

WESTERN ASSET HIGH INCOME FUND II INC.  
Form N-CSR  
July 06, 2007

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 811-8709

Western Asset High Income Fund II Inc.  
(Exact name of registrant as specified in charter)

125 Broad Street, New York, NY  
(Address of principal executive offices)

10004  
(Zip code)

Robert I. Frenkel, Esq.  
Legg Mason & Co., LLC  
300 First Stamford Place, 4<sup>th</sup> Fl.  
Stamford, CT 06902  
(Name and address of agent for service)

Registrant's telephone number, including area code: (800) 451-2010

Date of fiscal year April 30,  
end:

Date of reporting period: April 30, 2007

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ITEM 1. REPORT TO STOCKHOLDERS.

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

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**Western Asset  
High Income Fund II Inc.  
(HIX)**

**ANNUAL REPORT**

APRIL 30, 2007

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

|   |                |   |    |
|---|----------------|---|----|
| Annual Report   | April 30, 2007 | <b>Western Asset<br/>High Income Fund II Inc.</b>                         |    |
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| <b>Fund Objective</b>   |                | Statements of Changes in Net Assets                                       | 26 |
| The Fund seeks to maximize current income by investing at least 80% of its net assets, plus any borrowings for investment purposes, in high-yield debt securities. As a secondary objective, the Fund seeks capital appreciation to the extent consistent with its objective of seeking to maximize current income. |                | Statement of Cash Flows   | 27 |
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## Letter from the Chairman

Dear Shareholder,

The U.S. economy expanded at a moderate pace during the 12-month reporting period. After expanding 2.6% in the second quarter of 2006, U.S. gross domestic product (GDP) increased 2.0% in the third quarter and 2.5% in the fourth quarter. The preliminary estimate for first quarter 2007 GDP growth was 0.6%. While consumer spending remained fairly solid, the cooling housing market continued to negatively impact the economy. In addition, corporate spending was mixed during the reporting period.

After increasing the federal funds rate <sup>ii</sup> to 5.25% in June 2006 – its 17th consecutive rate hike the Federal Reserve Board (Fed<sup>ii</sup>) held rates steady at its last seven meetings. In its statement accompanying the May 2007 meeting, the Fed stated, “Economic growth slowed in the first part of this year and the adjustment in the housing sector is ongoing. Nevertheless, the economy seems likely to expand at a moderate pace over coming quarters. Core inflation remains somewhat elevated. Although inflation pressures seem likely to moderate over time, the high level of resource utilization has the potential to sustain those pressures.”

**R. JAY GERKEN, CFA**  
Chairman, President and  
Chief Executive Officer

During the 12-month reporting period, both short- and long-term Treasury yields experienced periods of volatility. Yields fluctuated early in the period given mixed economic data and shifting expectations regarding the Fed’s future monetary policy. Then, at the end of February 2007, yields fell sharply as economic data weakened and the stock market experienced its largest one-day decline in more than five years. Overall, during the 12 months ended April 30, 2007, two-year Treasury yields moved from 4.87% to 4.60%. Over the same period, 10-year Treasury yields fell from 5.07% to 4.63%. Looking at the 12-month period as a whole, the

Western Asset High Income Fund II Inc. I

overall bond market, as measured by the Lehman Brothers U.S. Aggregate Index<sup>iv</sup>, returned 7.36%.

The high yield bond market generated solid results over the 12-month period ended April 30, 2007. During that time, the Citigroup High Yield Market Index<sup>v</sup> returned 12.39%. With interest rates relatively low, demand for higher yielding bonds remained strong. The high yield market was further aided by strong corporate profits and low default rates.

Despite periods of weakness, emerging markets debt generated a positive return, as the JPMorgan Emerging Markets Bond Index Global (EMBI Global)<sup>vi</sup> gained 11.92% during the reporting period. Strong investor demand, an expanding global economy and solid domestic spending supported many emerging market countries.

Please read on for a more detailed look at prevailing economic and market conditions during the Fund's fiscal year and to learn how those conditions have affected Fund performance.

#### **Special Shareholder Notices**

Effective November 30, 2006, Western Asset Management Company Limited (Western Asset Limited) became an additional subadviser to the Fund, under an additional subadvisory agreement between Western Asset Management Company (Western Asset) and Western Asset Limited. Western Asset and Western Asset Limited are wholly-owned subsidiaries of Legg Mason, Inc. Western Asset and Western Asset Limited provide day-to-day portfolio management of the Fund as the Fund's subadviser and sub-subadviser, respectively. Western Asset Limited provides certain advisory services to the Fund relating to currency transactions and investments in non-U.S. dollar denominated securities. Western Asset Limited has offices at 10 Exchange Place, London, England. Western Asset Limited acts as an investment adviser to institutional accounts, such as corporate pension plans, mutual funds, and endowment funds.

On May 17, 2007, the Board of Directors of the Fund approved changes to the non-fundamental investment policies relating to the Fund's definition of emerging market country.

II Western Asset High Income Fund II Inc.

Pursuant to the Board's approval, effective June 1, 2007, the Fund changed its definition of "emerging market country" to include any country which is, at the time of investment, represented in the JPMorgan EMBI Global or categorized by the International Bank for Reconstruction and Development ("World Bank"), in its annual categorization, as middle- or low income. Under the Fund's previous investment policy, the Fund defined an "emerging market country" as: any country which is considered to be an emerging country by the World Bank at the time of the Fund's investment. The countries that will not be considered emerging market countries include: Australia; Austria; Belgium; Canada; Denmark; Finland; France; Germany; Ireland; Italy; Japan; Luxembourg; Netherlands; New Zealand; Norway; Spain; Sweden; Switzerland; the United Kingdom; and the United States. This revision to the definition of "emerging market country" is intended to allow Legg Mason Partners Fund Advisor, LLC ("LMPFA"), the Fund's investment manager, and Western Asset greater flexibility and opportunity to achieve the Fund's investment objectives and make consistent the range of countries available for investment by the Fund consistent with the countries represented in its new benchmarks. Management believes that the definition, as revised, is consistent with that utilized by funds with comparable investment objectives.

Additionally, the Fund changed its benchmark from the Citigroup High Yield Market Index to the Lehman Brothers U.S. Corporate High Yield 2% Issuer Capped Index<sup>vii</sup> and the JPMorgan EMBI Global Index, effective June 1, 2007. In the opinion of the Fund's investment subadviser, the change provides for broader, more effective, benchmark indexes for the Fund and more accurate reflections of the portfolio strategies with which the Fund is managed.

Prior to October 9, 2006, the Fund was known as Salomon Brothers High Income Fund II Inc.

#### **Information About Your Fund**

Important information with regard to recent regulatory developments that may affect the Fund is contained in the Notes to Financial Statements included in this report.

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As always, thank you for your confidence in our stewardship of your assets. We look forward to helping you meet your financial goals.

Sincerely,

R. Jay Gerken, CFA

Chairman, President and Chief Executive Officer

*June 4, 2007*

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i Gross domestic product ( GDP ) is the market value of all final goods and services produced within a country in a given time period.
- ii The federal funds rate is the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans.
- iii The Federal Reserve Board ( Fed ) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- iv The Lehman Brothers 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.
- v The Citigroup High Yield Market Index is a broad-based unmanaged index of high yield securities.
- vi 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. Countries covered are Algeria, Argentina, Brazil, Bulgaria, Chile, China, Colombia, Cote d Ivoire, Croatia, Ecuador, Greece, Hungary, Lebanon, Malaysia, Mexico, Morocco, Nigeria, Panama, Peru, the Philippines, Poland, Russia, South Africa, South Korea, Thailand, Turkey and Venezuela.
- vii The Lehman Brothers U.S. Corporate High-Yield 2% Issuer Capped Index is an issuer-constrained version of the U.S. Corporate High-Yield Index that covers the U.S. dollar denominated, non-investment grade, fixed-rate, taxable corporate bond market. The U.S. High-Yield 2% Issuer Capped Index follows the same index construction rules as the uncapped index but limits issuer exposure to a maximum 2% and redistributes the excess market value index-wide on a prorata basis.

IV Western Asset High Income Fund II Inc.



**Fund Overview**

**Q. What were the overall market conditions during the Fund's reporting period?**

A. As the fiscal year began, the bond market faced a number of challenges, including additional short-term interest rate hikes by the Federal Reserve Board ( Fed), inflationary pressures and signs of solid economic growth. However, as the period progressed, oil prices moderated, a cooling housing market triggered slower economic growth and the Fed paused from raising rates after June 2006. These factors, as well as a flight to quality when the U.S. stock market abruptly fell in February 2007, helped both short- and long-term yields to fall during the 12-months ended April 30, 2007. Over this time, there were several periods of increased volatility in the bond market. This was often triggered by changing perceptions regarding the economy, inflation and the Fed's future monetary policy.

**Performance Review**

For the 12 months ended April 30, 2007, the Western Asset High Income Fund II Inc. returned 13.58%, based on its net asset value ( NAV ) and 25.58% based on its New York Stock Exchange ( NYSE ) market price per share. In comparison, the Fund's unmanaged benchmark, the Citigroup High Yield Market Index<sup>iii</sup>, returned 12.39% and the Lipper High Current Yield (Leveraged) Closed-End Funds Category Average<sup>1</sup> increased 13.47% over the same time frame. Please note that Lipper performance returns are based on each fund's NAV.

During the 12-month period, the Fund made distributions to shareholders totaling \$0.89 per share. The performance table shows the Fund's 12-month total return based on its NAV and market price as of April 30, 2007. **Past performance is no guarantee of future results.**

**Performance Snapshot as of April 30, 2007 (unaudited)**

| <b>Price Per Share</b> | <b>12-Month<br/>Total Return</b> |
|------------------------|----------------------------------|
| \$12.38 (NAV)          | 13.58%                           |
| \$11.61 (Market Price) | 25.58%                           |

**All figures represent past performance and are not a guarantee of future results.**

Total returns are based on changes in NAV or market price, respectively. Total returns assume the reinvestment of all distributions in additional shares.

<sup>1</sup> Lipper, Inc. is a major independent mutual-fund tracking organization. Returns are based on the 12-month period ended April 30, 2007, including the reinvestment of all distributions, including returns of capital, if any, calculated among the 31 funds in the und s Lipper category.

**Q. What were the most significant factors affecting Fund performance? What were the leading contributors to performance?**

A. We maintained our disciplined investment approach that is grounded in conducting extensive research on each potential holding for the portfolio. Looking at the fiscal year as a whole, this approach proved beneficial to performance in a number of areas. From an asset class perspective, the Fund's overweight to the strong performing high yield market and underweight to emerging market debt enhanced results. In terms of credit quality, a bias toward lower-rated securities boosted returns, as they outperformed their higher-rated counterparts. Finally, in terms of sector positioning, the Fund benefited from its overweight in three of the top five performing sectors in the Citigroup High Yield Market Index, during the fiscal year ended April 30, 2007. Over the same period, the Fund held underweight positions in all five of the worst performing sectors in the Citigroup High Yield Market Index.

**What were the leading detractors from performance?**

A. During the reporting period, the Fund's overweights in the weak performing Argentina and Mexico markets detracted from the Fund's performance.

**Q. Were there any significant changes to the Fund during the reporting period?**

A. There were no significant changes to the Fund's portfolio during the reporting period.

**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 *XHIXX* 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.leggmason.com/InvestorServices](http://www.leggmason.com/InvestorServices).

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 6:00 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,

Western Asset Management Team

*May 11, 2007*

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.

**RISKS:** As interest rates rise, bond prices fall generally, reducing the value of the Fund. 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 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. The risks are magnified in emerging markets.

All index performance reflects no deduction for fees, expenses or taxes. Please note that an investor cannot invest directly in an index.

- i The Federal Reserve Board ( Fed ) is responsible for the formulation of policies designed to promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.
- ii NAV is calculated by subtracting total liabilities 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 at the Fund's market price as determined by supply of and demand for the Fund's shares.
- iii The Citigroup High Yield Market Index is a broad-based unmanaged index of high yield securities.

**Fund at a Glance (unaudited)**

**Investment Breakdown**

**As a Percent of Total Investments**



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Schedule of Investments (April 30, 2007)

WESTERN ASSET HIGH INCOME FUND II INC.

| Face<br>Amount                           | Security   | Value        |
|--|--|--------------|
| <b>CORPORATE BONDS &amp; NOTES 88.5%</b> |  |              |
| <b>Aerospace &amp; Defense 1.6%</b>      |  |              |
| 1,585,000                                | Alliant Techsystems Inc., Senior Subordinated Notes, 6.750% due 4/1/16 | \$ 1,608,775 |
| 1,535,000                                | DRS Technologies Inc., Senior Subordinated Notes:                      | 1,558,025    |
| 3,350,000                                | 6.625% due 2/1/16  | 3,525,875    |
|  | 7.625% due 2/1/18  |              |
|  | Hawker Beechcraft Acquisition Co.:                                     |              |
|  | Senior Notes:  |              |
| 1,190,000                                | 8.500% due 4/1/15 (a)  | 1,258,425    |
| 1,920,000                                | 8.875% due 4/1/15 (a)(b)   | 2,025,600    |