Inc., Secured Notes	5.000%	10/15/25	1,240,000	1,269,450 (a)
Aramark Services Inc., Senior Notes	5.000%	4/1/25	1,330,000	1,424,763 (a)(b)
Bossier Casino Venture Holdco Inc., Senior Secured Bonds (14.000% PIK)	14.000%	2/9/18	2,469,689	2,469,689 (a)(c)(d)(e)
Brinker International Inc., Senior Notes	5.000%	10/1/24	3,786,000	3,795,465 (a)(b)
Carrols Restaurant Group Inc., Secured Notes	8.000%	5/1/22	1,910,000	2,026,987 (b)
Carrols Restaurant Group Inc., Secured Notes	8.000%	5/1/22	1,590,000	1,687,388 (a)(b)
CCM Merger Inc., Senior Notes	6.000%	3/15/22	1,720,000	1,793,100 (a)(b)
CEC Entertainment Inc., Senior Notes	8.000%	2/15/22	2,060,000	2,139,825 (b)
Fontainebleau Las Vegas Holdings LLC, Senior Secured Notes	10.250%	6/15/15	975,000	98 *(a)(b)(f)
GLP Capital LP/GLP Financing II Inc., Senior Notes	5.375%	4/15/26	2,177,000	2,362,045 (b)
Hilton Worldwide Finance LLC/Hilton Worldwide Finance Corp., Senior Notes	4.625%	4/1/25	3,350,000	3,463,062 (b)
Hilton Worldwide Finance LLC/Hilton Worldwide Finance Corp., Senior Notes	4.875%	4/1/27	1,910,000	2,010,275 (b)
MGM Resorts International, Senior Notes	4.625%	9/1/26	990,000	994,950